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CHARTING A COURSE THROUGH DANGEROUS WATERS: A LANDLUBBER'S INTRODUCTION TO THE RULES OF MARITIME INDEBTEDNESS IN THE CONTEXT OF A MARITIME BANKRUPTCY

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***196** Introduction

EVEN as we enter the 21st century, merchant ships continue to transport an enormous quantity of goods around the world. [FN1] In contrast to the shipping industry's vitality in the modern world, the specialized body of admiralty law that has developed around the maritime industry draws on a tradition of substantive law that is hundreds of years old. [FN2]

Admiralty law, however, does not exist in a vacuum. Common law principles of contract and tort influence the treatment of shipping contracts and collisions at sea, [FN3] and many of the factors defining non-admiralty ***197** federal jurisdiction influence the scope of admiralty jurisdiction. [FN4] These "outside influences" give rise to conflicts between admiralty and non-admiralty law. This article examines one such conflict, the maritime indebtedness rules and their application in a maritime bankruptcy context. When a maritime debtor files for protection in bankruptcy, jurisdictional and substantive bankruptcy rules collide head-on with rules developed to administer claims against a non-bankrupt maritime debtor. This conflict has rarely been considered at the appellate level, and the Supreme Court has never considered it. Over the past twenty years, district courts, relying on a mixture of respected commentary, an understanding of bankruptcy and admiralty law, and common sense, have fashioned a system for administering a maritime bankruptcy.

Section I of this article provides an overview of maritime and bankruptcy jurisdiction, noting the areas where the bankruptcy and admiralty courts may have concurrent jurisdiction, and the approach used by courts to ultimately resolve jurisdiction in these matters. Section II discusses the complexity of maritime indebtedness, beginning with a detailed look at two types of security interests: the maritime lien [FN5] and the preferred ship mortgage. [FN6] Both interests are extremely unfavorable to the debtor's non-maritime creditors (e.g., unsecured or under-secured creditors or creditors with blanket liens). Section II also explores the justification for this inequity and examines some criticisms of it. Section III investigates the application of the law to maritime liens, in a maritime bankruptcy. The effect that international law has played in shaping the administration of a U.S. maritime bankruptcy is examined in Section IV. International aspects are particularly relevant because when a bankruptcy is filed, a maritime debtor may have assets distributed throughout the world. International recognition of bankruptcy proceedings is critical to any reorganization or liquidation involving foreign creditors. Additionally, an international maritime bankruptcy presents a unique problem as a new owner of the ***198** maritime debtor's vessel, historically, could only acquire an unencumbered title if the sale was administered by an admiralty court. [FN7] Section V examines two criticisms of the rules of maritime indebtedness. Finally, this article concludes that even though the rules of maritime indebtedness are complicated, a prudent lender can navigate through the morass, analyze the risk, and make intelligent investments.

I. Jurisdiction

A. Maritime Jurisdiction and Maritime Bankruptcy

Historically, the terms "admiralty law" and "maritime law" had distinct meanings. Today, they are used interchangeably. [FN8] Maritime law is the "set of legal rules, concepts, and processes that relate to navigation and commerce by water." [FN9] Federal courts exercise admiralty jurisdiction pursuant to a constitutional extension of the federal judicial power to "all cases of admiralty and maritime jurisdiction." [FN10] This constitutional grant was implemented by the Judiciary Act of 1789. [FN11] An admiralty court (or a court "sitting in admiralty") is a federal district court exercising admiralty jurisdiction by applying maritime law.

Congress and the courts struggled with the definition of admiralty jurisdiction for nearly 200 years, but today it is fairly well defined. In a tort action, admiralty jurisdiction is appropriate when an injury occurs on navigable waters, bears a substantial relationship to traditional maritime activities, and has a potential impact on maritime commerce. [FN12] In a contract action, the court will look either to the subject matter or "nature" of the contract, including "whether it ha[s] reference to maritime service or ***199** maritime transactions," [FN13] or to various federal statutes which specifically provide for an admiralty cause of action. [FN14]

The procedure to attain admiralty jurisdiction over a vessel, or the assets of a vessel's owner or operator, is provided in the Supplemental Federal Rules of Civil Procedure. [FN15] Whether the jurisdiction sought is in rem (jurisdiction over the ship) or quasi in personam (jurisdiction over the shipowner through a "foreign attachment" of his assets), jurisdiction commences when a federal marshal serves notice of the arrest or attachment of the vessel on the designated individual. [FN16]

B. Bankruptcy Jurisdiction

Unlike admiralty courts, the bankruptcy courts' jurisdiction is not expressly conferred by the Constitution, but is instead established by statute. [FN17] A congressional attempt to grant federal jurisdiction directly to the bankruptcy courts was found unconstitutional in the landmark case, Northern Pipeline Construction Co. v Marathon Pipe Line Co. [FN18] Thereafter, the Bankruptcy Code [FN19] was amended [FN20] to award district ***200** courts "original and exclusive jurisdiction of all cases under Title 11." [FN21] To allow the bankruptcy courts to hear the matter, individual district courts may designate that Title 11 cases "shall be referred to the bankruptcy judges for the district." [FN22]

C. Concurrent Jurisdiction

When a maritime debtor files bankruptcy, a maritime creditor's primary claim is against the debtor's most valuable asset--the vessel--and jurisdiction over the ship is often at issue. [FN23] A determination to award jurisdiction to the bankruptcy court will ultimately affect the disposition of the vessel. [FN24]

The Bankruptcy Code does not expressly reference admiralty matters, but it does grant "exclusive jurisdiction of all of the property, wherever located, of the [insolvent] debtor" [FN25] This clause should bring the debtor's maritime assets within the jurisdiction of the bankruptcy courts, but directly opposes the constitutional award of exclusive jurisdiction to the district courts for all admiralty matters. The consequences of this conflict may appear insignificant, since admiralty and bankruptcy both fall within the jurisdiction of the federal district courts. Practically, however, the differences between an admiralty and a bankruptcy proceeding may be substantial.

While bankruptcy matters are automatically referred from the district courts to the bankruptcy courts, [FN26] an admiralty matter must be ***201** retained by the district court and is often assigned to a judge experienced in admiralty matters. Familiarity with district court practice and procedure is comforting to admiralty practitioners, who may question a bankruptcy judge's ability to deal with unique admiralty issues, or may perceive the bankruptcy courts as generally pro-trustee or pro-debtor. [FN27]

On the other hand, bankruptcy lawyers are usually unfamiliar with the lien priority rules established under admiralty law and are also unwilling to see the debtor's most valuable asset (the ship) removed from the bankruptcy estate. As a result, they understandably prefer to keep the entire proceeding within the jurisdiction of the bankruptcy court.

The admiralty-bankruptcy conflict continues after disposition of a bankruptcy, potentially barring a possible admiralty appeal. In many districts, if the matter is a "core proceeding," in a bankruptcy court, the judge's findings of fact may only be set aside if held "clearly erroneous" by a bankruptcy appellate panel. [FN28]

To add to the confusion, the Bankruptcy Code is silent on the admiralty-bankruptcy jurisdictional conflict and there is no leading case to clarify matters. As with much of the law surrounding maritime indebtedness, jurisdiction has been shaped by respected commentary and a long line of district court opinions. [FN29] Ultimately, courts developed a resolution to the conflict, depending primarily on whether the debtor has filed for protection during reorganization under Chapter 11, or whether the business will be liquidated under Chapter 7.

When a bankruptcy petition is filed, all actions against the debtor or his assets are automatically stayed, pending development of a plan of reorganization in Chapter 11, or conversion of the matter to a Chapter 7 liquidation. [FN30] As long as the stay is operative, the bankruptcy court will retain jurisdiction. [FN31]

***202** "The purpose of reorganization is to save a sick business, not to bury it and divide up its belongings." [FN32] In a reorganization, the matter remains under the jurisdiction of the bankruptcy court, because "the goal of reorganization--continuation of the debtor's business--requires the supervision of a single court." [FN33]

Conversely, the primary function of an admiralty court in a bankruptcy is to sell the ship and distribute the proceeds. [FN34] Without the ship, there can be no reorganization. Arguably, a successful reorganization of a shipping firm is unlikely in any event. [FN35] The shipping industry is very sensitive to economic cycles. Demand for shipping is somewhat unpredictable and subject to factors over which the shipping industry has no control, including the demand for goods and changes in the climate of international relations. This inconsistent demand aspect of the economic equation is complemented by an inelastic supply side. The "supply" in this case is shipping capacity, and the process of adding to or reducing the supply is lengthy and expensive. This economic analysis leads creditors to conclude that a shipping firm attempting reorganization under Chapter 11 cannot possibly succeed. On these grounds, they will argue for relief from the automatic stay to allow them to sell the ship under the supervision of an admiralty court. [FN36]

In a Chapter 7 liquidation action, courts look to the custodia legis doctrine to determine jurisdiction. Under custodia legis "the court that first secures custody of the property administers the property." [FN37] The doctrine, based on principles of comity, is "a practical means of resolving a jurisdictional dispute between two courts with concurrent jurisdiction over a single res." [FN38] Notably, "only an admiralty court [pursuant to an in rem ***203** action brought directly against the ship] can give a[n unencumbered] title to [a] ship which will achieve worldwide recognition." [FN39] Moreover, admiralty's policy of favoring vessel mobility may be more readily achieved with a speedy sale by an admiralty court. [FN40] Accordingly, in bankruptcy liquidation proceedings, a motion to remove the sale of the ship from the jurisdiction of the bankruptcy court to an admiralty court will usually be granted. [FN41]

II. Rules of Maritime Indebtedness

A. The Maritime Lien

The cornerstone of a claim against a maritime debtor is the maritime lien. A maritime lien is quite different from its familiar land-locked equivalent ("land lien"). As pointed out by a leading treatise in admiralty law, "[t]he beginning of wisdom in the law of maritime liens is that maritime liens and land liens have little in common. A lien is a lien is a lien, but a maritime lien is not." [FN42]

"The maritime lien developed as a necessary incident of the operation of vessels. The ship[ ] . . . is peculiarly subject to vicissitudes which would compel abandonment . . . unless repairs and supplies were promptly furnished." [FN43] The maritime lien is "a unique security device which serves the dual purpose of keeping ships moving in commerce while not allowing them to escape their debts by sailing away." [FN44] The policy of keeping the ship in service is a constant theme throughout the rules of maritime indebtedness. [FN45] "The whole object . . . is to furnish wings and ***204** legs to the forfeited hull, to get back [to sea] for the benefit of all concerned; that is, to complete [the] voyage." [FN46]

Most "maritime claims" will create a maritime lien. [FN47] A maritime claim is a contract or tort claim which falls within the jurisdiction of an admiralty court. [FN48] A maritime lien is similar to a security interest in the ship, enforced by a special in rem process, which permits seizure without a hearing and before judgment, by ex parte order of the court. [FN49] An admiralty proceeding in rem is a proceeding against the vessel itself, [FN50] although it is the owner who is ultimately affected. Additionally, the owner may have personal liability above and beyond the value of the vessel. [FN51]

Despite the maritime lien's similarity to a security interest, practitioners familiar with secured transactions find many differences between a maritime lien and a land lien. A maritime lien is not controlled by the Uniform Commercial Code ("U.C.C.") or other state law. [FN52] The maritime lien developed under general maritime law (judge-made law) and was refined by federal statute.

Maritime liens arising from contract claims are controlled by the Federal Maritime Lien Act, which states that: [FN53] "a person providing necessaries to a [private] vessel [with the owner or owner's agent's permission] . . . has a maritime lien on the vessel," may enforce the lien in a civil in rem action, and "is not required to allege or prove that credit was given to the vessel." [FN54]

***205** The maritime lien is non-consensual. [FN55] "The Maritime Lien Act automatically gives rise to a maritime lien when a person furnishes necessaries to a vessel, and neither intent nor consent is involved in its formation." [FN56] The parties can neither opt to create a lien which would not otherwise qualify as a maritime lien, nor opt out of a lien which meets the requirements. [FN57] This non-consensual aspect further removes maritime liens from the scope of U.C.C. Article 9, which is limited to transactions "intended to create a security interest." [FN58] Maritime liens, free from the guidelines of the U.C.C., are governed by a distinct set of rules that reflect the historical practicalities of the shipping industry. These rules are often particularly perplexing to non-maritime creditors because they are not codified.

1. The Priority Scheme. The most troublesome aspect of the maritime lien framework is the priority scheme used to distribute proceeds from the sale of a ship, when proceeds are insufficient to satisfy all claims against the ship. Typically, this priority scheme plays an important part in bankruptcy actions, because by definition, a debtor is insolvent when his liabilities exceed the value of his assets. [FN59] This subsection reviews two different types of creditor conflicts. First, conflicts between maritime and non-maritime creditors are examined. Next, conflicts among maritime creditors are analyzed.

a. Conflicts Between Maritime and Non-maritime Creditors

Priority between maritime and non-maritime creditors is easily determined. Simply put, all maritime creditors have priority over all non-maritime creditors. As discussed earlier, maritime transactions are not covered by the U.C.C. Routinely, courts have held that maritime liens prevail over non-maritime claims, [FN60] or more specifically, "perfected UCC ***206** security interest[s] [are] subordinate to valid maritime liens." [FN61] Although this result has been criticized as unfairly and illogically favoring maritime interests, [FN62] it is consistent with the underlying maritime policy, to keep the ship, independent of the shipowner, operating. [FN63]

b. Conflicts Among Maritime Creditors [FN64]

Priority among maritime creditors is generally determined by time of attachment, with one particularly unique feature. Priority is determined in reverse chronological order, so that last in time is first in right. "[T]he general rule . . . is that [liens] are to be paid in inverse order, because it is for the benefit of all the interests in the ship that she should be kept in condition to be navigated." [FN65] This approach is unique in the law of secured transactions, has been frequently criticized, and is now riddled with exceptions. The last in time, first in right rule, however, is designed to keep the ship in operation. For instance, a fuel supplier will be more likely to conduct business with a ship if the supplier knows a senior lien is created, without the need to conduct a worldwide search for competing security interests.

Ranking creditors by class is concurrently applied with the last-in-time priority rule. The general classes of maritime liens, listed in order of priority, are provided in the following subsections. A "grey area" exists when a claim ranked higher by class is ranked lower in time. Which claim is granted priority depends upon which class is being considered. To further confuse matters, ship mortgages subject to the Ship Mortgage Act [FN66] have their own priority, independent of these rules. The following ***207** priority list is not created by statute, nonetheless there is "general agreement" on the rankings. [FN67]

i. Custodial Expenses. Custodial expenses generally arise from the care and operation of the ship, while it is in the custody of the court. Although technically not a maritime lien, [FN68] a custodial expense is awarded highest priority as an "expense of justice." [FN69]

ii. Claims by Seamen for Wages. Seamen's wages have priority over all other liens, regardless of their timing. [FN70] Maritime liens for seamen's wages are "'sacred liens' entitled to protection 'as long as a plank of the ship remains."' [FN71] Granting seaman's wages such a high priority may be traced to courts historically treating seamen as "wards of the admiralty," who are "generally poor and friendless, and acquire habits of gross indulgence, carelessness, and improvidence." [FN72]

iii. Salvage Claims. Salvage outranks other claims (except for wages), regardless of timing, based on the theory that the salvor has preserved the property for the benefit of all claimants. [FN73]

iv. Tort Claims for Collision and Personal Injury. These specific tort claims are ranked without regard to timing. [FN74]

v. Tort Claims Against a Tug for Negligent Towage. Timing priority for these claims has never been established, but their subordination to other forms of negligence suggests that they may be found inferior to subsequent claims for repairs. [FN75]

vi. Repairs, Towage, Supplies, and "Other Necessaries." These are the most common types of maritime liens. They are the most ***208** likely to have competing claims within the same class, and the most likely to give rise to a conflict calling for application of the timing rules. [FN76]

vii. Preferred Ship Mortgages Under the Ship Mortgage Act. The Ship Mortgage Act includes its own priority rules, which may or may not move the mortgage ahead of other classes of liens. The ship mortgage lien's ranking is based on the date of the mortgage and on whether certain conditions--such as proper recording of the mortgage--are met. [FN77]

viii. Other Liens. The remaining liens include claims by shippers against a vessel for damaged cargo, claims for "general average," [FN78] and liens against cargo for unpaid freight. [FN79] Application of the timing rules between this class and the "repairs/supplies" class is unclear. [FN80] The principal favoring continued operation of the ship suggests these claims would be inferior to liens for repairs and supplies regardless of timing. [FN81]

2. The Secret Lien. Another troublesome area for practitioners is the secret nature of a maritime lien. A maritime lien, "though adhering to the vessel, is a secret one; it may operate to the prejudice of general creditors and purchasers without notice." [FN82]

Deciding whether to record most maritime liens is optional, and in fact, only possible where the ship is already encumbered by a preferred ship mortgage. [FN83] Unlike secured transactions subject to the U.C.C., [FN84] there is no recording or possession requirement for perfection of most ***209** maritime liens. [FN85] Maritime liens are automatically perfected at the time of the transaction. [FN86] Ship mortgages and certain liens which must be perfected under state law are exceptions to the secret nature of maritime liens. [FN87] The secret lien rule may have particularly harsh results in instances where a vessel is arrested, with no notice to other creditors. [FN88]

A subsequent purchaser of a vessel subject to liens may be severely impacted by the harsh nature of secret maritime liens. A maritime lien is usually foreclosed only by an admiralty court acting in rem. [FN89] Until this procedure takes place, a valid maritime lien is good against all the world, including a good faith purchaser without notice of the lien's existence. [FN90]

The policy reasons for not requiring maritime liens to be recorded are anchored in practicality. Given the transient nature of the ship and types of transactions that may give rise to a maritime lien, it is simply impractical to require most maritime liens to be recorded. Seamen and suppliers, in particular, conduct transactions for a single ship throughout the world, with each transaction giving rise to a separate lien.

In contrast, there are no policy reasons justifying the provision which prevents recording liens against a vessel not covered by a preferred mortgage. Arguably, the recording system could be expanded to accommodate liens against unmortgaged vessels. [FN91] Such a modification would certainly benefit all parties concerned, but there is no current indication that Congress or the courts are considering the issue. It is unlikely that the recording system will be expanded, therefore, potential creditors must constantly be aware of the possibility of an unrecorded lien.

Surprisingly, the secret nature of maritime liens has had little adverse effect on maritime suppliers. Maritime suppliers are aware that ***210** under the priority scheme their lien is automatically perfected with instant last-in-time priority, making prior liens irrelevant.

The unwary non-maritime creditor may be trapped by the maritime lien's secret nature. They may believe they are taking a security interest in an otherwise unencumbered ship, yet the vessel may be encumbered by silent supplier liens.

3. Extinction of Maritime Liens

a. Payment A maritime lien is extinguished by payment to the lienor. [FN92] If payment is made by a third party, the third party is subrogated to the rights of the original lienor [FN93] and receives a lien "of equal dignity to the one discharged." [FN94]

b. In Rem Sale

The in rem decree of an admiralty court following a judicial sale executes all liens, whether or not the lien claimants have intervened in, or received notice of, the proceeding. [FN95] While an in rem sale will extinguish the claimant's maritime lien, the personal liability of a vessel owner, or another party responsible for the claim, is not affected. [FN96]

c. Laches

"Laches is an equitable principle terminating claims which are asserted after inexcusable delay and which result in prejudice to the party against whom the claim is asserted." [FN97] In the context of a maritime lien, laches may be used by a bona fide purchaser of a vessel against a lienholder attempting to assert his lien against the new owner. [FN98] Application of the doctrine will depend on the facts of each case because there is no universal rule regarding the length of time that may elapse before a claim is considered stale. [FN99] The defense is most effective when ***211** asserted against the holder of an unrecorded lien, because recordation may effectively preclude any claim of prejudice. [FN100]

Laches acts as a mechanism to ensure diligence in pursuing the debtor. [FN101] "The standard of diligence required by the holder of an unrecorded lien against a bona fide purchaser of a vessel is 'a high degree of diligence.'" [FN102] Without diligence, the lienholder may find that his lien is unenforceable after the ship is sold, even though the sale was not pursuant to an in rem proceeding. [FN103]

d. Statute of Limitations

For two types of maritime liens, a statute of limitations may provide a defense, without resorting to laches. [FN104] A strict six month statute applies to claims for wages earned on certain fishing vessels, [FN105] and injury and wrongful death claims are subject to a three year statute of limitations. [FN106]

e. Delivery of Cargo

The non-payment of shipping charges (the "freights") creates a maritime lien against cargo. [FN107] This lien entitles the shipowner to retain possession of the cargo until payment is received. [FN108] Unlike a lien on a ship, which attaches to the ship itself, the cargo lien is extinguished upon delivery to the consignee, regardless of whether payment is received. [FN109] A freight lien is a possessory right, waived upon surrender of the goods, unless otherwise provided for in the bill of lading. [FN110]

***212** f. Destruction of the Res

When a ship sinks, all liens that had attached to it are extinguished. [FN111] However, the liens created before the catastrophe do not attach to the insurance proceeds of the destroyed vessel. [FN112] Insurance has been held to be a contract between the insured and the insurer, which in no way affects the relationship between the lienor and the shipowner. [FN113]

The non-maritime creditor may benefit when a ship is destroyed. If the security agreement includes insurance proceeds, loss of the ship instantly advances the non-maritime creditor ahead of the extinguished maritime liens. [FN114] Maritime lien holders are left with unsecured in personam claims against the shipowner.

B. The Preferred Ship Mortgage

1. The Ship Mortgage Act. "A ship is born when she is launched. Prior to her launching, she is a mere congeries of wood and iron--an ordinary piece of personal property . . . and subject only to mechanics' liens created by state law . . . ." [FN115] Prior to enactment of the Ship Mortgage Act ("Act"), [FN116] financing a ship's construction did not give rise to a maritime lien. In fact, the actual construction contract still does not generate a maritime lien. [FN117]

Before Congress acted, the Supreme Court held that "the mere mortgage of a ship . . . is a contract without any of the characteristics or attendants of a maritime loan, and is entered into . . . without reference to navigation or perils of the sea." [FN118] Therefore, a ship mortgage used to be junior to every valid maritime lien, making financing difficult to obtain. [FN119]

After World War I, risk capital was required to finance the sale of a substantial fleet of government owned ships to private buyers. [FN120] The ***213** Ship Mortgage Act was enacted to bolster these sales and to encourage the establishment of a strong U.S. merchant marine fleet. [FN121] Certain types of ship mortgages, [FN122] "preferred ship mortgages," are given maritime lien status under the Ship Mortgage Act. [FN123]

2. The Preferred Maritime Lien. The Ship Mortgage Act modified the timing priorities by creating the "preferred maritime lien." [FN124] This was necessary because under the maritime lien priority scheme, the ship mortgage may be the oldest lien, and therefore, subordinate to other claims.

A preferred maritime lien is a lien arising prior to the ship mortgage, based on the date the mortgage is recorded with the Coast Guard, [FN125] or regardless of the timing relative to the ship mortgage, a lien arising from a maritime tort, a maritime wage claim, salvage, or general average. [FN126] Preferred maritime liens are awarded priority over the ship mortgage, [FN127] while all other liens are subordinated to the mortgage. [FN128]

This priority system removes all doubt as to the seniority of the mortgage and any prior maritime liens. However, since the last-in-time method was retained for determining priorities among non-mortgage maritime liens, [FN129] a circularity problem was created. For example, consider the following hypothetical: a maritime lien is created when supplies are furnished to a ship, then a preferred ship mortgage is granted to a lender for some purpose, [FN130] and finally, a new maritime lien is created for repairs or supplies. The Ship Mortgage Act grants priority to the first supply lien, followed in seniority by the mortgage. The second supply lien, however, should be senior to the first lien because of its last-in-time status. A careful reading of the original statute clears up this confusion. The Act did not affect priorities among preferred maritime ***214** liens. [FN131] A repair or supplies lien arising after the mortgage is not awarded preferred status, [FN132] and is therefore not superior to the mortgage. The resulting order of priority for all claims against the ship is: (1) expenses of justice, (2) preferred maritime liens, (3) the preferred mortgage, and (4) other maritime liens. [FN133]

3. Priority Over Land Liens. As with other maritime liens, the preferred ship mortgage enjoys priority over all land liens. [FN134] The U.C.C. excludes from Article 9 any "security interest subject to any statute of the United States to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property." [FN135] The Official Comment to Article 9 expressly references the Ship Mortgage Act as an example of such a statute. [FN136]

4. Equitable Subordination of a Ship Mortgage The ship mortgage is not invincible. Principles of equitable subordination may be applied where a mortgage has been granted to a related party. [FN137]

Ordinarily, the priority awarded to the preferred ship mortgage will protect a lender from claims by other maritime lienors, except holders of a preferred maritime lien. [FN138] A shipowner may attempt to use a preferred ship mortgage to his advantage by granting a mortgage to a related party, thereby rendering future claims against the vessel worthless. [FN139] This scheme would undermine the priorities established by the Ship Mortgage Act. [FN140] Accordingly, admiralty courts have used their equitable powers to subordinate such a mortgage to other claims against the ship. [FN141] These powers will be exercised where three conditions are present:

(i) The claimant has engaged in some type of inequitable conduct, such as fraud, illegality, breach of fiduciary duty; ***215** undercapitalization; or the claimant's use of the debtor as a mere instrumentality or alter ego.
(ii) The misconduct resulted in injury to the creditors or conferred an unfair advantage on the claimant.

(iii) Equitable subordination is not inconsistent with other statutory provisions. [FN142]

III. Application of the Law

The rules of priority and validity must be applied to a maritime bankruptcy, regardless of whether the proceedings take place in a bankruptcy court or an admiralty court. [FN143] "The bankruptcy court can and will adjudicate the validity and priority of maritime liens." [FN144] Furthermore, "[t]he trustee has the power to determine the relative priorities of maritime liens and must apply maritime law in doing so." [FN145] Therefore, the contested issues in a maritime bankruptcy tend to center around interpretation of these essential rules.

One of the most critical issues in a maritime bankruptcy is determining preferred maritime lien status, since, under the Ship Mortgage Act, a lien so classified is awarded the highest priority. [FN146] Failure to achieve preferred status puts the lien behind the ship mortgage, even if the lien still qualifies as an "other" maritime lien, and may leave the claimant with nothing.

For the most part, the Act is clear on the types of liens that meet the requirements for preferred status. However, the statute includes liens for "damages arising out of tort," without defining "tort." [FN147] Collisions and personal injury clearly seem to qualify as "torts," [FN148] but claims for negligent towage or negligent custody of cargo, for example, are not as clear. These latter claims sound both in tort (preferred lien status) and in contract ("other" lien status if arising after the ship mortgage). The ***216** dilemma of "hybrid" claims was considered long before enactment of the Ship Mortgage Act, in The JOHN G. STEVENS. [FN149] The Supreme Court held that a lien for damage to a tow caused by its tug's negligence sounded in tort, independent of any contract made for towage. [FN150] Following the 1920 version of the Act, it may be that in classifying claims under the Ship Mortgage Act, The JOHN G. STEVENS opinion should be construed very narrowly, and limited to towage contracts. Such an interpretation could be based on the fact that the Act was created to encourage ship financing by granting seniority to the mortgage, and policy considerations call for narrow interpretation of conflicting law.

Recent decisions, however, have pointed to dicta in The JOHN G. STEVENS, stressing that "even an action by a passenger, or by an owner of goods, against a carrier, for neglect . . . is an action for the breach of a duty imposed by law, independently of contract . . ., and is therefore founded in tort." [FN151] The resulting rule is that if the action may be brought in tort, it is a tort claim and a preferred maritime lien. [FN152]

IV. International Considerations

International uniformity is pervasive in maritime law because "[a]dmiralty law is really the law of nations." [FN153] The international character of maritime commerce often prevents an American plaintiff from bringing suit in personam against a foreign shipowner. [FN154] The availability of in rem jurisdiction, however, and the uniform requirements for obtaining jurisdiction over the ship, wherever it may be located, will provide a forum for the plaintiff. Though there may be some variation in the procedural rules of in rem jurisdiction, the ship must generally be arrested within the jurisdiction for the action to proceed. [FN155] Failure to recognize the proceedings of a foreign admiralty court would delay the release of ships ***217** after arrest, cause ships to needlessly remain idle, and ultimately interfere with international trade.

International comity among courts of admiralty jurisdiction has allowed ships the freedom to sail the world, without fear of unexpected legal action based on the acts of a prior owner. Such comity has not extended to the traditional bankruptcy courts.

Foreign courts may find that a U.S. bankruptcy court, applying maritime law, does not have jurisdiction to declare a vessel free from all encumbrances. [FN156] "It is unclear that a foreign jurisdiction would recognize the sale of a vessel by the bankruptcy court." [FN157] The limited case law on the issue supports this view. [FN158]

An admiralty court does possess the power to sell a vessel free of liens. [FN159] The seminal case interpreting the international effect of an in rem judicial sale is The TRENTON, [FN160] which held that a sale pursuant to an in rem proceeding in a foreign court will "vest a clear and indefeasible title in the purchaser" [FN161] that is recognized internationally. The TRENTON involved an in rem sale by a Canadian admiralty court, however, U.S. courts have since recognized the proceedings of foreign admiralty courts throughout the world. [FN162]

***218** V. Criticism of the Rules of Maritime Indebtedness

This section examines two criticisms of the rules controlling the maritime indebtedness system. First, it explores the system's reluctance to allow a ship to be sold through any method other than an in rem proceeding in an admiralty court. The second subsection reviews criticisms of the creditor priority scheme. [FN163]

A. Criticism of the Jurisdiction Assignment System

Some commentators and bankruptcy practitioners suggest that the provisions of the Bankruptcy Code should require the bankruptcy court to retain jurisdiction over all of the debtor's assets, regardless of the circumstances. [FN164] On the other hand, sophisticated admiralty lawyers believe that the current system, with the district court automatically referring bankruptcy cases to the bankruptcy court, is unconstitutional. Thus, the issues raised in Marathon Pipe Line Co. have never been resolved.

> What could not be undertaken in "two steps" in the now repealed 28 U.S.C. §§ 1471 and 1481, appears to have been undertaken in "two and a half steps". First, 28 U.S.C. § 1334(e) (formerly § 1334(d)) by its terms vests exclusive jurisdiction in the district court of "all of the property, wherever located, of the debtor. . ." Second, 28 U.S.C. § 157(a) by its terms allows the district court to refer these matters to the bankruptcy court. The district courts throughout the country entered general orders referring the cases filed pursuant to Title 11 to the bankruptcy courts. The effect of the two statutes and the referral order (i.e. the "two and a half step process"), however, is no different than the effect and intent of the "two step" process in the now-repealed 28 U.S.C. §§ 1471 and 1481. The constitutional infirmity still exists. Admiralty and maritime matters simply cannot be referred to an Article I bankruptcy court. [FN165]

***219** Arguably, the jurisdiction question should be resolved in favor of the admiralty court, because the bankruptcy court's jurisdiction remains unconstitutional.

Article III requires Congress to appoint life-tenured judges to its "inferior" federal courts. [FN166] Political considerations may have forced Congress to take the "two and a half step" approach, rather than simply establishing bankruptcy courts as formal Article III courts. Whatever the congressional justification, and despite the admiralty lawyers' persuasive argument, the prospects for a successful constitutional challenge seem remote.

Lower courts considering the constitutional question have dismissed this argument summarily. [FN167] These lower courts have found the referral procedure constitutional because the district court may withdraw the referral of a particular case to the bankruptcy court, or review the bankruptcy court's decision. [FN168] In the context of a maritime bankruptcy, no appellate court has decided which court, admiralty or bankruptcy, should have jurisdiction, nor has an appellate opinion addressed the constitutional aspects of allowing a bankruptcy court to maintain jurisdiction over the ship. The voice of the admiralty bar may not be loud enough to influence Congress on the matter. Change is unlikely unless the courts begin criticizing the current method of granting a bankruptcy court its jurisdiction.

The critics of the current method of granting jurisdiction in a maritime bankruptcy overlook the factors which justify its use. These justifications include efficient reorganization and foreign recognition of the sale. Moreover, the criticisms ignore the fact that the modern approach is fundamentally logical, and most importantly, seems to be working. In a Chapter 11 reorganization, the bankruptcy court must retain jurisdiction to give the plan a chance to succeed. In a Chapter 7 liquidation, an admiralty court must take over to effectively administer the sale of the ship.

The current jurisdictional approach typically concedes jurisdiction of the entire matter to the bankruptcy court, at the outset of litigation. [FN169] ***220** For an admiralty court to obtain jurisdiction, maritime creditors must petition the bankruptcy court for relief from the automatic stay. [FN170] Those maritime creditors who question the constitutionality of a bankruptcy court's jurisdiction in admiralty matters seem to believe the petition adds unnecessary cost and delay to the liquidation process.

Notwithstanding dissatisfaction from both the admiralty and bankruptcy bar, several factors may prevent the issue from ever being definitively decided. First, the cost of appeal is prohibitive. Most maritime bankruptcies do not involve shipping companies with multi-million dollar estates. Maritime bankruptcies usually concern independent operators, such as commercial fishermen, with limited resources. The cost and delay of appealing the bankruptcy court's original jurisdiction will undoubtedly outweigh the cost and delay of petitioning for relief from stay. If a case finally reaches the appellate courts, the bankruptcy court may, by that time, have allowed the vessel to be released, sold, or subjected to new (and therefore senior) maritime liens. [FN171] Any of these events may render the jurisdictional issue moot, further precluding appellate review. The appellate court could find that the jurisdictional issue is "capable of repetition yet evading review," [FN172] but the decision is committed to the discretion of the court. Thus, the issue is never presented to the appellate court during that window of time between it becoming ripe for review and before it becomes moot.

The appellate courts appear satisfied with the status quo. In the rare cases where they have been faced with the bankruptcy/admiralty jurisdictional conflict, appellate courts have simply accepted the current system.

In United States v. ZP CHANDON, [FN173] for example, the Ninth Circuit purported to consider "whether the enactment of the Bankruptcy Act ***221** and the congressional grant of jurisdiction to the bankruptcy courts restricts the district court's jurisdiction in admiralty or maritime cases." [FN174] The court concluded that, because of the ancient origins of maritime law, maritime matters do not "arise under the construction or laws of the United States." [FN175] The founders were therefore required to make a separate award of federal jurisdiction "to all cases of admiralty and maritime jurisdiction." [FN176] A careful analysis of this ruling reveals that the court never answered its own question. After presenting the question (essentially, whether the congressional grant of jurisdiction to the bankruptcy court is exclusive--a critical question that goes to the heart of this jurisdictional conflict), the court actually answered a different question: whether bankruptcy and maritime are separate jurisdictional matters--a question of considerably less significance.

With the matter commencing in the bankruptcy court, the remaining question for the court is whether to grant relief from the automatic stay, allowing an admiralty court to sell the ship. [FN177] The controlling factor should be that when a ship is sold through an admiralty proceeding, internationally recognized clear title is provided. A bankruptcy court, however, is also a court of "competent jurisdiction," [FN178] and some commentators question the inability of a bankruptcy court to ensure international clear title. [FN179]

While a bankruptcy court may be able to provide international recognition of non-maritime bankruptcy proceedings, maritime law compels a different conclusion. Generally, maritime law is uniform throughout the world, and this uniform law will not recognize clear title unless the sale is administered by an admiralty court. [FN180] The U.S. courts recognize this fact, invariably assigning jurisdiction over the ship to an admiralty court, in cases where the ship is to be sold. [FN181] Generally, the bankruptcy trustee accepts this determination, because the procedure is consistent with the ***222** goals of a liquidation proceeding. Allowing an admiralty court to sell the vessel entails the least title risk to the buyer, commands the highest sale price, and benefits the creditors entitled to proceeds from the sale.

B. Criticism of the Creditor Priority System

Finally, the maritime lien priority scheme is subject to criticism. [FN182] Non-maritime creditors complain when a secret lien achieves a higher priority than their recorded security interest. Moreover, non-maritime creditors find it particularly disturbing when a service provided for a debtor's maritime asset qualifies for this priority, while a similar service provided for the debtor's non-maritime assets does not reach the same status. [FN183] Arguably, a maritime lienor is actually a general creditor. [FN184] The fact that a maritime lien does not arise by agreement between the parties should, "by definition," prevent it from being a security interest. [FN185] This argument fails, however, because the "definition" is taken from the Bankruptcy Code. [FN186] As discussed above, the bankruptcy court must apply maritime law in determining lien priorities against a maritime asset, therefore the Bankruptcy Code definition of a security interest is irrelevant. [FN187]

The critics of the maritime lien priority system fail to consider either the special nature of the ship as an asset, or accept the policy of keeping the ship in service as vital to international commerce. Each class of maritime liens developed with an eye toward these considerations, as well as the practicalities of the industry. [FN188] Providing fuel to a ship, for example, allows the ship to continue on its journey, a journey that often begins before the fuel is paid for. The seniority of this claim provides a supplier security, encouraging the fuel delivery. [FN189] Additionally, a maritime lienholder can arrest a ship wherever the ship may be found, furnishing the maritime creditor with additional security. [FN190]

***223** Conclusion

The complicated rules of maritime indebtedness cause problems for practitioners unfamiliar with these rules. There is little appellate authority on the application of the rules in a maritime bankruptcy, however, courts seem content to apply the rules developed by the district courts. These rules are likely to be in place for the foreseeable future because maritime law is very slow to change. Attorneys and creditors need to be familiar with the rules of maritime bankruptcy and protect themselves accordingly.

Protection starts by recognizing the mortgage holder as captain of the ship. The ship mortgage proceeds are not required to be used for a maritime purpose, [FN191] therefore, even a lender providing operating capital need not abandon ship. If the vessel is not already encumbered, the lender may take a preferred ship mortgage. If a mortgage is not possible, the lender should price this increased risk accordingly, by charging a higher interest rate.

A lender able to obtain a mortgage is senior to all other claims against the ship, except for a preferred maritime lien. [FN192] Careful planning may reduce exposure from this class of creditor as well.

A potential tort victim creates the greatest risk to a mortgage holder. A tort claim may arise at any time, it may exceed the value of the ship, and it qualifies as a preferred maritime lien. The mortgage holder may protect himself, however, simply by requiring the debtor to obtain sufficient insurance against tort claims.

Exercising due diligence, by analyzing the debtor's operations prior to granting credit, minimizes the lender's risk of exposure from other liens qualifying for preferred status. Finally, if an existing lien remains undiscovered, it may be barred by laches.

Advancing credit in any context is a business of risk analysis. If the proper steps are taken, a maritime creditor may enjoy smooth sailing, even in bankruptcy.

ENDNOTES

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[FN1]. In 1992, the 50 largest shipping ports in the United States handled over 1.8 billion tons of cargo. Funk & Wagnalls Corp., The World Almanac and Book of Facts 203 (1995). As of January 1, 1993, the major merchant fleets of the world operated 23,753 ocean going merchant ships, with an aggregate cargo carrying capacity of over 700 million tons. Id. at 205. Note that these statistics do not recognize the thousands of commercial fishing vessels, tug boats, entertainment vessels, and yachts operating throughout the world.

[FN2]. See Thomas J. Schoenbaum, Admiralty and Maritime Law § 1-2 (1st ed. 1987). “There is an unbroken tradition and connection between contemporary maritime law and the customs of earliest antiquity.”

[FN3]. See, e.g., M/V BREMEN v. Zapata Off-Shore Co., 407 U.S. 1, 1972 AMC 1407 (1972) (upholding the validity of a forum selection clause in a contract which was made using arm's-length dealing between experienced and sophisticated businessmen).

[FN4]. See, e.g., Garrett v. Moore-McCormack Co., 317 U.S. 239, 1942 AMC 1645 (1942). The Court referenced the federal versus state choice of law analysis in Erie R.R. v. Tompkins, 304 U.S. 64 (1938), and held that federal law applied rather than state law over a seaman's challenge to a signed, but allegedly fraudulent, release which absolved his employer from all liability. Garrett, 317 U.S. at 245. The rule governing the burden of proof on releases was held to be a substantive right controlled by federal law, and not a procedural right controlled by state law. Id. at 249.

[FN5]. "A maritime lien is a privileged claim upon maritime property, such as a vessel, arising out of services rendered to or injuries caused by that property." Thomas J. Schoenbaum, Admiralty and Maritime Law § 7-1, at 421 (2d ed. 1994).

[FN6]. Id. § 7-5.

[FN7]. See infra note 145 and accompanying text.

[FN8]. Grant Gilmore & Charles Black, The Law of Admiralty § 1-1, at 1 (2d ed. 1975).

[FN9]. Id.

[FN10]. U.S. Const. art. III, § 2.

[FN11]. Ch. 20, 1 Stat. 76-77 (1789) (codified at 28 U.S.C. § 1333(1) (1994)).

[FN12]. Sisson v. Ruby, 497 U.S. 358, 1990 AMC 1801 (1990); see also Executive Jet Aviation, Inc. v. City of Cleveland, 409 U.S. 249, 268, 1973 AMC 1 (1972) (finding that no admiralty jurisdiction arose when a plane crashed into navigable waters even though the alleged negligence occurred in flight over navigable waters).

[FN13]. North Pac. S.S. Co. v. Hall Bros. Marine Ry. & Shipbuilding Co., 249 U.S. 119, 125 (1919).

[FN14]. See The Federal Maritime Lien Act of June 23, 1910, Pub. L. No. 61-259, 36 Stat. 604-05 (1910), amended by The Act of August 10, 1971, Pub. L. No. 92-79, 85 Stat. 285 (1971) (current version at 46 U.S.C. §§ 31301-31343 (1994)); The Ship Mortgage Act of June 5, 1920, Pub. L. No. 66-261, 41 Stat. 988, 1000-06 (1920) (originally enacted at 46 U.S.C. §§ 911-961, 971-975 (1920), amended by The Act of August 10, 1971, Pub. L. No. 92-79, 85 Stat. 285 (1971), repealed by Title I of Pub. L. No. 100-710 (1989) (current version at 46 U.S.C. §§ 31301-31343).

[FN15]. Supplemental Rules for Certain Admiralty & Maritime Claims, Fed. R. Civ. P. Supp. B, C, E.

[FN16]. Jonathan M. Landers, The Shipowner Becomes a Bankrupt, 39 U. Chi. L. Rev. 490, 493 (1972).

[FN17]. Constitutional authority for establishment of the bankruptcy court system is through Congress's article III power to "create such inferior courts as [they] may from time to time ordain." U.S. Const. art III, § 1.

[FN18]. 28 U.S.C. § 1471 (1978) was declared unconstitutional by the Supreme Court in Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), primarily because the bankruptcy judges were not life-tenured, as required when an "inferior" federal court is established under article III. Marathon, 458 U.S. at 87.

[FN19]. 11 U.S.C §§ 101-1330 (1994).

[FN20]. The Bankruptcy Amendment and Federal Judgeship Act, Pub. L. No. 98-353, 98 Stat. 333 (1984) (codified as amended in scattered sections of 11 U.S.C. and 28 U.S.C.). For a complete discussion of the legislative history of the Bankruptcy Code, see Jeffrey T. Farriell, Constitutionality of the Bankruptcy Amendments and Federal Judgeship Act of 1984, 63 Am. Bankr. L.J. 109 (1989).

[FN21]. 28 U.S.C. § 1334(a) (1982). The amended code also provided that bankruptcy courts would "constitute a unit of the judicial district." 28 U.S.C. § 151 (1994).

[FN22]. 28 U.S.C. § 157(a). "Every district court has adopted a local rule or standing order automatically referring all bankruptcy cases and proceedings therein to the bankruptcy judges for the district." Hon. David H. Coar & Gerald F. Munitz, Basics of Bankruptcy and Reorganization: 1995, in Jurisdiction, Venue, Procedure, And Appeals, at 389 (PLI Com. Law Practice Course Handbook Series No. 789, 1995). The rule has been promulgated, for example, in California, in N. Dist. Cal. B.L.R. § 5011-1 (1996), and Cent. Dist. Cal. B.L.R. § 101 (1996). The reason for this sleight-of-hand is to allow for a federal bankruptcy court system without the article III requirements that judges be life tenured with no fear of salary reductions.

[FN23]. "[T]he ship itself is to be treated in some sense as a principal, and as personally liable for the negligence of any one who is lawfully in possession of her ...." The BARNSTABLE, 181 U.S. 464, 467 (1901); see also Schoenbaum, supra note 5, § 7-1, at 431.

[FN24]. This conclusion flows from the fact that "[o]nly in an in rem proceeding can the ship be sold free of liens, with a consequently greater fund for distribution among claimants." Gilmore & Black, supra note 8, § 9-19, at 622. For a more complete discussion of the in rem sale process, see infra notes 95-96 and accompanying text.

[FN25]. 28 U.S.C. § 1334(e).

[FN26]. See supra text accompanying notes 8-21.

[FN27]. Landers, supra note 16, at 492.

[FN28]. A panel staffed by three bankruptcy judges. 28 U.S.C. § 158(b).

[FN29]. See, e.g., Morgan Guar. Trust Co. v. Hellenic Lines Ltd., 38 B.R. 987, 1984 AMC 1074 (D.D.C. 1984) (finding admiralty jurisdiction over freights, based on court's proper jurisdiction over the vessels).

[FN30]. 11 U.S.C. § 362 (1994).

[FN31]. Where the United States has provided or guaranteed a mortgage on the vessel, however, the Bankruptcy Code provides for automatic relief of stay 90 days after the filing of the bankruptcy petition. 11 U.S.C. § 362(b)(12). This has been held to allow the government to immediately foreclose on the ship without filing a petition with the bankruptcy court. In re Prudential Lines, Inc., 69 B.R. 439, 1987 AMC 2798 (Bankr. S.D.N.Y. 1987).

[FN32]. Hellenic Lines Ltd., 38 B.R. at 998 (quoting Susquehanna Chem. Corp. v. Producers Bank and Trust Co., 174 F.2d 783, 787 (3d Cir. 1949)).

[FN33]. Id. at 997 (citing Landers, supra note 16, at 509).

[FN34]. The very nature of a proceeding to transfer jurisdiction over the ship from the bankruptcy court is to effect a sale which will transfer unencumbered title to the purchaser. See infra note 40 and accompanying text.

[FN35]. Edward M. Keech, Problems in the Liquidation and Reorganization of International Steamship Companies in Bankruptcy, 59 Tul. L. Rev. 1239 (1985). “From the perspective of a bankruptcy and admiralty practitioner in 1985, the possibility of a successful bankruptcy reorganization of an international steamship company is remote.” Id. at 1263.

[FN36]. For a complete discussion of the economics of a shipping bankruptcy, see George A. Rutherglen, Admiralty and Bankruptcy Revisited: Effects of the Bankruptcy Reform Act of 1978, 65 Tul. L. Rev. 503, 519 (1991).

[FN37]. Hellenic Lines, 38 B.R. at 996.

[FN38]. Id.

[FN39]. Id. at 998. For discussion of the international aspects of bankruptcy see infra Section IV.

[FN40]. Graydon S. Staring, Bankruptcy: An Historical View, 59 Tul. L. Rev. 1157, 1166 (1985).

[FN41]. Removal is authorized under 28 U.S.C. § 157 (1994). "[I]f the court determines that resolution of the proceeding requires consideration of both Title 11 and other laws of the United States regulating ... interstate commerce." Id. § 157(d).

[FN42]. Gilmore & Black, supra note 8, § 9-2, at 589.

[FN43]. Piedmont & George's Creek Coal Co. v. Seaboard Fisheries Co., 254 U.S. 1, 9 (1920); see also Tramp Oil and Marine Ltd. v. M/V MERMAID I, 630 F. Supp. 630, 1987 AMC 129 (D.P.R. 1986), aff'd 805 F.2d 42 (1st Cir. 1986). "A maritime lien, once accrued, attaches to a vessel and will follow the ship until it is satisfied or payment is obtained through a sale in an in rem proceeding." Id. at 632.

[FN44]. In re Riffe Petroleum Co., 601 F.2d 1385, 1389, 1979 AMC 1611, 1615 (10th Cir. 1979); see also Schoenbaum, supra note 5, § 8-1, at 247.

[FN45]. Staring, supra note 40, at 1166.

[FN46]. The ST. JAGO DE CUBA, 22 U.S. 409, 416 (1824).

[FN47]. Gilmore & Black, supra note 8, § 9-20, at 625.

[FN48]. Id. at 624.

[FN49]. Supplemental Rules for Certain Admiralty and Maritime Claims, Fed. R. Civ. P. Supp. Rule C. Rule C(3) provides that "the verified complaint and supporting papers shall be reviewed by the court and, if the conditions for an action in rem appear to exist, an order so stating and authorizing a warrant for the arrest of the vessel ... shall issue."

[FN50]. See generally Gilmore & Black, supra note 8, § 1-12, at 36-37 (discussing in rem proceedings).

[FN51]. See, e.g., Baker v. Raymond Int'l, Inc., 656 F.2d 173, 1982 AMC 2752 (5th Cir.1981), cert. denied, 456 U.S. 983 (1982). "If injured by [a vessel's] unseaworthiness, [a seaman] should be able to sue its owner ... [with liability] subject to the ceiling established by the Limitation Act, 46 U.S.C. § 183(a)." Id. at 184.

[FN52]. After enactment of the Ship Mortgage Act of 1920 and the related Federal Maritime Lien Act, state created liens have "generally faded from sight"--though the Supreme Court has never considered the question. Gilmore & Black, supra note 8, § 9-31, at 654; see also In re Pacific Caribbean Shipping (U.S.A.), Inc., 789 F.2d 1406, 1408, 1986 AMC 2308 (9th Cir. 1986) (holding that the U.C.C. should not be interpreted to apply to [maritime] liens).

[FN53]. 46 U.S.C. §§ 31301-31343 (1994).

[FN54]. 46 U.S.C. § 31342.

[FN55]. In re Topgallant Lines, Inc., 154 B.R. 368, 376, 1993 AMC 2775 (Bankr. S.D. Ga. 1993) (referring to 46 U.S.C. § 31342(a)(1)).

[FN56]. Id.

[FN57]. Gilmore & Black, supra note 8, § 9-2, at 587.

[FN58]. U.C.C. § 9-102(1)(a) (1978) (emphasis added).

[FN59]. 11 U.S.C. § 101(32) (1994).

[FN60]. See, e.g., Taiwan Int'l Line Ltd. v. Matthew Ship Chartering Ltd., 546 F. Supp. 826, 829, 1983 AMC 798 (S.D.N.Y. 1982) (finding that a shipowner's "maritime lien prevails over all non-maritime claimants ... and all maritime claimants whose liens arose earlier in time"); In Re Pacific Caribbean Shipping, 789 F.2d 1406, 1408, 1986 AMC 2308 (9th Cir. 1986) (maritime lienor was not required to perfect his security interest under U.C.C. Article 9 to prevail over bankruptcy trustee).

[FN61]. In re Topgallant Lines, 154 B.R. at 376.

[FN62]. See, e.g., Michael J. Ende, Adrift on a Sea of Red Ink: The Status of Maritime Liens in Bankruptcy, 11 Fordham Int'l L.J. 573 (1988). "[T] he maritime lien distinguishes between the person who paints the ship and the person who paints the dock. The former is given the status of a secured creditor, while the latter['s] ... claim is subordinate to that of the maritime lienor." Id. at 579.

[FN63]. Staring, supra note 40, at 1166.

[FN64]. See Delos E. Flint, Jr., Current Developments in United States Maritime Lien Law, 8.2 U.S.F. Mar. L.J. (1996); Charles S. Donovan, Arrest and Attachment in Admiralty, 5.1 U.S.F. Mar. L.J. (1992).

[FN65]. The JOHN G. STEVENS, 170 U.S. 113, 119 (1898); see also Gilmore & Black, supra note 8, § 9-2, at 588.

[FN66]. The Ship Mortgage Act of 1920, Pub. L. No. 66-261, 41 Stat. 988, 1000-06 (1920) (current version at 46 U.S.C. §§ 31301-31343 (1994)).

[FN67]. This entire list of lien classes is presented by Gilmore & Black, supra note 8, § 9-61, at 737. Additional internal citations are provided to support their position.

[FN68]. "[N]o claims arising while the vessel is in the custody of the court are recognized as liens strictly, though they may be paid out of the remnants." The YOUNG AMERICA, 30 F. 789, 790 (S.D.N.Y. 1887).

[FN69]. "The most elementary notion of justice would seem to require that services or property furnished upon the authority of the court ... should be paid from the fund as an 'expense of justice."' New York Dock Co. v. The POZNAN, 274 U.S. 117, 121 (1927).

[FN70]. "The cases and authorities definitely establish that 'seaman's wage liens are especially favored and are found in the first class of order."' Fredelos v. Marritt-Chapman & Scott Corp., 447 F.2d 435, 439 (5th Cir. 1970) (quoting from Martin J. Norris, The Law of Seamen §§ 454, 530 (3d ed. 1970)).

[FN71]. United States v. ZP CHANDON, 889 F.2d 233, 238, 1990 AMC 316 (9th Cir.1989) (quoting The JOHN STEVENS, 170 U.S. 113, 119 (1898)). ZP CHANDON held that there is no automatic stay provision within the Bankruptcy Act applicable to a lien for seaman's wages. Id.

[FN72]. Harden v. Gordon, 11 F. Cas. 480, 483-85 (C.C.D. Me. 1823) (No. 6047).

[FN73]. Gilmore & Black, supra note 8, § 9-61, at 738-39.

[FN74]. Id. at 739-40.

[FN75]. Id. at 740.

[FN76]. Id. at 740-41.

[FN77]. Schoenbaum, supra note 5, § 7-5. The Preferred Ship Mortgage is discussed in more detail in Section IIIB, infra.

[FN78]. General average is a maritime principle of pro rata loss which operates when a "sacrifice" necessary to save the venture is made in an emergency, for example, cargo thrown overboard to lighten the load. Recognizing that such a sacrifice benefits the ship and the remaining cargo, the loss is shared proportionately by the ship and cargo. Gilmore & Black, supra note 8, §§ 5-1, 5-2, at 244-48.

[FN79]. Id. § 9-61, at 740-42.

[FN80]. Id. at 741.

[FN81]. Id. at 741-42.

[FN82]. The YANKEE BLADE, 60 U.S. 82, 89 (1857).

[FN83]. "[A] person claiming a lien on a vessel covered by a preferred mortgage ... may record ...." 46 U.S.C. § 31343(a) (1994) (emphasis added). "A notice of claim of lien is not entitled to filing and recording unless the vessel ... is covered by a preferred mortgage ...." 46 C.F.R. § 67.255 (1995) (emphasis added). This recording procedure is available to benefit existing lienholders (primarily the mortgage holder), rather than other creditors, by ensuring that existing lienholders will receive notice of any action against the ship.

[FN84]. "Conflicting security interests rank according to priority in time of filing or perfection." U.C.C. § 9-312(5)(a) (1978). U.C.C. security interests must be perfected under the requirements laid out in §§ 9-302 to 9-306 of the U.C.C. (basically through filing or possession).

[FN85]. "Maritime liens generally are 'secret' in that neither possession nor notice through filing is required to establish their validity." Chase Manhattan Fin. Serv., Inc. v. McMillian, 896 F.2d 452, 456 (9th Cir. 1990).

[FN86]. In re Topgallant Lines, 154 B.R. 368, 1993 AMC 2775 (S.D. Ga. 1993); see supra text accompanying note 55-57.

[FN87]. 46 U.S.C. § 31343(d).

[FN88]. Supplemental Rules for Certain Admiralty and Maritime Claims, Fed. R. Civ. P. Supp. Rule C.

[FN89]. Gilmore & Black, supra note 8, § 9-2, at 588.

[FN90]. Id.

[FN91]. Recording systems exist for most other forms of security interests. See, e.g., U.C.C. § 9-302 (1996) (requiring filing a financing statement to perfect a security interest in personal property).

[FN92]. See 46 U.S.C. § 31321(f); 46 U.S.C § 31343(c).

[FN93]. Schoenbaum, supra note 5, § 7-1, at 426.

[FN94]. The MINNIE and EMMA, 21 F.2d 991, 992 (D. Md. 1927).

[FN95]. 46 U.S.C. § 31326(a).

[FN96]. Id.; see also Gilmore & Black, supra note 8, § 9-2, at 588; Morgan Guar. Trust Co. v. Hellenic Lines Ltd., 38 B.R. 987, 1984 AMC 1074 (D.D.C. 1984).

[FN97]. John W. Stone Oil Distrib., Inc. v. The M/V MISS BERN, 663 F. Supp. 773, 778, 1988 AMC 28 (S.D. Ala. 1987); see also Schoenbaum, supra note 5, § 7-7, at 453.

[FN98]. M/V MISS BERN, 663 F. Supp. at 778.

[FN99]. The KEY CITY, 81 U.S. 653, 655 (1871).

[FN100]. Schoenbaum, supra note 5, § 7-8, at 454.

[FN101]. Id.

[FN102]. Tagaropulos, S.A. v. S.S. SANTA PAULA, 502 F.2d 1171, 1172, 1974 AMC 2453 (9th Cir. 1974).

[FN103]. Id. at 1172 (holding that the lienholder failed to exercise even a minimum degree of diligence).

[FN104]. See Fuller v. Golden Age Fisheries, 14 F.3d 1405, 1408, 1994 AMC 1275 (9th Cir. 1994).

[FN105]. 46 U.S.C. § 10602 (a) (1994).

[FN106]. 46 U.S.C. app. § 763a (1994).

[FN107]. Schoenbaum, supra note 5, § 7-1, at 425.

[FN108]. Id. at 425 n.17.

[FN109]. 4,885 Bags of Linseed, 66 U.S. 108, 114 (1861).

[FN110]. Id. at 114-15.

[FN111]. Walsh v. Tadlock, 104 F.2d 131, 132 (9th Cir. 1939).

[FN112]. Id.

[FN113]. Id.

[FN114]. Id.

[FN115]. Tucker v. Alexandroff, 183 U.S. 424, 438 (1902).

[FN116]. Act of June 5, 1920, Pub. L. No. 66-261, 41 Stat. 988, 1000-06 (1920) (current version at 46 U.S.C. §§ 31301-31343 (1994)).

[FN117]. Schoenbaum, supra note 5, § 5-7, at 183.

[FN118]. Bogart v. The Steamboat JOHN JAY, 58 U.S. 399, 400 (1854).

[FN119]. Schoenbaum, supra note 5, § 7-5, at 442-44.

[FN120]. Id.

[FN121]. Id.

[FN122]. 46 U.S.C. § 31325 (1994).

[FN123]. A preferred mortgage is a mortgage on the entire vessel, where the ship meets certain requirements, including documentation (registration) under federal law, U.S. construction, U.S. ownership, and the mortgage itself meets certain requirements, including recording with the Coast Guard and endorsement of the ship's documents. See 46 U.S.C. § 31322.

[FN124]. Schoenbaum, supra note 5, § 7-6, at 450.

[FN125]. 46 U.S.C. § 31301(5).

[FN126]. Id.

[FN127]. 46 U.S.C. § 31326(b)(1).

[FN128]. Schoenbaum, supra note 5, § 7-6, at 450.

[FN129]. Gilmore & Black, supra note 8, § 9-68, at 751-52.

[FN130]. The proceeds of the loan need not be used to finance original construction. Detroit Trust Co. v. The THOMAS BARLUM, 293 U.S. 21, 23 (1934).

[FN131]. 46 U.S.C. § 974(4) (1920) (current version at 46 U.S.C. § 31305).

[FN132]. 46 U.S.C. § 953 (1920) (current version at 46 U.S.C. § 31301(5) (1994)).

[FN133]. Schoenbaum, supra note 5, § 7-6, at 450; see also First Nat'l Bank v. The Oil Screw Vessel LITTLE GROWLER, 1981 AMC 977 (D. Mass. 1980) (approving the priority approach).

[FN134]. Schoenbaum, supra note 5, § 9-4, at 500; id. § 9-6, at 507-09.

[FN135]. U.C.C. § 9-104(a), cmt. 1 (1978).

[FN136]. U.C.C. § 9-104(a) cmt. 1.

[FN137]. Custom Fuel Servs., Inc. v. Lombas Indus., Inc., 805 F.2d 561, 566, 1987 AMC 1321 (5th Cir. 1986) (holding that a corporation could not insulate its vessel from maritime liens by transferring title to its undercapitalized wholly owned subsidiary, taking back a preferred ship mortgage in an amount equal to the value of the vessel).

[FN138]. Id. at 564.

[FN139]. Id.

[FN140]. Id. at 569.

[FN141]. Id. at 566.

[FN142]. Id.

[FN143]. Morgan Guar. Trust Co. v. Hellenic Lines Ltd., 38 B.R. 987, 995, 1984 AMC 1074 (D.D.C. 1984).

[FN144]. Id.

[FN145]. David W. Skeen, Liens and Liquidation: Preferences, Strong Arm Clause, Fraudulent Transfers, Equitable Subordination, Priorities and Other Limitations on Lien Claims, 59 Tul. L. Rev. 1401, 1428 (1985) (citing West Kentucky Coal Co., v. Dillman, 15 F.2d 25, 26-27 (8th Cir. 1926)).

[FN146]. Schoenbaum, supra note 5, § 7-6, at 450.

[FN147]. 46 U.S.C. § 31301(5)(b) (1994).

[FN148]. Schoenbaum, supra note 5, § 7-1, at 424.

[FN149]. The JOHN G. STEVENS, 170 U.S. 113 (1898).

[FN150]. Id. at 124.

[FN151]. Id. at 125. See, e.g., Atlantic Banana Co. v. M/V CALANCA, 342 F. Supp. 447, 453, 1972 AMC 880 (S.D.N.Y. 1972); Oriente Commercial, Inc. v. the M/V FLORIDIAN, 529 F.2d 221, 222, 1975 AMC 2484 (4th Cir. 1975).

[FN152]. The JOHN G. STEVENS, 170 U.S. at 125.

[FN153]. Keech, supra note 35, at 1256.

[FN154]. See C. Taylor Simpson, The Restrictive Theory of Sovereign Immunity Under the Foreign Sovereign Immunities Act: The Perspective of a Maritime Lienholder, 19 Tul. Mar. L.J. 37, 43-44 (1994).

[FN155]. Schoenbaum, supra note 5, § 18-3, at 896.

[FN156]. Morgan Guar. Trust Co. v. Hellenic Lines Ltd., 38 B.R. 987, 999, 1984 AMC 1074 (D.D.C. 1984).

[FN157]. Id. at 999.

[FN158]. See, e.g., Gilmore & Black, supra note 8, § 9-95, at 817 (discussing The GOULANDRIS, 27 Lloyd's Rep. 120 (Adm. 1927) (sale of a ship administered by an Egyptian bankruptcy court not recognized in England as extinguishing all prior liens)); see also The CHARLES AMELIA, 3 Mar. L. Cas. 203 (Adm. 1868) (sale of vessel by French court considered equivalent of British bankruptcy proceeding and did not extinguish all liens); Todd Shipyards Corp. v. F/V MAIGUS LUCK, 243 F. Supp. 8, 1996 AMC 1608 (D.C.Z. 1965) (Panamanian sale not recognized by U.S. court).

[FN159]. See generally Gilmore & Black, supra note 8, § 9-95, at 816-17 (discussing the power of a bankruptcy court to sell a ship free of maritime liens).

[FN160]. 4 F. 657 (E.D. Mich. 1880).

[FN161]. The TRENTON, 4 F. at 658.

[FN162]. See, e.g., Gulf Oil Trading Co. v. Creole Supply, 596 F.2d 515, 1979 AMC 585 (2d Cir. 1979). The court recognized that all maritime liens were extinguished by decree of a Bahamian court, "for the court in the Bahamas had jurisdiction over the vessels in its own ports." Id. at 521; Atlantic Ship Supply v. M/V LUCY, 392 F. Supp. 179 (M.D. Fla. 1975), aff'd, 553 F.2d 1009 (5th Cir. 1977) "[I]t is a recognized principle of admiralty that the sale of a vessel by a court with admiralty jurisdiction gives title to the purchaser good against the entire world." Id. at 181.

[FN163]. See, e.g., Ende, supra note 62, at 578-79.

[FN164]. Id. at 585.

[FN165]. Brief for Susan Adams, Special Administrator for the Estate of Louis J. Thomas, deceased, at 9-10, Adams v. S/V TENACIOUS, (9th Cir. 1997) (No. 96-36189). Steven J. Shamburek, of Farleigh & Shamburek in Anchorage, Alaska and counsel for Susan Adams, provided considerable assistance to the author on this issue and on the practical aspects of resolving the jurisdictional question.

[FN166]. U.S. Const. art. III.

[FN167]. See In re Finevest Foods, Inc., 143 B.R. 964 (Bankr. M.D. Fla. 1992).

[FN168]. Id. at 966.

[FN169]. Schoenbaum, supra note 5, § 7-9, at 460.

[FN170]. Id.

[FN171]. See,for example, United States v. ZP CHANDON, 889 F.2d 233, 1990 AMC 316 (9th Cir. 1989) where the court concluded that "[t]he automatic stay provisions of Section 362(a)(4) do not apply to a maritime lien for seamen's wages earned after the filing of a petition for reorganization pursuant to the Bankruptcy Act." Id. at 239.

[FN172]. The "capable of repetition yet evading review" theory allows appellate review of an issue that would otherwise be moot. "[T]he doctrine [[[is] limited to the situation where two elements [are] combined: (1) the challenged action was in its duration too short to be fully litigated prior to its cessation or expiration, and (2) there was a reasonable expectation that the same complaining party would be subjected to the same action again." Southern Pac. Rail Co. v. ICC, 219 U.S. 498, 515 (1911).

[FN173]. 889 F.2d 233, 1990 AMC 316 (9th Cir 1989).

[FN174]. CHANDON, 889 F.2d at 236.

[FN175]. Id. at 237-38.

[FN176]. Id.

[FN177]. See generally Rutherglen, supra note 36; see also Gilmore & Black, supra note 8, § 9-95, at 817 (indicating that once it has been determined that relief from stay should be granted, releasing the ship to admiralty jurisdiction is a simple matter).

[FN178]. Schoenbaum, supra note 5, § 7-9, at 461.

[FN179]. Ende, supra note 62, at 584.

[FN180]. See, e.g., The GOULANDRIS 27 Lloyd's Rep. 120 (Adm. 1927); Todd Shipyards Corp. v. F/V MAIGUS LUCK, 243 F. Supp. 8 (D.C.Z. 1965).

[FN181]. See, eg., Morgan Guar. Trust Co. v. Hellenic Lines Ltd., 38 B.R. 987, 997 1984 AMC 1074 (D.D.C. 1984).

[FN182]. See, e.g., Ende, supra note 62, at 578-79.

[FN183]. Id. at 578.

[FN184]. Id. at 586.

[FN185]. Id. at 580.

[FN186]. 11 U.S.C. § 101(51) (1994).

[FN187]. Morgan Guar. Trust Co. v. Hellenic Lines Ltd., 38 B.R. 987, 995, 1984 AMC 1074 (D.D.C. 1984).

[FN188]. Schoenbaum, supra note 5, § 7-1, at 422.

[FN189]. Id. at 421.

[FN190]. Id. § 8-3, at 894.

[FN191]. Id. § 7-5, at 442-43.

[FN192]. Id. § 7-6, at 450.