

Creditors' Rights in Canadian Maritime Actions Part 2 – Priorities

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This column in April 1999 discussed a number of procedural issues which arise in the context of a seizure and sale proceedings commenced against vessels. At that time, the Admiralty Bar was awaiting two decisions, the “*Atlantis II*” and the “*Nel*”, dealing with the issue of priorities and creditors’ right to the pool of funds created by the sale of a foreclosed vessel. These decisions have now been delivered by the Federal Court of Canada and this article, as promised, provides a review of the Canadian law of priorities.

The “*Atlantis II*”

The decision of the “*Atlantis II*” was given by Prothonotary Hargrave. This case received a great deal of attention from the local media. The Coast Guard detained the “*Atlantis II*” in Vancouver while repairs were effected by a local shipyard in December 1997 and January 1998 to bring the ship in compliance with Port State Control requirements. The ship’s owners did not pay for the repairs that were done and, consequently, the ship was arrested in Federal Court proceedings. The officers and crew intervened in the court proceedings to obtain an order for the sale of the ship.

The ship and its bunkers were sold by court order on August 11, 1998 for U.S.\$1,100,000 and U.S. \$58,393.49, respectively. The proceeds from the sale of the “*Atlantis II*” were held in Court until the priorities between 13 competing creditors could be determined at a hearing.

The creditors were comprised of Canadian companies that supplied goods and services to the ship while it was at Vancouver, the officers and crew of the ship who were claiming for outstanding wages and repatriation costs, a foreign bank that was owed approximately U.S. \$11,000,000 pursuant to two mortgages which were registered as security against the ship and foreign suppliers who provided goods and services to the ship at various ports around the world.

¹ Due to the circumstances under which the vessel was abandoned, the officers and crew were left without funds and the Government of Canada stepped in to cover crew wages and

repatriation costs on behalf of the officers and crew. Thus, the officers' and crew's claim for wages and repatriation costs was assigned to Citizenship and Immigration Canada.

The "Nel"

A Scottish bank, which held a mortgage against the "Nel" as security for a loan and operating account that were extended to the owners of the "Nel", commenced seizure and sale proceedings against the "Nel" in the Federal Court of Canada after the owners defaulted on their loan repayment. Following default, the owners of the "Nel" abandoned the ship, closed shop and disappeared. In November 1997, the bank commenced the seizure and sale proceedings and arrested the "Nel" while it was in Vancouver laden with cargo. The bank's claim, as mortgagee, was approximately U.S. \$14,000,000.

Under the Federal Court Rules, a ship that is under seizure and sale proceedings may be sold by public auction or by "private treaty sale" (private contract). The "Nel" was sold by private contract for U.S. \$4,500,000. The purchaser agreed with the shipper whose cargo was on board to continue the voyage. A hearing was held to determine the priority of the claims of 12 competing creditors, including the bank, against the proceeds from the sale. The Court's decision was rendered recently.

Priority of Maritime Claims in Canada

The ranking of maritime claims in Canadian maritime law generally follows the British ranking with a few differences. The conventional ranking of creditors' claims against a vessel is as follows:

1. Disbursements incurred by the Admiralty marshal or sheriff in protecting the vessel prior to sale.
2. The costs of sale, including the costs of arrest, appraisal and sale of the ship.
3. Possessory liens, such as repairers' liens, held by a creditor who has possession of the vessel and whose possession predates other liens.

4. Traditional maritime liens for salvage, master's and crews' wages, master's disbursements and pilotage.
5. Possessory liens arising after a maritime lien.
6. The claim of a mortgagee or mortgage holder.
7. Statutory rights *in rem* including claims of necessities suppliers, claims arising out of a contract for the construction, repair or equipping of a ship and claims for necessities supplied to sisterships of the ship that is being seized and sold. Necessaries suppliers are those companies which provide goods and services to the vessel.

The above categories are rights that are recognized in a certain ranking of priority under Canadian law. The nature of the right is determined by the substantive law of the jurisdiction in which the claim is based. The appropriate jurisdiction is determined by considering a number of factors including the jurisdictional or applicable law provisions of the supplier's contract with the ship owner. The Court will also look at the country where the contract was formed to determine if there is a sufficient nexus with that country such that its law ought to apply. For example, the right of a U.S. company that supplies necessities to a ship in a U.S. port may be determined by U.S. law. If, under U.S. law, the creditor is entitled to a maritime lien, the creditor will assert a claim based on a U.S. maritime lien in Canadian seizure and sale proceedings.

A maritime lien is a right against a ship which attracts priority without court action or registration. It attaches to a ship and travels with that ship unconditionally until it is discharged. It will remain with that ship despite its sale to an owner who has no knowledge of the lien.

Once the nature of the right is determined, the remedy that attaches to that right including its ranking against other types of liens, is determined by Canadian law. For example, a creditor with a U.S. maritime lien will take priority over the mortgagee's claim because it falls within fourth category listed above.

Under the Canadian law of priorities, a U.S. necessities supplier receives a more favourable position than a Canadian necessities supplier because, under Canadian law, a

necessaries supplier is not entitled to a maritime lien. This position has been rejected in the law of England and other nations where the claim will be categorized along with English necessities claims and given the same priority.

Special Circumstances

The Admiralty Court has discretion, based on equitable circumstances, to depart from the conventional ranking of maritime claims competing for payment from the proceeds of the sale of a ship. This discretion will be exercised only in extraordinary circumstances where necessary to prevent an obvious injustice.

One interesting outcome in the “*Atlantis II*” was the Court’s decision to exercise its equitable jurisdiction in favour of the claim of Fraser Shipyards, the company that did the repairs on the “*Atlantis II*” while it was detained in Vancouver. Fraser Shipyards claimed as a Canadian necessities supplier and thus, under the conventional ranking, would have ranked after the mortgagee. Since there were insufficient funds after the mortgage and other creditors were paid (the mortgagee itself was left with a significant shortfall), Fraser Shipyards would not have recovered any of its claim. However, the Court found that the repair work performed by Fraser Shipyards increased the sale value of the ship, which would have otherwise sold for scrap value, and thus generated a larger pool of funds for the creditors. Consequently, the Court granted Fraser Shipyard’s a portion of its claim for the repair work based on the contribution to the added value of the ship in priority to the claim of the bank.

Sistership Claims

Another interesting finding by the Court relates to the claim of an offshore necessities supplier that claimed a U.S. maritime lien. Unitor ASA is a Norwegian company that is in the business of supplying marine goods to ships. Through an American agent, it supplied goods to the “*Atlantis Two*” in Mexico in November 1997 and in Vancouver in December 1997 and January 1998, totalling approximately U.S. \$7,400. The Court accepted the legal opinion of a U.S. maritime law expert and held that an offshore necessities supplier, acting through an American agent, was entitled to a U.S. maritime lien. Thus, its claim had priority over that of the mortgagee.

Unitor also claimed for the price of goods supplied to two sisterships of the “*Atlantis II*”, the “*Epta*” and the “*Atlas*”. Again, Unitor had delivered the goods using an American agent and, accordingly, was entitled to claim a U.S. maritime lien against each of those ships. However, it was not entitled to enforce those maritime liens against the “*Atlantis II*”. The maritime lien attaches only to the particular ship to which the goods were supplied. It cannot attach to any sisterships of the ship to which the goods were supplied. Thus, Unitor’s claim was simply a sistership claim which is a statutory right created by sections 22(m) and 43(8) of the *Federal Court Act* and ranks after the mortgagee’s claim.

There are currently four actions underway in the Federal Court of Canada involving the seizure and sale of four vessels, the “*Golden Trinity*”, “*Ypapadi*”, “*Kimisis III*” and “*Zoodotis*”, by mortgagees. The priorities hearing will likely occur next year and the outcome is expected to add to the development of the rights and priorities of creditors in Canadian ship seizure and sale proceedings.