UPDATE ON PRIORITIES

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1.0 INTRODUCTION

This paper is intended to provide the reader with a summary of the significant recent developments in the Canadian law relating to priorities on the judicial sale of a vessel. The judicial decisions discussed in this paper were mostly rendered during the period from January 1998 to February 2000. During this period there has been an exceptionally large number of priorities cases due to a corresponding large number of international bankruptcies involving various ship owners. Priorities hearings have been held and decisions rendered in two of these bankruptcies involving the ships "Atlantis Two" (*Fraser Shipyard and Industrial Centre Ltd. v Expedient Maritime Co. (The "Atlantis Two")*, [1999] 170 F.T.R. 1, varied [1999] F.C.J. No. 1212) and "Brussel" (*Holt Cargo Systems Inc. v A.B.C. Container Line N.V. (The "Brussel")*, [2000] F.C.J. No. 197). These decisions deal with a number of important issues, some of which are quite novel, and they are therefore considered at length in this paper. A third bankruptcy that is currently before the court involves the ship "Nel". The priorities hearing in respect of the "Nel" has been held but a decision has not yet been rendered. A fourth large bankruptcy involving the ships "Zoodotis", "Kimisis III", "Ypapadi", and "Golden Trinity" is also before the court. The priorities hearing for these ships has not yet been held but is scheduled for August 2000.

2.0 THE USUAL ORDER OF PRIORITIES

The usual order of priorities is well known and has been set out in a number of cases. (The leading cases are *The Frank and Troy,* [1971] F.C. 556, *The Atlantean I,* [1979] 2 F.C. 661, varied 7 D.L.R. (4th) 395, *The Lowell Thomas Explorer,* [1980] 1 F.C. 339, and *The Ionnis Daskalelis,* [1974] 1 Lloyd's 174.) The usual order of priorities is as follows:

1. Court costs and Marshall's expenses (*Custodia Legis);*

2. Possessory liens predating other liens;

3. Statutory liens (including the statutory lien for seaman's wages under the *Canada Shipping Act*);

4. Maritime liens (including foreign maritime liens);

5. Possessory liens arising after other maritime liens;

6. Claims by mortgage holders; and

7. Statutory rights in rem (including ship repairers and necessaries suppliers).

This usual order of priorities is rarely departed from. However, the court does have an equitable jurisdiction and discretion to alter the usual order in appropriate circumstances. (See below under Varying The Usual Order of Priorities)

3.0 COSTS AND MARSHALL'S EXPENSES (*CUSTODIA LEGIS*)

3.1 Costs

The costs associated with the arrest and sale of a ship, including expenses incurred with leave of the court to maintain the ship after arrest, are normally granted a first priority on the proceeds from sale. This priority insofar as it relates to the costs of arrest and sale was recognized in *The "Atlantis Two"* where the court awarded costs to

only the crew and the Plaintiff to reflect the extra work by their counsel in bringing the sale of the "Atlantis Two" to a successful conclusion. The costs were awarded on a lump sum basis (paras. 29 & 212). Similarly, in *The "Brussel"* the Plaintiff was granted a priority for the costs of appraisement and sale of the vessel, including solicitor's costs (para.45). Additionally, in *Neves v The "Kristina Logos"*, [1999] F.C.J. No. 1295, the Crown was awarded a priority for its costs relating directly to the sale of the vessel.

3.2 Marshall's Expenses (*Custodia Legis)*

In *The "Atlantis Two"* and *The "Brussel"* motions were also brought before the court for orders that various expenses be approved in advance and granted priority equivalent to Marshall's expenses. In *The "Brussel"* the court approved and granted priority to a terminal operator for expenses relating to the movement and storage of abandoned containers. The containers had been removed from the ship and stored pursuant to an earlier order of the court. That order, however, did not provide that the terminal would be entitled to recover the costs as Marshall's expenses from the proceeds of the sale of the ship. In a motion reported at (1997), 131 F.T.R. 41, affirmed (1998), 234 N.R. 98, Justice McKay allowed the terminal operator's claim for priority on the grounds that the charges were incurred for the benefit of all claimants and to facilitate the sale of the vessel. Further, he reasoned that, if the ship had not been unloaded when it was, the Marshall would have had to incur those expenses.

3.2.1 Requirement of Prior Approval

The "Atlantis Two" and *Neves v The "Kristina Logos"*, [1999] F.C.J. No. 1295, illustrate the importance of obtaining prior court approval before supplying goods or services to a vessel under arrest.

In *The "Atlantis Two"*, while the vessel was at anchor in Vancouver harbour, diesel fuel was supplied to the vessel by a local supplier pursuant to a court order obtained in advance. The order specifically granted the supplier a priority equivalent to Marshall's expenses. At the priorities hearing that supplier claimed a priority for the fuel supplied to the vessel and that priority was, of course, granted (paras. 21-24). In contrast to this, the charterer of the "Atlantis Two" also claimed a priority in respect of fuel consumed on board the "Atlantis Two" while she lay at anchor in Vancouver harbour. The fuel comprised fuel the vessel had on board when she arrived at Vancouver and fuel purchased while she was at Vancouver. The charterer's claim for priority was disallowed by the court on the grounds that the charterer did not obtain a court order in advance of supplying fuel to the vessel. The court further considered whether there were any special circumstances that might justify a variation in the normal order of priorities but held that there were no such special circumstances (paras. 41-51).

In *Neves v The "Kristina Logos"* the Federal Crown seized the "Kristina Logos" pursuant to the provisions of the *Fisheries Act*, R.S.C. 1985 c. F-14, for offences committed under that Act. Prosecutions were commenced in the Newfoundland Supreme Court against the Captain and against one of the owners of the vessel. Upon the conviction of the Captain the vessel was forfeited to the Crown. The conviction and forfeiture were later set aside by the Newfoundland Court of Appeal. The vessel, however, remained under Crown seizure. During the period of time from the initial seizure until the sale of the vessel by the court, the Crown spent approximately $350,000.00 on the care and preservation of the vessel and claimed this amount in priority. The Crown's claim for priority was refused. The court held that the Crown had incurred the costs not because of the arrest of the ship in the Federal Court but rather in furtherance of remedies it pursued under the *Fisheries Act.* Accordingly, the court held it was the provisions of the Fisheries Act that should govern and section 71(1) of that

Act provided that any claim for reimbursement for such costs had to be made to the Newfoundland courts. (Note: The Newfoundland Court of Appeal in a decision reported at [1999] N.J. No. 232, at para 22 said it would not deal with the question of the costs of maintenance as this was before the Federal Court.) Further, the court held that the Crown could and should have brought an application at the time of arrest or shortly thereafter for an order that the costs of preserving the vessel be treated as Marshall's expenses. The court also considered whether there were any special circumstances that might justify the priority sought by the Crown but found that there were none.

3.2.2 Removal of cargo

An interesting question was raised but not decided in *Royal Bank of Scotland plc v The "Kimisis III"*, [1999] F.C.J. 300. This was a motion by a mortgagee for an order that the owner of a cargo of wheat on board the "Kimisis III" remove the cargo at its expense. The motion was denied on the grounds that it was premature as the mortgagee had not entered into possession of the vessel and had not applied for a court ordered sale. However, during the course of his reasons, Prothonotary Hargrave noted that there was a difference between the English approach to the removal of cargo from a ship under arrest and the American approach. The English approach is that the costs of discharging the cargo should fall upon the cargo owner whereas the American approach is that the costs of discharging cargo are in the nature of *custodia legis* and are therefore recoverable from the fund in priority to other claims. It would appear to be an open question which of these two approaches a Canadian court will follow.

3.2.3 Classification Society Fees

In England there appears to be a practice whereby the Marshall strikes a bargain with the classification societies that the Marshall will agree to make an application to

the court to pay any outstanding classification society fees as Marshall's expenses, provided the classification society keeps the ship in class and makes its records available to potential purchasers. The English courts have generally approved of this practice and have given the classification societies a priority for their outstanding fees. (See: *The Parita,* [1964] 1 Lloyd's Rep. 199 and *The Honshu Gloria,* [1986] 2 Lloyd's Rep. 63) Until recently there had been no reported Canadian cases involving a priority for classification societies. This changed however when Lloyd's Classification Society brought an application in *The "Atlantis Two"* for an order that it be given priority for amounts due to it for classification services rendered to the "Atlantis Two". At the time of the motion the "Atlantis Two" had been ordered to be sold *pendente lite* and the Acting Marshall had requested that Lloyd's make its books and records available to potential purchasers. Lloyd's refused to do so and refused to provide further classification services unless the Acting Marshall agreed to pay its outstanding account in full. The Acting Marshall declined to pay the outstanding account and the matter came before the court on the motion by Lloyd's. At the initial hearing of the motion the Prothonotary urged the parties to attempt to reach a settlement of the dispute. The parties were able to achieve a settlement which was ultimately included in an Order. The settlement was that Lloyd's would make its records available but reserved the right to claim a priority for its fees. Notwithstanding the settlement, the Prothonotary issued reasons reported at [1998] F.C.J. No. 1138 in which he noted that the English practice of having the Marshall recommend payment of classification society fees at the conclusion of the sale (provided there has been an enhanced sale price as a result of the classification societies cooperation) was a sensible and workable practice. However, he also commented that Lloyd's came to the court with "unclean hands" and that, under the circumstances, it would have been premature and improper to have granted Lloyd's immediate priority. At the later priorities hearing, the classification society did not appear and, therefore, its right to a priority was not determined. It would therefore appear to be a possibility that, under appropriate circumstances, a classification society

will be entitled to a priority.

4.0 CREW'S WAGES AND REPATRIATION COSTS

The wages owing to the crew of a vessel are normally granted the highest priority second only to Marshall's expenses and the costs of appraisement and sale. This high priority was confirmed in *The "Atlantis Two"* (para. 28) and *The "Brussel"* (para.10). In *The "Atlantis Two"* it was further recognized that repatriation costs when borne by the seamen themselves rank equally with wage claims (para. 31).

5.0 MASTER'S DISBURSEMENTS

Master's disbursements are similarly granted a high priority. In *The "Atlantis Two"* the court stated that such claims now rank *pari passu* with wage claims (para. 26, note 3). Maritime liens for Master's disbursements are now very rare because it is a necessary requirement of the lien that the Master must have been unable to communicate with the owner before making the disbursement. With modern communication systems this requirement can rarely be met. Nevertheless, in *The "Atlantis Two"* the Master's disbursements for food for the crew was recognized. (para. 27) Undoubtedly, this was because the ship owner had abandoned the vessel and her crew leaving the crew stranded in Vancouver without adequate provisions.

In contrast, in *Doris v The Ferdinand,* (1999), 155 F.T.R. 236, the court disallowed a claim for Master's disbursements. The Plaintiff was the C.E.O. of a company that in turn owned 12 other companies each of which owned one ship. The ships were floating homes. The Plaintiff alleged that as Master of the ships he disbursed funds for the payment of maintenance expenses. The Plaintiff claimed a maritime lien for Master's disbursements in respect of such payments. The court held that the

payments by the Plaintiff were for operating expenses of the company (primarily for principal and interest payments on loans) and not for necessaries. Further, the court held the payments were not made by the Plaintiff in the capacity of Master but in his capacity as a shareholder. Finally, the court held that a critical element of a Master's disbursement is the Master's inability to communicate with owners and that such element was totally missing in this case.

6.0 STATUTORY LIENS

6.1 Canada Ports Corporation Act

In *The "Brussel"* the Halifax Port Corporation claimed a statutory priority under the *Canada Ports Corporation Act*, R.S.C. 1985, c. C-9, Sched. I, Part II, s. 17(5) for fees and charges in respect of the "Brussel". Justice McKay allowed the claim in the principal amount and allowed interest at 18% up to the date of the sale of the ship and, thereafter, at the rate attributed to the sale proceeds held in court.

6.2 Assignments

The question of assignments of statutory liens was considered in both *The "Brussel"* and *The "Atlantis Two"*. In *The "Brussel"* the issue arose in the context of wharfage fees. The claimant, Halterm, paid the wharfage for the "Brussel" to the Halifax Port Corporation and claimed to be subrogated to the statutory lien of the Port Corporation. The court found, however, that there was no evidence of an explicit assignment of the Port Corporation's lien rights and further noted that the *Canada Ports Corporation Act* was silent regarding whether such rights could be assigned. The court ultimately held that there had been no assignment in favour of Halterm. In reaching this decision the court was careful to note that it did not "foreclose the

possibility that a maritime right in rem or other lien may be assignable" (paras. 70-74).

In *The "Atlantis Two"* the issue of assignment arose in the context of repatriation expenses. In that case the vessel had been abandoned by her owners at Vancouver with a full crew on board. The crew, who were mostly of Indian origin, had no funds to pay for their own repatriation. The Federal Crown agreed to pay their repatriation expenses provided the court authorized an assignment of the crew's lien for repatriation costs. Prior to the expenses being incurred, the crew brought two motions before the court for an order that they be allowed to assign their lien for repatriation expenses to the Federal Crown. The Court granted the orders expressly authorizing the crew to assign their lien to the Federal Crown. At the later priorities hearing, the court recognized the assignment and granted the Federal Crown a priority for the repatriation costs (paras. 32-35).

6.3 Sister ships

In *The "Brussel"* both the Halifax Port Corporation and the Atlantic Pilotage Authority claimed a priority for fees and charges in respect of services rendered to sister ships of the "Brussel". Justice McKay held that the *Canada Ports Corporation Act* did not extend the statutory lien to sister ships. He further held that pursuant to section 43(8) of the *Federal Court Act*, these claimants merely had a right of action *in rem* in respect of their sister ship claims but did not have a priority.

7.0 FINES AND FORFEITURE - *The "Kristina Logos"*

Whether the Crown can recover forfeited amounts and fines in a priorities hearing is a novel issue that was considered in *The "Kristina Logos"*, [1999] F.C.J. No. 1295. The Crown in that case commenced successful prosecutions against one of the

co-owners of the vessel for violations of the *Fisheries Act* which resulted in the Newfoundland Supreme Court levying a fine of $120,000.00 against the co-owner and ordering forfeiture to the Federal Crown of $50,000.00 from the proceeds of sale of the "Kristina Logos". The Crown claimed both amounts at the priorities hearing and claimed a priority in respect of the $50,000.00. The Federal Court had no difficulty recognizing the Crown's claim to a priority over the forfeited $50,000.00. Unfortunately, the court did not give reasons for this and it is not obvious why the Crown should have received a priority or exactly what priority the Crown was given. The Crown's claim to the $50,000 ranked ahead of that of the mortgagee, the only other creditor, but this ultimately made no difference as the sale proceeds were sufficient to pay the mortgagee in full. The only other claimants to the proceeds were the owners of the vessel.

With respect to the fine of $120,000.00, the Crown did not claim a priority for this amount but there was an issue as to whether the amount could be claimed at all from the proceeds of sale. The court held that it could be on the grounds that the order imposing the fine could be executed against any of the co-owner's property, including the ship or its proceeds. The court therefore held that the $120,000.00 should be paid from any amounts which would be due to the co-owner on distribution of the fund after payment to creditors. This aspect of the decision is, in the opinion of the author, difficult to understand. Priorities hearings are not execution proceedings. Every claimant in a priorities hearing must have a valid *in rem* claim that comes within sections 22 and 43 of the *Federal Court Act*. The Crown's claim for the $120,000.00 fine would not appear to come within any of the headings in section 22(2) of the *Federal Court Act.* Nor does the *Fisheries Act* give an *in rem* right in respect of collection of fines. Arguably, the Crown's claim for the $120,000.00 should have been pursued and enforced in separate execution proceedings and secured by way of charging orders on the proceeds from sale held in Federal Court.

It is noteworthy that subsequent to the decision of the Federal Court in *The Kristina Lagos* the Newfoundland Court of Appeal rendered a decision in respect of an appeal by the co-owner from its conviction and a cross-appeal by the Crown as to sentence. (This decision is reported at *R v Ulybel Enterprises Ltd.,* [1999] N.J. No. 232.) In that decision the Newfoundland Court of Appeal held that the Crown had no authority under the *Fisheries Act* to dispose of the vessel by sale prior to the disposition of the Newfoundland court proceedings (para.45) and further held that by applying for and obtaining an order for sale in the Federal Court the Crown released the vessel from detention and terminated its rights to forfeiture(para 50). Accordingly, the Newfoundland Court of Appeal held that the trial judge had no authority to make the order of forfeiture.

8.0 PILOTAGE

In *The "Brussel"* the Atlantic Pilotage Authority claimed a preferred maritime lien for pilotage services rendered to the "Brussel". Justice McKay noted that the *Pilotage Act*, R.S.C. 1985, P-14, did not confer a statutory lien for such services. Nevertheless, on the authority of *Osborn Refrigeration Sales and Service Inc. v The Ship "Atlantean I",* [1979] 2 F.C. 661, varied on other grounds 7 D.L.R. (4th) 395, and *Ultramar Canada Inc. v Pierson Steamships Ltd. et. al.*, (1982), 43 C.B.R. (N.S.) 9, he granted the Pilotage Authority a maritime lien. It is important to note that the other claimants represented to the court that they did not dispute the claim or priority of the Pilotage Authority. Thus, the decision of the court on this point cannot be faulted. However, the authorities on this point are not unanimous. In *Ostogota Enskilda Bank v Starway Shipping Ltd.,* (1994), 78 F.T.R. 304 at 306, Justice Muldoon said it had not been established "that there is in law a maritime lien for Canadian pilotage services". This decision was apparently not brought to the attention of Justice McKay in *The "Brussel".* Therefore, whether there is a maritime lien for pilotage services remains

uncertain.

9.0 POSSESSORY LIENS

Canadian maritime law recognizes the common law possessory lien of a ship repairer. Such a lien has priority over mortgages and also over any subsequently accruing maritime liens. However, the lien only applies to the extent of the value of the repairs made by the repairer. In *Canadian Imperial Bank of Commerce v The "Barkley Sound"*, (March 4, 1999) Vancouver Reg. No.A983054 (B.C.S.C.), the issue was whether a ship repairer in possession could claim priority over the mortgagee for storage charges and interest. The court found that the storage charges were incurred for the purpose of protecting the repairer's interest and could not be added to the maritime lien. On the matter of interest the court held that the repairer was entitled to interest at 5% per annum in priority to the bank.

The right of a charterer to a possessory lien was considered in *Greeley v The "Tami Joan"* (1997) 135 F.T.R. 290. The Plaintiff had leased the vessel from its owner and had effected improvements to it. Unknown to the Plaintiff the vessel was mortgaged and the mortgage was in arrears. The mortgagee seized the vessel pursuant to the mortgage and it was eventually sold. The Plaintiff alleged that the mortgagee had wrongly deprived him of possession of the vessel and that he was entitled to a possessory maritime lien for the materials and services he had supplied to the vessel. The court held that the mortgagee was entitled to seize the vessel because the mortgage was in arrears and its security was impaired by reason that the vessel was uninsured. The court further held that the Plaintiff was not entitled to a possessory lien because he had lost possession of the vessel to the mortgagee. The Plaintiff was, at most, entitled to a statutory right of action *in rem* which gave him no priority.

10.0 FOREIGN MARITIME LIENS

10.1 Determination of Applicable law

The preliminary issue in cases involving foreign maritime liens is the determination of the applicable law of the contract or tort. In most cases this issue is without complications as where the contract clearly specifies the applicable law or where the tort occurred in only one jurisdiction. However, in other cases the issue is not so clear. This occurred in *The "Atlantis Two"* in respect of a claim by the sub-charterer for a preferred maritime lien under American law for breach of the charter party. The charter party in that case provided that any disputes were to be referred to arbitration in New York. The sub-charterer argued that this provision made American law the proper law of the contract. Affidavits of law were filed by both the sub-charterer and the mortgagee in which the deponents agreed that the arbitration provision made the contract subject to American law. The court appears to have accepted the experts' determination on this issue and proceeded to analyse the sub-charterer's claim on the basis of American law. (paras. 102-103) This decision to accept the opinions in the affidavits as to the applicable law may, in the opinion of the author, be open to question. The authorities suggest that the determination of the applicable law of the contract is to be made according to the conflict of laws rules of the forum deciding the dispute, i.e. Canadian law. (See for example *Ontario Bus Industries Inc. v The Federal Calumet*, [1992] 1 F.C. 245 at p. 252, affirmed on appeal (1993) 150 N.R. 149.) However, even if Canadian conflicts rules had been applied the result may have been the same. (See *Castel, Canadian conflict of Laws* (4th ed.) at p. 596, and the authorities cited therein.)

10.2 Recognition

The recognition and enforcement of foreign maritime liens is one of the more troubling issues in the law of priorities because it is often difficult for practitioners to explain and justify this aspect of the law to their Canadian clients. The problem most frequently arises in the context of American repairers and suppliers of necessaries. Under American law the claims of these suppliers are given a priority over some mortgages. In *The Strandhill v Walter W. Hodder Co.,* [1926] S.C.R. 680, and in *Todd Shipyards Corporation v Altima Compania Maritima S.A. (The Ionnis Daskalelis),* [1974] S.C.R. 1248, the Supreme Court of Canada held that such claims are to be recognized and given priority as a maritime lien in Canada. (It is noteworthy that the Privy Council rejected this approach in *The Halcyon Isle*, [1980] 2 Lloyds Rep. 325.) This has had the effect of granting American repairers and necessaries suppliers a higher priority than their Canadian counterparts. This, in turn, means that American repairers and necessaries suppliers often obtain a recovery following a priorities hearing whereas their Canadian counterparts usually walk away empty handed. Not surprisingly, this is seen by many as unfair and has resulted in challenges to the recognition of such liens.

In both *The "Atlantis Two"* and *The "Brussel"* the granting of maritime liens to American necessaries suppliers was challenged. In neither case, however, was the challenge successful. The decisions in both cases are aptly summarized by Justice McKay in *The "Brussel"* at para. 16:

> While recognition of such a claim, with priority ahead of that of the mortgagee, reduces the fund available to be paid to the intervenor, it is not the role of this Court to question established Supreme Court authority, unless the circumstances are exceptional. In my opinion, the circumstances here are not so exceptional that I should seek to distinguish

the established jurisprudence.

This recognition of foreign maritime liens by Canadian courts can have bizarre results because, although the substantive nature of the lien is determined by the foreign law, the ranking is determined by the local law. This can result in an American maritime lien claimant obtaining a higher priority in Canada than it would in the United States. This is exactly what happened in *The "Atlantis Two"*. There the court recognized an American maritime lien in favour of the sub-charterer for breach of charter party. The court further recognized that if the priorities were to be determined according to American law the sub-charterer's lien would rank behind the prior registered mortgage. However, the court held that priorities were to be determined according to Canadian law and under Canadian law the maritime lien of the sub-charterer ranked ahead of the mortgagee (paras. 110-121). Hence, the sub-charterer received a higher priority than it would have before an American court.

10.3 Interest and Costs

In *The "Atlantis Two"* Prothonotary Hargrave granted maritime liens to American necessaries suppliers in respect of the principal amounts of their claims and in respect of contractual interest (paras. 68 & 71). The Prothonotary, however, refused to extend the lien to solicitors fees, notwithstanding the terms of the contract. (para. 67)

In *The "Brussel"* Justice McKay also granted contractual interest but only up to the date of the sale of the "Brussel". Thereafter, interest was allowed only at the rate attributed to the sale proceeds held in court (Paras. 26 & 27).

10.4 Exchange Rates

One issue in *The "Brussel"* was the date on which claims expressed in foreign currency should be converted to Canadian dollars. Justice McKay noted that normally the appropriate date is the date when the invoices underlying the claims were due. He further noted that in an earlier case (*Lee S. Wilbur & Co. v The "Martha Ingram"*, [1989] F.C.J. No. 427) the court had adopted the date of judgement. However, he found that conversion at the date of judgement would significantly adversely affect the mortgagee. He therefore held that the appropriate date was the date when the invoiced amount became due, if that date was available in the evidence, otherwise the appropriate date was the date of the sale of the vessel (paras. 28-31).

10.5 Supplies Delivered at a Foreign Port

An issue in *The "Atlantis Two"* was whether an American maritime lien could be enforced in respect of goods supplied at Mexico and Vancouver by a Norwegian company through an American agent. Prothonotary Hargrave held that such a lien could be enforced (para. 88).

10.6 Goods Sold F.O.B an American Port

Yet a further issue in *The "Atlantis Two"* was whether an American maritime lien could be enforced in respect of cylinder heads sold F.O.B. Houston, Texas and delivered to Australia and Vancouver. At first instance, Prothonotary Hargrave found that there was no evidence that the goods were, in fact, delivered to the "Atlantis Two" and held therefore that no maritime lien arose. On appeal ([1999] F.C.J. No. 1212), Justice Rouleau found that the shipping invoices clearly indicated that the cylinder heads were to be shipped to a specifically identified vessel (the "Atlantis Two") in Australia and Vancouver. This, he held, was sufficient to establish delivery to the vessel and to find a maritime lien.

10.7 Sister ships

In both *The "Atlantis Two"* and *The "Brussel"* an issue was raised concerning whether an American maritime lien for goods supplied to a sister ship could be enforced utilizing section 43(8) of the *Federal Court Act*. Both courts held that American liens did not attach to sister ships. In result, the American suppliers could enforce their sister ship claims against the ship under arrest but they would have a mere statutory right *in rem* and would rank as an ordinary *in rem* claimant and not as a maritime lien holder.

10.8 Liens and Mortgages Convention, 1926

Article 2(5) of the Unification of Certain Rules Relating to Maritime Liens and Mortgages, 1926, gives a maritime lien for contracts entered into by a Master provided, *inter alia*, the vessel is away from her home port the contracts were necessary for the preservation of the ship or the continuation of the voyage. This provision was relied upon by a bunker supplier in *The "Brussel"* who provided bunkers to the vessel at Belgium. The court disallowed the lien claim on the grounds that the bunkers were ordered by the owner and not the Master (paras. 76-78).

11.0 MORTGAGEES AND BUNKERS

An interesting issue in *The "Atlantis Two"* was whether the mortgagee had an interest in the bunkers on board the vessel when it was sold. The value of those bunkers was approximately $58,000.00. The mortgagee argued that the terms of the mortgage charged the fuel as well as the vessel. The court, however, held that the term "appurtenance" did not cover fuel. Further, the court held that pursuant to the terms of the head charter party between the owners and charterers the fuel belonged to the charterers and not the owners. In result, the court ordered that the net proceeds from the

sale of the fuel be paid out to the charterer.

12.0 IN REM CREDITORS

12.1 Retention of Title

It is trite law that *in rem* claimants are mere unsecured creditors having no priority. The majority of such creditors are suppliers of necessaries. In a priorities hearing their position is often hopeless as the proceeds from the sale of the ship are rarely sufficient to satisfy any part of their claim. There is, however, a way in which such suppliers can protect themselves, namely, by ensuring in their contract that title does not pass until they are paid in full. This was the means by which a supplier of bunkers was able to achieve a priority in *The Bank of Scotland v The "Nel"*, [1999] 2 F.C. 578. In this case the supplier of bunkers did not render an invoice to the ship owner and satisfied the court that its intention was to not transfer title to the ship owner until it was paid in full. The court therefore held that property in the bunkers had not passed and the supplier was entitled to the proceeds from the sale of the bunkers.

12.2 Contractual Liens

A minor issue in *The "Brussel"* was whether a container lessor had a maritime lien for unpaid lease payments on containers supplied to the "Brussel". The lease agreement expressly provided that the lessor was to have a contractual lien against the lessee's vessels. The court held that such a lien has no special priority as against third parties (para. 81). It is noteworthy that in *The "Atlantis Two"* the Prothonotary seemed to suggest that a contractual lien might be of some effect in a priorities hearing (para 98).

13.0 VARYING THE USUAL ORDER OF PRIORITIES

The equitable jurisdiction of the court to vary the usual order of priorities was considered in great detail by Prothonotary Hargrave in *Scott Steel Ltd. v The "Edmonton Queen" et. al.*, [1996] 2 F.C. 883, affirmed (1997), 125 F.T.R. 284. The contest in that case was between the builder who had a possessory lien over the vessel, the mortgagee, and a supplier of goods and services. The usual ranking of priorities in such a case would be that the possessory lien holder would rank first (after the Marshall's fees) and the mortgagee would rank second. The mortgagee sought to vary this normal ranking.

The Prothonotary in *The "Edmonton Queen"* began with the acknowledgment (taken from Thomas on Maritime Liens) that:

> Maritime priorities have been shaped by considerations of equity, public policy and commercial expediency in order to produce a result that is just in the circumstances of each case.

The Prothonotary then noted that one must read some of the earlier Canadian cases with care since the courts deciding these earlier cases did not possess full equitable jurisdiction. He noted that full equitable jurisdiction was not obtained by the Federal Court until the *Federal Court Act, 1970.*

The Prothonotary reviewed the English approach as illustrated by *The "Pickaninny"*, [1960] 1 Lloyd's Rep. 533, and noted that it was the view of Mr. Justice Hewson that "the court ought to be slow to depart from the usual order of priorities and then do so where there was very strong reliable evidence". He then reviewed and analysed the Canadian position as outlined in *The "Atlantean I"*, [1979] 2 F.C. 661, appeal (1984), 7 D.L.R. (4th) 395, and *The "Galaxias"*, [1989] 1 F.C. 386. At p.89 he

concluded that the Canadian authorities established that there had to be very special circumstances or an obvious injustice before the court would alter the usual order of priorities.

> The outcome in The *"Atlantean I"* indicates to me that priorities ought not to be departed from except in very special circumstances or, as Mr. Justice Rouleau put it in The *"Galaxias"* (citation omitted) "As I understand it, my powers in equity to upset the orders of priority long established in Canadian Maritime Law should be exercised only where necessary to prevent an obvious injustice"
>
> ....
>
> It was in this context that Mr. Justice Rouleau formulated what I take to the present Canadian rule, that the Court's equitable jurisdiction, to upset the priorities long established in Canadian Maritime Law, should only be exercised where necessary to prevent an obvious injustice.

The Prothonotary next considered the case of *The "Lyrma" (No.2)*, [1978] 2 Lloyd's Rep. 30, where the test established was that the usual order of priorities should not be departed from unless their application on the special facts of the particular case "produced a plainly unjust result". The Prothonotary noted that the test in *The "Lyrma"* was not particularly different from that established in *The "Galaxias"* and further noted that both put a "heavy onus" on the person seeking to depart from the usual order. Applying these tests to the facts before him, he held that there was no basis for altering the normal order of priorities in favour of the mortgagee.

The analysis in *The "Edmonton Queen"* was relied upon heavily in *The "Atlantis Two"*, one of the few cases in which the normal order of priorities was altered. In that case the Plaintiff ship repairer without a possessory lien argued that it was entitled to priority over a registered mortgage on two grounds: first, it argued that

the mortgagee should lose its priority because it had been dilatory in enforcing the mortgage; second, it argued that the court in the exercise of its equitable discretion should grant it an enhanced priority because of the mortgagees delay in enforcing the mortgage and because the repairs done to the vessel immediately prior to the arrest had added to the value of the vessel to the benefit of all creditors. With respect to the first argument the Prothonotary accepted at para.178 that a dilatory mortgagee might lose its priority:

> The point here is that a maritime lien holder, who is dilatory in enforcement, may lose both the Court's sympathy and the favourable ranking accorded a maritime lien...Now there is no reason why this concept ought not, in an appropriate instance, apply against a mortgage holder if the mortgage holder in fact stood by, knowing full well that repairs to a ship were being undertaken, repairs for which the owner could not pay and the value of which would fall into the pocket of the mortgagee on a forced sale of the ship.

The Prothonotary next considered *The "Pickaninny"*, [1960] 1 Lloyd's Rep. 533, and concluded at para 179 that a mortgagee might lose its priority if there was strong evidence the mortgagee knew money was being spent on the ship by the repairer and knew that the ship owner was insolvent.

> The elements here, needed to postpone a mortgagee's claim, are strong and reliable evidence of knowledge of money being spent on the ship which would be of direct benefit to the mortgagee and, concurrently, knowledge that the mortgagor was insolvent.

The Prothonotary then applied this test and found as a fact that the mortgagee was not aware of the insolvency of the owner and was not fully apprised of the extent and value of the repairs being undertaken by the repairer. Accordingly, he held that the mortgagee did not lose its priority.

The Prothonotary next considered whether he ought to exercise his equitable discretion to grant the Plaintiff an enhanced priority. The Plaintiff relied on various factors justifying an enhanced priority which are summarized at para 184 of the decision. The most important factors were that the repairs were done to correct deficiencies that had resulted in a detention order against the vessel being issued by Port State Control. The Plaintiff argued that as a result of the work done by it the detention order was lifted and the value of the vessel was significantly enhanced. The Plaintiff argued that all of this increase in value would go to the mortgagee who had been dilatory in enforcing its mortgage, if the usual ranking was not altered.

The Prothonotary reviewed his own decision in *The Edmonton Queen* and then considered the decision of the Supreme Court of Canada in *The Montreal Dry Docks and Ship Repairing Company v Halifax Shipyards Limited*, (1920), 60 S.C.R. 359, wherein the Supreme Court granted a ship repairer an enhanced priority (to the extent of the increase in the value of the vessel consequent upon the repairs) on the basis of unjust enrichment. At para. 203 -204, in reference to the principle of unjust enrichment and *The Montreal Dry Docks* case, the Prothonotary concluded that there would be an unjust enrichment if the usual order of priorities was not altered.

> That is a principle which clearly finds application in the present circumstances where, if priorities were left in their usual ranking, would result in unjust enrichment, which is the foundation of the principle in the Montreal Dry Docks case.
>
> The present unjust result is that, without the Fraser Shipyard work, the ship would, in all likelihood, have sold at scrap value plus an intrinsic value increment. Instead it sold for something more which, were no adjustment made to priorities, would go to the benefit of American necessaries suppliers, some of whom have slept on their claims for months or years and (the mortgagee) which, while not displaying a culpable lack of action, might well have been more diligent in protecting itself in its overall dealings with its customers.

The Prothonotary granted the Plaintiff a priority equivalent to that of the American maritime lien claimants to the extent of US$ 220,000.00, being the increase in the value of the vessel consequent upon the repair work.

The "Atlantis Two" is one of very few cases in which the usual ranking of priorities was altered. A more typical case is *Canadian Imperial Bank of Commerce v The "Barkley Sound"*, (March 4, 1999) Vancouver Reg. No.A983054 (B.C.S.C.), where the court refused to give a supplier of goods priority over the mortgagee on the basis of unjust enrichment. The court held that the supplier was a simple unsecured creditor and that he had not established any of the requirements of unjust enrichment.

14.0 MARSHALLING

The doctrine of marshalling forces a secured creditor with two funds or securities to exhaust his rights against the fund or security that the other claimants have no access to before proceeding against the "shared" fund or security. In *The Governor and Company of the Bank of Scotland v The "Nel"* (July 2, 1998) No. T-2416-97 (F.C.T.D.) Prothonotary Hargrave considered at length the doctrine of marshalling and whether it could apply to the benefit of *in rem* creditors as against the mortgagee. The Prothonotary held that notwithstanding some Canadian case law to the contrary, unsecured creditors, and particularly *in rem* creditors could benefit from marshalling.

15.0 BANKRUPTCY

The special issues that arise when bankruptcy proceedings have been commenced against a ship owner are the subject of a separate paper to be presented at this seminar. Hence, these issues will not be considered here. However, note should be taken of recent judgements by the Federal Court (Trial Division) and Court of Appeal in

Holt Cargo Systems v The "Brussel", [1997] 3 F.C. 187, affirmed (1999) 239 N.R. 114, in which an application by the Trustee in Bankruptcy of the ship owner was refused on the grounds, *inter alia*, that it was unlikely the Belgium courts would recognize the Respondent's *in rem* claim. Leave to appeal this decision was granted by the Supreme Court of Canada on December 9, 1999.

16.0 CONCLUSION

As is apparent from the foregoing, there has truly been a large number of priorities cases in recent years, some of which have raised quite interesting and novel issues. More such cases can be expected with the "Nel", "Zoodotis", "Kimisis III", "Ypapadi", "Golden Trinity"and other *in rem* cases working their way through the courts.