The financial distress of a charterer presents a significant challenge for shipowners, particularly concerning the recovery of unpaid hire. A primary tool at the owner's disposal is the contractual lien over sub-freight. However, the effectiveness of this lien is severely tested when the charterer enters liquidation. The timing of the exercise of this lien thus becomes critical.

This article examines a core doctrinal tension at the intersection of maritime security and insolvency law: whether a shipowner's contractual lien over sub-freight can crystallise automatically upon a charterer's winding up, or whether, crystallisation remains contingent on the service of a Notice of Lien on the sub-charterer. The resolution of this tension has significant consequences for creditor priorities and insolvency policy in Singapore.

A. The Nature of the Lien Over Sub-Freight

A shipowner's lien over sub-freight is not a possessory lien but an equitable lien created by contract, typically within the charterparty. Singaporean case law has established that such a lien operates as a floating charge over the charterer's contractual right to receive sub-freight from sub-charterers.

The Court of Appeal in *Diablo Fortune Inc v Cameron Lindsay Duncan and Anor*[1] held that a lien over sub-freight creates an assignment that is equitable because it assigns future choses in action. The lien would create an immediate security interest on the date of the charterparty, but the shipowner would not hold any proprietary interest in any sub-freight until sums due under the charterparty are unpaid and the shipowner issues notice of the lien to the sub-charterer, thus crystallising the charge. Before notice is given, the charterer is free to deal with the sub-freight as they wish.

At the time of the issuance of this decision, it created significant industry concern as the Court of Appeal held that shipowners' liens were registrable charges under the Companies Act 1967. This created a lot of confusion and worry among shipowners as the industry practice at that time, and indeed still is, for such liens not to be registered.

[1] [2018] SGCA 26 ("**Diablo Fortune**")

A subsequent amendment to the Companies Act 1967 meant that shipowners' liens created after 2018 are no longer registrable charges, whether as a charge on book debts or a floating charge. This removes a procedural hurdle, but the fundamental nature of the lien as a floating charge remains, which is crucial to understanding its behaviour upon the charterer's insolvency.

B. Crystallisation: The Decisive Moment

For a floating charge to become effective against specific assets, it must "crystallise" and transform into a fixed charge. The Court of Appeal has held that a lien over sub-freight crystallises when the shipowner gives a formal Notice of Lien to the sub-charterer, instructing them to pay the sub-freight directly to the owner. Until such notice is given, the sub-charterer can validly discharge their debt by paying the charterer, and the lien is rendered ineffective.

The critical issue arises when a charterer's winding-up proceedings commence before the shipowner has given this notice.

C. The Tension with Insolvency Law

The commencement of winding-up proceedings introduces a significant complication. Under Section 130 of Singapore's Insolvency, Restructuring and Dissolution Act 2018 (IRDA), any disposition of a company's property made after the commencement of winding up is void unless validated by the court.

This creates a legal tension, as if the shipowner had not given notice of the lien before winding up proceedings were commenced, the lien would be void as exercise of the lien would mean that sub-freight, which otherwise would have been paid to the charterer and constitute part of the assets of the company, would be paid instead to the shipowner.

In the case of *Malayan Banking Bhd v Bakri Navigation Co Ltd* [2020] SGCA 41 ("**MBB**"), the Court of Appeal accepted that either the winding up of a company or the *de facto* cessation of trading could bring about crystallisation of a floating charge as a matter of law.[2]

The Appellant in that case had provided financing to a shipbuilder NGV Tech Sdn Bhd ("**NGC**"). The first Respondent was the original buyer of vessels built by NGV pursuant to two shipbuilding contracts with NGV. These contracts were later novated to the second Respondent. The credit facilities extended by the Appellant created a fixed and floating charge over the Respondent's undertaking. NGV eventually defaulted on its repayment obligations to the Appellant and the Appellant served two notices in writing on NGV to crystallise its floating charge in March 2013. In May 2014, NGV was ordered to be wound up in Malaysia.

The Court of Appeal held that there exists a category of events which could crystallise a floating charge when an event incompatible with the continuance of trading as a going concern occurs. However, this would not mean that there existed a mandatory rule of law which precluded a floating charge from continuing to float when a company ceased trading.

[2] MBB at [73]

If floating charges could automatically crystallise upon winding up, this would mean that shipowners would not have to give notice of their lien before winding up commenced, and their floating charge would automatically crystallise.

While there is no direct case law resolving this tension, we take the position that notice should remain a prerequisite for crystallisation specifically for shipowner liens over sub-freight, even in an insolvency context.

A lien over sub-freight involves a third-party debtor (the sub-charterer), who must be notified to redirect payment. Without notice, the sub-charterer would continue to pay the charterer or its liquidator, and the asset (i.e. the sub-freight) would fall into the general pool for creditors.

To allow a lien over sub-freight to crystallise as a matter of law without notice could result in such floating charges crystallising without the sub-charterer being aware of the existence of the charge even. Crucially, MBB did not involve a security interest whose efficacy depended on notice to a third-party debtor. A lien over sub-freight operates within a tripartite structure - owner, charterer, and sub-charterer - such that crystallisation without notice would be conceptually problematic and commercially unworkable.

In addition, this position aligns with the Court of Appeal's finding in *Diablo Fortune* that if a Notice of Lien was not issued to the sub-charterer to pay sub-freight directly to the owner before payment was made to the charterer, the lien would be spent, and the owner could not claw back the sub-freight already paid.

This approach also accords with fundamental insolvency policy. Post-commencement acts that divert assets from the general pool risks the dissipation of assets which would have otherwise formed part of the liquidation assets, and allows for a backdoor reordering of creditor priorities, thus undermining the pari passu principle.

D. Conclusion and Practical Implications

For shipowners, the key takeaway is that notice remains a prerequisite for the crystallisation of a lien over sub-freight, even in an insolvency context. Absent timely service of a Notice of Lien prior to the commencement of winding up, any attempt to enforce the lien is likely to be characterised as a post-liquidation disposition.

To effectively secure sub-freight, a Notice of Lien must be given to the sub-charterer before winding-up proceedings against the charterer have commenced.

Once winding up is commenced, any actions perceived as an attempt at "self-help" to bypass the statutory order of priorities will be examined strictly by the Singapore courts. An attempt to exercise a lien over sub-freight after this point is fraught with risk and is likely to fail, leaving the shipowner as an unsecured creditor. This underscores the need for vigilant credit monitoring and swift, decisive action at the first sign of a charterer's financial instability.

Key practical takeaways:

- A lien over sub-freight is inchoate until notice is given.
- Automatic crystallisation upon winding up is ill-suited to liens over sub-freight given the tripartite payment structure.
- Automatic crystallisation upon winding up also risks contravening key insolvency principles.
- Vigilant monitoring and early notice remain essential.

Further information

Should you want to stay updated on the regulatory changes in Vietnam and how these developments may affect you or your business, please get in touch with the following persons:

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