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BRIEFING

OSX 3 – SUPERIOR COURT REMOVES
DOUBT OVER RECOGNITION OF NON-
BRAZILIAN MORTGAGES

FEBRUARY 2018

- FEDERAL SUPERIOR COURT OF JUSTICE IN BRASILIA OVERTURNS LOWER COURT'S DECISION REFUSING TO ENFORCE LIBERIAN MORTGAGE AGAINST FPSO OPERATING IN BRAZILIAN WATERS
- A REASSURING DECISION FOR NON-BRAZILIAN PROVIDERS OF EQUIPMENT TO THE BRAZILIAN OFFSHORE OIL EXPLORATION AND PRODUCTION INDUSTRY



In June 2016, we noted in a Briefing that in a surprising decision a São Paulo state appellate court on 3 February 2016 upheld a lower court decision refusing to enforce a Liberian mortgage against FPSO OSX 3, which was operating on a long-term charter outside Brazilian territorial waters in the Brazilian exclusive economic zone. The decision was appealed to the Federal Superior Court of Justice in Brasilia (the highest court in the country for subject-matter other than constitutional issues).

“WITH THE RELEASE OF THE JUDGMENT IN JANUARY 2018, IT IS NOW CLEAR THAT THE SUPERIOR COURT HAS ROBUSTLY OVERTURNED THE DECISION OF THE STATE APPELLATE COURT.”

In November 2017, we sent an email alert reporting that the Superior Court had unanimously overturned the decision of the state appellate court. At that time the written judgment had not yet been published. With the release of the judgment in January 2018, it is now clear that the Superior Court has robustly overturned the decision of the state appellate court. This removes the substantial concerns which the lower court decisions had created for non-Brazilian providers of equipment to the Brazilian offshore oil exploration and production industry – and in particular for their financiers. It also removes (possibly less acute) concerns which the lower court decisions had created for mortgages of non-Brazilian flagged internationally trading cargo vessels calling at Brazilian ports¹.

Facts

The Dutch company OSX 3 Leasing BV is the owner of the FPSO, which is registered in Liberia. As security for a US\$500m bond issued by OSX 3 Leasing in Norway, the

¹ No Brazilian-law advice is intended to be provided. The comments in this Briefing are based on free translations of court documents and informal discussion with Brazilian law firms, including Basch & Rameh and Kincaid, Souza Cescon and Veirano.

“REFLECTING THE IMPORTANCE OF THE CASE AND THE WIDESPREAD INTERNATIONAL CONCERN WHICH THE DECISION OF THE LOWER COURTS HAD CREATED, BOTH THE LIBERIAN SHIPS' REGISTER AND THE INTERNATIONAL CHAMBER OF SHIPPING WERE ALSO INVOLVED IN THE APPEAL.”

owner granted a mortgage to Nordic Trustee ASA (as trustee for the bondholders). The mortgage is governed by Liberian law and registered in the Liberian Ships' Register. Nordic Trustee registered the mortgage with the Registry of Titles and Documents in Rio de Janeiro, but the mortgage could not be registered with the Port Authority (as the owner was not Brazilian) or the Maritime Tribunal (as the FPSO was not Brazilian flagged).

Brazilian creditor Banco BTG Pactual S/A (through its Cayman Islands branch) asserted an unsecured claim of almost US\$27.4m against OSX 3 Leasing and applied to the lower court for an attachment of the FPSO in order to enforce the debt. Nordic Trustee applied to that court for the dismissal of Banco BTG's attachment asserting the priority of its mortgage. In June 2015 the first instance court made a declaration that Banco BTG's attachment had priority. Nordic Trustee appealed. The São Paulo state appellate court dismissed the appeal.

Holding by the São Paulo state appellate court

The salient features of the now-overruled judgment of the state appellate court can be briefly summarised as follows:

- Only ship mortgages registered in Brazil or registered in a country with which Brazil has a recognition treaty will be given effect to in Brazil (two such treaties being the International Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages (Brussels 1926) and the Convention on Private International Law (the Bustamante Code) (Havana 1928)).
- Unlike Brazil, Liberia was not a party to either treaty, so a Liberian mortgage would not be recognised.
- On the evidence presented the court found that there was no principle of customary international law that flag-state mortgages are recognised and enforced. The court rejected Nordic Trustee's argument that under Brazilian conflict-of-laws rules, interests in movable property are governed by the law of the owner's domicile, in this case the Netherlands. The court found that, because the FPSO was to operate in Brazil for 20 years, it should not be treated as movable and the law of the site where the FPSO is located should apply.

Appeal to the Federal Superior Court of Justice

Following the state court appellate decision and a further unsuccessful application to the same court for clarification and reconsideration, Nordic Trustee appealed to the Federal Superior Court of Justice. Reflecting the importance of the case and the widespread international concern which the decision of the lower courts had created, both the Liberian Ships' Register and the International Chamber of Shipping were also involved in the appeal.

Nordic Trustee was granted permission to appeal by the Superior Court which then made its November 2017 decision. The salient points arising from the decision of the Superior Court of Justice are as follows:

- Brazilian and other legal systems have traditionally made laws providing for ship mortgages owing to the invariable need for significant financing during construction, maintenance and operation.
- The registration of ships is an act of sovereignty of the flag State. Brazilian law gives effect to the law of the register of foreign ships, with the United Nations

Convention on the Law of the Sea, the 1926 Brussels Convention and the 1928 Bustamante Code all being cited in support of this proposition.

- The FPSO was a ship in both the technical and legal senses.
- The mortgage was not capable of registration with the Brazilian Maritime Authority or the local Port Authority and its non-registration was of no consequence to the issues in this case.
- Economic considerations and the need for legal certainty pointed to recognition of the mortgage.

“THE DECISION OF THE FEDERAL SUPERIOR COURT OF JUSTICE RESTORES SOME CALM AND AT LEAST REMOVES A TROUBLESOME LEGAL PROBLEM FOR AN INDUSTRY AND SECTOR WHICH CURRENTLY FACES OTHER ISSUES AND PROBLEMS.”

Conclusion

The initial first instance decision caused concerns in the international oil services industry, which were intensified by the decision of the São Paulo state appellate court in February 2016. That decision was widely thought by Brazilian lawyers to be incorrect as a matter of Brazilian law, leaving aside the adverse consequences for the financing, and hence operation, of foreign-registered assets in the Brazilian offshore sector. The decision of the Federal Superior Court of Justice restores some calm and at least removes a troublesome legal problem for an industry and sector which currently faces other issues and problems.

FOR MORE INFORMATION

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