

Prioritizing, Handling, Settling – And Avoiding: Vessel Arrests

Slow Start for a Fast Boat: In June 2004, the Bahamian-flagged catamaran Spirit of Ontario began a twice-daily, fast-ferry service linking Rochester, NY with Toronto, Ontario. Perhaps a harbinger of things to come (prior to startup) was its widely publicized April 2004 allision with a New York City pier. In early September, a scant three months after startup, the owners suspended service. By the end of September, a fuel supplier began legal action to collect on outstanding receivables totaling approximately \$373,000.

The actual arrest of the vessel is one step in a larger process. In the Spirit case, the arrest by the U.S. Marshal followed a court complaint (in this case, by the fuel vendor to the U.S. District Court for Western New York). In this pivotal part of the legal process, an Admiralty Court (with a unique body of laws) gains jurisdiction over the matter at hand.

After an initial vessel arrest, vessel owners will typically post bond through insurance or banking channels, and the vessel will usually be released. If they do not post a bond, federal rules detail a process whereby a notice must be posted, often in a trade newspaper, allowing others who may have claims against the now-seized vessel to “intervene,” or file motions expressing their interest against the vessel. In addition, the Court may order an “Interlocutory Sale” – an auction which will provide the funding to settle claims.

Priorities, Priorities

Bruce Paulsen, a partner at New York attorneys Seward & Kissel, who was heavily involved in the legal actions that unfolded in Rochester, told MarEx, “This was the last major maritime foreclosure in the U.S.” In February 2005, five months after the actual arrest, the vessel was auctioned in a U.S. Marshal sale for \$32 million. Ironically, the buyer was the City of Rochester, which tried and failed to revive the Lake Ontario ferry. Two years later, the Australian-built vessel was sold to a European investor group, which deployed her in runs across the English Channel. Paulsen, who teaches courses as part of lawyers’ Continuing Education classes, uses the case to explain the intricacies of prioritizing and settling the numerous claims that often arise in maritime cases.

Another expert, Don Soutar, a UK lawyer who is the Director of National Marine Services’ (NMS) commercial ship arrest and custody business, based in Fort Lauderdale, described several well-known cases handled by his firm. NMS manages the nuts and bolts of vessel seizures, custody (while a vessel is under arrest) and auctions for the U.S. Marshals Service as well as for various state and local jurisdictions. Its clients include admiralty

lawyers, insurance companies and leading ship-finance banks. Soutar, in explaining NMS’s role, told MarEx, “We prefer to be involved from the outset, even before legal action.”

Logistical Challenges

A view from the principals’ side came from Captain Ulf Huzell, who runs South Florida-based Nordic Ship Consultants, a service provider procuring and operating vessels for projects around the world. He told MarEx about a case from the late 1990s where a shipowner, having difficulties performing a time-sensitive voyage from Korea to the U.S. East Coast, hired an ocean-going tug to tow the vessel through the Panama Canal and around to its destination. The vessel and cargo configuration made for slow going and little progress moving across the Pacific. At a stop in Honolulu, the shipowner who had contracted for the tug, filed a breach-of-contract suit. After consulting with the local maritime community, the tug’s owner discovered that various repair providers and suppliers had not been paid on the ship’s previous calls in Hawaii and “The tug owner and the other parties made a joint decision to place an arrest order through the court in Honolulu, under the custody of the U.S. Marshal. Guards were placed aboard for 24 hours a day.”

Soutar also described a group of other recent cases involving commercial vessels. In a 2004 bank foreclosure, the 2001-built container feeder vessel Shamrock, with perishable cargo aboard in refrigerated containers, was arrested at Portland, Maine. Soutar told MarEx, “We were able to work well in conjunction with the bank’s counsel to resolve the matter and get a most favorable outcome for the bank, recovering almost 100 percent on the dollar.” The ship was eventually bought by Toronto-based investors, who began operating her between Florida and the Cayman Islands.

He also described two important cases where cruise ships were arrested: the gaming vessel St. Tropez, arrested in Port Everglades in June 2005, and the Regal Empress, arrested at Port Manatee in April 2003. Soutar told MarEx, “In the St. Tropez

case, we managed the sale based on a court-ordered auction.” Where cruise ships are arrested, repatriation of foreign crews presents formidable logistical challenges. If passengers from distant locales are involved, as in the case of the *Regal Empress*, additional transportation arrangements must be made.

Motions, Interventions and Necessaries

Bruce Paulsen provided an overview of the legal process following a vessel arrest, with real examples from the *Spirit of Ontario* case. Motions to intervene were quickly filed by two claimants with preferred vessel mortgages, followed by seamen who had served on the vessel and other vendors to the vessel. He explains, “Wages of the crew of a vessel have priority over all claims on the vessel. Wage liens have been characterized as ‘sacred’ in admiralty law, and that seamen have a secret lien,” meaning that seamen need not actually file the lien. In fact, arrests related to crew wages are often instigated by seamen’s unions and sometimes the ITF (International Transport Workers Federation).

In the case described previously by Captain Huzell, he noted, “The bank elected not to participate in the actual arrest but filed the mortgage claim with the court in Honolulu after the joint arrest had taken place.” Huzell added that the vessel sat in Honolulu for 14 months before “the local court dissolved the lawsuit against the tug’s owner and ordered the vessel to be sold through a marshal’s auction.” He said that “The German bank holding the mortgage on the ship was the lucky party, taking the largest share of the funds created by the sale.” Local service providers were reimbursed for roughly 50 percent of the amounts owed to them, but the tug’s owner “drew the short straw” due to contractual technicalities surrounding a London arbitration clause. He added, “The London arbitrators advised that an effort toward a settlement could not be started with a shipowner’s only asset sitting in Hawaii – way outside the London jurisdiction.”

Lawyer Bruce Paulsen also described an important distinction in U.S. admiralty law between U.S.-registered vessels, where preferred mortgage holders’ liens take precedence over nearly everything else, and foreign-flag ships, where “necessaries” (which include vessel repairs, drydocks and towing services, among other things) stand in front of preferred mortgage liens. Paulsen pointed out that the “secret lien” concept applies not only to seamen’s wages, but also to other “necessaries” and contract liens.

Don Soutar’s firm sometimes steps into the role of substitute custodian for an arrested vessel (not yet auctioned). He explains, “Either the lender or claimant will ask us to use their preferred lawyer, or we can suggest a suitable firm if they are not aware of one in any particular location at home or abroad.” After the lawyers secure the arrest order from the court, the

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U.S. marshal will go aboard and attach the warrant and court order to the vessel and then call for the custodian and repossess or store the vessel. Soutar added, “We will do a full inventory walk-through and take still and video pictures and, once this is done, we sign the ‘USM-102’ (a document recording the chain of custody), and the marshal leaves us in charge of the vessel.”

The final pecking order of the creditors is determined through established legal “priorities” but can be finalized by a combination of negotiations among the plaintiffs and the ruling of the judge. The bunker supplier who triggered the *Spirit* matter was considered a provider of “necessaries;” however, the software provider was not. Paulsen told MarEx, “If that software company had been providing electronic charts, for example, that were integral to a vessel’s navigation, the judge may have ruled differently.”

Keeping the Lights On

The U.S. Marshals Service is not set up to provide husbandry for an arrested vessel. In the *Spirit of Ontario* case, a substitute custodian was appointed in response to a request from the two large security holders. Some firms – NMS for example – can provide this type of service, which includes aspects of technical management such as securing insurance coverage, handling crewing matters (including repatriations) and assure that the vessel is properly maintained.

The sale of a vessel at auction – the culmination of the legal process following the foreclosure action set in motion by the vessel arrest – cleanses the vessel of all other claims. As a practical matter, once the foreclosure process begins, a court auction may be the only way forward. Paulsen cautions that “Potential buyers’ concerns about secret liens could inhibit the sale of the vessel by other means, or could require a discount in price or an agreement to indemnify.” Soutar, citing a recent case where a vessel had a lien claim (even though it had been sold privately to an innocent third party) said, “The vessel was arrested and sold to pay the prior claim.”

Busts Follow Booms

Although Paulsen and Soutar focus on specific matters at hand,

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both are mindful of the cyclical nature of international shipping markets. Seward & Kissel’s Paulsen explained to MarEx that his legal practice also includes courtroom litigation in securities and regulatory cases, “which provides plenty of work while the admiralty business is less active.” The intersection of maritime law and ship finance can be seen from the title of a 2007 article that Paulsen wrote for a leading maritime law journal: “New Horizons: An Analysis of Public Markets Financing of Shipping Ventures and the Impending Wave of Shipping Securities Litigation.”

Soutar’s work at NMS spans the spectrum from smaller boats to larger vessels. He tells MarEx that “About 75 percent of our business directly relates to arrest and repossession of boats and ships.” Both he and Paulsen know that today’s boom will inevitably be followed by tomorrow’s downturn. Soutar, who earlier worked for well-known London firms Norton Rose and Clifford Chance, opined that “There will soon be an oversupply, when all the present newbuilding activity starts to come online. With the expected slump in world trade, there will be a fall in freight rates, leading to banks and other lienholders increasing arrests to secure or realize their investments.”

Start Planning Now

Sometimes it’s best to work out solutions and Huzell often advises attorneys and others on how to come to a factual solution. He adds, “Many times, a lenient attitude allowing shipowners to carry on (with creditors contemplating seizure) has helped a shipowner survive and pay his debt, even though most times at a slower than contracted schedule.” Don Soutar offered a similar viewpoint. “The claimant will usually be amenable to an agreement for payment in full or installments rather than arrest. So usually arrest is a last-resort action. But even when the marshal is ready to pounce, we can agree to a settlement at the last minute.”

Ship managers need to pay particular attention, especially when times are good. Bruce Paulsen insists, “Executives should be proactive; thinking about cash flows, budgets, and how to keep their creditors happy when the market does slip, since history shows that earnings move downward as well as up.” Captain Huzell added, “The typical reasons for arrests are poor financial planning, poor voyage planning, or technical problems that lead to delays and demurrage situations.”

Seward & Kissel’s Bruce Paulsen offered a simpler formula: “The best way to avoid a vessel arrest is to pay your bills.”