

**EHLERMANN
RINDFLEISCH
GADOW**

RECHTSANWÄLTE
PARTNERSCHAFT MBB

BALLINDAMM 26, 20095 HAMBURG

TELEFON	+49 40 37 48 14 - 0
TELEFAX	+49 40 37 48 14 - 30
E-MAIL	INFO@ERG-LEGAL.COM
INTERNET	WWW.ERG-LEGAL.COM

**FINANCING CHARTERS – STRUCTURAL
ELEMENTS AND POSSIBLE RECORDATION**

Update on Marshall Islands Law
Amathus Beach Hotel Limassol, 2nd December, 2015

Tonio Lechner

- ✓ **law firm with offices in Hamburg (20 lawyers) and London (5 lawyers)**
- ✓ **specialized in ship finance**
- ✓ **special relationship with IRI Registries and the Marshall Islands**
- ✓ **2 lawyers admitted to the bar of Majuro, Marshall Islands**
- ✓ **3 lawyers acting as special agents for the Marshall Islands register of ships**
- ✓ **firm was involved when one of the first financing charters was recorded (via IRI Registries Athens)**

BALLINDAMM 26
20095 HAMBURG

TELEFON
+49 40 37 48 14 - 0

TELEFAX
+49 40 37 48 14 - 30

E-MAIL
INFO@ERG-LEGAL.COM

INTERNET
WWW.ERG-LEGAL.COM

New Section 302A of RMI Maritime Act (March 2013)

New Section 302A of RMI Maritime Act (March 2013)

- **now possible to register a **financing charter** and to provide a financing charter with a security interest having the same priority as a mortgage**

New Section 302A of RMI Maritime Act (March 2013)

- **now possible to register a **financing charter** and to provide a financing charter with a security interest having the same priority as a mortgage**

Why that and what is a "financing charter"?

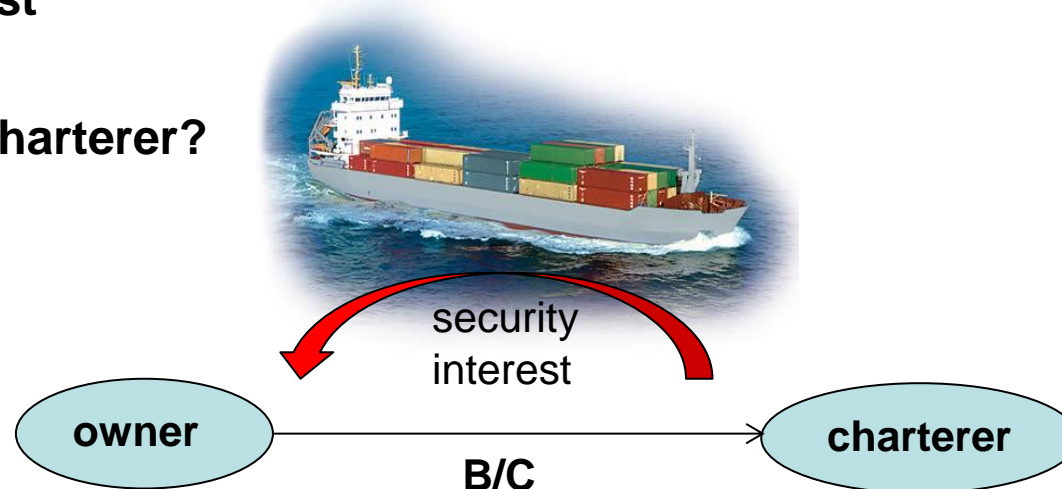
Definition of "**financing charter**"

“a contract in the form of a demise or bareboat charter, regardless of duration, between the documented owner and the charterer of the entire vessel, which contract is agreed by the parties to be or is determined in judicial or arbitral proceedings to create in favour of the documented owner a security interest in the vessel granted by the charterer”

(Section 112 (7) of RMI Maritime Act)

What kind of transaction did the legislator have in mind when defining a **financing charter** as

- a demise or bareboat charter contract
- agreed by the parties to be or determined in judicial or arbitral proceedings to create
- in favour of the documented owner
- a security interest
- in the vessel
- granted by the charterer?

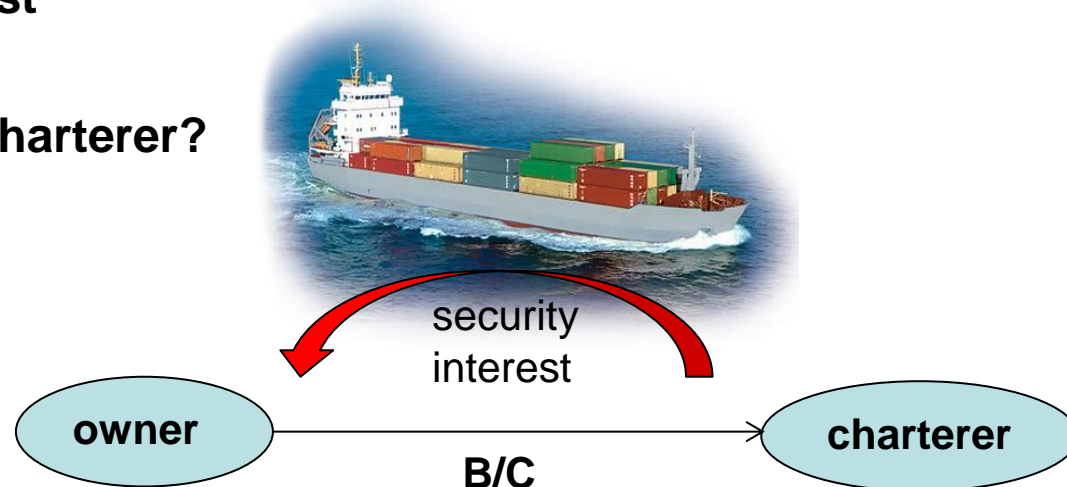


INTRODUCTION

What kind of transaction did the legislator have in mind when defining a **financing charter** as

- a demise or bareboat charter contract
- agreed by the parties to be or determined in judicial or arbitral proceedings to create
- in favour of the documented owner
- a security interest
- in the vessel
- granted by the charterer?

It is Leasing.



- **Introduction: New Section 302A RMI Maritime Act**
 - **Ship Mortgage Finance vs Lease Finance**
 - **Lease Charters – structural elements**
 - **Lease Charters and Insolvency**
 - **Lease Charters in Chapter 11 proceedings (“True Lease” or “Disguised Financing”?)**
 - **Recordation of Financing Charters**
- **Excursus: What about Cyprus?**

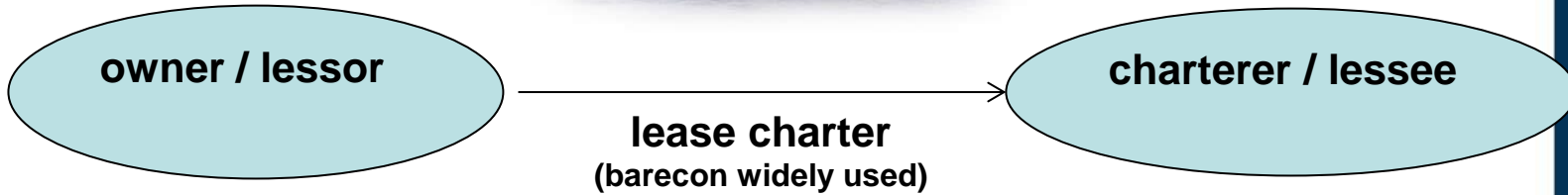
SHIP MORTGAGE FINANCE VS LEASE FINANCE

➤ Traditional: Ship Mortgage Finance



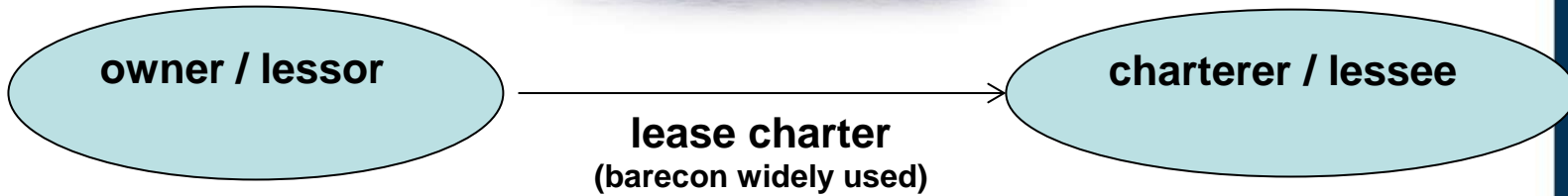
SHIP MORTGAGE FINANCE VS LEASE FINANCE

➤ **New:
Lease Finance**



LEASE CHARTERS – STRUCTURAL ELEMENTS

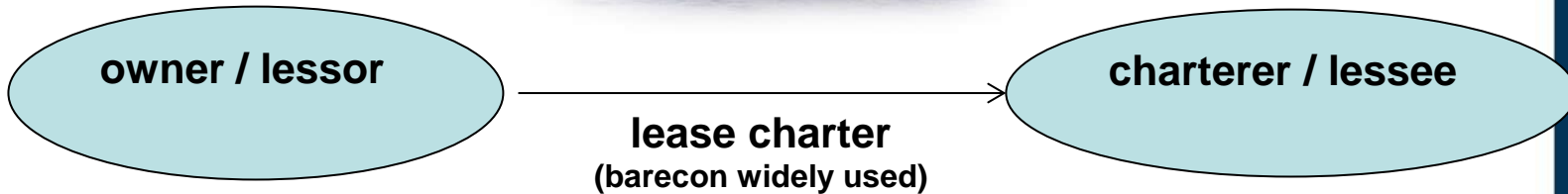
➤ **New:
Lease Finance**



➤ **“hell and high water”- operating risk with lessee**

LEASE CHARTERS – STRUCTURAL ELEMENTS

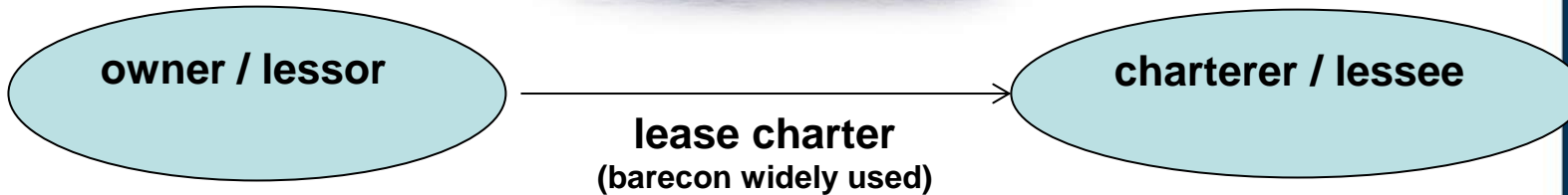
➤ **New:
Lease Finance**



- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured

LEASE CHARTERS – STRUCTURAL ELEMENTS

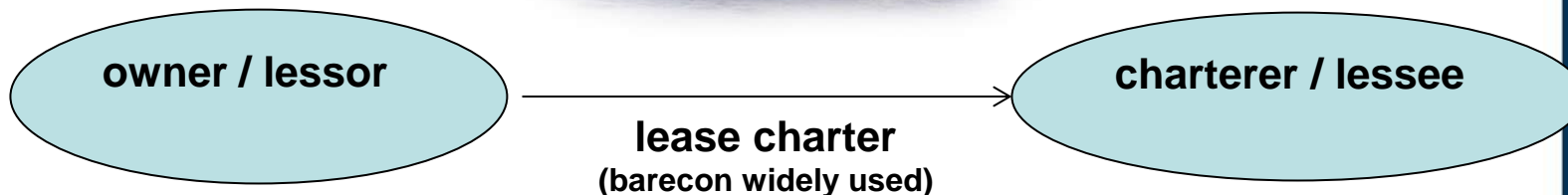
➤ **New:
Lease Finance**



- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured
- duration comparable to mortgage loan (8-10 years)

LEASE CHARTERS – STRUCTURAL ELEMENTS

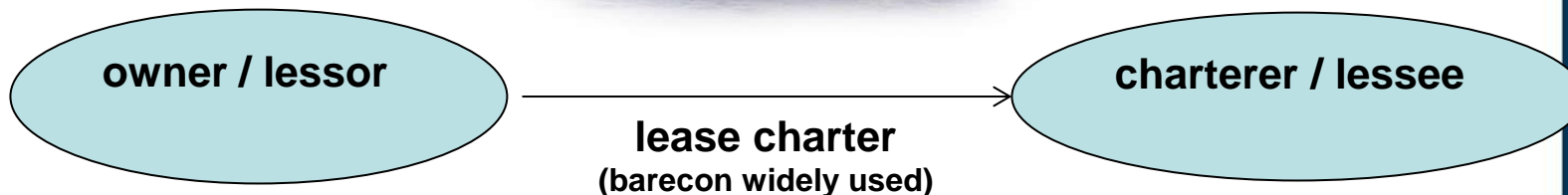
➤ **New:
Lease Finance**



- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured
- duration comparable to mortgage loan (8-10 years)
- aggregate charter - calculated as instalments plus interest – equals depreciation

LEASE CHARTERS – STRUCTURAL ELEMENTS

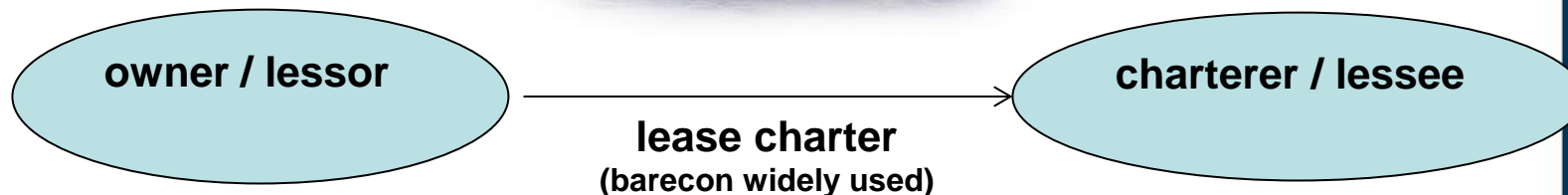
➤ **New: Lease Finance**



- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured
- duration comparable to mortgage loan (8-10 years)
- aggregate charter - calculated as instalments plus interest – equals depreciation
- purchase options
 - lessor’s put option
 - lessee’s call option

LEASE CHARTERS – STRUCTURAL ELEMENTS

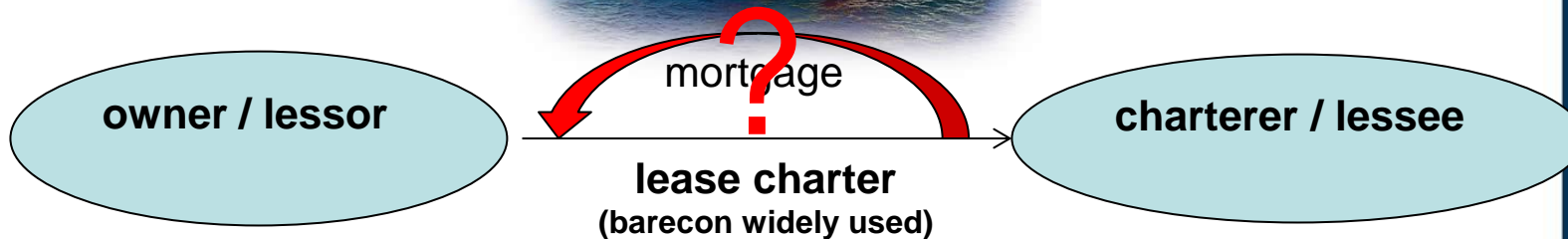
➤ **New: Lease Finance**



- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured
- duration comparable to mortgage loan (8-10 years)
- aggregate charter - calculated as instalments plus interest – equals depreciation
- purchase options
 - lessor’s put option
 - lessee’s call option
- **lease charter has finance character, but ...**

LEASE CHARTERS – STRUCTURAL ELEMENTS

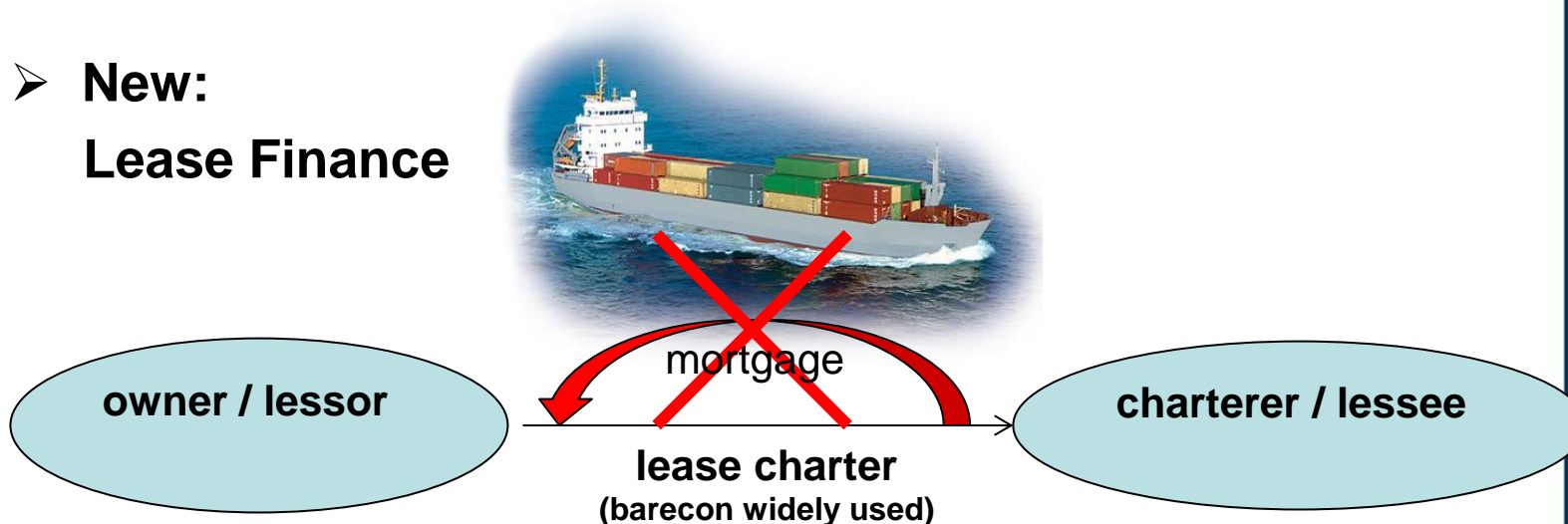
➤ New: Lease Finance



- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured
- duration comparable to mortgage loan (8-10 years)
- aggregate charter - calculated as instalments plus interest – equals depreciation
- purchase options
 - lessor’s put option
 - lessee’s call option
- **lease charter has finance character, but ...**

LEASE CHARTERS – STRUCTURAL ELEMENTS

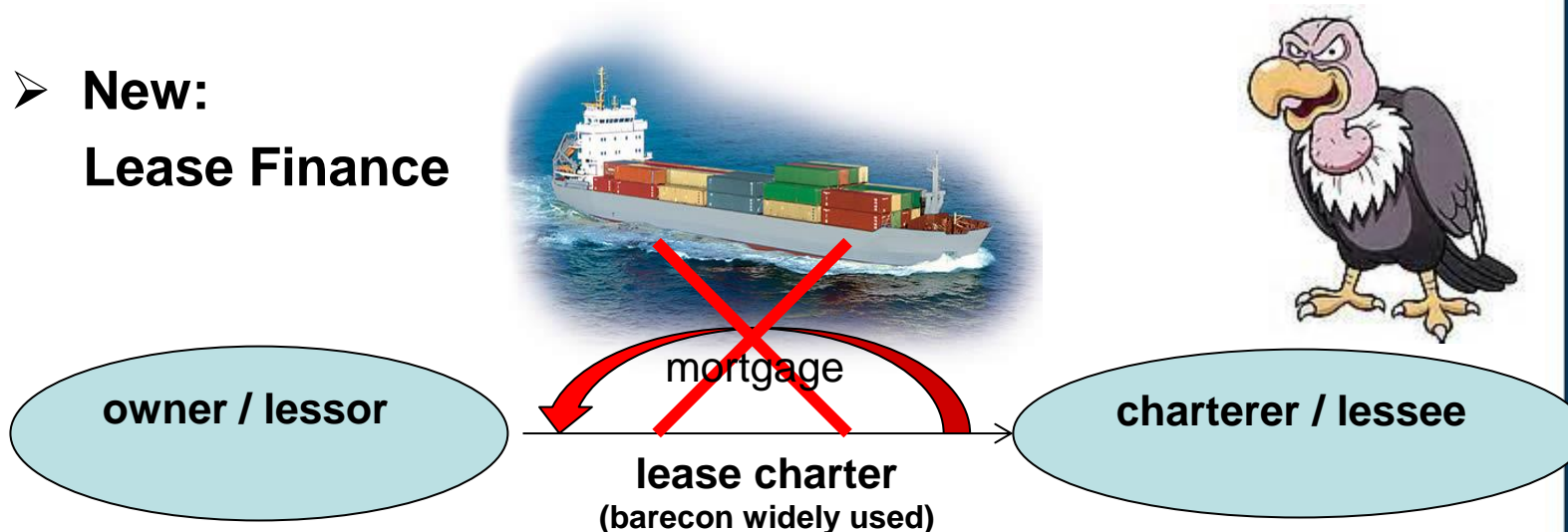
➤ New: Lease Finance



- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured
- duration comparable to mortgage loan (8-10 years)
- aggregate charter - calculated as instalments plus interest – equals depreciation
- purchase options
 - lessor’s put option
 - lessee’s call option
- lease charter has finance character, but ...
- owner/lessor has no mortgage

LEASE CHARTERS AND INSOLVENCY

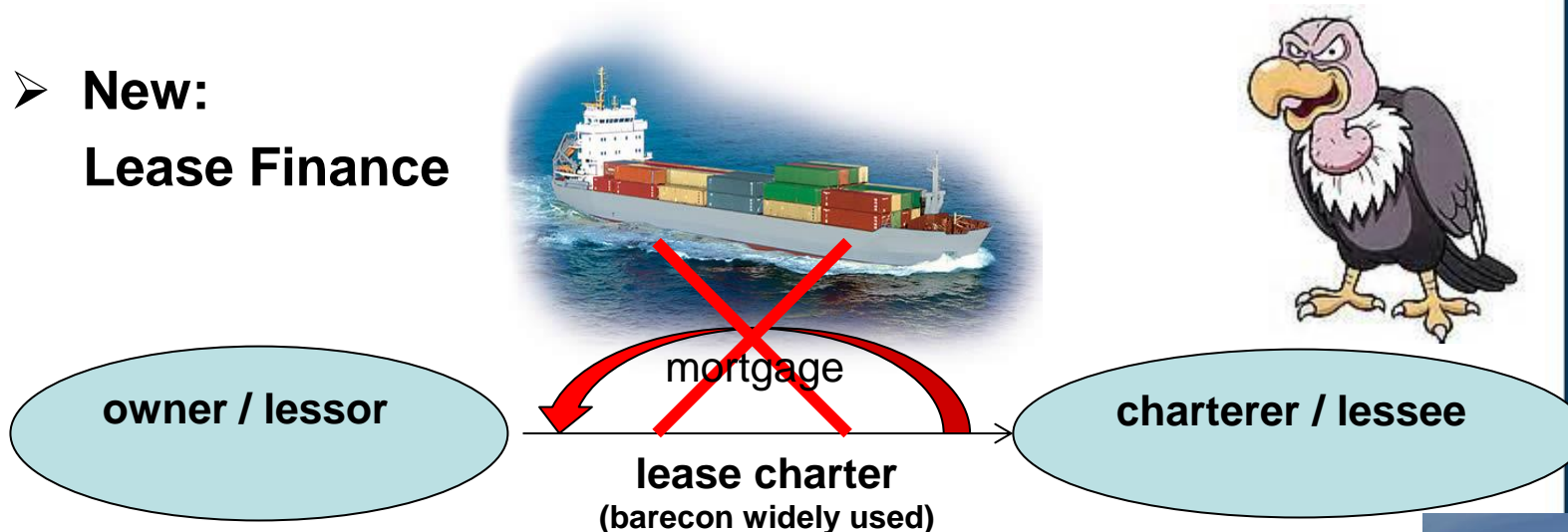
➤ New: Lease Finance



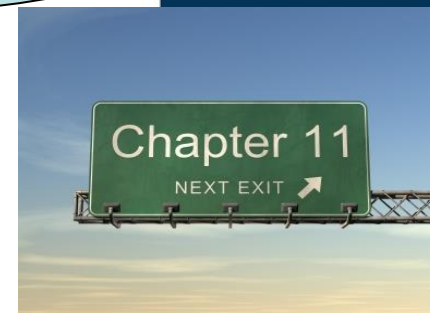
- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured
- duration comparable to mortgage loan (8-10 years)
- aggregate charter - calculated as instalments plus interest – equals depreciation
- purchase options
 - lessor’s put option
 - lessee’s call option
- lease charter has finance character, but ...
- owner/lessor has no mortgage

LEASE CHARTERS AND INSOLVENCY

➤ New: Lease Finance



- “hell and high water”- operating risk with lessee
- lessor’s ownership interest to be insured
- duration comparable to mortgage loan (8-10 years)
- aggregate charter - calculated as instalments plus interest – equals depreciation
- purchase options
 - lessor’s put option
 - lessee’s call option
- lease charter has finance character, but ...
- owner/lessor has no mortgage



BALLINDAMM 26
20095 HAMBURG

TELEFON
+49 40 37 48 14 - 0

TELEFAX
+49 40 37 48 14 - 30

E-MAIL
INFO@ERG-LEGAL.COM

INTERNET
WWW.ERG-LEGAL.COM

LEASE CHARTERS IN CHAPTER 11 PROCEEDINGS

US Forum? Quickly established.



© 2015 www.paddy-boehm.de

**EHLERMANN
RINDFLEISCH
GADOW**
RECHTSANWÄLTE
PARTNERSCHAFT MBB

BALLINDAMM 26
20095 HAMBURG

TELEFON
+49 40 37 48 14 - 0

TELEFAX
+49 40 37 48 14 - 30

E-MAIL
INFO@ERG-LEGAL.COM

INTERNET
WWW.ERG-LEGAL.COM

Section 365 of the US Bankruptcy Code

- **prevents the non-debtor from terminating the agreement as a result of the bankruptcy**
- **gives the debtor the option to assume or reject the agreement**

regardless of contract language

Assumption by lessee means

- **benefit for lessor remains unchanged**

Assumption by lessee means

- **benefit for lessor remains unchanged**

Rejection by lessee means

- **lessee's payment obligation ceases**

Assumption by lessee means

- **benefit for lessor remains unchanged**

Rejection by lessee means

- **lessee's payment obligation ceases**
- **lessor entitled to damage claim equal to all amounts due under the lease charter (but unsecured)**

Assumption by lessee means

- **benefit for lessor remains unchanged**

Rejection by lessee means

- **lessee's payment obligation ceases**
- **lessor entitled to damage claim equal to all amounts due under the lease charter (but unsecured)**
- **lessor regains control of the vessel**

Assumption by lessee means

- **benefit for lessor remains unchanged**

Rejection by lessee means

- **lessee's payment obligation ceases**
- **lessor entitled to damage claim equal to all amounts due under the lease charter (but unsecured)**
- **lessor regains control of the vessel**

In either case

- **lessor's ownership is respected**

Assumption by lessee means

- **benefit for lessor remains unchanged**

Rejection by lessee means

- **lessee's payment obligation ceases**
- **lessor entitled to damage claim equal to all amounts due under the lease charter (but unsecured)**
- **lessor regains control of the vessel**

In either case

- **lessor's ownership is respected**

So far so good, but ...

LEASE CHARTERS IN CHAPTER 11 PROCEEDINGS

Applicable only to **"true lease"** under applicable state law
(*Liona Corporation, N.V. v. PCH Associates (In re PHC Associates)*, 804 F.2d 193, 198-199 (2nd Cir. 1986))

Lessor's protection by Section 365 not applicable if lease charter actually is **"disguised form of financing"** (*id*)

Applicable only to **"true lease"** under applicable state law
(*Liona Corporation, N.V. v. PCH Associates (In re PHC Associates)*, 804
F.2d 193, 198-199 (2nd Cir. 1986))

Lessor's protection by Section 365 not applicable if lease
charter actually is **"disguised form of financing"** (*id*)

- lessee considered to be the actual owner
- lessor loses title
- lease payments are unsecured claims against estate

LEASE CHARTERS IN CHAPTER 11 PROCEEDINGS

Applicable only to **"true lease"** under applicable state law
(*Liona Corporation, N.V. v. PCH Associates (In re PHC Associates)*, 804
F.2d 193, 198-199 (2nd Cir. 1986))

Lessor's protection by Section 365 not applicable if lease
charter actually is **"disguised form of financing"** (*id*)

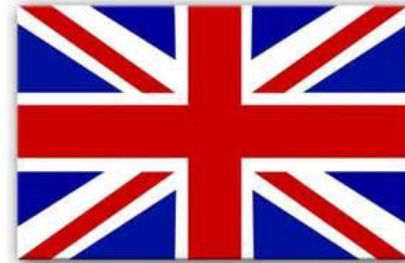
- lessee considered to be the actual owner
- lessor loses title
- lease payments are unsecured claims against estate



“TRUE LEASE“ OR “DISGUISED FINANCING“

Determined under which rules?

- pursuant to the law the parties agreed to in the charter contract (mostly English law)



or

- pursuant to the law where the court is seated (US-law)?



“TRUE LEASE“ OR “DISGUISED FINANCING“

New York bankruptcy courts apply choice-of-law statutes of the New York Uniform Commercial Code

Section 9-301 of the N.Y.-U.C.C.:

- **Jurisdiction in which collateral is located**
 - **US jurisdiction**



“TRUE LEASE“ OR “DISGUISED FINANCING“

US-courts have drawn two tests, applied sequentially, to determine whether a transaction is really a financing and not a lease:

**EHLERMANN
RINDFLEISCH
GADOW**

RECHTSANWALTE
PARTNERSCHAFT MBB

BALLINDAMM 26
20095 HAMBURG

TELEFON
+49 40 37 48 14 - 0

TELEFAX
+49 40 37 48 14 - 30

E-MAIL
INFO@ERG-LEGAL.COM

INTERNET
WWW.ERG-LEGAL.COM

“TRUE LEASE“ OR “DISGUISED FINANCING“

US-courts have drawn two tests, applied sequentially, to determine whether a transaction is really a financing and not a lease:

1. The *Per Se* Test

“TRUE LEASE“ OR “DISGUISED FINANCING“

US-courts have drawn two tests, applied sequentially, to determine whether a transaction is really a financing and not a lease:

1. The *Per Se* Test

2. The Economic Realities Test

“TRUE LEASE“ OR “DISGUISED FINANCING“

1. The *Per Se* Test

Lease = Financing, if

“TRUE LEASE“ OR “DISGUISED FINANCING“

1. The *Per Se* Test

Lease = Financing, if

- **lessee cannot terminate lease before stated end date without paying all amounts that would otherwise be due for the full term of the lease and**

“TRUE LEASE“ OR “DISGUISED FINANCING“

1. The *Per Se* Test

Lease = Financing, if

- lessee cannot terminate lease before stated end date without paying all amounts that would otherwise be due for the full term of the lease **and**
- **one of the following four factors** is met (*PSINet, Inc. v. Cisco Systems Capital Corp. (In re PSINet, Inc.)*, 271 B.R. 1, 44 (Bankr. S.D.N.Y. 2001))

“TRUE LEASE“ OR “DISGUISED FINANCING“

1. The *Per Se* Test

Lease = Financing, if

- lessee cannot terminate lease before stated end date without paying all amounts that would otherwise be due for the full term of the lease **and**
- **one of the following four factors** is met (*PSINet, Inc. v. Cisco Systems Capital Corp. (In re PSINet, Inc.)*, 271 B.R. 1, 44 (Bankr. S.D.N.Y. 2001))
 - original lease term is equal to or greater than remaining economic life of leased object

“TRUE LEASE“ OR “DISGUISED FINANCING“

1. The *Per Se* Test

Lease = Financing, if

- lessee cannot terminate lease before stated end date without paying all amounts that would otherwise be due for the full term of the lease **and**
- **one of the following four factors** is met (*PSINet, Inc. v. Cisco Systems Capital Corp. (In re PSINet, Inc.)*, 271 B.R. 1, 44 (Bankr. S.D.N.Y. 2001))
 - original lease term is equal to or greater than remaining economic life of leased object
 - lessee is bound to renew lease for the remaining economic life of leased object or is bound to become the owner of it

“TRUE LEASE“ OR “DISGUISED FINANCING“

1. The *Per Se* Test

Lease = Financing, if

- lessee cannot terminate lease before stated end date without paying all amounts that would otherwise be due for the full term of the lease **and**
- **one of the following four factors** is met (*PSINet, Inc. v. Cisco Systems Capital Corp. (In re PSINet, Inc.)*, 271 B.R. 1, 44 (Bankr. S.D.N.Y. 2001))
 - original lease term is equal to or greater than remaining economic life of leased object
 - lessee is bound to renew lease for the remaining economic life of leased object or is bound to become the owner of it
 - lessee has option to renew the lease for the remaining economic life of leased object for no additional consideration or nominal additional consideration **or**

“TRUE LEASE“ OR “DISGUISED FINANCING“

1. The *Per Se* Test

Lease = Financing, if

- lessee cannot terminate lease before stated end date without paying all amounts that would otherwise be due for the full term of the lease **and**
- **one of the following four factors** is met (*PSINet, Inc. v. Cisco Systems Capital Corp. (In re PSINet, Inc.)*, 271 B.R. 1, 44 (Bankr. S.D.N.Y. 2001))
 - original lease term is equal to or greater than remaining economic life of leased object
 - lessee is bound to renew lease for the remaining economic life of leased object or is bound to become the owner of it
 - lessee has option to renew the lease for the remaining economic life of leased object for no additional consideration or nominal additional consideration **or**
 - lessee has option to become owner for no additional consideration

2. The Economic Realities Test

If, after the *Per Se* Test no clear answer US courts turn to the **Economic Realities Test** and typically consider the following:

2. The Economic Realities Test

If, after the *Per Se* Test no clear answer US courts turn to the **Economic Realities Test** and typically consider the following:

- purchase option price at the end of the lease nominal?

2. The Economic Realities Test

If, after the *Per Se* Test no clear answer US courts turn to the **Economic Realities Test** and typically consider the following:

- purchase option price at the end of the lease nominal?
- lessee required to make aggregate rental payments equal to or exceeding original cost of leased object?

2. The Economic Realities Test

If, after the *Per Se* Test no clear answer US courts turn to the **Economic Realities Test** and typically consider the following:

- purchase option price at the end of the lease nominal?
- lessee required to make aggregate rental payments equal to or exceeding original cost of leased object?
- does lease term cover total useful life of leased object?

2. The Economic Realities Test

If, after the *Per Se* Test no clear answer US courts turn to the **Economic Realities Test** and typically consider the following:

- purchase option price at the end of the lease nominal?
- lessee required to make aggregate rental payments equal to or exceeding original cost of leased object?
- does lease term cover total useful life of leased object?
- unique equipment / designed specifically for lessee?

2. The Economic Realities Test

If, after the *Per Se* Test no clear answer US courts turn to the **Economic Realities Test** and typically consider the following:

- purchase option price at the end of the lease nominal?
- lessee required to make aggregate rental payments equal to or exceeding original cost of leased object?
- does lease term cover total useful life of leased object?
- unique equipment / designed specifically for lessee?
- risk of loss borne by lessee?

2. The Economic Realities Test

If, after the *Per Se* Test no clear answer US courts turn to the **Economic Realities Test** and typically consider the following:

- purchase option price at the end of the lease nominal?
- lessee required to make aggregate rental payments equal to or exceeding original cost of leased object?
- does lease term cover total useful life of leased object?
- unique equipment / designed specifically for lessee?
- risk of loss borne by lessee?
- lessor active in financing business?

“TRUE LEASE“ OR “DISGUISED FINANCING“

If answer is yes, it is a financing, what are the effects?

“TRUE LEASE“ OR “DISGUISED FINANCING“

If answer is yes, it is a financing, what are the effects?

- **vessel considered as owned by debtor / lessee**

“TRUE LEASE“ OR “DISGUISED FINANCING“

If answer is yes, it is a financing, what are the effects?

- **vessel considered as owned by debtor / lessee**
- **lessee not bound to perform its obligations**

“TRUE LEASE“ OR “DISGUISED FINANCING“

If answer is yes, it is a financing, what are the effects?

- **vessel considered as owned by debtor / lessee**
- **lessee not bound to perform its obligations**
- **lessor's claims are unsecured rights against the bankruptcy estate**

“TRUE LEASE“ OR “DISGUISED FINANCING“

If answer is yes, it is a financing, what are the effects?

- **vessel considered as owned by debtor / lessee**
- **lessee not bound to perform its obligations**
- **lessor's claims are unsecured rights against the bankruptcy estate**

Lessor loses vessel and receives no further funds to repay his bank loan

“TRUE LEASE“ OR “DISGUISED FINANCING“

If answer is yes, it is a financing, what are the effects?

- **vessel considered as owned by debtor / lessee**
- **lessee not bound to perform its obligations**
- **lessor's claims are unsecured rights against the bankruptcy estate**

Lessor loses vessel and receives no further funds to repay his bank loan



RECORDATION OF FINANCING CHARTERS

Solution?

**EHLERMANN
RINDFLEISCH
GADOW**
RECHTSANWÄLTE
PARTNERSCHAFT MBB

BALLINDAMM 26
20095 HAMBURG

TELEFON
+49 40 37 48 14 - 0

TELEFAX
+49 40 37 48 14 - 30

E-MAIL
INFO@ERG-LEGAL.COM

INTERNET
WWW.ERG-LEGAL.COM

RECORDATION OF FINANCING CHARTERS

Solution?

Recordation of lease charter as **financing charter**
Section 302A RMI Maritime Act

Solution?

Recordation of lease charter as **financing charter**

Section 302A RMI Maritime Act

- **creating a security interest in favour of owner/lessor**

Solution?

Recordation of lease charter as **financing charter**

Section 302A RMI Maritime Act

- **creating a security interest in favour of owner/lessor**
- **which is “deemed to be a preferred mortgage”**

Solution?

Recordation of lease charter as **financing charter**

Section 302A RMI Maritime Act

- **creating a security interest in favour of owner/lessor**
- **which is “deemed to be a preferred mortgage”**
- **securing the aggregate of all charter hire payments and purchase option amounts payable or to become payable (exclusive of any interest, indemnities, expenses or fees)**

Recordation of a lease charter

- **has not yet been tested in Chapter 11 proceedings**

Recordation of a lease charter

- **has not yet been tested in Chapter 11 proceedings**
- **has not yet been tested in arrest and/or foreclosure proceedings**

Recordation of a lease charter

- **has not yet been tested in Chapter 11 proceedings**
- **has not yet been tested in arrest and/or foreclosure proceedings**
 - **does recordation of the lease charter allow lessor to arrest his own vessel and to commence foreclosure proceedings against his own vessel?**

Recordation of a lease charter

- **has not yet been tested in Chapter 11 proceedings**
- **has not yet been tested in arrest and/or foreclosure proceedings**
 - **does recordation of the lease charter allow lessor to arrest his own vessel and to commence foreclosure proceedings against his own vessel?**
 - **does recordation of the lease charter provide the lessor's claim with priority in foreclosure proceedings started by others against the lessor's vessel?**

Recordation of a lease charter

- **has not yet been tested in Chapter 11 proceedings**
- **has not yet been tested in arrest and/or foreclosure proceedings**
 - **does recordation of the lease charter allow lessor to arrest his own vessel and to commence foreclosure proceedings against his own vessel?**
 - **does recordation of the lease charter provide the lessor's claim with priority in foreclosure proceedings started by others against the lessor's vessel?**
- **may have to be coordinated with (first) mortgagee bank (if applicable)**

RECORDATION OF FINANCING CHARTERS

Summary:

Recordation of a lease charter

Summary:

Recordation of a lease charter

- **is logical consequence of the fact that lessor in fact is financier and lease charter a finance contract**

Summary:

Recordation of a lease charter

- **is logical consequence of the fact that lessor in fact is financier and lease charter a finance contract**
- **is deemed to protect the lessor's rights against the lessee in a similar way a mortgage protects the bank's rights**

Summary:

Recordation of a lease charter

- **is logical consequence of the fact that lessor in fact is financier and lease charter a finance contract**
- **is deemed to protect the lessor's rights against the lessee in a similar way a mortgage protects the bank's rights**
- **is something one should have in mind when dealing with lease charters**



Excursus: What about Cyprus?

- could a lease charter be registered against the vessel?
- could a lease charter be registered as a charge against the lessee?
- if not, would it be a good idea to have something in place like the new Section 302A of the RMI Maritime Act?



**EHLERMANN
RINDFLEISCH
GADOW**

RECHTSANWÄLTE
PARTNERSCHAFT MBB

BALLINDAMM 26, 20095 HAMBURG

TELEFON	+49 40 37 48 14 - 0
TELEFAX	+49 40 37 48 14 - 30
E-MAIL	INFO@ERG-LEGAL.COM
INTERNET	WWW.ERG-LEGAL.COM

Thank you!