

Summary of Canadian Law of Priorities

These are lecture notes of a lecture given by Christopher Giaschi to the maritime law course at the Faculty of Law, University of British Columbia in 1999. The notes are produced here to give readers a brief introduction to Canadian Maritime Law as it relates to priorities.

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Generally

For case law on priorities see generally:

The Frank and Troy, [1971] FC 556

The Atlantean I, [1979] 2 FC 661

The Lowell Thomas Explorer, [1980] 1 FC 339

The Ionnis Daskaleais, [1974] 1 Lloyd's 174

The leading Canadian text on liens and priorities is Professor Tetley's *Maritime Liens and Claims*, (2nd ed.), International Shipping Publications.

Procedure

The procedure for determining priorities is always for one claimant to commence an *in rem* action and to arrest the ship. Sometimes, more than one action is commenced and more than one arrest warrant is served. After the arrest, an application is made to the court for the sale of the vessel. All parties who have filed Caveats against Release are served with the application. Usually the Order authorizing the sale of the vessel will require that an advertisement be placed in local papers as well as one or two international shipping publications. The advertisement invites tenders and notifies all creditors of the pending sale. The Order and advertisement usually require that any creditors with a claim against the ship must file their claims by affidavit in the court by a specified date. Sometimes the Order will provide for

cross-examination, otherwise, special orders to cross-examine must be obtained. Once all claims are filed and cross-examinations are completed a hearing is held to determine the priorities. Evidence at the hearing is by affidavit and cross-examination transcript. At the hearing, each claimant presents their claims and the other claimants may, if they deem it expedient, oppose the claim.

The Usual Ranking of Priorities

1. Special Legislative Rights

- a. Canada Ports Corporation Act gives a priority for amounts owing for dock and harbour dues to harbour authorities governed by the Act;
- b. The Navigable Waters Protection Act and the Canada Shipping Act give the Federal Crown a priority for amounts incurred to remove wrecks from navigable waters or to prevent pollution;
- c. Pursuant to the Income Tax Act the Crown has a priority for unremitted source deductions;
- d. Forfeiture under various acts (i.e.. for drug trafficking or breach of Customs Act and Excise Tax Act)

2. Marshall's Expenses (*Custodia Legis*)

The costs and expenses of the Marshall in bringing the ship to sale have a priority second only to special legislative rights. At one time the Marshall actually took possession of the ship and these costs would include all things necessary to maintain the ship and bring it to sale including wages, moorage towage, fuel etc. Possession is no longer transferred by arrest and hence these costs are not usually incurred by the Marshall. The Marshall does, however, still incur some costs such as advertisement,

appraisal fees and commissions payable on the sale. All of these costs would have a priority.

In addition, the party who is responsible for arresting the ship and bringing the sale application is normally granted their costs of doing so.

Finally, costs or expenses incurred during the arrest by one party **for the benefit of all** are often granted a priority equivalent to Marshall's expenses. It is normal, and advisable, for a person about to incur such costs to obtain a prior order from the court authorizing the expenditure and granting the priority. Examples of the types of costs and expenses that are sometimes given this priority are:

- . diesel fuel to keep the ship operating;
- a. tug charges to move the ship as necessary;
- b. wages for a skeleton crew;
- c. repatriation costs of the crew when paid by the Crown or a third party;
- d. costs for the removal of cargo

This is an open point under Canadian Maritime Law. (See *The Kimisis III*, (February 9, 1999) No. T-38-99 (F.C.T.D.);

- e. fees owing to classification societies

The English practice seems to be for the Marshall to strike a bargain with the classification societies that the Marshall will agree to make an application to court pay the outstanding fees as Marshall's expenses provided the classification society has kept the ship in class and has made its records available to potential purchasers. The rationale for the bargain is that the vessel will probably fetch a higher price upon sale by reason of being in class. The only Canadian case to consider this issue was *The Atlantis Two*, (August 4,

1998) No. T-11-98 (F.C.T.D.). The approach taken by the classification society in *The Atlantis Two* was, however, different than the practice adopted in England. In *The Atlantis Two* the classification society refused absolutely to make its records available unless it was granted a priority in advance of the sale. In open court, the Prothonotary was very critical of the approach being taken by the classification society. The issue was ultimately resolved by agreement of counsel which provided that the classification society would make its records available and would reserve a right to claim for priority after the sale. The Court therefore refused the application to immediately grant a priority. At the later priorities hearing, the classification society did not appear and, therefore, its right to a priority was not determined. It is, in the writer's opinion, quite probable that if the classification society had appeared it would have been given the priority provided it had filed evidence that the ship fetched a higher price by reason of the classification society's co-operation. The issue is, however, still open under Canadian maritime law.

3. Possessory Liens attaching prior to subsequently accruing maritime liens

- See below

4. Traditional Maritime Liens

A traditional maritime lien is a lien unique to the common law. It is a privileged claim, upon maritime property. It accrues from the moment the claim arises. It travels with the property unconditionally, even into the hands of bona fide purchasers for value whether with or without notice (This is its defining characteristic.). It is enforced, as with other claims, by means of an action in rem.

The current claims that are classified as maritime liens are:

. Life Salvage

Rank in inverse order to date salvage operation performed

a. Property Salvage

Rank in inverse order to date salvage operation performed

b. Collision Damage

Damage done by a ship in collision with another ship is subject to a traditional maritime collision lien.

c. Seamen's Wages

Wages is broadly defined to include bonuses, termination pay, and repatriation costs.

Where repatriation costs are paid by the Crown because the owner has abandoned the ship and crew the Crown has the same priority for such expenses.

In addition to a their common law lien, seamen also have a statutory lien under the Canada Shipping Act and will often rank before other statutory liens.

d. Master's Disbursements

Disbursements made by the Master that meet the following criteria are a traditional lien.:

- The disbursements must be for necessities;
- The disbursements must be for the ship and common venture;
- The Master must have disbursed his own money or put his personal liability on the line as opposed to the owner's liability;
- The Master must have personally paid;
- The Master must have had express or implied authority from the owner to make such disbursements; and
- The Master must have been unable to communicate with the owner.

Today, Master's disbursements are virtually extinct because modern communication systems almost always allow communication with the owner. Further, modern shipping practice is for the owner to appoint agents in each port who look after the obtaining of goods and services for the ship on behalf of the owner.

e. Bottomry

The bottomry bond is an instrument securing an advance of money made on the credit of the ship, not the owner. The owner is never personally liable on a bottomry bond. The advance of money is usually to repair or supply the ship. It is a term of the bond that if the ship be lost the lender loses his money. This form of bond is virtually non-existent today.

5. Possessory Liens

The common law possessory lien of a ship repairer is recognized under Canadian maritime law. Such a lien has priority over mortgages and also over any subsequently accruing maritime liens. However, maritime liens that attached prior to the possession of the repairer have priority. For example, wage claims that accrued prior to possession

would have priority over the repairer's lien but those wage claims that arose subsequently would rank after the repairer's lien.

The repairer's lien only extends to the repair work done by the repairer. Subsequent storage charges while the repairer retains possession are not covered by the lien and are not given a priority. (*Canadian Imperial Bank of Commerce v The "Barkley Sound"*, (March 4, 1999) Vancouver Reg. No.A983054 (B.C.S.C.))

6. Registered Mortgages

The ranking as between registered mortgages is determined by the order of registration.

Where there are two mortgages registered, any advances made under the first mortgage after notice of the second mortgage will rank behind the second mortgage. Advances made before notice of the second mortgage will, of course, have a priority over the second mortgage.

A registered mortgage always has priority over an unregistered mortgage regardless of the dates on which the mortgages were made. It has been said that a registered mortgage has priority over an unregistered mortgage even if the registered mortgagee knew of the prior unregistered mortgage. (*Black v Williams* [1895]1 Ch. 408). However, in *H.F. Russell Seafoods Ltd. v Mason and Mason* (1980) 36 NSR (2d) 322, the Nova Scotia Supreme Court held that an unregistered chattel mortgage had priority over a subsequently registered ship's mortgage where the registered mortgagee had knowledge of the prior chattel mortgage. The facts in that case were unique in that at the time the chattel mortgage was made the vessel was not registered and, hence, it was not possible to register the mortgage. Further, there was some evidence of a fraudulent preference being given to the second mortgagee.

7. Unregistered Mortgages

Any mortgage that is not registered is an equitable mortgage. The ranking as between equitable mortgages is determined by the date each mortgage is made.

8. Other *In Rem* Claims and unsecured creditors

In rem claimants pursuant to sections 22 and 43 of the Federal Court Act do not have any kind of priority. They are mere unsecured creditors *themselves*. *Coastal Equipment Agencies v The Comer*, [1970] Ex.C.R. 13) However, as a procedural matter it may be that *in rem* creditors have a de facto priority over non *in rem* unsecured creditors. This is because most bankruptcy proceedings are against shipowners resident outside of Canada and, therefore, the bankruptcy proceedings are commenced outside of Canada. In *Holt Cargo Systems Inc. v The "Brussel"*, (March 12, 1999) No. A-307-97 (F.C.A) the Federal Court of Appeal refused a stay application brought by a Trustee in Bankruptcy in respect of bankruptcy proceedings in Belgium. The effect of refusing the stay is that the *in rem* creditors could conceivably have their claims paid, in whole

or in part, whereas other general unsecured creditors would not. The situation would, however, probably be different if the bankruptcy proceedings were commenced in Canada. In such a case a stay of the Federal Court action would probably be granted. (See Ultramar v Pierson S.S. Ltd., (1982) 43 CBR (NS) 9)

Variations to the usual ranking

The court has an inherent discretion to depart from the usual ranking of priorities in appropriate cases. The equitable jurisdiction of the Court 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 FTR 284. In order to depart from the usual order of priorities the Court must be satisfied that the usual ranking would produce "an obvious injustice" or "a plainly unjust result". It has been noted in many authorities that there is a heavy onus on the person seeking to depart from the usual ranking and that very strong and reliable evidence is required.

Not surprisingly, there are few cases in which the usual ranking is upset by equitable considerations. Most of the authorities acknowledge the discretion but then refuse to exercise it. One of the few cases in which the usual ranking was altered is *Montreal Dry Docks v Halifax Shipyards Ltd.* (1920) 60 SCR 359, in which the Supreme Court of Canada granted a ship repairer a priority for work done after an arrest on the grounds that the repairer had added to the value of the res. The facts of the case were somewhat unique in that the ship repairer had a possessory lien for work done prior to arrest but upon arrest, pursuant to the Court Rules then in effect, possession was transferred to the Marshall and the ship repairer lost its possessory lien. Because of this, it is not entirely clear from a reading of the case the extent to which the Supreme Court was relying upon equitable principles to alter the normal ranking of priorities. A more recent case which directly raised the question of the extent of the court's ability to alter the normal priorities is *Fraser Shipyard v The "Atlantis Two" et.al.*, (June 11, 1999) No. T-11-98 (F.C.T.D.) (Reversed in part (July 28, 1999) No. T-11-98 (F.C.T.D.)). In this case a 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; secondly, it argued that it should be given an enhanced priority because the repairs done to the vessel immediately prior to the arrest had added to the value of the res to the benefit of all creditors and because the mortgagee had been dilatory in the enforcement of the mortgage. The Court refused to declare that the mortgagee had lost its priority but it did, in the exercise of its equitable discretion, grant an enhanced priority to the shipyard to the extent that the repairs increased the value of the res.

Foreign Maritime Liens

It is now well established in Canadian maritime law that the characterization of a claim as a maritime lien or a mere right *in rem* is determined by the law of the jurisdiction in which the claim arose. The priorities between the various claims is however determined by the law of the forum. The application of these conflicts of laws rules may result in non-Canadian claimants obtaining a higher priority than their Canadian counterparts. For example, pursuant to the laws of the United States a supplier of necessities to a ship is granted a priority over some, but not

all, mortgages. Because of this priority given by American law, an American necessities claimant is considered by Canadian maritime law to have the priority of a maritime lien. This is so even if the goods were supplied in Canada, provided the contract called for the application of American law. (See *The Atlantis Two* (July 28, 1999) No. T-11-98 (F.C.T.D.) A Canadian supplier of necessities, on the other hand, is a mere *in rem* claimant with no priority. This is viewed by many as patently unjust and there is some call for legislative reform.

An interesting result of the application of conflicts of laws rules is that it is possible for an American necessities supplier to in fact obtain a higher priority in Canada than could be obtained in the United States. This is because American law recognizes more than one kind of mortgage and allows for certain kinds of mortgages (called preferred mortgages) to rank ahead of necessities suppliers. Canadian priorities law, on the other hand, only recognizes one kind of mortgage which always ranks behind a maritime lien. It is possible that under Canadian law an American necessities supplier would rank ahead of a "preferred mortgage" whereas under American law the same supplier would rank behind the preferred mortgage. This is, in fact, what happened in *The Ionnis Daskaleais*, [1974] 1 Lloyd's 174, although the court may not have appreciated what it did. (See also the discussion of this issue by Prothonotary Hargrave in a paper he wrote entitled *Case Management and Judicial Sale of Vessels*, which was published by The Continuing Legal Education Society of B.C. as part of a seminar on Federal Court Practice - 1999.)

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