

MARITIME ADVOCATE - APRIL 2003 issue

Foreign lien clauses are enforceable in Canada!

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Belgian trustees for the bankrupt ABC Containerline found out to their amazement a while ago just how far the Canadian courts were prepared to go when they refused to turn over the judicial proceeds of sale of a ship, the BRUSSEL, to the Belgian Bankruptcy court for further adjudication without first paying down, in Canada, the claims of American stevedores who asserted liens against the fund, knowing that such liens would never be recognized in Belgium. Amazement turned to astonishment when the claims of Canadian suppliers of goods and services were not even given the same consideration!

The maritime supply and service industry has been recently discovering that properly drafted US lien clauses in their contracts can also benefit their cause in Canada even where the laws of their residence do not grant them any protection as secured creditors. To qualify as a "supplier", a claimant has to show that his contribution was necessary for the commercial operation of the vessel in the current trade. Then to obtain the benefit of a US lien clause, the claimant has to show that the law governing the lien – not just the contract – is the law stipulated in his contract.

Unlike most countries in the world, Canada is not a party to any convention with respect to the arrest of ships or with respect to the recognition of maritime liens and mortgages. Canadian courts purportedly follow and apply the law as applied by the former English Admiralty courts and "what would have been so administered if that Court had had unlimited jurisdiction". The subject matter covered by maritime law is wider than that covered in the United Kingdom. One of those subjects is the recognition and enforcement of maritime liens created by a law other than by Canadian law. The significance of a maritime lien is that it attaches against the ship itself notwithstanding the lack of consent or of the personal liability of the ship owner and the lien is opposable against successive purchasers of that ship.

Canada's statute created law on ship arrest is somewhat similar to the English counterpart, that is, the ship must be the subject matter of the cause of action, and with some exceptions including when a maritime lien is asserted, the owner of the ship must be personally liable for the claim and the ownership of the ship must be the same at the commencement of the lawsuit as at the time the cause of action arose. Sister-ship arrest is available provided that the ownership of the sister-ships is at all times the same.

In 1926, the Supreme Court of Canada suggested in *The STRANDHILL*, that as a matter of comity and due respect for the laws of other nations, it saw no reason to refuse recognizing and enforcing maritime liens granted by the foreign laws governing the formation and performance of contracts even though those laws extended the benefit of a maritime lien to creditors whose Canadian counterparts do not enjoy the same advantage under Canadian Maritime Law. This decision went unnoticed in the common law world.

In 1974, the Supreme Court of Canada in *the IOANNIS DASKALEDIS* referred to *The STRANDHILL* as the governing authority and upheld the US lien rights asserted by a US domiciled ship repairer and then said that since the right asserted was a maritime lien, then following traditional creditor ranking in maritime law, the ship repair claim, because it was secured by a maritime lien, was to be ranked ahead of the bank's mortgage! This set the stage for the inevitable showdown in the English law world where the same US domiciled ship repairer asserted the same case against a British ship, *The HALCYON ISLE* for repair work effected in the United States in the courts of Singapore whence an appeal was taken to the Privy Council. The latter court purportedly speaking for all courts, which follow the English maritime law, directed that the characterization of lien rights was a matter of procedure for the particular court seized with the case, and not a matter of substantive law. Accordingly, if there is no maritime lien for the subject matter of the claim asserted under the law where the lawsuit is instituted, then the maritime lien, wherever it was created, will not be enforced.

In 1984, in *The HAI RAI*, the Canadian Supreme Court dismissed the Privy Council's criticisms of its earlier decisions and averred that it was following a different policy path. In this case, the Court upheld a US bunker broker's lien claim which arose from a contract with the time charterer for supplies delivered in Long Beach, California. What made this case such a departure from the norm is that the Court held that notwithstanding the usual rule that there must be personal liability of the ship owner for the debt claimed in order to exercise the right to arrest the ship, the fact that a claimant held a maritime lien under the governing law was a sufficient basis to arrest the ship and force the ship owner, a purchaser subsequent to the delivery of the bunkers, to pay the claim.

In 2001, the Federal Court of Appeal, in the *Imperial Oil* case, had to decide whether a contract between a US resident ship manager and a US bunker broker which stipulated that US law, including the US Maritime Lien Act, governed the relationship, created a maritime lien under US law, when the bunkers were supplied in Canada to a Canadian-owned ship operated by a Canadian demise charterer. The Canadian demise charterer had subcontracted the management of the ship to the US resident ship manager. In the Trial Division, it was held that US law governed and a lien was created. In appeal, since the Court was not satisfied with the evidence which did not disclose the nature or authority given by the Canadian companies to the US ship manager, it was held that the closest

connecting factors available according to the evidence was Canadian law that governed the lien – which does not provide a maritime lien for bunker suppliers, only a right to arrest subject to strict procedural conditions. The bunker broker's action was dismissed. The decision has left the question wide open – suppose the Canadian demise charterer gave the fullest authority to the US ship manager to contract on its behalf and on behalf of the ship, then would a supply of bunkers to a Canadian ship in Canada be, exceptionally subject to a US maritime lien?

Early in 2002, the Federal Court of Appeal, in the *MYS CHIKHACHEVA*, followed the closest connecting factors analysis. The plaintiff, a US resident, entered into a financing, management and supply contract with a Russian demise charterer with respect to Russian fishing boats operating in the Bering Strait and the Ohanst Sea, that is, they were never going to visit US ports to be supplied. The plaintiff was to be given the exclusive right to market their catch. The contract provided that US law was to govern their relationship. The Canadian court found that US law was a significant and substantial connecting factor because otherwise the vessels would never have received the benefit of the financing, supplies and various services. Accordingly, the US maritime lien agreed to between the parties was upheld to be opposable against a ship owner who disclaimed any knowledge of how the demise charterer was financing its operations.

Later on in 2002, the Trial Division of the Federal Court in the *PANAMAX LEADER* decided that since it wasn't proven that the ship owner had not adequately warned third party suppliers that its demise charterer had no authority to create or consent to liens against the vessel. A Panamanian bunker broker operating in the Ukraine caused bunkers to be supplied in Malta to a Maltese flag ship pursuant to a contract which stipulated that US law governed their relationship, at the request of a Ukrainian agent acting on behalf the demise charterer, a Carribean company. The bunkers were not paid for and a claim was made against the ship following redelivery by the demise charterer. Neither the place of supply, Malta, nor the residence of the supplier, Panama, nor the Ukraine confers the benefit of a maritime lien on ship bunker brokers.

At the trial, the ship owner gave uncontradicted evidence of the presence of a Prohibition of Lien Notice in prominent places on the ship; the trial judge held that this was not sufficient – particularly since it was not the broker who was delivering the bunkers! None of the parties had any connection whatsoever to the US and the only connection to Canada was the misfortune of the ship to be there on another voyage when it was arrested. The court held that part of the risks of ownership when an owner demised its vessel was that the charterer would be entering into these types of agreements. The court also held that US law governed the lien as that was the agreement of the parties. The case is under appeal, but its progeny should be followed closely.

The three foregoing cases show Canadian willingness to bind ship owners to the consequences of contracts entered into by demise charterers and their agents acting on their behalf with third party suppliers. It should be noted that, unlike United States, under Canadian Maritime Law, a time or a voyage charterer can never bind the ship owner because neither can be said to be in possession of the ship. However, the door may be now slightly left ajar for an attempt to be made by a maritime supplier on the account of a time charterer on the ground that ship owners know or must be assumed to be aware that their time charterers will likely be entering into contracts, which may contain US lien clauses. Ship owners should be reviewing what they can do to advise suppliers of the charterer's lack of authority to create liens against the vessel and how their receipt expressly qualifies the ship's understanding with the supplier prior to the commencement of delivery that the ship was not subject to lien. Suppliers should consult their legal counsel to review their contracts as to whether the choice of law and the specificity of the maritime lien is sufficient in order to give themselves a remedy they might be able to use in North America.

This stew of developments has given rise to some interesting strategies and debt collection tactics. If a supplier can show that the governing law of its contract or lien is US law which its debtor is able to agree to, then regardless or whether the activity was even done in the US, whether any of the parties are US citizens or even whether the ship owner even had actual knowledge of what was being done on its behalf, a supplier may benefit from a US lien clause according to its agreement. And Canada may be a willing forum to enforce the claim!