



# Emerging Markets:

A Review of Business and Legal Issues

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Article:

***“LEGAL PROBLEMS IN RELATION TO FINANCING AND  
SECURING THE CONSTRUCTION OF THE HULL”***

**Ewa Kozak**



# Emerging Markets: A Review of Business and Legal Issues

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**Ewa Kozak**

## **"LEGAL PROBLEMS IN RELATION TO FINANCING AND SECURING THE CONSTRUCTION OF THE HULL"**

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In 2008 I graduated from one-year programme in Maritime Law at Oslo University (LL.M. Programme).

The aim of the programme was to provide basic knowledge of the rules and framework in international commercial affairs. The focus of the programme was on maritime-related commerce under Norwegian law, but all subjects are also approached with an international perspective.

For one year I was also attending the School of American Law, which was organized by the University of Florida and the University of Warsaw.

During my studying in Warsaw I was working as a trainee at the Office of Competition and Consumer Protection in Warsaw and at the Notary Office.

Last year I participated in the six months internship program at the US maritime law firm where I gained new experience in Admiralty and Transportation law. During my internship I took part in the different conferences, trials and seminars, I learned about the legal system of handling disputes in the United States, the new cases in Admiralty and Transportation Law, treaties, regulations, court rules and statutes, both American and international, their impact on legal practice as well as the opinions of different attorneys.

This year I was working as a trainee the Magnusson – The Baltic Sea Region Law Firm in Warsaw.

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## 1. INTRODUCTION

### 1.1 General view

I will present the legal issues in connection with finance and security when the ship is being built in Norway and the construction of the hull takes place in a Polish shipyard.

It is not uncommon for the sections of the ships to be built in foreign yards, such as in Poland. The international character of the shipbuilding may cause many problems and complications. The shipbuilding rules are established separately by each nation. The result is that they differ from country to country. This situation creates many complications for lawyers and businessmen. There is a great need for uniform legal regulations of the financing and securing the shipbuilding.

Shipbuilding plays a significant role in the economies of many nations. This industry involves millions of dollars and has a crucial role in international relations.

The major shipbuilding countries are Japan, Korea, Taiwan, United Kingdom, Germany, Sweden, the Netherlands, the United States of America, France and Italy. Norway is one of the great maritime nations and has a leading position in the world in the shipbuilding.<sup>1</sup>

### 1.2 Presentation of the issues I am dealing with in my thesis

Growing costs of the shipbuilding are the reason for the demand for high credits. There is large scale of international and domestic credit activity in the maritime business which is characterized by the economic fluctuation. When the hull is being built the substantial amount of money is at risk. The crucial issue for the parties of the hullbuilding contract is the possible security in the case when the hull is being built in Poland on the Norwegian's yard account with the loan from the Norwegian bank. Each party has an interest to secure its rights. The parties are concerned to ensure that in the event of the other's

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<sup>1</sup> Harwood, *Shipping Finance*, p.50

insolvency or non-performance, their loss will be kept to a minimum. In the legal systems where the ships are treated as regular chattels, it is difficult to secure the interests of the parties to the shipbuilding. I will present the qualification of the ship and the ship under construction in Polish law.

Securing the construction of the hull can create a few problems. A typical situation is when a shipyard wishes to subcontract for a hullbuilding. Normally, it does not have at his disposal the necessary funds. The bank or another institution gives a loan to the shipyard. Usually, the potential lender's promise to lend is conditional upon obtaining a security, usually a mortgage, in the hull which is to be procured for money. The question is about the security which the Norwegian yard can offer the hull financier for the period between the signing of the contract and the delivery of the hull. Shipyard can offer the lender security in vessels it already owns or in real property or other assets ashore. However, the bank will prefer to obtain security in the values which are procured for the borrowed money. The chances for obtaining a loan will depend on whether it is possible to give the financier the security in the hull under construction and in the materials intended for it. I will present the possible security available for the bank which is financing the hullbuilding.

The Norwegian yard's interest is to have the hull built and delivered according to the contract. It is the party which can be responsible towards the hullyard for the financing of the hull under contractual regulations. Therefore, it needs the security against the subcontractor which is building the hull on his behalf. The security should protect its interest.

The Polish yard, which plays the role of subcontractor, requires the security for unpaid installments of the purchase price. It is building the hull for the Norwegian yard and it is liable for damages. It needs protection against the creditors of Norwegian yard. The type of security will depend on the way of financing the hullbuilding and the ownership's option.

The ownership right is very important. The question is who will be the owner of the hull during its construction at the Polish yard. There can be two options. According to the first one, the Polish yard is the owner of the hullbuilding. The second is that the Norwegian yard owns the hull during its construction. I will present the rights of the party which has the title

to the hull during its construction. Transfer of the hull and the hull's sections ownership is very important from the Polish yard, Norwegian yard, and from the financier's point of view. The parties have to find the method and time of transfer. I will take into consideration various options of transfer and its implications for the parties. Closely connected to the transfer of ownership is the transfer of the risk of loss or damage to the hull during construction and until final delivery to the customer. I present the general rule and solutions of the passing risk in Polish legal system.

Before I start to write about the most important topic, the law of security, I will describe the rules of registration. The function of the ship register is very crucial for the parties of the hullbuilding contract. Registration of the rights is the condition to make the rights effective against the third parties and gives the possibility to use the hull as the security of debts.

There is a wide catalogue of legal means which are used to secure maritime claims. They are mostly regulated in the Polish Civil Code and Polish Civil Code of Procedure. Security can be divided into two categories, security *in rem* and security *in personam*. Security *in personam* creates a relationship between the contracting parties; security *in rem* extends its effectiveness beyond the contracting parties and can be enforced against third parties, which is especially important in the case of bankruptcy. The form of security needed in the first place is a mortgage on the hull under construction. If the Norwegian yard has obtained the title to the hull, it will be the party acting as the mortgagor. The mortgage may in this case be created in favour of the bank which finances the hullbuilding, or in favour of the Polish yard as security for the remaining instalments of the purchase price. The established security will serve as the protection for the correct fulfilment of the hullbuilding contract. Under Polish law, maritime mortgage creates the security *in rem*. It is a limited material right which can encumber the hull. Maritime mortgage is one of the liens securing monetary claims on the hull which entered the ship register. The mortgage becomes effective on the date it entered the ship register. The other securities *in rem* which I will present are ordinary pledge and registered pledge. I will also mention the legal instrument called maritime liens.



The different forms of security *in personam* are, among others, a bank guarantee and a bank warranty. I will try to answer the question what kind of security they constitute and if they can secure the interest of the parties to the hullbuilding contract. Right of retention is the other form of security *in personam*. I will explain the interest which can be secured by this right. Assignment of bank guarantee and the assignment of hullbuilding contract serve as the security of the pre-delivery financing of the hullbuilding in the case when the hull did not enter the ship register.

When securing the hullbuilding under the Polish law, the terms of debt and liability appears. It is very important to make the distinction between these two terms as they have two different meanings in Polish law. I will present two types of liability of the mortgagor in the Polish civil law. The parties to the hullbuilding contract are free to choose the form of the security of the debt. The form of security will decide about the liability which can be material and personal. The personal liability for the debt is unlimited, which means that the debtor is responsible by all his present and future property. In the case of mortgaging or pledging the hull there is the material liability which is independent of the personal liability. Under this liability, the bank has an absolute and direct right to satisfy from the hull and the materials unless the debtor does fulfil his obligations. Material liability provides stronger security for the interest of Norwegian the creditor, as it is not dependent on the property of the debtor which can change any time.

The conflict of law problems can appear in the situation when the hull is being built by the Polish hullyard on the account of the Norwegian shipyard and the loan is provided by the hull financier. I will present the general view of that problem and explain what “conflicts of law rules” means.

Parties to the hullbuilding contract have to choose the way of solving the litigation. In Poland there are two types of arbitration courts. Poland has also signed the international agreements in relation to the arbitration which have binding effect in Polish law.<sup>2</sup>

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<sup>2</sup> European Convention on International Commercial Arbitration of 1961 and New York Convention on Recognition and Performing the Arbitration Judgement of 10 June 1958.

My task is to analyze the problems connected to the financing and securing of the hullbuilding and to indicate the type of solutions which have been chosen or which may be possibly chosen. I will present relevant Polish and Norwegian rules. My thesis will concern maritime civil law which contains private law aspects of the parties' activity in the maritime business. I will refer to international private maritime law and administrative maritime law in the part which is addressed to registration and the administrative organisation.

## 2. QUALIFICATION OF THE SHIP AND SHIP UNDER CONSTRUCTION

From a legal standpoint ships and their hull are assimilated as chattels. Usually chattels cannot be registered in most legal systems. Ships and ships under construction are however different from most other chattels. They are regulated by special law. The hull under construction is treated like a ship under construction in relation to registration. Therefore, ships and ships under construction are allowed to be registered as the immovable property.

From a financial standpoint, the registration of a hull under construction allows the parties to secure the financing of the hullbuilding.

The period of construction is a period of transition during which the ordinary rules concerning chattels apply. At the moment the hull enters the ship register the rules of ship register start to apply as well.<sup>3</sup> The combination of these two set of rules, rules concerning chattels and rules of the ships register, is possible. The registration of the hull under construction enables the establishment of mortgage. Therefore, the opportunity to register the hull under construction will solve the Norwegian yard's financial problems by security financing of the hullbuilding and facilitate the acquisition of new hullbuilding contracts by Polish hullyard.<sup>4</sup>

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<sup>3</sup> The Act on Real Estate Registers and Mortgages of 1982.

<sup>4</sup> Maruno, *Practice and law of international ship finance*, p.84.

### 3. THE OWNERSHIP RIGHT (*ius in rem*)

#### 3.1 General meaning of “hull ownership” in Polish law

Ownership, property and title are the synonyms used for the entirety of rights and duties of the owner in relation to the hull and the hull sections. Ownership is the most widespread form of using goods under Polish law.<sup>5</sup>

The right of ownership gives its holder privileges which can be opposed to all other persons who, in turn, are obligated not to breach the ownership right. Of all rights the right of ownership gives to its holder the most extended power to use goods under Polish law.

According to Polish Civil Code, the right of ownership included: the right to possess it (*ius possidenti*), to exercise it (*ius utendi*), to derive benefits and other profits (*ius fruendi*), and the right to dispose of it (*ius disponendi*) or the right to destroy it (*ius abutendi*).<sup>6</sup> It contains the right to transfer ownership to an other person and to relinquish title of ownership. The right of possessing also includes the right to encumber the hull. The last right is crucial to my topic.

Other persons are allowed to interfere with the owner’s rights only with his consent.

The right of ownership can be limited in three instances. First, the provisions of an act of Parliament can restrict such right, mostly in civil and administrative law. The main reason for the limitation such rights is the protection of the property, itself according to the Polish Constitution. The other two restrictions are: “the principles of social coexistence” and “the social and economic purpose of the right”. These two principles which limit the right of ownership are interpreted on a case by case basis by the courts.<sup>7</sup>

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<sup>5</sup> Ignatowicz. *Property Law*, p.73.

<sup>6</sup> Polish Civil Code of 1964, art.140.

<sup>7</sup> Ibid., art.126-231.



### 3.2 The ownership – two options

The owner has a very strong position under Polish law. He has rights and duties in relation to the hull. He may dispose of it in many different ways, for example by sale, mortgage or pledge. He has the remedies to protect it from seizure by the creditors of another person, for example the creditors of the Polish yard. He also bears the risk of loss.

Usually the hull and the materials are owned by the builder before they become the ownership of customer. In the exceptional cases the customer owns and supplies the materials for construction.<sup>8</sup>

There can be two possibilities. Either, the Polish yard is the owner of the building hull, or the Norwegian yard is the owner. There should be expressed agreement on this issue as it is very important to define the role of the parties.

Parties to the hullbuilding contract are free to allow either the purchaser or the subcontractor to be designated as the owner. The solution will therefore vary from one hullbuilding contract to the other.

According to the Norwegian law, the Norwegian yard becomes the owner of the hull at the time of final delivery of the hull, and the Polish yard would be entitled to register as the owner of the hull not until that time.<sup>9</sup> It is also expressly provided under Norwegian law that a subcontractor can mortgage the hull with the pertaining materials but at the time of delivery the hull should be unencumbered.<sup>10</sup>

In the case where the subcontractor, the Polish yard is registered as the owner of the hull before the final delivery of the hull, it has the right to encumber the hullbuilding with the securities to the benefit of his creditors.<sup>11</sup> In this situation the Norwegian yard's creditors may only seek security in the Norwegian yard's rights pursuant to the hullbuilding contract. If, according to the hullbuilding contract the subcontractor is registered as the owner it will

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<sup>8</sup> Clarke, *Shipbuilding Contracts* (...), p.21.

<sup>9</sup> NSFS of 2000, art.XI no.1.

<sup>10</sup> Ibid., art.VIII no.1.

<sup>11</sup> Polish Maritime Code of 2001, art.77.

typically be responsible for financing the purchase of the materials to build the hull and it will be entitled to register his rights pursuant to the contract. The parties can decide that the Norwegian yard will pay the price in installments during the period of construction of the hull. Then, they usually arrange for taking of the security to guarantee the payment of the installments prior to delivery. As the subcontractor will own the hull during its construction it would be advisable to define, in the contract that the subcontractor is prohibited from disposing of the hull, or from registering the mortgage or lien to the third parties unless there is consent of the Norwegian yard. This clause can be very important in the situation where the subcontractor becomes insolvent prior to the time of delivery. According to Standard Form: “The builder may mortgage the vessel and its materials as security for the construction financing, including provision of refund guarantee for the vessel. The buyer shall if necessary give its consent for that purpose”.<sup>12</sup> Unless the Norwegian yard limits the subcontractor’s right it may find himself among many unsecured creditors as the subcontractor may mortgage the hull to the lenders. In this situation the Norwegian yard will not be able to prevent the priority of the mortgagee. The bankrupt subcontractor will be liable for damages to the purchaser, but this liability will be a debt with no greater priority or security than any other unsecured creditor. The clause relating to the hull builder’s guarantee not to allow a lien or mortgage on the hull without the prior consent of the Norwegian yard is a good concept because it would seem that the hull builder will use the installments to meet the cost of the hull construction. Otherwise, the hull builder would have to secure short-term loans which could amount to liens or mortgages on the hull under construction.

In the case of the bankruptcy of the Polish yard, the registration of paid installments may be of great importance. If the payments of the Norwegian yard are not registered they will not be protected in relation to the estate and then the yard will have to pay second time before the estate of the bankrupt Polish yard is obliged to deliver the hull.

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<sup>12</sup> NSFS of 2000.

If the Norwegian yard is registered as the owner, the Polish yard's rights with respect to the hullbuilding are limited. It can not encumber the hullbuilding. As the practical matter, the Norwegian yard would be responsible for the financing of the material, equipment and labour. As the owner, the Norwegian yard may encumber the hullbuilding and the security can be created in Poland.

For the Norwegian yard, as the owner the procedure of marking has crucial consequences.<sup>13</sup> It is important to identify and separate all materials, parts and equipment which belong to the Norwegian yard.

The role of the owner is significant in the execution proceeding against the hull, governed by the Polish Code of Civil Procedure. The owner is liable from the mortgage debt even if he is not the personal debtor of the mortgagee. The court proceeding commences by bringing an action against the owner. He can also lose his right to the hull as the result of execution.

### 3.3 Transfer of the hull and the hull sections' ownership under Polish law

The transfer of ownership is very important, not only in the relation between the Polish yard and the Norwegian yard, but also from the point of view of any party who financed the hullbuilding. This is especially important when the hull builder is insolvent or has many creditors.

“From the financier point of view, the transfer of property in a ship under construction is one of the most important interests because if the financier wants a security in the ship under construction which is to be procured by the loan, the yard cannot grant him satisfactory security, until it has obtained the property in the ship under construction”.<sup>14</sup> The construction gradually becomes a hull and the rights and duties attaching to it may change with the shape

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<sup>13</sup> See: *infra*. p.12.

<sup>14</sup> Maruno, *Practice and law of international ship finance*, p.65.

of the thing itself. The moment at which the property is transferred will depend on general principles of law and on the terms of the hullbuilding contract.

Polish Maritime Code does not contain any provisions describing the transfer of ownership of the building hull. Parties to the hullbuilding contract must define in the contract a moment when the ownership of the hull is transferred. There are various ways of arranging the methods for transfer of property. The parties are free to decide when the property in the hull under construction will pass from the builder to the buyer.<sup>15</sup> The schedule of payments and the securities given by one party to the other are linked to the contractual provisions on the transfer of property.

First, parties can decide that the property in the hull under construction is to be transferred from the Polish yard to the Norwegian yard as soon as the hull is identifiable. In Polish law the hull is identified when the keel is laid. This is also the moment when the hull can enter the ship register in Poland.

Second, the property right to materials, equipment, etc., may be transferred to the Norwegian yard as soon as it has paid the first instalment of the purchase price. This method facilitates obtaining the financing for the hullbuilding. It allows mortgaging the hull and therefore it is possible to arrange the pre-delivery finance. The hull financier may ask for it, in order to secure the hull loan.

Third, the property can be transferred when the entire purchase price has been paid.

Under the other solution the purchaser becomes the owner of the materials and the hull as soon as the contract comes into force.

If the shipbuilding contract does not stipulate any specific time for the transfer of property, in most countries the general rule is that the property shall pass at the time of delivery. This rule can be found in standard contract forms. For instance, in Norwegian Standard Form Shipbuilding: "The buyer shall become the owner of the vessel upon delivery and acceptance".<sup>16</sup> In some jurisdictions, transfer of property requires a particular agreement

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<sup>15</sup> "Freedom of agreements". Art.353 of the Polish Civil Code of 1964.

<sup>16</sup> Documents used in Shipping. 2003.



which is distinguished from the original hullbuilding contract, where the seller has the contractual duty to deliver the hull and transfer the property. In this case, the hullbuilding contract and the transfer of property will have a completely independent existence. In most cases however, the right of property will be transferred at the moment of agreement between the hull builder and the main shipyard.<sup>17</sup>

The parties may of course choose to depart from the above solutions. They may agree that the ownership will pass gradually during construction of the hull between the conclusion of the contract and payment of the final instalment. In this case the value of the hullbuilding must be assessed and then the total amount paid must be applied to such value in order to establish the percentage paid and the percentage of the property transferred. The method to pass property in proportion to paid installments is complex and therefore not the best solution in a hull under construction.<sup>18</sup>

In the case where the parties to the hullbuilding contract did not define the time of the transfer, provisions of the Polish Civil Code regarding the transfer of ownership of movables are applicable. Transfer of ownership is defined by the contract according to the Civil Code.<sup>19</sup> As the subject of the contract is the future thing (hull under construction) transfer of the ownership has a place by the transfer of the right of the possession.<sup>20</sup> The condition is that the hull is building from the materials which are owned by the hull yard. When the materials are owned by the Norwegian yard provisions of the Polish Civil Code regarding the passing property are not applying. In this case the Norwegian law will be relevant. According to the Polish Code, transfer of possession takes place when two elements are fulfilled. First, the person who acquires the hull must have physical disposition of the hull and, second, this person must have the will to use its ownership right. The way to transfer the possession is to deliver the hull to the Norwegian yard.<sup>21</sup>

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<sup>17</sup> Maruno, *Practice and law of international ship finance*, p.71.

<sup>18</sup> Ibid., p.71, 79.

<sup>19</sup> Polish Civil Code of 1964, art.155§1.

<sup>20</sup> Ibid., p. art.155§2.

<sup>21</sup> Ibid., art.348.

According to the Polish Maritime Code, the transfer of the hullbuilding's property entering the Polish ship register must be documented by notary deed.<sup>22</sup>

According to the Polish Maritime Code, the registration of the ship under construction is not mandatory.<sup>23</sup> As a result, transfer of the hull does not need to be registered in the ship register. If the hull under construction is entered into the register, then the transfer of the property must be registered as well. Parties can decide that the Norwegian yard will be the owner of the hull and/or hull sections before delivery. The Norwegian yard which has the valid title to the materials will automatically obtain a valid title to the hull that is being built from these materials and in the same time he has obtained real security for paid installments.

The transfer of property in materials cannot be registered in the ships register in Poland. The protection as against third parties is decided by the ordinary rules of transfer of movables. According to the Polish Civil Code, if the hull which is subject to the transfer is encumbered by a right of the third person, this right expires at the moment of issuing the hull to the transferee, unless it is acting in the bad faith. If the person who is not eligible to transfer the hull is issuing it to the transferee, this act is valid unless the transferee in the moment of acquiring is in the bad faith.<sup>24</sup> Under this regulation the position of the Norwegian yard is not very well protected.

The parties may agree with the binding effect that the Norwegian yard can register its rights on the hull sections as soon as the materials have been identified as intended for the hullbuilding.<sup>25</sup> This is consistent with the optional provision of the Convention on the Registration of Rights in Respect of Vessels under Construction of 1967: "The national law may provide that the registered rights on a vessel under construction shall attach to materials machinery and equipment which are within the precincts of the builder's yard and which by marking or other means are distinctly identified as intended to be incorporated in the

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<sup>22</sup> Polish Maritime Code of 2001, art.60.

<sup>23</sup> Polish Maritime Code of 2001.

<sup>24</sup> Polish Civil Code of 1964, art.169 and 170.

<sup>25</sup> Maruno, *Practice and law of international ship finance*.

vessel”.<sup>26</sup> This regulation is in accordance with art.82 §2 of the Polish Maritime Code and the Norwegian Maritime Code.<sup>27</sup>

Before the identification, the Polish yard is the owner of sections of the hullbuilding. The conditions of transfer of property in the materials will be the same as the transfer of title to the hull, but in practice, it will be more difficult to have a right to the first kind than the right to the latter kind. “Whenever title passes to the purchaser prior to delivery of the hull under construction the customer is advised to register his rights in the ship as to preserve them against third parties, particularly when the contract changes the usual local rule concerning the passing of property”.<sup>28</sup>

### 3.4 Transfer of risk – connected to transfer of the ownership

In most countries, it is clear that the question of the transfer of risk is subject to the freedom of contract.<sup>29</sup>

Usually, the risk of loss or damage of the sold goods passes to the buyer simultaneously with the title. In some legal systems, transfer of the rights is connected to receiving by the buyer the protection concerning the sold goods as against the seller’s creditors. In other legal systems, the risk passes when the goods are delivered to the buyer. In most countries where the shipbuilding contract is seen as a contract for the sale of goods, it is often provided that the risk shall only pass to the owner when the hull is delivered, and then regardless as to whether the title to the hull has passed at an earlier stage. In the countries in which the shipbuilding contract is seen as a contract for work and materials, the result is the same. The general rule is that when the materials and components are supplied by the

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<sup>26</sup> Brussels Convention of 1967, art.8.

<sup>27</sup> Norwegian Maritime Code of 1994, art.43.

<sup>28</sup> Clarke, *Shipbuilding Contracts (...)*, p.25

<sup>29</sup> IBA, *International Shipbuilding Contracts (...)*

customer, it bears the risk of their loss or destruction on the builder's yard under the condition however that the loss or destruction is not due to a fault of the builder.<sup>30</sup>

According to Polish civil law, the subcontractor bears risk of loss or damage to the hull until delivery. It is responsible for the result of his work. There are two exceptions to this rule however. First, when the materials for the hullbuilding are supplied by the Norwegian. Second, when the hull was lost or damaged as a result of the defectiveness of materials delivered by the Norwegian yard or if the Polish yard worked according to the instruction of the Norwegian yard.<sup>31</sup> The rules concerning risk allocation may be modified by parties to the contract. The time of passing the risk is important for the hull insurance.

### 3.5 Significance of marking

Marking is the technical activity which has the particular meaning for the Norwegian yard and the hull financier. Provided that the Norwegian yard is delivering the materials for the hullbuilding to the Polish yard and that the lender finances the construction, both the Norwegian yard and the lender have an interest to have the property properly marked.

The written inventory of the materials which have been marked as belonging to the hullbuilding and consequently to the Norwegian yard, can make it easier for the owner to prove his title in the estate of the insolvent Polish yard.

The identification of the hull is usually simple. As far as the materials are concerned, their identification can be sometimes problematic. The builder may have bought the same materials for the other vessel and may keep it in the general stock of materials.

The practice of the Polish yard is to identify each piece of the material with the yard number of the hullbuilding. This marking should be completed as soon as materials bought for the hullbuilding arrive at the yard.

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<sup>30</sup> Clarke, *Shipbuilding Contracts* (...)

<sup>31</sup> Polish Civil Code of 1964, art.641.



## 4. POSITIONS OF THE PARTIES TO THE SHIPBUILDING CONTRACT

### 4.1 The position of the Norwegian shipyard

The Norwegian yard is the party which is responsible for building the whole ship and is ordering the hull from the Polish hullyard.

Assuming that the Norwegian yard and Polish yard agreed on the type of the hull, delivery time, and price, the Norwegian shipyard in most cases will be requested to pay the basic contract price in installments from the date the contract is signed until final delivery of the completed hull. According to the general rule, the Norwegian yard will obtain the title to the hull at the moment it takes delivery of the completed hull from the subcontractor.<sup>32</sup> Therefore, it needs the protection of its interests. There are three different systems which can secure the interests of the Norwegian yard.

First, the Norwegian yard can receive the protection through the mortgage on the hull as security for installments it pays during construction period. Since the hull which is still under construction, can be officially registered in the ship register, the possibility exists to encumber the hull with a mortgage. The mortgage works in favour of the Norwegian yard.<sup>33</sup>

The weak point of this method is that it is not possible to register a ship under construction before the laying of the keel; therefore, the mortgage can not be registered before that date.<sup>34</sup>

Second, the Norwegian yard can arrange with the Polish yard that it will get the ownership of the hull and all the materials before the date of delivery. If the materials belong to the Norwegian shipyard then the hull, which is built from these materials, belongs automatically to the shipyard. The subcontractor should take care of these materials, store

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<sup>32</sup> See: *supra*. p.9.

<sup>33</sup> Adamczak, *Maritime Liens and Maritime Mortgage*, p.103.

<sup>34</sup> Polish Maritime Code of 2001, art.23 §6.

them, insure them, and most importantly the subcontractor must mark them in such a way that they clearly show who the owner is.

The Norwegian yard can strengthen its position as the owner of the hull during its construction by having the hull under construction registered on its name in the official Polish ship register. The nationality of the owner is of no consequence when registering a hull under construction. Even if the owner is a foreigner, the hullbuilding is subject to the Polish law until it is handed over to the Norwegian yard. At that point, the hull loses Polish nationality and therefore must be deleted from the ship register. The Norwegian legislation has been recently changed in order to allow registration of the hullbuilding in both the Norwegian and Polish shipbuilding registers at the same time. Double registration of the shipbuilding is allowed under Polish law. Registration of the hull in the name of the owner means that his ownership is officially known and third parties could not say that they were not aware of the contractual arrangements between the owner and the hullbuilder whereby the owner obtains the hull as property before the actual delivery. Registration is the evidence of the Norwegian yard's ownership right.

Third, the Norwegian yard can request that the hullyard provides the bank guarantees or bank warranty for the installments which the subcontractor received from the Norwegian yard during the building period, in order to secure the repayment of these installments in case of non-delivery of the hull.<sup>35</sup> The institution of bank guarantee constitutes a satisfactory protection to the shipbuilder, but at the same time, it is expensive and difficult to arrange. The bank guarantee provides that the bank shall refund the shipbuilder the total amount of the installments already paid by him to the hullbuilder, possibly including a certain interest rate if and when at the certain agreed date the hullyard neither delivered the hull to the shipbuilder nor repaid the installments it has received for the construction of the hull, which for some reason was never been built.

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<sup>35</sup> See: *infra*, pp. 38-41

#### 4.2 The position of the Polish hullyard

Polish hullyard is the party which is responsible for a building the hull on the account of the Norwegian shipyard. The position of the hullbuilder does not need to be protected in the same way as the position of the shipbuilder, assuming that the hullbuilder has followed the general practice of covering the greater part of his expenses for building of new hull with the installments of the purchase price it receives from the shipbuilder during the construction period. If the hullbuilder accepts, as occurs in some exceptional cases, to be paid the full contract price at the delivery of the hull, without receiving any payment during the construction period, then the problem is quite different and the hullbuilder has to take appropriate measures to secure the payment of the contract price by the shipbuilder at the time the yard is able to deliver the completed hull. They must protect themselves against creditors of the Norwegian yard, if the latter might get into financial difficulties during the construction, and also against any financial problems of the shipyard where the ship being built.

In the normal contract, with the payment of installments during the building period, the hullbuilder can not be forced to deliver the completed hull without receiving payment of the outstanding balance of the contract price. Usually, the contracts concerning particular sections contain stipulations to this effect, giving the hullbuilder the right to refuse of a delivery of completed section unless the payment of the outstanding balance of the purchase price is effected simultaneously or is secured by the appropriate guarantees. The interest of the hullbuilder can be protected by the stipulation in the hullbuilding contract that the shipbuilder, when it is the owner of the hull under construction, shall not be entitled to assign his rights to third parties without the approval of the hullbuilder and cannot to grant mortgages without the same approval.

The subcontractor can also claim a right of retention to get paid for the work it has done. The subcontractor is constructing the property which belongs to the main shipyard. Therefore, it would be doubtful whether such a right could be maintained against third parties,

which have in good faith obtained certain rights on the hull under construction. Even if the hullbuilder would have a right of retention, it would not help him in case the shipbuilder had granted against the will of the hullbuilder certain rights to third parties, which were in good faith.<sup>36</sup>

#### 4.3 Position of the banks and other financial institutions which have granted credits for the building of the hull

The bank or the institution which has granted loans to finance the costs of the hullbuilding needs protection in case of bankruptcy of the subcontractor. In this case, it has already paid, the normal creditor will get refunded for the part of the hullbuilding price and it will have to share the proceeds of a forced sale of all assets of the shipbuilder with all other creditors without being able to claim preferential rights.

The hullbuilder normally asks for payment of the contract-price in installments during the construction of the hull and the shipowner has to arrange that the bank or financial institution starts to pay of the credit already during construction. The bank or financial institution which starts to pay installments to the shipyard during the construction of the hull needs to protect its interests. This can be done in various ways:

First, the bank can ask for a mortgage on the hull under construction. If the Polish yard is the owner of the hull during construction, its cooperation will be needed for granting the mortgage to the bank. If the Norwegian yard has obtained the ownership of the hull, it can himself grant a mortgage to the bank and this mortgage will be officially registered.

Second, the bank can be the owner of all materials and equipment of the shipbuilding intended for it as security for the credit during the construction. According to this method, the hull can be registered in the name of the bank. It should, however, be the hullbuilder who transfers the ownership of the hull and all materials intended for it to the bank, because the

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<sup>36</sup> See: *infra*, p.41.

hullbuilder will in that only case be able to stipulate that the proceeds of a forced sale of the hull under construction shall first of all be used to repay principal sum and interest of the credit to the bank and that a possible balance shall be used to satisfy any claims the hullbuilder might still have against the shipbuilder. If the shipbuilder was the original owner which transferred the ownership to the bank, such balance of the proceeds would go to him, and the hullbuilder would have to queue up with the other creditors for payment of a possible unpaid balance of the contract price. If the shipowner has the other vessels, the collateral security can be established in other vessels. But I will not elaborate on this method.

The bank in order to protect its interest will require documents in relation to the hull and the Polish yard where the hull being built. The hull contract is the most crucial for the bank. It shows the complete relationship between the Norwegian and Polish yard with regard to the construction and purchase of the hull, including price and the terms and conditions of delivery. In practice, the bank will need legal advice from a local law firm. It is crucial for the bank to obtain legal opinions on the issues relating to the corporate status and existence of the hullyard and the opinions confirming that the hullyard has finally and with binding effect entered into the hull contract and the contract may be enforced against the hullyard in accordance with its terms and conditions. The bank can require as the precondition for financing that the Norwegian yard has the full and unrestricted ownership to the hull and the hull sections, and by that simple procedure can take possession of the hull and the materials in case the Polish yard goes bankrupt or materially breaches the contract. It is also very important for the bank to obtain a legal opinion concerning the security documents required for financing. It must be proved that the documents have been validly entered into and they are binding and enforceable in accordance with their terms and conditions in the actual jurisdiction, in each case to the extent required by the bank.

Finally, there must be information provided that any retention right the hullyard may have is limited to unpaid parts of the payment obligations in relation to the relevant hull.

#### 4.4 Norwegian regulations which apply to the legal relations between parties in the case of subcontracting the hullbuilding in the shipbuilding contract

Under Norwegian law a contract to build a ship is a sales contract. Accordingly, the contract to build the hull will be the sale contract. The subcontractor which is building the hull plays the role of the seller and the shipyard which building the ship is the buyer (the main builder, main shipyard). The third party will be the buyer of the Norwegian yard which is buying the whole ship. The bank will play the role of financier of the hullbuilding. Under Norwegian law the relationship between parties of the contract can be governed by Sale of Goods Act.<sup>37</sup> “This is no mandatory regulation with respect to shipbuilding contract and does not apply where the parties have decided the specifications of the completed ship and performance of the contract relationship. The Act can have a useful interpretative role when the contract is uncompleted or when contractual provisions are unclear”.<sup>38</sup>

In practice, shipbuilding contracts are comprehensive, detailed documents that attempt to solve all the potential problems without reference to the background law. The contracts are often standardised. Some of these forms are the result of negotiations where both builder and buyer interests have been represented.

Standard Form, which is the result of the negotiation between the Norwegian Shipowners' Association and Norwegian Shipbuilders' Association, replaced the Standard Form from 1981.<sup>39</sup> Under the Standard Form, the Norwegian yard which is building the ship may subcontract the building of the hull, but is fully responsible for the work as if done by the Norwegian yard at his yard.<sup>40</sup> Therefore, if there is any defect caused by the Polish yard, the main builder is obligated to repair it. The subcontractor is liable for damages to the builder. According to the Standard Form, it is practical to establish contract between subcontractor

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<sup>37</sup> Norwegian Sale of Goods Act of 1988

<sup>38</sup> Falkanger, *Scandinavian Maritime Law*, p.83.

<sup>39</sup> NSFS of 2000.

<sup>40</sup> *Ibid.*, art.II4

and shipowning company as opposed to the Norwegian yard.<sup>41</sup> The main shipyard, upon buyer's request shall assign its rights pursuant to the subcontractors. Norwegian yard shall endeavour to include provisions in the subcontract whereby the buyer may bring claims directly against subcontractor. Therefore, the buyer of the Norwegian yard will be able to bring claims against Polish yard which is building the hull and plays the role of the subcontractor.<sup>42</sup>

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<sup>41</sup> Ibid., No.4.

<sup>42</sup> Falkanger, *Scandinavian Maritime Law*, p.99.

## 5. REGISTRATION

### 5.1 Significance of registration

The ability of the customer or of the ship financier to secure its position varies from country to country, in particular, according to whether and by what means rights in ships under construction can be registered.<sup>43</sup> In an attempt to unify the variety of practices on this matter, the Convention on Registration of Rights in Respect of Vessels under Construction was signed at Brussels 27 May 1967. Only five states have ratified or acceded to this Convention: Norway, Denmark, former Yugoslavia, Sweden and France. Therefore, registration is not unified in the international scale. It is related to the nationality of the vessel and the rules depend on the law of the particular state. The hull which is being constructed in Poland is subject to the Polish law.

Registration in the ship register has a purpose both as concerns the public and private law.

The Polish ship register has an important administrative function. Additionally it has a crucial commercial role as it reveals the property rights. The rights which can enter the register are the private law nature. The most important right is the maritime mortgage. The registration of the hullbuilding is facultative. Therefore, each of the parties may register hullbuilding, and in this case will have to adhere to the registration rules for all later creation of rights, or they may leave off registration and the ordinary rules for chattels will apply.<sup>44</sup> The ship register has the same legal function as the register of real-estate. This solution is the same in the Polish and Norwegian law. In Poland, the Act on Real Estate Registers and Mortgages applies for the interpretation of the effects of the registration in ship register.

Article 11 of the Brussels Convention of 1967 states that the limited property rights which entered the register have priority over the rights which are not registered. The priority in relation to the other rights on the hull depends on the date of registration. One of the

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<sup>43</sup> Clarke, *Shipbuilding Contracts* (...), p.32.

<sup>44</sup> Meeting at the Law Firm - Zelaznowski & Glowinski.



reasons of the registration is the protection against third parties. The claimant's interest can be damaged if the rights are not registered even if it is not obligatory for the ships under construction.<sup>45</sup>

The registration is a condition for making the rights effective as against third parties. It is very important for the Norwegian yard to have rights in the hullbuilding protected as against the Polish yard's creditors.

The register constitutes the list of the ships and ships under construction (hullbuilding) with Polish nationalities, which are subject to Polish legislation and which are under the Polish jurisdiction and legal protection. The register informs about suspension and receiving of the Polish nationality. It states the identity of the hull and discloses the right of the possession of the hull, limited material rights and other limitation of the hull's disposal. The main interest of registration can be the possibility of using the hull as the security of the debts.

The Norwegian yard, to be protected against insolvency of the Polish yard, must have at any time during the later stages of the construction a good security for his advantage installments.

It must have satisfactory security in the hullbuilding and the materials. If the Norwegian yard is the owner, it must obtain protected position against the creditors of the hullbuilder.

The bank which finances the hullbuilding and the Norwegian shipyard has the main interest to have its rights protected by the registration while the hull is being built in the Polish shipyard. This is the reason why the bank can require evidence that the hull or the hull sections are fully owned by the Norwegian yard and become unencumbered when delivered.

## 5.2 Double registration

The prohibition of double registration is a common rule which exists in many legal systems. In relation to ships under construction, the rule is contained in the Brussels

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<sup>45</sup> Falkanger, *Scandinavian Maritime Law*.

Convention. According to art.3 of the Convention, the rights in relation to the vessels which are constructed in one contracting state should not be registered in the other contracting state. There are two exceptions to this rule.<sup>46</sup> First, when the contract for the building of a properly specified vessel has been executed and the second is when the builder declares that it has decided to build such a vessel for its own account. Poland has not ratified the above Convention. However, the rule of prohibition of double registration exists in Polish law in a limited form.<sup>47</sup> The provision of the Polish Maritime Code which refers to the double registration does not concern ships which are under construction and the rights registered on these ships. The conclusion is that after the registration of the hull in the Polish ship register it can enter also the other registers, for example the Norwegian register. It is now possible to register the building both in the Norwegian shipbuilding register and in the Polish shipbuilding register at the same time. According to the previous legislation, in the situation when the hull was being built abroad for example in Poland the registration in Norwegian ship register was possible only after delivery of the hull from the hull yard. Additionally, (BYGG) Norwegian ship register had to receive necessary documentation of removing hull from Polish register. According to these provisions the mortgage could not be registered before the delivery of the hull to Norway.

### 5.3 Registration of the hullbuilding in the Polish ship register

Parties can decide to register the hull, and then the motion must be submitted to Maritime Chamber.<sup>48</sup> Maritime Chambers are the entities which are responsible for keeping the ships register<sup>49</sup> which is an official register of the ships.<sup>50</sup> The hull which is being built in

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<sup>46</sup> Brussels Convention of 1967, art.4.

<sup>47</sup> Polish Maritime Code of 2001, art.27.

<sup>48</sup> Młynarczyk, *Maritime Law*, p.90.

<sup>49</sup> The Act on Maritime Chambers of 1961.

<sup>50</sup> Decree of the Ship Register of 1996.

the Polish shipyard and which is owned by the Norwegian yard is qualified to enter the register. This register is kept by the Maritime Chamber, which is proper for the place where the hull is building. Hull registration is typical administrative act which is regulated in the Maritime Code.<sup>51</sup> Detailed information on the registration is included in the Decree of the Ship Register.<sup>52</sup> Unless the Decree states otherwise, the registration of the hull is done according to the Civil Code of Procedure<sup>53</sup> and the Act on the Real Estate Register and Mortgages.<sup>54</sup> According to art.23 §4 of the Maritime Code, the ships and the ships under construction which are not under the obligation of the registration can enter the ship register on the motion of the owner. The nationality of the owner is of no consequence when registering hullbuilding. The registration of hull under construction is facultative but the construction must reach a certain stage. According to Polish law the keel must be laid.<sup>55</sup> The purpose of this limitation is to make certain of the identity of the hullbuilding.

#### 5.4 Legal consequences of the registration

The crucial consequence of the registration is that the registered facts are effective against third persons. The facts which were not registered can be effective against third persons unless they did not know about them.<sup>56</sup> For the assessment of the effects of the registration, the provisions of the public rights of the real estate register are applicable.<sup>57</sup>

The most important is the presumption of credibility. It means that the registered right is in accordance with the law and the deleted right does not exist. In the case of the inconsistency of the registered rights with the actual legal status, the register is interpreted to the advantage of the person who obtained public right by the legal action with the qualified

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<sup>51</sup> Polish Maritime Code of 2001, art.23 – 39.

<sup>52</sup> Decree of the Ship Register of 1996.

<sup>53</sup> Polish Civil Code of Procedure of 1964, art.506.

<sup>54</sup> The Act on Real Estate Registers and Mortgages of 1982.

<sup>55</sup> Polish Maritime Code of 2001, art.23 §6.

<sup>56</sup> Ibid., art.35 §1.

<sup>57</sup> The Act on Real Estate Registers and Mortgages of 1982.

person. After entering the register, the hull owner receives the certificate of the hullbuilding. The Maritime Code defines the circumstances which are the basis of the deletion the ship from the register.<sup>58</sup> One of them is the loss of the Polish nationality. According to art.31 §2, the deletion of the ship from the register is possible only if there is the mortgagee's consent which must be in written form.

There is the additional rule in relation to the hullbuilding. Accordingly, the deletion can have a place when the building of the hull was abandoned or the hull was destroyed during the building. Every time there must be the written consent of the mortgagee unless the ship entered the permanent register in Poland and the mortgage entered the register ex officio.

The hullbuilding which is not under the obligation of entering the ship register must enter the Maritime Administrative Register.<sup>59</sup>

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<sup>58</sup> Polish Maritime Code of 2001, art.31

<sup>59</sup> Decree on the Ship Register of 1996.

## 6. THE LIABILITY OF THE MORTGAGOR IN THE POLISH CIVIL LAW

### 6.1 Debt and liability

The debt expresses only the obligation of the debtor to complete the consideration. The liability refers to the coercive completion of the consideration. The debt depends on the mortgagor's will. The liability is not dependent on the debtor.

Sometimes, the third person can have the liability for the debtor's debt and in the same time that person can not bear any personal responsibility to complete the consideration. In this instance, the liability for the other person's debt is separated from the obligation to complete the consideration. This situation has a place when the debt is secured by the mortgage or the pledge. In the present case, the Norwegian yard can be the debtor and the creditor can be the bank which finances the shipbuilding. The debt is secured by the mortgage on the hull which is being built at the Polish yard. Then Polish yard is liable to satisfy the mortgagee from the hull. The mortgage is established in favour of the Norwegian bank. Therefore the debt is separated from the liability.<sup>60</sup>

### 6.2 Types of liability

There are two types of the liability for the debt: personal and material. In the case of hullbuilding, in most cases, the material liability is taken into consideration.

### 6.3 Personal liability

Personal liability expresses the obligation of the debtor towards the creditor to complete the consideration. According to Polish law it is the property liability. The guarantee of completing the consideration is the debtor's property. Debtor's property means all property

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<sup>60</sup>Czachorski, *Obligations*, p.60.

assets. Personal liability for the debt is unlimited. It means that the debtor answers for the debt by all his future and present property. The creditor can choose which items belonging to the debtor it wants to satisfy its debt. It can also choose the coercive way of satisfaction of its debt.<sup>61</sup> If there is more than one creditor and the property of the debtor is not sufficient then each creditor is satisfied partly according to the value of the debt.<sup>62</sup> The limitation of the personal liability of the debtor until certain item from his property is not permissible.

#### 6.4 Material liability

Material liability is independent of the personal liability. It exists in situations when the debt is secured by the mortgage or pledge. Material liability of the mortgagor or pledgor exists when the hull is encumbered by the maritime mortgage or the registered pledge.

The guarantee of the satisfaction of the creditor is not the property of the debtor but the defined property object like a hull. The bank has the absolute and direct right to satisfy from the encumbered hull and the materials if the debtor does not fulfil its obligations.

The bank can realise its rights independent of who is the owner of the thing which serves as the security. It can be either the Norwegian or the Polish yard. The responsibility encumbers the thing which can have different owners. The owner of the encumbered object does not have any obligation of performance but only to tolerate the right of the bank to satisfy from the hull. In case of the concurrence during the execution of the personal and the material claims the creditor has the priority to satisfy from the encumbered hull over the others creditors secured by the personal rights. The personal and the material liability of the mortgagor can exist together.

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<sup>61</sup> Polish Code of Procedure of 1964, art.797 and 799.

<sup>62</sup> Ibid., art.1026.

#### 6.5. The difference between the personal and the material liability

First, the personal liability is larger than the material liability. It encumbers not only one object but all of the property of the debtor. Second, the personal liability can give lesser security as the satisfaction is dependent on the property of the debtor which can change any time. The personal liability does not recognise the privileges in favour of one creditor against another. Therefore the creditor bears the biggest risk.

## 7. SECURITY *IN REM*

### 7.1 Maritime mortgage

#### 7.1.1 Definition of the maritime mortgage

A mortgage on the ship is one type of maritime lien. The Maritime Code regulates mortgages in the part called “Law of Property”, in the chapter named “Maritime Liens”. Mortgage property law is applicable to the maritime mortgages even though the ship is movable and the mortgage is one of the lien’s types. The act which regulates the real estate registers and mortgages also applies to maritime mortgages.<sup>63</sup> Maritime mortgages are regulated by civil laws concerning mortgages according to art.76§1 of the Maritime Code and civil laws concerning the pledge of chattels according to art.89. Civil Code regulations concerning limited material rights (art.244-251) also apply to maritime mortgages.

There are three conventions in international law which regulate the maritime mortgage. There is the Brussels Convention on Uniform Rules for Maritime Liens and Mortgages of 10 April 1926, which was ratified by Poland.<sup>64</sup> Art.1 and Art.12 concern the maritime mortgage. Art.1 states that all mortgages and any other encumbrances which are attached to the ship will be accepted by all the states of the contract, but only if they are lawfully established according to the law of the state of the ship’s ownership and they entered the public register of the shipyard where the ship is registered or in the central authority. According to art.12, state law should prescribe the type and the form of the documentations with the information about encumbrances. Polish law meets the above requirements. Therefore, the mortgage established on the hull in Poland is supposed to be accepted by Norway. Two other conventions, the Brussels Convention of 1967<sup>65</sup> and the Geneva Convention of 1993<sup>66</sup>, were not ratified and did not come in to force in Poland. However, in many cases, the Convention of 1967 serves as the model for the Polish provisions. One

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<sup>63</sup> The Act on Real Estate Registers and Mortgages of 1982

<sup>64</sup> Brussels Convention of 1926

<sup>65</sup> Brussels Convention of 1967

<sup>66</sup> Geneva Convention of 1993.



crucial change of the Geneva Convention is strengthening the role of the maritime mortgage as an important mean to secure credits in the shipping business. The maritime liens which have priority over the mortgages were limited. Mutual recognition of the maritime mortgages has important meaning, such as the application of similar formal requirements when entering or deleting the ships from the ship register and the encumbrances attached to them. It must prevent dishonest mortgagor from avoiding satisfying creditors.<sup>67</sup>

According to Polish law, the mortgage is one of the liens on the ship.<sup>68</sup> The main difference between these two institutions is that the mortgage must enter the ship register. Maritime mortgage is a limited material right which can secure the indicated debt. The economic purpose of the maritime mortgage is to secure the mortgagee's interest if there is a fear that its debtor will not satisfy the consideration. The hull can be legally charged, which means that the mortgagee has the right to be paid off with the hull regardless of who is the owner of the property each time; also the mortgagee has priority over the personal creditors of the owners, who do not use the mortgage security. The priority right is not absolute. It can be overtaken by the privileged debts.<sup>69</sup> According to Brussels Convention of 1926, maritime mortgages are only overtaken by the maritime liens established according to the Convention. Therefore, there are certain doubts concerning the applicability of the domestic provisions of Civil Code and Civil Procedure Code in relation to the priority rights towards maritime mortgage.

According to art.72 of the Act on the Real Estate Register and the Mortgages, the hull owner has a right to have it at his disposal during the duration of the mortgage unless there is otherwise stated in contract between parties. The maritime mortgage can secure monetary debts, which therefore can be established only in certain amount of money.<sup>70</sup> There is the possibility to establish maritime mortgages in maximum amount of money to secure the claims which amount is not defined. In Polish law, this kind of mortgage is called "kaucyjna".

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<sup>67</sup> Adamczak, *Maritime liens and Maritime Mortgage*, p.22.

<sup>68</sup> Polish Maritime Code of 2001, art.76.

<sup>69</sup> *Ibid.*, art.91.

<sup>70</sup> The Act on Real Estate Registers and Mortgages of 1982, art.102.

It can secure existing and future claims. This mortgage can secure the claim from the endorsable document (which can be disposed by endorsement) even if the amount of the claim was defined.<sup>71</sup> According to Polish Civil Code of Procedure, mortgage can also secure the claim for interests that are not time-barred and for adjudged costs of proceedings.<sup>72</sup> The “Kaucyjna” mortgage can secure only these expenses which are not higher than the established maximum amount of money.<sup>73</sup> This type of mortgage is very convenient in cases when the parties can not define the exact costs of hullbuilding. The parties must then define the maximum price. “Kaucyjna” mortgage can be changed for ordinary mortgage and ordinary mortgage can be changed for “kaucyjna” mortgage. Another kind of maritime mortgage is a joint mortgage. A joint mortgage can be established in more than one ship to secure the same claim. The mortgagee can choose if it wants to be satisfied entirely or partly from all the ships or from some of them or from single ships.<sup>74</sup>

#### 7.1.2 Maritime mortgage as a security in the hullbuilding

The hullbuilding is treated as the vessel under construction, and as a result, all the rules of the vessel under construction apply. The hull under construction can be mortgaged in the same manner and with the same effect as a completed vessel according to art.82 of the Polish Maritime Code.

The mortgage deed must be signed by both the hull owner and the mortgagee. A mortgagee does not become the owner of the hull, nor does the owner of the hull lose ownership as a consequence of the mortgage. If the Norwegian yard has obtained the title to the hull, it will be the party acting as the mortgagor. The mortgage may in this case be created in favour of the bank which finances the hullbuilding, or in favour of the Polish yard as security for the remaining installments of the purchase money.

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<sup>71</sup> Ibid., art.103

<sup>72</sup> Ibid., art.69.

<sup>73</sup> The Act on Real Estate Registers and Mortgages of 1982, art.104

<sup>74</sup> Ibid., art.76 §2.

There is a specific subject of this mortgage. It attaches to materials and equipment which are placed in the yard and which are marked or identified by any other way as intended to be used to build the hull. Maritime mortgage on the ship under construction also secures all the debts of the owner in respect of loss or damage to property, insurance compensation and salvage reward. When the loan secured by a mortgage has been fully repaid or the mortgage has otherwise been satisfied, the mortgage can be discharged by the recording of a satisfaction of mortgage and an appropriate insertion in the register.

To remove the hull from the register of the ship, there must be consent of the mortgagee, the consent must have written form, unless the ship under construction entered the regular ship register and the mortgage was registered *ex lege*.

### 7.1.3 Establishment of the maritime mortgage

Declaration of will of the hull owner is necessary to establish a maritime mortgage. Declaration of will can have a contractual or a statutory form. Usually the agreement is signed by the person, whose debt must be secured, meaning that the bank or the Norwegian yard and the hull owner are personal debtors of a mortgagee. If the hull is owned by more than one person, then there must be the consent of all of the co-owners.<sup>75</sup>

The mortgage can be established by the person who is not the personal mortgagor of the mortgagee. It can also be established by the person who is not the owner of the hull but who has a right to dispose of the hull according to the contract.

The owner's declaration of will is null and void unless there are written, notarized authenticated signatures of the parties.<sup>76</sup> The other indispensable condition to establish maritime mortgage, beside the declaration of will, is the entry in the ships register.<sup>77</sup>

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<sup>75</sup> Polish Civil Code of 1964, art.199.

<sup>76</sup> *Ibid.*, art.73 §2.

<sup>77</sup> Polish Maritime Code of 2001, art.76 §2.

Maritime mortgage can be established in Polish currency, currency of the other country, or in the SDR defined in the London Convention on the Limited Liability for the Maritime Claims of 1976.<sup>78</sup>

#### 7.1.4 The assets subject to the mortgage

In general, the assets subject to the maritime mortgage can be sea-going vessels which are entered in the register. It encumbers all component parts and appurtenances of a vessel and also the shipowner's claim due to him for charter hire. There is specific subject of the mortgage which is established on the ship under construction. It is attached to materials and equipment which are placed in the yard and which are marked or identified by any other way as intended to be used to build the ship. According to this provision, it is possible to establish the mortgage on the materials intended for the hullbuilding which are placed at the Polish shipyard and which are marked as for the hullbuilding. A maritime mortgage on the hull also secures the entire owner's claims for the damages in respect to loss or damage to property and insurance compensation.

From the economic point of view, it seems natural to consider the materials and the hull under construction as a unit because the whole has been financed by the bank. A maritime mortgage also secures the hull owner's debts which were arisen after establishment of the mortgage. According to art.79 §2 of the Polish Maritime Code the parties to the contract are allowed to agree on the types of debts which can be secured by the mortgage.

#### 7.1.5 Security of the maritime mortgagee's interest

A maritime mortgagee's interest is secured under the provisions of Polish Maritime Code. According to art.80, consent of the maritime mortgagee is obligatory in the case of the

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<sup>78</sup> Ibid., art.101 §2.

transfer of the property of the mortgaged hull to the foreigner who can be either a natural or legal person.<sup>79</sup> The consent must be a written form with an authenticated signature. Security of the maritime mortgagee is very important in the situation when transfer of the hull's ownership results in the loss of Polish nationality of the hull and deletion from the ship register together with the maritime mortgage. Maritime mortgagee's consent is also required to delete the hull from the ship register. In the situation when the hull has been sold to the Norwegian yard, then there is an automatic deletion from ship register. Therefore, there the maritime mortgagee must consent to transfer the ownership of the hull.

The consent of the maritime mortgagees is also the condition of the suspension the Polish nationality of the hull, according to art.19§2 of the Polish Maritime Code.

#### 7.1.6 Transfer and termination of the maritime mortgage

Mortgage is an accessory right, therefore the transfer of this right must be made together with the secured claim. The claim can not be transferred without the mortgage unless the act constitutes differently.<sup>80</sup> In case of the transfer of the claim, the purchaser has the right to adduce the regulations on warranty public trust of the ship register in relation to the secured mortgage and to the pleas against the claim which can be raised against the seller.<sup>81</sup> In the case of the transfer of the claim secured by the mortgage, the owner of the encumbered property who has already paid the transferor does not have a right to invoke before the transferee that he didn't know about the transfer. If the owner already paid the interest to the transferor, he can invoke it before the transferee if he was not informed about the transfer by the transferor, the transferee, or by the maritime chamber which keeps the ship register.<sup>82</sup>

According to art.94 of the Act on Real Estate Registers and Mortgages, the maritime mortgage expires at the time that the claim expires. The termination of the claim does not

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<sup>79</sup> The definition of the foreigner is in art. 4.3 of The Act on Law of the Economic Activity of 1999.

<sup>80</sup> Act on Real Estate Registers and Mortgages of 1982, art.79.

<sup>81</sup> Ibid., art.80.

<sup>82</sup> Ibid., art 81.

infringe the right of the mortgagee to satisfy from the mortgaged hull with the exception of the interest.

In the case of the deletion of the hull from the registration without valid legal basis the maritime mortgage expires in the case of absence of re-entering hull register during the next ten years after. The mortgagee can disclaim a right to secure his claim by the mortgage without the expiring of the claim unless this disclaiming is not deleted from the ship register according to art.96 of the above act. The maritime mortgage expires when the owner of the hull and the mortgagee is the same person. An example is when the mortgagee buys the ship. The maritime mortgage terminates when its subject does not exist.

If the claim is eligible and the mortgagee is having difficulties paying or he is in delay, the mortgage expires when the hull owner deposits the secured money with the court and he relinquished to have the money back. In the case of the expiring of the maritime mortgage, the mortgagee is obliged to act in the way to delete the hull from the ship register.<sup>83</sup>

#### 7.1.7 Satisfaction of the mortgagee

For the execution from hull which entered the ship register the regulations of the execution from immovable are to be applied accordingly, and for execution from the hull, which did not enter the ship register, the rules relating to the execution from movables are applicable.

There are no provisions in the Polish Maritime Code which regulate the process of the mortgagee's satisfaction. The civil law regulations of execution proceeding apply to the satisfaction of the mortgagee.<sup>84</sup> Any other agreement is allowed. The condition for the maritime mortgagee to be satisfied from the hull is taking it in the possession in the relevant time and place.

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<sup>83</sup> The Act on Real Estate Registers and Mortgages 1982, art.100.

<sup>84</sup> Ibid., art.75.

In the proceeding to satisfy the mortgagee there is the need to sue the hull owner, even if he is not the personal debtor of the mortgagee because the owner has material liability towards the mortgagee.

#### 7.1.8 Priorities between liens encumbering the hull

There are relevant regulations regarding the priority of the different types of liens. The claims secured by the mortgages or liens are satisfied on the sixth place from the amount received after the executory selling of the property.<sup>85</sup> Among all of the liens established on the hull only the privileged liens have priority.<sup>86</sup> There are rules in relation to the priorities between the registered mortgages.<sup>87</sup> They rank according to their date and time of recording. If mortgages are recorded at the same time, the mortgage which motion was submitted earlier in date takes precedence. If the motions were submitted in the same date then these mortgages have the same priority.

All registered rights take the priority over these which did not enter the register. The parties are allowed to change the priority of existing mortgages in the contract.

#### 7.1.9 Mortgage governed by Norwegian law

Norwegian mortgage is regulated by the provisions of the Norwegian Maritime Code. The scope of the mortgage can be determined by interpreting the mortgage agreement. Art.45 of the Norwegian Maritime Code, which concerns the mortgage, is partly mandatory and partly supplementary. According to art.41, the rights under a newbuilding contract or the rights to the actual newbuilding can be mortgaged. Art.43 provides the rules of the mortgaging. It concerns only the ships which are being built in Norway. The sections of the

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<sup>85</sup> Code of Civil Procedure of 1964, art.1025.

<sup>86</sup> Polish Maritime Code of 2001, art.83 §1.

<sup>87</sup> The Act on Real Estate Registers and Mortgages of 1982, art.11 and 12.

ship such as the hull are also the subject of the mortgage unless otherwise provided in the loan agreement. The sections can be built by the yard or can be brought from a subcontractor to the yard. The materials brought to the building yard also fall within the security rights unless there is an agreement to the contrary. According to art.41, the mortgages receive protection only once the registration has taken place.

The registration is required in order to receive full protection of the mortgage on the ships. In cases where the appurtenances are the special security for the unpaid purchase price, the registration is necessary to obtain protection against subsequent encumbrances on the vessel and against the creditors of the owner. According to art.41 of the Code, the mortgages on the ships under construction obtain legal protection by registration in the newbuildings register. The mortgage attaches the materials and equipment brought to the shipyard site unless there is an agreement to the contrary. The materials must be marked or identified in some other way. The charge on materials and equipment is extinguished when they are sold and taken away from the yard, provided that the acquiring party neither knew nor ought to have known that the sale was contrary to the mortgagee's rights.

## 7.2. Ordinary pledge, registered pledge and maritime liens

### 7.2.1 Ordinary pledge

Ordinary pledge is regulated by the Polish Maritime Code and additionally by the provisions of Civil Code. Art.89 of the Polish Maritime Code provides the general rules of using the civil law regulations concerning pledging the chattels to the pledges which does not constitute the maritime mortgage. Therefore it is possible to establish the pledge on the hull which entered the ship register, as well as on the hull, which did not enter the ship register. There is a special kind of pledge named "kaucyjny" which can be established on the hull which did not enter the ship register. The question is whether the ordinary pledge is the proper right to use as the security in the hullbuilding. The pledge encumbers the hull and its



appurtenances and components. If the hull is owned by more than one person then the pledge also encumbers the shares. It can also be established on the rights.

The ordinary pledge can secure the specified claim. The pledgee who will be the Norwegian bank financing the building has a right to satisfy from the hull. It is without any meaning who is the owner in that time. He has a priority over the personal creditors of the owner with the statutory exceptions. If the hull is already encumbered, then the pledge which was created later has the priority over the rights which arose earlier unless the pledgee acts in bad faith. To establish a pledge, a contract is needed between the owner who does not have to be a personal debtor and the bank. There is also the form of statutory pledge.<sup>88</sup> The rule is that the encumbered chattels must be removed from the possession of the owner. The possession of the hull must be transferred to the pledgor or to the agreed third person. The establishment of the ordinary pledge on the hull and its components is not in use in the case of hullbuilding when the owner is the Polish yard. The obligation to give the pledged item away infringes the interest of subcontractor who loses the possibility to build the hull.

## 7.2.2 Registered pledge

### 7.2.2.1 General description

The registered pledge is the legal instrument which can be used as the security in the case of hullbuilding. It is quite new construction in the Polish law, which is regulated by the Decree of 1996.<sup>89</sup> This type of right is established in the situations when the bank is giving the credit to secure the debt. The registered pledge does not constitute a separate right. It is one of the forms of the pledge. According to the act, in relation to the issues which are not regulated by the act, the Civil Code regulations about the pledge are applicable.

The definition of the registered pledge is the same as for the regular pledge. The registered pledge is the law which gives the pledgee the right to satisfy from the items with

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<sup>88</sup> Polish Civil Code of 1964, art.670.

<sup>89</sup> Decree on the Ship Register of 1996.

the priority over the personal debtors and regardless of who is the owner. The future and conditional debts can be secured. Additionally, the pledge does not terminate in spite of the termination of the secured debt. The registered pledge is established by the contract between the person who is eligible to dispose the subject of the pledge and the creditor. Therefore the contract can be established between the Polish yard, which has the title to the hull and the Norwegian bank which is financing the building. The contract must be in written form. For the establishment of the pledge, the entry in the register is needed. The pledged hull and the components do not have to be given away like it is in the case of the regular pledge. The registration replaces the obligation of giving the pledged items away.

The hull and the materials are the subject of the register as they are movables. The condition is that the hull does not enter the ship register. In this case the regulations about the maritime mortgage are applicable. Only the immovable property and the rights which can be encumbered by the mortgage can not be the subject of the registered pledge.

Encumbering the components of the hull by the pledge is valid even if it is subject to changes. It can be mixed or combined with the other things during the hull construction. Then the pledge encumbers all the things together. If the hull which is encumbered by the pledge becomes the part of the vessel, the registered pledge terminates and the bank can demand establishment of the mortgage from the owner of the vessel.

Unless the contract states otherwise, the registered pledge includes the bank's claims for damages on the ground of the loss, destruction, damages or reduction of the value of the hull.

There is only the specific group of subjects whose claims can be secured by the registered pledge. The entitled person must run the business. Accordingly, the entitled persons are the national bank, foreign bank, the legal entity who is giving the loans and credits, international financial organisation whose Poland is the member and other subject who runs the business in Poland. The registered pledge can secure the monetary and non-monetary debts. The monetary debts can be expressed in the foreign currency. According to this regulation, the Norwegian bank is entitled to establish a registered pledge on the hull.

Future and conditional debts can be secured only until the highest amount defined in the contract. The satisfaction of the bank from the hull is according to the regulation of the judicial execution proceeding. The parties to the pledge contract can choose in the contract the other methods of satisfaction. They are free to choose one of the methods defined in the act like: receiving the company earnings by the bank, the sale of the hull by the tender or taking over the possession of the hull according to the contract.

The registered pledge expires when the hull is being built and delivered to Norwegian yard, then the secured debt does not exist any more, when the bank relinquished his right or when the hull becomes the part of the vessel. It expires also when the parties terminate the contract or the pledge will be deleted from the register on the application of the bank.

#### 7.2.2.2. Differences with the ordinary pledge

The most important difference compared to a maritime lien is the lack of obligation of giving the pledged item to the pledgee and using methods of pledgee's satisfaction other than execution. It makes this pledge useful in the hullbuilding relations. The parties to that pledge are able to form their legal relationship. The norms are mostly *iuris dispositiva*, which means that the parties to hullbuilding contract are free to decide which norms will bind them. In relation to the registered pledge, there is the exception in accordance with the accessory rule of the pledge.

In relation to this pledge, the rule that the limited property rights which were later established has the priority over the earlier right does not apply. According to art.15 of the act, the limited property right which was established later can not be executed with the disadvantage to the registered pledge established earlier. The parties to the registered pledge contract can establish the obligation for the pledgor under which he will not be able to sell or to pledge the subject of the pledge. Therefore, the act allows for the contractual limitation of the disposition of the pledge's subject. This kind of reservation must be signed in the pledge's

register. According to this provision, the parties to the hullbuilding contract can decide that the Polish yard will not be able to dispose the hull.

#### 7.2.2.3 Function of the pledge

The main function of this pledge is to secure the credit. A registered pledge is the instrument by which facilitates obtain the credit for economic activities' financing. This institution can be useful in the case of building the hull by the Polish shipyard that is being financed by the Norwegian bank.

#### 7.2.2.4 Pledge register

Entering the pledge register has very crucial legal effects. The registration creates the law. The pledge registers are kept by the district courts.

Without the registration, the pledge will not be established. The contract and the registration are being required. The application is required to register. After the registration, no one can plead ignorance of the information from the register unless someone could not know about that even the reasonable care was kept. The main function of the registration is to provide the information. Neither the shipyard nor the bank can state towards the third persons that the facts from the register are not valid. The register has public character. The copies of the register are available for everybody who will apply for that. The registration proceeding is according to the Code of Civil Procedure and the Decree of the Ship Register.

#### 7.2.3 Maritime liens

Maritime liens are a specific institution of maritime law. The institution of maritime liens acquired a different character in individual states. The articles 90 – 96 of Polish Maritime Code and Brussels Convention of 1926 regulate the maritime liens. They increase

significantly the possibility to claim damages. It is a very useful instrument in the shipping business towards financially weak ship owners. Maritime liens can not arise as a result of the contract. They secure privileged claims which arise exclusively by virtue of the statute. They exist independently on the lienees and the ship owners. Maritime liens can encumber only maritime vessel. It can not encumber the part of the ship or shipbuilding. Therefore maritime liens are not taken into consideration in relation to the building of the hull.<sup>90</sup>

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<sup>90</sup> Pazdan, *Private International Law*, p.319.

## **8. SECURITY *IN PERSONAM***

### 8.1. Bank guarantee

#### 8.1.1. General overview

According to the Polish law, the institution of guarantee serves to increase the liability of the debtor in relation to the creditor. The guarantee creates additional security in the form of the guarantor's liability for the main debt. From the economic point of view, this is security for the benefit of the Norwegian bank that is financing the hullbuilding. However, the legal institution of the guarantee can create the security for the Norwegian yard.

The guarantee for someone else debt is in the form of personal security, as opposed to other forms of the security for property like the mortgage or pledge. The guarantor is responsible by all his future and actual property, not only by the defined thing.

Polish yard can post a bank guarantee for repayment of installments. The guarantee is in the event the contract is lawfully cancelled by the Norwegian yard, or when the builder's payments are delayed, or when the contractual obligations are not fulfilled. The guarantee is regulated by the Civil Code.<sup>91</sup>

#### 8.1.2. Definition

Parties to the hullbuilding contract may agree that the guarantor will be the bank, the Norwegian bank plays the role of the creditor, and the Polish hullyard will be the debtor. The debt of the Polish yard will constitute the repayment of the installments. In this situation, the guarantor obliges himself towards the Norwegian bank to fulfil the payment obligation in case the Polish shipyard infringes his duty. The bank incurs his obligation towards the creditor.<sup>92</sup>

The guarantee has an accessory character; Meaning that it is dependent on the main debt. This means that the invalidity of the main debt of the Polish makes the guarantee

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<sup>91</sup> Polish Civil Code of 1964, art. 876 – 887.

<sup>92</sup> Ibid., art.876§ 1.

invalid. It does not matter if the Norwegian bank was satisfied or not as well. The extent of the guarantor is the same as the extent of the obligation of the Polish yard.<sup>93</sup>

The bank that has the role of the guarantor is protected by the establishment of the guarantee because any legal act of the debtor can not increase the obligation of the bank. The guarantor has the same objections as the debtor.<sup>94</sup>

#### 8.1.3. Subject of the guarantee

The subject of the guarantee can be each debt. It can be the debt of the Polish yard towards the Norwegian bank. This debt can constitute the repayment of the installments paid by the bank to the Polish yard to build the hull. It can also be the future debt, but in this case, the guarantee must indicate the amount of the debt. There is no obligation to indicate the term of raising the future debt.

#### 8.1.4 Establishment

The special form is required to establish the guarantee. The statement of the guarantor should have the written form under the clause of nullity.<sup>95</sup>

#### 8.1.5 Legal effects

The main obligation of the bank as the guarantor is to fulfil the Polish yard's obligation unless it realized its duty of repayment the installments.

There are two variants possible. First, the liability of the guarantor can be auxiliary. Accordingly, the Norwegian bank is eligible to request the payment from the guarantor in

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<sup>93</sup> Ibid., art. 879 § 2.

<sup>94</sup> Ibid., art. 883 §1.

<sup>95</sup> Ibid., art 876§2.

case of the delay of the Polish yard, which is the main debtor. Second, the liability of the guarantor can be parallel with the liability of the debtor. Unless the parties decide in the contract, the second variation variant is applicable.<sup>96</sup> Therefore, the bank as the guarantor, is responsible the creditor as a joint debtor. The liability of the guarantor differs from the liability of the joint debtor. The guarantee is always dependent on the main debt and the satisfaction of the creditor by the guarantor does not cause the debt to expire. In this case, the guarantor enters into position of the creditor.<sup>97</sup>

The guarantee is established in the interest of the Norwegian bank, who is the creditor.

The Norwegian bank's obligation is to inform straight away the guarantor promptly about the hull yard's delay.<sup>98</sup> This can constitute the prerequisite of the obligation for the guarantor if he is an auxiliary guarantor. The creditor's infringement of his obligation to inform can cause damage for the guarantor in relation with the debtor. In this situation, the Norwegian bank bears the liability for damages towards guarantor.

#### 8.1.6 Expiration of the guarantee

The guarantee expires in the same time as the duty of repayment, according to the rule of accessory. The guarantee also expires as the result of the termination the guarantor's obligations.

### 8.2. Bank warranty

#### 8.2.1 Definition and the function

The bank warranty came into existence through economic activities, mainly in international relations. The warranty has a similar function to the bank guarantee.

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<sup>96</sup> Polish Civil Code of 1964, art. 881.

<sup>97</sup> Ibid., art.518§1.1.

<sup>98</sup> Ibid.,art. 880.



Bank law regulates bank warranties in the Act from 1997.<sup>99</sup>

A bank warranty is the unilateral obligation of the bank, which plays the role of guarantor. The bank has to fulfil the monetary obligation towards the beneficiary directly by itself or indirectly by among the other bank under the condition that the beneficiary (entitled subject) realises the defined payment's terms. The Norwegian yard plays the role of the beneficiary and the debtor is the Polish yard.

The guarantor obliges himself in relation to the warranty's beneficiary to perform the obligation in the case of the lack of fulfilment by the Polish yard. Therefore, the bank takes over the liability for the other person to fulfil the obligation towards the warranty's beneficiary. In the case of hullbuilding, the bank is obligated to repay the installments to the Norwegian bank under the condition that the Polish yard does not perform its duty. This legal instrument is the beneficiary for the bank that is financing the building of the hull.

#### 8.2.2. Comparison with the bank guarantee

The bank guarantee and the bank warranty are instruments for securing the claims of the creditor. They are not the same. The guarantee always depends on the main debt. The warranty has a more autonomous character. The common practice is that the invalidity of the basic relation is without any influence on the guarantor's obligation.

The bank's right to provide give the bank guarantee and the bank warranty is regulated in the bank's law<sup>100</sup> and in the Decree of the Bank Inspection's Commission.<sup>101</sup>

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<sup>99</sup> The Act on Bank Law of 1997, chapter: VI.

<sup>100</sup> Ibid., art.5 and art.80.

<sup>101</sup> Decree of the Bank Inspection's Commission of 1998.

### 8.3. Right of retention (*ius retentionis*)

#### 8.3.1 Characteristic

The right is recognized in most countries, including both Poland and Norway. The right of retention may be based on the contract or legal act. In Polish law, the right of retention is regulated in art.461 of Civil Code and is not subject to any registration.

The act grants this right to the creditor in defined cases. The Polish yard is the party which is entitled to exercise the right of retention on the condition that “he is the party which is obliged to give away somebody else’s object” is fulfilled. The hullyard is qualified to keep the hull until the payment or the proposition of payment is made for the expenses which the creditor spent on the hullbuilding. The second situation when the right can be exercised is in the case of the withdrawal from the hullbuilding contract. In this situation, the parties are obliged to return what they have got. In that case, both the Norwegian and the Polish yards have the right of retention until its claim is satisfied.<sup>102</sup> This rule applies to the cases where the contract was invalid or dissolved with retrospective effect.<sup>103</sup> The right of retention ceases on payment by the Norwegian yard or by the bank on behalf of the yard. It also ceases when the claim does not exist or from the others, the yard voluntarily gives up the possession of the hull.

Ius retentionis can have an effect only between two parties: the creditor and the debtor. It has no effect on any third parties. In the hullbuilding relations, the Polish yard has the position of creditor and the Norwegian yard is the debtor. If the right concerns the hull which belongs to the Norwegian yard, the creditor does not have a right to satisfy from this object.<sup>104</sup>

The right of retention is passive, which means that Polish yard does not have the right to sell or to satisfy from the hull.

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<sup>102</sup> Polish Civil Code of 1964, art.496.

<sup>103</sup> Ibid., art 497.

<sup>104</sup> Ibid., art 461.

### 8.3.2 Function

The right of retention provides the security for the expenses bared by the Polish yard. The hull serves as the security for the claims of the Polish yard. If the hullyard has a claim for the payment which is due, it has the right to retain the hull belonging to the Norwegian yard until satisfaction is obtained. According to general principle, the right of retention can be exercised when there is reasonably close connection between the claim of the Polish yard and his possession of the Norwegian yard's asset. In practice, it is important for the Polish yard to obtain the right to retain the hullbuilding until the purchase price is paid.<sup>105</sup> The interest of the Norwegian yard is to ensure that the retention right of the hull yard is limited to unpaid parts of the payment obligations in relation to the relevant hull.

Beside the security function, the right of retention is the legal means which can be used to put pressure on the Norwegian yard in the negotiations when Polish yard is building the hull.

### 8.4. Assignment of rights

Parties to the hullbuilding contract can decide to register the hull under construction in the Polish ship register to secure pre-delivery financing. In Poland, parties are not obliged to register the hullbuilding, since registration is not mandatory. In many countries, it is not possible to register a ship or the hull under construction.<sup>106</sup> In these countries, the interest of those concerned with the proper performance of the shipbuilding contract must be secured by the other means.

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<sup>105</sup> Falkanger, *Scandinavian Maritime Law*, p.137.

<sup>106</sup> Japan, the United Kingdom and the United States.

In the situation when parties do not register their rights, the hull financier can require the assignment of the hullbuilding contract and bank guarantee. The above means can serve as the additional security to the material right.<sup>107</sup>

The Norwegian yard, which is the buyer, can require that bank guarantee be provided for the installments paid to the Polish yard during the construction period. In the event that the hull financier makes the loan to Norwegian yard, he can require assignment of the bank guarantees to him as security for pre-delivery financing.<sup>108</sup>

The other method to ensure security of the hullbuilding's pre-delivery financing can be the assignment of the hullbuilding contract. Under this method in the event the Norwegian yard fails in his repayments, the hull financier may tender any unpaid installments and acquire the right to take delivery of the hull from the Polish yard, which is unencumbered by any claims of other creditors of the Norwegian yard. The hull financier has the right to succeed to all the Norwegian yard's rights in respect to made payments. The effective assignment of hullbuilding contract prevents any superior subsequent assignment of the contract to any other creditors of the Norwegian yard. The hull financier's task is to make sure that the hull owner has not previously assigned its interest to the others. In most countries, the hullbuilding contract and the assignment are not recordable; therefore the hull financier must rely on representations of the hull owner, prompt notice to the hull builder and acknowledgment of such notice. Sometimes the hull financier will be required to ask the hull builder to consent to the assignment of the hullbuilding contract.

This method of security would be unsatisfactory in the event that the hull builder does not complete the hullbuilding. It will be difficult for the hull financier to complete the hull and the uncompleted hull is of little value if it is sold. It is advisable to indicate in the shipbuilding contract that in case of breach of hullbuilding contract by the hull builder, the hull financier may take the hull and complete it somewhere else on the account of the hull builder.

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<sup>107</sup> Clarke, *Shipbuilding Contracts* (...)

<sup>108</sup> Maruno, *Practice and law of international ship finance*, p.75.

There are also other ways to secure pre-delivery finance. The customer's security for the amount of the installments, which he has paid during construction, lies in the fact that these installments are so arranged that the amount paid at any given time during the course of construction is approximately equal to the value of work performed at that stage. In the fact that the contract often provides that the property in the hull, but not the risk, passes to the customer as the hull is constructed at the same time, the builder may ensure that under the contract, he retains ownership of what has been built, at least to the extent that he has not received proportionate installment payment.

## 9. CONFLICT OF LAW RULES

### 9.1 Definition

The conflict of law rules are the national norms which indicate which legal system of which country which is properly applicable to the particular maritime relations which include foreign element. The foreign element from the Polish shipyard's point of view constitutes the building of the hull on behalf of the Norwegian yard. "The conflict of law rules does not content the rights and the obligations of the person of the particular legal relation but indicates the legal system which encloses the norms deciding about these rights and obligations".<sup>109</sup>

### 9.2 Characteristics

The fact that the hull is being built in the Polish shipyard on the account of the Norwegian shipyard and the fact that the money is borrowed from a third party ship financier can create conflict of law problems. Theoretically, the hull can be encumbered by the rights which were created under different legal systems. Conflict of law can be related to the acknowledgement of the maritime liens, mortgages and the claims which they secured. The problems can arise in relation to the order of satisfaction of the claims or the reasons for their termination. The qualification of the legal terminology can create many problems especially in relation to maritime liens and mortgages. One example is the maritime mortgage, which in many legal systems is a separate right. According to the Polish law, it is one type of the lien. There are even more conflict of law problems regarding maritime privileges. They often have different content and legal character in different legal systems.

In primary question in all of the above situations, is: which country's laws are applicable? In the present case, it can be either the Polish or the Norwegian law. It is a common rule that the legal effects of the hullbuilding contract and the relationship between

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<sup>109</sup> Pazdan, *Private International Law*, p.43.

the contracting parties are governed by the law which they wish to apply in the hullbuilding contract, in accordance with the party autonomy. The most practical method is to apply the law of the hullbuilder's country to the hullbuilding contract. It is the most convenient law to use, not only between the hull builder and the buyer, but also in relation to third parties who are not mentioned in the contract.

### 9.3 Conflict of law rules according to the Polish legal system

The conflict of law norm includes the legal relations and the link which shows the contract legal system (Polish or Norwegian) for these relations. There are two types of norms: objective and subjective. The subjective norms allow the parties to choose the legal system for their legal relations and the objective norms indicate the correct system. For the immovable estate, the choice of the law by the parties is not allowed. The proper law is always the law of the place of the property. Hullbuilding which entered the ship register is considered the immovable estate. Therefore, the parties are not free to choose the legal system which will govern their relations.

In the situation of encumbering the hull being built by the Polish yard on behalf of the foreign yard, the conflict of law rule which is included into Polish Maritime Code will indicate the which legal system will apply.<sup>110</sup> The general principle is that the mortgage or other law of property which encumbers the ship and which did not enter the ship register is interpreted according to the law of the flag country.<sup>111</sup> There is a separate collision norm applicable to the property rights which encumber the hullbuildings. According to art.7§3 these rights are subject to the law of the state where the hull is building. Accordingly, the mortgage which encumbers the hullbuilding is subject to the regulations of the Polish law. Therefore,

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<sup>110</sup> Polish Maritime Code of 2001, art.355.

<sup>111</sup> Ibid., art 355 §1.

the provisions of the Maritime Code will apply in most cases.<sup>112</sup> Mortgages or other rights which have entered the permanent ship register are subject to the law of the register's state.<sup>113</sup>

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<sup>112</sup> Ibid., art.7§4.

<sup>113</sup> Ibid., art.355§2.



## 10. ENFORCING THE MARITIME CLAIMS

Interested parties can decide that property litigation related to maritime claims can be subject to economic, civil, or arbitration courts. Maritime property litigation which results from Polish and international relations is usually subject to arbitration courts.<sup>114</sup> If the parties decide to subject the litigation to an arbitration court, then the state court will not be eligible to decide the case.<sup>115</sup>

In Poland there are two types of arbitration courts: courts called up by the parties to adjudicate certain litigation (*ad hoc*) and specialised permanent courts which proceed on the basis of statute and regulations. Maritime issues are adjudicated by the permanent courts called: International Arbitral Court for The Sea and Inland Shipping in Gdynia and Arbitral Court of The National Commercial Chamber in Warsaw. Rules in relation to arbitral courts are enclosed in the Code of Civil Procedure in art.695 – 715. Poland ratified the international multilateral agreements concerning international commercial arbitration. Among others: New York Convention of 10 June 1958 on Recognition and Performing the Arbitration Judgement and European Convention of 21 January 1961 on International Commercial Arbitration. The arbitral court's competence to adjudicate the dispute is the result of parties' contract" called "arbitration clause".<sup>116</sup> The arbitration clause has legal force even if the main contract is terminated, renounced, or becomes invalid or ineffective. The arbitration clause binds only the parties of the main contract. According to art.711 §2 of the Code, the judgement of the arbitral court and the concluded compromise have the same legal force as the judgement and the compromise concluded in the state court.<sup>117</sup> Imposing an execution clause results in the judgment of the arbitral court becoming an execution title which constitutes the basis of starting the execution proceeding.<sup>118</sup>

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<sup>114</sup> Jodlowski, *Civil Procedure*, p.37.

<sup>115</sup> Code of Penal Procedure of 1996, art.697 §2.

<sup>116</sup> *Ibid.*, art.698 §2.

<sup>117</sup> Code of Civil Procedure of 1964.

<sup>118</sup> *Ibid.*, art.776 and 777 §2.

## 11. CONCLUSION

The crediting of the shipbuilding is usually the international activities. Therefore there is a great significance of the rule of mutual recognition of the material encumbrances under the condition that they were established according to the flag law of the encumbered ship and disclosed in the public register. Some encumbrances exceed the legal area where they were established and they can appear in the area where they are not recognisable. That situation can cause certain practical and legal problems. Limited material rights constitute a crucial part of the international financial relations, especially concerning the building and selling of the ships. The development of maritime transport in the 19<sup>th</sup> century caused the need of the international uniformity of the rules governing the maritime liens and mortgages.<sup>1</sup> The effect of the CMI's works was the Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages.<sup>2</sup> This convention was ratified by Poland and more than twenty other countries. CMI has signed new convention in 1967<sup>3</sup>. This convention did not bring satisfactory results. The last Convention was formulated by the United Nations and International Maritime Organisation in 1993.<sup>4</sup> The Convention of 1926 is the only binding international legal act. The convention has been incorporated into the Polish Maritime Code.

With reference to the qualification of the ship and the ship's section, there are special regulations in laws which apply in relation to the hullbuilding. In Polish law, the Act on Real Estate Registers and Mortgages applies.<sup>5</sup> In its effect it is possible to secure the pre-delivery finance of the hullbuilding that is in the interest of each party to the contract.

The ownership right has crucial meaning for the parties to the hullbuilding contract. This is the widest right which gives the most powers of using the goods among all other rights in Polish law. The parties are free to decide that either the Norwegian yard or the Polish yard

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<sup>1</sup> Adamczak, *Maritime liens and Maritime Mortgage*. pp.17-23.

<sup>2</sup> Brussels Convention of 1926 .

<sup>3</sup> Brussels Convention of 1967

<sup>4</sup> Geneva Convention of 1993

<sup>5</sup> The Act on Real Estate Registers and Mortgages of 1982.

to be designated as the owner. The solution will depend on the individual contract. The moment when the property is transferred will depend on general law and on the terms of the hullbuilding contract. If the parties do not stipulate any specific time, the Polish Civil Code is applicable. Usually, the title to the goods passes simultaneously with the risk of casual loss of or damage of the goods. According to the general rule, the risk of loss or damage to the hull during its construction is carried by the hullbuilder unless the parties decide otherwise. This rule is consistent with the Polish Civil Code.<sup>1</sup> The procedure of “marking” allows identifying of the property which belongs to the Norwegian yard. “Marking” makes it easier for the owner to prove his title in the case of insolvency of the hullyard. As a consequence, the court may grant the Norwegian yard the right to withdraw the materials from the hullbuilder’s insolvent estate.

Each party to the hullbuilding contract needs to have the protection of its rights. It is in the interest of the Norwegian yard to have the hull built by the Polish hullyard. The security methods can be arranged by the registration, ownership rights, mortgaging the hull, the bank warranties and the bank guarantees. The hullyard is establishing the security of the payment of the contract price by the shipbuilder. The third party, which needs the protection of the bank or other financial institution, is providing the loan for the building of the hull.

Closely connected to the security of the hullbuilding are the rules concerning registration. Under the Polish law, there is the opportunity to register the hull under construction in the ship register. It gives the parties the possibility to secure the pre-delivery finance of the construction.

In case of mortgaging or pledging the hull under the Polish law, it is important to make a distinction between the debt and liability. They have two different meanings in Polish law.

The type of liability will depend on the form of security. There is personal and material liability. The personal liability for the debt is unlimited, which means that the debtor

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<sup>1</sup> Polish Civil Code of 1964, art.641.

is responsible by all his present and future property. In the case of mortgaging or pledging the hull, there is the material liability which is independent of the personal liability. Under this liability, the bank has an absolute and direct right to satisfy from the hull and the materials unless the debtor does fulfil his obligations.

I presented the different types of security which can be used by the parties to protect their interests. The various forms of security can be divided into two categories, the security *in rem* and the security *in personam*.

The maritime mortgage is regarded as a highly effective security and mortgage has a great importance as the means to secure the credit to purchase the hull, which is being built in the Polish shipyard. In Poland, the maritime mortgage has more considerable meaning in the foreign trade relations than in the internal relations. Recently the maritime mortgage is subject to the greater interest in Poland. The evidence is the Decree on the Ship Register which changed the Polish Maritime Code. The act enclosed the chapter on maritime mortgage which replaced the previous provisions which referred to the Civil Code regulations on mortgage. The previous lack of interest of the maritime mortgage was the result of the socialistic economy. At the moment, maritime mortgage is the main form for the security of the credit in the maritime business in Poland. It can definitely enhance the foreign shipyards to cooperate with the Polish shipyards in building the vessels and parts of the vessels. The institution of the maritime mortgage, which regulation does not differ much from the foreign regulations, what makes the maritime shipbuilding business easier and more transparent.

The other right which can be established on the hull under construction is the ordinary pledge. The rule that the encumbered chattel must be removed from the possession of the owner makes this right unpractical in the case where the Polish yard is established as the owner of the hullbuilding. The legal instrument which is more useful is the registered pledge. It is one of the forms of the pledge. The registration replaces the obligation of giving the pledged item away but the condition is that the hull under construction will not enter the ship register. Registered pledge facilitates the obtainment of the credit for the hullbuilding. This legal instrument can be useful for the Norwegian bank, which is financing the construction of

the hull. The institution of maritime liens is not taken into consideration in relation to the building of the hull as they can encumber only the whole vessel, not part of the vessel. Maritime liens have the role as means for increasing the satisfaction of the claims for damages instead of securing repayment of the credit.

The right which can secure the interest of the Polish yard is the right of retention. The basis of this right is the Polish Civil Code or the contract. The right of retention has the security function and additionally puts pressure on the Norwegian yard which is responsible for the payment to the Polish hullyard.

The bank guarantee and the bank warranty constitute the other forms of the security which are not the real security. These legal institutions strengthen the liability of the debtor in relation to the creditor. The Polish yard can establish bank guarantee or bank warranty for repayment of the installments. They constitute the security for the benefit of the Norwegian bank financing the hullbuilding. They can also create the security for the interest of the Norwegian yard.

Assignment of a bank guarantee and assignment of the hullbuilding contract can serve as the security in the case when the parties will not decide to register the hullbuilding. The Norwegian yard can require arranging the bank guarantee by the Polish yard. The hull financier can demand the assignment of the bank guarantee for the pre-delivery financing. The assignment of the hullbuilding contract can be established in the interest of the hull financier in the case when the Norwegian yard will not perform its obligations.

The security regime in Poland is well established and functions well, provided that the security is properly executed under Polish law and the enforcement rules are followed.

Parties are free to decide who will finance the hulbuilding. The solutions are different in various legal systems. In some countries, it is the builder who is providing the finance, and in others, the finance is found by the customer.

In the situation when the encumbered hull is being built by the Polish hullyard on behalf of the Norwegian shipyard the “conflict of law rules” included into Polish Maritime Code will indicate the applicable legal system. The function of the above rules has a great

meaning in the case of the question about the applicable legal system in the particular maritime relations with a foreign element.

The parties to the hullbuilding contract can decide to subject the property litigation relating to maritime claims to economic, civil courts or arbitration courts. It is very common to use the arbitration clauses in the contracts. In Poland there are specialized permanent arbitration courts and the courts called up by the parties to decide certain litigation.

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