

Mortgage, Necessaries and Good Faith

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The Governing Laws

- The Admiralty law and practice in the State of Israel are still based on the provisions of the British Admiralty Court Acts of 1840 and 1861 and the rules of procedure of the Vice Admiralty Rules of 1883.
- The Israeli Shipping Law of 1960 deals with mortgages over Israeli registered vessels and was also applied to foreign vessels.

Maritime Liens and the rank of priorities

1. The **official expenses of selling the vessel**;
 2. **Port and port related charges and expenses**;
 3. Expenses of **maintenance of the vessel** during the time of the arrest until the day of the sale;
 4. Wages of the master and the crew including damages for personal injury;
 5. **Salvage expenses** relating to the vessel, the cargo and equipment on board and expenses incurred in salving the lives of the crew and passengers;
 6. **Compensation for the death or bodily injury of passengers** in the vessel;
 7. Compensation for damage resulting from collision at sea or from other navigational accident;
 8. **Necessaries** - payments in connection with supplies or services provided to the vessel.
- According to the Shipping Law the only lien which has no priority over a mortgage is necessaries.

Arrest procedure in Israel

- The arrest procedure is initiated by filing a claim "in rem" against the vessel.
- At the same time, an application is submitted for the arrest of the vessel. The application must be supported by an affidavit.
- Court fees at the rate of 2.5% of the amount of the claim.
- In case the action is uncontested by vessel's owners, the vessel would be sold at a judicial sale.

The "Stropus" case

UAB Passat, a Lithuanian company,
the owner
of the Lithuanian flag cargo vessel
"Stropus".



AB Bank Snoras is a Lithuanian bank
which had loaned Passat 3 million Euro to finance
the purchase of the vessel

The fuel suppliers filed 3 different claims
that amount to approx. 1 million \$ USD.

The vessel was sold at a judicial sale for 2.7 million USD.

Factual Background

Passat was unable to pay the bills for the bunkers

The Vessel was arrested by fuel suppliers that claimed to have a maritime lien on the vessel.

AB Bank Snoras had loaned Passat 3 million Euro.

The loan was secured by a Lithuanian ship mortgage on the vessel.

Passat defaulted several times during 2009-2011 in making payments to the bank.

The vessel was rearrested by the bank.



The vessel was sold at a judicial sale for 2.7 million USD.
The amount is insufficient to pay the balance of the loan secured by the mortgage.

The Legal Standing:

- According to the Israeli law, the supply of "necessaries" gives rise to a maritime lien. However, a foreign mortgage has priority over all claims of necessaries against the vessel.

Arguments of the Fuel Suppliers:

- The loan documents show a very uncommon and heavy security package in favor of the bank.
- The bank had all possibilities to use its securities granted by Passat at time of default, instead of leaving the mortgage as the only security.
- The bank has been acting, for a very long period of time, in a low banking standard.
- The bank signed several supplemental agreements to the original loan agreements to maintain false appearance of normality.
- The bank should have not allowed the vessel continue trading and incur debts to suppliers.
- The bank was acting by way of wrongful trading, bad faith and deliberately deceived third parties such as the fuel suppliers.
- Sound and reasonable banking practice and good faith would have prevented these damages.

Arguments of the Bank:

- It is a common banking practice to request extra securities other than the vessel.
- Passat was a client of the bank since 2002 and have already returned another loan in full.
- Passat paid the monthly installments (mainly interest payments) to the bank up until few months before the arrest of the vessel.
- The actions of the bank were common and reasonable.
- There was no evidence that the fuel suppliers were aware of the identity of the bank as the mortgagee or relied on the acts or omissions of the bank.
- The bank had no commitment toward the fuel suppliers.
- The fuel suppliers had to make their own assessment of risk when supplying Passat with fuel and extending the company credit.

The argument of Equitable Subrogation:

- According to the Custom Fuel Case (*Custom Fuel Services, Inc. v. Lombas Indus, Inc.* 805 F.2d 561 (5th cir. 1986), there are two conditions to justify the equitable subordination of another claim:
 1. The claimant must have engaged in some type of inequitable conduct.
 2. The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage of the claimant.
- Three types of inequitable conduct are sufficient to warrant subordination:
 1. Fraud and illegality.
 2. Undercapitalization.
 3. Claimant's use of the debtor as a mere instrumentality or alter ego.

- There was no evidence in our case of such wrongdoing.
- A mortgagee's postponement of a declaration of default on a loan for a reasonable period of time, is insufficient to warrant equitable subordination of a ship mortgage to a fuel lien.
- Therefore, there was no basis for changing the priority of the bank's mortgage claims over the fuel claims.

The Result

- The case was settled.
- The fuel suppliers - 8% of the proceeds of the sale
- The bank – the rest of the funds (approx. 2.2 million Dollars).

Main reasons for the settlement:

- The bank went bankrupt and went under administration proceedings.
- The shareholders of the bank were detained in London after Lithuanian prosecutors issued an arrest warrant on suspicion of fraud and embezzlement.
- It was not clear whether the administrator would approve to continue with the trial in Israel.
- During the same time, a judgment was given by our judge, in a different case where the mortgage was contested. For the first time, a mortgage claim was set aside and the suppliers split between them the proceeds of the sale.

**NO CASE IS
A “CLEAR CUT” CASE !**

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