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Canadian Marine Bankruptcy Law & Practice

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> Ships are elusive. The power to arrest in any port and found thereon an action in rem is increasingly required with the custom of ships being owned singly and sailing under flags of convenience. A large tanker may by negligent navigation cause extensive damage to beaches or to other shipping: she will take very good care to keep out of the ports of the 'convenient' forum. If the aggrieved party manages to arrest her elsewhere, it will be said forcibly (as the appellants say here): 'The defendant has no sort of connection with the forum except that she was arrested within its jurisdiction.' But that will frequently be the only way of securing justice.[2]

Introduction

For corporate debtors in most industries, Canadian bankruptcy law is simple – either seek reorganization under the Company Creditors Arrangement Act or file for formal bankruptcy by making a proposal to creditors. Once protection is granted and a Monitor or Trustee is formally appointed, all legal action is stayed and all future legal action prohibited, without special permission from the Superior Court exercising its Bankruptcy jurisdiction. Even secured creditors are put on notice and the exercise of their rights to foreclose on their security might be either constrained or delayed.

In the marine industry, there is an additional factor, being the Federal Court exercising its jurisdiction through the administration of Canadian Maritime Law, which may have an impact on the Monitor's or Trustee's administration of the bankruptcy.

The Admiralty Court

In Canada, both bankruptcy law (which includes corporate reorganizations) and admiralty law are federal law[3]. Bankruptcy law[4] is administered by the Superior Courts exercising bankruptcy jurisdiction in each of the ten provinces and three territories. Admiralty law, however, is a product not only of statute law[5], but all the law that was

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[1] Much of this paper has been drawn from the Answers to a Questionnaire of the Comité Maritime Internationale which was prepared by the Arrest and Sale of Ships Committee of the Canadian Maritime Law Association in 2012 and is available at www.cmla.org. All errors and omissions are my own.

[2] Lord Simon, dissenting, in *The Atlantic Star*, [1973] 2 All E.R. 175 (H.L.), at p. 197 and cited with approval by Binnie, J. in Holt Cargo Systems v ABC Containerline [2001] 3 S.C.R. 907 at p.948

[3] *Constitution Act, 1867*, s.91(21) Bankruptcy and Insolvency and s.91(10) Navigation and Shipping

[4] The expression "bankruptcy law" includes matters governed by the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c.B-3, *Companies' Creditors Arrangement Act*, R.S.C., 1985, c.C-36, and *Winding-up and Restructuring Act*, R.S.C., 1985, c.W-11

[5] Significant statutes concerning maritime matters include *Canada Shipping Act, 2001, S.C.2001, c.26*
Canada Marine Act, S.C., 1998, c 10
Coasting Trade Act, 1992, c 31

administered by the old English Admiralty Courts, the Canadian Vice-Admiralty Courts and the Exchequer Court, as that law has been altered from time to time by the Federal Parliament and developed through subsequent decisions of the Federal Court.[6]

Typical matters that come regularly before the Federal Court as the Admiralty Court are:

- Collisions at sea, groundings and damage to fixed and floating objects;
- Pollution or other environmental damage caused to the marine environment and fishery;
- Death and personal injury caused by or while on a ship;
- Salvage operations and contributions to General Average;
- All nature of claims arising from carriage of goods by sea including Cargo loss or damage claims;
- Ship building, repair and equipping of a ship;
- Goods, services and materials supplied to a ship;
- Disputes arising from charter parties relating to the use, hire and possession of a ship;
- Limitation of Liability for all Maritime Claims by various marine participants;
- Towage, pilotage, transit of seaway or canals, use of port facilities;
- Claims arising from or in connection with marine insurance, including coverage issues;
- Marine Sale, Mortgage, and other security interests in a ship or other marine property and disputes with respect to possession, employment or earnings derived from a ship;
- Seaman's wages, property, benefits;

Federal Courts Act, RSC 1985, c F-7 and Federal Courts Rules of Practice
Marine Liability Act, SC 2001, c 6
Canadian Transportation Accident Investigation and Safety Board Act, S.C.1989, c.3

[6] *Federal Courts Act,* s.2(1) definition : ***Canadian maritime law*** means the law that was administered by the Exchequer Court of Canada on its Admiralty side by virtue of the *Admiralty Act*, chapter A-1 of the Revised Statutes of Canada, 1970, or any other statute, or that would have been so administered if that Court had had, on its Admiralty side, unlimited jurisdiction in relation to maritime and admiralty matters, as that law has been altered by this Act or any other Act of Parliament;

- Ship and other marine property arrest, and Judicial Sale and subsequent adjudication, ranking of creditor claims and distribution of sale proceeds and all other issues arising from a marine insolvency

- Private International Law disputes arising in a maritime matter including recognition and enforcement of foreign judgements and arbitration awards

What has an impact on the administration of any reorganization or liquidation by the Bankruptcy Court is the exercise of the action "in rem" in the Federal Court against ships and other marine property.

The procedure whereby marine property is placed under the jurisdiction of the Federal Court is through service of an action "in rem" and, where necessary, the Warrant of Arrest. Since both the Federal Court and the Superior Courts exercising bankruptcy jurisdiction are administering federal law by federally appointed judges, there are instances of possible conflict, which is the subject of this paper, particularly with respect to which maritime claims constitute "secured claims" and when the assertion of jurisdiction by the Federal Court pre-empts a Superior Court from exercising its jurisdiction in bankruptcy (and, likewise, vice-versa),

The Action "in rem"

Historically, the Admiralty Courts enforced maritime liens which had attached to the vessel by issuing Warrants for the Arrest of the Ship and the Ship owner. If the Ship owner could not be found, or did not voluntarily appear in the action and defend its interests, judgment was given in favour of the claimant and the ship was ordered sold, and the judgment debt was to be paid from the proceeds of sale[7].

The process for obtaining a Warrant of Arrest is relatively simple. The claimant swears an Affidavit to Lead Warrant describing its cause of action, invoking the maritime jurisdiction of the Admiralty Court with reference to provisions of the Federal Courts Act, and states that the claim has been unsatisfied and identifies the property to be arrested by its nationality and port of registry. The Warrant is issued by the Registrar and an authorized person acts as the Marshall and serves the Warrant, Affidavit to Lead Warrant and the Statement of Claim on the Ship.[8] There are no requirements to allege jeopardy or disappearance of assets, if the warrant is not issued, (as is the case with mareva injunctions or seizure before judgments in Quebec) or to post security for the arrest in Canada.[9]

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[7] Compania Naviera Vascongada v Steamship Christina (1938) 19 Asp.M.L.C.159 (H.L.) at 160

[8] Rule 481 of the Federal Courts Rules of Practice (Canada)

[9] There is also a process for arresting ships within the same ownership for causes of action which arise on their "sister-ship"

The Maritime Lien

Traditionally, maritime liens were rights which attached to the ship when the cause of action arose and traveled with the ship through changes in ownership until the lien was extinguished either by payment or by judicial sale. They were recognized in cases involving:

Legal and marshal's custodial costs

Possessory liens

1. Salvage
2. Damage to or by a Ship, whether by collision or allision
3. Seamen's and Master's Wages
4. Bottomry (in desuetude)[10]
5. Master's Disbursements

Statutory basis

During the expansion of commercial activity in the 19th century, the English Parliament expanded the subject matter over which the Admiralty Court could adjudicate by statute thereby expanding the number of liens. However, in case law development, these new liens created by statute did not have the same status nor the same ranking as the traditional maritime liens. They were called "statutory rights in rem" liens which could only be enforced against ships where the ownership of the ship was the same at the time the action was commenced as when the cause of action arose. Once the ship was sold by its owner, the statutory right to proceed against that ship was extinguished. Moreover, the status of "statutory rights in rem" claims was that of "unsecured creditors".

Typical statutory rights in rem claims include:

1. Damage claims – other than damage to or by a Ship
2. Cargo damage or loss claims
3. Claims under a through bill of lading
4. Personal injury
5. Marine insurance
6. Towage, stevedoring
7. Suppliers of goods, services and materials
8. Pilotage claims
9. Claims in general average
10. Ship construction, repair and equipping of a ship

[10] "the pledging of the ship by the master to a lender in a foreign port (away from the home port)"

Marine Mortgage

The ship mortgage, under English law, gives an immediate right of possession to the property, if not ownership, to the mortgagee who can take possession by a simple notice without the necessity of court proceedings. If a mortgagee was to enforce its mortgage in the Admiralty Court, the resulting judicial sale will free the vessel from all liens and encumbrances.[11]

Modern Statutory Maritime Liens

Port authorities and seaway management – s.122 of the Canada Marine Act[12],

The "Ship Supplier's Lien" - section 139 of the Marine Liability Act[13]

As seen above, ship suppliers of services, goods and materials and ship builders, repairers and "equippers" had a statutory right "in rem" to arrest the ship provided ownership of the ship was the same at the time of the commencement of the action as at the time the cause of action arose (e.g. when the debt became due).

In 2001, in order to achieve parity with American ship suppliers which had the benefit of a maritime lien, which was enforceable in Canada, the Federal Parliament enacted legislation to grant a similar maritime lien right to ship suppliers and repairers.

MARITIME LIEN

Definition of *"foreign vessel"*

139. (1) In this section, *"foreign vessel"* has the same meaning as in section 2 of the Canada Shipping Act, 2001.

Maritime lien

(2) A person, carrying on business in Canada, has a maritime lien against a foreign vessel for claims that arise

- (*a*) in respect of goods, materials or services wherever supplied to the foreign vessel for its operation or maintenance, including, without restricting the generality of the foregoing, stevedoring and lighterage; or
- (*b*) out of a contract relating to the repair or equipping of the foreign vessel.

Services requested by owner

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[11] Tetley, William, Maritime Liens and Claims, 2nd Edition, Yvon Blais, 1998, page 474.; see also, s.69 of the *Canada Shipping Act, 2001* – note that the effect of registration is not to validate the mortgage, but rather to establish the priorities among mortgage holders according to time of registration, if the mortgage is registered at all.

[12] S.C. 1998, c.10

[13] *Marine Liability Act*, S.C. 2001, c.6, s.139

> (2.1) Subject to section 251 of the Canada Shipping Act, 2001, for the purposes of paragraph (2)(*a*), with respect to stevedoring or lighterage, the services must have been provided at the request of the owner of the foreign vessel or a person acting on the owner's behalf.

As the statute stipulates, the supplier must carry on business in Canada, although it need not be a Canadian, and the ship must be a foreign vessel, i.e. not Canadian by registry or otherwise. The goods, services and/or supplies must be for "the operation and maintenance of the ship" and must be delivered to the ship. Likewise, repairs or equipment must be performed on the ship. The fact that a supplier or ship builder may have a statutory right in rem under s.22 and s.43 does not automatically mean they qualify for a "maritime lien" under s.139 of the Marine Liability Act.

Moreover, there is a controversy over whether the "maritime lien" attaches to the vessel by virtue of the activity to the vessel or by virtue of the relationship between the ship owner and the supplier. In other words if goods are ordered by the ship operator (a time charterer) who is not authorized to bind the ship, will the supplier's account receivable be protected by the maritime lien?[14]

The second controversy is the scope of the phrase "operation and maintenance of the ship" which usually meant ship parts, equipment, fuel, the crew's groceries, hardware tools and materials and the like. With the advance of container ships which rely on networks of rail and truck transport to bring containerized cargo to and from the ship, the question arises whether these land modes of transport are "necessary" for the operation of a container ship.[15]

Conflicts of law – recognition of foreign maritime liens

Contrary to the position followed by most of the rest of the world[16], Canadian Maritime Law recognizes claims which have the status of maritime liens under the foreign law even for matters which Canadian Maritime Law would not give a maritime

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[14] So far there has only been obiter in the cases, where a relationship between the ship owner and the supplier is required; the effect of this is that many services, such as towage, stevedoring, bunkering, do not benefit from a maritime lien if they are ordered by the ship operator, who is not the owner, of the ship. World Fuel Services Corporation v The Ship "Nordems" et al. 2010 FC 332 at paragraph 15

[15] Argosy Marine Co. v SS "Jeannot D" [1970] Ex.C.R.350 at 355 -"Whatever is fit and proper for the service on which a vessel is engaged, whatever the owner, as a prudent man, would have ordered if present at the time, comes within the meaning of 'necessaries' as applied to those repairs done or things provided for the ship by order of the master, for which the owners are liable" The Riga (1860s) L.R.3 A&E 522. A more modern definition comes from Hawker Industries Ltd. v Santa Maria Shipowning and Trading Company [1979] 1 FC 183 at 189 per Jackett, CJ: "…a contract for the repair of a ship disabled at sea is, and has always been recognized as, a contract for enabling the ship to carry on its navigation operations in the same way as a contract to provide a ship with 'necessaries' has always been so recognized; and, in my view, it is not an over-generalization to say that the doing of what is necessary to enable ships to carry on their navigation operations is something which falls within the field of activity regulated by Admiralty law".

[16] "The Halcyon Isle" [1981] AC221, [1982] 2 Lloyd's Rep.325 which is followed by most jurisdictions – see "The Sea Hawk" 2016 FCAFC 26 (Federal Court of Australia) [2016]2 Lloyd's Rep.639

lien status[17]. In the case involving "The Brussel", various creditors holding US maritime liens as ship suppliers of goods and services filed claims against the proceeds of sale of the ship and were ranked as maritime lien holders over a Belgian Bank holding a marine mortgage. The claims of Canadian suppliers of goods and services, at the time, did not benefit from a maritime lien, but only a statutory right in rem. Consequently, following payment of the balance to the mortgage holder, the Canadian creditors received nothing.

Ship Sale by the Admiralty Court (as opposed to sale by the Superior Courts)

Judicial sales of assets, including a ship, by Superior Court cannot result in the buyer obtaining a better title to the asset than what the judgment debtor had at the time of the sale. However, a judicial sale by an Admiralty Court gives a "title free and clear of all liens and encumbrances"[18] and is the preferred way to transfer title of ships belonging to troubled ship owners, whose title may be suspicious, and sometimes may not even exist. Therefore, a purchaser of a ship at an Admiralty Court sale is assured of obtaining a title, which the former owner never had, and that title is "free and clear of all liens and encumbrances" enforceable against the world.[19]

Admiralty practitioners have often been called upon by the bankruptcy and insolvency Bar in various business reorganizations or amicable company creditors' arrangements to assist in arranging a voluntary judicial sale through the Federal Court for the purpose of eliciting the broadest advertisement of the ship and the grant of a "free and clear" title following a successful bidding process.

Ranking of Maritime Liens, Mortgages and Statutory Rights "in rem"[20]

The Admiralty Court has always exercised an insolvency jurisdiction when liquidating assets belonging to someone. Once the ship was sold and the proceeds were deposited into Court, other maritime lien holders would be given the opportunity to submit their claims which, once adjudicated upon, would be joined in the sharing of the proceeds. If the proceeds were insufficient to pay all the claims submitted, the Court would rank each claim in the order of preference granted by Canadian Maritime Law, the traditional ranking being as follows:

Legal Costs
Marshall's Costs
Possessory Liens

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[17] The Strandhill v Walter W.Hodder Co.[1926] S.C.R.680; Todd Shipyards Corp. v Altema Compania Maritima S.A. [1974] S.C.R.1248; See also "The Brussel" being Holt Cargo Systems v ABC Containerline [2001]3 S.C.R.907 and Re Antwerp Bulkcarriers [2001] 3 S.C.R.951

[18] Rule 490(3) – even accrued Crown rights are extinguished – see Lietz v The Queen [1985] 1 FC 845

[19] There are recorded instances where foreign nations do not recognize the full scope of the "free and clear" representation, particularly when seaman pension dues or corporate taxes are owing. See Canada v The Ship "Galaxias" [1989] 1 FC 375 at 381 Certain states refuse to issue a deletion certificate until all state taxes have been paid – which could be a surprise to an unsuspecting successful bidder at a judicial sale.

[20] Comeau's Sea Foods Ltd. v The Frank and Troy [1971] FC 556 (TD)

Maritime liens – both traditional and modern
Maritime mortgages – both registered and unregistered, legal and equitable
Provincial security interests – all those recognized under the provincial law as granting security and a "secured creditor" status to the holder[21]

The above claims in a bankruptcy context are considered "secured claims" whereas statutory rights in rem claims and non-marine claims are considered to be "unsecured claims".

Lastly, whatever remaining equity is paid to the ship owner or trustee acting on its behalf that remained after all creditors were paid.

Inter-court relations

First Grab rule

While no such rule exists nor has been sanctioned, in effect the first court – be it the Superior Court sitting in Bankruptcy or the Federal Court exercising its admiralty jurisdiction – that is seized with the matter by a creditor (or creditors) takes the lead in adjudicating on the rights of the parties.

In "The Brussel" affair, ABC Containerline operated a container – bulk shipping service world-wide using six ships. As the owners of the business became increasingly insolvent, they abandoned their venture leaving five ships trying to enter into different jurisdictions – Singapore, Hong Kong, Australia, New Zealand and Halifax, Canada with no ability to meet expenses which they were about to incur and to pay current indebtedness[22]. "The Brussel" was arrested on arrival at the Port of Halifax.

The owners assigned themselves into bankruptcy before the courts of Belgium and Trustees were appointed. The Belgian Court ordered all ships to return to the home port, being Antwerp, and issued Letters Requesting Assistance from foreign Courts. The Belgian Trustees sought leave to intervene in the Federal Court proceedings and asked the Court to stay proceedings and order the release of the ship so that it could return to Belgium where all creditors could file their claims. The US lien holders objected, reminding the Court that the Canadian court always recognized and enforced the US maritime lien. The Court refused to stay proceedings, permitted the US creditors to proceed to judgment and granted their request for the sale of the ship.

The Belgian Trustee then sought recognition and the assistance of the Superior Court sitting in Bankruptcy. The Superior Court granted recognition and agreed to

[21] Ballantrae Holdings Inc. v The Ship "Phoenix Sun" 2016 FC570, paragraphs 126 to 145, Justice Harrington recognized that under s.22(3) of the Federal Courts Act, the court's jurisdiction extended to adjudicating any claim against a ship however or under whatever law, federal, provincial, foreign, whether a national or state law and that historically the Admiralty Court's role was to adjudicate all claims against the ship in the exercise of its insolvency jurisdiction in the distribution of proceeds to and among all creditors.

[22] In the end, one ship made it back to the home port of Antwerp. All other ships were sold in the jurisdiction in which they were found and each jurisdiction had its own distribution process among creditors.

provide assistance by directing that all proceeds from the sale of the "Brussel" by the Federal Court be paid to the Belgian Trustee who would be charged with their distribution in accordance with the laws of Belgium.

The "back story" to this drama is that while Canadian law and courts recognized the US maritime lien, Belgian law and courts did not. Therefore, unless the US suppliers were going to suffer the same fate as the Canadian suppliers, watching the sales proceeds being paid over to either the Belgian bank mortgage holder or to the Belgian Trustees, they had to resist the Superior Court's order.

Appeals from the Federal and Provincial Courts were heard by the Supreme Court of Canada.

The Court reiterated its view that foreign maritime liens were recognized by Canadian Maritime Law and that the US creditors were entitled to have their liens recognized and enforced by the Canadian courts. They upheld the Federal Court's decision that there was no jurisdictional barrier against the Court continuing to adjudicate the US creditors' maritime lien claims against the ship. In addition, even though the ship's connection with Canada was tenuous and the connection with Belgium was very strong, this was a feature of international maritime commerce.

With respect to the Bankruptcy Court's purported interference with the exercise of the Federal Court's jurisdiction the Court held:

1. The assertion of jurisdiction by the Canadian Bankruptcy Court did not oust the maritime law jurisdiction of the Federal Court;
2. The bankruptcy court had no power to deal with an asset (the ship) already captured by the competent order of another superior court in Canada (the Federal Court); and
3. In any event, the issuance of what amounted to be an "anti-suit injunction" against the parties before the Federal Court was an improper attempt to restrict that court's ability to exercise its jurisdiction.

Since Canada has two distinct court administrations, a comity among courts has developed whereby the first court that is seized with an action is owed deference by the other court.

The Model Law

Canadian bankruptcy statutes were amended to impose the obligation on the Bankruptcy Court to cooperate with the foreign representative of a foreign bankruptcy court involved in the foreign proceedings and to review and revise any order it has already rendered with respect to the debtor to provide consistency and coherence to the overall administration of the debtor's affairs and property.[23]

[23] *Bankruptcy and Insolvency Act*, s.275 et seq. *Company Creditors' Arrangement Act*, s.52 et seq.

Is it still "a race to the court house" and if so, which court house?

There is significance about which court – the bankruptcy court or the admiralty court – is seized with the action. In the Bankruptcy Court, when the court pronounces its order, the order dates back to the date when the action was filed. The same approach applies in the Admiralty Court; the court is automatically seized with jurisdiction from the moment of the arrest of the ship which relates back to the moment the action was filed.[24] In light of that, it is common for admiralty practitioners to file "in rem" actions against a ship even though the ship is not within the Canadian territory and there is no information as to when it will be returning. At the same time, a wary ship owner who foresees an insolvency developing may consider consulting a trustee about preparing a proposal to its creditors, opening a court file with the Superior Court sitting in Bankruptcy and serving the creditors with a Notice of Intent to make a Proposal to forestall any temptation to arrest the ship!

And the Fun is just starting!

When a ship in financial distress approaches its next port of call, it may have to deal with resistance from pilotage authorities which may refuse to provide a pilot to bring the vessel into berth, tug boat operators who may refuse to assist the ship to safely berth, and a port authority which may refuse to allow the ship to enter into its territorial limits unless payment of its expected operating expenses is guaranteed.

The ship may be fully loaded with cargo to be discharged at the port – if it can get in! Once in, stevedoring and terminal services will have to be secured to unload the ship and store the cargo pending delivery. A terminal may be reluctant to accept cargo, particularly containerized cargo, unless payment of its charges are secured and rail and truck services have been obtained to move the cargo out of the terminal to the next point of transport or to deliver the cargo.

Each bankruptcy has brought its own problems, and solutions were found either among cargo interests who pooled their resources to organize the discharge and delivery of the cargo (or its forced sale disposal for those who refused to participate) and / or the trustee or monitor was able to secure debtor in possession financing.

Meanwhile secured creditors, such as maritime lien holders and mortgagees will secure their interests by arresting the ship and forcing its sale.

Montreal, October 25, 2018

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[24] The Cella (1888) 13 PD 82 at 88, per Lopez, J. "From the moment of the arrest, the ship is held by the court to abide the result of the action, and the rights of parties must be determined by the state of things at the time of the institution of the action, and cannot be altered by anything which takes place subsequently." Cited with approval by Harrington, J. in Ballantrae Holdings Inc. v The Ship "Phoenix Sun" 2016 FC 570 at paragraph 32