The Shipowner Becomes a Bankrupt*

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Both admiralty and insolvency law have their roots in the bowels of antiquity. For example, Moses told the assembled Israelites of their obligations as creditors: "At the end of every seven years you shall grant a release. And this is the manner of the release: every creditor shall release what he has lent to his neighbor; he shall not exact it of his neighbor, his brother, because the LORD's release has been proclaimed."¹

Admiralty too is of ancient vintage, with its precise ancestral heritage resting upon the reliability of such ancient sources as the famous passage from *Justinian's Digest*, where Antoninus is quoted as saying: "I am indeed lord of the world, but the Law is lord of the sea. This matter must be decided by the maritime law of the Rhodians, provided that no law of ours is opposed to it."² And, too, courts of admiralty have been trying to maintain their jurisdiction against incursions by other courts since long before Sir Edward Coke attempted to eliminate the Admiralty as part of his battle to establish the supremacy of the common law courts.³

The conflict between admiralty and competing courts, and between maritime law and competing systems of law, has continued unabated into modern times. Litigants have sharpened the conflict by arguing such jurisdictional and choice-of-law questions to courts in strongly partisan terms, and this same spirit has often infused the judges themselves. The ego of a court, as expressed by its judges, has crept into many an otherwise learned opinion, and no court has asserted its jurisdiction and law with more pride than the Admiralty.⁴ Indeed, its dis-

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¹ *Deuteronomy* 15:1-2.

² JUSTINIAN'S DIGEST 14:2:9. See generally G. GILMORE & C. BLACK, *THE LAW OF ADMIRALTY* §§ 1-2 (1957) [hereinafter cited as GILMORE & BLACK].

³ See D. ROBERTSON, *ADMIRALTY AND FEDERALISM* 28-64 (1970).

⁴ See, e.g., *Taylor v. Carryl*, 61 U.S. (20 How.) 583, 600 (1857) (Taney, C.J., dissenting); *De Lovio v. Boit*, 7 F. Cas. 418 (No. 3776) (Story, Circuit Justice, 1815). See also *Majority*

tinctive vocabulary, which has largely survived the unification of the admiralty and federal rules, attests to its individuality and endurance.

Both jurisdictional and substantive conflicts between maritime and insolvency law become sharply focused when a maritime company becomes enmeshed in an insolvency proceeding. This article will consider these conflicts as they arise in bankruptcies involving vessel owners. Specifically, two separate areas of tension will be examined: (1) jurisdictional disputes in which both admiralty and bankruptcy courts seek to administer and distribute maritime assets belonging to the bankrupt shipowner; and (2) substantive law conflicts in admiralty and bankruptcy rights and liabilities of the shipowner, secured and unsecured creditors, and the bankruptcy trustee. Even with respect to these two narrow areas, this article is necessarily selective and focuses on some recurring situations.

I. JURISDICTION

Consider this situation: A vessel is owned by a bankrupt. It is attached by admiralty process issued by a federal court, which would ordinarily give the admiralty court jurisdiction. But the owner of the vessel has filed a bankruptcy petition, which, pursuant to section 70a of the Act,⁵ gives the bankruptcy court constructive possession of all the bankrupt's property. This hypothetical raises two questions: First, which court has jurisdiction over the vessel? Second, if jurisdiction is vested in the bankruptcy court, to what extent can that court enforce, and foreclose, distinctively maritime interests such as maritime liens and ship mortgages?

Because the same uniform federal law will be applied by either court, one would normally assume that the question of jurisdiction would be unimportant.⁶ Indeed, although the initial decision in a

Report of the Maritime Law Ass'n Comm. on Proposed Rule Requiring Receivers to Provide Security for Maritime Lienors, in 4 E. BENEDICT, ADMIRALTY § 613, at 229-32 (6th ed. 1940); Fiddler, *The Admiralty Practice in Montana and All That*, 17 ME. L. REV. 15 (1965).

⁵ Bankruptcy Act § 70a, 11 U.S.C. § 110(a) (1970). All textual references to certain section numbers or to "the Act" refer to the Bankruptcy Act, which is contained, as amended, in 11 U.S.C. §§ 1-1103 (1970).

⁶ The proposition that admiralty and bankruptcy courts will apply the same law seems so obvious that no explicit statement has been found to that effect. However, it has been implicit in a great number of cases. See, e.g., *The Robert & Edwin*, 32 F.2d 390 (D. Mass. 1929) (trustee takes property subject to valid maritime liens enforced according to admiralty priorities); *The Ironsides*, 13 F. Cas. 103 (No. 7069) (N.D. Ill. 1869) (maritime lien tested under Bankruptcy Act). Indeed, in *Northwest Marine Works v. United States*, 307 F.2d 537 (9th Cir. 1962), the court held that Chapter XIV of the Bankruptcy Act had impliedly modified the mortgagee's power under the Ship Mortgage Act to operate vessels involved in mortgage foreclosures; such operations were subject to the protective provisions of Chapter XIV.

bankruptcy proceeding will usually be rendered by the referee, that decision may be appealed to the same federal district judge who presides over the federal court when exercising admiralty jurisdiction. It may be useful, therefore, to consider the reasons litigants frequently go to great expense to enforce their own jurisdictional preferences. It must be emphasized that these "reasons" are, at least in part, fanciful and imagined, rather than rational responses to actual conditions. Not surprisingly, those with distinctively maritime interests typically seek to invoke the jurisdiction of admiralty, while the bankruptcy trustee and general nonmaritime creditors seek to shift the locus to the bankruptcy court.

Maritime creditors are familiar with the admiralty court, its judges (to the extent that certain judges are regularly assigned to admiralty cases and/or may be identified with leading admiralty cases or particular doctrines of maritime law), and its practices. Maritime creditors, particularly those with a security interest or lien, may believe that admiralty will be more protective of their interests than the bankruptcy court. The same uniform federal law which governs the case whether it is litigated in admiralty or bankruptcy is—as the subsequent discussion will show—quite uncharted. It would be natural for the admiralty court to call close questions of fact or law in favor of the maritime interests, especially when an unfavorable ruling might be contrary to ordinary business methods of maritime companies. There is also some nagging doubt that, even if distinctively maritime interests are ultimately enforced in bankruptcy, the claims may be subordinated to other bankruptcy claims such as administration expenses and other statutory priorities. In addition, since a vessel may be only one of many assets that must be administered by the bankruptcy court, maritime creditors may fear long delays in selling the asset and distributing the proceeds. Even worse, maritime creditors may apprehend that in the bankruptcy court, they will be dragged into an arrangement or reorganization which, at best, would delay any payment and might, in fact, make any ultimate recovery problematical. In contrast, admiralty can quickly sell the vessel and distribute the proceeds in a proceeding limited to the vessel and its creditors. While such preferences cannot serve as jurisdictional arguments, the issue often comes to the fore in expressions of doubt over the ability of bankruptcy referees to cope with the doctrines of admiralty.⁷

The trustee and general creditors, on the other hand, are often perplexed by the distinctive procedures and vocabulary of admiralty and

⁷ See *The Robert & Edwin*, 32 F.2d 390 (D. Mass. 1929); *Hearings on H.R. 6439 Before a Subcomm. of the House Comm. on the Judiciary*, 75th Cong., 1st Sess. 18-20 (1937).

disturbed by the cliquish nature of the admiralty bar. For these parties, the bankruptcy court is the more familiar forum. Moreover, the litigation will be before the referee, with whom the trustee is apt to have a close working relationship. Further, it is generally believed that the referee will be more sympathetic toward the trustee and beleaguered general creditors in deciding close questions of law and fact than would an admiralty court. In addition, litigation in the bankruptcy court may be cheaper, especially when the admiralty court is at a substantial distance from the locus of the bankruptcy. Then, too, the litigation with maritime creditors may involve issues common to other nonmaritime litigation (*e.g.*, insolvency of the debtor) with attendant economies of joint trials and common discovery if the litigation is in the bankruptcy court.

A. Which Court Administers Maritime Assets?

There are two principal procedures by which an admiralty court may obtain jurisdiction over a vessel: First, it may obtain jurisdiction *in rem* in an action to enforce a maritime lien or ship mortgage.⁸ Second, if a creditor's claim does not give rise to a maritime lien, but is a so-called maritime claim, the admiralty court may obtain jurisdiction over a vessel if the creditor brings an *in personam* action against the shipowner and attaches the vessel. This so-called foreign attachment is available when the owner of the vessel is not "found" in the district.⁹ The *in personam* claim with a clause of foreign attachment differs little from an ordinary attachment pursuant to the process of a federal or state court. In either the *in rem* proceeding or the *in personam* claim with a clause of foreign attachment, admiralty obtains jurisdiction over the ship at the time the vessel is physically served or "plastered" by the marshal.¹⁰

The bankruptcy court, on the other hand, obtains jurisdiction over the vessel, pursuant to section 70a, at the time of the filing of the petition in bankruptcy.¹¹

1. *Admiralty in rem Jurisdiction and the Bankruptcy Court.* If admiralty jurisdiction is based on an *in rem* action, it is painfully simple to tell whether a vessel will be administered in admiralty or in bankruptcy. The first court to obtain jurisdiction over the asset

⁸ FED. R. CIV. P. supplementary admiralty rule C.

⁹ *Id.* supplementary admiralty rule B.

¹⁰ *E.g.*, *Taylor v. Carryl*, 61 U.S. (20 How.) 583, 599 (1857).

¹¹ *E.g.*, *Straton v. New*, 283 U.S. 318, 321 (1931), *Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734, 737 (1931); 1 W. COLLIER, BANKRUPTCY ¶ 2.62[1] (14th ed. 1971) [hereinafter cited as COLLIER]; 4A *id.* ¶¶ 70.05-.06.

administers it.¹² Thus, if the marshal, pursuant to admiralty process, has attached the vessel first, the admiralty court administers the asset. If the bankruptcy petition is filed before the marshal reaches the vessel, the bankruptcy court administers the asset. Indeed, this principle of comity is not limited to jurisdiction over ships involved in maritime bankruptcies, but applies generally to the allocation of jurisdiction over the property of a bankrupt among the bankruptcy court and other federal or state courts.¹³

Needless confusion over the respective jurisdictions of bankruptcy and admiralty has occasionally resulted from a failure to focus on the date bankruptcy jurisdiction attached and from overexuberance on the part of admiralty courts in assuming jurisdiction. Previous versions of the Bankruptcy Act were interpreted to provide that bankruptcy jurisdiction did not attach upon the filing of a petition, but at some later date, such as the bankrupt's adjudication or the appointment of a receiver.¹⁴ Similarly, courts interpreting the jurisdiction of state court receiverships held that jurisdiction did not attach until a receiver was appointed and had qualified.¹⁵ In such cases, if the admiralty marshal attached the vessel after the filing of a bankruptcy petition, but before adjudication or before a state court receiver was appointed or had qualified, admiralty had jurisdiction under the principle of comity that the first court to obtain jurisdiction over an asset administers it.

2. *Admiralty Attachment Jurisdiction and the Bankruptcy Court.* When the admiralty process which precedes the bankruptcy petition is pursuant to an in personam action with a clause of foreign attachment, and no in rem attachment occurs until after the petition, it is more difficult to determine which court has jurisdiction. In this situation, as distinct from the maritime lien, the lien is created by judicial pro-

¹² *Morgan v. Sturges*, 154 U.S. 256 (1894); *Taylor v. Carryl*, 61 U.S. (20 How.) 583 (1857); *Murphy v. Bankers Commercial Corp.*, 203 F.2d 645 (2d Cir. 1953); *The Philomena*, 200 F. 859 (D. Mass. 1911); *In re Hughes*, 170 F. 809 (D.N.J. 1909), *aff'd*, 177 F. 916 (3d Cir. 1910); cases cited in notes 66-68 *infra*.

¹³ *E.g.*, *Straton v. New*, 283 U.S. 318, 326 (1931); 1 COLLIER ¶¶ 2.62[1], 2.63.

¹⁴ See 4A COLLIER ¶ 70.05[3]. *The Ironsides*, 13 F. Cas. 103 (No. 7069) (N.D. Ill. 1869), was such a case. The vessel was attached first by a bankruptcy marshal, then by an admiralty marshal, and thereafter, a bankruptcy assignee was appointed. The court held that the bankruptcy court had no custody over the asset until the appointment of the assignee. Thus, admiralty had the initial custody. Cf. *The Bethulia*, 200 F. 862 (D. Mass. 1911), where the court refused to decide whether bankruptcy jurisdiction was complete upon adjudication because it would then have been compelled to decide the more difficult question of the competence of the bankruptcy court over maritime liens. The only teaching that can be derived from *The Bethulia* is that a court should not decide one issue if it will require the decision of a second and more difficult one.

¹⁵ *E.g.*, *Moran v. Sturges*, 154 U.S. 256 (1894).

cess. Thus, if the bankrupt was insolvent at the time the marshal attached the vessel, the lien is voidable under section 67a(1).¹⁶ Moreover, section 67a(4) gives the bankruptcy court summary jurisdiction to invalidate the lien.¹⁷

The question may be posed whether the summary jurisdiction of the bankruptcy court is affected or limited in some way by the custody of the res by the admiralty marshal. Section 67a(4) could be interpreted to grant the bankruptcy court either exclusive jurisdiction, paramount jurisdiction, or concurrent jurisdiction to avoid 67a(1) liens obtained by legal or equitable proceedings within four months of bankruptcy. The argument against interpreting section 67a(4) to provide for exclusive bankruptcy jurisdiction which would deny the admiralty court the power to pass on the voidable lien is strong, based on three considerations: First, section 67e grants concurrent jurisdiction to state and federal courts for proceedings under "this section" (presumably all of section 67 and not just 67d).¹⁸ Second, section 67a(4) was enacted to overrule *Taubel-Scott-Kitzmillier Co. v. Fox*,¹⁹ which had denied the bankruptcy court jurisdiction to avoid liens obtained within four months of bankruptcy by legal or equitable proceedings, even though the court had such jurisdiction under the related preference and lien-avoidance sections of the Act. There is no indication that in correcting this anomaly and conferring jurisdiction upon the bankruptcy court in 67a cases, Congress meant an exclusive jurisdiction which would exclude other federal and state courts from exercising power even though such courts had traditionally heard 67a cases and it might be more convenient and expeditious for them to continue doing so in particular instances.²⁰ Third, in a number of cases nonbankruptcy courts have adjudicated claims under section 67a(1).²¹

The question of paramount versus concurrent jurisdiction is more difficult. The argument that section 67a(4) provides for paramount

¹⁶ See text at notes 145-48 *infra*.

¹⁷ Section 67a(4) provides: "The court shall have summary jurisdiction of any proceeding by the trustee or debtor, as the case may be, to hear and determine the rights of any parties under this subdivision a [to invalidate judicial liens] . . ."

¹⁸ Section 67e provides: "For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."

¹⁹ 264 U.S. 426 (1924).

²⁰ See 4 COLLIER ¶ 67.18, at 205.

²¹ See 4 COLLIER ¶ 67.18. For example, in *Diana Compania Maritima, S.A. v. Subfreights of the S.S. Admiralty Flyer*, 280 F. Supp. 607 (S.D.N.Y. 1968), the court sitting in admiralty considered the validity of certain maritime liens under section 67a, without any discussion of its power to do so. *But see* *Emil v. Hanley*, 318 U.S. 515, 520 (1943), suggesting that bankruptcy jurisdiction over section 67a liens is exclusive.

jurisdiction is strong. First, the wording of section 67a(4) may be sharply contrasted with the provisions of sections 60b, 67e, and 70e, which establish concurrent jurisdiction of state and federal courts for the avoidance of preferences, fraudulent conveyances, and voidable liens. Second, the purpose of section 67a was to speed up the liquidation of the bankrupt's estate,²² and this would be frustrated if the summary proceeding could not be utilized in any case where the bankruptcy court could not obtain jurisdiction of all the assets because of other pending proceedings. Section 2a(21) of the Act, which gives the bankruptcy court the power to require receivers or trustees appointed in nonbankruptcy proceedings to deliver property to the trustee, may be employed summarily to require court officers to surrender to the trustee any property held by them which is subject to liens avoided by section 67a.²³ Accordingly, the bankruptcy court has been held to have summary jurisdiction over lien avoidance proceedings even when the property involved was in the hands of an adverse claimant or court officer.²⁴ Moreover, state proceedings to enforce liens invalidated by section 67a(1) may be enjoined by the bankruptcy court.²⁵ Consequently, the bankruptcy court's jurisdiction must be regarded as paramount.²⁶

If, in the exercise of its paramount jurisdiction, the bankruptcy court determines an attachment lien procured in admiralty to be invalid under section 67a(1), does the admiralty court retain jurisdiction to pass on claims for maritime liens which were asserted after the filing of the bankruptcy petition? Although nonbankruptcy courts having jurisdiction over property, including an admiralty court which has asserted jurisdiction to enforce a maritime lien, may adjudicate all lien claims even if filed after bankruptcy,²⁷ this power requires an

²² See 4 COLLIER ¶ 67.18, at 199.

²³ See *Emil v. Hanley*, 318 U.S. 515, 518-19, 521 (1943); 1 COLLIER ¶ 2.78[1], at 390.9, 390.13-14, 390.18-19; 4 *id.* ¶ 67.18, at 205-06. As a matter of comity, it may be wise for the trustee initially to seek a stay in the nonbankruptcy court or, at least, to give that court notice of the pending section 67a proceedings in the bankruptcy court. 1 *id.* ¶ 2.78[1], at 390.19; 4 *id.* ¶ 67.19.

²⁴ See *In re Wilks*, 196 F. Supp. 640 (N.D. Cal. 1961); *In re Estes*, 105 F. Supp. 761 (N.D. Tex. 1952), *aff'd sub nom.* *Pearson v. Rapstine*, 203 F.2d 313 (5th Cir. 1953).

²⁵ See *In re Barry Indus., Inc.*, 127 F. Supp. 793 (E.D. Mich. 1955); 1 COLLIER ¶ 2.63, at 351 n.5, 356.

²⁶ See *In re Admiralty Lines, Ltd.*, 280 F. Supp. 601 (E.D. La. 1968), *aff'd*, 410 F.2d 398 (5th Cir. 1969), where the court allowed an ancillary bankruptcy court to invalidate attachment liens under section 67a, although the funds were held in the registry of the admiralty court in the same district. Two judges on separate occasions rejected the attaching creditor's claim that the proper procedure was for the trustee to intervene in the then pending admiralty proceeding.

²⁷ See *Atlantic Flooring & Insulation Co. v. Russell*, 145 F.2d 493 (5th Cir. 1944), *cert.*

initially valid custody in the nonbankruptcy court prior to the filing of the bankruptcy petition. Section 67a(3) provides that any property discharged from a voidable lien "shall pass to the trustee," and this may be interpreted to place the trustee who has invalidated an attachment lien in the same position as if the lien had never been placed on the property. Consequently, the bankruptcy court would be the first court to have custody of the vessel and would administer it.²⁸

B. Jurisdiction of the Bankruptcy Court over Maritime Liens and Ship Mortgages

If the admiralty court administers the assets, it has the power to execute maritime liens and ship mortgages. But if, as under the foregoing discussion, the bankruptcy court is administering the assets, its power to do so may be subject to serious question. Initially, a distinction should be noted between the power of a court to *enforce* maritime liens and ship mortgages upon the consent of a creditor and its power, over the objection of a creditor, to sell a vessel free of such interests and transfer the liens to the proceeds, or, in other words, to *execute* such liens and mortgages. It is possible that the bankruptcy court may have the power to enforce liens but not to execute them.

1. *Maritime Liens: The Scope of the Problem.* Although a very recent decision of the prestigious United States District Court for the Southern District of New York regarded the question of the bankruptcy court's power over maritime liens as still unsettled,²⁹ Judge Blatchford, of the Eastern District, had had very little difficulty in deciding this issue more than 100 years earlier in *In re People's Mail S. S. Co.*³⁰ There, after the bankruptcy assignee secured jurisdiction over a vessel belonging to the bankrupt, the vessel was attached by an admiralty marshal at the instance of a maritime lienor seeking to enforce his claim for personal injuries. Judge Blatchford readily enjoined the admiralty proceedings and told the maritime lienor that his claim should be submitted to the bankruptcy court: "If libellants have . . . a lien on the vessel, this court, sitting in bankruptcy, has full power under section 1 of the bankruptcy act, to ascertain and liquidate such lien, on its being presented . . . to this court sitting in bankruptcy."³¹

Some forty years later, notwithstanding extensive talk during the

denied, 325 U.S. 862 (1945); *The Philomena*, 200 F. 859, 862 (D. Mass. 1911). See generally 1 COLLIER ¶ 2.78[1], at 390.10-.12.

²⁸ Cf. *In re Bowden*, 274 F. Supp. 729 (D. Me. 1967).

²⁹ See *Empire Stevedoring Co. v. Oceanic Adjusters, Ltd.*, 315 F. Supp. 921, 925 (S.D.N.Y. 1970).

³⁰ 19 F. Cas. 211 (No. 10,970) (E.D.N.Y. 1869).

³¹ *Id.* at 212.

intervening period about the exclusive power of admiralty courts over maritime liens, the matter seemed equally obvious to District Judge Ward, then sitting in a case involving the power of a federal equity receivership to foreclose maritime liens. Judge Ward stated:

A court of bankruptcy would apparently have a right to sell free of maritime liens. Such courts are created by statute, and it has been held in decisions under the bankruptcy acts of 1841, 1867, and 1898 that they have this power under those statutes. These courts, however, proceed in rem. They seize the bankrupt's estate and finally distribute it among all his creditors, and as Congress may pass laws impairing the obligation of contracts, they are empowered to discharge the bankrupt from all liabilities for his debts.³²

Nevertheless, some courts were queasy about the power of the bankruptcy court over maritime liens. In one case, *In re Hughes*,³³ the bankruptcy court, although it had first obtained jurisdiction over the vessel, authorized an admiralty sale for the purpose of avoiding expensive litigation. Undaunted, the bankruptcy court then subjected the fund to various bankruptcy administration expenses. In other cases, the courts "consolidated" bankruptcy and admiralty proceedings so that the judge could be considered to be wearing his admiralty hat when the vessel was sold.³⁴ Yet in other instances, bankruptcy courts apparently sold vessels free of liens without objection from maritime lienors.³⁵

In view of the dominant authority supporting the complete administration of maritime liens by bankruptcy courts, why in 1970 did

³² *Hudson v. New York & Albany Transp. Co.*, 180 F. 973, 978 (2d Cir. 1910) (dictum) (district court opinion); *accord*, *Hudson v. New York & Albany Transp. Co.*, 175 F. 519, 520, 522 (S.D.N.Y. 1909). The "decisions under the bankruptcy acts of 1841, 1867, and 1898" are not cited, and it can only be surmised that Judge Ward was referring to *In re People's Mail S.S. Co.*, 19 F. Cas. 211 (No. 10,970) (E.D.N.Y. 1869), and other unreported decisions.

³³ 170 F. 809 (D.N.J. 1909), *aff'd*, 177 F. 916 (3d Cir. 1910); *see* *The Artemis*, 53 F.2d 672, 680 (S.D.N.Y. 1931) (vessels sold in ancillary admiralty proceeding, but bankruptcy, "as the dominant jurisdiction, has control of [the] proceedings in admiralty"); *In re New England Transp. Co.*, 220 F. 203 (D. Conn. 1914) (foreclosure in admiralty authorized by bankruptcy court, part of proceeds subjected to bankruptcy expenses). Apparently, a similar procedure was adopted in *Atlantic Steamer Supply Co. v. The Tradewind*, 144 F. Supp. 408 (D. Md. 1956), where the whole proceeding was transferred to the admiralty court. There is no indication that jurisdictional issues were raised.

³⁴ *Collier Advertising Serv. v. Hudson River Day Line*, 14 F. Supp. 355 (S.D.N.Y. 1936), *aff'd*, 93 F.2d 457 (2d Cir. 1937).

³⁵ *In re Fougner Concrete Shipbuilding Co.*, 286 F. 379 (2d Cir. 1923); *In re Marine Transit Corp.*, 20 F. Supp. 414 (S.D.N.Y. 1937), *modified*, 94 F.2d 7 (2d Cir. 1938); *see In re Atlantic, Gulf & Pac. S.S. Co.*, 3 F.2d 309 (D. Md. 1923), *aff'd sub nom. Standard Oil Co. v. Miller*, 3 F.2d 438 (4th Cir. 1925).

the Southern District regard the issue as still unsettled? There are two principal reasons: First, a line of cases seemed to stand for the proposition that only an admiralty court could execute maritime liens and no one had bothered to consider the scope and powers of different nonadmiralty courts separately. Second, no case on point had been decided since the issue had never been squarely presented.

2. *The Waters Muddy*. Shortly before the turn of the century, a line of cases began to propagate the view that maritime liens could be executed and the vessel sold free of such liens only in admiralty and could not be so sold in either a federal equity receivership or a bankruptcy proceeding. This notion was derived from some unfortunate language by the Supreme Court in *Moran v. Sturges*,³⁶ compounded by the failure to differentiate among state court proceedings, federal equity receiverships, and bankruptcy proceedings and fueled by a little overstatement of the scope and powers of admiralty. *Moran* itself was an innocuous case involving a jurisdictional contest between admiralty and a state court receivership. The admiralty court was held to have jurisdiction over the vessel involved because the federal marshal had attached the vessel prior to the qualification of a state court receiver, and as a matter of interpretation of the state law involved, the state court's jurisdiction was held not to attach until the receiver had qualified.³⁷ This result is as unexceptionable now as it was then, resting on the familiar principle of comity that the admiralty court, having first obtained jurisdiction over the asset, administers it.

But the Supreme Court in *Moran* was not content to limit itself to such traditional doctrine; the opinion also contained a lengthy dictum about the exclusive power of admiralty courts to enforce and execute maritime liens in in rem proceedings.³⁸ One cannot quarrel with a narrow construction of the dictum—that state courts had no power to enforce and execute maritime liens—since this too was part of the conventional wisdom. The constitutional and statutory grants of admiralty jurisdiction to the federal courts had been held, in a series of cases, to bar the state courts from administering the distinctive in rem procedure of admiralty.³⁹

After *Moran* came *Hudson v. New York & Albany Transportation*

³⁶ 154 U.S. 256 (1894).

³⁷ The dissenters pointed out that under New York law, as construed by the highest New York court, the state court has custody from the time the state proceeding was initiated. *Id.* at 286-87. It is not clear on what basis the majority substituted its own view of when the state court's custody began for that of the New York courts.

³⁸ *Id.* at 277-78, 283, 285.

³⁹ *The Moses Taylor*, 71 U.S. (4 Wall.) 411 (1866); *The Hine v. Trevor*, 71 U.S. (4 Wall.) 555, 571 (1866).

Co.,⁴⁰ where the issue was the power of a federal court, administering an equity receivership, to execute maritime liens and to sell a vessel free of such liens. Relying on *Moran*, the court of appeals held that the equity court had no such power, but also held that the maritime lienors had consented to the sale by appearing in the equity proceeding. And, while not made explicit in the court's opinion, the district court had distinguished the equity receivership from a bankruptcy proceeding and had acknowledged the power of a bankruptcy court to execute maritime liens.⁴¹

The reasons for the distinction in *Hudson* between an equity receivership and a bankruptcy proceeding are obscure. Presumably, it was partially because of the specific constitutional and statutory authority for bankruptcy proceedings. To deny the bankruptcy court the power to sell maritime property free of maritime liens and to transfer the lienor's rights to the proceeds, it would be necessary to hold either that there was something so inviolate about maritime liens that the constitutional bankruptcy power did not authorize any interference with the remedial rights of maritime lienors or that Congress had not given bankruptcy courts the power to enforce and execute maritime liens. Judge Ward rejected the former possibility by noting that the bankruptcy clause authorized impairing contractual obligations,⁴² and numerous decisions since that time—although not focusing specifically on maritime liens—have attested to the broad constitutional power of Congress to authorize the sale of the bankrupt's property free of liens or otherwise to alter the remedial rights of secured or lien creditors.⁴³ Indeed, it may be argued that Congress could constitutionally subordinate the rights of maritime lienors to other interests or eliminate them entirely.⁴⁴ No reason appears for denying the effectiveness of this constitutional power over maritime liens.

⁴⁰ 180 F. 973 (2d Cir. 1910).

⁴¹ See note 32 *supra*.

⁴² 180 F. at 978; *accord*, *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502 (1938); *Kuehner v. Irving Trust Co.*, 299 U.S. 445 (1937); *In re Prima Co.*, 88 F.2d 785, 788 (7th Cir. 1937); *Campbell v. Alleghany Corp.*, 75 F.2d 947, 953 (4th Cir.), *cert. denied*, 296 U.S. 581 (1935).

⁴³ See *Wright v. Vinton Branch of the Mountain Trust Bank*, 300 U.S. 440 (1937); *Continental Ill. Nat'l Bank & Trust Co. v. Chicago, R.I. & P. Ry.*, 294 U.S. 648, 680-81 (1935); *Van Huffel v. Harkelrode*, 284 U.S. 225 (1931); *Allebach v. Thomas*, 16 F.2d 853 (4th Cir.), *cert. denied*, 274 U.S. 744 (1927); cases cited notes 45-46 *infra*.

⁴⁴ See *Kuehner v. Irving Trust Co.*, 299 U.S. 445 (1937) (constitution authorizes limiting claim for breach of lease to three years rental, notwithstanding greater amount due under terms of lease); *In re Dania Corp.*, 400 F.2d 833, 837 (5th Cir. 1968), *cert. denied*, 393 U.S. 1118 (1969) (constitution authorizes diminution of value of secured creditor's collateral in Chapter X reorganization); *Campbell v. Alleghany Corp.*, 75 F.2d 947 (4th Cir.), *cert. denied*, 296 U.S. 581 (1935) (constitution authorizes modification of rights of secured

Once the constitutional question is answered, the only remaining issue is whether Congress has given bankruptcy courts the power to sell vessels free of maritime liens. Judge Blatchford in *People's Mail* found authority for the execution of maritime liens in the general bankruptcy power (now contained in sections 2a(7) and 70f) to collect the bankrupt's estate, liquidate all inchoate and vested interests, and sell the bankrupt's property. While it would be difficult at this point in time to attribute a specific intention to Congress to grant bankruptcy courts the power to execute maritime liens, it is possible to infer such a power from the statutory scheme giving the bankruptcy court broad power to deal with the bankrupt's property and to liquidate the estate in an orderly manner. It has been held that the Bankruptcy Act supersedes the contractual rights of secured creditors to realize on their security in a designated way (e.g., at a private sale) and authorizes the bankruptcy court to administer the assets, with the creditor's interest attaching to the proceeds of their sale.⁴⁵ Similar holdings have been made with respect to other liens which, absent the bankruptcy, would be enforced in a state court.⁴⁶ Although no case has specifically applied the broad doctrine laid down by these cases to maritime liens, it can only be presumed that the decisions sustaining the power of the bankruptcy court found that the Bankruptcy Act provisions are sufficiently broad to embrace maritime liens.

As another basis for distinguishing bankruptcy from equity proceedings, Judge Ward in *Hudson* emphasized that a court of bankruptcy acts in rem. Presumably, he was thinking of the old saw that equity acts in personam and not in rem and questioning the power of an equity court to render a decree against unknown lienors or those not subject to the court's jurisdiction. Whatever the validity of the old saw at the time of the *Hudson* decision, the advent of large and complex equity receiverships some years later should have put it to rest.⁴⁷ This ground of distinction, then, is of doubtful validity.

creditors in Chapter X reorganization); Bankruptcy Act § 67c, 11 U.S.C. § 107(c) (1970); cf. *Louisville & N.R.R. v. Mottley*, 219 U.S. 467, 480-82, 484 (1911); *Legal Tender Cases*, 79 U.S. (12 Wall.) 457, 549-50 (1871). See also *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

⁴⁵ See, e.g., *Wright v. Vinton Branch of the Mountain Trust Bank*, 300 U.S. 440, 470 (1937); *Allebach v. Thomas*, 16 F.2d 853 (4th Cir.), cert. denied, 274 U.S. 744 (1927); *In re Gimbel*, 294 F. 883 (5th Cir. 1923); *In re Franklin Brewing Co.*, 249 F. 333 (2d Cir. 1918).

⁴⁶ See *Van Huffel v. Harkelrode*, 284 U.S. 225 (1931); *In re Wiltse Bros. Corp.*, 361 F.2d 295 (6th Cir. 1966). See generally 1 COLLIER ¶ 2.44; 4A *id.* ¶¶ 70.97, 70.99, at 1133-36 & nn. 15-17.

⁴⁷ Developments and refinements in the equity receivership cast grave doubt on the "old saw," and equity receiverships often appeared to act in rem. See *Dodd, Equity Receiverships as Proceedings in Rem*, 23 ILL. L. REV. 105 (1928).

Notwithstanding this distinction between equity proceedings and bankruptcy proceedings, Judge Learned Hand held in *In re Interocean Transportation Co.*⁴⁸ that the bankruptcy court had no power to execute and enforce maritime liens. In that case, the question was whether the bankruptcy court had jurisdiction to administer funds representing freight paid by a shipper and claimed by a maritime lienor. Jurisdiction was denied on the ground that the funds were held adversely to the trustee and, therefore, were not in the constructive possession of the bankruptcy court to provide a basis for the assertion of summary jurisdiction. But, alternatively, even though the fund in question was attached by admiralty process after the filing of the bankruptcy petition, the court found no jurisdiction on the ground that the bankruptcy court had no power to execute maritime liens under *Moran* and that *Moran* was "equally applicable between a federal court sitting as a court of admiralty and the same court sitting in any other capacity as it is between the admiralty court and a state court. . . ."⁴⁹ Judge Hand did not support this proposition with any analysis, and his sole case law authority was *Hudson*, which, as previously noted, sharply distinguished equity receiverships from bankruptcy proceedings and did not equate all federal courts sitting in nonadmiralty capacities.⁵⁰

3. *Moran v. Sturges: Admiralty Courts and Equity Receiverships.* Much of the support for the proposition that the bankruptcy court cannot execute maritime liens appears to be based on the notion that a federal court administering an equity receivership cannot do so. Since this proposition is derived from *Moran v. Sturges*,⁵¹ it may be useful to focus on the rationale for the *Moran* decision and to ask whether that rationale may properly be applied to a federal equity receivership.

The underpinnings of *Moran* are hard to decipher. Arguably, *Moran* was based on jurisdictional grounds—i.e., that only a federal admiralty court had subject matter jurisdiction to enforce and execute maritime liens. This proposition, however, is doubtful in light of another dictum

⁴⁸ 232 F. 408 (S.D.N.Y. 1916).

⁴⁹ *Id.* at 410.

⁵⁰ See text at notes 41–46 *supra*. Actually, even assuming that the bankruptcy court lacked power to enforce maritime liens, this did not prevent it from administering the fund. Thus, in *Taylor v. Carryl*, 61 U.S. (20 How.) 583 (1857), the Supreme Court held that a state court which first obtained jurisdiction over a vessel could administer it even though state courts lacked the power to execute maritime liens. Perhaps Judge Hand did not apply the *Taylor* rule because of a line of cases, apparently approved in *Moran*, which held *Taylor* inapplicable when the property was not a vessel but a fund. 154 U.S. at 279–81. The theory was that unlike a vessel, which could be sold subject to a lien, the fund, once distributed, contained nothing to which a maritime lien could attach.

⁵¹ See text at notes 36–50 *supra*.

in *Moran*, which suggested that even a state court could enforce a maritime lien upon the consent of the creditor and, presumably, that a vessel could be sold free of the lien of such a consenting lienor. The notion that a maritime lienor could consent to enforcement of his lien in a nonadmiralty forum was reinforced in *Hudson*, where the court held that by participating in an equity receivership, the maritime lienors had consented to jurisdiction and that, consequently, the vessel involved was subject to sale free of liens. Yet under familiar principles, subject matter jurisdiction cannot be conferred by consent.⁵² It is hard, therefore, to reconcile *Moran* and *Hudson* with a subject matter jurisdiction rationale.⁵³

It is possible to resurrect the exclusive subject matter jurisdiction rationale if it is assumed that admiralty courts had sole subject matter jurisdiction over the distinctive in rem procedure for enforcing and executing maritime liens, but that the underlying claims could be adjudicated in any forum which otherwise had subject matter jurisdiction over the case, personal jurisdiction over the claimant, and custody of the vessel. In the case of a federal equity receivership, jurisdiction would originally be based on a diversity suit to enforce a debt, and custody of the vessel would be based on a need to conserve the estate after execution on a judgment was returned unsatisfied.⁵⁴ Under this analysis, the consent discussed in *Moran* and *Hudson* is not consent to subject matter jurisdiction, but consent to personal jurisdiction over the claimant. On this reasoning, the equity court does not execute the maritime lien as it would if proceeding in admiralty. But the court does "recognize" (enforce) the lien and may accord it priority as sort of a *quid pro quo* for participating in the equity proceeding. And, under general principles of res judicata, waiver, and estoppel, the maritime lienor's participation in equity will prevent him, if he is dissatisfied with the equity result, from proceeding anew in admiralty.⁵⁵ Of course, the equity court would still lack the power to sell the vessel free of all liens, including those of nonconsenting lienors, or, in other words, to execute all maritime liens.⁵⁶

There are several difficulties with this rationale. First, it would mean

⁵² E.g., C. WRIGHT, FEDERAL COURTS § 7 (2d ed. 1970).

⁵³ Numerous other statements attest to the power of a nonadmiralty court to enforce liens upon consent. See, e.g., *The J.G. Chapman*, 62 F. 939, 940 (D. Minn. 1894); *The Willamette Valley*, 62 F. 293, 297 (N.D. Cal. 1894), *aff'd*, 66 F. 565 (9th Cir. 1895).

⁵⁴ See 6 COLLIER ¶ 0.04[2.1].

⁵⁵ See *The Resolute*, 168 U.S. 437, 441 (1897); *Northwestern Commercial Co. v. Bartels*, 131 F. 25 (9th Cir. 1904).

⁵⁶ In *Hudson*, all lienors were before the court, and the vessel could therefore be sold free of such liens.

that if the equity court could obtain personal jurisdiction without the claimant's consent, as by personal service, it would be able to adjudicate the lien claims. There is no indication of this in either *Moran* or *Hudson*. But, more fundamentally, it is based on a conception of federal equity courts which, though widely propagated, is best forgotten.

To find that a federal equity court lacks the power to execute maritime liens, it is necessary to assume that the Constitution set up a tripartite jurisdictional scheme—law, equity, and admiralty—with each court being separate and distinct and not possessing the powers of the others. At first blush, this conception seems hardly farfetched. Distinguished jurists and scholars have spoken of courts of admiralty as if they were specialized tribunals,⁵⁷ and the journeyman might be surprised to learn that this “admiralty court” is really the federal district court presided over by a federal district judge. The tripartite jurisdictional conception is reinforced by recurring statements that admiralty courts have no general equity powers and are unable to enforce quasi-contractual obligations.⁵⁸ This conception has even pervaded Supreme Court opinions. Thus, the decision in *Romero v. International Terminal Operating Co.*,⁵⁹ holding maritime claims to be outside the general federal question jurisdiction, is partially an attempt to distinguish federal courts generally from admiralty courts and to preserve the distinctive jurisdictional and procedural rules (mainly absence of jury trial) to admiralty.

One gets a nostalgic feeling in talking about courts of admiralty. The discussion provokes the image of great clipper ships and men with long beards recounting, over steins of ale, tales of far-off places, strange peoples, and rich treasures. Perhaps it inspires a pang of regret that the admiralty proctor can no longer be a part of this world, albeit vicariously. But such longings should not be permitted to obscure the nature of the federal courts. Section 1333 of the Judicial Code gives

⁵⁷ In *The Sarah*, 21 U.S. (8 Wheat.) 391, 394 (1823), Chief Justice Marshall stated: “Although the two jurisdictions are vested in the same tribunal, they are as distinct from each other as if they were vested in different tribunals, and can no more be blended, than a Court of Chancery with a Court of common law.” Among the commentators who have been found to talk of “admiralty courts” are GILMORE & BLACK §§ 1-11, 1-14, at 29, 37; Fiddler, *supra* note 4.

One can get a feeling for the separateness of the admiralty court in some of the commentary over the unification of the federal civil and admiralty rules. See Crutcher, *Imaginary Chair Removed from the United States Courthouse; or, What Have They Done to Admiralty?*, 5 WILLAMETTE L.J. 367 (1969); Wiswall, *Admiralty: Procedural Unification in Retrospect and Prospect*, 35 BROOKLYN L. REV. 36 (1968).

⁵⁸ The authorities are succinctly marshaled and analyzed in D. CURRIE, *FEDERAL COURTS* 409-12 (1968). Professor Currie concludes, as had several earlier commentators, that these limitations on the remedial powers of admiralty are ridiculous.

⁵⁹ 353 U.S. 354 (1959).

admiralty jurisdiction to the district courts,⁶⁰ not to some special type of admiralty tribunal, and, despite the language denying equity powers to admiralty, most admiralty courts have given equitable-type remedies when the occasion has demanded.⁶¹ Moreover, the majority of federal courts have refused to accept this tripartite concept and have adopted a unitary approach in dealing with maritime cases which, for some reason, were improperly brought on the admiralty or law side.⁶² Finally, while it is beyond the scope of this paper to analyze this concept of federal admiralty courts as a separate jurisdiction in great detail, Prof. Brainerd Currie has done so in the personal injury context and has concluded that the symbol of separatism, the famous Silver Oar, "[s]hould never interfere with the unitary character of the district court, nor with the just, convenient, and efficient conduct of judicial business"⁶³

Although the author believes that Professor Currie's analysis would be equally applicable to prove the power of a federal equity receivership to execute maritime liens, this question is now moot. The enactment of the reorganization and arrangement provisions of Chapters X and XI of the Bankruptcy Act has sounded the death knell of the much criticized and less flexible equity receivership. In a Chapter X

⁶⁰ See *West Ky. Coal Co. v. Dillman*, 15 F.2d 25, 26 (8th Cir. 1926); D. CURRIE, *supra* note 58, at 412.

⁶¹ E.g., *Swift & Co. Packers v. Compania Colombiana Del Caribe, S.A.*, 339 U.S. 684, 691-92 (1950); *Tropicana Shipping, S.A. v. Empresa Nacional "Elcano,"* 366 F.2d 729, 732 (5th Cir. 1966).

⁶² See *Stern, Hays & Lang, Inc. v. M/V Nili*, 407 F.2d 549, 551 (5th Cir. 1969); *James Richardson & Sons v. Connors Marine Co.*, 141 F.2d 226, 229 (2d Cir. 1944) (Clark, J.); *Prince Line v. American Paper Exports*, 55 F.2d 1053 (2d Cir. 1932) (L. Hand, J.). *But cf. Higa v. Transocean Airlines*, 230 F.2d 780 (9th Cir. 1955), *appeal dismissed per stipulation*, 352 U.S. 802 (1956); *Kunkel v. United States*, 140 F. Supp. 591 (S.D. Cal. 1956). *Higa* appears to have been watered down, if not overruled, by *Beverly Hills Nat'l Bank & Trust Co. v. Compania de Navegacione Almirante S.A.*, 437 F.2d 301, 306 (9th Cir.), *cert. denied*, 402 U.S. 996 (1971).

⁶³ Currie, *The Silver Oar and All That: A Study of the Romero Case*, 27 U. CHI. L. REV. 1, 65 (1959); see 5 J. MOORE, *FEDERAL PRACTICE* ¶ 38.08[4] (2d ed. 1969); Comment, *The Adjudication of Maritime Liens in Bankruptcy Proceedings*, 10 TUL. L. REV. 461 (1936). In *Stern, Hays & Lang, Inc. v. M/V Nili*, 407 F.2d 549, 551 (5th Cir. 1969), Judge Brown stated: "The melding of the civil with admiralty does more than obliterate the cherished hoary title of proctor. It invests the Judge with all of the statutory powers, whether their genesis be formerly at law, in equity, or in admiralty."

One author has argued that, whatever the pre-1966 situation, the merger of the federal civil and admiralty rules removed any limitations on the powers of admiralty to grant equitable remedies. Colby, *Admiralty Unification*, 54 GEO. L.J. 1258, 1268-69 (1966). The evaluation of this conclusion—which seems to be reinforced by Stern—must await another date. But if it is correct, perhaps the merger may also lay to rest any nagging doubts of the power of a federal court administering an equity receivership to exercise admiralty powers by executing maritime liens.

or XI case involving a question of the court's power to execute maritime liens, it is possible to rely not only on a general notion of federal court power as in the case of an equity receivership, but on the specific lien liquidation provisions of the Bankruptcy Act.⁶⁴

4. *Maritime Liens: Old Cases Never Die, They Just Fade Away.* There is no reason to belabor the question raised by *Moran* since, in any event, the most important aspect of *Moran* and its progeny, *Hudson* and *Interocean*, is that they are conspicuously absent from a line of decisions beginning in 1916 with *The Casco*,⁶⁵ which give broad interpretations of the power of a federal court over maritime liens. While the power of a federal court to enforce maritime liens upon consent seems to have been conclusively settled—if, after the *Moran* dictum and the *Hudson* holding, it was ever open—the power over a non-consenting lienor is still somewhat in doubt because none of these decisions explicitly held that a federal court has the power to execute maritime liens.

The Casco is typical. After an ancillary bankruptcy court had obtained jurisdiction over a vessel, a maritime lienor moved to have the vessel surrendered to an admiralty marshal so that maritime lien claims could be tried in admiralty. The motion was denied. The court found that the bankruptcy court had acquired jurisdiction first since the vessel was in its *custodia legis* prior to the admiralty seizure. Moreover, the court alluded to a possible violation of the Bankruptcy Act if the bankruptcy court relinquished its custody. The maritime lienor was told to intervene in the bankruptcy proceedings then pending in another district.

Following *The Casco*, other cases held similarly that when a vessel was in the *custodia legis* of the bankruptcy court, it could not be released to admiralty, and the rule was applied without distinction to equity receiverships.⁶⁶ None of these cases, however, specifically dealt with the power of the federal court to enforce and execute maritime liens over the objection of a maritime lienor. In several, the courts opined that the bankruptcy court was a fairer forum to consider the maritime interests since the claims of all creditors would be considered, told the maritime lienor to intervene in the equity or bankruptcy proceedings, and intimated that the lien could be enforced there.⁶⁷ Some cases went

⁶⁴ See text at notes 42–46 *supra*.

⁶⁵ 230 F. 929 (D. Mass. 1916).

⁶⁶ *First Union Trust & Sav. Bank v. Consumers' Co.*, 63 F.2d 273 (7th Cir.), *rev'd as moot*, 290 U.S. 585 (1933); *Consumers' Co. v. Goodrich Transit Co.*, 53 F.2d 972 (7th Cir. 1931), *cert. denied*, 286 U.S. 548 (1932).

⁶⁷ *First Union Trust & Sav. Bank v. Consumers' Co.*, 63 F.2d 273, 274 (7th Cir.), *rev'd as*

further and suggested in dicta that the bankruptcy court did have the power to enforce and execute maritime liens upon a res which was within its custody.⁶⁸ Although it appears likely that the question of the power of the bankruptcy court was raised in at least some of these cases, all may be interpreted as turning on the basic principle of comity which allocates jurisdiction to the first court obtaining custody of the asset. The only way to obtain a precise holding of the bankruptcy court's power would be for a maritime lienor to object to enforcement and foreclosure in a nonadmiralty proceeding or to await the non-admiralty sale and then sue to enforce his lien on the ground that the sale did not execute the lien.⁶⁹ Consequently, there may still be room, albeit slight, for a creditor to raise such a point some time in the future.⁷⁰

5. *Ship Mortgages.* Until 1920, ship mortgages were not considered maritime contracts. This meant that suits to foreclose such mortgages could not be brought in admiralty, whether in personam or in rem. If an in rem action had been brought by another maritime lienor, the mortgagee might intervene and claim surplus proceeds. But procedurally he was required to await action by such a maritime lienor, and substantively his interest was subordinate to those of all maritime lienors. Needless to say, ship mortgages were not considered attractive investment vehicles.⁷¹

moot, 290 U.S. 585 (1933); *In re New York, N.H. & H.R.R.*, 17 F. Supp. 488 (D. Conn. 1936); *The Robert & Edwin*, 32 F.2d 390 (D. Mass. 1929); see *Butler v. Ellis*, 45 F.2d 951 (4th Cir. 1930). There is some authority suggesting that *The Robert & Edwin* is a direct holding on the power of a bankruptcy court to enforce and execute maritime liens. Comment, *supra* note 63, at 465. However, the lienors apparently simply argued that admiralty was the "better" forum, 32 F.2d at 390, and did not make a full-fledged jurisdictional attack.

⁶⁸ See *West Ky. Coal Co. v. Dillman*, 15 F.2d 25, 26 (8th Cir. 1926); *Defense Plant Corp. v. United States Barge Lines, Inc.*, 57 F. Supp. 14 (S.D.N.Y.), *aff'd*, 145 F.2d 766 (2d Cir. 1944); *In re New York, N.H. & H.R.R.*, 17 F. Supp. 488 (D. Conn. 1936).

⁶⁹ This was the situation in *The Goulondris*, [1927] P. 182. That decision involved an Egyptian bankruptcy proceeding which the English court interpreted as being in personam and selling only the owner's interest in the vessel. It seems clear that if the Egyptian proceedings were in rem, the lien would have been extinguished. See *Castrique v. Imrie*, L.R. 4 H.L. 414 (1870).

⁷⁰ The commentators are not unanimous, but generally approve foreclosure of maritime liens in bankruptcy. See GILMORE & BLACK §§ 9-91 to -95; G. ROBINSON, ADMIRALTY §§ 59, 65 (1939); Comment, *supra* note 63. *Contra*, 1 E. BENEDICT, ADMIRALTY § 17 (6th ed. 1940); Fiddler, *supra* note 57, at 27-28; Fridlund, *Federal Taxes and Preferred Ship Mortgages*, 38 HARV. L. REV. 1060, 1072 (1925). The Fridlund discussion is an obiter dictum in a generalized discussion of, alas, ship mortgages and taxes. It is, in the author's judgment, superficial and lacking in authoritative support.

⁷¹ See *Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21 (1934); GILMORE & BLACK §§ 9-47 to -49; Gyory, *Security At Sea: A Review of the Preferred Ship Mortgage*, 31 FORDHAM L. REV. 231 (1962).

The Ship Mortgage Act of 1920⁷² changed this pattern. Ship mortgages were given a priority status, subordinate only to certain preferred maritime liens. The Ship Mortgage Act provides:

Upon the default of any term or condition of the mortgage, such lien may be enforced by the mortgagee by suit in rem in admiralty. Original jurisdiction of all such suits is granted to the district courts of the United States exclusively.⁷³

Hence the problem: If, as indicated above, a bankruptcy court can enforce and execute a maritime lien, can it also enforce and execute a ship mortgage?

The existing authority on this question is hardly definitive. In *The Fort Orange*,⁷⁴ a mortgage trustee commenced a foreclosure action in equity, and the court held that equity had no jurisdiction to foreclose the mortgage. However, the mortgage trustee had also sought foreclosure in an admiralty proceeding which was pending simultaneously with the equity suit, and so the same judge, wearing his admiralty hat, foreclosed the mortgage. By contrast, in a series of cases involving an equity receivership of the owner of *The Alabama*, the mortgagee was twice denied leave to file an admiralty suit to foreclose the mortgage and was told to intervene in the equity proceeding, where his rights could be fully protected.⁷⁵ Although the court did not specifically state that the mortgage could be enforced in equity, that is the clear import of the decision. Indeed, if equity had no power over the mortgage, it is hard to see what advantage the mortgagee could have obtained by intervening in the equity proceeding.

Although seemingly inconsistent, these two decisions may not be irreconcilable. The statutory language of the Ship Mortgage Act may be read simply to compel the mortgagee to initiate a foreclosure suit in admiralty. Once the mortgagee brings such a foreclosure action, admiralty jurisdiction is not ousted by a subsequent bankruptcy petition. On the other hand, the mortgagee's enforcement of his mortgage in bankruptcy would be permitted when the bankruptcy petition was filed prior to the commencement of the foreclosure action and the mortgage lien was to be executed as part of the process of liquidating the bankrupt's estate. Such an interpretation would reconcile the Ship Mortgage Act with the general bankruptcy power, previously dis-

⁷² Merchant Marine Act of 1920, § 30, 41 Stat. 1000, as amended, 46 U.S.C. § 911 (1970).

⁷³ 46 U.S.C. § 951 (1970).

⁷⁴ 5 F. Supp. 833 (S.D.N.Y. 1933); accord, *In re Munson S.S. Line*, 1938 A.M.C. 837 (S.D.N.Y.).

⁷⁵ *First Union Trust & Sav. Bank v. Consumers' Co.*, 63 F.2d 273 (7th Cir.), *rev'd as moot*, 290 U.S. 585 (1933); *Consumers' Co. v. Goodrich Transit Co.*, 53 F.2d 972 (7th Cir. 1931), *cert. denied*, 286 U.S. 548 (1932).

cussed, to marshal and liquidate liens and to sell the bankrupt's property free of such liens.

6. *Reorganizations and Arrangements.* Absent a reorganization, it has already been shown that the first court to gain custody of maritime assets will administer them. In a reorganization or an arrangement, on the other hand, the prior custody of admiralty is irrelevant. Instead, the approval of a Chapter X petition automatically operates as a stay of any mortgage foreclosure or lien enforcement proceeding, unless otherwise ordered by the judge, and a stay may also be obtained in an arrangement proceeding or by a motion prior to the approval of a Chapter X petition.⁷⁶ At least one case has specifically affirmed the power of a reorganization court to restrain admiralty proceedings already in progress when the reorganization petition was filed.⁷⁷

The dominance of the bankruptcy court in reorganizations and arrangements is necessitated by the rehabilitative nature of such proceedings. Ordinary or straight bankruptcy contemplates a liquidation of the bankrupt's assets, and the principle of comity allows the court which first obtained custody of an asset to supervise its liquidation. A reorganization or arrangement, by contrast, looks toward a continuation of the debtor's business, and this requires the supervision of a single court. In a reorganization, if two-thirds of the creditors of a particular class approve, the maritime lienor or ship mortgagee may be compelled to accept a modification of his interest in the debtor's property.⁷⁸ A reorganization could easily be frustrated if creditors could resort to other forums to sell, or to enjoin use of, assets of the reorganized company. Accordingly, the bankruptcy court must have the power to restrain maritime creditors and nonbankruptcy courts from interfering with the reorganization.⁷⁹

⁷⁶ Bankruptcy Act §§ 113, 148, 314, 11 U.S.C. §§ 513, 548, 714 (1970).

⁷⁷ *In re J.S. Gissel & Co.*, 238 F. Supp. 130 (S.D. Tex. 1965); 4 E. BENEDICT, *supra* note 70, at §§ 613-14; GILMORE & BLACK § 9-92; *cf.* *Texas Co. v. Hauptman*, 91 F.2d 449 (9th Cir. 1937). The opinion in *In re Martin*, 78 F. Supp. 433 (E.D.N.Y. 1948), wrongly denied the power of the bankruptcy court to issue the stay, but was interpreted in *Gissel* as simply involving a question of custody to which the traditional rule of comity was applied. The difficulty with this interpretation is that there is much talk in *Martin* about the lack of power of a nonadmiralty court over maritime liens.

If a reorganization court does decide to operate vessels, it may be required to provide adequate insurance to protect maritime lienors. BANKRUPTCY RULES X-11 (S.D.N.Y.), X-15 (E.D.N.Y.). *See generally* 4 E. BENEDICT, *supra* note 70, at §§ 613-14.

⁷⁸ *See In re J.S. Gissel & Co.*, 238 F. Supp. 130, 133 (S.D. Tex. 1965); Bankruptcy Act §§ 179, 216, 11 U.S.C. §§ 579, 616 (1970).

⁷⁹ A detailed consideration of shipping reorganizations is beyond the scope of this paper. At least one commentator has argued that such reorganizations present great dangers to ship mortgagees and maritime lienors and should be undertaken only when the situation is

II. THE BANKRUPTCY DISTRIBUTION

Jurisdictional questions have now been decided. The vessel which belonged to the bankrupt shipowner has been sold in either admiralty or bankruptcy proceedings, and a fund remains. Portions of the fund may be claimed by maritime lienors, ship mortgagees, holders of non-maritime claims, and the trustee in bankruptcy. This section will discuss the interaction of the claims of these different categories of creditors and the trustee under the Bankruptcy Act.⁸⁰

A. Maritime Liens

A maritime lien is an interest in a vessel given to suppliers of goods or services to that vessel or claimants against that vessel. For example, crew's wages, bunkers (fuel oil), supplies furnished to the ship, pilotage, stevedoring, repairs (although not initial construction), wharfage, maritime torts, and charter party breaches have consistently been held to give rise to maritime liens.⁸¹ The distinctive feature of a maritime lien is that its holder may "personify" his claim against the vessel. In other words, the maritime lienor may sue the vessel in rem for his obligation in any federal court which can obtain custody over the vessel.

The maritime lien is easily created and may be readily extinguished. It is created when the goods are supplied or when the services are rendered. It is immediately perfected. No notice of the lien is required to be filed on the vessel, at the place the goods or services are furnished, in the vessel's home port, or anywhere else. It is said that the lien is an indelible mark on the ship. A bona fide purchaser does not cut off the rights of the maritime lienor.⁸² On the other hand, the lien may be easily lost through laches. It may also be destroyed without notice to the lienor if the vessel is arrested by the process of another admiralty court sitting anywhere in the world and sold to satisfy the claim of another maritime lienor. Finally, the lien itself may be upstaged by newer liens. Unlike land-based liens, which are generally ranked by some notion of first in time is first in right, maritime liens are ranked inversely—*i.e.*, the last attaching lien of the same rank has priority.⁸³

promising. Gyory, *supra* note 71, at 241-42, 244-45 & n.70. It is hard to see why secured maritime creditors should be any better off than any other secured creditors, and it would appear that a reorganization should be attempted when there is a reasonable prospect of success. See cases cited notes 75, 77 *supra*.

⁸⁰ I have consciously refrained from discussing the interaction of these different secured and maritime interests *inter se*, except when a peculiar bankruptcy problem is involved. A failure to observe such a limitation would alter the original bankruptcy-admiralty focus of this paper.

⁸¹ GILMORE & BLACK § 9-20; G. ROBINSON, ADMIRALTY §§ 49, 50 (1939).

⁸² See GILMORE & BLACK § 9-1; G. ROBINSON, *supra* note 81, § 48.

⁸³ GILMORE & BLACK § 9-1; G. ROBINSON, *supra* note 81, §§ 55, 59, 61.

The maritime lienor may find his interest subject to challenge by the bankruptcy trustee in two situations: First, if the lien is not paid until bankruptcy and the lienor seeks to enforce his claim against the vessel, the trustee may attack it under the antilien provisions of sections 67 or 70. Second, if the lien was discharged by a payment within four months of bankruptcy, the trustee may allege that the payment was a voidable preference under section 60. If the lien is not subject to attack under these sections, it will be valid against the trustee.⁸⁴

1. *Enforcement Against the Bankrupt's Assets: Sections 67a, 67c, 60, and 70.*—a. *Section 67a.* Section 67a of the Act invalidates liens obtained through legal or equitable proceedings within four months of bankruptcy and while the debtor was insolvent. Although section 67a contains no definition of liens "obtained" through legal or equitable proceedings, this section has never been interpreted to invalidate all liens which may, at some point, require legal proceedings for effective enforcement. Instead, section 67a has been employed to invalidate only liens whose source is in legal or equitable proceedings, such as liens by attachment, garnishment, judgment, or execution levy.⁸⁵ In such situations, the lien does not arise at the time of the claim, but rather, when the creditor invokes some legal process to enforce it.

Section 67a does not invalidate liens which do not have their source in the invocation of judicial process. Thus, statutory liens given to mechanics, artisans, and the ubiquitous tax collector are specifically validated by section 67b of the Act. In addition, liens created by contract or common law have never been thought to be within the purview of section 67a.⁸⁶ While these liens may require judicial action for enforcement, they are "created" by statute, contract, or court-made rule.

If this distinction is applied, maritime liens do not fall within section 67a. Maritime liens arise upon the furnishing of supplies or services and, in this respect, are most similar to mechanics' and artisans' liens. While not expressly "created" by statute, there is presently statutory authority for their enforcement.⁸⁷ The few reported cases have agreed with this analysis, usually reasoning that the lien is not created by legal or equitable proceedings, but rather is created by admiralty

⁸⁴ Although the Bankruptcy Act does not expressly validate any, liens have been held to be valid and enforceable against the bankrupt's property unless specifically invalidated by section 60, 67, or 70. *See, e.g.,* *Porter v. Searle*, 228 F.2d 748, 750 (10th Cir. 1955); 4A COLLIER ¶ 70.70[1].

⁸⁵ *See* 4 COLLIER ¶¶ 67.07-12; 4 H. REMINGTON, BANKRUPTCY LAW § 1610 (1957).

⁸⁶ *E.g., In re Black Ranches, Inc.*, 362 F.2d 8, 13-14 (8th Cir.), *cert. denied*, 385 U.S. 990 (1966); 4 COLLIER ¶ 67.03[1].

⁸⁷ Maritime Lien Act of 1910, §§ 1-5, 36 Stat. 604, *as amended*, 46 U.S.C. §§ 971-75 (1970).

law or maritime contract and is enforced simply through legal proceedings.⁸⁸

b. *Section 67c.* The trustee may have more success in invoking section 67c to defeat some maritime liens. Subsection 67c(1)(B) invalidates against bona fide purchasers statutory liens not perfected on the date of bankruptcy. "Statutory lien" is defined in section 1(29a) as a lien "arising solely by force of statute upon specified circumstances or conditions," and not one "dependent upon an agreement to give security." Almost all maritime liens now find their source in the Maritime Lien Act,⁸⁹ rather than in security agreements, and therefore might readily be held to be statutory liens.⁹⁰ In addition, a small number of maritime liens may arise by virtue of state statutes akin to those creating the unquestionably "statutory" mechanics' and artisans' liens.⁹¹ Finally, some maritime liens may arise by agreement of the parties.⁹² These cannot be called statutory liens.

⁸⁸ *Diana Compania Maritima, S.A. v. Subfreights of the S.S. Admiralty Flyer*, 280 F. Supp. 607, 613-14 (S.D.N.Y. 1968); *In re North Atlantic & Gulf S.S. Co.*, 204 F. Supp. 899, 905 (S.D.N.Y. 1962), *aff'd on other grounds sub. nom.* Schilling v. A/S D/S Dannebrog, 320 F.2d 628 (2d Cir. 1963); *cf.* *The Ironsides*, 13 F. Cas. 103 (No. 7069) (N.D. Ill. 1869). In several cases where maritime lienors contested the jurisdiction of the bankruptcy court, the opinions intimated that maritime liens were valid in bankruptcy. *See* *West Ky. Coal Co. v. Dillman*, 15 F.2d 25 (8th Cir. 1926); *In re New York, N.H. & H.R.R.*, 17 F. Supp. 488 (D. Conn. 1936); *The Robert & Edwin*, 32 F.2d 390 (D. Mass. 1929). In some cases, the lien has simply been enforced without any discussion of its validity under the Bankruptcy Act. *See In re Bauer S.S. Corp.*, 167 F. Supp. 909 (S.D.N.Y. 1957); *In re Marine Transit Corp.*, 20 F. Supp. 414 (S.D.N.Y. 1937) (two opinions), *rev'd*, 94 F.2d 7 (2d Cir. 1938); *In re Kirkland*, 14 F. Cas. 677 (No. 7842) (D. Md. 1873).

⁸⁹ 36 Stat. 604 (1910), *as amended*, 46 U.S.C. §§ 971-75 (1970).

⁹⁰ *See In re Chesterfield Developers, Inc.*, 285 F. Supp. 689 (S.D.N.Y. 1968) (mechanic's lien); *In re Trahan*, 283 F. Supp. 620 (W.D. La.), *aff'd*, 402 F.2d 796 (5th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969) (vendor's privilege giving seller of merchandise priority is a statutory lien since it arises by operation of law and cannot be created by agreement). Although the maritime lien may not arise if there is a charter provision forbidding the creation of such liens, or if the creator of the lien lacks authority, GILMORE & BLACK §§ 9-39 to -46, this should not affect the statutory character of any lien which otherwise finds its source in the Lien Act.

⁹¹ Section 5 of the Maritime Lien Act, 46 U.S.C. § 975 (1970), provides that state statutes conferring liens enforceable by suits in rem for repairs, supplies, towage, use of dry dock or marine railway, and other necessities are superseded. Although this does not leave much room for state regulation, GILMORE & BLACK § 9-35, the few decided cases have enforced state-created liens in rem in cases not within the superseded areas. *See* *Grow v. The Steel Gas Screw Loraine K.*, 185 F. Supp. 803 (E.D. Mich. 1960), *aff'd*, 310 F.2d 547 (6th Cir. 1962) (lien for insurance premiums); *Murray v. The Meteor*, 78 F. Supp. 637 (E.D.N.Y. 1948), *rev'd on other grounds sub nom.* *Murray v. Schwartz*, 175 F.2d 72 (2d Cir. 1949) (wharfage for vessel withdrawn from navigation); *cf.* *The F.S. Loop*, 63 F. Supp. 105 (S.D. Cal. 1945) (no lien for watchman's wages).

⁹² *E.g.*, *American Steel Barge Co. v. Chesapeake & Ohio Coal Agency Co.*, 115 F. 669 (1st Cir. 1902); *Freights of The Kate*, 63 F. 707 (S.D.N.Y. 1894).

If a maritime lien is a statutory lien, it will be voidable under section 67c(1)(B) if not perfected on the date of bankruptcy and therefore not enforceable on that date against a bona fide purchaser. This perfection requirement of section 67c(1)(B) must be interpreted in light of the admiralty doctrine of laches, which requires maritime lienors to enforce their liens within a reasonable period of time. Although there is no precise definition of a reasonable time for lien enforcement, the Supreme Court has stated that "the defense [laches] will be held valid under shorter time, and a more rigid scrutiny of the circumstances of the delay" will be made when enforcement of the lien is sought against a bona fide purchaser than when it is sought against the original owner.⁹³ As against a bona fide purchaser, laches will probably bar lienors' claims which are more than a few months old unless the vessel had departed for foreign ports almost immediately after the lien arose.⁹⁴ The effect on maritime liens, if the trustee were given this status, could be nothing short of disastrous. The trustee, as a hypothetical bona fide purchaser under section 67c, could invoke the doctrine of laches to bar the enforcement of all maritime liens more than a few months old.

No intention may be attributed to the draftsmen of the 1966 amendments to the Bankruptcy Act—which added section 1(29a) and amended section 67c—to have the new sections act on maritime liens. The changes were designed to protect the scheme of bankruptcy priorities from the encroachment of state liens which were disguised priorities and to eliminate certain circular priority problems which had arisen under the prior version of section 67c.⁹⁵ It is the attempt to invalidate disguised priorities which creates the confusion regarding the treatment of maritime liens. A disguised priority is a debt which has no lien or priority status when it arises, but which is accorded lien status, and hopefully priority, with the approach of bankruptcy or insolvency. The method of distinguishing "real" liens from disguised priorities was the bona fide purchaser test in section 67c(1)(B) since a "real" lien would presumably be valid against a bona fide purchaser, whereas a disguised priority would not. This purpose was further emphasized by the proviso to section 67c(1)(B), which permitted delayed perfection of liens having sufficient vitality on the date of bankruptcy to withstand attack by lien and judgment creditors. However, a maritime lien does not possess the

⁹³ *The Key City*, 81 U.S. (14 Wall.) 653, 660 (1871).

⁹⁴ 3 E. BENEDICT, *supra* note 70, at § 464; GILMORE & BLACK §§ 9-77 to -78, at 625 ("[a]ttempts to assert liens over the defense of good faith purchaser without notice have been few and usually unsuccessful").

⁹⁵ See H.R. REP. NO. 686, 89th Cong., 1st Sess. (1965); Kennedy, *The Bankruptcy Amendments of 1966*, 1 GA. L. REV. 149, 153-56, 160-66 (1967). See also Marsh, *Triumph or Tragedy? The Bankruptcy Act Amendments of 1966*, 42 WASH. L. REV. 681 (1967).

key characteristic of a disguised priority—becoming effective upon insolvency, bankruptcy, or the approach of bankruptcy. Indeed, because of the doctrine of laches, the maritime lien, which is initially valid against a bona fide purchaser, is less effective on the date of bankruptcy than when it arises. Thus, the maritime lien presents a situation exactly the opposite of that which the 1966 amendments were intended to reach.

To yield a result which would not subject the maritime lien to the bona fide purchaser test, the definition in section 1(29a) of "statutory lien" might, in the light of this purpose, be interpreted to eliminate disguised priorities and be held not to embrace a maritime lien. The difficulty with this method, however, is that it would also justify excepting all other liens from section 1(29a) which were not "disguised priorities." Any attempt to limit the "statutory lien" in sections 1(29a) and 67c to "disguised priorities" would presuppose the very function section 67c was designed to serve—to provide a test to determine which liens should be invalidated.

Alternatively, it may be argued that the draftsmen of the 1966 amendments were preoccupied with state statutory liens and that the legislation should be interpreted to exclude federal statutory liens.⁹⁶ A related argument would allow the maritime lien to revert to its common law heritage and therefore to be free of section 67c. However, it is impossible to be confident that either argument will carry the day in view of the express maritime lien statute and the apparently absolute definition in section 1(29a). Indeed, a lively debate has been going on whether certain Uniform Commercial Code and judicial liens, which are further removed from the traditional statutory lien category than are maritime liens, might be subject to section 67c.⁹⁷ Moreover, at least some maritime liens do not have their heritage in the common law, but rather in "home port" statutes closely related to those giving rise to the admittedly statutory liens for mechanics, artisans, and the like. The only sure remedy for this dilemma may be corrective legislation.

c. *Section 60.* In a case involving the *S. S. Admiralty Flyer*, the trustee, in addition to attempting to invoke section 67a to defeat maritime liens, also argued that payment of the maritime lienor's claim after bankruptcy would constitute a voidable preference.⁹⁸ It is diffi-

⁹⁶ Indeed, Professor Marsh has argued that a major difficulty with the 1966 amendments was the congressional failure to deal with the policy question of whether state statutory liens should be totally invalidated by the Act. Marsh, *supra* note 95, at 732-34.

⁹⁷ See Kennedy, *supra* note 95, at 152-53; Marsh, *supra* note 95, at 715-19.

⁹⁸ *Diana Compania Maritima, S.A. v. Subfreights of the S.S. Admiralty Flyer*, 280 F. Supp. 607, 614 (S.D.N.Y. 1968).

cult to understand the trustee's argument in this connection. Since a maritime lien arises at the time the goods or services are sold or furnished,⁹⁹ the antecedent debt requirement of section 60 is not fulfilled. The payment of the claim *after* bankruptcy does not invoke section 60 since that section applies only to transfers prior to the filing of the petition. However, the court in *Admiralty Flyer* apparently ignored section 60 and treated the case as if the payment had been a prebankruptcy transfer. This will be discussed in the following section.

d. *Section 70c.* The foregoing discussion has raised questions about the trustee's use of the antilien provisions of section 67 to resist payment of maritime liens. Regardless of the application of these provisions, section 70c allows the trustee to assert any defense which the bankrupt-shipowner could have asserted against the lienor absent the bankruptcy. The most common defenses of shipowners are want of authority, contractual provisions limiting the power to create liens, and laches.¹⁰⁰ The trustee's use of such defenses does not raise any particular bankruptcy problem and therefore is beyond the scope of this article.

2. *Payment of the Maritime Lienor as a Preference.* A preference is a transfer of the debtor's property to a creditor on account of an antecedent debt, within four months of bankruptcy and while the debtor is insolvent, which enables that creditor to obtain a greater percentage of his debt than another creditor of the same class. Since a maritime lien arises at the time the goods or services are provided, and is not a transfer on account of an antecedent debt, the creation of a maritime lien is not preferential.¹⁰¹

A preference may arise if, within four months of bankruptcy, an insolvent debtor makes a payment to the creditor resulting in the discharge of a maritime lien. In the words of section 60, there has been a "transfer" (the payment) "on account of an antecedent debt" (the claim secured by the maritime lien). Indeed, taken literally, section 60 could make any payment of a secured claim preferential since it would involve a "transfer . . . on account of an antecedent debt." The only remaining obstacle—the requirement that the creditor receive a greater percentage of his debt than creditors of the same class—may be more conveniently discussed below.

⁹⁹ See *In re North Atlantic & Gulf S.S. Co.*, 204 F. Supp. 899, 904, 906 (S.D.N.Y. 1962), *aff'd on other grounds sub nom. Schilling v. A/S D/S Dannebrog*, 320 F.2d 628 (2d Cir. 1963); *In re Bauer S.S. Corp.*, 167 F. Supp. 909 (S.D.N.Y. 1957).

¹⁰⁰ See generally GILMORE & BLACK §§ 9-39 to -46, 9-77 to -84.

¹⁰¹ The creation of a maritime lien is undoubtedly a "transfer" under section 1(30). Section 60a(2) artificially postpones the date of transfer until it is perfected against a simple contract lienor. Since the simple contract lien is nonmaritime and a maritime lien is superior to a nonmaritime judicial lien, see text at notes 116-24 *infra*, the transfer is deemed to take place when the lien is created.

Section 60 has not, however, been interpreted to render as preferential payments to creditors who have security interests or liens which are valid in bankruptcy. This result could have been reached by focusing on that element of a preference which requires that a creditor receive a greater percentage of his debt than creditors of the same class. Arguably, secured and lien creditors are members of a different class than unsecured creditors, and therefore payments to such secured or lien creditors do not give them a greater percentage of their debts than other creditors of the same class. For reasons which are unclear, the courts have generally not utilized this analysis. Instead, in examining the preferential character of payments to secured or lien creditors, principal reliance has been placed on that element of a preference which requires that the payment be on account of an antecedent debt.¹⁰² This requirement has been held to be satisfied only when the payment depletes the bankrupt's estate and, consequently, the fund otherwise available for paying creditors. Ordinarily, payment of a secured or lien creditor does not deplete the estate and is not preferential if there is a "fair equivalence" between the value of the security or lien surrendered and the amount of the payment.¹⁰³ But the payment of a secured or lien claim in full is preferential to the extent that the value of the security or lien released is less than the amount of the payment, and, by the same reasoning, if the security or lien is worthless, the payment is fully preferential.¹⁰⁴

This reasoning may be applied to the bankrupt's prebankruptcy payment to a maritime lienor. Accordingly, the bankrupt's estate is not depleted because the creditor's lien on the vessel is reduced pro tanto by the amount of the payment. However, the discharge of a maritime lien could be preferential per se if the security given up—the maritime lien—were held to be inherently of so little value that the bankrupt's payment would in fact deplete the estate. Such an

¹⁰² See 3 COLLIER ¶¶ 60.20, 60.22; authorities cited notes 103-04 *infra*.

¹⁰³ See, e.g., *Small v. Williams*, 313 F.2d 39, 44 (4th Cir. 1963); *Ricotta v. Burns Coal & Bldg. Supply Co.*, 264 F.2d 749 (2d Cir. 1959); *Moskowitz v. Nelson*, 218 F. Supp. 710, 715 (E.D. Wis. 1963); *Perkins v. Lakeport Nat'l Bank*, 139 F. Supp. 898 (D.N.H. 1955); 3 COLLIER ¶¶ 60.20, 60.22.

¹⁰⁴ See, e.g., *Virginia Nat'l Bank v. Woodson*, 329 F.2d 836, 840 (4th Cir. 1964); *Ricotta v. Burns Coal & Bldg. Supply Co.*, 264 F.2d 749, 751 (2d Cir. 1959); *Mercantile Trust Co. v. Schlafly*, 299 F. 202 (8th Cir. 1924), *cert. denied*, 266 U.S. 614 (1924); *Sloan v. Garrett*, 277 F. Supp. 235 (D.S.C. 1967); *Douglass v. Pugh*, 177 F. Supp. 274 (E.D. Ky. 1959), *aff'd*, 287 F.2d 500 (6th Cir. 1961); *In re Dibblee*, 7 F. Cas. 651, 656 (No. 3884) (S.D.N.Y. 1869). Of course, if the payment discharges a lien on property which is not part of the bankrupt's estate, the estate is depleted and the payment preferential. See *Schilling v. McAllister Bros.*, 310 F.2d 123 (2d Cir. 1962) (bankrupt charterer paid creditors discharging liens on vessels of nonbankrupt shipowner).

argument would focus on the frailty of the lien: it is easily lost through laches, it may be destroyed by an admiralty court without notice to the lienor, and it may be upstarted by newer liens.¹⁰⁵

Nevertheless, it is quite clear that, at least in many instances, creditors do enforce such liens and recover on their debts. Moreover, several decisions have enforced maritime liens against vessels of a bankrupt during bankruptcy proceedings and after the filing of a bankruptcy petition.¹⁰⁶ It would be strange indeed, on the one hand, to enforce such liens against the trustee after bankruptcy, but, on the other, to hold the debtor's discharge of such liens prior to bankruptcy to be preferential per se on the ground of intrinsic worthlessness.

Assuming that the payment of the lien is not per se preferential, it is necessary to "value" the lien to determine whether the lien surrendered was the fair equivalent of the payment received. The bankrupt's payment of a claim secured by a maritime lien is preferential to the extent that the creditor could not enforce the lien for the full amount of the debt.¹⁰⁷ Payment of the claim will be fully preferential if, in fact, the lien is worthless. The lien may be worthless where laches applies, where the vessel was previously arrested in an admiralty proceeding and all lines were executed, where the vessel is subject to a charter containing a clause forbidding the creation of subsequent liens, where the lien was unauthorized, or where there were prior-ranking liens on the vessel exceeding its value. Alternatively, the payment may be partially preferential to the extent that the lien could not be enforced for the full amount of the debt, as for example if there were liens on the vessel outranking the creditor's lien.

In order to value the lien, it must be decided whether the relevant time is the date of payment or the date of bankruptcy. No case involving the payment of a secured claim has been found which discusses the problem. Normally, perfected security interests in land or personal property would not present a severe diminution problem because of the short time period involved (four months at most) and the fact that such perfected liens generally have priority over all subsequently perfected interests. Maritime liens, however, are upstarted by subsequently incurred maritime liens, and such subsequent liens are not uncommon. If the shipowner is in dire financial straits, it may be his ability to incur substantial maritime liens which enables him to stay afloat. Then too, there is the ever-present risk of maritime catastrophes. The subsequent discussion of the valuation date may be clarified by reference

¹⁰⁵ See text at note 83 *supra*.

¹⁰⁶ See cases cited note 88 *supra*.

¹⁰⁷ See cases cited note 104 *supra*.

to an example: On the date the debtor pays the claim of a maritime lienor, the lienor would realize eight hundred dollars on a one thousand dollar claim in a hypothetical execution of all liens on the vessel. On the date of bankruptcy, the same execution of liens brings the lienor five hundred dollars. Is the amount of the preference two hundred (one thousand less eight hundred) dollars or five hundred (one thousand less five hundred) dollars?

The preferential concepts of depletion and insolvency may require valuation on the date of payment. The concept of diminution is supposed to insure that the estate will be in the same position with respect to assets before and after the payment. The payment of a creditor's claim by a third party, for example, is not preferential because the estate is not depleted.¹⁰⁸ Similarly, the payment of a lien claim where the lien could be enforced in full on the date of payment does not leave the estate with fewer assets to pay its creditors since, in the event of bankruptcy, an equivalent amount would otherwise be withdrawn from the estate to pay the lien claim. If the value of what is received by the estate—extinction of the lien—is less on the date of bankruptcy than it was on the date of the transfer, it is not because of the payment. Rather, it is because of some other factor, such as the attachment of new and prior liens or a diminution in the value of the asset. Insolvency must be determined on the date of the payment,¹⁰⁹ not because the creditor is not preferred by the payment, but, presumably, because there is nothing wrong with solvent debtors paying antecedent debts. These examples suggest a sort of "closing of the books" on the date of the payment, with later events to be ignored. This same closing-of-the-books rationale could be applied to fixing the time for determining whether there is a "fair equivalence" between the value of a maritime lien and the amount of the payment. On this reasoning, the amount of the preference in the above example would be two hundred dollars.

In *Palmer Clay Products Co. v. Brown*,¹¹⁰ the Supreme Court refused to apply this closing-of-the-books rationale to the part payment of an antecedent debt within four months of bankruptcy, even though on the date of the payment the debtor's assets would have been sufficient to make an equivalent percentage payment to all of its other creditors. The Court held that whether the creditor had received a greater percentage of his debt than other creditors of the same class was to be determined "by the actual effect of the payment as determined when bankruptcy results." The actual effect in this case was that the defen-

¹⁰⁸ 3 COLLIER ¶ 60.26.

¹⁰⁹ 3 COLLIER ¶ 60.31.

¹¹⁰ 297 U.S. 227, 229 (1936).

dant, who had or received full payment for part of his claim and a percentage of the rest, was better off than other general creditors, who had received only a percentage of their entire claims. Under the *Palmer Clay Products* rule, the amount of the preference is the amount of the payment. It is not open to the preferred creditor to argue that he would have received fifty percent of his debt in a hypothetical liquidation on the date of the preference, whereas on the date of bankruptcy—after repaying the preference—he will receive only twenty-five percent of his debt.

Perhaps the only authority focusing specifically on the time for measuring the amount of a preferential diminution of the estate is *In re Hygrade Envelope Corp.*,¹¹¹ where the bankrupt transferred a term life insurance policy covering a key employee to a creditor, Gibraltar Factors, within four months of the petition. The employee died prior to the filing of the petition, but after the transfer. Gibraltar argued that the amount of the preference was either the surrender value at the date of the transfer or the cost of a similar policy (at most one thousand dollars). The court agreed with the trustee, however, that the value of the transfer was the one hundred thousand dollar face amount of the policy. Finding that the transfer was on account of an antecedent debt when the debtor was insolvent, Judge Friendly focused on the remaining element of a preference, which requires that the transfer enable the creditor to obtain a greater percentage of his debt than another creditor of the same class. Relying on *Palmer Clay Products*,¹¹² he found that the actual effect of the payment as determined when bankruptcy resulted was to diminish the estate by one hundred thousand dollars rather than the one thousand dollars urged by the creditor.

There is one distinction between the case involving the payment of a maritime lien and *Hygrade*. In *Hygrade*, it was the asset preferentially conveyed—the insurance policy—which increased in value between the date of the preferential transfer and the date of the petition. In the case of the maritime lien, it is the security which is supposed to be the “fair equivalent” for the payment—the maritime lien itself—which decreases in value. As a result, the differential between the value of the lien and the amount of the payment becomes greater; in the example, it increases from two hundred to five hundred dollars. This distinction does not, however, appear significant in the light of the

¹¹¹ 393 F.2d 60 (2d Cir.), cert. denied, 393 U.S. 837 (1968), rev'g 272 F. Supp. 451 (E.D.N.Y. 1967).

¹¹² The district court in *Hygrade* did not refer to the *Palmer* case and instead adopted the closing-of-the-books rationale referred to in the text. 272 F. Supp. at 460-61.

rationale of *Palmer Clay Products* and *Hygrade* that the amount of the preference should be measured by the actual effect of the payment as determined on the date of bankruptcy. In the maritime lien case, the actual effect is to diminish the estate by the difference between the payment and the value of the lien on the date of the petition—five hundred dollars in the example. Indeed, any other result would treat the maritime lienor whose lien claim was paid prior to bankruptcy better than another maritime lienor whose claim was not paid. The unpaid lienor, although in the same class as the paid lienor,¹¹³ will receive only the value of his lien on the date of bankruptcy.

B. Ship Mortgages Under the Ship Mortgage Act

Regardless of whether the Ship Mortgage Act is considered to confer maritime lien status upon ship mortgages, such mortgages present specialized bankruptcy problems. This is because a ship mortgage is a consensual lien, dependent upon agreement of the parties and the satisfaction of various legal requirements in order to obtain perfected status, whereas an ordinary maritime lien arises automatically by operation of law and is immediately perfected. This paper will treat only the problems of relating the Bankruptcy Act to such mortgages. Questions involving the validity and effectiveness of the mortgage per se or the mortgagee's rights vis-a-vis other maritime lienors will be left to others.

1. *Preferences and Fraudulent Conveyances.* One consequence of the consensual nature of the ship mortgage is that such a mortgage may be attacked as a preferential or fraudulent transfer if the requirements of sections 60 and/or 67d are met. If the attack is successful, the trustee may attempt to preserve the mortgage lien for the benefit of the estate. Absent the problem of delayed perfection of ship mortgages as discussed below, the trustee's action will not present distinctive maritime bankruptcy problems.

a. *Section 60.* Under conventional principles, if the mortgage is given for a present consideration it is not preferential, but if given

¹¹³ If the maritime lien is valued at an amount equal to the payment, the maritime lienor is not in the class of general creditors. See *Swarts v. Fourth Nat'l Bank*, 117 F. 1, 6-7 (8th Cir. 1902); *Dean v. Planters Nat'l Bank*, 176 F. Supp. 909, 912-13 (E.D. Ark. 1959); 3 COLLIER ¶ 60.34, at 904. Conversely, if the maritime lien is worthless, the maritime lienor is considered to be a member of the class of general creditors. See *Glessner v. Massey-Ferguson, Inc.*, 353 F.2d 986, 992 (9th Cir. 1965), cert. denied, 384 U.S. 970 (1966). By the same reasoning, the maritime lienor may be said to be in the class of general creditors to the extent that the value of his lien—as determined on the date of the petition—is less than the amount of the payment. In this way, he receives the same treatment as his brother lienor whose claim was not paid.

for an antecedent debt it is preferential if the other requirements of section 60 are met. The matter is more perplexing, however, if the mortgage is given for a present consideration but is not immediately recorded and therefore is not perfected under the Ship Mortgage Act.¹¹⁴

Although a security interest may be given for a present consideration, section 60a(2) contains a perfection clause which "postpones" the date of the transfer until the security interest is perfected against the creditor holding a lien by legal or equitable proceedings on a simple contract. The question of perfection turns on whether the holder of a lien by legal or equitable proceedings on a simple contract has priority over an unperfected mortgage, so that the date of the "transfer" will be postponed under 60a(2). If postponed, the transfer, when perfected, becomes one for an antecedent debt and, accordingly, a preference.

Initially, this "simple contract lienor" test is not easily applied to maritime interests. For example, the simple contract lienor may be either a simple contract creditor in a case where breach of the contract gives rise to a maritime lien; a simple contract creditor whose claim is a so-called "maritime claim" but who does not have a maritime lien;¹¹⁵ or a general, nonmaritime creditor. This is important because a subsequent maritime lien has priority over a previous, but unrecorded, mortgage.¹¹⁶ Therefore, if the simple contract lienor is given maritime lien status, the transfer of an unrecorded mortgage will be postponed under section 60a(2) to the date of perfection, so that the transfer will be for an antecedent debt.¹¹⁷

It is not likely that the simple contract lienor under section 60a(2) will be accorded maritime lien status. Section 60a(4) defines a simple contract lien as one "arising in ordinary course of [legal or equitable] proceedings upon the entry or docketing of a judgment or decree, or upon attachment, garnishment, execution, or like process." The mari-

¹¹⁴ To be perfected against maritime liens, a ship mortgage must not only be recorded, but must be indorsed in specified places and be supported by an affidavit of good faith. 46 U.S.C. §§ 921-22, 953 (1970). By definition, however, an unrecorded mortgage is unperfected. The textual discussion will assume that the ship mortgage is unperfected because it is not recorded; because of the conclusions reached with respect to the proper interpretation of the nature of the section 60a(2) lien, and the application of section 60a(2) to unrecorded mortgages, it is not necessary to consider the preference question with respect to recorded but unperfected mortgages. See note 124 *infra*.

¹¹⁵ See text at notes 145-48.

¹¹⁶ See *Morse Drydock & Repair Co. v. S.S. Northern Star*, 271 U.S. 552 (1926); *Walter E. Heller & Co. v. M/V Mr. Ed*, 270 F. Supp. 830, 834 (E.D. La. 1967); *The Emma Giles*, 15 F. Supp. 502, 507 (D. Md. 1936); Lord & Glenn, *The Foreign Ship Mortgage*, 56 YALE L.J. 923, 937 & n.44 (1947).

¹¹⁷ This statement is qualified by section 60a(7)(I)(B), which provides that, for the purpose of section 60, the transfer would not be considered to have been for an antecedent debt if perfected within twenty-one days after the actual transfer.

time lien, which arises without the intervention of legal proceedings, does not meet this definition. Moreover, the reference to liens by legal or equitable proceedings should be interpreted in the light of the similar provisions of sections 67a and 70c. As shown above, the maritime lien is not a judicial lien subject to avoidance under section 67a.¹¹⁸ And the courts have eschewed interpreting the analogous provisions of section 70c, which accord the trustee the status of a judicial lienor, as involving a particularized type of lien which might be entitled to special priority.¹¹⁹ Finally, the result of conferring maritime lien status on the simple contract lienor under section 60a(2) would be to invalidate any nonmaritime lien on a vessel. This is because a maritime lien on a vessel always has priority over nonmaritime liens,¹²⁰ and a nonmaritime lien on a vessel could never be perfected against the simple contract lien *qua* maritime lien under section 60a(2) prior to bankruptcy. Indeed, any maritime lien which could be upstaged by a subsequent simple contract maritime lien could never be perfected against the 60a(2) simple contract lien and might also be avoided as preferential.

It makes little difference whether the contract lienor is given the status of a maritime contract creditor or a nonmaritime contract creditor. In either case, the issue under section 60a(2) would be whether the unrecorded ship mortgage would be subordinate to the attachment or execution lien which might be obtained by the simple contract creditor. Section 921 of the Ship Mortgage Act declares an unrecorded mortgage invalid against "any person other than the grantor or mortgagor, his heir or devisee, and a person having actual notice thereof." Under section 60a(2), the time of the "transfer" of an unrecorded mortgage would be delayed if section 921 were interpreted to allow either a gap simple contract creditor (a person extending credit in the period between the giving of the mortgage and its perfection) or a gap judicial lienor to prevail over an unrecorded mortgage. When perfected, the mortgage would be deemed to be for an antecedent debt.

While the matter is not free from doubt, section 921 will probably be interpreted to invalidate the unrecorded mortgage only as to intervening claims giving rise to maritime liens. Maritime liens have long been regarded as outranking nonmaritime liens regardless of when the respective liens arose or were perfected.¹²¹ Prior to the Ship Mortgage

¹¹⁸ See text at notes 85-88 *supra*.

¹¹⁹ See V. COUNTRYMAN, CASES AND MATERIALS ON DEBTOR AND CREDITOR 494 (1964). Indeed, section 60a(4) specifically excludes a lien given a specialized priority over prior liens.

¹²⁰ See note 121 *infra*.

¹²¹ See *The J. E. Rumbell*, 148 U.S. 1 (1893) (prior mortgage); *United States v. Flood*,

Act, a ship mortgage was a nonmaritime contract which was nevertheless subject to federal recording requirements. In pre-Mortgage Act cases, the courts readily held an unrecorded mortgage subordinate to intervening attachment liens.¹²² However, these cases appear to be based on the nonmaritime character of the mortgage liens. It would be incongruous to hold that all maritime liens outrank nonmaritime liens, but that the ship mortgage—which Congress tried to put on a parity with maritime liens—did not similarly outrank nonmaritime liens.¹²³ Consequently, for the purpose of section 60a(2), the transfer of an unperfected ship mortgage would never be subject to avoidance by the nonmaritime lien of a simple contract creditor and is therefore deemed to take place when the mortgage is given, notwithstanding any delay in recordation.¹²⁴

The result is no different if the mortgage has not been recorded as of the date of the petition. By the same reasoning as above, the mortgage, if recorded after bankruptcy, would have priority over the nonmaritime lien status of the trustee under section 70c. The trustee cannot utilize section 70c, which gives him the defenses of the bankrupt, since section 921 of the Mortgage Act specifically provides that the recorded mortgage is valid against the "mortgagor" (the shipowner), and the trustee simply steps into the bankrupt-shipowner's shoes. Consequently, the mortgage will be enforceable notwithstanding its lack of perfection on the date of the petition.

The conclusion that an unperfected ship mortgage is not voidable by the trustee under sections 60 and 70c is based on the peculiar consequence of applying the statutory language of the Bankruptcy Act to maritime transactions and liens. This result is, to be sure, one which was not contemplated by the draftsmen of the bankruptcy provisions. One of the overriding purposes of the Chandler Act, which led to the

247 F.2d 209 (1st Cir. 1957) (prior tax lien); *cf.* *The St. Jago de Cuba*, 22 U.S. (9 Wheat.) 409 (1824) (maritime lien has priority over forfeiture to government).

¹²² See *Potter v. Irish*, 76 Mass. (10 Gray) 416 (1858); *Parker Mills v. Jacot*, 21 N.Y. Super. (8 Bos.) 161 (1861); *Secrist v. German Ins. Co.*, 19 Ohio St. 476 (1869). *But cf.* *Fort Pitt Nat'l Bank v. Williams*, 43 La. Ann. 418, 9 So. 117 (1891). On the federal recording act, see 1 G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* §§ 13.2, 19.9 (1965).

¹²³ This matter is discussed in more detail in connection with the relative priorities of maritime liens and tax liens. See text at notes 132-37 *infra*.

¹²⁴ A ship mortgage may be recorded and still be unperfected if certain other requirements of the Mortgage Act are not met. See note 114 *supra*. However, the conclusion in the text that an unrecorded ship mortgage is not subject to avoidance by the nonmaritime lien of a simple contract creditor and therefore is not postponed under section 60a(2) applies, a fortiori, to a mortgage which is recorded but not perfected. In any event, such a recorded but unperfected mortgage would only be subject to avoidance by a maritime lienor. 46 U.S.C. § 953 (1970). Since under section 60a(2) the simple contract lienor does not have maritime lien status, see text at notes 118-20 *supra*, a recorded but unperfected mortgage is never postponed under section 60a(2).

present version of the antipreference and antilien provisions of the Act, was to strike down unperfected (usually because of a failure to record) security interests.¹²⁵ If sections 60 and 70c were interpreted in the light of that purpose, there is little doubt that the unrecorded ship mortgage would be invalidated. But it is hard to reach the invalidating result under the present statutory language unless, for the purpose of maritime cases, the lien status granted the trustee by sections 60 and 70c is deemed to be that of a maritime lienor. Prior to the Chandler Act, many courts did not allow the trustee to avoid unperfected security interests presenting some slight variation from section 60, and doubts may be expressed about reaching variations from the norm under the present section 60.¹²⁶ Accordingly, one cannot be too sanguine that the trustee will be permitted to avoid an unrecorded ship mortgage when that result can be reached only by virtually ignoring or badly convoluting the statutory language.

b. *Section 70e.* If the trustee cannot invoke section 60 to attack a mortgage that is given for a present consideration but not immediately recorded, will he be more successful under 70e? Section 70e gives the trustee the power to avoid any transfer which is voidable as to any "creditor" having a provable claim. Accordingly, if there is a gap maritime lienor whose lien has priority over the unrecorded mortgage pursuant to section 921 of the Ship Mortgage Act, can the trustee step into that lienor's shoes and invalidate the mortgage? Stated generally, the problem is whether the trustee may invoke the rights and status of secured or lien creditors under section 70e or whether he is limited to the status of a general unsecured creditor. The debate has been hot and heavy. Complicating the matter is the doctrine of *Moore v. Bay*,¹²⁷ which would completely invalidate the ship mortgage if it were voidable as to a single lienor.

Although section 70e might be read literally to invalidate the ship mortgage if there were a gap maritime lienor, recent scholarship has cast doubts on whether the term "creditor" in section 70e should be interpreted to include the status of a secured or lien creditor. It has been pointed out that the effect of such a reading of section 70e would be to invalidate all but one security interest or lien since all junior

¹²⁵ See 3 COLLIER ¶¶ 60.38[1]-[2]; Countryman, *The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act*, 16 LAW & CONTEMP. PROB. 76 (1951).

¹²⁶ The pre-Chandler Act cases are discussed in 3 COLLIER ¶¶ 60.37[3]-[5] and Countryman, *supra* note 125, at 77-78; post-Chandler Act cases involving a very rigid construction of section 60 include *Carina Mercury, Inc. v. Igaravides*, 344 F.2d 397 (1st Cir. 1965), and *Porter v. Searle*, 228 F.2d 748 (10th Cir. 1955), *noted in* 69 HARV. L. REV. 1492 (1956).

¹²⁷ 284 U.S. 4 (1931).

security interests or liens are, by definition, "voidable" as to the senior lien. Moreover, if the superior lien were itself voidable by the trustee, the effect of allowing the trustee to avoid any security interest which the superior but defeasible lien might invalidate would be to render unnecessary the lien preservation provisions of sections 60, 67 and 70. Accordingly, it is convincingly argued that under section 70e the trustee has the status and avoidance powers only of a general unsecured creditor and cannot rely on the rights and powers of secured or lien creditors.¹²⁸ However, there is a nagging doubt: recent decisions of the Fifth Circuit, although arguably distinguishable, appear to have allowed the trustee to step into the shoes of lien and secured creditors.¹²⁹

2. *Raising the Preference or Fraudulent Conveyance.* If the mortgage is being foreclosed in admiralty, the trustee may raise any claimed preference or fraudulent conveyance as a bar to recovery. The consequences of his failure to do so are uncertain. The majority of cases seem to hold that the trustee's failure to assert the preference or fraudulent transfer in the foreclosure proceeding will bar a subsequent suit by the trustee—as part of the bankruptcy proceeding or in a plenary action—regardless of whether the trustee intervenes in, or simply has knowledge of, the foreclosure proceeding.¹³⁰ The theory of these cases

¹²⁸ See, e.g., Kennedy, *The Trustee in Bankruptcy as a Secured Creditor Under the Uniform Commercial Code*, 65 MICH. L. REV. 1419 (1967) (reviewing pertinent authorities). An alternative approach to that taken in the text is to find that secured creditors do not have provable claims and, on that account, do not fall within the definition of "creditor" in section 70e. However, since a strong argument can be made that secured creditors do have "provable claims," e.g., 4A COLLIER ¶ 70.90[1], at 1033-34, Professor Kennedy's analysis in terms of the policy of section 70e seems appropriate.

¹²⁹ *Electric Constructors, Inc. v. Azar*, 405 F.2d 475 (5th Cir. 1968) (trustee can utilize landlord's lien under 70e); *Abramson v. Boedeker*, 379 F.2d 741, 748-49 (5th Cir.), cert. denied, 389 U.S. 1006 (1967), noted in 20 S.C.L. REV. 311 (1968) (trustee can utilize liens of subsequently perfected assignment, attaching creditor or tax lienor). In 4A COLLIER ¶ 70.90[1], at 20 (Supp. 1970), it is suggested that the trustee in *Azar* could have obtained the same result by stepping into the shoes of general unsecured creditors. In *Abramson*, the lien was probably vulnerable under section 70c. See also *Cherno v. Dutch Am. Mercantile Corp.*, 353 F.2d 147, 155 (2d Cir. 1965) (trustee under section 70e(2) can assert defense of creditor having bona fide purchaser status).

¹³⁰ See *Clark v. Mutual Lumber Co.*, 206 F.2d 643 (5th Cir. 1953); *Carter v. Bank of Cal. Nat'l Ass'n*, 116 F. Supp. 902 (N.D. Cal. 1953); *Stark v. Baltimore Soda Fountain Mfg. Co.*, 101 F. Supp. 842, 845 (D. Md. 1952); cf. *The Fort Orange*, 5 F. Supp. 833, 843 (S.D.N.Y. 1933) (in intervening, trustee acquiesced in prior decisions sustaining validity of mortgages; not clear whether trustee had opportunity to object). The case of *Liman v. Bank of Nova Scotia*, 337 F. Supp. 62 (S.D.N.Y. 1971), was pregnant with this issue since the trustee was attacking as a preference the payment by the bankrupt of a second mortgage out of the proceeds of a vessel which had been sold in foreclosure proceedings in Oregon. The prior Chapter X trustees had appeared in the foreclosure proceeding. See *Brock v. S.S. Southampton*, 231 F. Supp. 278, 280, 283 (D. Ore. 1964) (other proceedings in same case). For reasons which are unclear, the mortgagee failed to raise this issue in the trustee's preference

is that the foreclosure proceeding conclusively determines the rights to the fund being administered. There is, to be sure, contrary authority.¹³¹

From a policy standpoint, there are persuasive reasons for not requiring the trustee to litigate preferences and fraudulent conveyances in the foreclosure forum, especially when it is distant from the bankruptcy court, which otherwise has summary jurisdiction over the recipients of the preferences and fraudulent conveyances. The issues involved in the foreclosure—the validity of the mortgage and its relative priority—are vastly different from the bankruptcy issues of antecedent debt, fair consideration, insolvency, and reasonable cause to know of insolvency. On such matters, both the evidence and the witnesses are likely to be proximate to the bankruptcy court. Furthermore, at least some of the issues may be common to related avoidance proceedings brought by the trustee against other creditors, thus raising the possibility of joint trials and common discovery.

If these factors are persuasive reasons for allowing the preference or fraudulent conveyance claims to be tried separately from the foreclosure action, however, they are not an adequate excuse for the trustee's silence in the foreclosure proceeding. It is not too much to require the trustee to call the matter to the attention of the admiralty court by seeking a stay while suitable proceedings are either commenced or, if already commenced, prosecuted in the convenient forum or by moving to include in the final foreclosure decree an express provision that the decree does not bar preference or fraudulent conveyance actions. In view of the cases cited earlier, the trustee's failure to do so may be costly indeed.

C. Tax Liens

The relative priorities of maritime and tax liens do not present distinctive bankruptcy problems unless the tax lien may, under some circumstances, be accorded priority. *The Milissa Trask*,¹³² a 1923 case, involved the relative priorities of a preferred ship mortgage and a postmortgage claim by the federal government for "head taxes" on aliens brought into the United States. In a much criticized decision, the district court awarded priority to the government, relying on the broad policy of according priority to tax claims. The next three dec-

action and instead litigated on a statute-of-limitations defense. 337 F. Supp. 62 (S.D.N.Y. 1971). The trustee's action was subsequently settled.

¹³¹ See *Berrara v. City Real Estate Co.*, 64 F.2d 498 (2d Cir. 1933). In any event, the trustee will probably not be barred if the mortgage foreclosure is taking place in a foreign forum. See *Murphy v. Bankers Commercial Corp.*, 203 F.2d 645 (2d Cir. 1953).

¹³² 285 F. 781 (D. Mass. 1923).

ades produced little enlightenment whether tax claims (or liens) would have priority over maritime liens and, if so, under what circumstances.¹³³

Beginning in 1952 with *The J. R. Hardee*,¹³⁴ a series of decisions has cast significant doubt on the continued vitality of *The Milissa Trask*. *The J. R. Hardee* involved a contest between a ship mortgage and a federal tax lien which had arisen before, but was perfected by filing after, the mortgage. In holding the mortgage entitled to priority, the district court uttered a broad dictum that tax liens were always subordinate to maritime liens no matter when the respective tax and maritime liens arose. This decision can be considered to be an application of the more general principle that maritime liens always outrank non-maritime liens.¹³⁵ Moreover, the decision finds support in a series of cases upholding maritime liens against vessels which had been forfeited to the United States for slave trading, piracy, and the like.¹³⁶ Finally, such a scheme of priorities may be found to be implicit in section 953 of the Ship Mortgage Act, which provides for subordination of the ship mortgage only to preferred maritime liens; by implication, the preferred maritime liens are not subordinate to other types of liens. This decision according priority to maritime liens, which avoids the necessity of inserting a tax lien into the scheme of relative priorities between ship mortgages, preferred maritime liens, and nonpreferred maritime liens, has been followed in a number of subsequent cases.¹³⁷

To the extent that *The Milissa Trask* has continued vitality, it may trigger the application of the provisions of section 67c of the Act.¹³⁸ If the tax lien was not accompanied by filing, the lien will be invalid under section 67c(1)(B),¹³⁹ and the trustee may preserve the lien for the

¹³³ The same question was involved in two other cases which reached opposite results. Compare *The River Queen*, 8 F.2d 426 (E.D. Va. 1925), with *Colonna's Shipyard, Inc. v. Rowe*, 14 F.2d 267 (4th Cir. 1926). Among the critiques, see GILMORE & BLACK §§ 9-75 to -76; Fridlund, *supra* note 70.

¹³⁴ *Gulf Coast Marine Ways, Inc. v. The J.R. Hardee*, 107 F. Supp. 379 (S.D. Tex. 1952).

¹³⁵ See, e.g., *The J.E. Rumbell*, 148 U.S. 1 (1893); *United States v. Flood*, 247 F.2d 209 (1st Cir. 1957). See also *United States v. The Pomare*, 92 F. Supp. 185 (D. Hawaii 1950) (wage claims and ship mortgage outrank tax liens; apparently, no other maritime liens involved).

¹³⁶ See, e.g., *The St. Jago de Cuba*, 22 U.S. (9 Wheat.) 409 (1824); GILMORE & BLACK § 9-74, at 618 n.370 (citing authorities).

¹³⁷ *United States v. Flood*, 247 F.2d 209 (1st Cir. 1957); *National Bank v. S.S. Oceanic Ondine*, CCH SECURED TRANS. GUIDE ¶ 51,596 (S.D. Tex. Apr. 8, 1971); *United States v. Oil Screws Ken, Jr.*, 275 F. Supp. 792, 796 (E.D. La. 1967) (dictum); *United States v. Jane B. Corp.*, 167 F. Supp. 352 (D. Mass. 1958).

¹³⁸ For reasons stated above, see text at notes 127-29 *supra*, the trustee cannot utilize the tax lien and section 70e to invalidate maritime liens which might be subordinate to the tax lien.

¹³⁹ According to the decision in *United States v. Speers*, 382 U.S. 266 (1965), the un-

estate under section 67c(2). But if the tax lien was filed, although not accompanied by possession, the subordination provisions of section 67c(3) may be invoked to allow the trustee to carve the administration expense and wage priorities out of the amount of the lien. Thus, under section 67c(3) the proper order of priorities would be: (1) the tax lien, out of which is taken administration expenses and wage claims; (2) subsequent maritime liens; and (3) the leftover portion of the tax lien. But if, in addition to the post-tax lien maritime liens, there are pre-tax lien maritime liens which are given priority over the tax lien,¹⁴⁰ there would be a circular priority: the pre-tax lien maritime liens would be prior to the tax lien; the tax lien would be prior to the post-tax lien maritime liens; and the post-tax lien maritime liens would be prior to the pre-tax lien maritime liens. Although *The J. R. Hardee* and its progeny appear to have spared us the necessity of dealing with such questions,¹⁴¹ a congressional resolution of the tax lien-maritime lien priority question is much to be desired.

D. Nonmaritime Security Interests

In order for ship mortgages to be valid, they must be perfected under the Ship Mortgage Act.¹⁴² In some instances, a supplier of equipment to a vessel or the holder of a floating lien on all the assets of a debtor may perfect his security interest under the Uniform Commercial Code. As already noted, to the extent that the UCC security interest attaches to property subject to maritime liens, the maritime liens will outrank the nonmaritime UCC security interest. The primary difficulty in the interaction between ship mortgages and UCC and pre-UCC security interests has been accession litigation over whether certain equipment or appurtenances became a part of the ship and therefore subject to paramount maritime liens and preferred mortgages.¹⁴³ There has also been some litigation over the relative priority of nonmaritime mort-

recorded tax lien would be subordinate to the trustee's judicial lienor status under section 70c and therefore would fall under the test in section 67c(1)(B).

¹⁴⁰ As already noted, the absence of litigation in the three decades following *The Milissa Trask* meant that there was no authority as to whether maritime liens which were prior in time to the tax lien might be granted priority. The Government conceded the priority of such liens in the *Trask* case; hence, there is at least some basis for making the assumption stated in the text.

¹⁴¹ On the resolution of circular priorities, see, for example, G. GILMORE, *supra* note 122, §§ 39.1-4.

¹⁴² UNIFORM COMMERCIAL CODE § 9-304(3) makes the filing provisions of the UCC inapplicable to security interests which are subject to federal legislation providing for national registration or filing. This includes the provisions of the Ship Mortgage Act. See G. GILMORE, *supra* note 122, § 19.9.

¹⁴³ Some recent cases discussing the problem are *G.I.T. Corp. v. Oil Screw Peggy*, 424 F.2d 767 (5th Cir. 1970); and *Payne v. S.S. Tropic Breeze*, 412 F.2d 707 (1st Cir. 1969). See G. GILMORE, *supra* note 122, § 13.2, at 406 n.3; Gyory, *supra* note 71, at 263-66.

gages and other security interests or liens.¹⁴⁴ Such issues, however, do not raise distinctive problems of maritime bankruptcies and therefore may be regarded as outside the scope of this paper.

E. Maritime Claims (Nonlien)

Some maritime claims do not give rise to maritime liens, yet still serve as a basis for admiralty jurisdiction. In certain instances, a creditor not holding a maritime lien may attempt to better his position as a general creditor by some action in admiralty either before or after bankruptcy. He may, for example, obtain an attachment before bankruptcy or, after bankruptcy, attempt to participate in the surplus proceeds from the sale of a vessel where the fund is being administered in admiralty. Such action must be tested against the provisions of the Bankruptcy Act.

1. *In Personam Claims with a Clause of Foreign Attachment.* A creditor holding a maritime claim which does not give rise to a maritime lien may, of course, sue the debtor in personam in admiralty, but he will not have immediate access to the vessel for payment of his claim. If, however, the owner cannot be "found" in the district where the vessel is then located, the maritime creditor may commence an in personam action by attaching the vessel¹⁴⁵ and thus secure quasi-in-rem jurisdiction over the debtor and security for his debt.

In comparison to an attachment issuing from a nonadmiralty court, there is nothing distinctive about the in personam claim with a clause of foreign attachment in admiralty. The availability of attachment is not limited to particular types of claims, as is the case with maritime liens, but rather may be obtained in a suit on any maritime claim. Moreover, the lien does not arise at the time of the underlying claim, but rather at the time of the attachment.¹⁴⁶ Consequently, any attachment within four months of bankruptcy is considered to be a lien arising from legal or equitable proceedings and is voidable under section 67a so long as the bankrupt was insolvent at the time the attachment was completed.¹⁴⁷ If the attachment comes after the filing of the petition, it is void under section 70a.¹⁴⁸

¹⁴⁴ See *Jackson v. Inland Oil & Transp. Co.*, 318 F.2d 802 (5th Cir. 1963).

¹⁴⁵ FED. R. CIV. P. supplementary admiralty rule B(1).

¹⁴⁶ See *In re Admiralty Lines, Ltd.*, 280 F. Supp. 601 (E.D. La. 1968), *aff'd*, 410 F.2d 398 (5th Cir. 1969); cf. *Coastal Marine Serv. v. Zealand Transp., Ltd.*, 1961 A.M.C. 2175 (D. Md. 1960).

¹⁴⁷ *In re Admiralty Lines, Ltd.*, 280 F. Supp. 601 (E.D. La. 1968), *aff'd*, 410 F.2d 398 (5th Cir. 1969); *In re North Atl. & Gulf S.S. Co.*, 204 F. Supp. 899, 907-08 (S.D.N.Y. 1962), *aff'd on other grounds sub nom. Schilling v. A/S D/S Dannebrog*, 320 F.2d 628 (2d Cir. 1963).

¹⁴⁸ See 1 COLLIER ¶¶ 2.62[1], 2.63; 4 *id.* ¶ 67.04[3], at 94 n.18; 4A *id.* ¶ 70.06.

2. *Remnants: Rights of Nonlien Maritime Creditors.* The admiralty court administering an in rem proceeding will first discharge the claims of maritime lienors. Any funds which are left over may be sought by maritime creditors holding nonmaritime liens, general maritime creditors, and the trustee in bankruptcy. If there are no other claims, any surplus will be awarded to the trustee in bankruptcy.¹⁴⁹

Admiralty has never successfully worked out the rights of various parties to these leftover funds, or "remnants." The second *Lottawanna* decision held that maritime creditors with nonmaritime liens ought to be paid from remnants.¹⁵⁰ Assuming that the nonmaritime liens do not violate any of the antilien or antipreference provisions of the Bankruptcy Act, this same distribution should occur if the owner is bankrupt. The right of general maritime creditors to remnants under maritime law is more uncertain. Several of the post-*Lottawanna* decisions awarding remnants to maritime creditors with nonmaritime liens denied participation to general maritime creditors and awarded the surplus funds to the vessel's owner.¹⁵¹ There is at least some authority supporting the participation of general maritime creditors in remnants,¹⁵² but most of these cases were decided before *The Lottawanna*.

It is hard to resist the conclusion that solely as a matter of maritime law, admiralty should be able to determine the rights of all maritime claimants, and possibly nonmaritime claimants, to participate in remnants. Arguments denying this power appear to be based on a compartmentalized conception of admiralty as acting in rem when foreclosing lien interests in a vessel, thus precluding consideration of in personam claims against the owner. Whatever the historical basis for this conception, it appears hopelessly out of date in the light of modern concepts of joinder of parties and claims.

In any event, an award of remnants to general maritime creditors

¹⁴⁹ See *Atlanta Flooring & Insulation Co. v. Russell*, 145 F.2d 493, 495 (5th Cir. 1944), cert. denied, 325 U.S. 862 (1945); *In re Admiralty Lines, Ltd.*, 280 F. Supp. 601 (E.D. La. 1968), aff'd, 410 F.2d 398 (5th Cir. 1969); 4A COLLIER ¶¶ 70.16[3], 70.18[10]; cf. *The Edith*, 94 U.S. 518, 523 (1876); *The Ethel V. Stowman*, 16 F. Supp. 540 (D.N.J. 1936).

¹⁵⁰ *The Lottawanna*, 88 U.S. (21 Wall.) 558, 582-83 (1874); accord, *Jackson v. Inland Oil & Transp. Co.*, 318 F.2d 802 (5th Cir. 1963).

¹⁵¹ See *The Edith*, 94 U.S. 518 (1876); *The Balize*, 52 F. 414 (6th Cir. 1887); *The Lydia A. Harvey*, 84 F. 1000 (D. Mass. 1898); *The Willamette Valley*, 76 F. 838 (N.D. Cal. 1896). If a mortgage fails to attain preferred status, it is unclear whether it can be enforced as a nonmaritime common law mortgage and paid out of remnants. Compare *The Emma Giles*, 15 F. Supp. 502, 507 (D. Md. 1936), with *The Edith*, supra (no participation in remnants after lien is lost by failing to comply with statute), and Bankruptcy Act § 60a(6), 11 U.S.C. § 96(a)(6) (1970).

¹⁵² See GILMORE & BLACK § 9-88, at 649 (collecting authorities).

as against the trustee in bankruptcy would violate the scheme of the Bankruptcy Act. Section 70a vests the trustee with the title of the bankrupt in the surplus proceeds above lien or mortgage claims,¹⁵³ and a transfer of this interest after bankruptcy to a general creditor would violate section 70d(5), which forbids any postbankruptcy transfers of the property of the bankrupt.¹⁵⁴ In addition, to allow such payments would be inconsistent with the antilien and antipreference provisions of the Act. Thus, if a general creditor received a mortgage on a vessel or an appurtenance of the vessel within four months of bankruptcy, it would be preferential and subject to avoidance if the other provisions of section 60 were satisfied. If he procured an attachment or judgment lien on the vessel within four months of bankruptcy, this too would be voidable, under section 67a. An attachment lien obtained by the same general creditor after the petition would be void. The purpose of these rules is to assure an equality of distribution among general creditors by refusing to allow those who have received payments or liens before or after bankruptcy to be elevated to a preferred position. This rationale applies, a fortiori, to a general maritime creditor who tries to recover his debt, in full or part, by participating in remnants to the detriment of nonmaritime general creditors. Finally, if the bankrupt owned more than one ship, any maritime creditor could theoretically file in all foreclosure proceedings for each vessel in the hope of being awarded remnants. This could convert each admiralty proceeding into a mini-bankruptcy proceeding in contravention of section 57 of the Act, which contemplates an orderly liquidation in the bankruptcy proceeding.¹⁵⁵

III. MARINE INSURANCE AND GENERAL AVERAGE

No discussion of the relationship between admiralty and bankruptcy law would be complete without some mention of marine insurance and general average. While there has been surprisingly little litigation and comment on insurance in nonmaritime bankruptcies, the frequency of marine casualties and disasters suggests that insurance-related questions will be an important element in any maritime bankruptcy.

¹⁵³ *E.g.*, *First Presbyterian Church v. Rabbitt*, 118 F.2d 732, 736 (9th Cir. 1940); *In re Jersey Island Packing Co.*, 138 F. 625 (9th Cir. 1905); authorities cited note 149 *supra*.

¹⁵⁴ *See Lake v. New York Life Ins. Co.*, 218 F.2d 394, 399 (4th Cir.), *cert. denied*, 349 U.S. 917 (1955).

¹⁵⁵ The question of the right of maritime nonlien creditors to participate in remnants as against the trustee in bankruptcy was squarely presented in *Brock v. S.S. Southampton*, 231 F. Supp. 278, 280, 283 (D. Ore. 1964). A timely settlement, pursuant to which the maritime claimants each received about fifteen percent of their claims, was approved by the court in early 1965.

An average loss is a partial loss, as contrasted with a total loss of vessel and cargo. A general average loss occurs when some of the values at risk in a maritime venture—ship, freight, or cargo—are sacrificed to save the venture from a common impending peril. In general average, the loss is spread ratably in accordance with the contributory values of the interests of the parties to the venture.¹⁵⁶ For example, consider the following case: Emergency repairs to a vessel are made necessary by damage from a severe storm. The master declares a general average and puts into the nearest port for repairs, resulting in total expenditures of \$100,000. The notion of general average is that the repairs are carried out for the benefit of the shipowner, the party who would receive the freight (owner or charterer), and the cargo interests. Since all benefited from the expenditure, each ought to pay in accordance with its stake in the venture. If the vessel has a value of \$1,000,000, the freight payable was \$200,000, and the cargo was valued at \$800,000, the owner contributes fifty percent of the cost of the repairs or \$50,000; the freight contributes ten percent or \$10,000, and the cargo contributes forty percent or \$40,000. Other common examples of general average losses are jettison of cargo to lighten the vessel, damage to the vessel or cargo resulting from extinguishing a fire, or damage to the vessel or its engines caused by extraordinary maneuvers to extricate the ship from peril.¹⁵⁷

A particular average loss is a partial loss which is not a general average loss. It is a loss not involving an expenditure to save the common venture from an impending peril. This loss falls entirely on the owner of the damaged property, subject to the owner's right to obtain indemnity from another party if, for example, the loss was negligently caused.

A. Particular Average

A vessel crashes into a dock and is seriously damaged. A shipyard has repaired the vessel but has not been paid, and the vessel owner is now in bankruptcy. The bankrupt holds a hull insurance policy. The insurance company claims that bankruptcy releases its obligation to pay, and both the trustee and the shipyard claim the proceeds. To put it simply, who wins?

There is nothing distinctively maritime about this question as it relates to the rights between the trustee and the insurance company. An insurance policy is an asset of the bankrupt's estate, which inures

¹⁵⁶ See, e.g., *Ralli v. Troop*, 157 U.S. 386, 395 (1895); *Hobson v. Lord*, 92 U.S. 397, 404 (1875); *Barnard v. Adams*, 51 U.S. (10 How.) 270, 303 (1850).

¹⁵⁷ See GILMORE & BLACK §§ 5-6 to 5-11.

to the benefit of the creditors. Any other rule would give a windfall to the insurer because of the happenstance of the intervening bankruptcy. Thus, the bankruptcy of the shipowner does not release the insurance company.¹⁵⁸

As between the trustee and the shipyard, the shipyard will claim that it has some sort of lien on the insurance proceeds. It may argue that its maritime lien for repairs to the vessel was transferred to the insurance proceeds and that it has some sort of equitable lien or constructive trust interest in the proceeds. Several decisions have, however, denied the maritime lien transference theory on the ground that insurance is a personal contract between the parties involved—insured and insurance company—and that insurance proceeds are not a “substitute” for the vessel.¹⁵⁹ The shipyard’s lien is said to attach to the wreck, or possibly to any rights against third parties which may be said to inhere in the vessel.

The equitable lien or constructive trust theory would be based on a notion of unjust enrichment: the owner’s vessel was worth more because of the repairs, and therefore the owner should account for the increment. The mere fact that a creditor brings a fund into existence has, however, never been thought to create a lien or interest which would survive bankruptcy. Otherwise, any general creditor who could either trace his contribution to the bankrupt’s estate or otherwise fix his claim on specific assets of the estate could claim an equitable lien for augmenting the estate. The claimed lien is simply too flimsy.¹⁶⁰ Moreover, in cases where the creditor could have enforced a maritime lien in a foreclosure proceeding, but failed to do so, the policy of section 60a(6) denying enforcement of equitable liens which could have been, but were not, properly perfected as legal liens may be applied by analogy to proscribe enforcement.¹⁶¹

¹⁵⁸ See *In re Podolsky*, 115 F.2d 965 (3d Cir. 1940); *Michigan Fire & Marine Ins. Co. v. Genie Craft Corp.*, 224 F. Supp. 636 (D. Md. 1964); *In re Chelsea Pure Food Corp.*, 18 F.2d 112 (S.D.N.Y. 1926).

¹⁵⁹ See *The City of Norwich*, 118 U.S. 468, 493-95 (1886); *Walsh v. Tadlock*, 104 F.2d 131 (9th Cir.), cert. denied, 308 U.S. 584 (1939); *The Donald T. Wright*, 30 F. Supp. 610 (W.D. Ky. 1939); *A.M. Bright Grocery Co. v. Lindsey*, 225 F. 257 (S.D. Ala. 1915); cf. *Universal C.I.T. Credit Corp. v. Prudential Inv. Corp.*, 101 R.I. 287, 222 A.2d 571 (1966) (insurance is not “proceeds” under UCC § 9-306(1) so as to be subject to security interest).

¹⁶⁰ See *Cherno v. Dutch American Mercantile Corp.*, 353 F.2d 147, 153-54 (2d Cir. 1965); *Donald W. Bower, Inc. v. Frank*, 219 F.2d 509 (D.C. Cir. 1955); *In re Podolsky*, 115 F.2d 965 (3d Cir. 1940) (fire settlement apparently included goods owned by claimants); *Arkwright Mut. Ins. Co. v. Bargain City, U.S.A., Inc.*, 251 F. Supp. 221 (E.D. Pa. 1966), *aff’d*, 373 F.2d 701 (3d Cir.), cert. denied, 389 U.S. 825 (1967); *In re Luber*, 261 F. 221 (E.D. Pa. 1919) (attorney brought insurance fund into existence). *But cf. Kossian v. American Nat’l Ins. Co.*, 254 Cal. App. 2d 647, 62 Cal. Rptr. 225 (1967).

¹⁶¹ See *Cherno v. Dutch Am. Mercantile Corp.*, 353 F.2d 147, 152-53 (2d Cir. 1965); *Em-*

If the shipyard has no interest in the insurance proceeds under common law, is its position improved if the insurance policy contains, as many marine policies do, a loss-payable clause awarding the proceeds to "owner or others as interests may appear"? It is clear that a party specifically named as a loss payee in an insurance policy will be awarded the proceeds of the policy as against the trustee in bankruptcy.¹⁶² The theory is that under section 70a of the Act, the trustee takes the policy rights only of the bankrupt, and the bankrupt's rights are subordinate to those of the named assured. Moreover, the "as interests may appear" clause has been held to authorize a recovery by those originally intended as beneficiaries, although not specifically named, and even by "intended" beneficiaries (*e.g.*, future bailees in a warehouse) who were unknown at the time the policy was procured.¹⁶³ However, recovery under an "as interests may appear" clause has been limited to parties who had an "insurable interest" in the property at the time the loss occurred.¹⁶⁴ Since the shipyard did not, by definition, have an interest in the vessel at the time of the accident, it cannot have an "insurable interest" and is not within the coverage of the insurance policy. Accordingly, the proceeds will probably be paid to the trustee in bankruptcy.

B. General Average

Dusty volumes have been written on the circumstances constituting a general average occurrence and the propriety of various expenses in general average. For this discussion, however, it may be assumed that a particular misfortune was a general average occurrence and that an average adjuster, appointed by the shipowner to apportion properly the loss among the interests at stake, has prepared a statement of general average. The statement may show a net credit balance due the cargo interests, as, for example, if cargo were thrown overboard. Or the statement may show a credit in favor of the shipowner, as, for example,

pire Stevedoring Co. v. Oceanic Adjusters, Ltd., 315 F. Supp. 921, 926 (S.D.N.Y. 1970); Michigan Fire & Marine Ins. Co. v. Genie Craft Corp., 224 F. Supp. 636, 640 (D. Md. 1964).

¹⁶² See *In re Summer*, 35 F.2d 930 (E.D.N.Y. 1928); *In re Stucky Trucking & Rigging Co.*, 240 F. 427 (D.N.J. 1917).

¹⁶³ See *Hagan v. Scottish Ins. Co.*, 186 U.S. 423, 429 (1902); 5A J. APPLEMAN, *INSURANCE LAW & PRACTICE* § 3336 (1970). While some older cases awarded policy proceeds to intended beneficiaries even without any "as interests may appear" clause, see, *e.g.*, *In re Jeffries*, 18 F.2d 149 (E.D. Tex. 1926); *In re Zitron*, 203 F. 79 (E.D. Wis. 1913), such cases appear to have been overruled by the Chandler Act's change in section 60. See *Michigan Fire & Marine Ins. Co. v. Genie Craft Corp.*, 224 F. Supp. 636 (D. Md. 1964).

¹⁶⁴ See *Hagan v. Scottish Ins. Co.*, 186 U.S. 423, 429-31 (1902); *Hooper v. Robinson*, 98 U.S. 528, 537-38 (1878); *The John Russell*, 68 F.2d 901 (2d Cir. 1934); *The Sydney*, 27 F. 119, 125 (C.C.S.D.N.Y. 1886), *appeal dismissed for want of jurisdiction*, 139 U.S. 331 (1891). See also *In re P.B. McChesney & Son*, 31 F. Supp. 202 (W.D. Ky. 1940).

if the vessel had undergone emergency repairs. Substantial sums may hinge on the rights of the shipowner and the other interests to general average proceeds.

1. *Credit in Favor of Cargo Interests.* If there is a net credit in favor of the cargo interests, this means that cargo suffered a disproportionate loss relative to its contributory value and is supposed to receive more from the general average fund than the cargo's contributory share. This amount will give rise to a maritime lien against the vessel.¹⁶⁵ If, however, for some reason the maritime lien is worthless or inadequate, the cargo interests will have to look to the bankrupt—more particularly, to any insurance carried by the bankrupt—in order to realize the full amount due in general average.

The bankrupt may carry either a liability or an indemnity policy to cover such a potential contributory obligation. Under a liability policy, the insurer's obligation becomes fixed when the insured's liability is determined, regardless of any actual payment by him. Indeed, the insurance company ordinarily makes the payment. If the insured has indemnity coverage, the insurance carrier is not liable until the insured actually suffers a loss by making a payment to the injured party.

Regardless of whether the policy is construed to be one of liability or indemnity coverage, the shipowner's bankruptcy will not terminate the insurer's obligation to make a payment to the cargo interests as beneficiaries of the general average. Many liability policies contain provisions that the bankruptcy of the insured shall not release the insurer's obligation, and some states have express statutory provisions giving injured parties a direct action against the bankrupt's insurer.¹⁶⁶ Even without an express policy or statutory provision, the injured party has generally been allowed to recover against the insurer.¹⁶⁷ This may be justified on the ground either that the injured party is a third-party beneficiary of the bankrupt's policy or that section 16 of the Bankruptcy Act, in providing that the bankruptcy of the principal shall not alter the liability of a codebtor, guarantor, or surety, applies to insurance.¹⁶⁸ Moreover, since the insurance is against the liability of the shipowner, the shipowner as such never has any direct interest in the proceeds, unlike the situation in which the policy insures the property of the bankrupt.

¹⁶⁵ GILMORE & BLACK § 9-20, at 515.

¹⁶⁶ See 8 J. APPLEMAN, *supra* note 163, §§ 4834-35.

¹⁶⁷ See, e.g., *Sorenson v. Boston Ins. Co.*, 20 F.2d 640 (4th Cir.), *cert. denied*, 275 U.S. 555 (1927); 8 J. APPLEMAN, *supra* note 163, § 4834. The New York statutory provision is not applicable to marine insurance. N.Y. Ins. LAW §§ 46(21), 112 subd. 2(c)(1), 167(2) (McKinney 1966).

¹⁶⁸ See 1A COLLIER ¶ 16.15.

If the policy is one of indemnity, it will be necessary for the bankrupt to make a payment in order to trigger the insurer's policy obligations. If the bankrupt cannot make such a payment, the insurance obligation is theoretically released.¹⁶⁹ However, several decisions have authorized various arrangements by which a third party or the injured party himself may "lend" the bankrupt the funds to make the payments.¹⁷⁰

One recent case raised an interesting wrinkle in this situation. In *Liman v. American Steamship Owners Mutual Protection & Indemnity Association*¹⁷¹ (*American Club*), the bankrupt was covered by an indemnity policy with a \$1,000 deductible, and numerous suits and claims had been filed and otherwise asserted by injured seamen. Although there were sufficient funds in the estate to make the initial payments to successful plaintiffs in accordance with the policy provisions, the question arose as to how the deductible should be paid. The American Club took the position that if, for example, a \$10,000 claim was involved, the estate had to pay the full \$10,000 subject to reimbursement of \$9,000. However, a priority creditor objected to such a payment on the ground that the payment of the \$1,000 not subject to reimbursement would interfere with its priority claims. To avoid this dilemma, the trustee proposed a plan by which the personal injury plaintiff would agree to reimburse the bankrupt estate, out of the proceeds of any recovery, the amount of the \$1,000 deductible actually required to be paid by the assured. Judge Mansfield approved this arrangement against contentions that the \$1,000 actually had to be paid by the assured, pointing out that the insured had paid over \$300,000 in premiums for the protection involved and that any other result would create a windfall to the carrier at the expense of the beneficiaries because of the insolvency of the insured. The purpose of the deductible, according to the court, was to avoid responsibility for small claims, and this was served by the trustee's proposal. While this case relates to personal injury claims, it should be equally applicable to general average claims. It would seem that counsel should be able to formulate some arrangement to avoid any problems arising from the insured bankrupt having to make an initial payment under an indemnity policy.

2. *Credit in Favor of the Shipowner-Bankrupt.* If there is a credit balance in favor of the cargo interests, the shipowner may still recover

¹⁶⁹ See 8 J. APPLEMAN, *supra* note 163, § 4834, at 232.

¹⁷⁰ *E.g.*, *Employers Liab. Assur. Corp. v. International Milk Prods. Co.*, 192 App. Div. 88, 182 N.Y.S. 337 (1920).

¹⁷¹ 299 F. Supp. 106 (S.D.N.Y.), *aff'd*, 417 F.2d 627 (2d Cir. 1969), *cert. denied*, 397 U.S. 936 (1970).

from his own insurance carrier for any general average expenses incurred. And if there is a credit balance in favor of the shipowner, it will receive contributions from the cargo interests in addition to those of its own insurer. If the general average expenses are for damage to the vessel or other paid expenses, the situation is the same as the particular average situation, and the general average fund belongs to the shipowner.¹⁷² But when the monies are for general average expenses which the shipowner has failed to pay, the question arises whether the insurance and cargo interests may resist making general average payments on this ground.

The question has not been litigated. Under rule A of the York-Antwerp Rules, which is incorporated into most bills of lading and charter parties, a general average occurrence results when "any extraordinary sacrifice or expenditure is intentionally and reasonably made or incurred for the common safety" of the participants in the maritime venture. This language would permit a reading that the mere "incurring" of "expenditures," without actual payment is sufficient to give rise to an obligation to make general average contributions.¹⁷³ This interpretation is reinforced by some case authority speaking of general average contributions as becoming due and enforceable at the end of the voyage,¹⁷⁴ even though the amount remains unliquidated. And rule G of the York-Antwerp Rules provides that both loss and contribution are to be adjusted "upon the basis of values at the time and place when and where the adventure ends." This fixing of time suggests that other subsequent developments such as payments of expenses incurred should not be considered. Finally, the theory of general average is that a sacrifice by one party to the maritime venture should be borne ratably by the other parties. No reason appears for giving the cargo interests a windfall when the shipowner is bankrupt and, because of the bankruptcy, may be excused from paying general average expenses.

If a general average fund is collected, what are the respective rights of the trustee in bankruptcy and any creditor whose claim comprised part of the general average expenses? In *Empire Stevedoring Co. v. Oceanic Adjusters, Ltd.*,¹⁷⁵ a general average occurrence required the unloading and reloading of the *S. S. Beatrice* by Empire at a cost of over fifty thousand dollars. Empire's charges were duly listed in the general average statement. Meanwhile, the owner of the vessel, A. H. Bull Steamship Company, had successively been involved in Chapter XI and Chapter X

¹⁷² See text at notes 158-64 *supra*.

¹⁷³ See GILMORE & BLACK § 5-2.

¹⁷⁴ See *United States v. Atlantic Mut. Ins. Co.*, 298 U.S. 483, 489-90 (1936).

¹⁷⁵ 315 F. Supp. 921 (S.D.N.Y. 1970).

proceedings and, ultimately, was adjudicated as a bankrupt. For reasons which are unclear, Empire failed to press its claim for a maritime lien in foreclosure proceedings involving the *Beatrice*. Thus, Empire and the trustee both claimed the general average fund.

Judge Pollack held that the funds belonged to the bankrupt estate. He analyzed the law of general average as an attempt to apportion ratably extraordinary sacrifices or losses among the three interests at stake in a maritime adventure—the vessel, freight, and cargo interests. Empire, as a stranger to the maritime adventure, was relegated to enforcing its maritime lien against the vessel and, having lost that, to its claim as a general creditor of the bankrupt. The court rejected Empire's argument that because it had helped to create the general average fund, a constructive trust or equitable lien should have been impressed on the fund in its favor. The court also refused to attach any significance to the inclusion of Empire's claim in the statement of general average prepared by the average adjuster on the ground that the statement was without legal effect. As an additional reason, the court noted that if the cargo interests had become insolvent and were unable to make general average contributions, Bull would not have been excused from paying Empire, and suggested that there was no reason to reward Empire when it was the shipowner who had become financially embarrassed.

In refusing to allow the stevedore to participate in the general average fund, which it had admittedly helped to augment, *Empire Stevedoring* lends support to the conclusion suggested above that particular average insurance proceeds belong to the trustee as against a ship repairer and that the repairer acquires no interest simply because it augmented the estate or had a maritime lien against the vessel. Moreover, in refusing to alter the general average scheme because of the bankruptcy of one of the parties involved, *Empire Stevedoring* supports the conclusion that insurers and cargo interests are not relieved of their obligation to contribute to the general average fund because of the shipowner's bankruptcy. Indeed, *Empire Stevedoring*, coupled with the *American Club* case, provides a clear indication that the shipowner's bankruptcy will not be the occasion for a general windfall for marine insurers at the expense of creditors of the bankrupt and that the courts will, to the extent possible, determine rights and obligations as they would in the absence of bankruptcy.

CONCLUSION

In 1938, when Congress was considering the Chandler Act, a proposal came before the House that admiralty jurisdiction be conferred

upon the bankruptcy courts. This was a response to the uncertainty in the decided cases—discussed in detail in the text of this article—regarding the power of a bankruptcy court to execute maritime liens. Would the admiralty bar agree to such heresy? David Teitelbaum, apparently representing the bankruptcy bar, was not sure, but was sufficiently sanguine to venture an educated guess in the affirmative.¹⁷⁶

How wrong he was. When the bankruptcy legislation reached the floor of the House, Rep. Walter Chandler reported that the Senate had rejected the amendment. The reasons, according to the Congressman, were that (1) the dearth of cases in the bankruptcy court involving admiralty claims meant that there was no pressing necessity for the change, (2) the amendment might create jurisdictional confusion between admiralty and bankruptcy courts, and (3) the United States Maritime Commission had formally objected to the change.¹⁷⁷ These "reasons" may be criticized: The number of cases—which was and is actually not so small as one might imagine—is hardly an adequate excuse for perpetuating uncertainty when clarification may be easily obtained. The supposed jurisdictional confusion which would result ignores the purpose of the amendment—to correct jurisdictional uncertainties that already existed and continue to exist. The Maritime Commission's objection is undoubtedly symptomatic of that of the admiralty bar. Sensible or not, its members wanted nothing to do with bankruptcy courts.

Substantive conflicts between admiralty doctrines are hardly unique to admiralty-bankruptcy cases. They occur frequently in maritime cases when a personal injury plaintiff claims rights under admiralty law (unseaworthiness), federal law (Jones Act), and state law (common law negligence). Bankruptcy law, too, seems forever to be on a collision course with commercial law doctrines protecting secured and lien creditors. Complaints have been lodged that the draftsmen of the bankruptcy provisions ignored simultaneous developments in the drafting of the Uniform Commercial Code,¹⁷⁸ and the number of cases and commentators discussing conflicts between the UCC and the Bankruptcy Act is staggering. If the bankruptcy draftsmen ignored the UCC, it is a sin of omission. It is doubtful, however, that the draftsmen of the bankruptcy provisions even understood admiralty concepts, let alone

¹⁷⁶ *Hearings on H.R. 6439 Before the House Comm. on the Judiciary*, 75th Cong., 1st Sess. 18-20 (1937).

¹⁷⁷ 83 CONG. REC. 9106 (1938) (remarks of Rep. Walter Chandler). A similar proposal, which was introduced in 1949 as a "noncontroversial" extension of bankruptcy jurisdiction, foundered upon the strong opposition of the admiralty bar. See Fiddler, *supra* note 4, at 27-28.

¹⁷⁸ See 2 G. GILMORE, *supra* note 122, § 45.4, at 1303 n.15.

made any attempt to reckon with them in the bankruptcy provisions. The fact is that admiralty and bankruptcy concepts do not mesh. The maritime lien does not fall neatly within the antilien and antipreference provisions of the Bankruptcy Act, and that species of maritime lien known as a ship mortgage produces even more aberrational results. Indeed, in some cases, the Bankruptcy Act affects maritime interests in a manner diametrically opposed to that which might be supposed to be the intention of Congress.

Perhaps this effort at a reconciliation should not have been attempted. The subject could have been left as it was—just as the *Mighty Queen Elizabeth* was left, ablaze and adrift in Hong Kong Harbor. Perhaps the ignominious end of the *Great Queen* heralds the continued decline of the shipping industry on both sides of the Atlantic. Today's merchantmen are built in Japan, not the United States or England. Their crews come from nations where the price of labor is less dear than in our own, and they fly the flag of Liberia, Panama, or Greece. They may be owned by local interests, but, if so, it is through a maze of subsidiaries—themselves often foreign-chartered—so as to be virtually untraceable. Perhaps there will never again be a major maritime bankruptcy in our courts. Only time will tell.

But even if our courts never face another maritime bankruptcy, some courts in distant lands will do so. This article has avoided the complex conflict-of-law and international law questions which would be presented in such a bankruptcy, focusing instead on the issues as presented in a single jurisdiction. The foreign shipping bankruptcy must be left to others. One can only hope that when such a case arises, there will be doctrine to furnish a guide for decision. An analysis of the problems confronted by the courts of the United States will perhaps contribute to its formulation.