NOTE OF JUDGMENT IN SPV SAM DRAGON INC V. GE TRANSPORTATION FINANCE (IRELAND) LIMITED DELIVERED ON 15 JUNE 2012

1. Introduction

1.1 As the purchaser of a vessel at judicial auction, you probably think that the process is risk free at least as to your rights and title. You will need to reconsider this following the delivery of judgment by Mr Justice McGovern, in the SPV Sam Dragon Inc v. GE Transportation Finance (Ireland) Limited case in the Irish High Court on Friday, 15 June, 2012 in view of some unexpected findings as to the international norms applicable to such sales. The case also contains consideration of the tests to be applied in determining the applicable law to foreign torts under the EC Rome II Regulation.

1.2 The case involved a situation that might have been thought to be unexceptional. The claim was brought by SPV SAM Dragon Inc. ("**SAM**") as purchaser of a geared Handymax bulkcarrier, the M/V "*Pretty Flourish*" (the **"Vessel"**), at judicial sale in Belgium, against the defendant mortgagee incorporated in Ireland ("**GE**") which held security over the vessel created by the previous Korean owners, who were under insolvent administration in Korea. The claim arose from GE's refusal following the sale of the vessel to sign the necessary forms required by the vessel's Korean registry to delete the mortgage inscription at the request of the new owners until the proceeds of the judicial sale had been distributed, a process which, on the facts, took ten months. The judge found that the mortgagee was not obliged to delete the entry and not liable for the foreseeable consequences and losses flowing from its retention.

2. The Background Facts and Evidence

2.1 SAM, a Panamanian company, purchased the Vessel, to be re-named "*SAM Dragon*" at judicial sale in Belgium on 12 October 2009. The Vessel was previously owned by a South Korean company, Samsun Logix Corporation (**"Samsun"**), which had entered into a US$ 35 million loan facility agreement with GE on 30 September 2005. The Vessel was registered on the Korean Shipping Register. A registered mortgage on the Vessel in favour of GE formed part of the security for the loan facility, which also included a registered mortgage over another vessel, the M/V "*Pretty Prosperity*".

2.2 Despite being one of Korea's largest operators of bulkcarriers, Samsun was unable to weather the sudden market collapse in 2008 and, on 6 February 2009, filed a petition for rehabilitation in South Korea, which was found to be similar to the examinership insolvency process under Irish law. As part of this insolvency regime, a preservation order was made to prevent the assets of Samsun from being alienated.

2.3 GE demanded full repayment of the loan following Samsun's default in making a monthly mortgage repayment on 13 February 2009. The Vessel was arrested in January 2009 in the port of Ghent, Belgium, by various creditors of Samsun. The total amount owed to the creditors was US$ 51.5 million. GE obtained a conservatory arrest order on the Vessel on 1 April 2009, and on 29 July 2009 the court appointed a bailiff for the purposes of selling the Vessel by public judicial auction. Samsun sought to challenge the jurisdiction of the Belgian court to order the sale on the basis of a demand for recognition of the Korean rehabilitation regime but this challenge was rejected by the Belgian court on various grounds on 13 July 2009, and no appeal was taken. Samsun applied to set aside GE's arrest of the Vessel but the Belgian court declared GE's mortgage to be enforceable on 7 July 2012, and this was confirmed by subsequent order dated 14 July 2012 so that GE obtained rights as an inscribed creditor in Belgium. A partial settlement was subsequently concluded in January 2010 between Samsun and GE whereby Samsun agreed not to challenge GE's priority in respect of the sale proceeds of the Vessel in return for GE not opposing Samsun's scheme of arrangement under the rehabilitation regime. The scheme was subsequently approved.

2.4 By that time, the conditions of sale had been fixed for the public judicial auction and had been advertised by the bailiff. The conditions recited that the sale was being held "*at the request of the firm of GE Transportation Finance*". They assured the purchaser of "*the use and enjoyment of the property following the payment in full of the price and the expenses*" and that "*the vessel is sold free and unencumbered*". SAM made a successful bid on 12 October 2009 at € 10.6 million, which was paid in full to the bailiff.

2.5 SAM intended to register the Vessel on the Hong Kong shipping register in accordance with its group's trading policy and applied for provisional registration there. Permanent registration required delivery to the Hong Kong registry of a deletion certificate from Korean registry, which could only be issued after deletion of the mortgage, which itself required an application for deletion from the mortgagee, GE. The bailiff wrote formally to GE on 9 November 2009 requesting it to apply for deletion of the mortgage, and to the Korean registry informing it of the sale, that SAM was the new owner, and that the Vessel was "*free and unencumbered*". GE replied to the bailiff that it was unable to comply with this request, whereupon SAM took the matter up with GE, which again refused its intervention until it received distribution of the sale proceeds, being an indeterminate period.

2.6 During the period while the Belgian court was deciding on the order of priority in respect of distribution and awaiting notification of possible claims by creditors, the sale proceeds remained deposited with the court bailiff. The court decided on 7 December 2009 that Korean rules of priority would apply to the distribution of the sale proceeds, being the rules operative under Korean law as at the date of the sale. Apart from a small proportion of the proceeds that was payable in priority for local port charges, the whole of the balance

was expected to be applied towards GE's secured debt albeit that this would be insufficient to satisfy the entire sum owed.

2.7 As noted by the judge in his decision, due to the rehabilitation proceedings that were on-going at the time of the judicial sale of the Vessel, GE, as mortgagee, "*had some uncertainty as to what would happen in the event that no scheme of arrangement was approved by the court and Samsun went into bankruptcy*". This uncertainty seems to have been as to the operation of Korean law in the Belgian distribution proceedings notwithstanding the Belgian judgment of 7 July 2009. GE therefore obtained legal advice regarding the deletion of the mortgage from the Korean register. Notwithstanding that GE claimed legal privilege over the contents of this legal advice, and that such evidence was not disclosed to SAM or the court, the court took the view that the legal advice had persuaded GE that it should not voluntarily delete the mortgage on the Korean Shipping Registry until it had received the sale proceeds in Belgium.

2.8 GE's refusal to delete the mortgage from the Korea register prevented SAM from obtaining permanent registration of the Vessel on the Hong Kong shipping register. SAM was not in a position to provide the required deletion certificate within the time period afforded by the Hong Kong shipping register due to GE's refusal to delete the mortgage entry in Korea. In consequence, SAM's provisional registration of the Vessel was forcibly removed by the Hong Kong shipping registry. In such circumstances, SAM was constrained to obtain an alternative provisional registration under another flag. SAM applied to the Panamanian shipping register for the indefinite period until GE obtained payment of the sale proceeds, deleted its mortgage entry on the Korean register, and a deletion certificate issued from the Korean register.

2.9 SAM presented evidence that, on top of the additional costs incurred by it for the alternative registration in Panama and re-registration in due course in Hong Kong, it had incurred higher crewing costs in operating under the alternative non-national registration. GE argued that SAM was the author of its own misfortune in failing to act prudently as an experienced owner and manager in seeking registration of the Vessel initially in a register that did not require a deletion certificate for permanent registration prior to re-registration of the Vessel in Hong Kong. This was rather undermined by the fact that GE had not informed SAM of its unwillingness to delete its mortgage at any time prior to the sale or until after SAM had obtained registration of the Vessel in Hong Kong and, at that time, had informed SAM that the absence of a deletion certificate would *not* be an impediment to permanent registration in Hong Kong.

2.10 During the indeterminate period prior to distribution of the sale proceeds, SAM was faced with the anomalous situation of having its Vessel registered in two different registries simultaneously. It was also unable to obtain a "closed CSR no. 3" from the Korean registry under the International Ship and Port

Security Code. This situation imposed a substantially greater material prejudice on SAM insofar as it was unable in such circumstances to sell, mortgage or, even, time charter the Vessel in the absence of regularisation of the registration. Evidence of SAM's inability to time charter the Vessel following withdrawn by the prospective charterer from the fixture after rates had been agreed, due to concerns about potential disruption to trading arising from the registration irregularities. Fortunately, SAM was able to fund the purchase through its shareholders. No financier would advance loan funding to a purchaser while an undischarged mortgage remained registered against the Vessel in any register.

2.11 SAM issued proceedings against GE on 24 February 2010. SAM's claim sought a declaration that the Vessel had been purchased by it free from all encumbrances; a mandatory injunction ordering GE to discharge the mortgage; and/or an injunction restraining GE from refusing to discharge the mortgage, or from obstructing SAM from registering the Vessel on the Hong Kong register. SAM also claimed damages under Irish law for negligence, misrepresentation, unlawful interference, slander of title/injurious falsehood, and for costs incurred by it as a result of GE's failure to delete the mortgage inscription. GE opposed the proceedings.

2.12 A final order was made by the Belgian court regarding the distribution of the sale proceeds on 8 June 2010. The appeal period for challenging the final order expired on 24 July 2010, and on 26 July 2010, GE consented to the deletion of the mortgage from the Korean register. On 6 August 2010, GE signed the required application for discharge of the mortgage from the register, and the entry of the mortgage was eventually deleted on 31 August 2010. Thereafter, it was no longer necessary for SAM to proceed with its claim for an injunction ordering GE to delete the mortgage entry. However, SAM continued its claim for damages and costs incurred over the ten months' period prior to deletion.

3. The Application of the EC Rome II Regulation to SAM's Tort Claims

3.1 Although the Vessel was sold under a set of written conditions of sale which contained a Belgian choice of law clause, those conditions of sale were binding as between the bailiff, who issued them, and SAM as purchaser, and did not create any contractual relationship between GE as instigator of the sale and applicant for the appointment of the bailiff and SAM as purchaser of the Vessel.

3.2 SAM's claims as introduced before the Irish court were originally framed under a variety of categories of tort under Irish law. In light of the applicable Rome II Regulation (Regulation (EC) No. 864/2007 of 11 July 2007) dealing with the attribution of the law applicable to claims in tort, GE asserted that the claims were governed by Belgian law or, in the alternative, by Korean law. This was on the basis either of the Regulation's Article 4(1) that the applicable

law "*shall be the law of the country in which the damage occurs irrespective of the country where the event giving rise to the damage occurred* ..", or, alternatively, on the basis of the "displacement provision" in Article 4(3), that "*it is clear from all the circumstances of the case that the tort/delict is manifestly more closely connected*" with Belgium in view, "*in particular, of a pre-existing relationship between the parties*" arising from the conditions of sale which stipulated Belgian law.

3.3 GE pleaded that an argument could be maintained for Korean law in respect of one of the heads of claim, namely slander of title/injurious falsehood since this related directly to the inscription in the Korean register, but concluded that, since it was a subsidiary claim to the main heads, Belgium should be considered as the country most closely connected with the "*claims as a whole*" and/or that the EC Regulation did not envisage any severance of claims for the purpose of applying different laws to different heads of claim. In light of this, SAM amended its pleading to adopt the view that Belgium law applied to all the clams.

3.4 After the court had heard the evidence of the Belgian and Korean foreign law experts, GE altered its stance and, in its closing submissions to the court, submitted that the damage claimed by SAM was either clearly suffered in Korea under Article 4(1) and/or that Korea was more closely connected with the claims under Article 4(3) except as concerns the claim for misrepresentation prior to the sale in Belgium. Surprisingly, and with only cursory forensic analysis, the court accepted this view and applied Korean law to all the heads of claim except the pre-sale misrepresentation claim, which was accepted by both parties as being subject to Belgian law.

4. Consideration of the Judge's Findings on the Applicable Law of the Tort

4.1 On the threshold question of which law applied to SAM's claims, the judge accepted, without analysis, the parties' view that Belgian law applied to the false appearance claim arising from GE's alleged failure to disclose, prior to the sale, that it did not intend to delete its mortgage inscription. In any case, it was reasonable to view Belgium as the place where the "damage" occurred since this was where the purchase took place that resulted from the alleged false appearance.

4.2 The judge then proceeded to find that Korean law applied to the claim that GE failed to delete the entry after SAM requested it to do so. In reaching this view, little consideration was given to the main test contained in Article 4(1) of the Rome II Regulation that the applicable law is that of "*the country in which the damage occurs irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event occur*". Article 2(1) defines damage as covering "*any consequence arising out of tort …*". The loss to SAM associated with the expulsion and closure of the Vessel's new register in

Hong Kong was consequent upon GE's failure to delete the mortgage inscription in Korea.

4.3 SAM claimed that consequential costs of the closure were incurred in various countries, such as Hong Kong, Panama and Switzerland, as well as some legal costs in Belgium and Korea. The judge rejected all of these – except those in Korea – by characterising them as mere "*indirect consequences*". This assumes that they were indirect consequences of "an event" occurring elsewhere, but there is no express determination of what event or where. Article 4(1) refers to indirect consequences emanating from "*that event*", ie the event giving rise to the damage. That event was the failure to delete the mortgage, and that failure occurred in Korea. This, then, makes it seem plausible that the various costs incurred elsewhere were mere indirect consequences of the failure to delete in Korea.

4.4 However, the underlying premise of Article 4(1) is that there can be indirect consequences only if there is another place at which direct damage occurs. There cannot be indirect consequences alone because their existence assumes that there were direct consequences in some other location. Thus, the presence of indirect consequences does not imply that the primary test under Article 4(1) has no application. The primary damage apparently occurred in Hong Kong. No one suggested that Korea was the country in which the primary damage occurred, and the claim did not allege damage in Belgium after the Vessel had been purchased (other than local legal costs).

4.5 It was certainly unappealing to focus on the multiple locations at which the damage was incurred, meaning to SAM's economic interests as required under the primary Article 4(1) test, since there were several possible locations – such as Panama, Hong Kong and Switzerland – none of which had any other relevance to the claim. So it was understandable that the judge took the view that this particular tort claim was "*manifestly more closely connected with a country other than* [where the damage occurred]" and opted for applying the displacing test in Article 4(3). Unfortunately, by his process of reasoning the judge conflated the two tests in Articles 4(1) and 4(3), so that his enquiry wrongly became, which of the counties where damage occurred was most closely connected with the alleged wrong arising out of the failure to delete.

4.6 His decision to apply the displacing test under Article 4(3) did not provide a ready answer because there were two candidates with a close connection: Belgium and Korea. In its closing submissions – and despite previously having insisted that the closest connection was with Belgium – GE argued for Korea and presented a list of factors connecting the claim to Korea. The judge adopted this list and view, and held that Korea was "*the country most connected with the alleged wrong arising out of the failure by the Defendant to delete the entry of the mortgage from the Korean Register'.*

4.7 This particular finding was central to the judgment and it was wrong. It ignored the equally long list of factors presented by SAM connecting this claim to Belgium and, in particular, the existence specified in Article 4(3) of "*a pre-existing relationship between the parties that is closely connected with the tort*" and which in this case arose from the sale in Belgium. This was all the more compelling in light of the fact that GE petitioned for the sale and in that capacity approved and could dictate the conditions of sale.

4.8 There were naturally many facts and circumstances connecting the claim to Korea just as there were to Belgium, but in both cases these were largely circumstantial. The main factor connecting the tort to Korea was the accident that this was the location of the register. Its main attribute was, therefore, that it was the country in which the event "*giving rise*" to the damage occurred. As such, it was specifically disqualified under Article 4(1), so that it is unappealing that the same attribute should be seen to qualify it under Article 4(3).

4.9 In contrast, the country in which both parties chose to deal, where GE had obtained its rights as inscribed creditor over the Vessel, and to whose law both parties had submitted, was Belgium. The judge gave no consideration to any connecting factors with Belgium. Also the sale took place subject to conditions of sale prepared by the Belgian bailiff for use in Belgium and which were subject to Belgian law. In this regard, we will see that the judge's view of the merits of this claim rested very largely on his view of SAM's obligations arising from clause 10 of those conditions. This was unquestionably a factor closely connected to determining liability for the tort.

4.10 The choice of different laws for application to different claims between the same parties arising from essentially the same complaint was also undesirable. The application of Belgian law to the first claim was itself a connecting factor relevant to the choice of law in respect of the second claim. Given that one of the claims was clearly subject to Belgian law and the other main claim arose out of a pre-existing relationship in Belgium between the parties that was closely connected with the tort, it might be thought evident that Belgian law should have been applied across the board.

5. SAM's Formulation of its Claims under Belgian Law and the Judge's Findings

5.1 In their final expression by reference to Belgian law, SAM's claims were formulated under three heads reflecting three separate factual and temporal situations, being: (a) failure by GE prior to the sale properly to disclose its intentions not to delete the mortgage inscription; (b) failure by GE after the sale to delete the mortgage when requested to do so by the bailiff and by SAM; (c) false assertion of an interest in the Vessel following payment by SAM of the purchase proceeds to the bailiff. This did not involve separate categories of tort as understood and classified by Irish common law, but the application of general principles of liability in tort derived from the provisions

of the Belgian civil code. This involved three general claims under Belgian law, being: (i) interfering with the right to use an asset; (ii) abuse of a right; and (iii) creating a false appearance.

5.2 The font of liability for tortious acts under Belgian law is Article 1382 of the Civil Code, which provides that "*An act which causes damage to another renders the person at fault liable to make reparation*", and is coupled with Article 1383, which provides that "*Each is liable for the damage he causes not just wilfully but also by his negligence or imprudence*". This root principle supported the three branches of SAM's claims.

5.3 As to the first claim, both parties' experts accepted that '*limiting someone in the free use of its assets is a tort*'. Both also concurred that the refusal by GE to remove the mortgage inscription was an infringement of SAM's right to free use of its assets unless GE had a right to refuse to delete the inscription. GE contended that it was subject to no positive obligation by law or international practice to intervene or take steps to delete the inscription – even if it was the only person with the standing to delete it – which should just be expected to fall away in due course if the registration of the Vessel was not maintained by the new owner.

5.4 The judge found that there was no infringement by GE of SAM's liberty. This was both because "*there was no duty on the defendant to de-register the mortgage upon a judicial sale*" either under Belgian law or established international practice, and because the evidence showed that "*the defendant had received advice to the effect that its position might have been compromised if it de-registered the mortgage*" – this being advice for which GE had claimed privilege and refused to disclose. The judge considered that in the absence of actions taken or not taken in bad faith it was unobjectionable for GE to refuse to correct the register if it considered that this might harm its interests and rejected SAM's expert's evidence to the contrary.

5.5 As to the second claim, '*abuse of a right*' is itself a tort in Belgium. Abuse comprehends the exercise of a right in a way that exceeds the limits of normal exercise by a prudent and advertent person (objectively symbolised by the traditional *bonus pater familias* or good head of the household) as well as the purported exercise of a right in circumstances in which it does not bring an objectively justifiable advantage that outweighs the negative effects of the interference caused by its exercise. The key premise is the existence of a right to retain the mortgage (but this became an artificial construct in this case since the most GE could point to was the absence of any obligation to delete).

5.6 The question then becomes whether the disadvantage flowing from the exercise of that right outweighs the advantage to the party claiming the right. Even at this level GE could not point to an objective advantage in retaining the inscription either in Korea or Belgium. The judge expressly did not accept the view of GE's Korean expert that it was necessary for GE to maintain the entry

in order to keep its secured rights as mortgagee. As concerns Belgium, GE was unable to explain why the presence of the inscription was necessary to ensure its priority in distribution of the proceeds of the sale since its rights (and the rights of all other competing creditors, known or unknown), were fixed in Belgium as at the date of adjudication of the sale notwithstanding any subsequent alterations arising from the Korean rehabilitation proceedings, so that there was no possibility subsequently for new rights to spring up in favour of a competing creditor or for GE's rights to be devalued. The most GE could manage as justification was its own subjective concern that something might come up, possibly even in another jurisdiction, which made it desirable to retain its inscription for future production. Nonetheless, the judge found that there was no abuse of right in refusing to delete because the exercise of GE's 'rights' (such as they were) was not manifestly beyond a normal exercise by a reasonable, considered or prudent person in the circumstances, even though GE was unable to identify the prejudice that it might suffer from deleting.

5.7 Finally, as to the third claim, both Belgian law experts acknowledged that '*giving a false appearance*' that is misleading to a third party was a tort in Belgium but disagreed about its application to the situation at hand. SAM asserted that GE's failure to notify bidders at the auction of its intention to retain the Korean mortgage inscription was wrongful because it was inconsistent with the published terms that the Vessel would be sold free and unencumbered and constituted a limitation on the rights which purchasers were led to believe they would receive. SAM bought the Vessel relying on that appearance. GE, having initially pleaded that it did not intend at the time of sale to delete the inscription, re-considered its plea during the hearing and countered that at the time of sale it had not specifically adverted to any need to do anything about the inscription because it was assumed that it would be deleted automatically. Such position was difficult to reconcile with GE's view that it needed to retain the inscription in case future unforeseen circumstances required it to assert its security interest and rights. Nonetheless, the judge accepted GE's evidence and found that '*no false appearance*' had been created prior to the sale.

5.8 SAM claimed that GE was also liable for giving a false appearance after the sale that it retained mortgage rights over the Vessel by maintaining the inscription. This was founded on evidence given by the parties' Korean legal experts that the inscription was inaccurate following the sale (which GE's expert described as "*not reflecting the subsequent change*"). GE countered that the continuing registration did not constitute notice to the world of any entitlement but only a warning that there had been an entitlement in the past and that the current position would need to be verified. In short that it was no more than an administrative vestige of former rights. The judge accepted this and the view of GE's Korean expert and held "*that the mortgage entry was no more than that, and was not an inaccurate or false statement made by the mortgagee*".

6. The Judge's Findings under Korean Law

6.1 In light of the view adopted by the judge, Korean law became determinative of SAM's claims. If the judicial sale of the Vessel had taken place in Korea, the mortgage inscription would automatically have been deleted. SAM's Korean legal expert gave evidence that GE was obligated to delete the Korean mortgage upon the demand of the new owner that the inaccurate entry in the register be corrected. GE's expert was unable to say whether a mortgagee was obligated to act to delete its Korean mortgage entry in circumstances of a foreign judicial sale – although he acknowledged that he was unaware that GE had applied for the sale. The judge misconstrued this as evidence that there was no obligation to delete and found accordingly.

6.2 The enquiry then concentrated on the prejudice to GE of deletion. It was common ground between the parties that both by operation of Belgian law and under the sale conditions the Vessel had been sold free and unencumbered – although GE's Korean law lawyer gave evidence that maritime liens were not erased under Korean law – and that the rights of the mortgagee had transferred to the proceeds of sale. GE acknowledged that it had retained no security interest in the Vessel – although GE's counsel contended cryptically that the mortgage "*remains equally valid and may have implications beyond the vessel itself*". GE also acknowledged that it could not seek to arrest the Vessel in order to recover the outstanding balance due from Samsun – although GE's Korean expert gave evidence that, in the event of Samsun's bankruptcy, Korean law would not recognise the foreign sale so that, astonishingly, it would not be binding on the trustee in bankruptcy, who could demand that the Vessel or her proceeds of sale be returned to Korea (which the judge did not accept).

6.3 GE's Korean expert further maintained that, in the event of bankruptcy, GE would need to be able to show the continuing inscription of its mortgage in order to be able to exercise a right of exclusion of the Vessel and/or the sale proceeds from the bankruptcy pool of assets. He acknowledged that the mortgage deed stood as proof of the mortgage, and that a transcript showing the prior inscription could be obtained, but asserted that under Korean law it was necessary for GE to maintain its entry on the Korean register in order to prove its secured rights as mortgagee (which the judge did not accept).

6.4 GE's expert postulated various dates until which the inscription was needed: until the closing of the confirmatory proceedings between GE and Samsun in respect of GE's rights of recovery; until approval of the rehabilitation plan by Samsun's creditors on 5 February 2010; until GE received distribution of the sale proceeds in Belgium due to the risk of competing creditors acting in Belgium to challenge GE's priority rights; and while any shortfall in recovery remained outstanding to GE. Ultimately, however, he was unable to identify any scenario under which GE would suffer prejudice in Belgium from the deletion of the mortgage in Korea given that the Belgian court did not

recognise the Korean incidents of Samsun's rehabilitation regime and looked to Korean legal requirements only as to its rules of priority as applicable at the date of sale but not later. Ultimately, the judge's view did not depend on his findings of Korean law but of his findings as to international practice and the Belgian conditions of sale to which we now turn.

7. The Court's Findings of International Practice

7.1 In dismissing SAM's claim on all counts and formulations, the judge based himself on a number of findings of general importance to the shipping community.

(i) Court's Findings as to International Comity

7.2 As his starting point, the judge was conscious of the importance of the general consensus in the international maritime world as to the effect of a judicial sale of a vessel, namely that the sale gives the purchaser a title free of all liens and encumbrances, and that such title is good as against the whole world. He expressly endorsed the view expressed in the leading authority of the House of Lords in *Castrique* v. *Imrie* (1869) LR 4 HL 414 that the honest exercise of jurisdiction by a foreign court to sell a vessel cannot be impeached in England as against the purchaser even if invalid under English law. He noted the view of Hewson, J in *The Acrux* [1962] 1 Lloyds Rep 405 that this was "*part of the comity of nations as well as a contribution to the general well-being of international maritime trade*". He also indorsed Sheen, J's reflection in *The M/V "Cerro Colorado"* [1993] 1 Lloyds Rep 58 that "*No innocent purchaser would be prepared to pay the full market price for the ship, and the resultant fund, if the ship were sold, would be minimised and not represent her true value*". Ironically from the viewpoint of GE's overall business interests, the judge went on to cite Sheen, J's caution that:

> "*From time to time, almost every ship owner wants to borrow money from his bank and to give as security a mortgage on a ship. The value of that security would be drastically reduced if, when it came to be sold by the Court, there was any doubt as to whether the purchaser from the Court would get a title free of encumbrances and debts*".

Apparently GE considered that its short term interests in avoiding liability for SAM's losses outweighed any longer term interest in reinforcing the confidence of purchasers at judicial auctions.

7.3 For his part the judge recognised that "*maritime affairs, by their nature, have an international dimension and are governed to a significant extent by international conventions which have been widely adopted*". Evidence was led from both sides as to international practice. GE led evidence of practice in Gibraltar which conceded that once the mortgagee's secured rights had been established (as was the case for GE in Belgium) there was no need for the mortgage inscription. SAM led evidence of practice in England which cited

an order of the English Admiralty Court made on 28 January 2011 in which relief was granted by way of declaration that an Italian bank as holder of a third mortgage over the M/V "*Atlas Star*" which had been sold by judicial auction under the auspices of the English court, had no right to retain its mortgage registration in the vessel's registry in Madeira. The bank's refusal to delete its mortgage prevented the issuance of a deletion certificate from the Madeira registry – being facts that closely resembled SAM's situation. The English court recited in the order "*that the conduct of the* [third mortgagee] … *is preventing enforcement of the Sale Order*". The court's declaration spelt out in clear terms the legal operation of a judicial sale:

> "*Upon the sale of the vessel by the Admiralty Marshall pursuant to the Sale Order all mortgages, charges, liens and other encumbrances on the Vessel … will be extinguished as against the Vessel and will no longer bind the Vessel and any such encumbrances will be enforceable solely against the proceeds of sale.*"

The English order was recognised and given effect to by the Madeira registry, but the judge made no reference to this order in his decision.

7.4 It is understandable that courts will not tolerate a mortgagee's recalcitrance in giving effect to their own order for sale. Why should their view be different merely because the sale was ordered by a foreign court? Since *Castrique v. Imrie*, the English courts have acknowledged the binding force and effect of foreign judicial sales even when they *conflict* with rights under English law. This is not merely in the interests of comity but also to ensure that vessels submitted for sale may achieve their maximum market value in the interests of the owners and their financiers. It is all the more perplexing that an Irish court should refuse in this manner to give full effect to a sale emanating from another member state of the European Union.

7.5 Nonetheless, the clear logic and desirability of a free, unencumbered and unrestricted title and interest as against the whole world was not seen to commend itself to the judge in this case. Notwithstanding that GE had no security or other interest in the Vessel, that its security rights had been officially recognised and inscribed in Belgium, that the mortgage entry was false, and that GE was the only person able to correct the entry (the judge appeared erroneously to think that Samsun could also but its application to do so had been rejected by the registry), GE was held to be under no obligation to act to correct the position and could not be liable for any damage resulting from its refusal to do so no matter how long this persisted. In effect the judge distinguished between the mortgagee's security interest in the Vessel – which no longer existed – and the words on paper recording that interest – which continued to exist, and for which continued existence the mortgagee had no responsibility: a distinction more likely to be appreciated by a lawyer than a shipowner.

(ii) Court's Findings as to Purchaser's Onus

7.6 This was so, even though GE was unable to point to any objectively foreseeable prejudice from acting to correct the entry, at least – in the judge's view – as long as its refusal to act was not done in bad faith. It suffices that the mortgagee apprehends that deleting was "*going to harm its interests*". In fact the degree of probability of harm envisioned by the judgment as being sufficient to justify retention of the mortgage inscription is rather less than this since GE was quite unable to specify how it *might* be harmed. It was able to say only that deletion "*would have put its priority at risk in the Belgian proceedings, due to the lack of clarity in relation to the interaction between Korean law and Belgian law in this regard*". Thus, the merest possibility of harm would seem to be sufficient, and the mortgagee can satisfy that requirement if it "*had received advice to the effect that its position might have been compromised if it de-registered the mortgage*". This judgment effectively places a heavy burden on the purchaser of proving that the mortgagee is acting in bad faith in maintaining the inscription.

(iii) Court's Findings of International Practice not to Delete

7.7 The rationale for this sprung from the judge's finding of the existence of another international maritime custom and practice that was incompatible with any such obligation, namely that a former "*mortgagee would never be asked to delete its mortgage from a shipping register in circumstances where there was a judicial sale*", and cannot be constrained to cooperate in doing so in the absence of a pre-existing legal obligation requiring it to act. As we have seen above, the judge found that there was no such obligation under Korean law in the circumstances of a foreign judicial sale.

7.8 Nor was there an obligation to delete the entry under Belgian law. In addition to his view of international maritime custom and practice, the judge found that the Belgian conditions of sale required SAM to deal with any de-registration formalities in Korea. Clause 10 provided that:

> "*The definitive adjudicatee shall have the obligation to inform the keeper of the Ship's Classification Register in Korea, where the vessel is currently registered, of this sale. Any and all fees and duties relating to the transfer of title and inscription in the Register of maritime liens and mortgages, in Belgium, in Korea or in any other country, are for the definitive adjudicatee's account and shall be borne by the latter. The definitive adjudicatee must also fulfil all formalities in this respect*".

The judge considered that this "*provided that the purchaser was to fulfil all formalities with regard to registration. It was the responsibility of the purchaser to arrange de-registration in Korea*". This finding is all the more surprising in that clause 10 makes no reference to de-registration and is confined to providing that the purchaser fulfils all formalities with regard to

registration. This was apparently also the bailiff's view since he himself, unprompted, informed the Korean registry of the sale. The judge's view of clause 10 was of crucial significance because he discounted the evidence of SAM's Korean law expert that GE had an obligation to delete under Korean law on the ground that the expert was unaware of the existence of clause 10.

7.9 It would appear that the judge also erroneously concluded that clause 10 determines the division of contractual responsibility between SAM and GE. The conditions of sale were binding as between the bailiff and the purchaser only – a point acknowledged by GE's expert on Gibraltar practice – and provided that as between them the bailiff is not responsible for registration formalities. There was no basis for a finding that they also determine the rights and obligations as between a former mortgagee and the purchaser. It was common ground that the conditions of sale created no contract between GE and SAM, and GE insistently maintained that it could not be made liable under the clause 14 provision of the conditions of sale that the Vessel was sold free and unencumbered.

(iv) Court's Findings of International Practice to Register under Flag of Convenience

7.10 The judge went on to find that established custom and practice is such that the purchaser will "*usually register the vessel in an open registry*" and maintain that registration until the previous register is struck off "*after a period of time for non-payment of registration fees*". This was crucial to the outcome in the case since the judge expressly declared that his view of such practice would be used to assist in resolving conflicts in the expert evidence on Belgian and Korean law.

7.11 The notion that there could be an established practice sits uncomfortably with the view – pressed by GE and accepted by the judge – that the situation arising in this case was exceptional. The fact that a mortgagee might 'never' be asked to delete its mortgage following a judicial sale carries no implication that it is entitled to refuse; it is quite consistent with the situation in which it never needs to be asked because it would never risk interference with the purchaser's rights. In any event, the evidence for this could be little more than anecdotal.

(v) Considerations as to the Rights and Interests of Purchaser and Mortgagee

7.12 Whether or not there is such a practice – and the evidence given for it was so uncompelling that the judge called in aid a strained view of clause 10 of the conditions of sale – the question remains whether it is compatible with the rights and interests of the purchaser and of the former mortgagee and can be relied upon in the face of an express demand addressed by the purchaser that the inscription be deleted. GE's pleaded stance was that:

"*Pending the distribution proceedings in Belgium, it could not be expected that the Defendant would delete the registration of its mortgage as long as it needed it to enforce its mortgage on the sale proceeds, against which the mortgage lay after the judicial sale.*"

7.13 As a matter of elementary and uncontested principle, the mortgagee retains no interest in the vessel that can be relied upon to justify the retention of its inscription in the previous register. Its previous interest is transferred to the sale proceeds but there is no mortgage over the sale proceeds. The untutored might think that this was the beginning and the end of the analysis no matter what prejudice the mortgagee might apprehend or, indeed, face.

7.14 It is equally elementary that the inscription constitutes a published statement to the world of the existence of a security interest and is not merely an historical record of the interest asserted at the time of the registration as GE contended. Indeed, GE pleaded that, "*The purpose of this entry was to put persons who examined the Register on notice of an encumbrance that potentially affected the Vessel*". If it had no on-going legal connotation, a transcript of the entry at the date of its deletion would suffice to prove its existence and there would be no need to retain the actual inscription. GE acknowledged in its submissions that it needed the inscription not just to show what its rights had been prior to the sale but in order to have the possibility of asserting a "*security interest and rights*" in future if necessary. If that was so, then GE could not even have permitted the inscription to lapse in accordance with the assumed international maritime practice, and would, if necessary, have had to intervene to preserve it, such as by paying the Vessel's local registration fees. There is an irreconcilable contradiction in this stance which belies GE's assertion that it was content for the inscription to be deleted by official action on the part of the registry. It is also quite unclear why the consequences of 'voluntary' action to delete at the behest of the purchaser should be viewed differently from official action. GE's Korean expert distanced himself from GE's official stance and expressed his (unsupported) opinion that either action "*may seriously prejudice and jeopardise GE's interest*".

7.15 The retention of the inscription following the sale was both an inaccurate assertion of rights, an attaint on the purchaser's clean title and an on-going interference with the purchaser's rights. It could not be justified once the purchaser called for its deletion unless GE had acquired some new supervening right to its retention. Apart from the purely theoretical construct, referred to above, considered as part of Belgian tort law as 'abuse of a right', no one ever suggested the existence of any such 'right'.

7.16 One looks in vain for any pre-existing or acquired right which might permit the mortgagee to determine where and when and at what cost the purchaser may be permitted to register its vessel. In this case, it could not be said that the mortgagee was an innocent bystander to someone else's actions. It was the petitioning party for the sale who brought it about and approved the sale

conditions, so that its refusal to act appears even less justifiable. Moreover, at the time when it sought the sale, GE was in full possession of the facts and information about Samsun's situation and able to evaluate the risks of undertaking such course of action. Nor was GE faced with new, unexpectedly adverse circumstances. The circumstances actually improved; something the judge misunderstood. He considered that Samsun's 'rehabilitation' status caused GE "*some uncertainly as to what would happen in the event that no scheme of arrangement was approved by the court and Samsun went into bankruptcy*". If that was GE's worry, in fact, the scheme of arrangement was approved following the agreement GE reached with Samsun on 18 February 2010 (which still did not remove all risk of bankruptcy), but GE still refused to delete the mortgage.

7.17 One cannot escape the conclusion that GE was seeking to preserve its non-existent security interest as a means of countering some as yet unknown eventuality, at least after the sale was no longer capable of annulment. It was clear that GE could not define the prejudice to be suffered from deleting the entry. The advice underlying the perceived risk was, judiciously, never disclosed. The most that it could find to say was that this action seemed 'prudent'.

7.18 It may be thought that the counter-intuitive result in this case proceeds from an assumed right to act prudently which takes priority even over property rights. This presumes the absence of an obligation to act inconsistently with the mortgagee's perceived interests. The judge put the issue in just those terms:

> "*In order to determine whether the defendant has a legal liability, the court must decide whether there is a legal duty on the mortgagee of a vessel to take affirmative steps to delete the entry of the mortgage on the Ship's Register in circumstances where there has been a judicial sale in a country other than the court of registration*".

The judge found that there was no such legal duty. In jurisprudential terms this was a finding of a negative right – a right of inaction in GE's favour, which is equivalent to a right to retain the inscription. It may be thought that he put the wrong question: the correct enquiry was as to whether there was a right to retain the inscription, and as to what possible source there could be for such a right. In casting the enquiry in such terms he would have recognised that there was none.

7.19 The judge justified the absence of a legal duty by what he considered to be an established international practice. But practice does not create rights just as practice provides no defence to liability in tort. Practice must be consistent with pre-existing rights to avoid exposure to liability.

7.20 The reasoning for GE's actions ultimately reduces itself to the unattractive proposition cited by GE's counsel that, GE could not be made responsible for

failing to do something that is not 'mandatory'. Thus, to cite GE's counsel's analogy, I cannot be liable for failing to open a barrier at your request so that you can exercise your acknowledged "*entitlement to drive on both sides of it*". If I do not have to do it, you cannot compel me. This was inapt: the analogy actually asserted is that I cannot be made liable for erecting or maintaining the barrier – of course you can if you have no right to erect or maintain it. GE was not an innocent observer of others' actions: the situation arose only because of its own actions and the prior exercise of its rights in procuring registration of the mortgage. And once that interest was extinguished (also by its acts), it was the only person who could act to delete it. In such circumstances, it was bound to act, and if it failed to do so, it was answerable for its interference with the owner's rights. It cannot pray in aid of its inaction any supervening right. In the simplest of terms, GE was appropriating something of value to SAM – and of value to GE – and to which it was not entitled, without offering compensation. It is a corollary of this position that GE denied that SAM possessed any legal right – or even freedom – at least under Belgian law, to register the Vessel in the registry of its choice.

7.21 The judge reached his result because he found no such 'mandatory' provision in either Belgian or Korean law. To the contrary he considered that clause 10 of the sale conditions imposed a mandatory obligation on the purchaser to arrange de-registration. This is the crux of the matter: in the absence of a source for a negative right in favour of GE to do nothing, he found a positive duty in SAM to act to arrange the de-registration. Even assuming that the sale conditions created enforceable rights and duties between SAM and GE – which everyone accepted they did not – those conditions could not be relied upon by GE to refuse to take a necessary step which only it could perform. GE's legal duty to act arose from the situation in which the purchaser found itself, and had been placed by GE's actions.

7.22 The situation is which SAM found itself – and through no fault of its own despite GE's contentions to the contrary – did not involve some short term hiatus in correcting the pre-existing register: the situation continued for nearly ten months and might well have continued much longer. The final claim was limited to relatively modest damages of US$ 150,000. It might have been exponentially greater. The judge openly questioned the commercial interest of pursuing a claim of this quantum to trial. One senses that he might have viewed matters differently if the losses had been larger. However, the original claim was for injunctive relief that GE be ordered to delete the mortgage. The implications of this judgment are that such equitable relief would not have been granted because GE was subject to no legal duty to delete the mortgage. Yet when measured against equitable principles, GE's refusal hardly appears conscionable, and equity is itself the source of the mortgagor's equity of redemption that protects property rights from unjustified encroachment by mortgagees.

7.23 It is also noteworthy that the judge relied heavily – referring to it three times – on the rationale that "*the facts of this case are clearly unusual" and "that there were complex and novel issues arising in Korean law … having regard to the existence of the rehabilitation proceedings*". It is unclear why this should be thought to be '*unusual*'. Ship ownership has been progressively morphing into larger commercial conglomerates for several decades and this process has accelerated since the introduction of the ISM Code in 1998. Such conglomerates have much enhanced access to financing and are more likely to seek recourse to the bankruptcy rehabilitation and protection regimes which have sprouted throughout the advanced trading nations in emulation of the US's Chapter 11 provisions.

7.24 In addition, it almost goes without saying that vessels financed and trading internationally are likely to be arrested and judicially auctioned outside the country of their registration. Evidence was led from both parties' Korean law experts that such situations involving a rehabilitation procedure on-going in Korea "*is not very uncommon*" and "*many Korean shipping companies have gone through eventual bankruptcy proceedings*", evidence ignored by the judge in his judgment. Although the Belgian court would apply Korean rules of priority these were fixed and known, and connoted the rules extant at the date of adjudication and not any subsequent rules and did not admit any subsequent claims or variations which might have arisen from the rehabilitation proceedings, for which the Belgian court had already expressly denied recognition. It is, thus, unconvincing to view this situation as uncertain and exceptional.

8. General Implications of the Judgment

8.1 As a result of the court's decision in this case, there are a number significant implications of general significance for the shipping industry and which are not limited to the particular facts and circumstances of this case.

8.2 The main implication is that the purchaser of a mortgaged vessel at a judicial auction held outside the vessel's place of registration is obliged to accept the continuing inscription of previously registered mortgages notwithstanding that the vessel has been sold free and clear of encumbrances. This derives from the judicial finding that there is an international practice that mortgagees are under no obligation to take steps or cooperate in discharging their mortgages following a judicial sale. It was said that previously there had been no legal authority expressly upholding the existence of a mortgagee's obligation to delete; this judgement now stands as authority that there is none.

8.3 This situation is not limited to situations of insolvency regimes applicable to the former owner in view of the wide and general findings of the court as to international maritime practice. This case shows also that there is no time limit to such situation which perpetuated for 10 months and might have run for as many years. Belgian experience in the recent case of the "*Subhan Allah*"

shows that the time period for resolution of competing creditor challenges prior to distribution of the sale proceeds can be as much as twelve years. During such period the purchaser would be faced potentially with operating under duplicated registrations, one of which recorded a non-existent security interest.

8.4 The second implication is that the purchaser of a mortgaged vessel at judicial auction will be expected to register the vessel in a flag of convenience registry prior to re-registering in its intended permanent registry of operation after the vessel has been, as the judge expressed the position, "*struck off the old register after a period of time for non-payment of registration fees*".

8.5 A related implication is that the work, cost and consequences of procuring discharge of any pre-existing mortgage are to be borne by the purchaser as a matter of international practice even in the absence of any specific conditions of sale requiring this.

8.6 A third implication of the judgment relates to the legal significance of a mortgage inscription. This judgment holds that the inscription can properly be maintained purely as an historical record of rights which no longer exist, and, furthermore, that it may be necessary to do so in order to prove the existence of those rights at a point in time prior to the sale. Many might find such propositions surprising insofar as this implies that the register cannot and should not be relied upon on its face and that any one searching the register is obliged to approach the mortgagee in order to ascertain the continuing existence of its security interest. More disquieting is that this judgment states that the purchaser of the Vessel has no recourse against a prior mortgagee to ensure that the register accurately records security interests affecting its title.

8.7 In practice this judgment means that:

(a) a purchaser at auction cannot limit his dealings to the court appointed bailiff or broker and must ascertain from a registered mortgagee what its specific intentions are concerning deletion of its mortgage inscription in the vessel's place of registration;

(b) a purchaser must ensure that any financier of the purchase is ready to accept the possible continuing inscription of a prior mortgage under which the previous mortgagee has no continuing rights but which might need to assert its security interest and rights if circumstances were to arise – excluding, however, the right to re-arrest the vessel;

(c) a purchaser cannot freely choose the new flag of registration of the vessel and, if it intends to change the existing flag, must select a registry which does not require the filing of a deletion certificate from the previous registry as condition of permanent registration. This will entail additional registration costs upon the change to the ultimate register,

may entail additional operating costs, and may prevent the vessel from engaging in certain trades and in certain localities;

(d) a purchaser may be constrained to operate the vessel with two concurrent registrations, one of which contains a continuing inscription of a non-existent security interest in favour of the former mortgagee;

(e) a purchaser wishing to operate the vessel may have to persuade charterers and/or port state inspectors that the vessel does not require a closed CSR from the previous registry under the International Ship and Port Security Code;

(f) a purchaser that wishes to sell the vessel prior to discharge of the mortgage inscription will have to advert the buyer to the inscription and persuade it that this is not an encumbrance on the title and can be ignored by the buyer's financier.

The repercussions of this Irish High Court decision are, therefore, particularly unfavourable from the point of view of prospective buyers, may create reticence on the part of prospective buyers at judicial auction in circumstances akin to the facts at hand, and will certainly inhibit the level of offers made in view of the additional, unpredictable risks. If impetus was needed for a new international convention on inter-jurisdictional recognition of judicial sales, this judgment has provided it.

8.8 SAM has appealed the judgment to the Irish Supreme Court.

MARC STURZENEGGER

Geneva, 17 September 2012