

Securing Ship Finance Transactions in the UAE

by Mamoon Khan - m.khan@tamimi.com - Dubai International Financial Centre
James Newdigate - j.newdigate@tamimi.com - Dubai International Financial Centre
Omar N. Omar - o.omar@tamimi.com - Dubai International Financial Centre

October 2016

Bank financing of new and second-hand ships remains the leading source of finance for shipowners. This traditional source of finance has been forced to adjust to a new era of shipping over the last several years. The current market is characterised by increasingly volatile (and generally depressed) freight rates, increased sources of finance coupled with an excess of available capital, and consequent oversupply of tonnage. Market conditions have placed tremendous pressure on many owners, and lenders routinely find themselves consumed with tending to defaults and restructurings.

The current state of affairs has encouraged lenders to more carefully assess how they secure the facilities they provide. Lenders are becoming increasingly aware, and concerned, about the effectiveness of their standard securities. Here the authors consider ship finance in an UAE context, with a focus on securing debt financing transactions.

Registration of Vessels

Vessel registration is largely governed by the UAE Commercial Maritime Law No. 26 of 1981 as amended (the 'Maritime Code'). The UAE maintains a closed register. Only vessels owned by UAE nationals, or majority UAE owned corporate entities, are eligible for registration. The Federal Transport Authority – Land & Maritime (the 'FTA') is the body charged with overseeing, and administering, the national ship register. There is continued debate in the UAE surrounding the desirability of establishing of a separate open ship registry, catering to vessels with foreign owners, and bearing features of a convenience registry. At date of publishing this article, such registry had not been established.

Certain vessels are exempt from federal registration. These include fishing boats, pleasure boats, vessels less than ten tons in total weight, lighters, barges, tugs, cranes, dredgers and diving boats. The Maritime Code further prohibits the registration of oil and gas tankers older than ten years at date of sought registration.

Ship Mortgages

The ship mortgage is arguably the most effective, and robust, security available to lenders. It provides a lender with an in rem right directly against the vessel, granting it priority over unsecured creditors of the vessel and its owner. A lender is afforded powerful rights in the event of any default by the borrower, including; pursuing the sale of the vessel to recover any indebtedness.

Mortgages registered against UAE flagged vessels are widely accepted and enforced in UAE and foreign courts. Parties are generally free to agree on the structure and contents of the mortgage agreement, and underlying instruments, with relatively intricate and complex arrangements secured through a registered mortgage. Lenders are also permitted to utilise security agents to hold and administer a mortgage.

The Maritime Code does however require a ship mortgage to adhere to certain basic confines. A mortgage must be recorded through an official deed, failing which, it will be considered void.

Practically, this requires a mortgage to be in writing, in Arabic, and notarised before a Notary Public. Generally a dual English/Arabic text is filed. Parties should be aware that if enforced before UAE Courts, the Arabic text will prevail over the English text. A good quality translation is accordingly essential. The mortgage must also indicate the following details:

- Amount of debt. If against more than one vessel, details of debts related to each vessel. If against a vessel and other property, it must indicate the amount secured by the vessel;
- Date and type of contract and details of borrower and lender;
- Maximum mortgage amount (which should be fixed);
- Any conditions relating to the debt;
- Description of mortgaged vessel and confirmation that the vessel is over ten tons (as required);
- Details of any possible interest.

The underlying debt instrument does not need to be registered or filed with the mortgage, although it is customary to do so. Parties are required to file any substantive amendments to the mortgage as may arise from time to time.

A mortgage may be registered against a vessel under construction. A further declaration in this context is required from a local FTA office with jurisdiction over the port where the vessel is being built. Such declaration must provide details of the vessel, including; its length and dimensions, approximate tonnage and details of the yard under which it is being built.

Assignment of Earnings or Charterparty Contracts

In addition to the vessel mortgage, lenders may also take security over the cash flows generated by the mortgaged vessel by way of assignment of earnings or charterparty contracts.

Under UAE law assignment of earnings is considered an assignment of rights or otherwise known as assignment of receivables. The jurisprudence on assignment of rights and receivables has been developed by the judicial decisions of the courts of various Emirates of the UAE including the Emirates of Dubai and Abu Dhabi. It is important to note that the underlying right or receivable needs to be in existence at the time of the assignment. In other words, UAE law may not recognise assignment of future rights or receivables or an assignment of a charterparty contract that will be executed at a later date.

It is customary for the lender and borrower to enter into a formal assignment agreement which outlines the relevant perfection requirements and would also reflect the details of the charterparty contract being assigned. The assignment can be perfected by the borrower (as assignor) issuing a notice of assignment to the third party debtor. The mode of delivery of notice can be by registered post, courier and very recently notices by fax and email have been accepted as necessary evidence of delivery of the notice. Whilst the evidence of delivery of notice of assignment is sufficient, cautious lenders generally require the borrower to procure a formal acknowledgment of the assignment from the third party debtor.

Pledge over Bank Accounts

The assignment by way of security over earnings is supported by a pledge or security over the bank account where such earnings are deposited by the third party debtor.

The notice of assignment discussed above generally directs the third party debtor to pay the charter income into a designated bank account. This bank account is ordinarily the borrower's account, as held with the relevant branch of the lender and is be subject to a pledge or security allowing the lender to exert a certain level of control over the charter income.

If the charter income or receivables is also the mode of repayment of the loan availed from the lender then such lender may also prescribe a payment waterfall mechanism either in the facility agreement or the account security document. It is also important to note that it is difficult to create security or pledge under UAE law over an account with a fluctuating balance. This is due to the absence of specific law on creating security over fungibles and the application of the law on pledge over movable assets – which requires the underlying assets to be fixed and identifiable. Therefore lenders mostly rely on the set-off clauses in the account pledge agreements which may be considered independent of the pledge by the UAE courts in enforcement. Due to this uncertainty some foreign lenders may also stipulate offshore accounts where such floating security would be recognized.

Assignment of Insurances

In mid market transactions, particularly in the financing of offshore support vessels, lenders usually rely on 'loss payee' provisions in the hull and war risk insurances and other insurance policies customarily linked to the financed vessel. It has been observed that lenders generally do not enter into or perfect assignment of insurances discussed above. In the absence of a formal assignment the lender would not be able to 'step in' and enforce its rights against the insurer and would have to wait for a claim to be lodged by the insured under the policy. Therefore it is recommended that in addition to the lender being named as loss payee in the policy the borrower should formally assign the policy in favour of the lender. However such assignment may oblige the lender to pay the premium under such policy if the insured fails to fulfill its payment obligations.

Guarantees

It is common to obtain personal and corporate guarantees from the borrower's shareholders or affiliates respectively. When preparing guarantees it is important to ensure that the guarantee instrument clearly reflects the details of loan availed by the borrower or details of the relevant facility agreement. The absence of the loan or facility details in the guarantee may render it as an 'all monies guarantee' which may not be recognized by UAE courts. Further, any claim under guarantee provided by a guarantor needs to be made within six (6) months from the date of default by the borrower under the facility agreement, otherwise such guarantor may rely on the above six (6) month rule provided for in the UAE Civil Code (Federal Law No. 5 of 1985) and exclude its liability on account the above time bar.

Share Pledges

The new UAE Company Code (Federal Law No. 2 of 2015) now recognizes pledges over shares of a limited liability company ('LLC'). Therefore, as most UAE flagged vessels are owned by LLCs, lenders now have the option to extend their security coverage by taking security / pledge over the shares of the LLC borrower. The parties (i.e. the shareholders of the borrower) and the lender need to enter a bilingual (Arabic/English) share pledge agreement after obtaining initial approval from the relevant Department of Economic Development. The share pledge agreement is signed in the presence of a local notary public and subsequently registered with the Department of Economic Development.

Conclusion

Even though the UAE maintains a closed ship registry, it is a jurisdiction that offers relatively wide-ranging security options to lenders, which are on par with many popular international registries. Despite the poor shipping market conditions, there appears to be an increasing appetite amongst several local, and foreign, banks in the regional ship finance market. It is important that lenders in the region take careful note of the available securities, and their respective requirements, in order to best tailor an efficient security package.