

Coventry University Repository for the Virtual Environment
(CURVE)

Author names: Panesar, S.

Title: Is a ship mortgage inherently different from a mortgage over land?

Article & version: Published version

Original citation & hyperlink:

Panesar, S. (2004) Is a ship mortgage inherently different from a mortgage over land?. *International Company and Commercial Law Review*, volume 15 (8): 239-243.
<http://www.sweetandmaxwell.co.uk/Catalogue/ProductDetails.aspx?recordid=423&productid=6944>

Published by Sweet & Maxwell.

Copyright © and Moral Rights are retained by the author(s) and/ or other copyright owners. A copy can be downloaded for personal non-commercial research or study, without prior permission or charge. This item cannot be reproduced or quoted extensively from without first obtaining permission in writing from the copyright holder(s). The content must not be changed in any way or sold commercially in any format or medium without the formal permission of the copyright holders.

Available in the CURVE Research Collection: March 2012

<http://curve.coventry.ac.uk/open>

International Company and Commercial Law Review

2004

Editorial

Is a ship mortgage inherently different from a mortgage over land?

Sukhninder Panesar

Subject: Banking and finance

Keywords: Arrest; Bad faith; Cargo; Cinemas; Duty of care; Mortgagees powers and duties; Power of sale; Ships

Legislation: Law of Property Act 1925

Cases: Caricom Cinemas Ltd v Republic Bank Ltd [2003] UKPC 2 (PC (Trin))

Den Norske Bank ASA v Acemex Management Co Ltd (The Tropical Reefer) [2003] EWCA Civ 1559; [2004] 1 All E.R. (Comm) 904 (CA (Civ Div))

***I.C.C.L.R. 239 Introduction**

Much has been written on the nature of the duty owed by a mortgagee when exercising its power of sale under the terms of the mortgage or the Law of Property Act 1925.¹ However, most of that has been in the context of mortgages of land as opposed to mortgages of other types of property. In two recent cases, the courts have had to deal with the nature of the mortgagee's duty when exercising its power of sale in a purely commercial context. What is interesting is that one case has been in the context of a mortgage of a moveable chattel such as a ship whilst the other has been in the context of land. These two cases have given the opportunity to establish whether the nature of the duty imposed by law is the same in respect of both types of property.

In *Den Norske Bank ASA v Acemex Management Co Ltd (The Tropical Reefer)*,² the Court of Appeal had to consider whether the mortgage of a ship was any different from that of land and, further more, whether the duties owed by the mortgagee to the mortgagor were any different from those owed in the context of land--in particular, whether the rule of law that a mortgagee had a power to decide when and where the sale took place without regard to the interest of the mortgagee could be displaced in the context of a mortgage of a ship by a rule that he was under a duty to take care to sell at a time and place where the best price was available. In *Caricom Cinemas Ltd v Republic Bank Ltd*,³ the Privy Council had to consider the question of whether a bank was liable for selling the mortgaged land at a time when the market had fallen and the amount recovered was less than the amount that could have been recovered if the sale had taken place at an earlier time. This article examines the nature of the duty owed by a mortgagee to a mortgagor and comments on the decisions in these two recent cases.

The modern rules in respect of land mortgages

Most typically, a mortgagee of land will purport to exercise its power of sale under the statutory provisions found in ss.101-107 of the Law of Property Act 1925. Section 101 of the Act provides that the statutory power of sale arises as soon as the mortgage money becomes payable under the terms of the mortgage, and that the mortgage is one which is created by deed.⁴ Although the statutory power of sale arises as soon as the mortgage money is due, it can only be exercised in the event of one of three things happening: (1) where notice requiring payment of the mortgage money has been served on the mortgagor and default has been made in payment of part or all of it for three months thereafter; (2) where some interest is two months in arrears; or (3) where there has been some breach under the terms of the mortgage agreement or the Law of Property Act 1925.⁵

Whilst it is settled law that a mortgagee who exercises his power of sale is not a trustee for the mortgagor, he does owe a duty of care to the mortgagor and he must act in good faith and take reasonable care to ***I.C.C.L.R. 240** obtain the true market value of the

mortgaged property.⁶ What has been uncertain until recent times is the nature and the source of the duty of care. In particular, is the mortgagee under a general duty of care governed by the tort of negligence, or is the duty more confined to equity alone rather than the common law? In *Parker-Tweedale v Dunbar Bank plc*,⁷ Nourse L.J. commented that:

“it is both unnecessary and confusing for the duties owed by a mortgagee to a mortgagor and the surety, if there is one, to be expressed in terms of the tort of negligence ... the duty owed by the mortgagee to the mortgagor was recognised by equity as arising out of the particular relationship between them”.⁸

More recently, in *Corbett v Halifax Building Society*,⁹ the Court of Appeal had the opportunity to consider the nature of the duties owed by the mortgagee to the mortgagor. The facts concerned the sale of mortgaged land by Halifax Building Society to a purchaser who happened to be related to one of its own employees and who subsequently sold the land to the employee. Not only were the claimants (the mortgagors) concerned with the sale of the land to a relative of an employee of the building society, but they also alleged that the sale was at an undervalue and that the purchaser had not acted in good faith. On these grounds, it was argued that the sale should be set aside. The Court of Appeal held that although the mortgagee sold the land below the reasonable price available on the open market, it would not set the sale aside since there had been no bad faith, corruption and collusion with the purchaser. The fact that it was sold at undervalue meant the mortgagor had a personal claim against the mortgagee to recover the shortfall. In the course of his judgment, Pumfrey J. explained that:

“a mortgagee is strictly speaking not a trustee of the power of sale. It is a power given for his own benefit, to enable him to better realize his debt. If he exercises it bona fide for that purpose, without corruption or collusion with the purchaser, the Court will not intervene even though the sale be very disadvantageous, unless the price is so low as in itself to be evidence of fraud.”¹⁰

Furthermore, Pumfrey J. reinforced the point that the mortgagee's duty to take reasonable steps to get a proper price was not one imposed under the tort of negligence.¹¹

Rules in relation to the mortgage of a ship

A mortgage of a ship has many of the features of a mortgage of land.¹² Once the owner of the ship defaults on payment or fails to comply with the obligations under the mortgage, the mortgagee can sell the ship in order to recover the sums due under the mortgage. However, the mortgagee must have given the owner of the ship a reasonable time to make the payments demanded before he decides to exercise any power of sale.¹³ There are two principal options available to a mortgagee if the owner of a ship fails to pay the mortgage monies due under the mortgage once demanded. First, it can seek to exercise its power of sale by taking possession of the ship and selling it, or secondly, it can arrest the ship and apply to the court for a judicial sale. Whichever option the mortgagee takes, it must first take possession of the ship. The mortgagee's right to possession, just like in the case of a mortgage of land, is one of the normal incidents of a mortgage. Most typically, the right to take possession will have been expressly conferred in the mortgage deed.

What is, however, quite unique about a ship mortgage when compared to a mortgage over land is that the mortgagee of a ship need not apply to the court for an order for possession. If the ship is at a particular port, the mortgagee may take actual possession of the ship by appointing a master and a crew. If the vessel is at sea, the mortgagee, although not able to take any actual possession, is able to obtain **I.C.C.L.R. 241* constructive possession by giving notice to the owner and all other relevant parties including the master and the managers.¹⁴

Once the mortgagee has taken possession of the ship, it can purport to exercise its power of sale. The power of sale will in most cases be contained in the mortgage deed. However, like in the case of land, a statutory power of sale is conferred upon a registered mortgagee by para.9 of Sch.1 to the Merchant Shipping Act 1995. With regard to the rules relating to mode of sale, it is clear that many of the rules applicable to land mortgages apply to a mortgage of a ship. For example, the sale can be either a private sale or through public

auction. It is equally clear that although the mortgagee cannot himself purchase the ship, a sale to a connected person will be regarded as satisfactory if the mortgagee can show that all reasonable steps were taken to obtain the best price.¹⁵ With regard to the timing of the sale, there had been little by way of case law (until the recent decision in *The Tropical Reefer*) to suggest that the mortgagee was under a duty to sell at a time when the best price was available.

The Tropical Reefer

In *The Tropical Reefer*,¹⁶ the claimant bank had loaned US\$6 million to three companies in order to purchase three vessels. The security of the loan was a mortgage on each of the three vessels, one of which was the *Tropical Reefer*. The borrowers defaulted on payment of the mortgage money on several occasions, and the claimants proceeded to arrest the *Tropical Reefer* in Panama. In order to sell the vessel in Panama, the claimants expended some US\$204,140 discharging the cargo of bananas overboard at sea. The claimants then proceeded to deduct these costs from the final proceeds of sale of the vessel. In February 2002, the bank brought proceedings in the Commercial Court against the defendants to recover the outstanding amount of the loan. The defendants resisted this claim on the grounds that the claimant bank was in breach of its duty to sell the vessel at a time when a higher price would have been available for the vessel. The main argument presented by the defendants was that the *Tropical Reefer*, laden with cargo, should have been allowed to proceed to its destination in Germany. If it had been allowed to proceed, then the costs of discharging the cargo in Panama would have been avoided, and consequently there would not have been a shortfall in the proceeds of sale of the vessel to meet the monies due under the loan.

The main argument presented by the defendants requires a little more explanation. In essence, the main argument was broken down into two arguments. The first, described as the argument in equity, was that the mortgagee was under a general equitable duty to act in good faith and take reasonable steps to ensure that a proper price was obtained. On the facts of the case, the claimant bank had not acted reasonably because it would have been more sensible to allow the vessel to proceed to its destination in Germany where it could discharge the cargo to its rightful owners, thereby not incurring the additional costs of discharging the cargo overboard in Panama. In this respect, the argument was that the claimant bank had been negligent in its exercise of its power of sale. The second argument, described by Longmore L.J. as the shipping argument, was that the mortgagee was under an implied duty not to interfere with contracts made by the shipowner for the carriage of goods unless such contracts impaired the mortgagee's security. It was argued that a mortgage of a ship was a rather different creature from a mortgage of land in that the mortgagee of a ship had impliedly allowed the mortgagor to enter into contracts for the employment of the ship.

***I.C.C.L.R. 242** The leading judgment was delivered by Longmore L.J., who proceeded to address the issue by asking whether "a ship mortgage was inherently different from a mortgage of land?" In coming to the conclusion that a ship mortgage was no different from a mortgage over land, his Lordship relied on a number of land law authorities to explain that a mortgagee was not a trustee of the power of sale for the mortgagor.¹⁷ The mortgagee could sell at any time, and his decision to sell would not be fettered by the fact that the sale may occasion loss to the mortgagor. His Lordship explained that a mortgagee was not under a duty to postpone the sale simply because a better price may be obtained at some other time. With regard to the nature of the duty of care imposed on the mortgagee, Longmore L.J. explained that the duty arose in equity alone and not in tort. It was argued on behalf of the defendants that a vessel was a rather different type of property than land and as such should attract a rather different set of rules. They contended that because a vessel was a moveable chattel, the ability of the *Tropical Reefer* to do so warranted the postponement of sale until it had reached a destination where a better price could have been obtained. His Lordship, however, explained that these rules could not be sidestepped in the case of a ship, which, despite being a moveable object, still carried the problem that if the sale was to be deferred for a considerably long period of time, it would

present the mortgagee with a risk should anything happen to their security.

With regard to the shipping argument, Longmore L.J. explained that there could never be an implied duty in the loan contract that a mortgagee was under a duty not to interfere with the contracts entered into by the mortgagor with third parties in respect of the employment of a vessel. Quite simply, the rights and duties of the mortgagee were to be found in the terms of the loan agreement. The express provisions in the loan agreement conferred upon the mortgagee a right to take possession in the event of default by the mortgagor and sell the vessel. To contend that there was an implied duty on the mortgagee not to impair any contracts made by the mortgagor and third parties would simply mean that the mortgagee could not sell the vessel in the event of a default. This would be inconsistent with the express terms of the loan agreement.

The nature of the mortgagee's power of sale in the Privy Council

The nature of a mortgagee's power of sale was the subject of discussion in *Caricom Cinemas Ltd v Republic Bank Ltd*.¹⁸ This case involved an appeal from the Court of Appeal of Trinidad and Tobago by the appellants Caricom Cinemas Ltd, Trinidad Cinemas Ltd and a certain Mr Leschaloupe against the Republic Bank Ltd. The basis of their claim against the bank was that the bank had acted improperly in selling the mortgaged land (the cinemas) at a time when the market value of land had dropped.

The facts of the case are rather complex and lengthy, and begin circa 1970 when a cinema proprietor obtained finance from a bank to develop a cinema. The money had been advanced subject to a charge over two cinemas, one that was already complete, and one that was the subject of development. The bank was also given certain guarantees by the proprietor in the region of US\$800,000. The new cinema land was transferred to a company called Trinidad Cinemas Ltd where the proprietor was a major shareholder in that company. Later on, the company came under the control of Mr Leschaloupe, who had assisted the proprietor in the development of the cinema, the proprietor having died. Once the cinema had been completed, it began to experience problems with business, and the bank proceeded to realise its security. **I.C.C.L.R. 243* The bank proceeded to sell the cinemas by first attempting to enter into private negotiations with the widow of the proprietor, who over the years had become very concerned with Mr Leschaloupe's involvement with her husband's business. The bank did not purport to tell the claimants that it was entering into private negotiations, but instead gave the impression that it was exercising its statutory power of sale. The claimants in the meantime requested the bank to sell privately. When the bank was eventually advised to sell by private sale, the value of the cinemas had dropped substantially from what would have been available had it proceeded with a private sale straight away. In this context, the claimants argued that the bank had acted improperly in the exercise of its power of sale by entering into secret discussions with the widow and then selling the land at a time when the price of the cinemas had dropped substantially.

At first instance, it was held that the bank had acted improperly in the exercise of its power of sale. The Court of Appeal of Trinidad and Tobago, with whom the Privy Council agreed, held that the bank had not purported to act improperly in the exercise of its power of sale. The bank was not a trustee owing fiduciary duties to the mortgagor. Instead, Lord Walker explained that the bank was under a duty to act in good faith in the exercise of its power of sale. The onus, therefore, fell on the mortgagors to prove that the bank had acted in bad faith, which led to the failure to get a proper price for the mortgaged land. On the facts, the bank was at all times acting in good faith. The secret negotiations with the widow were attempts to discharge the company's liabilities without recourse to sale of the cinemas. When that was not practical, the bank proceeded to sell the land in good faith, albeit at a time when a lower price was available for the mortgaged land.

Conclusion

Where a mortgagee purports to exercise its power of sale, the courts will not hold the sale to be improper unless it can be shown that the mortgagee acted in bad faith and as a consequence failed to obtain a proper price. The decision of the Court of Appeal in *The*

Tropical Reefer and that of the Privy Council in *Caricom Cinemas Ltd* illustrate some interesting points of law concerning the exercise of the power of sale. It is clear that a mortgagee exercising the power of sale is doing so for its own benefit rather than for the mortgagor. The mortgagee is not a trustee of the power of sale, and as a consequence does not stand in a fiduciary capacity with respect to the mortgagor. Although the mortgagee must take all reasonable steps to obtain a proper price, the timing of the sale does not matter. In *The Tropical Reefer*, the mortgagee sold as soon as it was possible to sell even though, had they waited, a higher price could have been obtained. In contrast, in *Caricom Cinemas Ltd*, the mortgagees delayed sale with the consequence that a lower price was obtained on final sale. The onus on the mortgagor is to show that the mortgagee acted in bad faith and that alone resulted in a lower price being received on final sale. Where that onus cannot be discharged, then the court will not hold the sale improper even though the proceeds of sale may well be quite different from what they would have been had the mortgaged property been sold at a different time. It is also clear that the liability arises in equity alone as opposed to in the tort of negligence, and applies irrespective of the type of property in question.

Sukhninder Panesar

Senior Lecturer in Law

Coventry University

I.C.C.L.R. 2004, 15(8), 239-243

[1.](#)

More recently, see S. Panesar, "The Duties owed by a Mortgagee when Exercising its Power of Sale" [2003] J.I.B.L.R. 338.

[2.](#)

[2004] 1 Lloyds Rep. 1.

[3.](#)

[2003] UKPC 2; [2003] W.L. 116687.

[4.](#)

The mortgage money due under a mortgage will become due as soon as the contractual date of redemption has passed or, in the case of mortgages payable in instalments, as soon as an instalment is due or unpaid.

[5.](#)

s.103.

[6.](#)

See *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch. 949; *Standard Chartered Bank Ltd v Walker* [1982] 1 W.L.R. 1410; *Yorkshire Bank plc v Hall* [1999] 1 W.L.R. 1713.

[7.](#)

[1991] Ch. 12.

[8.](#)

The same view was expressed by Nourse L.J. in *AIB Finance Ltd v Debtors* [1988] 2 All E.R. 929 at 937.

[9.](#)

[2003] 1 W.L.R. 964.

[10.](#)

ibid., at 224.

[11.](#)

ibid., at 973.

[12.](#)

See, generally, Bowtle and McGuinness, *The Law of Ship Mortgages* (LLP, 2001).

[13.](#)

See *Toms v Wilson* (1863) 4 B. & S. 442; 122 E.R. 524.

[14.](#)

See Bowtle and McGuinness, *op.cit.*, p.136. Constructive possession, however, will only be possible where the owner and master agree to the orders of the mortgagee. If the owner and the master reject any such notice given by the mortgagee, there will be no constructive possession of the ship.

[15.](#)

See *Tse Kwong Lam v Wong Chit Sen* [1983] 1 W.L.R. 1349.

[16.](#)

[2004] 1 Lloyd's Rep. 1.

[17.](#)

Cuckmere Brick Co v Mutual Finance Ltd [1971] Ch. 949; *South Sea Bank Ltd v Tan Soon Gin* [1990] 1 A.C. 536; *Tse Kwong Lam v Wong Chit Sen* [1983] 1 W.L.R. 1349.

[18.](#)

[2003] UKPC 2; [2003] W.L. 116687.