



**Selling a Vessel Free and Clear of a Maritime Lien Pursuant to Section 363 of the
Bankruptcy Code**

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Cite as: *Selling a Vessel Free and Clear of a Maritime Lien Pursuant to Section 363 of the
Bankruptcy Code*, 11 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 15 (2019)

Introduction

Under title 11 of the United States Code (the “Bankruptcy Code”), a debtor in possession or trustee may sell property of the debtor’s estate. However, a lien on a maritime vessel may make such a sale challenging, in particular because of jurisdictional issues. When a debtor’s assets become subject to the jurisdiction of both admiralty and bankruptcy cases, a complex conundrum arises.¹ Maritime bankruptcies have generated complex legal issues and jurisdictional conflicts that have perplexed practitioners and implicated significant constitutional issues.²

Under section 363 of the Bankruptcy Code, a debtor or trustee may seek authority from the court to sell property of the debtor’s estate—such as a vessel or other marine property.³ When granted, the court may sell property of the estate “free and clear” of all liens.⁴ But in order

¹ See Michael J. Ende, *Adrift on a Sea of Red Ink: The Status of Maritime Bankruptcy*, 11 FORDHAM INT’L L.J. 573, 74 (1987).

² See *Universal Oil Ltd. V. Allfirst Bank (In re Millennium Seacarriers, Inc.)*, 419 F.3d 83, 87 (2d Cir. 2005).

³ 11 U.S.C. § 363 (2012).

⁴ *Id.*

to do so, the bankruptcy court must have jurisdiction and certain requirements must be met.⁵ For example, one of the requirements is that the sale of the property is permitted by applicable non-bankruptcy law.⁶

When a bankruptcy petition is filed, section 362 of the Bankruptcy Code automatically provides for a broad stay with respect to the commencement or continuation of litigation, lien enforcement, and all actions and attempts to set off against the debtor and the property of the debtor.⁷ Presumably, it would include liens enforceable under maritime law. Indeed, the filing of a bankruptcy petition will cause a vessel that is subject to foreclosure proceedings to be deemed property of the debtor's estate, staying the foreclosure proceeding, and releasing the vessel from arrest.⁸

However, in some cases, a vessel under *in rem* foreclosure proceedings that are pending prior to the filing of a bankruptcy have been held under the doctrine of *custodia legis*.⁹ In general, maritime principles provide that when a vessel was properly seized by a court of competent jurisdiction, the seizing court would administer the property.¹⁰ Therefore, a court would be prohibited from dealing with that asset, and the automatic stay would not impede or delay the pending and previously filed vessel-arrest proceeding.¹¹ However, the Bankruptcy Reform Act of 1978 provided that the filing of the bankruptcy petition stayed all types of proceedings including maritime actions.¹²

⁵ *Id.* § 363 (f).

⁶ *Id.* § 363 (f)(1).

⁷ 11 U.S.C. § 362(a)–(h).

⁸ *See* 11 U.S.C. §§ 362(4), 541.

⁹ *See* Wong Shing v. M/V Mardina Trader, 564 F.2d 1183, 1187–89 (5th Cir. 1977).

¹⁰ Coastal Prod. Credit Ass'n v. Oil Screw "Santee," 51 B.R. 1018, 1020 (S.D. Ga. 1985) (discussing the doctrine of *custodia legis*).

¹¹ Morgan Guar. Trust Co. of N.Y. v. Hellenic Lines Ltd., 38 B.R. 987, 995–96 (S.D.N.Y. 1984).

¹² *See* O'Hara Corp. v. F/V N. Star, 212 B.R. 1, 3 (D. Me. 1997).

This memorandum explores whether a bankruptcy court can discharge a vessel “free and clear” of maritime liens pursuant to the Bankruptcy Code. Part I discusses the legal issues that arise regarding whether a bankruptcy court’s all empowered “automatic stay” applies to a maritime vessel, or if the property remains subject to the jurisdiction of the admiralty court under principles of *custodia legis*. Part II addresses how even if a bankruptcy court has jurisdiction, it may not be able to sell a vessel “free and clear” of a maritime lien.

I. Jurisdiction of an Admiralty Court Not Likely to be Divested Upon Automatic Stay.

Enforcement of liens, in general, are subject to the automatic stay imposed by section 362 of the Bankruptcy Code such that relief from the stay is required to initiate an arrest after the initiation of bankruptcy or to continue such an action.¹³ The automatic stay protects creditors by ending the race to the courthouse for distribution of a debtor’s assets.¹⁴ Further, creditors benefit from the stay because it provides the time needed to sort out the debtor’s assets, make the necessary sales, and distribute the proceeds.¹⁵ However, a seaman’s maritime lien for wages or maintenance and cure (admiralty’s version of workers compensation) may be considered a “sacred lien” not subject to the automatic stay.¹⁶

Admiralty courts do not share the same concerns as bankruptcy courts. An admiralty court generally strives for the expeditious sale of a vessel.¹⁷ In bankruptcy, creditors are considered in terms of their secured or unsecured status.¹⁸ A creditor holding a maritime lien that is secured will find itself amongst secured creditors which could lead to their claims being settled to the same extent as a maritime proceeding. However, admiralty proceedings give precedence to

¹³ 3B E. Benedict, Benedict on Admiralty § 43 (7th ed., rev. 2017); see 11 U.S.C. § 362.

¹⁴ United States v. Lebouf Bros. Towing, 45 B.R. 887, 890 (E.D. La. 1985).

¹⁵ See Ende, *supra* note 1 at 577.

¹⁶ See Barnes v. Sea Haw. Rafting, LLC, 889 F.3d 517 (9th Cir. 2018).

¹⁷ *Id.*

¹⁸ *Id.* at 578.

maritime claims at the expense of any non-maritime claims—putting a maritime lienholder first among non-maritime secured creditors.¹⁹ Further, under the principles of *custodia legis*, a powerful weakness may be revealed in the bankruptcy courts’ power of the automatic stay.

A. Circuits Differ in Dealing with the Jurisdictional Conundrum of Maritime Liens.

Some courts have held that an automatic stay will apply to a vessel.²⁰ Other courts have differed as to whether a bankruptcy court may have jurisdiction over an asset and provide an automatic stay when such asset is a vessel subject to a maritime lien. Some courts have even avoided the question as to whether an automatic stay will protect a vessel.²¹ However, courts ruling on the issue have said more forcefully that the Bankruptcy Code “does not expressly refer to maritime liens,” which are considered “sacred” and to be protected as long as “a plank of the ship remains.”²²

In *Barnes*, the Ninth Circuit relied upon its prior holding in *Chandon*, where it reversed a district court’s ruling that an automatic stay applied to a maritime lien for seamen’s wages.²³ The Circuit examined the legislative intent surrounding the difficult collision of bankruptcy and admiralty.²⁴ Further, the Circuit held that bankruptcy courts are restricted in the fact that admiralty cases may only be adjudicated in district court. Similarly, the *Barnes* court further held that the timing of the filing of the bankruptcy petition relative to the maritime lien did not factor into the decision.²⁵

¹⁹ *In re Prudential Lines, Inc.*, 69 Bankr. 439, 451 (Bankr. S.D.N.Y. 1987) (holding that an admiralty court may hold a sale of a vessel and distribute the proceeds of the sale only to a maritime lien claimant with any surplus being turned over to the bankruptcy estate).

²⁰ *See, e.g., Atl. Richfield v. Good Hope Refineries*, 604 F.2d 865, 869–70 (5th Cir. 1979).

²¹ *See In re Millennium Sea Carriers*, 419 F. 3d at 94–96 (2d Cir. 2005) (noting the uncertainty of a bankruptcy court’s jurisdiction over maritime assets).

²² *United States v. ZP Chandon*, 889 F. 2d 233, 238 (9th Cir. 1989).

²³ *See id.* at 238.

²⁴ *See id.* (construing congresses omission of any reference to maritime law in § 362(a) as evidence of its intention to limit the reach of that statute to land-based transactions where a creditor first in time is entitled to property).

²⁵ 889 F.3d at 533

Conversely, the Fifth Circuit held that an admiralty court's jurisdiction over a vessel was divested once a bankruptcy petition was filed.²⁶ Giving bankruptcy court jurisdiction, and the question as to whether the automatic stay would apply and give the court the ability to hear such a case, was left open. Additionally, *In re Millennium Sea Carrier* also left the question open. In that case, the court noted the continued uncertainty of an automatic stay, where maritime lienors had voluntarily submitted themselves to the bankruptcy court's jurisdiction.²⁷

II. Even if a Bankruptcy Court has Jurisdiction, it May not be Able to Sell a Vessel Free and Clear of Maritime Liens.

Section 363 of the Bankruptcy Code provides that the sale of property to a third party may be authorized free and clear of a third-party's interest, under certain circumstances.²⁸ Those circumstances exist when: non-bankruptcy law permits such a sale, the third-party consents, its interest is a lien on the property and the price of the property to be sold exceeds the value of all liens on the property, there is a bona fide dispute to such interest, or the entity holding such an interest can be compelled to accept money in satisfaction of its interest.²⁹ A motion filed under section 363 seeking the sale of a vessel free and clear of liens, is similar to an admiralty court's order of sale in an *in rem* action.³⁰

A bankruptcy court's power may not extend far enough to extinguish a maritime lien. Congress did not grant bankruptcy courts the jurisdiction over admiralty matters; indeed, the power of a bankruptcy court over a lien in admiralty was omitted from the statutory jurisdiction given by Congress.³¹ Further, courts willing to answer the question have "construe[d] Congress'

²⁶ *In re Modern Boats*, 775 F.2d 619, 620 (5th Cir. 1985); *In re Louisiana Ship Management, Inc.*, 761 F.2d 1025 (5th Cir. 1985).

²⁷ *In re Millennium Sea Carrier*, 419 F.3d at 95.

²⁸ 11 U.S.C. § 363.

²⁹ 11 U.S.C. §§ 363–366.

³⁰ *See id.*; *see also* *Belcher Co. of Ala., Inc. v. M/V Maratha Mariner*, 724 F.2d 1161, 1164–65 (5th Cir. 1984).

³¹ *See In re Millennium Sea carriers, Inc.*, 419 F.3d at 100.

omission of any reference to maritime law in [§] 36a(a)(4) as evidence of its intention to limit the reach of that statute. . . .”³²

A. Questions Open and Closed.

Whether a bankruptcy court can sell a vessel free and clear of maritime liens “is an open question.”³³ The Ninth Circuit has held this question to be answered; this is because maritime liens follow the maritime property even through changes of ownership; and only federal courts sitting in admiralty and acting *in rem* have jurisdiction to extinguish maritime liens.³⁴

Conversely, the Second Circuit has held that a bankruptcy court may extinguish a maritime lien under admiralty law when a lienor submits to the bankruptcy court’s jurisdiction by filing proof of claim.³⁵ However, the Second Circuit also observed “when a debtors estate consists primarily of maritime assets . . . a measure of uncertainty exists regarding propriety of the bankruptcy court’s jurisdiction to sell those assets wholly free of maritime liens.”³⁶ At that time, it had not been something resolved by the circuits.³⁷ Maritime lienors facing a choice of whether to proceed and consent to bankruptcy jurisdiction or to challenge such jurisdiction, need to object to the court’s jurisdiction early before it waits to participate in it.³⁸

Courts have announced principles that only a federal admiralty court may conduct an *in rem* vessel foreclosure, however, Congress created a broad statutory basis for bankruptcy courts

³² *Chandon*, 889 F.2d at 238.

³³ 3B *Benedict on Admiralty* § 43.

³⁴ *Barnes*, 889 F.3d at 534.

³⁵ *In re Millennium Seacarriers*, 419 F.3d at 92.

³⁶ *Id.* at 94.

³⁷ *Id.* at 95.

³⁸ *See id.* at 91–93.

to conduct asset sales.³⁹ There is long line of Supreme Court cases suggesting that only a federal court sitting in admiralty may provide an *in rem* action.⁴⁰

B. Care Must be Taken by Maritime Lien Holders

In general, a maritime lien “accompanies the property to the hands of a bona fide purchaser” and can only be executed in a proceeding in admiralty.⁴¹ *Barnes* relied on these principles to hold that the bankruptcy court in that case could not proceed *in rem*, and that a maritime lien can only be extinguished when a lienor submits itself to the jurisdiction of another court.⁴² Further, traditional admiralty principles “suggest that only a federal admiralty court” has the jurisdiction to quiet title.⁴³

Conclusion

When an asset of a bankruptcy estate is a vessel subject to a maritime lien, care must be taken depending on the interests of the party holding the lien. Under current case law, courts will likely extinguish a maritime lien pursuant to the Bankruptcy Code if the lienholder consents to its jurisdiction by participating in the bankruptcy. Conversely, a court will likely keep jurisdiction over a vessel separate from the bankruptcy court under principles that it is a sacred lien, and that lien will have to be extinguished only under principles of admiralty law.

³⁹ Stewart F. Peck, *Navigating the Murky Waters of Admiralty and Bankruptcy Law*, 87 TUL. L. REV. 955, 972 (2013).

⁴⁰ *Id.* at 971.

⁴¹ See *In re World Imports Ltd.*, 820 F.3d 576, 583 (3d Cir. 2017) (noting that a maritime lien attached to the property from the moment a debt arises, and adheres, even through changes of ownership); see also Grant Gilmore & Charles L. Black, Jr., *The Law of Admiralty* §9-2, at 588 (2d ed. 1975) (“The Maritime lien can be ‘executed’ (which is the admiralty terminology for foreclosed) only by an admiralty court acting *in rem*.”).

⁴² 889 F.3d at 517.

⁴³ *In re Millennium Seacarriers*, 419 F.3d at 93.