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THE MARITIME LAW ASSOCIATION OF THE UNITED STATES

REPORT OF COMMITTEE ON PROPOSED RULE REQUIRING RECEIVERS TO PROVIDE SECURITY OR INSURANCE FOR MARITIME LIENORS BEFORE SUBJECTING VESSELS TO RISKS OF OPERATION.

Majority Report.

At the March meeting, 1934, the undersigned were appointed a Committee to deal with the subject of vessels operated by receivers and of obtaining security from such vessels in collision cases. It was pointed out at that meeting that the present practice of the courts placed serious obstacles in the way of arresting such vessels when proceeded against *in rem*, and, in consequence, of obtaining security by way of bail from them. It was stated that even when permission was given to file a libel the courts declined to stop the operation of the vessel pending the furnishing of a stipulation for value. It was further stated that, although receivers frequently insure vessels against the same risk as those against which private owners insure, the insurance is not so written as to accrue to the benefit of the persons sustaining loss, but that the insurance is for the benefit of the receivers alone. It was suggested that the situation might be remedied by a rule of court. Your Committee was directed to study the entire subject and report.

Although no formal resolution was adopted to which we can refer to ascertain the scope of our duties, the minutes of the last meeting of the Association indicated that the subject under discussion at that time did not include maritime liens which existed at the time vessels came into the custody and possession of re-

ceivers, but was limited to liens which accrued after that time. Notwithstanding this fact, your Committee has reached the conclusion that in order to deal intelligently with the subject, liens existing at the time of receivership should be dealt with in the same plan as that they recommend in connection with liens arising under receivership. For that reason, although we may be extending the subject of our inquiry, we include a study of liens attaching before receivership.

Underlying the entire subject there is a contest between two jurisdictions, viz., between Admiralty and Equity, Admiralty seeking to provide security to an injured party, and Equity seeking to preserve "a going concern" so that it will continue to have value as such, and a contest between stockholders and bondholders of insolvent companies on the one side, and maritime lienors, including seamen, supply men, cargo claimants and persons or vessels injured by the operation of a vessel of the insolvent company, on the other. The maritime lien is an invention of the admiralty to provide security to an injured person, and receiverships are the machinery of equity to prevent economic waste by keeping insolvents alive as going concerns. As the law now stands, the question whether victory is to security for the lien claimants or to preservation of "a going concern," depends upon who first secures possession of the vessel property of the insolvent shipowner. This is what was decided by the Supreme Court of the United States in *Moran* v. *Sturges,* 154 U. S. 256, as was pointed out by the two justices of the Supreme Court who dissented. In this contest the admiralty has a slight advantage, because even if the sheriff should first secure possession, the marshal, as the officer of the admiralty court, may sit by and await the day when the vessel is delivered by the sheriff to someone other than an officer of the court. The marshal may then assert the admiralty jurisdiction against the vessel. But if the marshal should first secure possession, then the sheriff is defeated for all time, for the sale in the admiralty court is a sale "against the world." The mere fact that a receiver has been appointed and the shipowner has been declared insolvent, does not prevent the marshal from taking possession as the officer of the admiralty court. In *Moran* v. *Sturges,* 154 U. S. 256, at p. 285, the Court held that a District Court of the United States sitting in admiralty

violated "no rule of comity nor any other rule in entertaining a libel" against vessels belonging to an insolvent for whom a receiver had been appointed by a state court, when at the time of arrest the vessels were not actually in the possession of an officer of the state court. It also held that the state court was without jurisdiction to prohibit maritime lienors asserting their claims in the federal admiralty courts. The Court said, at page 285:

> "As has been seen, maritime liens are incumbrances placed on vessels by operation of law, and neither the death nor the insolvency of the owner can divest or extinguish them or transfer jurisdiction over them to courts for the settlement of the estates of decedents or insolvents, although for the purposes merely of such settlement these are the appropriate tribunals. In the orderly administration of justice the representatives of such estates should apply to the court which alone has cognizance to ascertain and enforce these exceptional interests in the thing itself, which accompany it wherever it goes and into whosesoever hands it comes, and which cannot be displaced by the action of other courts *in invitum.*"

See also *The Philomena,* 200 Fed. 859, at pp. 861, 862, where the Court said:

> "But it is settled that the admiralty courts have exclusive jurisdiction over maritime liens, and that as other courts are without power to establish and enforce such liens, so they are without power to displace them. Moran v. Sturges, 154 U. S. 263, 14 Sup. Ct. 1019, 38 L. Ed. 981; Paxson v. Cunningham, 63 Fed. 132, 11 C. C. A. 111; Hudson v. New York etc. Co., 180 Fed. 973, 104 C. C. A. 129. It was said in Paxson v. Cunningham that an 'admiralty court has peculiar rules of its own in some respects, which cannot be conveniently, if at all, applied by a court of equity or common law.' 63 Fed. 134, 11 C. C. A. 113. It may well be that under the present Bankruptcy Act a bankruptcy court would encounter less difficulty in this respect than a court of equity or common law; but the fact remains that no admiralty jurisdiction has been given

to courts of bankruptcy. Their powers over the bankrupt's property, once their jurisdiction has attached, and their power to determine questions regarding liens thereon, however strongly these may be stated (see Carter v. Hobbs, [D. C.] 92 Fed. 594; Staunton v. Wooden, 179 Fed. 61, 63, 102 C. C. A. 355, and cases there cited), do not go to that extent. The admiralty court, therefore, cannot refuse to proceed, in an admiralty suit properly before it, wherein its jurisdiction over the property was complete before the bankruptcy proceedings were inaugurated; nor can it require the libellant, in order to get his lien established, to present and prosecute his claim in proceedings which, though also before it, are not proceedings wherein admiralty jurisdiction can be exercised. A materialman in such a suit is not to be regarded as prosecuting a claim provable in bankruptcy, but as asserting a right in the vessel libeled, irrespective of her ownership. He has the right in an admiralty court to be so regarded, and it is a right of which the court cannot deprive him. That his libel is filed within four months prior to the bankruptcy petition can in no event affect the question, because he does not obtain his lien by filing his libel, but seeks thereby to establish a pre-existing right.

To grant the receiver's application would be to make the proceeds of this vessel's sale, which now constitute the fund from which maritime liens upon her are to be paid in the order of their priority under the maritime law, chargeable, before applying any of them to the satisfaction of such liens, with a share of the expense of administering the estate in bankruptcy. If this might properly be done when admiralty proceedings are had by consent of a bankruptcy court after its jurisdiction over the property has attached, as in Re Hughes, (D. C.) 170 Fed. 809, I do not think it can be done with justice to the lien claimants when the admiralty court has acquired jurisdiction first, and it cannot be said that the entire vessel constitutes part of the estate which is to be administered in bankruptcy. Under such circumstances it seems to me that the bankruptcy court cannot administer, nor its trustee take title to, any-

thing more than the bankrupt's interest in the vessel, which will be only so much of her or her proceeds as may be left after the maritime liens are satisfied.

The vessel having once been subjected to the jurisdiction of the admiralty court by her arrest, I think that court should hear and determine all the liens claims which may be asserted against her, whether presented to it before or after the filing of the bankruptcy petition or the adjudication in bankruptcy. In admiralty the order of priority among conflicting liens upon the same vessel does not depend upon the dates of filing of the libels or petitions in which they are asserted. The libellant may or may not have priority over any one of the lien claimants who have intervened in its suit since its libel was filed. The court cannot, therefore, while retaining jurisdiction of the libel, refuse it to any of the subsequent interveners, and require them to prove their claims in bankruptcy."

See also *The J. R. Langdon,* 163 Fed. 472, at p. 475.

And see *Hudson* v. *New York & Albany Transportation Co.,* 175 Fed. 519, where Judge WARD, sitting in the old Circuit Court, held that a federal equity court had no power to force maritime lienors to submit their claims to that equity court. This result was affirmed by the Circuit Court of Appeals, 180 Fed. 973, the Court reversing only in respect of such claimants who the Court stated had voluntarily submitted their claims to the jurisdiction of the federal equity court. See in the same connection *In re James Rees & Sons,* 237 Fed. 555, at pp. 561, 563.

Before the Act of Congress of March 3, 1887, a receiver appointed by a federal court could not be proceeded against except in the court of his appointment. See *Barton* v. *Barbour,* 104 U. S. 126. This decision resulted in a remedial statute which permits suits against receivers. See the Act of March 3, 1887, which is now Section 125 of Title 28 of the United States Code, and Section 66 of the Judicial Code. The Act which accomplished that result reads as follows:

"§ 125. (JUDICIAL CODE, section 66.) SUITS AGAINST RECEIVER. Every receiver or manager of any property

> appointed by any court of the United States may be sued in respect of any act or transaction of his in carrying on the business connected with such property, without the previous leave of the court in which such receiver or manager was appointed; but such suit shall be subject to the general equity jurisdiction of the court in which such manager or receiver was appointed so far as the same may be necessary to the ends of justice. (March 3, 1887, c. 373, § 3, 24 Stat. 554; Aug. 13, 1888, c. 866, § 3, 25 Stat. 436; March 3, 1911, c. 231, § 66, 36 Stat. 1104.)" (U. S. Code, Title 28, § 125.)

The leading case interpreting this section is *Byers* v. *McAuley,* 149 U. S. 608, where the Court held that a receiver appointed by a federal court and in possession of property, may be subject to suit in a state court without leave being obtained from the federal court, but the administration of property in the hands of the receiver would remain with the federal court.

The statute is applicable to receivers appointed in the bankruptcy court. See *In re Kanter,* 121 Fed. 984 (C. C. A. 2); *In re Kalb & Berger Manufacturing Co.,* 165 Fed. 895 (C. C. A. 2).

In *Paxson* v. *Cunningham,* 63 Fed. 132, the Circuit Court of Appeals for the First Circuit held that the statute permitted the arrest in admiralty of a vessel operated by a receiver. Judge HORACE GRAY, a member of the Supreme Court of the United States, while sitting in the Circuit Court of Appeals for the First Circuit, said in that case, at page 135:

> "If the libel now in question had been in personam against the receivers, it would have been within the very terms of the statute, and might have been filed without leave of the circuit court which appointed the receivers, subject, however, to the control of that court, so far as necessary to the ends of justice. McNulta v. Lochridge, 141 U. S. 327, 12 Sup. Ct. 11; Railroad Co. v. Cox, 145 U. S. 593, 12 Sup. Ct. 905. The libel in rem against the steamboat for a wrong done by her while in the possession

> and employment of the receiver, if not within the terms of the statute, is within its reason and equity. Independently of the statute, there could be no objection to proceeding with that libel, so far as might be done without interfering with the possession of the receivers. Heidritter v. Oilcloth Co., 112 U. S. 294, 304, 5 Sup. Ct. 135. And, whether the libel in rem against the steamboat in the hands of the receivers is or is not considered as coming within the statute, it was clearly within the discretion of the circuit court to permit the libelants to establish and enforce their maritime lien in the district court in admiralty, as the appropriate tribunal to try and determine that matter. The receivers can regain possession of the steamship, if they have not already done so, by entering into a stipulation in the district court to abide its final decree, and that decree will be subject to review by this court on appeal.
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> Upon the facts in this case, therefore, the circuit court wisely exercised its discretion by declining to issue an injunction against the proceedings in admiralty."

As no proceeding *in rem* would be possible unless there was a maritime lien, it would seem from the decision in *Paxson* v. *Cunningham, supra,* that in so far as damages occasioned by receivers as a result of the operation of vessels is concerned, a lien is created against the vessel, for which the vessel may be arrested and sold, on condemnation, by the marshal, and such a sale is a sale against the world, as is the case with other sales by the marshal in admiralty. In other words, although the intervention of the receiver's possession may prevent a maritime lienor, whose lien attached before receivership, from asserting his lien while the receiver is in possession, the receiver may subject the property against which the lien exists to other maritime liens. It is possible that such new liens may destroy the security for the earlier liens. As a maritime lien "imports a tacit hypothecation of the subject of it" (*The Yankee Blade,* 19 How. 82, 89), and "is a right of property, and not a mere matter of procedure" (*The Lottawanna,* 21 Wall. 558, 579), and as no state legislation can divest the lien (*The J. E. Rumbell,* 148 U. S. 1), it is not entirely

clear how an equity receiver not vested with title* can thus jeopardize the security of the first lienors. That a lien is created as a result of a receiver's act seems to follow from the decision in *Paxson* v. *Cunningham, supra,* and in *The Willamette Valley,* 66 Fed. 565 (C. C. A. 9), and in *The St. Nicholas,* 49 Fed. 671 (D. C., Southern District of Georgia).

Arrest was permitted in the case of *The Willamette Valley, supra,* where the receiver took the vessel beyond the jurisdiction of the court and incurred debts. In the course of its opinion, the Circuit Court of Appeals for the Ninth Circuit said, at page 568:

> "When a receiver, under the order of his court, takes a vessel, the property of his trust, out of the jurisdiction of the court, and sends her into a foreign port under the charge of a master, he places her in the position of all other vessels engaged in like business. It is our judgment that in so doing he subjects her to the same conditions that other vessels are subject to. The master should be accredited with all the powers usually incident to his employment, one of which is the power to pledge the vessel for the supplies or repairs necessary to accomplish her voyage. If he is unsupplied with the funds wherewith to purchase in a foreign port the coals required for the navigation of his vessel, it must be presumed to have been the intention of the receiver, and of the court whose officer he is, to procure such supplies upon the vessel's credit, and to subject her to the usual maritime lien therefor. If such is not the policy of the receiver and of his court, the remedy is to furnish the master with the requisite funds, or to procure the supplies otherwise than upon the credit of the vessel."

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*NOTE: Unless a receiver is vested with title, as in *Bernheimer* v. *Converse,* 206 U. S. 516, and in *Converse* v. *Hamilton,* 224 U. S. 243, or suit is to recover property unlawfully taken for the receiver's actual possession (*Oakes* v. *Lake,* 290 U. S. 59), the receiver has not a sufficient title in the property involved in the receivership to permit him to sue in a foreign jurisdiction: *Sterrett* v. *Second National Bank,* 248 U. S. 73. See also *Lion Bonding Co.* v. *Karatz,* 262 U. S. 77, 78; *Great Western Mining Co.* v. *Harris,* 198 U. S. 561, 575, and *Booth* v. *Clarke,* 17 How. 322. For the most recent discussion of this subject by the Supreme Court, see *Clarke* v. *Willard,* 292 U. S. 112, 120. Under the bankruptcy law, of course, there is no question of title.

And at pages 566-567 the Court said:

> "The powers of a receiver are bounded by the territorial limits of the court under whose authority he is appointed and acts. Within that territory the possession by the receiver of the property placed under his control will be respected by all other courts, and his possession may not be disturbed by process issued out of any court. Taylor v. Carryl, 20 How. 583; Freeman v. Howe, 24 How. 450; Ellis v. Davis, 109 U. S. 485; Covell v. Heyman, 111 U. S. 176; Borer v. Chapman, 119 U. S. 587; Byers v. McAuley, 149 U. S. 608. The reason of the rule, as expressed in Covell v. Heyman, is that to disturb property in the possession of the receiver upon process from another court 'would be to invade the jurisdiction of the court by whose command it is held, and to violate the law which that jurisdiction is appointed to administer.'"

See also *The St. Nicholas,* 49 Fed. 671, where, at page 676, the Court said:

> "In support of this answer, it is insisted for the respondent that the United States Circuit Court in Florida, by which the respondent was appointed receiver, alone has jurisdiction of any matter relating to the liability of property in its custody, and, unless that court has given leave to the plaintiffs to sue its receiver, the libel and interventions should be dismissed. In support of this proposition, Barton v. Barbour, 104 U. S. 126, 130, 131; Heidritter v. Oilcloth Co., 112 U. S. 294, 303, 304, are cited. It will be sufficient, upon the last proposition, to suggest that these cases were decided before the act of Congress of March 3, 1887 (re-enacted August 13, 1888), by which it is provided that receivers may be sued without the leave of the court appointing them (24 U. S. St. p. 554; 25 U. S. St. p. 436—by which it is provided that a receiver may be sued without permission of the court by which he was appointed).
>
> It would be, moreover, in our opinion, true that if a receiver appointed in one district of the United States

> should send into another a vehicle of commerce like the St. Nicholas, that vessel would be liable, altogether irrespective of authority to sue, granted by the court by which the receivership was created, for any marine tort which it might commit. This statute, however, is controlling. Central Trust Co. v. St. Louis & T. R. Co., 40 Fed. Rep. 426, 427."

From these cases it appears that a lien does arise in favor of an injured party when a vessel operated by a receiver incurs a debt for supplies or inflicts injuries as a result of a maritime tort. In the first circuit the vessel may be arrested even within the jurisdiction of the court which appointed the receiver—*Paxton* v. *Cunningham, supra.* It has been held in the ninth circuit and in the Southern District of Georgia that, if a vessel operated by a receiver is sent beyond the territorial jurisdiction of the court of his appointment, and incurs a debt, or inflicts injury, she may be arrested—*The Willamette Valley, supra,* and *The St. Nicholas, supra.* Consequently, as the law now stands, there may or may not be a speedy and effective enforcement of such liens, depending upon whether the possession of the receiver is subject to disturbance, or upon whether the receiver has sent the vessels beyond the jurisdiction of his appointment. It is true that under Section 77-B of the Bankruptcy Act the ambit of a receiver's operations extends to the entire United States, and therefore it seems that no proceedings similar to those permitted in *The Willamette Valley* and in *The St. Nicholas* are now to be contemplated in the admiralty courts of the United States. Many vessels, however, operated by receivers appointed under that Act will enter foreign trade, and their arrest by officers of the courts of foreign countries must be contemplated. Moreover, a receiver should not be permitted to operate vessels which may do injury to other persons unless the vessels operated by the receiver are placed in such a position that adequate security may be given on their behalf to those whose property or persons they may injure. That the maritime lienor may be affected detrimentally by such operation is clearly shown by *The American Palestine* case, 15 Fed. (2d) 94, 1926 A. M. C. 1289, and by the receivership proceedings in the United States District Court for the District of New Jersey

in connection with the vessels of the Submarine Boat Corporation. When vessels are sent to ports of foreign countries with inadequate insurance, and insufficient funds have been provided, serious hardship has resulted to seamen, cargo owners and all persons who have been so unfortunate as to have dealings with such vessels. Counsel who were so unfortunate as to have had dealings with the Motor Vessel "Secundus" or the S.S. "Phoebus" will remember keenly the needless suffering caused to innocent persons by the failure of their owners to provide adequate funds. It was poor consolation to such persons to learn that the reason for the failure to provide such funds was that the owners were insolvent.

In the minority report it is stated that "The case may be that of a steamship line whose officers have used all the corporation's available cash in the futile effort to keep afloat." It is then argued in substance that the Court should disregard the rights of maritime lienors and should authorize subjecting the property of such lienors to risk of loss and damage for the benefit of the steamship company's stockholders. A more inequitable method of financing vessel operation can scarcely be imagined. Such a scheme would compel the maritime lienors to submit their liens to hazard of total loss in a venture entered into solely for the benefit of stockholders and bondholders. In contrast to that suggestion, the proposed rule of court constitutes notice at the outset to irresponsible operators that a court will not assist operators who "use all of a corporation's available cash" unless those interested as stockholders or creditors in the corporation regard their equity over the maritime liens as sufficiently valuable, and the hoped-for profits sufficiently tangible, to warrant their advancing security and providing insurance so as to place the risk of operation where it properly belongs.

The problem is a practical one, for which there should be a practical solution, i. e., maritime lienors should not be subjected to the hazard of the loss of the vessels against which they have liens while such vessels are being operated by officers and appointees of the court. In *The Esperanza,* 1928 A. M. C. 1557, the receiver solved the problem in so far as liens which existed at the time of shipment were concerned, by taking out insurance

on the vessel in respect of such liens. Your Committee is of opinion that all of these problems may be solved in the same way. The purpose of such insurance should be:

(1) To insure, in an amount to be estimated by the receiver, the vessels operated against all risks of operation, for the benefit of maritime lienors. When vessels pass into the hands of a receiver, so far as is possible, it should be ascertained what maritime liens exist, and the vessels should be insured under policies similar to those used in *The Esperanza, supra.*

(2) To insure against collision liability of the receiver and of vessels operated by him under the running down clause. This insurance should be in the broadest form obtainable (the four-fourths running down clause, with the sister ship provision, and with a provision covering the ship's liability for general average and salvage charges).

(3) To insure against all liability of the receiver and vessels operated by him not covered by the four-fourths running down clause. This form of insurance is customary and is commonly called protection and indemnity insurance. It should be in as comprehensive a form as is obtainable.

(4) Unless those interested in preserving the business of an insolvent shipowner are willing and are in a position to supply funds with which to pay the debts incurred by the receiver for supplies, etc., the Court should decline to permit a receiver to operate the vessels of such insolvent. Vessel property coming into the possession of a receiver should not be subjected to maritime liens as a means of obtaining credit with which to carry on the operation (*The Willamette Valley, supra*).

All insurance should be for the benefit of maritime lienors, and include both liens existing at the time the receiver is appointed, and liens arising during receivership. Such insurance should require the insurers to file a stipulation for value promptly on the filing of any libel.

In addition to *The Esperanza, supra,* we call attention to *The Willamette Valley,* 66 Fed. 565, where the Court stated that, if a

receiver was without funds he should not be permitted to operate a vessel and subject her to debts for which the law gives maritime liens; and to *The Trolltind,* 1929 A. M. C. 600, 606, where it was said that wages of the crew, claims for personal injury, cargo claims under contracts of affreightment, and "all claims arising out of accidents which occur in the business of operating the ship" are "operating expenses" of a receiver. See also *The Pacific Oak,* 1932 A. M. C. 1610, where the Court for like reasons allowed, as receiver expenses, wharfage incurred and paid by equity receivers, as a prior charge against the fund to that of the holder of a preferred ship mortgage.

The second paragraph of the proposed rule (as quoted at the end of this report) is not suggested by any decided case. We think, however, that its provisions are entirely reasonable and we find nothing in 77-B which would preclude the Court from adopting such a rule. Certainly an equity court should not restrain maritime lienors from proceeding against vessels to perfect maritime liens or from selling them at marshal's sale when those interested in the insolvent fail to provide adequate security for the protection of such lienors. Exacting a bond as a condition of granting any injunction is a practice of long standing; exacting this practical security to meet the needs of vessel property is no more than an extension of that well-settled principle.

We cannot agree with the suggestion that since the enactment of Section 77-B the power and authority of receivers when vessels are sent beyond the jurisdiction of the United States will not be disturbed or attacked. The possession of chattels by an officer or appointee of a court, does not, in our opinion, vest the chattels with that immunity from arrest which is enjoyed by chattels owned by a sovereign government. It seems apparent to us that it is to be expected that, if a vessel operated by a receiver fails to perform her engagement in a foreign port, or should inflict injury upon other persons for which she may be called to account in a foreign port, the vessel will probably be arrested, and the fact that she is being operated by a receiver or other appointee of a court of the United States will not obtain her release. We think that her release from arrest can only be obtained by arranging security for the debt or other obligation which may be imposed upon the vessel while in a foreign jurisdiction.

We find nothing in the language of Section 77-B of the Bankruptcy Act to indicate that maritime lienors should not have at least as extensive rights as a "secured creditor." Section 1, subdivision 23, of the Bankruptcy Act defines "secured creditor" as follows:

> "(23) 'secured creditor' shall include a creditor who has security for his debt upon the property of the bankrupt of a nature to be assignable under this title, or who owns such a debt for which some indorser, surety, or other persons secondarily liable for the bankrupt has such security upon the bankrupt's assets."

Indeed, a maritime lien is an interest or right of property in the vessel herself giving the lienor the same right as if the vessel were real property and he and the owner of the legal title were tenants in common (*The John G. Stevens,* 170 U. S. 113). The maritime lien is not dependent on possession and outranks all common law liens (*The J. E. Rumbell,* 148 U. S. 1).

> "Each [maritime lien for supplies furnished] rests upon the furnishing of supplies to the ship, on the credit of the ship herself, to preserve her existence and secure her usefulness, for the benefit of all having any title or interest in her. Each creates a *jus in re,* a right of property in the vessel, existing independently of possession, and arising as soon as the contract is made, and before the institution of judicial proceedings to enforce it" (*The J. E. Rumbell, supra,* at p. 19).

> "Originally, the primary liability was upon the vessel, and that of the owner was not personal, but merely incidental to his ownership, from which he was discharged either by the loss of the vessel or by abandoning it to the creditors. But while the law limited the creditor to this part of the owner's property, it gave him a lien or privilege against it in preference to other creditors. * * * Unlike a common-law lien, possession is not necessary to its validity. It is rather in the nature of the hypothecation of the civil law" (*The China,* 7 Wall. [U. S.] 53, at p. 68).

Under the Bankruptcy Act "secured or priority creditors need not surrender their securities, but the value thereof may be determined and deducted, and dividends paid on unpaid balances" (*Gilbert's Collier on Bankruptcy,* 3rd Edition, 1934, Sec. 1039, p. 766).

In *Gilbert's Collier on Bankruptcy,* 3rd Edition, 1934, Section 1044, at page 769, it is said:

> "A creditor cannot prove both a debt and the security thereof, but he may prove either one. He may rely on his security and enforce it according to his rights as they exist; in such a case it is optional with him to make a formal proof of his claim. The claim of a secured creditor is only allowable, prior to the determination of the value of his security, to enable him to participate in the creditors' meeting for such sum as to the court seems to be owing over and above the value of the security. He may, however, unless restrained by order of the bankruptcy court, enforce his security in another court (Matter of Southern Pharmaceutical Co., D. C., Tenn., 2 Am. B. R. N. S. 378, 286 Fed. 148). As has already been explained, the value of securities is often arrived at summarily at first meetings to permit a creditor to vote the unsecured balance. A claimant may, of course, be fully secured. If so, he should not be allowed to file a proof, and does not become a party to the proceeding. If a trustee does not elect to redeem the security by paying the debt, the secured creditor may sell the security, if under the terms of his lien he has such right, and file a claim for the unpaid remainder of his debt. * * * Where the claimant voluntarily appears before the referee in bankruptcy and presents his claim for allowance as a secured claim, alleging that he had a lien upon the land by virtue of a mortgage, deed of trust or the like, the referee has jurisdiction to determine the validity of the lien asserted, and to adjudge whether or not the claim should be allowed as a secured claim. If it be determined that the lien is invalid, the claim for the security of which the lien was given may be proven as unsecured. * * * Where the security is retained by the

creditor, he may enforce his lien in any court having jurisdiction, although he has availed himself of the privilege of filing his claim as a secured claim. *A lien claimant, asserting the right to possession of property which is lawfully in the possession of the bankruptcy court, may, in order to obtain such possession, or the cash into which such property may have been converted, file in such court a reclamation petition asking for the delivery to him of the possession or proceeds of the property sought, and need not file a proof of claim as a creditor, secured or unsecured* (Matter of Southern Pharmaceutical Co., D. C., Tenn., 2 Am. B. R. N. S. 378, 286 Fed. 148)." (Italics ours.)

Similarly, a maritime lienor has a "right to possession of property which is lawfully in the possession of the bankrupt court." He should have the same remedy as any other secured creditor. It has been suggested that the court should automatically grant all applications for immediate sale by a marshal by maritime lienors who have established their liens. We can see certain practical objections to that suggestion. It seems to us, however, that the rule of court which we have suggested, providing for sufficient cash to carry on the operation of vessels belonging to insolvent companies and adequate insurance, as outlined above, is a minimum requirement which the bankruptcy court should insist upon to protect the rights of maritime lienors and all persons who can be injured as the result of the operation of such vessels.

The Supreme Court of the United States decided on April 1, 1935, in *Continental Illinois National Bank & Trust Co. of Chicago* v. *The Chicago, Rock Island & Pacific Railway Co.*, that under the discretion vested in it by Section 77-B a district court can enjoin a secured creditor from enforcing his lien by sale of the collateral subject to the lien, provided the court is satisfied that the injunction will not "in any way impair the lien or disturb the preferred rank of the pledgee." Almost any operation of a vessel, and certainly the sending of a vessel outside the territorial jurisdiction of the United States, subjects the vessel to hazards which impair the lien and disturb the preferred rank of the maritime lienors.

This Committee recommends that this Association recommend to the appropriate courts the adoption of the following as a rule of court:

PROPOSED RULE TO BE ADOPTED BOTH IN EQUITY AND IN BANKRUPTCY.

"A vessel in the possession of an officer or appointee of a court of the United States (including a debtor continued temporarily in possession) shall not be operated except under the following conditions: (1) Sufficient cash funds must be made available to said officer or appointee of the court to pay all uncontested items of expense in connection with such operation; (2) Insurance or other satisfactory security must be provided in amount sufficient to pay contested items of expense of such operation; and (3) Insurance must be provided in favor of maritime lienors whose liens existed before the vessel came into the possession of an officer or appointee of the court in an amount which the court shall determine to be reasonable but in no event to exceed the value of said vessel.

No injunction or other order restraining maritime lienors from proceeding against any vessel in the possession of any officer or appointee of a court of the United States shall be granted until the conditions aforesaid are performed. If said conditions are not performed after the lapse of ten days from the time any vessel comes into the possession of an officer or appointee of a court of the United States, such vessel may be proceeded against in the same manner as if she were in the possession of private persons."

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W. H. MCGRANN.

New York, N. Y.,
April 9, 1935.

Minority Report.

Careful consideration of the matter of the operation of vessels by receivers and trustees brings the undersigned to the conclusion that no efforts should be made at this time toward the passage of any court rules which would deprive the District Judges of complete freedom of action in dealing with insolvent estates owning vessel property. Much that has been written in the opinions in cases dealing with conflicts between equity and state court receivers and maritime lienors and the power and authority of receivers where the vessels are beyond the jurisdiction of the court appointing them has now gone by the board.

The enactment by Congress of Section 77-B of the Bankruptcy Act has so changed the entire picture that there are not likely to be many more equity receiverships, especially of corporations operating vessels. Section 77-B, subdivision (c), vests title in the trustees, when appointed by the court, to all the debtor's property. Subdivision (a) provides:

> "* * * and the court in which such order approving the petition or answer is entered shall, during the pendency of the proceedings under this section, have exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section, * * *."

The section would certainly apply to domestic vessels on the high seas and the title might be recognized even in foreign ports. Under this section and the orders usually issued under it, the business of the debtor may be continued and no one may disturb the possession of the trustees. Any attempt to enforce liens on the property by judicial proceedings may upon notice and for cause shown be and usually is enjoined until entry of the final decree. In our opinion this section would give to the District Court power to enjoin the enforcement of the attachment of a vessel in a suit brought on a maritime lien.

If under 77-B property can be sold free of lien and bondholders and mortgagees can be enjoined from foreclosing their liens and finally if a certain percentage agree, can be compelled to accept less or different security, it can hardly be said that there is any discrimination against maritime lienors.

It is true that the remedy of the maritime lienor may be postponed, although he may be permitted to liquidate his claim in the admiralty court if he so desires, without enforcement of his security, but so is the remedy postponed for other lienors against the properties of the debtor, such as bondholders or mortgagees.

It is true that the vessel if operated may be injured or lost, but so may the property on shore covered by a lien be lost or destroyed by a casualty such as fire, earthquake or storm.

Under the intent of the section the advantages of a few may be postponed for the time being to preserve the interests of the many and the greater value of the whole property of the debtor and possibly in the public interest also. The great advantage of 77-B lies in the freedom of action given to the Judge having charge of the proceeding. To hamper that freedom is to destroy his efficiency. He must meet each situation as it comes to him, usually with its own peculiar difficulties. The case may be that of a steamship line whose officers have used all the corporation's available cash in the futile effort to keep afloat. It may be difficult to immediately arrange protection and indemnity insurance to cover all risks and there may be no money immediately in the treasury to pay for it. The line may have valuable mail, government or other contracts to be lost if the service is interrupted. To tie up all the vessels immediately would perhaps destroy the value of the whole operation. How can the court know at the inception of the proceeding who the bondholders or creditors are, in order to get interested parties together to furnish funds to pay all uncontested items of expense in connection with operation as provided in the rule suggested in the majority report? Such expenses are usually paid out of the freights. How can the court know in advance what the contested items of expense are likely to be, or what persons have valid liens on any of the vessels so as to provide insurance? Shall the court stop operations until some good angel provides it with funds, or shall the trustees, with the guidance of the court, feel their way, insuring against this and that liability and protecting the various interests and lienors as they find it possible and practicable to do and as directed by the court by various kinds of insurance? Claims incurred in the operation of vessels, such as collision, cargo

damage, etc., are an expense of operation and will be debts of the trusteeship and preferred to ordinary creditors' claims in the final wind-up.

The difficulty with the part of the suggested rule providing that no injunction shall issue except upon performance of the conditions there named is that 77-B itself provides that such injunction as we have seen may issue upon notice and for cause shown.

The opinion in the case of *In re Southern Pharmaceutical Co.*, 286 Fed. 148, relied upon in the quotation from *Gilbert's Collier on Bankruptcy,* found in the majority report itself, expressly states (p. 151):

> "The secured creditor, however, unless restrained by order of the bankruptcy court, may enforce his security dehors the court."

No rule of court can nullify or cut down the provisions of a statute. To accomplish the result desired it would seem necessary to amend the section.

The quotation from *Collier on Bankruptcy,* referring to secured claims, was plainly based on a case decided long before 77-B became law.

The provision in the suggested rule that if the conditions specified are not performed within ten days after a vessel comes into the possession of an officer of the court she may be proceeded against as if in the possession of private persons, would, it is safe to say, quite effectively prevent operation in most cases.

Therefore we conclude:

1. That each District Judge having charge of a trusteeship or receivership should be free to exercise his best judgment as to whether and if so under what conditions vessels should be operated by trustees or receivers, and whether and if so what insurance should be taken out to cover such vessels.

2. That the courts should not be asked to pass any rule on this subject.

GEO. WHITEFIELD BETTS, JR.

Dated, April 10, 1935.

Supplemental Report of the Majority of the Committee.

We have carefully considered the minority report. The minority assumes that

> "under 77-B property can be sold free of lien, and bondholders and mortgagees can be enjoined from foreclosing their liens and finally, if a certain percentage agree, can be compelled to accept less or different security."

No authority is cited to support that position. The contrary is held in *Continental Illinois National Bank* v. *Chicago, R. I. & P. Ry. Co.* (decided April 1, 1935). In that case the Supreme Court of the United States said:

> "The injunction does not infringe § 67 (d), U. S. C., Title II, § 107 (d). The substance of that provision is that *bona fide* liens shall not be affected by anything contained in the Bankruptcy Act. The injunction here in no way impairs the lien, or disturbs the preferred rank of the pledgees. It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action. * * * A claim that injurious consequences will result to the pledgee or the mortgagee may not, of course, be disregarded by the district court. * * *"

The proposed rule merely prevents reckless and unbusinesslike operation of vessels by financially irresponsible managers or receivers to the prejudice of maritime lienors. It does not prevent a receiver from operating vessels on the same terms as an ordinarily prudent business man. The insurance or security we suggest is what is customarily provided by careful operators of vessel property. The suggested rule does not bind the Court so as to prevent it taking appropriate action in special cases. It merely states what the Court considers a minimum required to be observed in the operation of vessel property.

The suggestion in the minority report that the quotation from *Collier on Bankruptcy* represents views which do not take sufficiently into account the innovations contained in Section 77-B

was undoubtedly made inadvertently because that quotation is from the very latest edition of *Collier on Bankruptcy,* which edition was apparently prepared for the purpose of discussing Section 77-B. An examination of that edition of *Collier* will disclose that Section 77-B is in fact considered and discussed at length in passages which almost immediately precede the language which we quote.

We feel that without some such protection as that provided by the suggested rule, maritime lienors will be seriously prejudiced. Through lack of notice, or because they reside at a distance from the scene of the legal proceedings, maritime lienors are often prevented from being represented and heard when the receiver or general creditors ask the Court's consent to further operation of an insolvent's vessels. Thus the rights of lienors are not called to the Court's attention, and the Court may inadvertently permit operation without insurance or security such as it would require if it knew of the existence of such liens. The proposed rule constitutes a simple and definite provision which precludes reckless operation of vessels at the expense of maritime lienors. It will insure seafaring men from being stranded in foreign ports, as was the case in the *Secundus* and the *Phoebus,* referred to in our main report.

Moreover, the rule frees the courts from the ever-recurring contest between maritime lienors and other interests which invariably results under present conditions. The suggested rule is the only remedy so far as we know which has been designed to terminate that contest. The minority does not suggest any remedy. It merely recommends that nothing be done. We submit that when a practical means exists, namely, the proposed rule of court, to end the contest between two jurisdictions of the same court, that means should be used. Therefore the proposed rule should be adopted.

T. Catesby Jones.
W. H. McGrann.

April 16, 1935.