The 'Ball and Chain' approach to debt collection

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Business owners and operators employ various methods to protect the vulnerability they face when work has been completed by them, but has not yet been paid for. Such protections can include, for example, robust terms of trade which provide for equipment and parts used by a tradesperson to remain the property of that tradesperson until payment is received.

But what happens when the party who has commissioned the work gets into financial strife before the bill has been paid? It possible to take an action against a vessel for unpaid debts. A claim against the vessel itself is called an action *in rem*, and a person can either have a claim under common law – called a maritime lien, or a claim under the Admiralty Act 1973. Grounds for unpaid debts arising from goods, materials or services supplied to a ship or the construction or repair of a vessel or its equipment give rise to specific types of claim – a maritime lien (at common law) or a claim under the Admiralty Act 1973.

A claim *in rem* entitles the party to whom money is owed to advance the arrest in conjunction with the *in rem* proceedings.

When a vessel is arrested, it is unable to be moved from the location it was in at the time the arrest was executed, without the prior approval of the High Court. Although a vessel cannot be "jailed", the effect of an arrest is a similar physical detainment. Understandably, vessel owners usually make a swift response when a party initiates arrest proceedings or indicates an intention to do so. The obvious inconvenience and resulting loss of income from having a vessel detained usually provides a sufficient incentive for a vessel owner to make good on debts owed. Once the arresting party's debt is satisfied, steps are taken to release the vessel.

Arrest proceedings are not something to be entered into lightly, however. The costs of initiating the proceedings are not insignificant. High Court filing fees alone are $1,500, plus legal costs. In addition, the arresting party assumes responsibility for the costs of having a vessel alongside under arrest. Those costs can include berthage fees, maintenance and other incidental expenses a vessel can incur. The costs associated with an arrest requires the claimant to undertake careful consideration of the likelihood of recovering the debt. It is important to consider the prospect of successfully recovering funds, while avoiding throwing good money after bad.

If, however, the entity that owns the vessel has struck financial difficulties and is either in receivership or liquidation, the competition between the differing claims can make matters a little murky. For the sake of clarity, when a company is in receivership, the available assets are realised for the benefit of the secured creditor who made the appointment. When a company is in liquidation the available assets are sold primarily for the benefit of unsecured creditors. A company is generally in either receivership or liquidation because it is unable to pay a debt to a creditor, and therefore the company's assets are outweighed by its liabilities. A company in receivership or liquidation generally has too few dollars to repay all its debts and, in this context, the prospects of fully recovering the debt are diminished..

When a company's debts are being prioritised by receivers or liquidators, secured creditors are at the front of the line, with unsecured creditors such as those owed money as a result of services provided, awaiting payouts, possibly pro rata, from the remaining pool of funds, if there are any.

Where a company which is in receivership owns one or more vessels, which have themselves given rise to a debt, there appears to be an interesting legal question as to the priority of claims for outstanding sums. It is usual practice for an entity advancing significant funds to take out a General Security Agreement. A GSA secures debts against tangible assets of the company such as vessels. Therefore it is easy to see competing claims arising when a creditor has a General Security Agreement (which should take priority over virtually all other claims) and a tradesperson has a claim that would entitle them to arrest the vessel.

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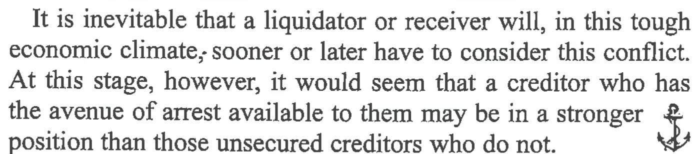
How then would a court resolve such competing interests? A liquidator or receiver is in a tight spot. Without obtaining release of the vessel, it is unable to liquidate the asset, but to obtain the release, funds are required to be paid. There have been overseas cases when a vessel has been arrested and funds provided by the receiver in order to obtain the release of that vessel. That process effectively puts an unsecured creditor before a secured party. The merits of the claim which gave rise to the arrest may be considered by the court but in any event, the funds to release the vessel have been forced to be set aside by a payment into court in order to obtain the release of the vessel.

It is inevitable that a liquidator or receiver will, in this tough economic climate, sooner or later have to consider this conflict. At this stage, however, it would seem that a creditor who has the avenue of arrest available to them may be in a stronger position than those unsecured creditors who do not.



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