BENEFICIAL OWNERSHIP OF VESSELS – NAVIGATING THE MAZE COMMERCIAL ASPECTS

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Beneficial ownership of vessels - navigating the maze

Part I
Commercial aspects

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Contents

Introduction

1. A common law claim operates *in personam*, meaning that it does not confer upon a plaintiff any property rights over the property of the defendant. In contrast the admiralty jurisdiction allows an aggrieved party to bring an action *in rem* against a ship connected with the cause of action and in some circumstances assert a proprietary claim in respect of a sister ship of the ship connected with the cause of action.. The exercise of these rights represent an extreme exercise of coercive power and is likely to have a devastating commercial impact for the ship owner and any party in possession of the relevant ship at the time of arrest.

2. A successful claimant in rem has recourse against the ship (or its sister ship) and can have it arrested. If its claims are not satisfied, a claimant can force a sale of the relevant ship and receive some or all of the proceeds.

3. In New Zealand the admiralty jurisdiction is governed by the *Admiralty Act* 1973. Section 4 of the Act sets out the types of claims which will be within the ambit of the jurisdiction. Section 5 of the Act entitled, 'actions in rem', divides these claims into two categories:

   3.1 claims which relate to ownership of or security over a particular ship and therefore allow the arrest of that particular ship irrespective of who owns it. (section 4(a), (b),(c) and (s)); and

   3.2 claims of a more general nature (for example a claim for damage of a ship or a claim for loss of goods carried on a ship) arising in connection with a ship which, subject to certain ownership requirements, allow the arrest, not only of the ship connected with the claim, but of a sister ship of that ship (section 4(d) to (r)). We will refer to these as general maritime claims.

4. The Australian Admiralty jurisdiction (governed by the *Admiralty Act* 1988 (Cth.)) draws a similar distinction by referring to:

   4.1 proprietary maritime claims which give rise to a right in rem against a particular ship irrespective of who owns it; and

   4.2 general maritime claims which, subject to certain ownership requirements, allow the arrest of both the ship connected with the claim and also a sister ship of that ship.

5. This seminar will focus on the latter type of claim and, more specifically, on the issue of beneficial ownership as it relates to arrest proceedings against sister ships. The seminar is to be divided into two parts. The first part will look at the commercial aspects of the beneficial ownership issue in respect of sister ships. How should a shipping investor structure and manage a fleet of ships so that it has the best chance of overturning an arrest of a ship's sister ship on the basis of a lack of ownership? The second part presented by James Allsop will look at the litigation aspects of the beneficial ownership issue and provide a more detailed analysis of the legislation and case law.

Arrest and sister ship arrest

6. New Zealand legislation permits proceedings in rem against both a ship connected with a claim and a sister ship of that ship. The relevant part of section 5 of the Admiralty Act states:

> [in relation to a claim] arising in connection with a ship *where the person* who would be liable on the claim in an action in personam *was, when the cause of action arose, the owner or charterer of, or in possession or in control of the ship,* the jurisdiction of the High Court may be invoked by *an action in rem against-*
>
> (i) *That ship if, at the time when the action is brought, it is beneficially owned* as respects all the shares therein *by,* or is on charter by demise to, *that person;* or
>
> (ii) *Any other ship which, at the time when the action is brought, is beneficially owned* or on charter by demise as *aforesaid.*
>
> [emphasis added]

7. The Australian legislation is worded differently. Section 19 of the *Admiralty Act* 1988(Cth) provides:

> A proceeding on a general maritime claim concerning a ship may be commenced as an action in rem against some other ship if:
>
> (a) a relevant person in relation to the claim was, when the cause of action arose, the charterer of, or in possession or control of, the first

mentioned ship; and

(b) that person is, when the proceeding is commenced, the owner of the second-mentioned ship.

Note that the Australian provision refers merely to ownership under both limbs of the test and contains no express reference to beneficial ownership.

Lifting the veil

7. When developing a fleet ownership structure in both jurisdictions, the issue of sister ship arrest is an aspect which should be carefully considered by ship owners and their advisers. Vesting ownership of the fleet in a single entity will leave no ownership defence to an arrest based on the sister ship jurisdiction. The entity will be the owner of the relevant ship at the time the incident took place and will be the beneficial owner of the relevant sister ship at the time proceedings are brought.

8. The most common way to address the issue of arrest and sister ship arrest is to use single ship companies. With this structure, each vessel is registered in the name of a separately incorporated company, with a parent company generally holding all the shares in each company. The parent company will sometimes contract out the management of the fleet to a third company.

9. If a claim is bought against the parent company in respect of one of the fleet ships and an alleged sister ship is arrested then it can argue that:

9.1 It was not the owner, the charterer of, or in possession or control of, the relevant ship at the time any liability arose as the subsidiary company was the registered owner.

9.2 It is not the beneficial owner of the alleged sister ship which has been arrested. It is merely a shareholder in the company who is the registered owner, a position which does not confer any form of beneficial ownership in the assets of the company.

10. There is English Court of Appeal authority in support of this argument. The case of *The Evpo Agnic* [1988] 1 WLR 1090 concerned the Skipper I, of which the registered owner was S. Company Limited, a Panamian one-ship company. The Skipper I sank with a cargo of shredded steel scrap. The cargo owners issued a writ in rem against the owners of the Evpo Agnic and applied for a warrant of arrest.

The Evpo Agnic was also owned by a Panamian one ship company which had the same president, vice president and shareholders as S.Company. A number of vessels, including the Skipper I and The Evpo Agenic were run as a fleet under the management of P Limited.

11. It was held by the Court that:

11.1 The ♂owner□ in the first limb of the test under the English equivalent of section 5 of the New Zealand legislation meant 'registered owner' and not merely someone with an equitable interest in the ship.

11.2 The right to bring an action in rem against a sister ship under the second limb of the test did not extend to a ship owned by a sister company of a genuine company owning the ship in connection with which the claim arose.

12. It is unclear whether or not this case represents the law in New Zealand. Decisions such as *The Ship Rangiora* (unreported, AD No 877) and *Baltic Shipping Co Ltd v Pegasus Lines SA* [1996] 3 NZLR 641 do not address directly the efficacy of one ship companies. In the former case, which concerned a fleet owned by German entities known as 'partenreedereim', it was however stated by Giles J that:

> the structure is not an unfamiliar one in the maritime and chartering industry. The concept of one-ship companies is well known. Frequently vessels are chartered by head and sub charters to a convenient flag for crewing, financing and taxation purposes. The involvement of Mr Lower in the company...is not necessarily fatal to a genuine structure...Mr Lower may well be the 'brains' behind the formation of these partenreederei created to own and operate these ships..but that fact, on its own, does not mean that the structures are shams. Neither does it necessarily create a basis for lifting the corporate veil.

8. Generally, NZ courts have shown a reluctance to lift the corporate veil except in circumstances where the doctrine of separate personality has been used to perpetrate fraud or those behind the company have engaged in some form of 'sharp practice': *Re Securitybank Ltd (No 2)*[1978] 2 NZLR 136. There is also authority that an organisation is entitled to design its corporate structure so as to minimise or avoid potential future liabilities*: Adams & Ors v Cape Industries Plc & Ors* [1990] 2 WLR. Based on this reasoning it seems more likely than not that a NZ Court would tend towards the reasoning in *The Evpo Agnic.*

13. The English approach has not been followed in the Australian jurisdiction. The decision of the federal court in *The Iron Shortland* (1995) 59 FCR 535 makes it clear that merely placing vessels in ship owning companies will not allow the 'real or true' owner of the vessels to escape the beneficial ownership provisions of the Australian Admiralty Act. In this case which will be discussed in much more detail in the second half of this presentation the plaintiff claimed damages in respect of the repair and equipping of the Newcastle Pride in Malaysia from a company named Capeco Limited. The repairs were done by agreement between the plaintiff and Capeco's agent appointed under a technical management agreement in which Capeco Limited was described as owner of the Newcastle Pride. In an insurance certificate, the Capeco group of companies were also described as owners of the Newcastle Pride and the registered owner of the ship, a single ship company (Newcastle Pride Limited), a wholly owned subsidiary of Capeco, was described merely as the disponet owner.

14. The Iron Shortland was arrested pursuant to an arrest warrant as surrogate for the Newcastle Pride when lying off Port Hedland. The registered owner of the Iron Shortland was Everbird Limited which was also a wholly owned subsidiary of Capeco.

15. It was held that 'owner' for the purposes of s 19 of the Australian Admiralty Act means or includes the beneficial (ie the real or true) owner who may not be the registered owner. Capeco was the owner of the Newcastle pride in the sense that it was the beneficial or true owner. The evidence did not however establish that Capeco was the beneficial owner of the Iron Shortland when the proceedings were commenced.

Structure and management

Structure

16. One objective when setting up a fleet structure should be to develop an ownership regime which limits the potential for a claim relating to one ship affecting other ships in the fleet.

17. In both jurisdictions but particularly in Australia those setting up such a structure should consider the following:

- *Funding* How the acquisitions of ships to be funded? Ideally, each vessel should have its own financing and security structure in the name of the ship

owning company. Each company should ensure that it passes the appropriate directors□ and shareholders□ resolutions relating to the purchase.

□ *Proper incorporation* Each company must be validly incorporated and should (in NZ) hold at its registered office the documents required by section 215 of the *Companies Act* 1993 - namely a certificate of incorporation, a constitution (if it has one), a share register and a directors register.

□ *Directors* Where possible, ship owning companies should have directors who are different from the directors of the parent company.

□ *Insurance* What insurance arrangements are put in place? It is important that insurance be in the name of the ship owning company rather than the parent. In the *Iron Shortland*, the fact that insurance was in the name of the parent company was held to be an important factor in determining that the parent was in fact the 'true owner' of the relevant vessel.

Management

18. As important as the initial fleet structure is the way in which the ship owing companies are run. The following is a non-exclusive guide to some of the issues which need to be considered by fleet owners

□ *Corporate governance* In both New Zealand and Australia it is important that there is evidence that management of the group treat the ship owing companies as distinct legal entities. This means that assets should not be transferred between companies in the group without proper documentation and evidence of some form of commercial benefit to both companies. Resolutions and proper documentation should be kept for each ship owing company

□ *Employees* Staff for a particular vessel should be employed by the ship owing company rather than by the parent company. Documentation provided to employees (for example Health and Safety Manuals) should refer to the ship owing company rather than the parent.

□ *Charters and contracts* It is important that charter agreements and contracts such as ship maintenance are in the name of the ship owning company

rather than the parent. In the *Iron Shortland* the presence of a maintenance agreement in the name of the parent company relating to a particular ship was considered to suggest beneficial ownership of that ship.

- *Premises* Ideally premises for the group should make some reference to the ship owning companies for example on a sign at reception.

- *Advertising and marketing* Advertisements for the group should, where practical, make it clear that the ship owning companies are different entities from their parent.

- *Operating expenses* Ideally each company should have sufficient cash flow to pay its own expenses out of its own operating funds.

- *Documents generally* Documents which clearly relate to a particular ship should be on that ship owning company's letterhead.