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## *The Issue of Priority and Statutory Ship Mortgages in the British Virgin Islands*

*Shipping business in the British Virgin Islands (BVI) is fast developing, and with this development, it is important to understand some critical elements, being financing and taking of security; hence, the significance of BVI statutory ship mortgages and the related matter of the lender's priority position.*

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*Shipping business in the BVI is fast developing with the vast majority of ships registered being owned by companies registered under the BVI Business Companies Act, 2004 (the BVIBCA).*

Considering the geographical make-up of the BVI, with its 60 islands and cays, and it being thought by many to be the number one sailing capital of the world, it is imperative that the policies and laws of the BVI's shipping industry are transparent and user-friendly to ensure that the jurisdiction is attractive for shipping business.

This task has been made all the more possible with the Virgin Islands Shipping Registry (**VISR**) being a Category One ship registry within the Red Ensign Group of British ports of registry, authorised by the Maritime and Coastguard Agency of the government of the United Kingdom to register yachts of up to 3000 gross tons, and general cargo ships of unlimited tonnage. This Category One status coupled with the BVI's geographical make-up makes this sailor's paradise a prime jurisdiction for shipping, and indeed it is. Shipping business in the BVI is fast developing with the vast majority of ships registered being owned by companies registered under the BVI Business Companies Act, 2004 (the **BVIBCA**).

Further, considering the BVI's reputation as an established international offshore financial centre, and particularly so in the context of international finance, lenders all over the world are familiar with and comfortable lending to companies registered under the BVIBCA (**BVI Companies**). As a result, yacht owners find it attractive to use BVI Companies to acquire ships. Lending is made easier, and therefore the acquisition of ships owned by BVI Companies is easier where acquisition financing is required by the person acquiring the yacht. In these

circumstances, the lender will generally require security for the grant of the loan, and in the ship finance context, the security would be the ship.

## Importance of security

The importance of having security cannot be overstated in the context of lending transactions. Where monies are loaned, lenders seek to secure the repayment of the same in the event that things go awry and the borrower defaults. The primary value of security is that a secured creditor (particularly in the context of the liquidation of a company) does not need to compete with unsecured creditors to recover monies owed. Securing payment is achieved by encumbering the specific asset that is to serve as security. In the context of ship finance, the security interest that encumbers the asset (the ship) is typically a ship mortgage. This security interest is created by registration with VISR under the Merchant Shipping Act 2001 (the **Act**). There is a second security registration regime which provides for registration of a security interest where BVI Companies grant security over their assets. This is registration under the BVIBCA. In the context of a ship finance transaction involving the grant by a BVI Company of a mortgage over its ship, there will be two layers of security registration, namely - registration with VISR under the Act to create a legal mortgage, and registration with the Registry of Corporate Affairs under the BVIBCA - both of which are discussed below. While the regimes do not conflict with each other, there will be uncertainty where the regimes are used on an either/or basis, particularly as it relates to determining the priority of a security interest which is a significant consideration for a lender taking security.

## Priority and registration of security

As far as priority is concerned, where there are competing lenders with competing interests in the same asset, a question arises as to whose interest should be recognised first, which is relevant to the issue of who gets paid out first on an enforcement and sale of the asset or liquidation of the BVI Company. In a lending context, the question is not just about security, but about the lender obtaining the most favourable security position in relation to the asset in question. The ranking of one lender's interest compared to another's is what is contemplated by the concept of priority. Priority is important because depending on the lender's rank, it determines the likelihood and extent to which the debt owed to the lender can be recovered. A priority system exists to ensure that a structure is in place to pay creditors, particularly in the event that a company falls into liquidation or even when the need arises to proceed with enforcement of the security interest. If a priority system did not exist, there would be issues in determining the standing of competing interests of creditors generally, and in the lending context, lenders.

In order to properly understand what priority is and how the priority system works, it is first necessary to explain the registration of the security interest under the two regimes, as this is a critical element of the security process. The registration regime under the Act offers ship-owners the ability to grant mortgages and create security interests over their ships, once granted/created using an instrument in the form prescribed under the Act. Ship mortgages, once executed in the prescribed form and produced to the Registrar of Shipping and Seamen (the **Registrar of Ships**), will be registered and noted in the Register of Ships (the **Register**), and will be registered in the order in which they are submitted to the Registrar of Ships for registration. On the other hand, under the BVIBCA regime, Part VIII of which deals with the registration of charges (the charge in our case being the ship mortgage), and which provides a general registration regime, the position is that a BVI Company may create any form of security interest over its property by an instrument in writing, and this security interest should be noted/recorded in a private register, which is a register that is required to be kept at the registered office of the BVI Company or at the office of the BVI Company's registered agent, containing all relevant details in respect of security interests created by the BVI Company. This recording of the security interests in a private register is often termed private registration. In addition, an application may be made to the Registrar of Corporate Affairs (the **Registrar**) (by the BVI Company or the person to whom the security interest is granted) to register the

security interest by filing an application (in the approved form) specifying the particulars of the security interest. Once the application has been approved, the security interest is registered in the Register of Registered Charges kept by the Registrar and a certificate of registration of the security interest is issued. The registration of the security interest with the Registrar is often referred to as public registration. A noteworthy difference between the private and public registrations under the BVIBCA, in the context of priority, is that although public registration is not mandatory under the BVIBCA (private registration is), it is the public registration which has the principal effect on the determination of priority, as third parties are deemed to have notice or knowledge of the security interest once it is filed and registered in accordance with the relevant provisions of the BVIBCA.

The two regimes outlined above, which provide for the registration of the security interest, also provide regimes for the determination of priority. The Act provides a regime that is specific in nature; specific in the sense that it applies to one particular kind of asset (ships), and the BVIBCA provides a regime that is general in nature as it pertains to all security interests created by the BVI Company over any of its assets. Where a ship owned by a BVI Company is the subject of the security interest, both regimes are triggered and coincide and operate parallel to each other. As both regimes provide for the determination of priority, there is some uncertainty where a BVI Company grants its ship as security in favour of multiple lenders, and those lenders register their respective security interests under either of the two regimes as opposed to both. How then do we determine priority?

### **Registration and Priority under the Act and the BVIBCA – Statutory priority rules**

Under the Act, ship mortgages are registered in the order in which they are produced to the Registrar of Ships for registration, and the date and time of registration are noted on the mortgage instrument by the Registrar of Ships. You would also find noted on the Register, any prohibitions on creating further mortgages over the ship without prior consent of the holder of the registered mortgage. If consent of the holder of the prior mortgage is not produced to the Registrar of Ships in writing, any mortgage registered in violation will be void. In the circumstances where two or more mortgages are registered over the same ship, priority of the mortgages between themselves will usually be determined by the order in which the mortgages were registered and not by reference to any other matter, and therefore priority would be determined by the order of registration. The word 'usually' is used above due to the existence of priority notices, which may, when registered in the Register, alter the usual order of priority in respect of the interest to which the notice relates. When recorded in the Register, the priority notice will determine the priority of the interest which is the subject of the notice irrespective of when that interest is actually registered. The position where two security interests are registered under the Act is clear, but it is unclear where there are two lenders with competing interests and one lender registers its security interest under the Act, and another lender registers its security interest under the BVIBCA.

The BVIBCA, particularly sections 166 and 167, provides its own regulatory regime (albeit general in nature) where priority of security interests is concerned. Section 166 of the BVIBCA provides that once a security interest created on or after the commencement date of the BVIBCA is registered in accordance with the provisions of the BVIBCA, it has priority over a security interest created on or after the commencement date and subsequently registered in accordance with the provisions under the BVIBCA, or a security interest created on or after the commencement date that has not been registered in accordance with the provisions under the BVIBCA. Section 167 of the BVIBCA provides that security interests created prior to the commencement date of the BVIBCA shall continue to rank in the order in which they would have ranked had section 166 of the BVIBCA not come into force, and where they would have taken priority over a security interest created on or after the commencement date, they will continue to take priority.

### **Reconciling these two regimes**

Therefore, the provisions under the two regimes on the face of it do not conflict. However, in the context of enforcement, a level of uncertainty presents itself where one regime for registration of the security interest was

used and the other was not. Which regime should be followed? One might consider that the doctrine of implied repeal (a doctrine where a statute which is inconsistent with an earlier statute (so that both cannot be applied) is taken to impliedly repeal the relevant provision) should arguably suggest that the latter statute (the provisions of the BVIBCA) should prevail. The position however is not clear-cut as both regimes operate parallel to each other, and a potential conflict only arises where there are competing interests registered under either regime. The issue therefore remains. Where Lender A registers his interest in a ship owned by a BVI Company only under the BVIBCA and Lender B registers his interest in the same but only under the Act, in an enforcement action, liquidation or situation in which the issue of priority is a relevant factor, would Lender B's interest rank in priority to Lender A's by virtue of Lender A's interest not being registered under the Act, irrespective of Lender A's interest being registered first in time, albeit under the BVIBCA? And similarly, would Lender B's interest, if not registered under the BVIBCA, rank lower in priority to Lender A's by virtue of Lender B's interest not being registered under the BVIBCA, but registered first in time under the Act?

Where a claim regarding a specific asset is concerned as opposed to a general pool of assets, or assets for which there is asset-specific legislation, the better view would seem to be to determine priority in accordance with the provisions of the legislation specific to that particular asset. Further, unlike the BVIBCA, the Act does not purport to deal with priority in all cases, but only where a particular asset (a ship) is concerned and therefore seems to negate any alternative basis for determining priority where a ship or the interest therein is concerned. The word 'seemingly' is used because the Act did not expressly state that any subsequent legislation enacted which purports to determine security does not apply. Of course, the variance in the two regimes would most likely surface in circumstances where competing mortgagees/lenders are faced with the reality that the debts for which they are secured will not be fully repaid to them due to the BVI Company having an insufficient pool of assets to satisfy all debts, and therefore there is a battle for the best piece of the pie. Although this area has a level of uncertainty and the potential for conflict between the two regimes exists where the matter of priority is in question (whether in an enforcement/liquidation context or otherwise), the issue is yet to be settled by the BVI Court, but no doubt has potential to land itself before a judge for determination.

## Conclusion

In relation to ships registered in the BVI, the Act governs legal ownership and title in the BVI and also governs security registration. Where the legal owner of a registered ship is a BVI Company, the regime for registration of security under the BVIBCA is also triggered. The two regimes for registration and determining priority under the BVIBCA and the Act undoubtedly create a potential conflict in determining priority where lenders opt to register their security interest under either regime as opposed to both. Ideally, a specific registration regime particular to a specific asset, like that under the Act with respect to ships, would trump a general regime with respect to all assets, such as that provided for under the BVIBCA. How the Act interacts with the general registration regime under the BVIBCA and the extent to which the priority regime under the Act trumps (if at all) that which is provided for under the BVIBCA, can only be definitely assessed and determined, in the absence of legislation, by a determination of the BVI Court. Suffice it to say, with there being no clear authority on the position in the circumstances where lenders register their security using the two regimes on an either/or basis, the recommendation to lenders is that while there is no time limit within which to register a mortgage or security interest under either regime, it is imperative that the security interest is registered under both regimes and as soon as possible for the purposes of securing the highest level of priority and thereby ensuring that the best protection is obtained.

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