

Exposing Secret Maritime Liens in Bankruptcy

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General maritime liens have no recording requirement and are known as “secret” liens.¹ Although the Bankruptcy Code does a good job of chasing secret lienholders out of a vessel’s shadow and into the sunlight of the bankruptcy court, federal maritime jurisprudence provides lienholders with rights that may surprise debtors, secured creditors and perhaps even the secret lienholders themselves. All parties in interest in a bankruptcy case should have a basic understanding of maritime liens to be armed with knowledge to protect their interests. This article focuses on maritime liens² for “necessaries” and will provide bankruptcy practitioners with a general understanding of these liens so that they can chart their course for the voyage through a bankruptcy case involving a vessel.³

Basics of Maritime Liens



Clinton Snow

“The federal maritime lien is a unique security device, serving the dual purpose of keeping ships moving in commerce while not allowing them to escape their debts by sailing away.”⁴ Maritime liens are considered an extraordinary remedy, considering they are nonconsensual and unrecorded.⁵ Moreover, because they encumber commerce, maritime liens are disfavored in the law, and courts will not extend them by construction, analogy or inference.⁶

¹ See *Osaka Shosen Kaisha v. Pacific Export Lumber Co. Inc.*, 260 U.S. 490, 499 (1923) (describing maritime liens as secret liens); but see 46 U.S.C. 31343 (governing recording and discharging notices of claim of certain types of maritime liens). Preferred ship mortgage liens are special maritime liens arising under the Preferred Ship Mortgage Act and are perfected by filing a notice of the mortgage with the U.S. Coast Guard National Vessel Documentation Center. With the exception of the authors’ passing notice that such liens constitute a type of maritime lien that requires recording for perfection, a discussion of such liens is beyond the scope of this article.

² This article seeks to provide a general overview and is not a comprehensive treatment of the nuanced law of maritime liens.

³ “The word ‘vessel’ includes every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water.” 1 U.S.C. § 3; 46 U.S.C. § 115; see also *Stewart v. Dutra Constr. Co.*, 543 U.S. 481, 497 (2005) (concluding that harbor-dredge with limited self propulsion is vessel).

⁴ *Garrett Construction Co. v. Knowles*, 2008 US DIST LEXIS 20641 (2008) (citing *Equilease Corp. v. M/V Sampson*, 793 F.2d 598, 602 (5th Cir. 1986)).

⁵ See, e.g., *Usher v. M/V Ocean Wave*, 27 F.3d 370, 373-74 (9th Cir. 1994).

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The Federal Maritime Liens Act governs maritime liens.⁷ In general, “a person providing necessities to a vessel on the order of the owner or a person authorized by the owner—has a maritime lien on the vessel.”⁸ Maritime liens are perfected without recording an interest in, obtaining possession of, or filing a claim against a vessel.⁹ A maritime lien arises for (1) equipment installed on a vessel,¹⁰ (2) money advanced to a vessel used to satisfy an outstanding or future lien on the vessel¹¹ and (3) “necessaries” provided to a vessel, including repairs, supplies, towage and the use of a dry dock or marine railway.¹²

thing that a vessel needs for its use that rescues the vessel from jeopardy or permits the vessel to carry out its intended purpose is a necessary item.¹⁵



Peter Ruggero

The maritime lien attaches to not only the vessel but also its appurtenances.¹⁶ A general rule for determining whether a particular item is an appurtenance was established by the U.S. District Court for the Southern District of Florida in *Gonzalez v. M/V Destiny Panama*.¹⁷ The court opined that “an appurtenance is any specifically identifiable item that is destined for use aboard a specifically identifiable vessel and is essential to the vessel’s navigation, operation, or mission.”¹⁸ The court analyzed a number of cases that found that particular pieces of uninstalled equipment constituted appurtenances.¹⁹ In rejecting an argument by the owner

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“Necessaries” is a broad term and encompasses “those things which a careful and prudent owner would provide to enable [a vessel] to perform well the functions for which...[it] has been designed...[including] money, medicines, labor and skill, personal services as well as materials.”¹³ Consequently, necessities include goods and services that both benefit the vessel and directly contribute to the vessel’s business.¹⁴ In short, any

of the M/V *Destiny Panama* vessel that two new engines were not appurtenances because they had not been installed on the vessel, the court observed that while installation will in many cases... be sufficient to establish that the item in question is an appurtenance[, it] does not follow, however, that installation is a necessary pre-condition to a finding that a given item is appurtenant to a vessel. Indeed...an item may be an appurtenance even though it has never been installed on the vessel to which it belongs.²⁰

Determining whether an item is an appurtenance is commonly done on a case-by-case basis “without great consistency of results.”²¹ Consequently, courts

⁶ See *Osaka*, 260 U.S. at 499; *Sweet Pea Marine v. APJ Marine Inc.*, 411 F.3d 1242, 1252 (11th Cir. 2005).

⁷ 46 U.S.C. §§ 31301-31343.

⁸ 46 U.S.C. § 31342(a); 46 U.S.C. § 31341(a) (“The following persons are presumed to have authority to procure necessities for a vessel: (1) the owner; (2) the master; (3) a person entrusted with the management of the vessel at the port of supply; or (4) an officer or agent appointed by— (A) the owner; (B) a charterer; (C) an owner *pro hac vice*; or (D) an agreed buyer in possession of the vessel.”); 46 U.S.C. 31341(b) (“A person tortiously or unlawfully in possession or charge of a vessel has no authority to procure necessities for the vessel.”).

⁹ *Garrett Constr. Co. v. Knowles*, 2008 U.S. DIST LEXIS 20641 (2008) (citing *Bermuda Express NV v. M/V Litsa*, 872 F.2d 554, 557-58 (3d Cir. 1989)).

¹⁰ *U.S. v. F/V Sylvester F. Whalen*, 217 F.Supp. 916 (D. Me. 1963) (“[I]tems of equipment installed aboard a vessel, which become an integral part of the vessel and are essential to its navigation and operation, are subject to the maritime liens upon the vessel.”).

¹¹ *G.E. Credit v. Mission Explorer*, 668 F.2d 811 (5th Cir. 1982).

¹² 46 U.S.C. §§ 31301(4), 31342.

¹³ Steven F. Friedell, 3 *Benedict on Admiralty* § 35 (7th rev. ed. 2003).

¹⁴ *Layton Indus. Inc. v. The Sport Fishing Cruiser Gladiator*, 263 F.Supp. 356 (D. Mass. 1957) (finding radar equipment to be necessary); *General Elec. Credit v. The Drill Ship*, 668 F.2d 811 (5th Cir. 1982) (holding food-catering services for crew members to be necessary); *Gerard Constr. Inc. v. M/V Virginia*, 480 F.Supp. 488 (W.D. Pa. 1979) (finding contract for fuel and oil to be contract for necessities).

¹⁵ *Equilease Corp.*, 793 F.2d at 603 (unpaid insurance premium held to give rise to lien).

¹⁶ *Gowen Inc. v. F/V Quality One*, 244 F.3d 64, 67 (1st Cir. 2001) (“Under maritime law, a maritime lien against the vessel and its appurtenances arises for certain liabilities, including wharfage and repairs, and the vessel can be arrested and sold to satisfy such liens.”); see 46 U.S.C. § 31342 (maritime lien statute); see also 2 *Benedict on Admiralty* § 32, at 3-3 (7th ed. 2000) (“The term ‘vessel’ includes its apparel and appurtenances.”).

¹⁷ 102 F.Supp.2d 1352, 1356 (S.D. Fla. 2000).

¹⁸ *Gonzalez v. M/V Destiny Panama*, 102 F.Supp.2d 1352, 1356 (S.D. Fla. 2000) (cited with approval by *F/V Quality One*, 244 F.3d at 67).

¹⁹ *Gonzalez*, 102 F.Supp.2d at 1356.

²⁰ *Id.* at 1355.

²¹ 1 Schoenbaum, *Admiralty and Maritime Law* § 9-1, at 489 (2d ed. 1994).

have looked to the policy considerations underlying maritime liens and asked whether treating a particular item as an appurtenance advances the objectives for which maritime liens were created and, if so, whether there are overriding objections to the contrary.²² One objective for which maritime liens exist “is to make readily available to a mobile borrower the secured credit that is often necessary to ensure that a vessel can obtain the basic supplies or services needed for its operations.”²³

It is important to note that a vessel need not be mobile for a maritime lien to attach to it and its appurtenances.²⁴ For example, in *Stewart & Stevenson Services Inc. v. The M/V Chris Way MacMillan*, the plaintiff mortgagee sought to foreclose its mortgage on a vessel after the ship’s owner failed to pay for services the mortgagee had rendered to the vessel while it was immobilized.²⁵ The court considered whether certain propellers and tail shafts that had not been installed and were not on board the vessel when it was arrested were nevertheless appurtenances of the vessel. The court held that because the propellers and tail shafts were necessary for the vessel’s general navigation, they were its appurtenances.²⁶ In making its determination, the court attributed no weight to the fact that certain of the propellers and tail shafts at issue had previously been installed on the vessel and had been part of the equipment.²⁷

Maritime Lien Issues Jurisdictional Issues

The U.S. Constitution expressly provides that jurisdiction involving admiralty vests in those courts created by Congress pursuant to Article III.²⁸ Bankruptcy courts, however, are Article I courts. Therefore, the question arises as to whether a bankruptcy court can determine a controversy regarding a maritime lien.²⁹

Admiralty jurisdiction is exclusively vested in Article III courts only as to *in rem* claims, where the vessel itself is the offender and made the defendant in a

lien-enforcement action.³⁰ However, a maritime lienholder who submits itself to a bankruptcy court’s equitable jurisdiction can have its lien adjudicated by the court.³¹ This is especially true given the current statutory scheme conferring jurisdiction on bankruptcy courts.³² Even when a maritime lienholder does not submit itself to the bankruptcy court’s jurisdiction, silence might serve as implied consent.³³ Therefore, a maritime lienholder that contests the bankruptcy court’s jurisdiction should plead their opposition and request that the reference to the bankruptcy court be withdrawn.³⁴

Maritime liens are sometimes in direct contradiction to the types of liens usually encountered on a daily basis in bankruptcy.... [P]ractitioners would be well advised to associate with an expert in maritime liens, or become an expert in secret liens, when maritime lien issues arise in a bankruptcy case.

Priority of Maritime Liens

The Federal Maritime Liens Act “supersedes any State statute conferring a lien on a vessel to the extent the statute establishes a claim to be enforced by a civil action *in rem* against the vessel for necessities.”³⁵ As such, maritime liens have priority over state statutory liens on vessels.

In fact, maritime liens have priority over every type of lien enforceable against a vessel *in rem* except for previously perfected preferred ship mortgage liens.³⁶ However, “preferred maritime liens”³⁷ have priority even over preferred ship mortgage liens.³⁸ Moreover, maritime liens for necessities provided in the U.S. have priority over preferred

ship mortgage liens on a foreign vessel whose mortgage has not been guaranteed under chapter 537 of title 46, regardless of the date of creation.³⁹

Maritime liens also trump the rights of a *bona fide* purchaser for value, including a bankruptcy trustee.⁴⁰ When determining priority among competing maritime liens, a maritime lien for necessities that is last in time is first in right (unlike most other liens).⁴¹

Selling Property Encumbered by Maritime Lien

To sell estate property outside of the ordinary course of business, the sale must be approved by the bankruptcy court in accordance with § 363. In addition, a debtor may sell property free and clear of any interest in such property in certain circumstances.⁴²

When a valid maritime lien is asserted against property of the estate, a debtor can still sell the property free and clear of the lien if the lienholder consents or the price that the property is to be sold for is greater than the aggregate value of all liens on such property.⁴³ Absent consent, determination of the validity and amount of the maritime lien is required. It remains unclear, however, whether a bankruptcy court can adjudicate a maritime claim and deliver clear title.⁴⁴

Moreover, § 363(k) provides a secured claimant the right to credit-bid at the sale of property subject to the secured claimant’s lien unless a court abrogates such right for cause.⁴⁵ A secured claimant may want to credit-bid because, among other reasons, it believes the sale price is otherwise insufficient.

In *Fontainebleau*,⁴⁶ certain holders of mechanic’s and materialmen’s liens sought to credit-bid at an asset sale. The court, concluding that it would need to afford all creditors holding valid liens the opportunity to credit-bid, denied the more than 300 lien claimants the right to credit-bid.⁴⁷ The court concluded that allowing credit-bidding by the lien claimants would delay the sale and deny all creditors the potential benefits of the

²² See *F/V Quality One*, 244 F.3d at 68.

²³ *Id.* See also *Equilease Corp.*, 793 F.2d at 602 (“One purpose [of the Federal Maritime Lien Act] was to establish sound security in favor of loans to ship owners.”).

²⁴ *M/V Marifax v. McCrory*, 391 F.2d 909 (5th Cir. 1968) (upholding maritime lien against vessel and its appurtenances for services rendered to vessel, which had been mothballed by U.S. Navy for 15 years prior to commencement of subject repairs).

²⁵ 890 F.Supp. 552 (N.D. Miss. 1995).

²⁶ *Id.* at 561-62.

²⁷ *Id.* at 562.

²⁸ U.S. Const. Art. III, § 2. The U.S.’ federal judicial power extends to “all Cases of admiralty and maritime Jurisdiction.” *Id.*

²⁹ See generally *Northern Pipeline v. Marathon Pipeline*, 458 U.S. 50 (1982) (declaring congressional grant of comprehensive jurisdiction to bankruptcy courts unconstitutional); *Granfinanciera v. Nordberg*, 492 U.S. 33 (1989) (holding that Congress cannot deprive party of constitutional rights even though matter might be designated as “core” matter).

³⁰ *In re Millenium Seacarriers Inc.*, 419 F.3d 83, 101 (2d Cir. 2005).

³¹ *Id.*

³² 28 U.S.C. §§ 151, 157(a), 1334(b).

³³ See John H. Strasburger, “The ABC’s of Admiralty and Bankruptcy in Concert or Conflict,” 21 *J. Mar. L. & Com.* 273, 281 (1990) (citing *Heci Expiration Co. Inc.*, 862 F.2d 513 (5th Cir. 1988); *Daniels-Head & Associates*, 819 F.2d 914 (9th Cir. 1987); *but cf. Home Ins. Co. v. Cooper & Cooper Ltd.*, 889 F.2d 746 (7th Cir. 1989)).

³⁴ See Strasburger, *supra*, n.34; 28 U.S.C. § 157(d).

³⁵ 46 U.S.C. § 31307.

³⁶ 46 U.S.C. § 31326(b); see also *In re Topgallant Lines Inc.*, 154 B.R. 368 (S.D. Ga. 1993) (reviewing cases).

³⁷ “Preferred maritime lien” means a maritime lien on a vessel “(A) arising before a preferred mortgage was filed under section 31321 of this title; (B) for damage arising out of maritime tort; (C) for wages of a stevedore when employed directly by a person listed in section 31341 of this title; (D) for wages of the crew of the vessel; (E) for general average; or (F) for salvage, including contract salvage.” 46 U.S.C. § 31301(5).

³⁸ 46 U.S.C. § 31326(b)(1).

³⁹ 46 U.S.C. § 31326(b)(2).

⁴⁰ See *Bay State Yacht Sales Inc. v. Squantum Engine & Servs. Inc.*, 117 B.R. 16 (Bankr. D. Ma. 1990); *In re Alberta*, 823 F.2d 712 (3d Cir. 1987).

⁴¹ *The St. Jago de Cuba*, 22 U.S. 409, 416 (1824).

⁴² 11 U.S.C. § 363(f).

⁴³ 11 U.S.C. § 363(f)(2), (3).

⁴⁴ Charles A. Lovell and Eugene G. Bernardo II, “The Continuing Debate over Custodia Legis: An Argument for Bankruptcy Court Primacy,” 30 *J. Mar. L. & Com.* 73, 78-79 (1999).

⁴⁵ 11 U.S.C. § 363(k).

⁴⁶ *In re Fontainebleau Las Vegas Holdings LLC*, Case No. 09-21481-AJC, (Bankr. S.D. Fla. (Miami)).

⁴⁷ Order Denying Emergency Motion for Determination of Lien Claims for Credit-Bidding, *In re Fontainebleau Las Vegas Holdings LLC*, No. 09-21481-AJC, (Bankr. S.D. Fla. (Miami) Dec. 7, 2009) (Docket No. 1201).

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§ 363 sale while continuing to erode substantial value of the subject property.⁴⁸ The court noted that “[e]ven if the lien claims could be adjudicated as to validity, priority and amount, prior to the Section 363 sale scheduled for Jan[.] 21, 2010, there is no feasible procedure to permit five (5) different groups, plus additional unrepresented lien claimants and the dozens of bank mortgage lenders, to bid as single bidders against prospective cash bidders.”⁴⁹

Maritime liens, like mechanic’s liens, can be the subject of prolonged litigation regarding their validity, amount and priority. A maritime lienholder is

entitled to assert a right to credit-bid on assets sold that are subject to its lien. A court might follow the holding in *Fontainebleau* and deny maritime lienholders the right to credit-bid if the court determines that allowing credit-bidding would be too cumbersome.

Determining When a Lien Is “Fixed”

Section 545 allows a trustee or debtor in possession to avoid the “fixing” of a “statutory lien” after a bankruptcy case is commenced.⁵⁰ In addition, § 362(a)(4) provides a stay of any act to perfect a lien in property of the estate. The nature of maritime liens, however, results in perfection of such liens without any need

for affirmative action such as recording. Therefore, a maritime lien can arise post-petition notwithstanding Code protections for property of the estate.⁵¹

Conclusion

Most bankruptcy practitioners are well-versed in secured claims and liens on property. Maritime liens are sometimes in direct contradiction to the types of liens usually encountered on a daily basis in bankruptcy. For this reason, practitioners would be well advised to associate with an expert in maritime liens, or become an expert in secret liens, when maritime lien issues arise in a bankruptcy case. ■

⁴⁸ *Id.*

⁴⁹ *Id.* See also 28 U.S.C. 157(d).

⁵⁰ See *U.S. v. ZP Chandon*, 889 F.2d 233, 238 (9th Cir. 1989) (determining maritime lien for seamen’s wages not statutory lien as defined in Code).

⁵¹ See *id.* (holding perfection of maritime lien for seamen’s wages not subject to automatic stay).

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