



IMO
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**MARITIME LIENS IN BANKRUPTCY
PROCEEDINGS: A LEGAL ANALYSIS OF THE NEED
TO HARMONIZE AND AMEND THE MONTENEGRIN
LEGISLATION**

**A Dissertation submitted in partial fulfillment of the requirements for the award of
the Degree of Master of Laws (LL.M.) in International Maritime Law at the IMO
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TABLE OF CONTENTS

<i>Acknowledgements</i>	iii
<i>Table of cases</i>	iv
<i>Abbreviations</i>	v
1. CHAPTER I - INTRODUCTION	1
2. CHAPTER II – MARITIME LIENS IN A NUTSHELL	
<u>2.1. Historical Origins</u>	4
<u>2.2. Definition, characteristics and legal nature</u>	5
<u>2.3. International framework</u>	8
2.3.1. <i>The 1926 MLM Convention</i>	8
2.3.2. <i>The 1967 MLM Convention</i>	9
2.3.3. <i>The 1993 MLM Convention</i>	10
<u>2.4 Enforceability - the major feature of maritime liens</u>	11
2.4.1. <i>Actio in rem</i>	11
2.4.2. <i>Attachment</i>	12
2.4.3. <i>Arrest conventions and their impact on enforcement of maritime liens</i>	12
2.4.4. <i>Common aspects of enforceability</i>	14
<u>2.5 Maritime privileges under Montenegrin legislation</u>	15
3. CHAPTER III -OVERVIEW OF BANKRUPTCY LAW	
<u>3.1. The nature and purpose of bankruptcy procedure</u>	17
<u>3.2. International background</u>	18

3.3. Bankruptcy procedures under Montenegrin legal system.....19

4. CHAPTER IV - POSITION OF MARITIME LIENS UNDER BANKRUPTCY PROCEEDINGS

4.1 General issues and conflicting points.....23

4.2 Comparative solution analysis.....24

4.2.1. Germany.....24

4.2.2. The United Kingdom.....25

4.2.3. Malta.....26

4.3 Particular problems recognized in Montenegrin laws and practice.....26

5. CHAPTER V - CONCLUSIONS AND RECOMMENDATIONS.....32

6. BIBLIOGRAPHY35

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TABLE OF CASES

Aro Co. Ltd [1980] 1 All ER 1067.....	23
Bold Buccleugh, The (1851) 7 Moo PC 267.....	14
Bolivia, The [1995] BCC 666.....	25
HIH Casualty & General Insurance Ltd [2008] 1 W.L.R.....	23
Indian Grace No.2, The [1998] AC 878 1 Lloyd's Rep 1.....	12
Luke v. Lyde (1759), 2 Burr 882, 97 ER 614 (KB).....	11
Marrama v. Citizens Bank of Massachusetts, 127 S.Ct. 1105 (2007).....	17
Mary Anne, The (1865) 9 Jur.194.....	6
Riffe Petroleum Co., L. Rep. P 67,195.....	2
Rio Grande do Sul Steamship Company (1877), 5 Ch D 282.....	23, 25
Tolten, The [1946] P.135.....	2, 7

ABBREVIATIONS

The 1952 Arrest convention	The 1952 International Convention Relating to the Arrest of Sea-Going Ships
The 1999 Arrest Convention	The 1999 International Convention on Arrest of Ships
The 1926 MLM Convention	The 1926 International Convention for the Unification of Certain Rules Relating to Maritime Liens and Mortgages
The 1967 MLM Convention	The 1967 International Convention for the Unification of Certain Rules Relating to Maritime Liens and Mortgages
The 1993 MLM Convention	The 1993 International Convention on Maritime Liens and Mortgages
The MLM Conventions	The 1926, 1967 and 1999 MLM Conventions
The LMIN	The Law on Maritime and Inland Navigation of Montenegro 2008 as amended in 2011 and 2013
The LOB	The Law on Bankruptcy of Montenegro 2011 as amended in 2016
CMI	The Comité Maritime International
COMI	Debtor's center of main interests
IMO	International Maritime Organization
UNCITRAL	The United Nations Commission on International Trade Law

CHAPTER I

INTRODUCTION

“Nothing is covered up that will not be revealed, or hidden that will not be known”
Luke 12:2-3

The shipping industry is almost entirely an international business, where various legal and commercial interests are interlaced, irrespective of boundaries, jurisdictions and different legal regimes. The transnational character of ships is reflected not only in their voyages, but in the diversity of owners, charters, managers, operators and crew, who are usually not of the same nationality as the ship herself. Those who are in charge of a ship enter many legal relations which are necessary for her operation overseas, or which emerge as a consequence of such operations, undertaking obligations and liabilities arising therefrom.

As any property, the ship is at the disposal of its owners, who often use it as a security for their financial transactions. But that does not mean that a ship can be burdened only on a voluntary basis. Ships are indeed a very special type of chattel, and in order to achieve their purpose they become inseparable from those working and living on it. A ship is also a carrier of the business activity of its holder. Therefore, security interests on a ship can arise also from operation of general law or as a result of enforcement of maritime claims. Even more, a ship, under specific circumstances, can be liable without any personal liability of her owner. Thus, the legal rules and approaches to securing interests in ships, whether for a secured creditor or a general maritime claimant, will adapt to that international and maritime environment.¹

Depending on the bases of their creation, security rights on ships can be distinguished into: contractual security rights (mortgages, hypothecs etc.), security rights created by the operation of the law (maritime liens or privileges) and the ones created through enforcement of maritime claims. Those created by the mere operation of maritime law are maritime liens. A maritime lien is a unique security device which serves the dual purpose of keeping ships moving in commerce while not allowing them to escape their

¹James Leslie Bain Allsop, ‘Security Interests in Ships’, in D. J. Attard etc. (eds), *The IMLI Manual on International Maritime Law, Vol. II: Shipping Law* (Oxford University Press 2016), 152, 153.

debts by sailing away.² It is a long standing concept of securing creditors of maritime claims, and by its wide recognition, it has become fully embedded in general maritime law. The jurisprudence even considers maritime liens as “one of the first principles of the law of the sea”.³ Nowadays they play an important part in most maritime jurisdictions, by being provided in national laws, or simply by their recognition in case law.

The reason why this relatively old legal concept still plays a significant role in securing the creditors lies not only in its international familiarity, but also in its informality, durability and efficacy. From the moment a service is rendered to or damage is done by the ship, the creditor is provided with a security right in the ship, which can be confronted to other creditors of same or different kind and exercised through an action *in rem*.⁴ Even though primarily used as a kind of pressure to a shipowner to take part in litigation, if no other way of payment is provided, actions against the ship herself eventually lead to her judicial sale and satisfaction of creditor’s claim. The types of claims giving rise to maritime liens can vary between different legal systems, but their number is always limited, and position and rules of ranking are provided on the national level.

A maritime lien is, as far as maritime objects are concerned, the supreme security device.⁵ Therefore, it always takes priority over other security rights thereto.⁶ Their supremacy is guaranteed under rules of national or international law. Nevertheless, it seems like that protection of maritime creditors is not always easily reachable, especially when the shipowner faces financial difficulties and insolvency. The bankruptcy of the shipowner will subject all its assets to the bankruptcy estate and therefore subject to judicial sale and distribution to the bankruptcy creditors. At that moment, both Admiralty and Bankruptcy law come into play, but, it may be the case that only one regime will be applicable for the satisfaction of creditors having maritime liens on the ship which belongs to a bankruptcy debtor. That is because the enforcement of maritime liens and bankruptcy procedures have the same aim: selling the ship in order for creditors’ claims to be settled. However, they are often applied in different courts and attract different procedures, and the rules for determining secured creditors and their priorities do not

² *In Re Riffe Petroleum Co.*, US District Court 4th Northern District of Oklahoma, 601 F.2d 1385 (10th Cir. 1979), L. Rep. P 67,195.

³ *The Tolten* [1946] P.135, *per* Scott L.J.at 144, as quoted by D.R. Thomas in *Maritime Liens* (London: Stevens, British shipping laws, v.14 1980) 2.

⁴ See more in *Ibid* 4.

⁵ Michael J. Ende, ‘A drift on a Sea of Red Ink: The Status of Maritime Liens in Bankruptcy’ (1988) *Fordham International Law Journal* 11 (3), 573, 575.

⁶ National legislation may however determine that other claims (as the late Professor William Tetley refers to them - ‘Special Legislative Rights’), such as *custodia legis*, will outrank claims secured by maritime liens.

usually correspond. In such a situation two categories of secured creditors are distinguished – maritime and bankruptcy creditors, who often compete with each other. In any case, the value of a ship as an asset is exhaustible and usually insufficient for the satisfaction of all creditors.

Therefore, it is necessary to determine whose security rights over the ship will prevail. Who will be given priority: the maritime lienees or secured creditors in the terms of bankruptcy law? Can the ship remain ‘untouched’ even in situations where all the assets of the company fall into hands of a bankruptcy administrator? Which court in case of the shipowner’s bankruptcy will have jurisdiction over the sale of the ship and the satisfaction of creditors’ claims?

The purpose of this research is to give answers to the above questions, by analysing parallel legal regimes and their coexistence, as well as to come up with desirable solutions to the conflict of applicable laws in Montenegrin legal practice. But first of all, it is indispensable to delve deeper into the very nature and purpose of maritime liens, having in mind that their proper understanding will justify the priority given to them worldwide. By highlighting their background and aim, it would be easier to bring them into the context of other types of creditors’ rights, and realise to which extent, if at all, they reflect bankruptcy procedures.

Therefore, Chapter II will give an overview of maritime liens, from the perspective of their historical origins and definitions, international background and treatment they have in various legal regimes, their enforcement mechanism as well as how they are regulated under Montenegrin law. Chapter III will explain the basis of bankruptcy proceedings, their purpose and international background, concluding with an analysis of the bankruptcy system in Montenegro. After that, Chapter IV will bring together two different systems of securing and satisfying creditors’ claims over the ship, basically by exposing their main conflicting points. It will also shed light into the solutions found in legal systems of countries with rich maritime tradition, indicating ways of resolving potential conflict of laws which were crystalized by the practice of their courts. Chapter IV will highlight the existing legal gaps in Montenegrin law and the difficulties met in practice with regards to the position of maritime liens in bankruptcy proceedings, whilst recommended solutions are to be comprehended together with final conclusions given in Chapter V.

CHAPTER II

MARITIME LIENS IN A NUTSHELL

2.1. Historical Origins

Before going into particular segments of their historical recognition, it is important to clarify one common misunderstanding about maritime liens. It was often thought that maritime liens are a creation of the common law and as such, known only in countries with English law tradition. Such misconception probably comes from the legal nature of maritime liens which basically gives rise to procedure against the ship herself. That concept as such was always being connected with the procedures *in rem* under common law, which procedures remained unfamiliar to civil law countries who knew only the *actio in personam*. However, the issue is more of terminological nature. What is considered as a maritime lien in the common law system, it has been long known in the civil law system as maritime privilege. It is rather curious that English law recognized maritime liens relatively late, after it was established in legislations of the Continent. As Scott, L.J. pointed out in *The Tolten*: “The phrase ‘maritime lien’ was not the original expression in our admiralty diction. We borrowed from the French, who had in their word ‘privilege’ a clearer and less ambiguous name... there is no difference of meaning... between the ‘privilege’ of Continental law and our maritime lien”.⁷

Some authors argue that first reference to liens (privileges) in maritime law can be found in ancient Greek law, in the case of *Zemonthemis v. Demon*, where it was declared that a master in a foreign port could hypothecate the ship and cargo not belonging to him.⁸

Roman law knew a few types of security rights on ships, codified in the Digest of Justinian. The nautical loan (later known in English law as *bottomry*) encumbranced the ship, and the security would extinguish if the ship was lost. Also, in case where the value of the ship was not sufficient to pay the whole loan with interest, the lender would also have a security right over the goods in the ship (cargo).⁹

⁷ As quoted by William Tetley in *Maritime Liens and Claims* (1st edition, Business Law Communications, London, 1985), 40.

⁸ Tetley cites Sir Paul Vinogradoff from F. R. Sanborn’s *Origins of the Early English Maritime and Commercial Law*, Ibid 2.

⁹ Alan Watson, *The Digest of Justinian*, Vol.2, Book 22, (Philadelphia: University of Pennsylvania Press, 1998), 185.

Another type of maritime lien existed for the security of a loan given for ship's repair,¹⁰ as well as for the building, purchase, fitting out, or equipment of a ship.¹¹

The principles of Justinian were codified under the Byzantine law known as *The Basilica* in the ninth century A.D., and also well-known in medieval Italian City maritime codes.¹² The Rules of Oleron (Rôles d'Oléron), dating from the end of 12th century and deemed to be one of the first codification of modern maritime law, established the right of a master to pledge the ship's equipment for obtaining the money for the operation of a ship.¹³ The compilation made of Consuls' decisions known as Consolato del Mare (1494) refers to seafarer's wages secured on the ship, cargo and freight.¹⁴

On the other hand, the English law tradition was highly marked by centurial conflicts between common law courts and admiralty courts. As Sir Thomas Scrutton summed up in *Roman Law Influence in Chancery, Church Courts, Admiralty and Law Merchant*, the foundations of Admiralty are to be found: 1. In the Civil Law, as embodied in the Law Merchant, especially in the Laws of Oleron, or introduced by subsequent clerical judges, mainly in procedure and 2. In the subsequent written and customary rules, adopted in the view of the developments of commerce.¹⁵ One of the very first judicial references to the liens was given in *Hartfort v. Jones* (1698), where the security was recognized in favour of the salvor.¹⁶

2.2. Definition, characteristics and legal nature

It is considered that maritime lien is a *sui generis* concept of maritime law, for practical purposes considered as a charge upon maritime property, arising by operation of law and binding the property even in the hands of *bona fidae* purchaser for value and without notice, which can only be enforced by an Admiralty claim *in rem*.¹⁷ It has also been said that "first and foremost, the maritime lien is a species of maritime claims enjoying priority ranking as against other claims which are not recognized as

¹⁰ Ibid 133.

¹¹ Alan Watson, *The Digest of Justinian*, Vol.4, (Philadelphia: University of Pennsylvania Press, 1998), 69.

¹² According to Tetley, The Code of Trani dates to 1063, the Code of Amalfi to 1160 and the Code of Pisa to 1160.

¹³ See Tetley (n7) 9.

¹⁴ Ibid 13.

¹⁵ Ibid 25.

¹⁶ See Tetley in parenthesis on page 38, Ibid.

¹⁷ Nigel Meeson and John A. Kimbell, *Admiralty Jurisdiction and Practice*, 5th edition (Lloyd's Shipping Law Library), 19.

maritime liens”.¹⁸ D. R. Thomas identifies six fundamental characteristics of a maritime lien and describes them as follows:¹⁹

1) a privileged claim or charge

Maritime lien represents a privilege of its holder over other types of creditors. Therefore, in most maritime policies, maritime liens maintain the highest position in ranking of claims, over mortgages, possessory liens and statutory rights of action in rem.²⁰

2) upon maritime property

Traditionally, considered to be a maritime property were: ship, her appurtenances, cargo and freight, or other property once associated with a ship and the maritime adventure on which she was employed. According to the English Law, bottomry maritime lien will attach to the ship, freight and cargo; damage maritime lien to the ship and freight; salvage maritime lien to the ship, freight, cargo, flotsam, jetsam, lagan, derelict and wreck, while wages and disbursement will attach to the ship and freight. However, the concept has been extended by the statute so as to include aircraft, when waterborne, and hovercraft, and property associated therewith.

3) for service render to it or damage done by it

The main *ratio* for the supremacy given to the maritime liens lies in the fact that they secure claims for service render to or damage done by the ship. However, the list of maritime liens is limited, not all such services or damages are secured by the maritime lien. English law traditionally recognizes as so called maritime liens proper: Damage done by a ship; Salvage; Seafarer’s wages (including Master’s wages), Master’s disbursements and Bottomry and Respondentia.²¹

4) accruing from the moment of the events out which the cause of action arises

Unlike other types of security rights which dependent on the contract or judicial procedure, maritime liens arise from the moment “the circumstances gave birth to it”.²² In case of damage and salvage, it would be from the moment damage or injury is caused by the offending ship, or from the time successful salvage services are rendered to the ship.

¹⁸ Ibid.

¹⁹ Thomas (n.3) 11-15.

²⁰ Ibid, Chapter 9.

²¹ See more in Tetley (n7), Part III – *Traditional Maritime Liens*.

²² *The Mary Ann* (1865), as quoted by Thomas (n.3) 13.

5) travelling with the property secretly and unconditionally

Described as invisible, secret, indelible or inalienable incumbrance,²³ maritime liens are rights on the ship which will not be affected with a change of its ownership (except when such ship is sold in a judicial sale).

6) enforced by actio in rem

The possibility to enforce the claim by the *actio in rem* is of great practical significance, because it gives rise to arrest the encumbered property and its subsequent judicial sale out of which the claim will be satisfied.

The main purpose of maritime liens is to confer a privileged security right over the property to which they attach. That means that maritime liens have a nature of a real security rights, acquired on a maritime property to secure an existing underlying claim. Such right, therefore, does not entail the transfer of title or possession, moreover, maritime liens exist irrespective of title or possession over the *res*. As recognized in theory,²⁴ there are two substantive elements of maritime lien: it is the proprietary charge which encumbrances the *res* from the moment it arises and it is a right in rem whereby the charge is crystallised or perfected.²⁵

However, the question whether a maritime lien is a substantive or procedural right gave rise to many divergences in theory but also in practice of different States, particularly when conflicts of laws take place. For example, according to English jurisprudence, unlike in other jurisdictions which do not follow such jurisprudence, the maritime lien is a question of remedy and therefore governed by *lex fori*.²⁶ That means that the foreign maritime lien will be recognized by the Admiralty Courts of England only if it is recognized as such under the substantial English law.²⁷ It could be of relevance to point out that International Conventions on Maritime Liens, which would be more elaborated in the next sub-chapter, implicitly recognize that maritime liens represent both substantial and procedural rights.²⁸

²³ Thomas (n.3) 14.

²⁴ Ibid 22.

²⁵ Ibid

²⁶ Ibid 23.

²⁷ However, the jurisprudence has not shown complete uniformity. In already mentioned case of *The Tolten*, Scott L.J. expressed the view that “the lien consists in the substantive right of putting into operation the Admiralty Court’s executive function of arresting and selling the ship.”

²⁸ Especially Article 16 of the 1926 MLM Convention which states: “Nothing in the foregoing provisions shall be deemed to affect in any way the competence of tribunals, modes of procedure or methods of execution authorized by the national law”.

2.3. International framework

The widespread acceptance of security interests over the ships sailing all over the world brought to attention the variety of national regimes on maritime liens. Especially insurmountable were (and still are, to some extent) differences in maritime liens recognized in common law from the ones of civil law tradition. During the past century, the continuous attempts of the international community to overcome such differences and create a uniform regime of maritime liens and other security rights on ships resulted in three international conventions.²⁹ Even though the Conventions have not been widely ratified, their importance is reflected in the great influence they have made on various national laws. The lack of success in reaching agreement may reflect the differences in national laws as to what claims give rise to a lien, rather than the characteristics of a lien.³⁰ A brief overview of the main features of the mentioned Conventions follows hereunder.

2.3.1. The 1926 MLM Convention

The claims giving rise to maritime liens and which should be recognized as such between the contracting States of the Convention are as follows:

1. Law costs due to the State, and expenses incurred in the common interest of the creditors in order to preserve the ship or to procure its sale and the distribution of the proceeds of sale; tonnage dues, light or harbour dues, and other public taxes and charges of the same character; pilotage dues, the cost of watching and preservation from the time of the entry of the ship into the last port;
2. Claims arising out of the contract of engagement of the master, crew, and other persons hired on board;
3. Remuneration for assistance and salvage, and the contribution of the ship in general average;
4. Indemnities for collisions or other accident of navigation, as also for damage caused to works forming part of harbours, docks, and navigable ways; indemnities for personal injury to passengers or crew; indemnities for loss of or damage to cargo or baggage;

²⁹ The 1926 and the 1967 International Convention for the Unification of Certain Rules Relating to Maritime Liens and Mortgages, created by CMI and the 1993 International Convention on Maritime Liens and Mortgages, jointly done by CMI, IMO and UNCTAD.

³⁰ J. L. B. Allsop (n1) 169.

5. Claims resulting from contracts entered into or acts done by the master, acting within the scope of his authority, away from the ship's home port, where such contracts or acts are necessary for the preservation of the ship or the continuation of its voyage, whether the master is or is not at the same time owner of the ship, and whether the claim is his own or that of ship-chandlers, repairers, lenders, or other contractual creditors.

Also, the property subjected to maritime liens includes the ship herself, the freight for the voyage during which the claim giving rise to lien arises and the accessories of the ship and freight accrued since the commencement of the voyage.³¹

Article 3 clearly establishes the priority of liens over the mortgages and other security rights. Articles 5 and 6 contain the rules on ranking of the liens: the claims which arose from the last voyage have priority over ones attaching to previous voyages, with the exception of claims for wages for one and the same contract of engagement extending over several voyages, which will rank with claims attaching to the last voyage. The liens will rank between themselves in accordance with the order given in Article 2. The right of secured creditors to put forward their claims in full against the sum resulting from the sale of the property is expressly confirmed by the Convention,³² as well as the indelible nature of maritime liens.³³ According to Article 9, liens are extinguished after one year (except liens for supplies which shall continue in force for not more than six months) or by a court sale after publicity of the arrest and sale.

2.3.2. *The 1967 MLM Convention*

The 1967 MLM Convention follows its predecessor in the view of its structure and approach, but also brings some significant changes. First, it seems like the extent of maritime property is narrowed, since the Convention mentions only maritime liens on the ship.³⁴ The Convention gave priority to wages and other sums due to the master, officers and other members of the ship's complement, after which port, canal and other waterway dues and pilotage dues.³⁵ The previous claims resulting from the contracts entered by the master (Article 2(1)(5) of the 1926 MLM Convention) are omitted in the 1967 Convention, the claims for damages are distinguished into two types, whereby tort claims are widened.³⁶ The legal costs of the procedure (*custodia legis*) previously given priority in Article 2(1)(1) of the 1926

³¹ Article 2 of the Convention.

³² Article 7.

³³ By virtue of Article 8 of the Convention, maritime liens follow the vessel into whatever hands it may pass.

³⁴ Article 4(1) of the 1967 MLM Convention.

³⁵ Ibid Article 4(1)(i) and 4(1)(ii).

³⁶ Ibid Article 4(1)(iii) and 4(1)(iv).

MLM Convention are not contemplated as liens anymore, but their priority over the liens is now guaranteed by Article 11(2) of the 1967 Convention. Pursuant to Article 6(2), national laws may establish the right of retention for shipbuilders and ship repairers (possessory liens), and rank them immediately after maritime liens (before mortgages). The provisions dealing with forced sale³⁷ are more detailed than the ones provided in 1926 MLM Convention.

Despite of the attempt to fix the deficiencies in the 1926 Convention by bringing closer the common law and civil law approach, the 1967 Convention was generally not accepted and never came into the force.³⁸ However, its provisions have been strongly reflected into laws of the Scandinavian countries.

2.3.3. The 1993 MLM Convention

The last Convention also follows the pattern of previous ones, with few distinctions. Article 3 provides more details about change of ownership or registration, including temporary registration of ships. The list of claims is similar to the one from the 1967 Convention, with the exclusion of claims for wreck removal and general average and some changes in priority. Therefore, wages have priority, claims for port, canal etc. become subsequent to claims in respect of loss of life or personal injury and salvage claims, and finally, tort claims including damage done by ship. However, the listed maritime liens shall rank in the order listed, provided however that the maritime liens for reward for the salvage of the ship shall take priority over all other maritime liens which have attached to the ship prior to the time when the operations giving rise to the said liens were performed.³⁹

As well as the 1967 Convention, the Convention leaves behind the principle of last voyage, putting together all claims of the same type, regardless of the time they arose. Regarding its scope of application, the Convention in Article 13 clarifies that, unless otherwise provided [i.e. state owned or operated ships, used only in non-commercial purposes] it applies to all seagoing ships registered in a State Party or in a State which is not a State Party, provided that the latter's ships are subject to the jurisdiction of the State Party.

³⁷ Ibid Articles 10 and 11.

³⁸ Information available at: <<https://diplomatie.belgium.be/sites/default/files/downloads/i16.pdf>>, accessed on 24 April 2019.

³⁹ Article 5(2) of the 1993 MLM Convention.

2.4 Enforceability - the major feature of maritime liens

Over the centuries of its development, *lex maritima* established and strengthened mechanisms of expeditious and effective enforcement of maritime liens. Indeed, like Lord Mansfield CJ emphasized in *Luke v. Lyde* case, “the maritime law is not the law of a particular country, but the general law of nations”.⁴⁰ Such systems enabled creditors to arrest a ship when it was under the jurisdiction of Admiralty courts. In those cases, the shipowner had three choices: 1. to pay the claim and have his ship released; 2. to take part in the proceedings and put up security to replace the value of the ship or 3. he could opt to ignore the procedure and allow creditors to satisfy their claims from the sale of ship.⁴¹ In every case, maritime liens enforcement procedures retain their supreme effectiveness over other means of satisfaction of the claims; they have been powerful enough to make the debtor (or shipowner) be involved in the procedure and eventually pay the claim, or to directly obtain satisfaction from the ship’s value.

However, enforcement remedies developed under different jurisdictions (particularly under common law and civil law procedures) often caused confusions, although maybe more in theory than in practice. Therefore, the distinction should be made between what is known in English law as *actio in rem* and *attachments* in civil law traditions, which are instituted in conjunction with the *actio in personam*. Furthermore, the international community has attempted to reconcile such contrasts and find a compromise solution for enforcement of maritime claims at an international level.

2.4.1. Actio in rem

The *actio in rem*, known only in countries with common law tradition, is a reflection of the personification theory of a ship. That means that the ship was seen as an offending object and therefore, in the eyes of law, liable for the claim in respect of which the maritime lien arose. That means that, even in the case that the shipowner does not appear, the procedure will be held against the ship and finally be completed with her sale and distribution of the sale proceeds to the creditors. Such right to proceed against the ship herself has been given only to limited number of claims. In England, it was restricted to the enforcement of maritime liens proper,⁴² but thereafter (due to the intervention of the legislator) the

⁴⁰ As quoted by Steven Rares in ‘Ship Arrests, Maritime Liens and Cross-Border Insolvency’ (2018) LMCLQ, 398, 399.

⁴¹ Ibid.

⁴² See Sub-chapter 2.2.

actio in rem was availed to support the enforcement of general (non-secured) maritime claims.⁴³ However, whilst the action against the ship could be brought for the enforcement of maritime liens regardless of its ownership or possession, when it comes to general maritime claims, it was necessary to identify the connection between the ship and the putative debtor.⁴⁴

2.4.2. Attachment

The civil law countries have developed the right of attachment of the property of a debtor provided such property was found within the jurisdiction of the court. Such procedural remedies are not necessarily of a maritime, but of a general nature, and therefore they refer to all movable and immovable assets of a debtor, his accounts etc. The purpose of this remedy is to put pressure over the debtor to subject himself to the jurisdiction of the court where the remedies are taking place, and secure satisfaction of a claim. Therefore, the enforcement procedures can be established only against the person responsible for a claim.

Even though English Admiralty is mostly characterized by action *in rem*, that does not prevent its conversion into *actio in personam*, should it be more convenient for a claimant. Moreover, should the defendant submit to the jurisdiction of the court, the initial action *in rem* may continue as an action *in personam*.⁴⁵

2.4.3. Arrest conventions and their impact on enforcement of maritime liens

As it is already indicated, differences in legislation and the practice of States, motivated 20-years work⁴⁶ of CMI which resulted in the 1952 Arrest convention.⁴⁷ The Convention achieved a compromise between attachment known in civil law systems and *in rem* claims under common law systems. Therefore, in terms of Article 1(2) of the Convention, “arrest” means the detention of a ship by judicial process to secure a maritime claim, but does not include the seizure of a ship in execution or satisfaction of a judgement. Article 1(1) spells out the list of 17 maritime claims which give rise to the arrest of the ship. Obviously, the object of arrest, according to the Convention, is a ship. Thus, civil law countries

⁴³ J.L.B.Allsop (n1) 163. It should be however emphasized that the list of such claims is exhaustive as provided in the relevant statute.

⁴⁴ In England, such connection is decided to be ownership. See Ibid 163.

⁴⁵ However, after the *Indian Grace No.2*, the position of the courts in this regard remains unclear.

⁴⁶ See more: Francisco Berlingieri, *Berlingieri on Arrest of Ships: A commentary on the 1952 and 1999 Arrest Conventions*, 4th ed.(Lloyd's Shipping Law Library, 2006).

⁴⁷ International Convention Relating to the Arrest of Sea-Going Ships, adopted on 10 May 1952, entered into force 24 February 1956.

which became parties to the Convention were required to establish a maritime connection through one of the identified claims.⁴⁸ However, a claimant may arrest either the particular ship in respect of which the maritime claim arose, or any other ship owned by the person who was, at the time when the maritime claim arose, the owner of a particular ship.⁴⁹ At the date, the Convention is ratified by 71 States and has widely influenced the legislation of various maritime nations.

The need for broadening the scope of claims giving rise to the arrest of ships brought together CMI, IMO and UNCTAD and resulted in the 1999 Arrest Convention.⁵⁰ The Convention expanded the number of claims allowing arrest;⁵¹ the demise charter arrest provisions were redrafted;⁵² and jurisdiction on the merits by arrest is recognized.⁵³ However, the 1999 Convention was less successful than its predecessor.⁵⁴

Unfortunately, both Conventions omit to establish the link with MLM Conventions, and stay silent on the question of enforcement of maritime liens. However, claims covered by the conventions on arrest and conventions on maritime liens do overlap to a wide extent, making obvious the intent of the drafters for the Arrest conventions to apply to maritime liens. As Berlingieri concluded,⁵⁵ in practice it means that the maritime liens can be enforced through arrest even if the claim secured is against a person other than the owner (expressly allowed under Article 3(1)(2) of 1999 Arrest Convention). Such enforcement on a ship regarding which the secured claim arose is also possible after the ship is sold to *bona fide* purchaser, which is expressly set out in Article 8 of the 1926 MLM Convention and in Article 8 of the 1993 MLM Convention, to which two Arrest Conventions yield, pursuant respectively to Article 10 (actually 9) of the 1952 Arrest Convention and the already mentioned Article 3(1)(e).⁵⁶

⁴⁸ J.L.B. Allsop (n1) 167.

⁴⁹ Article 3 of the Convention.

⁵⁰ International Convention on Arrest of Ships, adopted 12 March 1999, entered into force 14 September 2011.

⁵¹ Article 1(1) of the Convention enumerates 22 claims.

⁵² Article 6 of the Convention.

⁵³ J.L.B. Allsop (n1) 168.

⁵⁴ At the date (April 25th 2019), the 1999 Convention is ratified by 15 states.

⁵⁵ Francesco Berlingieri, 'Enforcement of Maritime Claims', in D. J. Attard etc.(eds), *The IMLI manual on international maritime law, Vol. II: Shipping Law* (Oxford University Press 2006) 529, 544.

⁵⁶ Ibid.

2.4.4. Common aspects of enforceability

Regardless of being characterized as a procedure or substantive right on the ship, it is submitted that maritime liens are enforceable against those who have interest in ship. Therefore, four different aspects in respect of enforceability of claims from which the lien arose can be distinguished:⁵⁷

1. Enforceability of the claim *in personam*: the method which operates independently of the maritime lien.

2. Enforceability against other creditors: the holder of a maritime lien, subject to rules regulating ranking between the liens themselves, has the priority over other creditors.

3. Enforceability against purchasers: as a real security right over the ship, maritime lien follows the property, whether or not the purchaser has knowledge about the lien. Therefore, voluntary change of ownership over the ship does not affect the rights of lien's holder.

4. Enforceability against the asset when the present owner is not liable *in personam*: an aspect considered to be in a nature of certain claims secured by the lien.⁵⁸

Finally, it can be said that the *in rem* enforceability as essence of a maritime lien is recognized in *The Bold Buccleugh* (Harmer v. Bell), 1851,⁵⁹ notwithstanding the obvious common law background of the judgement. As it was stated by Sir John Jervis:

“a maritime lien is to mean, a claim or privilege upon a thing to be carried into effect by legal process ... that process [being] a proceeding in rem ... wherever a lien or claim is given upon the thing, then the Admiralty forces it by a proceeding in rem, and indeed is the only Court competent to enforce it. A maritime lien is the foundation of the proceeding in rem, a process to make perfect a right inchoate from the moment the lien attaches ... This claim or privilege travels with the thing, into whosoever possession it may come. It is inchoate from the moment the claim or privilege attaches, and when carried into effect by legal process, by a proceeding in rem, relates back to the period when it first attached.”

⁵⁷ For further elaboration see David C. Jackson, *Enforcement of Maritime Claims*, 4th ed. (Lloyd's Shipping Law Library 2005) 488-496.

⁵⁸ As D. C. Jackson rightly points out, the strict liability of the owner not liable for the claim leads neither to personification of the property, nor provides any obstacle to seeing the action in rem as a procedural method of enforcement of the substantive lien. Ibid 489.

⁵⁹ 7 Moo. P.C.267.

2.5 Maritime privileges under Montenegrin legislation

As a country with civil law tradition, Montenegro recognizes the concept of maritime privileges over sea-going ships. Still strongly resting on former Yugoslav laws, the current regulation on maritime privileges is found in The Law on Maritime and Inland Navigation of Montenegro of 2008 as amended in 2011 and 2013,⁶⁰ which basically reproduced provisions of the 1978 Maritime and Inland Navigation Act of Yugoslavia. It is interesting that the provisions almost fully implement the provisions of 1926 MLM,⁶¹ even though neither Yugoslavia, nor Montenegro now, became party to that Convention.

According to Article 252 of the LMIN, maritime privileges exist for securing the same claims recognized in the 1926 MLM Convention, as well as for interest arising for such claims.

Maritime privileges attach to the ship's hull and machinery and all her accessories and freight.⁶² Maritime privileges in principle are not extinguished with the change of ownership of a ship.⁶³

When it comes to ranking of maritime privileges, according to Article 264, claims arising from the same voyage are ranked in accordance to the descending order prescribed in Article 252. When there is more than one voyage giving rise to maritime privileges, the ones from latter voyages have priority over previous ones. However, privileges for claims arising out of employment of the master, crew and other persons engaged on board the ship arising from more voyages, have the same priority like privileges for claims from the last voyage.⁶⁴ In distribution of assets, the rules on maritime liens shall be applied in determining priority between the creditors within the same payment order.⁶⁵

Pursuant to Article 268 of the Law, maritime privileges are terminated:

- 1) when the claim secured by the privilege is terminated.
- 2) by the expiration of one year, and in the case of privileges referred to in Article 252(5), by expiring of six months;
- 3) by sale of a ship in an executive or bankruptcy procedure;
- 4) by sale of the ship, provided that:
 - the transfer of the ownership over the ship is registered in the ship's registry;

⁶⁰ Published in the Official Gazzete of Montenegro No.51/2008, 40/11, 62/13.

⁶¹ Adopted 10 April 1926, entered into force on 2 June 1931.

⁶² Article 253 of the Law.

⁶³ Ibid Article 259.

⁶⁴ Ibid Article 265.

⁶⁵ Ibid Article 983.

- such registration is duly published in the official gazette in which registrations of companies and other legal entities are being published, in the place of the ship's registry;
 - the privileged creditor does not initiate the procedure of enforcement of the privilege within two months from the date of such publication is given, or before the expiration of the deadline referred to in item 2 of this paragraph.
- 5) by constitution of a limited liability fund for claims secured by privilege, subject to liability limitation.

According to Article 983 of the Law, from the funds acquired by judicial sale of ship (funds consist of purchase price and revenues made by use of the ship – Article 982), the assets will be distributed to the creditors pursuant to following priority:

- 1) maritime liens;
- 2) creditors secured by the contract; and
- 3) other creditors.

The provisions on maritime privileges provide specific regime of their ranking, however, do not contemplate potential consequences which bankruptcy of a shipowner may have thereto. But even their superficial overview indicates to incompatibility of said rules with the regime of bankruptcy, which will be seen in more details in the subsequent Chapter. Here should be indicated that, even though the Montenegrin Law uses the term *privilege*, the term used in this work is *maritime lien*, which would in addition have the same meaning as privilege.

CHAPTER III

OVERVIEW OF BANKRUPTCY LAW

3.1. The nature and purpose of bankruptcy procedure

Unlike in admiralty, bankruptcy procedures are almost completely subject to national laws and regulations. That is because they intimately affect the economy of a State from different angles and touch upon the rights of various stakeholders. Furthermore, in many legal systems, insolvency and bankruptcy laws are referred to as *lex specialis*, having in mind that they are usually enforced under separate procedural rules and produce various effects in the legal and political environment of a State.

However, irrespective of particular jurisdiction, the sole purpose of bankruptcy remains the same – equitable satisfaction of bankruptcy creditors. Another aim achieved through bankruptcy procedures is elimination of companies which are not able to meet their obligations and therefore prevent them from further endangering their business partners. From another point of view, bankruptcy grants a 'fresh start' to the 'honest but unfortunate debtor'.⁶⁶

By virtue of court's resolution, the statutory powers of board of directors, executive director or any other persons in charge to bring decisions and act on behalf of a company, are automatically and exclusively transferred to the bankruptcy administrator set by the court. That means that, from the moment the bankruptcy procedure is opened, the bankruptcy debtor is prevented from disposing of his property, bank accounts and exercising any of the acquired rights.

General characteristic of bankruptcy proceedings can be thus summarized as: bankruptcy procedures are performed by the State (in most cases they are juridical, but sometimes can fall under the competence of another national authority); they are urgent; inevitably invoke certain status and procedural consequences for the debtor, with a special regime of ranking of creditors and a requirement of registration in order for claims to be treated within the procedure.⁶⁷

⁶⁶ *Marrama v. Citizens Bank of Massachusetts*, US Supreme Court, 127 S.Ct. 1105 (2007).

⁶⁷ See in general: Prof. dr Vuk Radović, *Stečajno Pravo, Knjiga Prva* (Univerzitet u Beogradu – Pravni fakultet, 2017)

3.2. International background

The emphasis made on the domestic character of bankruptcy laws does not exclude the possibility of a foreign element to show up in such procedures. *A contrari*, when a debtor engages in international business activities, such as shipping, often it is inevitable not to face various claims, as well as proprietary and other legal issues which involve nationals of various countries based in different jurisdictions. Such reality prompted the adoption of 1997 UNCITRAL Model Law on Cross Border Insolvency which promulgates cooperation between the States and provides mechanisms for dealing with insolvency procedures with a foreign element.⁶⁸ The Model Law is intended to operate as an integral part of the existing insolvency law in the enacting State.⁶⁹

The main legal tool introduced by the Model Law is *recognition of foreign proceeding* by the court, which basically brings the same consequences as the bankruptcy was declared in that country. Therefore, upon recognition of a foreign proceeding, the commencement or continuation of individual actions or proceedings in that country concerning the debtor's assets, rights, obligations or liabilities is stayed; execution against the debtor's assets is stayed and the right to transfer, encumber, or otherwise dispose of the assets of the debtor is suspended.⁷⁰ The reason behind such solution is to provide a centralized system of management and sale of debtor's property, regardless of the jurisdiction where such property is located. In this way, the bankruptcy debtor is prevented from disposal of his property abroad, and, on the other hand, foreign creditors are subject to the same equitable treatment as the creditors in the country of bankruptcy procedure. However, the Model Law partially gives leeway for the State Parties to make certain exception from the general rule of the stay of proceedings against the foreign debtor. Article 20(2) of the Model Law is drafted as follows: "The scope, and the modification or termination, of the stay and suspension referred to in paragraph 1 of this article are subject to [*refer to any provisions of law of the enacting State relating to insolvency that apply to exceptions, limitations, modifications or termination in respect of the stay and suspension referred to in paragraph 1 of this article*]."

⁶⁸ According to the Preamble of the Model Law, its purpose is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of: (a) Cooperation between the courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency; (b) Greater legal certainty for trade and investment; (c) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor; (d) Protection and maximization of the value of the debtor's assets; and (e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment. Available at: <<https://www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf>> accessed 15 April 2019.

⁶⁹ Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency, UNCITRAL, 2014, 25.

⁷⁰ J. L. B. Allsop (n1) 178.

The European Union came up with Regulation 2015/848⁷¹ where the emphasis is made on debtor's center of main interests (COMI). According to Paragraph 23 of the Preamble, the main insolvency proceedings shall be opened in the Member State where the debtor has the centre of its main interests. Those proceedings have universal scope and are aimed at encompassing all the debtor's assets.⁷² However, the opening of insolvency proceedings shall not affect the rights *in rem* of creditors or third parties in respect of tangible or intangible, moveable or immovable assets, both specific assets and collections of indefinite assets as a whole which change from time to time, belonging to the debtor which are situated within the territory of *another* Member State at the time of the opening of proceedings. Such rights, inter alia, are the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim.⁷³ The main demand of the Regulation is that a country where the debtor's assets have been arrested or attached using admiralty procedures must recognize the primacy of insolvency proceedings in the debtor's COMI. However, the reciprocal comity demands that the country of the insolvency proceedings recognizes and respects the legitimacy of the security granted by the admiralty procedures in the country of arrest or attachment.⁷⁴

3.3. Bankruptcy procedures under Montenegrin legal system

Bankruptcy procedures in Montenegro are regulated by the Law on Bankruptcy of 2011 as amended in 2016.⁷⁵ The purpose of the procedure is clearly stated in Article 2 of the Law: "The bankruptcy procedure is conducted for the purpose of collective settlement of the creditors of the bankruptcy debtor, in case when he has the assets, by the sale of this property and the distribution of funds collected to the creditors." The principle of protection of bankruptcy creditors is especially guaranteed in the Law, as well as the equitable and fair treatment of the creditors.⁷⁶

The bankruptcy procedure is exclusively a judicial procedure, and under the Montenegrin legal system, only the Commercial Court of Montenegro is competent for hearing such proceedings.⁷⁷ Upon

⁷¹ Regulation 2015/848 of the European Parliament and the Council, 20 May 2015, entered into force on 26 June 2017, available at: < <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32015R0848> > accessed on 15 April 2019.

⁷² The Preamble of the Regulation, Paragraph 23.

⁷³ Article 8 of the Regulation.

⁷⁴ Martin Davies, 'Cross-border insolvency and admiralty: a middle path of reciprocal comity' (CMI Yearbook 2015) 195, 197.

⁷⁵ Official Gazette of Montenegro No. 1/2011 and No. 53/2016.

⁷⁶ Articles 3 and 4.

⁷⁷ Article 18 of the Law on the Courts of Montenegro.

declaration of bankruptcy of a particular company, the Court appoints a bankruptcy administrator, empowering him to manage and represent the debtor. The bankruptcy administrator *ex lege* enters into the shoes of the managing bodies established by the statute of the company, whose authorities are thereby taken away. The entire property of the debtor in the country and abroad on the day of the opening of bankruptcy forms the bankruptcy estate.⁷⁸ The bankruptcy estate is managed solely by bankruptcy administrator with the aim to be sold in the shortest time and at least costs for the most favorable price. Consequentially, all litigations and administrative procedures against the debtor stay upon the commencement of the bankruptcy proceedings. Moreover, no more security rights can be attached or enforced against the property of the debtor. In case of such proceedings ongoing, they will be dismissed by the court.⁷⁹

On the day of bankruptcy, all payments of the debtor become due. Montegrin Law recognizes two types of bankruptcy creditors, namely secured or non-secured, depending on the nature of the claim they have against the debtor at the moment of declaration of bankruptcy.

To be considered as a secured creditor in bankruptcy proceeding, one should have a security or enforcement right over the debtor's property which is subject to prior registration (e.g. real estates, ships, shares in other companies, etc.). Such creditors have the right to satisfy their claims from the value of the encumbered property, and in case the price achieved is not enough for their satisfaction, the amount left will be settled together with claims of other creditors from the rest of the assets of the debtor (should there be any).⁸⁰ In case where there are more secured creditors, their claims against the encumbered property to which they attach, are settled according to their priority, after the recovery of the procedural costs related to the sale of such property, including the award of bankruptcy administrator.⁸¹

In practice, the investment loans given by banks are usually secured by hypothecs attached on the debtor's business premises and other immovable property, among other collaterals. Therefore, once the property is sold – as part of the bankruptcy proceedings – in a judicial sale, the proceeds of the sale will satisfy banks primarily so as to cover unpaid loan principals and interest. This stems from the fact that secured creditors have privileged status in the distribution of the bankruptcy estate. But it should be

⁷⁸ Article 103(1) of the LOB..

⁷⁹ Ibid Article 95.

⁸⁰ Ibid Article 53.

⁸¹ Ibid Article 139.

recalled that, in accordance with the Montenegrin Law, they are also allowed to waive the privileged status for their convenience and settle their claims together with unsecured creditors.⁸²

And if there is no such security or enforcement right, i.e. if a creditor has not secured his claim by virtue of a contract or specific law, his claim is subject to the regime of ordinary, non-secured claims. Such claims are diverse by their nature, and according to priority, they are divided into three descending categories – payment orders:

1. First Payment Order:

- Employees' wages up to 24 average gross salaries in Montenegro on the day of opening the bankruptcy procedure, together with interest from the day of maturity to the day the bankruptcy has started; and
- Claims of employees on the grounds of personal injuries that occurred while working for the debtor.

2. Second Payment Order:

Claims for contributions to pension funds and disability insurance of employees and former employees, not included in the first payment order, as well as claims for all public revenues before the opening of the bankruptcy procedure.

3. Third Payment Order:

Other types of claims, together with claims of employees above the amount referred to in First Payment Order.⁸³

The payment orders are settled in accordance with the principles of exclusion and of proportionality within the same payment order. That means, until all creditors from one payment order are satisfied, there is no possibility to distribute the assets to the creditors of a subsequent payment order.

As it can be seen, employees and former employees of the debtor have priority over other unsecured creditors. However, such priority is referred only to limited amount of claims, the rest is transferred to the Third Payment Order. It is also clear that the most unfavourable position belongs to the creditors others than employees and the State, having in mind that their satisfaction comes after all costs of the

⁸² Ibid Article 53(7).

⁸³ Ibid Article 55.

proceedings and claims are paid. In practice, the value of the bankruptcy assets is often not enough to provide for the satisfaction of all unsecured creditors.

It is important to note that, according to Article 53(5) of the LOB, security rights acquired in the period of 60 days before bankruptcy procedure is opened, cease to exist and such creditors are not considered as secured creditors in the bankruptcy proceedings. They can exercise their rights only as a non-secured creditors, i.e. pursuant to the payment order they are placed in, according to the nature of their claim.

It is possible that during the procedure third parties show up and claim their real or personal rights over a (certain parts) of the bankruptcy estate. Such possibility in Montenegrin bankruptcy procedure is contemplated in Article 52 of the Law. Even though they are not bankruptcy creditors in the above sense and sometimes not creditors of bankruptcy debtor at all, such parties have the so-called *exclusion rights* to remove from the bankruptcy assets particular things over which their rights exist. The bases of such right is a title over the *res* found in debtor's possession. The typical and common example of exclusion is when equipment, machinery etc. found in the debtor's premises do not belong to the debtor, but to another persons who thereby seeks their exclusion from the procedure. Another situation is when immovable property registered under the name of the debtor automatically became part of bankruptcy estate, but after it has been shown that the property is in third parties' possession, based on valid legal grounds. That is usually in the case where the property has been sold and the title passed on another person before the initiation of bankruptcy procedure, but the change of the ownership has not been officially registered.

It is noteworthy that all claims in bankruptcy proceedings have to be submitted to the Court in the prescribed timeframe, otherwise, the creditors' rights to collect their claims against the bankruptcy debtor are extinguished.⁸⁴

⁸⁴ According to Article 112 of the LOB, all bankruptcy claims have to be submitted within 30 days from the date of publishing the declaration of the bankruptcy proceeding on the notice board of the Court. Such time period can be extended by the Court to the end of hearings for examination the claims, only if the creditor can justify reasons for his late submission.

CHAPTER IV

POSITION OF MARITIME LIENS UNDER BANKRUPTCY PROCEEDINGS

4.1 General issues and conflicting points

When a shipowner becomes insolvent, or it appears that it soon may be so, creditors often resort to admiralty procedures designed to protect the interests of local claimants, such as arrest of ship or attach his other assets.⁸⁵ Such procedures are generally recognized in different maritime jurisdictions and one of their main advantages is to serve the creditors, regardless of where the ship is actually located. On the other hand, the insolvency of a company leads to the bankruptcy procedures. Contrary to the Admiralty, the principle of universalism of the bankruptcy calls for courts in other countries to cooperate with the courts in the country of the debtor's insolvency to ensure that all of its assets are distributed to its creditors under a single and orderly system of distribution.⁸⁶ That means a demand for release of all seized assets of a bankruptcy debtor, and subjecting maritime creditors to the regime of bankruptcy. And this is where the conflict of these two regimes comes into play. The automatic stay of all enforcement proceedings over the debtor's property *prima facie* would include the ongoing enforcement of maritime claims on the ships, which are typically based upon a *separate* system of ranking and distribution.

However, maritime liens are generally viewed as a form of security for the purpose of insolvency.⁸⁷ The same applies other types of security rights on ships which are peculiar to the maritime law and which would certainly rank after maritime liens. As pointed out, contrary to freezing orders of the debtor's assets (Mareva injunction), the arrest of a ship by the Admiralty Court makes that ship a real security which cannot be defeated by insolvency and it is available only for maritime claims. As such, a claim secured by a maritime lien will be only defeated by a maritime claim having higher priority.⁸⁸ That is the reason why many countries provided in their national laws that bankruptcy proceedings over the shipowner will not affect the existence and enforcement of maritime claims which arose prior to the commencement of such bankruptcy procedures. However, unless the satisfaction of maritime claims is completely extracted from the regime of bankruptcy, the priority of such claims is likely to be affected.

⁸⁵ Martin Davies (n.74) 196.

⁸⁶ Re HIH Casualty & General Insurance Ltd [2008] 1 W.L.R. 852, 861-62, per Lord Hoffmann.

⁸⁷ Re Rio Grande do Sul Steamship Company (1877), 5 Ch D 282, Re Aro Co. Ltd [1980] 1 All ER 1067, 1072.

⁸⁸ N. Meeson and J. A. Kimbell (n.17) 25.

The reason is that the position of the bankruptcy creditors and the category of their claims usually do not correspond to the ranking system of maritime creditors in terms of maritime law. That is simply because the range of creditors of a bankruptcy debtor is usually wider than the range of the creditors having maritime claims, and bankruptcy procedures are usually oriented towards equal and proportional treatment of the creditors, without giving rise to substantial and procedural rights vested into maritime creditors. Of course, some legislators decided to preserve the supremacy of maritime claims and allowed their ranking within the bankruptcy procedure as the case would be in Admiralty. In every case, with the commencement of bankruptcy procedure over the shipowner, the Pandora's box is opened, and the possible overlap of different regimes of security rights requires significant level of regulation.

Looking from the procedural perspective of view, the legislation and practice of different nations recognize three basic systems of dealing with such conflict of laws. The first and dominant system is the one where admiralty prevails, i.e., the enforcement of maritime claims secured on ships is not affected by bankruptcy. The second one gives the bankruptcy procedure a character of *lex specialis*, therefore, the stay of all procedures against the shipowner's assets would also include the procedures in rem over his ships. On the other hand, the intermediary approach would be generally based on principle *prior tempore, potior iure*, where the future of maritime claims would generally depend on whether the bankruptcy or their enforcement procedure occurred first.

The following Sub-chapter 4.2. will give the brief overview of how the position of maritime creditors is regulated in comparative systems of laws (Germany, the UK and Malta). Furthermore, the Sub-chapter 4.3. will expand in details the problems which may arise from the bankruptcy of shipowners for their secured claimants based on existing legal regime of Montenegro and its insufficiencies.

4.2 Comparative solution analysis

*4.2.1. Germany*⁸⁹

According to Section 596 of the German Commercial Code, crew wages, public fees, damages arising out of the injury of death, salvage costs and social security fees are considered as maritime liens and

⁸⁹ This research is mostly based on the Replies to the Ship Financing Security Practice Questionnaire submitted to CMI. Available at: <<https://comitemaritime.org/work/ship-finance/>> and from European Judicial Network in Civil and Commercial Matters, available at: <http://ec.europa.eu/civiljustice/bankruptcy/bankruptcy_ger_en.htm>

they rank prior to the other security rights over maritime property. Their ranking is regulated separately from the ranking of other claims and it cannot be affected by other creditors' rights.

Pursuant to Section 50 of German Insolvency Statute 2002 (Insolvenzordnung, InsO),⁹⁰ the individual enforcement of rights of secured creditors remains admissible, regardless of the opening of any insolvency proceedings. The creditors whose security right is based on a contractual pledge, a pledge acquired by attachment or a lien over an object forming part of the bankruptcy assets shall be entitled to separate satisfaction of their claims, interest and costs, from the encumbered object (right of separation). For such separation right to be effected, secured creditors may bring a claim against bankruptcy administrator seeking the object of their security rights. The assets achieved by sale of the res encumbered shall be distributed to the secured creditors up to the level of their secured claims. Any surplus shall accrue to the insolvency assets and be available to satisfy the remaining creditors.

4.2.2. *the United Kingdom*

According to the English Insolvency Act 1986, the treatment of the secured creditors in winding up (bankruptcy) proceedings generally depends on the moment when their *in rem* claim was effected. None of the provisions of the Law *prima facie* prevents a person from issuing proceedings against a company after a petition for winding up has been presented, but before a winding-up order has been made.⁹¹ There were different interpretations of the provisions of the Act regarding enforcement of statutory rights *in rem* shown in practice.⁹² However, the legal practice with regards to the position of maritime lienees in the winding-up procedures remained unanimous. The maritime lienee is considered as a secured creditor, having a claim which is outside and independent of the liquidation, giving him the right to release his own security interest over the property of a debtor. Therefore, the court will always grant a leave for such creditor to proceed with his claim and realise the security.⁹³ Furthermore, the holder of a maritime lien will always be given leave to *commence* with his claim, even after the order for winding up has been made.⁹⁴

⁹⁰ Available at: <https://germanlawarchive.iuscomp.org/?p=773>

⁹¹ N. Meeson and J. Kimbell (n.17) 112.

⁹² In *re* Lineas Navieras Bolivianas S.A.M. (*The Bolivia*), the Judge Arden, J. concluded that there is nothing in the Insolvency Act 1986 to prevent an issue or service of claim *in rem* after the commencement of winding up, unless the court was able to stay the proceeding and the issue of a claim was not affected by the other section of the Act.

⁹³ N. Meeson and J. Kimbell (n.17) 115.

⁹⁴ Here N. Meeson and J. Kimbell (n.17) also refer to *re* Rio Grande do Sul Steamship Company (1877), 5 ChD 282 (CA), 115.

4.2.3. Malta

The Merchant Shipping Act of Malta⁹⁵ contains a special provision regulating the position of secured maritime creditors in the situation of bankruptcy of the shipowner. According to Article 37(C):

„(1) All registered mortgages, any special privileges and all actions and claims to which a ship may be subject shall not be affected by the bankruptcy of the mortgagor or shipowner happening after the date on which the mortgage was created or the special privilege, action or claim arose, notwithstanding that the owner at the commencement of the bankruptcy had the ship in his possession, order or disposition, or was the reputed owner thereof, and such mortgage, privilege, action or claim shall have preference, on the said ship, over all other debts, claims or interests of any other creditor of the bankrupt or of any curator, trustee or receiver, acting on behalf of any other creditors. (2) Any judicial sale proceedings instituted by any registered mortgagee or privileged creditor shall not be interrupted or in any way hindered by any curator in bankruptcy, whether voluntary or compulsory, or any liquidator or receiver of the shipowner for any cause other than a cause that could be set up by the owner.”

It can be concluded that, by virtue of the provisions quoted, considered to be a *lex specialis*, ships are extracted from bankruptcy procedure of a shipowner.

4.3 Particular problems recognized in Montenegrin laws and practice

The first insufficiency of the Montenegrin legislation which causes problems in practice is the lack of legal provisions regulating the relationship between maritime claims and bankruptcy proceedings on the national and international level. Also, rules on bankruptcy do not treat maritime property, as defined in the LMIN,⁹⁶ separately from any other property of a bankruptcy debtor, and maritime laws do not regulate separately the possibility of bankruptcy over shipping companies.

Both laws (LMIN and LOB) are considered to be *lex specialis*. Therefore, the following issues will be perceived from two different perspectives.

Firstly, if taken as a premise that bankruptcy laws will, because of their specific nature,⁹⁷ supersede the general maritime rules, that means that maritime claims secured by a lien should find their place under the provisions of the LOB. Having in mind that maritime lienholders have the claims secured on the ships,

⁹⁵The Merchant Shipping Act of Malta of 1973, as amended in 2018

⁹⁶ See Sub-chapter 2.6.

⁹⁷ See Sub-chapter 3.1.

which are the property subject to public registration, there is a prima facie link to the secured creditors under Article 53 of the LOB.⁹⁸ However, few issues are likely to occur in this situation.

The very first will come regarding identification of maritime claimants as a secured or non-secured creditors, based on the time their claim arose. By virtue of Article 53(5) of the LOB, maritime liens acquired 60 (or less) days before bankruptcy procedure is opened extinguish with the opening of the bankruptcy procedure, and such claimants are not considered as a secured bankruptcy creditors. Such rule which is merely procedural is given enough power to overthrow the existence of completely legitimately acquired security rights of maritime creditors. Here, it should be emphasized that in practice, the enforcement of maritime liens usually takes place just prior to the bankruptcy, when it is already obvious that the shipowner is on the edge of his financial existence. That means that in reality, there would actually be more creditors whose claims arose (and therefore maritime liens attach) in the time when the insolvency of a debtor was already manifested and due to which their claims could not be satisfied. In that particular moment, the enforcement of the maritime lien is the creditors' ultimate weapon. However, if the lienholders do not manage to enforce their claims in total prior to 60 days before the bankruptcy procedure starts, such right will be completely neglected in the bankruptcy procedure! Ironically enough, the general rules of ranking of maritime liens give priority to the creditors who acquired their liens later (opposite to the *prior tempore, potior iure* principle), but in the case of bankruptcy, such liens even "cease to exist".

But there are more problems even regarding liens which are *recognized* as such by the bankruptcy administration. They start when it comes to ranking of maritime lienholders together with the other secured creditors. Even though the supremacy of maritime liens over other secured claims is guaranteed under Article 983 of LMIN⁹⁹, the character of such provision from the perspective of bankruptcy procedure is disputable. That is because the provision could be considered of a procedural nature only, and therefore, applicable only in distribution of assets after judicial sale of ship outside bankruptcy procedure, but without importance when the shipowner goes bankrupt. Therefore, if the priority of maritime liens as a substantial right is not recognized by the bankruptcy administrator, the maritime lienholders are unfairly deprived from the essential advantage of their claims - supremacy over the other claims against the ship. Unfortunately, Montenegrin legislation does not contain clear provisions which would leave no doubts in the substantial nature of maritime liens and applicable as such in bankruptcy procedure. Therefore, if

⁹⁸ See Sub-chapter 3.3.

⁹⁹ See Sub-chapter 2.6.

the claims secured by maritime liens do not have the highest priority in the ranking, as guaranteed by maritime law, where would be their place in the distribution of ship's assets? Will it depend on the moment of their creation, like it would be the case with mortgages? Or maybe the fact that maritime liens do not require registration will place them after mortgages, hypothecs and other registered security rights? In every case, any kind of denial of supremacy of liens directly collides with the very purpose of their establishment under general maritime law.

Even if the supremacy of a lien is recognized over the ship belonging to the debtor, from the bankruptcy perspective, that does not include other maritime property on which maritime liens attach according to the Article 253 of the LMIN (all accessories of the ship and freight). That is because, recalling Article 53 of LOB, the status of the secured creditors in the bankruptcy procedure would be given to the claimants having security rights over ships only (because only ships are subject to registration). That means that, in case that the value of the ship is not sufficient for their satisfaction, maritime lienees are automatically deprived of the privileged position to satisfy their claims from other maritime property of a debtor.

Further difficulties for maritime creditors arise from the mere fact that the ship as a mean of their security is not a property *per se* anymore, but just a part of a bankruptcy estate. Therefore, it is at the discretion of bankruptcy administrator if the ship is going to be sold together with other property of a debtor or in a separate procedure. In any case, all secured creditors can object to the sale proposed by the bankruptcy administrator (Article 138), direct sale shall be previously approved by the creditors' committee (Article 134(12)), and there is a wide leeway in decreasing the purchase price (Article 134(10) and (11)).¹⁰⁰ Such sale procedures usually take time and unless the bankruptcy administrator is proficient in sale and purchase of ships, it is likely that it will lead to a significant decline of value of the ship (it should be recalled that the ship will be sold for the most favourable price, which does not always mean the best price).

It is possible that the bankruptcy debtor continues with its business activity while the procedure is on, under the management of bankruptcy administrator. In such case, it can be imagined that the ship of a debtor will also carry on with its activity, but all such incomes, if any, will form bankruptcy assets in general, and therefore be subjected to deductions in the name of satisfaction of bankruptcy costs overall.

¹⁰⁰ According to these provisions of the LOB, in case of failure of the first public sale of the bankruptcy assets, any subsequent sale may be carried out with the reduction of the lowest selling price by one fifth of the estimated value. In the event that the public sale failed even with under the one fifth of the total estimated value of the assets, the bankruptcy administrator may carry out the following public sale on the principle of the highest offered price.

Again, not particularly favourable for maritime creditors, especially if such disposals of the ship could bring more damage to the assets than income.

The question of the legal status of the claims which arise from the ship's operation during the bankruptcy will therefore appear as important. Obviously, such claims which would otherwise give rise to maritime liens, during the bankruptcy cannot be considered as such. (recalling the Article 95 of the LOB, no more security rights can be attached or enforced against the property of the debtor upon the bankruptcy procedure is opened). The only category where such claims could be placed are the expenses of the procedure. The same would happen with the costs of the maintenance and repair of such ship. Therefore, are such expenses to be covered only from the value of the ship? If yes, is it justifiable, having in mind that the costs are at the risk of maritime creditors (as a creditors *of a ship*), but incurred in the interest of the bankruptcy asset overall, therefore for all bankruptcy creditors?

Furthermore, the LOB recognizes as secured creditors only those who have a claim against property which is subject to registration. Having in mind that not all of the ships are subject to registration (especially smaller ships), that directly entails that maritime liens which attach to such ships will not be recognized as a security right within the bankruptcy procedure. Therefore, the mere fact that the claim arose in respect of the operation of a ship for which (according to particular Montenegrin or other countries' national laws) the public registration is not required, puts such creditors in unenviable position of non-secured bankruptcy creditor. It should be recalled however, that the creation of maritime lien is not conditioned by the size or registration of the ship, neither by Montenegrin Law, nor by the International Conventions in place.

The LOB deals with the ranking and satisfaction of creditors of the bankruptcy debtor. However, it does not contemplate the situation where the maritime lien is attached to the property for securing the claim against third person, not against the debtor - shipowner. That would typically be the case when the debtor, before going bankrupt, acquired the ownership over the ship which had already been encumbered by maritime liens. The only provision of the LOB which could be applicable in such case can be found in Article 53(8) and (9) of the Law. However, such creditors are obliged to provide appropriate evidence for their claim, within the specified deadline, and in case they fail to do so, their security rights extinguish.¹⁰¹ The further position of such creditors (priority, procedural rights, remedies etc.) remains unregulated by the Law.

¹⁰¹ Article 53(8) of the LOB.

Going deeper into the bankruptcy procedure, the only possibility of exclusion of certain property from the bankruptcy estate is given in Article 52 of the Law.¹⁰² However, such provision is inapplicable to maritime liens, having in mind that they are security rights accessory in nature (e.g. the underlying claim is principal and the ship serves as its security),¹⁰³ while the possibility of exclusion is given only to persons who have a legal title over the particular property - ship.

The reverse scenario, where the rules of maritime law enforcement because of their *speciality* exclude the application of the bankruptcy rules, is difficult to contemplate under the current regime. Simply because, one of the main consequences of the bankruptcy is a stay of all proceedings against the bankruptcy debtor and his assets. That means that no provision of the LMIN can prevent ships and other maritime property to become a part of bankruptcy assets and therefore be completely subjected to the jurisdiction of the bankruptcy court and rules applicable thereto.

The described reality of the general non-recognition of maritime liens in the regime of bankruptcy does not give much optimism for answering the dilemma on the procedural or substantial character of maritime liens. It is pretty much unlikely that the bankruptcy courts, which do not allow for complete realisation of maritime lienholders' rights guaranteed under the national laws, will recognize and enforce maritime liens acquired in accordance with foreign maritime laws. As already emphasized, despite various opinions shown in theory, maritime liens represent both substantial and procedural rights. Therefore, they should be recognized as vested rights of creditors, regardless of national laws under which they arose. Such intent is predominantly contemplated by maritime nations (see Sub-chapter 2.2.). However, the mere fact that Montenegro is not a party to any of the MLM Conventions and therefore not bound by the interpretation of such Conventions makes the issue even more complicated.

The above exposed legal lacuna in the Montenegrin legal system are very likely to affect rights of maritime claimants in bankruptcy procedures over a shipowner. However, the implications of the collision of two different legal regimes go further and reflect both ways around. For example, given that the system of bankruptcy does not recognize the exclusive nature of maritime liens, that will be the case also in the procedure of the enforcement of a liens. This means that in the situation when a foreign shipowner goes bankrupt, Montenegrin courts which were dealing with enforcement over such debtor's ship will order a stay of procedure and surrender the jurisdiction over the ship to the foreign bankruptcy court. Here it should be noted that Montenegro has implemented the UNCITRAL Model Law on Cross

¹⁰² See Sub-chapter 3.3.

¹⁰³ See general characteristics of maritime liens, Sub-chapter 2.2.

Border Insolvency in national law by the LOB. Having in mind that Montenegro did not opt for exclusion of *actio in rem* from the rule of automatic stay of procedures against the debtor's assets,¹⁰⁴ the Montenegrin Bankruptcy Courts will, upon the recognition of the main bankruptcy procedure, order automatic stay of all proceedings against debtor assets, including the enforcement of maritime liens. However, such provisions (or lack of provisions) are deemed to be contrary to Article 8 of the EU Regulation 2015/848. Even though Montenegro is not a state party to EU, it has been a candidate for future membership thereof since December 2010. Therefore, its legislation has to be amended in order to comply with Regulations of the Union which are binding upon the Parties.

¹⁰⁴ See Sub-chapter 3.2.

CHAPTER V

CONCLUSIONS AND RECOMMENDATIONS

The previous chapters intended to show how the interconnection of two different legal regimes, even though both established for the purpose of securing creditors, can actually result in the deprivation of maritime creditors' rights, rather than their protection. Even in regulated legal systems, the cross-border insolvency proceedings can impede the enforcement of maritime claims. However, where there is no proper legislation in place, as in the case of Montenegro, the position of secured maritime creditors remains obscure and unstable. As it was already indicated, neither existing rules on bankruptcy nor on maritime liens resolve any of the issues which may possibly arise from the insolvency of a shipowner.

Summa summarum, maritime liens are substantive, vested rights, and as such shall be neither subject to the recognition of bankruptcy administration, nor exposed to the variability of ranking rules. The supremacy of maritime lienholders in respect to the other claimants is owed to their contribution to the operation or preservation of the ship, or to the damage by the ship they have suffered. That is the reason why in no case other creditors can rank ahead of maritime lienholders, and the insolvency of a shipowner shall not make any exception.

The absurdity of this conflict in place can be illustrated with the simple example of a seafarers' claim for wages. From time immemorial, seafarers have had the right to arrest and sell the ship for the purpose of satisfaction of their unpaid wages, simply because they have always been the ones to operate the ships and perform the business activity of a shipowner. Nowadays, when the shipping industry is referred to as the *modern slavery*, the denial of seafarers' security rights on the ships and their supremacy thereto can lead to greater abuse of the workforce on board. And not only the fundamental human rights of seafarers are brought to the edge, but also there would be a clear threat for safety and security of navigation. Indeed, it cannot be a better incentive for a shipowner than the ultimate possibility of obtaining a *fresh start* through the bankruptcy, especially in the regimes which are not keen in piercing the corporate veil. The lack of financial security of seafarers can eventually diminish the overall interest for this profession.

Furthermore, in such unstable legal environment, even salvors will think wisely before rendering their services to the ships in danger, simply because they cannot rely on their security right on the ship

herself. In case of Montenegro, if the salvage service is rendered after a particular point in time,¹⁰⁵ the unlucky salvor will be completely deprived from his privileged status if the shipowner goes bankrupt.¹⁰⁶

Therefore, the starting point for harmonization of Montenegrin Laws shall be to amend the Law on Maritime and Inland Navigation by adding so-called overriding provision. Basically, Article 37(C) of the Merchant Shipping Act of Malta (see Sub-chapter 4.2.3) should serve as a good model for drafting such provision. By transforming ships into ring-fenced assets, they would remain ‘untouched’ by the bankruptcy regime and subject only to the rules of maritime law and separate enforcement procedure. In that way, security rights over the ships are addressed within the particular regime they belong to, regardless of the time of their creation (before or after the bankruptcy procedure over the shipowner commenced). That means that no maritime liens can be denied or conditioned by the security rights of other creditors of the debtor; that their ranking will not be performed or affected within the bankruptcy procedure, and finally, that the sale of ship will be adapted to the particularities of the ships as assets and the distribution of assets performed accordingly.

Like in the Maltese example, such provision of the law should contemplate the overall particularity of maritime liens. On one hand, the provision should reflect their substantial aspect: by use of express statement that rights of maritime lienees shall not be affected by the bankruptcy of a shipowner happening after the date on which the security right was created and that maritime liens will take priority over any other creditors of a shipowner. Also, the provision should prohibit any kind of implications that opening of a bankruptcy procedure, actions of bankruptcy administrator etc. could have on the judicial sale initiated by the maritime lienees. The complete extraction of ships from the bankruptcy estate shall serve to preserve the existing security rights thereto - not only maritime liens, but also other security rights on ships (acquired by the operation of law, contract or judicial procedure). Furthermore, not only ships shall be extracted from the bankruptcy estate, but also other maritime property in the virtue of Article 253 of the LMIN.

The suggested legislative solution appears to be the most acceptable for resolving legal issues described in Sub-chapter 4.3, and seems like its justification has been already given in this overall research.

Moreover, having considered the application of the LOB of Montenegro as *lex specialis*, it appears that ring-fencing of maritime property shall be re-confirmed by providing an additional provision therein on

¹⁰⁵ See Sub-Chapter 4.3. and the comment on Article 53(5) of the LOB.

¹⁰⁶ See Dr Svetislav Jankovic, *Privilegije na brodu u situaciji stecaja brodovlasnika* (Anali Pravnog fakulteta u Beogradu, LXIV, 1/2016) 196, 205.

extraction of maritime property from the bankruptcy assets of a shipowner. However, for overcoming practical problems in enforcement of maritime liens in Montenegro, one more legislative option should be exercised. As it is already indicated, following the European approach to the implementation of UNCITRAL Model Law, it is desirable that Montenegro secures by its Laws that the opening of insolvency proceedings over a debtor located in another State shall not affect the rights *in rem* of creditors or third parties in respect of ships belonging to the debtor. That means that the stay of enforcement procedures over property of such debtor located in Montenegro, resulting from the recognition of foreign bankruptcy procedure in accordance with national Law, will not affect the enforcement of maritime claims. The previous solution shall also be carried out through the amendments of the LOB.

Any surplus on the sale of maritime property upon satisfaction of maritime claimants will be transferred to the bankruptcy administrator to take part into bankruptcy assets.¹⁰⁷ This provision should be added to the amendments of the LMIN suggested above.

In case where only maritime property is found within the ownership of a bankrupt debtor, it should be left to the discretion of the bankruptcy judge whether the procedure shall temporary stay (until the ship is sold in separate procedure and secured creditor's claims satisfied), or it shall be concluded in shortened procedure, on the grounds that there are no bankruptcy assets found for the satisfaction of the bankruptcy creditors. Basically, it will be decided on a case by case basis, so if estimated values of the ship and secured claims give rise to the reasonable expectation of any surplus, the bankruptcy procedure will probably wait for the outcome of such sale.

The suggested inputs to the change of the domestic Laws are considered as simple legal solutions which do not require any additional effort, time or costs for the State's Administration. However, their practical implication is tremendous, because it would finally remove any ambiguity and uncertainty of the position of secured maritime creditors. By providing clear provisions in national Laws, there will be no space left for further interpretation by the courts and wrongful and unjustifiable deprivation of maritime lienees of their secured rights. It is understandable that two special regimes such as admiralty and bankruptcy require professional and educational specialisations in each area. Therefore it is also desirable to encourage the mutual cooperation of the bankruptcy and admiralty judges and other

¹⁰⁷ As suggested in Article 68 of Preamble of the EU Regulation 2015/848.

participants of described procedures,¹⁰⁸ in order to lessen conflicting points between the two, and accelerate the dispute resolution, having in mind that every process of enforcement and satisfaction of claims has its urgent nature.

To conclude, more uniformity in national Laws and practice will finally balance the interests of different creditors and provide for their equitable and fair treatment. And in dealing with rights of maritime secured creditors, the podium will be given back to the regime of maritime law and its distinctive and unique features.

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