

BRIEFING

THE "POSIDON"
SUPPLIERS FAIL TO TURN CLAIM
RANKINGS UPSIDE DOWN
OCTOBER 2017

- SINGAPORE COURT CONSIDERS WHETHER SUPPLIERS OF NECESSARIES CAN OVERTURN USUAL ORDER OF PRIORITIES ON JUDICIAL SALE OF A VESSEL
- A REASSURING JUDGMENT FOR SHIP FINANCIERS



In the recent Singapore case of The "Posidon"¹, the High Court considered the order of priorities on the proceeds of sale of a vessel following a judicial sale, focusing on the circumstances in which it would change the usual order of priorities. The court concluded that it would not alter the usual order of priorities and that "powerful reasons" would be needed for such an alteration to take place.

"THE COURT CONCLUDED THAT IT WOULD NOT ALTER THE USUAL ORDER OF PRIORITIES AND THAT "POWERFUL REASONS" WOULD BE NEEDED FOR SUCH AN ALTERATION TO TAKE PLACE."

Background

In February 2012 Piraeus Bank SA (the "Bank") entered into a loan facility for US\$17.1m with the registered owners of the Posidon (the "Borrowers"). The facility was secured by way of a second preferred Liberian ship mortgage over the vessel. The Borrowers failed to make necessary repayments and in September 2014, following discussions with the Bank, the Borrowers agreed to sail the vessel to Singapore. On 29 September 2014 the Bank issued a Notice of Default and Acceleration of the loan and the vessel was arrested by the Bank upon its arrival in Singapore in October 2014.

The Bank obtained an order for sale from the Singapore High Court and the vessel was put through a judicial sale. The Bank applied for an order for payment out from the proceeds of sale (the "Fund"), confirmation that the usual order of priorities would apply to payments out from the Fund and that it was entitled to the proceeds in satisfaction of the *in rem* judgments in its favour.

¹ [2017] SGHC 138

“WHILST SUPPLIERS OF NECESSARIES DO FEATURE IN THE ORDER OF PRIORITIES AS A MARITIME CLAIM IN SINGAPORE, AS IN THE UK, THEY RANK BELOW A MORTGAGEE.”

This application was opposed by World Fuel Services (Singapore) Pte Ltd, World Fuel Services Europe Ltd and World Fuel Services Trading DMCC (the “Bunker Suppliers”) who had supplied the Posidon with bunkers on 8 September 2014 but who had not been paid. Whilst suppliers of necessities do feature in the order of priorities as a maritime claim in Singapore, as in the UK, they rank below a mortgagee and the Bunker Suppliers therefore sought to overturn the usual order of priorities to secure a share of the proceeds of sale.

Judgment

The Judge held that the Bank’s mortgage claim took priority over the Bunker Suppliers’ claim for bunkers, i.e. that the usual order of priorities would apply. Following a review of case law from various commonwealth jurisdictions, the Judge concluded that the established order of priorities should only be disturbed if there were “powerful reasons” to do so. There would have to be “truly exceptional or special circumstances” and any departure from the usual order would have to be essential to prevent an obvious injustice.

When determining whether or not this case concerned “special circumstances”, the court considered the following points:

1. it had to be shown that the mortgagee had knowledge that the mortgagor was insolvent;
2. the mortgagee had to be fully aware, in advance, of the nature and extent of the expenditure incurred by the competing claimant; and
3. any such expenditure had to bring about some benefit to the mortgagee.

In respect of (1), the Bunker Suppliers argued that at the time the bunkers were delivered:

- a. the Bank knew the Borrowers were insolvent as the Borrowers missed certain repayments under the loan facility;
- b. the Bank was in de facto control of the Borrowers’ finances; and
- c. the Bank was aware of the state of the Borrowers’ finances.

The court decided in the Bank’s favour. In relation to (a), whilst the Borrowers missed five repayments, the loan facility allowed the Borrowers not to make the first four of those repayments in which case they would be capitalised to the outstanding loan under the facility and the Bank had agreed an extension of time for the Borrowers to make the fifth repayment. Consequently there had not been an event of default under the facility at the time the bunkers were supplied to the vessel. In relation to (b), the court found that the Bank did not control the Borrowers’ finances. The Borrowers were left to run their own affairs and the Bank had not become a mortgagee in possession of the vessel. Finally, in relation to (c), the Bank was aware that the Borrowers were operating at a loss and that they had accrued trade debts, but that did not necessarily mean that the Borrowers were insolvent, certainly not within the context of the volatile shipping market.

In respect of (2), the Bunker Suppliers tried to narrow the question and submitted that it was sufficient for the Bank to have “general knowledge” that bunkers were being supplied to the vessel. The case law cited to the court concerned competing claims between mortgagees and suppliers of necessities, and in particular vessel repairs (*The Orion Expedito* (1990)). In those cases the courts held that the mortgagees’

“WHEN DISTRIBUTING THE PROCEEDS FROM A JUDICIAL SALE THE ORDER OF PRIORITIES IS NOT SET IN STONE; IT ARISES MAINLY FROM GENERAL MARITIME LAW RATHER THAN STATUTE AND CAN BE UPSET IF THE CIRCUMSTANCES JUSTIFY A CHANGE TO THE ORDER.”

knowledge of the necessities supplied/repairs carried out to the vessel had to be clear and specific in order to vary the usual order of priorities. The Bunker Suppliers sought to draw a distinction between the supply of bunkers and ship repairs, arguing that bunkers could only be used for one thing (i.e., powering the vessel’s propulsion), as opposed to ship repairs (which could cover a wide variety of issues), and that the Bank would therefore have had sufficient knowledge about the necessities as the bunkers they had supplied could only have been used for the vessel’s propulsion. The court decided that this argument would stretch the authorities, and that it would be artificial to distinguish the case on this basis. For the order of priorities to be amended, the mortgagee had to be “fully aware in advance” of the arrangements made by the necessities suppliers and on the facts the Bank did not have that knowledge.

Finally, in respect of (3), the Bunker Suppliers contended firstly that the bunkers provided allowed the vessels to use its main engine to move, which allowed the vessel to avoid navigational dangers (thereby safeguarding the Bank’s security) and allowed it to trade (thereby generating earnings for the benefit of the Bank). Secondly, any earnings earned by the vessel had to be paid into the Borrowers’ operating accounts, over which the Bank held security. Thirdly, the Bunker Suppliers contended that the bunkers had been provided for the Posidon’s arrest voyage to Singapore, and the Bank therefore benefitted as the bunkers had allowed the Bank to arrest the vessels in a favourable jurisdiction. The court held firstly that it was too simplistic to argue that the Bank’s security interests were protected because the bunkers allowed the vessel to engage its main engine and navigate. Indeed, the court held that, as a trading asset, a mobile vessel would be exposed to a wider spectrum of risks than a vessel at anchor. Further, it was the Borrowers who retained possession of the vessels’ earnings and not the Bank. Secondly, the Bank only gained control of the operating accounts following the occurrence of the Event of Default, and the court considered that the language/communications between the Bank and the Borrowers did not support Bunker Suppliers’ contention that the Bank controlled the Borrower’ finances. Finally, it was found that the Bunker Suppliers delivered their bunkers to the vessel on 8 September 2014 but that the bunkers used by the vessel for its arrest voyage to Singapore were supplied in Fujairah on 15 September 2014 – and in fact those bunkers were funded by the Bank. The Bunker Suppliers’ bunkers were therefore not used for the arrest voyage and the Bank did not benefit from them as was suggested by the Bunker Suppliers.

Commentary

As a decision by the Singapore court, this case is merely persuasive before the English courts. However, it provides a useful reminder that when distributing the proceeds from a judicial sale the order of priorities is not set in stone; it arises mainly from general maritime law rather than statute and can be upset if the circumstances justify a change to the order. However, the courts will not lightly overturn the usual order.

This decision will be welcomed by banks and other lenders holding a mortgage over a borrowers’ vessel as it restates the importance of upholding the order of priorities on funds from a judicial sale under which mortgages rank very highly. Normal banking activity when monitoring a loan is unlikely to risk upsetting these priorities. However, such circumstances could arise where a bank has particular knowledge about the solvency of a borrower and the supplies being ordered for a vessel where those supplies are to be used in order to give a benefit the bank.

FOR MORE INFORMATION

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