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REGISTRATION OF SHIPS UNDER CONSTRUCTION IN PUBLIC REGISTERS

Summary

Maritime laws in a significant number of countries contain provisions governing the issue of registration of ships under construction in official public registers.

In certain countries registration of ships under construction and of the rights in such ships is compulsory. In other countries such registration is optional.

This paper deals with a number of important issues related to such registration, notably conditions for registration of ships under construction and of the rights in such ships required by the law; registration procedure; effect of registration regarding the ability of the parties to the shipbuilding contract and of the financiers to secure their rights and positions. Special attention shall be devoted to the question of acquisition and transfer of property rights in the ship under construction.

Provisions of the Croatian Maritime Code governing these matters shall be particularly elaborated and compared with applicable laws in some other countries.

Key words: register of ships under construction, transfer of property rights in the ship under construction

UPIS BRODOVA U GRADNJI U JAVNE UPISNIKE

Sažetak

Pomorski propisi značajnog broja zemalja sadrže odredbe koje uređuju pitanje upisa brodova u gradnji u službene javne upisnike.

U nekim državama upis brodova u gradnji i prava na tim brodovima je obavezan. U nekim drugim zemljama takav upis je neobavezan.

Ovaj rad bavi se nizom važnih pitanja koja se odnose na taj upis, kao što su: zakonski uvjeti za upis brodova u gradnji i prava na njima, postupak upisa, kao i utjecaj upisa u pogledu sposobnosti stranaka iz ugovora o gradnji broda i investitora da osiguraju svoja prava i položaj.

Posebna pažnja bit će posvećena pitanju stjecanja i prijenosa stvarnih prava na brodu u gradnji.

Odredbe Pomorskog zakonika koje uređuju ovu materiju bit će posebno prikazane i uspoređene s relevantnim propisima nekih drugih država.

Ključne riječi: upisnik brodova u gradnji, prijenos stvarnih prava na brodu u gradnji

1. Introduction

Realization of shipbuilding contracts requires considerable financial resources. Partial or complete failure of one of the parties (shipbuilder or a customer) to fulfil his obligations may cause a significant loss to other contracting party. Furthermore, in such circumstances, loss may be suffered also by the financier of the construction of the ship, which need not necessarily be the party to the contract.

On the other hand, performance of the shipbuilding contract lasts for a certain period of time. Legal certainty requires creation of legal framework governing property status of the ship under construction during this period. It is necessary to regulate which person has the title over the ship under construction, as well as what are possible rights of others persons. These issues are closely connected to the response to the question whether the ship under construction by itself may represent a satisfactory security for claims arising under the shipbuilding contract. Although the shipbuilding contract represents the primary legal source governing relations between the parties, it is necessary to know provisions of other relevant sources of law - international agreements and applicable national legislation. They also represent parts of the legal framework governing this matter. It is desirable for the parties involved to be familiar with all mentioned sources of law even before the negotiations related to the shipbuilding take place. Provisions of relevant international agreements and national legislation may have the influence on the creation of contractual clauses. For example, it is not unusual that some contractual provisions are created in order to avoid the possible application of "unattractive" provisions of certain national law.

An important part of the above mentioned legal framework is the institute of the registration of ships under construction (and of the rights established over them) in public registers, *i.e.* registers of ships under construction. This institute may be found in many jurisdictions. It exists under Croatian law too. Therefore, it is useful for the stakeholders to know the solutions of Croatian law regarding this institute in order to compare these solutions with applicable laws in other countries and to determine the compliance of Croatian domestic law with applicable international agreements. That is the goal of this paper.

2. Definition of ship under construction

Pursuant to Article 5/29 of Croatian Maritime Code (hereafter - CMC), ship under construction encompasses shipbuilding from the moment of laying the keel or similar activity in shipbuilding up to its entry in the register of ships¹. Therefore, the moment of the origin of a ship under construction is connected to specific technical (shipbuilding) activity. On the contrary, the moment of the cessation of a ship under construction is connected to specific administrative activity - its entry into the register of (existing) ships².

Ship under construction is a movable thing (CMC, Article 208). Furthermore, it is expressly stated that property rights and particularly right of ownership, mortgage and maritime liens may be established in respect of a ship under construction.

¹ See „Narodne novine“ (Official Gazette) No. 181/2004, 76/2007, 146/08, 61/2011. Pursuant to Article 196 of the CMC, there is a separate type of register for each type of maritime objects under construction - register of yachts under construction, register of floating facilities under construction and register of fixed off-shore facilities under construction. As far as the international sources are concerned, it should be noted that the Convention relating to Registration of Rights in Respect of Vessels under Construction, signed in Brussels, on May 27th, 1967 (hereafter - 1967 Convention) contains no definition of ship under construction. This Convention has never entered into force.

² Under English law, ship under construction is a future good with description. Therefore, during construction there is no ship.

3. Conditions for registration of ships under construction in register of ships under construction

Registration of ships under construction into Croatian register of ships under construction may be compulsory or optional (CMC, Article 189)³.

Registration is required in respect of a ship under construction which is entirely owned by a natural or legal person who is a Croatian citizen with residence or registered seat in the Republic of Croatia⁴.

Optional registration is prescribed in respect of a ship being built in a Croatian shipyard and owned by a foreign natural or legal person⁵.

Comprehensive set of rules governing procedure for registration of (existing) ships in the respective registers are contained in Articles 253-383 of CMC. If otherwise is not expressly stated in CMC, these rules shall accordingly be applied to ships under construction⁶.

The example of the special procedural provision of CMC applying only to ships under construction is contained in Article 314. Pursuant to this provision, the first registration in a register of ships under construction shall be permitted by the port authority (Harbour Master's Office maintaining the register of ships under construction where the ship under construction is to be registered), if the application or proposal for such registration is accompanied by the following documents:

- 1) a document proving the ownership in the ship under construction,
- 2) a certificate of the shipyard pertaining to technical data which are to be registered in folio A of the register of ships under construction, and the place and commencement date of construction,
- 3) a statement from the owner of a ship under construction regarding the name of said ship under construction, or, if the ship has no name, a statement from the shipyard regarding the designation of the ship under construction⁷.

³ Each register of ships under construction is maintained by the Harbour Master's Office in respect of ships being constructed in a shipyard located within the jurisdiction of respective Harbour Master's Office.

⁴ Although it is not expressly stated in Article 189/1 of CMC, this rule applies in respect of a ship being built in a Croatian shipyard.

⁵ A principle of possible but not compulsory registration is adopted in the 1967 Convention and in some other jurisdiction, for example in Finland, Norway and Canada.

⁶ All entries, including registration of ships under construction, shall be made on the basis of rulings by the competent port authorities (Harbour Master's Office), with the exception of those under the jurisdiction of courts as stipulated by CMC.

⁷ The register of ships under construction, similar as other registers established by the provisions of CMC, consists of a general register and collection of documents. The general register consists of files. A file consists of sheets (folios) A, B and C. By way of exception, a file of the general register of public ships consists only of folios A and B. Every ship under construction shall be entered in a separate file. Particulars on the identity of a ship under construction and its main technical characteristics shall be entered on folio A. The company name and seat or name and residence of the natural person who owns the ship under construction and the personal restrictions of the owner regarding free use of the ship under construction shall be entered on folio B of the file. The name of the company and its seat or name and residence of the ship operator or the customer may be entered on folio B of the file from the register of ships under construction. Charges over the ship under constructions and other restrictions regarding disposal of the ship under construction shall be entered on folio C of the file.

4. The effects of registration

Very important effect of registration of ships under construction is related to the acquiring and transfer of property rights over them. More precisely, rules of CMC governing matters of acquiring and transfer of the property rights over existing ships applies also to the ships being built in Croatian shipyards *from the time of their registration in the register of ships under construction* (CMC, Article 216).

Therefore, from the moment of the registration of a ship under construction in the register, ownership or any other property right over it which is acquired on the basis of a legal transaction (for example, on the basis of contract) shall be valid only if such transaction has been made in writing. A legal transaction that has not been concluded in writing shall have no legal effect.

Although there is no express provision in CMC governing this issue, it seems that the abovementioned “in writing principle” regarding validity of legal transactions related to the property rights does not apply to the transactions carried out before the registration, i.e. from the moment of origin of the ship under construction (laying the keel or similar activity in shipbuilding) until its (possible) registration into the register of ships under construction. In such cases, general provisions governing matters of acquiring and transfer of property rights over movables shall apply⁸.

Furthermore, the ownership and other property rights (with the exception of maritime liens) *over a registered ship under construction* may be acquired, transferred, limited or ceased only by an appropriate entry in the respective register⁹.

It must be recalled that, under the Article 970 of CMC, Croatian law shall apply to title and property rights to the ship under construction that is being constructed in the Republic of Croatia.

5. Registration of property rights

5.1. Right of ownership

Unless stated otherwise in the shipbuilding contract, a ship under construction shall be deemed the property of the shipbuilder (CMC, Article 432). Therefore, parties to the shipbuilding contract are free to create different solutions. For example, they may agree that a ship under construction is owned by the customer. Furthermore, it may be stipulated in the contract that the title shall be transferred from the shipbuilder to the customer at a specific

⁸ This probably may be only a theoretical issue. It is hard to imagine that parties to the agreement on transfer of property rights over the ship shall cease to create a writing contract and provide that any future changes of the said contract shall be made in writing. Furthermore, it seems that under Croatian law it is not possible to register a (future) ship prior to the beginning of the construction. That follows from the CMC provision that the moment of origin of the ship under construction is the moment of laying the keel or similar activity in shipbuilding. In a legal sense, before such activity has been carried out, ship under construction does not exist. There are different solutions in other jurisdictions regarding this issue. For example, under Article 3/3 of the Finnish Register of Ships Act, ships may be entered in the register of ships under construction even prior to construction, provided that they can be identified by their yard number and drawings or in some other reliable way.

⁹ However, there are some further exceptions from described principles, which are enumerated in Article 215 of CMC. Besides the introducing of the “registration proprietary system” over the registered ship under construction, the further effect of registration is related to the fact that a ship under construction registered in Croatian register acquires Croatian nationality (CMC, Article 211/1).

moment or/and if some specific circumstances (contractual obligations) are fulfilled¹⁰. There are differences regarding regulation of this issue in various jurisdictions [1]. However, if the ship is registered, such transfer of ownership may be finally carried out only by an appropriate entry into the register.

Pursuant to Article 212 of CMC, the title over a ship under construction encompasses things built into such a ship. Unless otherwise entered into the register of ships under construction, the right of ownership over a ship under construction shall also encompass things located in the shipyard that have not been built into the ship under construction, if at least one of the following two conditions is fulfilled:

- according to their manufacture, they are exclusively intended for being built into that particular ship under construction (*exclusive purpose criteria*), or
- they have been distinctly identified or set aside with the intention of being incorporated in that particular ship under construction (*exclusive identification/location criteria*)¹¹.

5.2. Charges

CMC expressly stipulates that mortgages and maritime liens may be established in respect of (*inter alia*) ships under construction (Article 209).

In addition to this general provision, there is a special rule contained in Article 252, pursuant to which provisions of CMC governing mortgages and maritime liens on existing ships shall also apply to ships under construction *when afloat*¹².

Moreover, in respect of mortgage there is a "super special" provision contained in Article 235. Pursuant to that rule, provisions of CMC dealing with mortgages on (existing) ships shall also apply to mortgages on ships under construction *entered in the register of ships under construction*. Therefore, mortgage over the registered ship under construction may be created only by an appropriate entry into that register¹³.

Under Article 219 of CMC, ship mortgage is a right entitling mortgagee to satisfy his claim from the price of a ship obtained by judicial sale or extrajudicial sale or by taking possession and use of a ship. Parties to the contract may exclude some of mentioned rights of a mortgagee.

Ship mortgage may be established either under a contract or a court decision. General rule is that a ship mortgage shall not be extinguished by a change of the shipowner¹⁴.

The meaning of provisions of CMC governing this issue is that the mortgage on ships under construction should secure mortgagee's claim in the same manner and to the same extent as the mortgage on existing ships¹⁵.

¹⁰ For example, it may be stated in the contract that the title shall pass to the customer at the moment of delivery of the ship; or at the moment when total amount of the building price has been paid.

¹¹ The 1967 Convention in Article 8 prescribes that national law of a Contracting State may provide that the registered rights on a ship 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 ship. Therefore, the scope of this provision is not limited to the right of ownership.

¹² Article 7 of the 1967 Convention stipulates that the ranking between registered mortgages and "hypothèques" on vessels under construction on the one hand and liens and rights of retention on such vessels on the other hand shall be determined according to the rules applicable to vessels registered after completion.

¹³ *Supra*, fn. 7.

¹⁴ Some exceptions from this general rule are enumerated in Article 236 of CMC.

Registration of maritime lien is not a condition for its existence. Therefore, such registration is not mandatory under CMC. Detailed provisions governing this issue are contained in Articles 241-252.

Pursuant to Article 437 of CMC, the shipbuilder shall be entitled to retain the ship under construction at the shipyard until payment has been completed pursuant to the contract on ship construction.

Registration of builder's right of retention is not necessary in order such right to be established under Croatian law.

CMC does not specify which powers may be executed by a shipbuilder retaining the ship under construction in order to satisfy his unpaid claim. Therefore, general rules of Croatian law governing right of retention should be applied. Pursuant to Article 74 of the Law on Obligations, the creditor whose claim is secured by the right of retention shall be entitled to satisfy his claim in the same way as the creditor whose claim is secured by a lien¹⁶. It means, *inter alia*, that shipbuilder is entitled to sell the ship. He is obliged to inform debtor in time about his intention to enforce this power [2].

It should be noted that, under Article 912 of CMC, in case of judicial sale of ship in enforcement proceedings, creditors' claims shall be settled according to the following order of priority:

- 1) creditors whose claims are secured by maritime lien,
- 2) creditors with the right of retention, as specified in Article 437 (shipbuilders, shiprepairers)¹⁷,
- 3) creditors whose claims are secured by a ship mortgage,
- 4) other creditors.

6. Registration of inland navigation vessels

Primary Croatian domestic source of law in respect of inland navigation is Law on Inland Navigation and Ports (hereafter – LINP)¹⁸. CMC shall apply in respect of issues which are not regulated by LINP.

LINP contains special provisions in respect of registration of inland navigation vessels in appropriate registers (Articles 79-103). These rules mainly govern registration procedure.

¹⁵ Ship mortgage is more precisely regulated by Articles 212-240 of CMC. Furthermore, provisions governing registration procedure in respect of all property rights (including mortgage) are contained in Articles 253-383. It should be noted that, under Article 260 of CMC, the entry of a ship mortgage into the register shall contain at least following particulars: the monetary sum of the claim secured by mortgage; the amount of interest if it is to be paid in conjunction with the claim; and the firm, i.e. the name and seat (or the name and residence) of the mortgagee.

¹⁶ Law on Obligations, Narodne novine (Official Gazette) No 35/2005, 41/2008. A lien should be understood in a broader sense, pursuant to the definition of such right in Croatian general law.

¹⁷ Under Croatian law, right of retention exists only over things belonging to the debtor. Therefore, if the owner of a ship under construction is a shipbuilder, there is no right of retention in a "classical" mean, as defined by the Law on Obligation because shipbuilder is holding his own (and not debtor's) thing. However, Article 437 of CMC should nevertheless apply to this situation. In described circumstances right of retention established by Article 437 should be understood as a kind of "pressure method" used by a shipbuilder in order his claim to be paid. Simply, the builder, pursuant to Article 437, does not have to deliver a ship to the customer if his due claim is not paid as stipulated by shipbuilding contract.

¹⁸ Narodne Novine (Official Gazette) No 109/2007, 132/2007.

They are created under the same principles as provisions of CMC regulating registration of seagoing ships.

One of the registers introduced by the LINP is register of inland navigation vessels under construction.

The inland navigation vessel under construction is defined as the building of the vessel from the laying the keel or similar activity in shipbuilding up to its entry in the register of vessels.

There are some important differences between registration regimes established by CMC and LINP. For example, it should be noted that pursuant to Article 82 of LINP, registration of inland navigation vessel under construction is always optional. It shall be carried out only upon the possible request of the owner of the vessel¹⁹.

However, the most important source of law regarding this issue is 1965 Convention on the Registration of Inland Navigation Vessels (hereafter – 1965 Registration Convention) with two annexed Protocols – Protocol No. 1 concerning rights *in rem* on inland navigation vessels and Protocol No. 2 concerning attachment and forced sale of inland navigation vessels. The 1965 Registration Convention entered into force on June 24, 1982. State Parties to the 1965 Registration Convention are: Austria, Belarus, Belgium, Croatia, Luxembourg, Montenegro, Netherlands, Serbia and Switzerland [3]. Croatia is bound by the 1965 Registration Convention as well as by its two Protocols.

Pursuant to Article 5 of the 1965 Registration Convention, each Contracting Party may lay down the conditions under which a vessel under construction in its territory may or must be registered in its registers. A vessel under construction in the territory of a Contracting Party may not be registered elsewhere than in the registers of that Contracting Party.

Both Protocols contain express provisions that they shall apply to rights *in rem* in any vessel used in inland navigation, even if it is under construction²⁰.

Pursuant to provisions of Protocol No. 1, the only rights *in rem* that may be established over the vessels are: ownership, usufruct, mortgages and liens. However, the Contracting Parties may attach the effect of a right *in rem* to attachment.

The Contracting Parties shall arrange for the entry of the rights of ownership, usufruct or mortgage over the vessel in the register in which that vessel is registered. Rights of ownership, usufruct or mortgage entered in a register of one of the Contracting Parties shall be recognized in the territory of the other Contracting Parties.

Furthermore, a mortgage shall extend to all objects permanently attached to the vessel by virtue of the purpose they serve and belonging to the owner of the vessel. Nevertheless, the law of the country of registration may permit agreements between the parties which provide otherwise.

Protocol No. 1 contains comprehensive provisions regarding liens on inland navigation vessels (Articles 11-18).

CONCLUSIONS

Registration of seagoing ships under construction is regulated primarily by the provisions of CMC. Pursuant to these provisions, registration of a ship under construction which has been built in Croatian shipyard may be either mandatory (if the ship is entirely

¹⁹ However, in practice the registration is necessary in order to register property rights over the vessel.

²⁰ Article 2 of Protocol No. 1 and Article 2 of Protocol No. 2.

owned by a natural or legal person who is a Croatian citizen with residence or registered seat in the Republic of Croatia) or optional.

It is possible to establish property rights on ships under construction. Once the ship under construction has been registered, the “registration principle” shall apply in respect of acquiring and transfer of property rights over such ship (with the exception of maritime liens). All legal transactions aiming at acquiring or transfer of the property rights on the registered ship under construction must be made in writing.

Provisions of CMC governing matters of registration of ships under construction and property rights on such ships are created under the “model” of the 1967 Convention.

As far as the registration of inland navigation vessels is concerned, provisions of the 1965 Registration Convention with two annexed Protocols are of particular importance.

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