WaveLength

JSE Bulletin No. 50
March 2005

CONTENTS

Who Is A Party? – Case of the Non-Signatory .... *Hiroyuki Tezuka* 1

Recent Reforms in Japanese Company Law .... *Yosuke Tanaka* 9

Summary of TOMAC Arbitration
Warranty or Due Diligence to Nominate a
Safe Berth under US Law 18

The Conundrum of the Role and Jurisdiction of U.S.
Bankruptcy Courts in Admiralty Cases .... *Jeremy J.O. Harwood* 21

© The Japan Shipping Exchange, Inc. March 2005, All Rights Reserved.

Published by The Japan Shipping Exchange, Inc.
Wajun Building
Koishikawa 2-22-2
Bunkyo-ku
Tokyo 112-0002
Japan

ISSN 0448-8741

© The Japan Shipping Exchange, Inc. March 2005, All Rights Reserved.

All correspondence should be addressed to:
The Japan Shipping Exchange, Inc.
Tel: +81-3-5802-8361
Fax: +81-3-5802-8371
E-mail: tomac@jseinc.org
Website: www.jseinc.org

Who is a Party? - Case of the non-signatory*

*Hiroyuki Tezuka***

1. Introduction

On March 1, 2004, Japan's new Arbitration Law (Law No. 138 of 2003) (the "Arbitration Law"), came into force and effect.[1] The Arbitration Law, which is based on the UNCITRAL Model Law on International Commercial Arbitration (the "Model Law"), replaces Japan's old arbitration law of 1890 (Law concerning Procedure for General Pressing Notice and Arbitration Procedure, Law No. 29 of 1890, as amended) (the "Old Law"), which was modeled on 19th century German arbitration law and more than 110 years old. Since Japan's Arbitration Law is so new, Japanese court decisions on important issues under the new Arbitration Law have not yet been made. However, court decisions under the Old Law are still important precedents, particularly on those issues for which the Model Law and the Arbitration Law do not have explicit provisions. The issue of "Who is a Party? - Case of the non-signatory" addressed in this paper is a typical example of such issues.

I will discuss the Japanese courts' approach to analyzing this issue, with a focus on (a) assignment and rights of assignor/assignee and (b) third party beneficiary.

2. Assignment and rights of assignor/assignee

(1) Assignment of rights by way of contractual arrangement

Rights and obligations under a contract that has an arbitration clause may be assigned by the assignor to the assignee by way of contract between them. Under the Japanese Civil Code, Art. 466(1) and (2), contractual rights can be assigned to a third party without the consent of the debtor unless (i) the nature of the assigned rights is such that the assignment shall not be permitted, or (ii) such assignment is restricted under the contract. It is generally interpreted that the debtor may not assign its debt to a third party without the consent of the creditor. Thus, the assignment of a party's rights and obligations generally under the contract (i.e., the assignment of the contract, including the rights and

---

* An address to the ICC-SIAC Symposium 18/19 February, 2005, Singapore

** Attorney-at-Law, Nishimura & Partners, Tokyo (e-mail:h_tezuka@jurists.co.jp)

[1] The English version of the Commentary on the new Arbitration Law, authored by members of the government's legislative team, has been recently published (Kondo, Goto, Uchibori, Maeda & Kataoka, *Arbitration Law of Japan* (2004)), and it contains a semi official English translation of the Arbitration Law prepared by a group of notable scholars and practitioners.

obligations arising thereunder) would normally require the consent of the other party, while, on the other hand, the assignment of a pecuniary right that has arisen from the contract (e.g., a monetary claim that has arisen from the contract or a breach thereof) would not normally require the consent of the other party (unless the contract requires the other party's consent to the assignment of rights arising under the contract).

As a practical matter, where there is consent to the assignment, and where the assignee and the other party providing such consent is deemed to have agreed to be bound by the arbitration clause contained in the original contract either explicitly or impliedly, there would be no problem in finding a binding arbitration agreement as between the assignee and the other party. However, disputes may arise where, for example, it is not clear whether there was any such agreement to arbitrate as between the assignee and the other party.

There are a few published court decisions on this issue under the Old Law, some of which are quite dated:

In a fairly old decision, the Tokyo District Court (October 19, 1918, Hyoron, Vol.7, Minso p.394) held that an arbitration clause under a charter party was binding upon the assignee of a claim arising from the charter party.

The Osaka District Court also held, in its similarly old decision (January 29, 1919, Hyoron, Vol.8, Minso p.43), that an arbitration clause under a charter party was binding upon the assignee of the Owner's position by assignment of the vessel, unless there was evidence to rebut such presumption.

On the contrary, there are relatively recent decisions in which the courts held that the assignee of a promissory note was not bound by the arbitration agreement as between the maker and the payee of the promissory note.

The Osaka High Court held in its 1984 decision (May 29, 1984, Hanrei Taimuzu 533-166) that in light of the nature of the rights under the promissory note (i.e., the rights under the promissory note are defined and exist absolutely based upon the language thereon and are entirely separate and independent from the underlying legal relationship between the maker and the payee, so that the assignee of the promissory note may rely solely upon the language of the promissory note), the arbitration agreement between the maker and the payee of the promissory note shall be binding only as between them but not upon the assignee of the promissory note, except where the assignee was aware of such arbitration agreement at the time of the assignment.

In another 1984 decision (May 31, 1984, Kinyu Homu Jijo 1077-35), the Osaka High Court also held that in order for the arbitration agreement between the maker and the payee of a promissory note to be binding upon the assignee of the promissory note by way of endorsement, there must be an agreement by the assignee that the payee's position under the arbitration agreement shall be succeeded by the assignee (indorsee).

These decisions are generally understood as consistent with each other. As one commentator puts it, the Japanese courts take the position that "the effect of the arbitration agreement is, in general, succeeded [by the assignee], but as an exception to this rule, in the case of the assignment of a promissory note by way of endorsement, in light of the [nature of the promissory note, which absolutely and solely depends upon the language and the need to protect the bona-fide assignee], the succession [of the arbitration agreement] shall be denied except where there was a specific agreement on the part of the assignee to such succession."[2]

It should be noted that with regard to the form requirements for an enforceable agreement to arbitrate, Article 13(2) of the new Arbitration Law (unlike the Old Law, but as contemplated in the New York Convention and the UNCITRAL Model Law) requires that the arbitration agreement be in writing. Article 13(2) expressly provides that documents exchanged by fax satisfy the form requirements. Article 13(4) of the Arbitration Law further provides that where an arbitration agreement is made by way of electronic or magnetic records (e.g., e-mails), it is made in writing.

Technically speaking, it may be possible that where the assignee and the other party have impliedly agreed to be bound by the arbitration clause in the original contract, there may be no written agreement directly signed by the assignee. However, so long as (i) there is a written arbitration agreement between the assignor and the other party and (ii) the assignee and the other party have, at least impliedly, agreed to be bound by such written arbitration agreement, the new Arbitration Law's requirement for a written arbitration agreement would be satisfied.

(2) Assignment by way of subrogation

Rights under a contract that contains an arbitration clause may be assigned to a third party by way of subrogation as opposed to a contractual assignment. A typical example is the insurer's subrogation of the insured's rights under a contract with the other party. Where the insurer has paid the insurance money to the insured for the damages suffered by the insured arising from a breach of a contract by the other party to the contract, the insured's claim for such damages under the contract would be assigned to the insurer by way of subrogation. The transfer of rights by way of subrogation is considered a transfer by operation of law, and it is generally interpreted that the consent of the obligor (i.e., the other party in the above-mentioned example) is not required.

It is generally interpreted that the arbitration clause under the contract is binding upon the subrogating claimant and the obligor. For example, the Tokyo District Court held in

---

[2] *See,* Yukio Kaise, "The Scope of the Effect of Arbitration Agreement—Mainly on Subjective Scope", p. 140, *Issues of Modern Arbitration Law, by Matsuura & Aoyama* (in Japanese).

its 1998 decision (August 27, 1998, Case No. Heisei 9, (wa) 22375) that the arbitration clause under the Bill of Lading is binding as between the subrogating claimant and the obligor of the Bill of Lading. The court dismissed the claim filed by the subrogating claimant with the court, stating that, according to the arbitration clause in the Bill of Lading, all the disputes arising from the Bill of Lading shall be resolved through the Maritime Arbitration Tribunal. It is the established practice in the TOMAC (Tokyo Maritime Arbitration Commission) arbitration for the insurer to prosecute the subrogation claim in arbitration based upon the arbitration clause in the bill of lading, etc., rather than bringing suit in court.

In one arbitration case before the JCAA (Japan Commercial Arbitration Association) tribunal in 1999, the insurer initiated an arbitration against a Japanese respondent for a subrogation claim under the Taiwanese Insurance Law. The respondent objected to the arbitration on the ground that the contract between the respondent (a Japanese consulting firm who designed a plant) and the insured (a Taiwanese company whose plant was destroyed by a fire that allegedly arose due to a design defect of the plant) had a contractual clause prohibiting the transfer or assignment of any rights or obligations under the contract. The tribunal rejected this objection and ordered the continuation of the arbitration, holding that the transfer of rights under the Taiwanese Insurance Law took place by operation of law, and therefore was not subject to the contractual restriction on the transfer of contractual rights.

3. Third Party Beneficiary

(1) Ringling Circus Case

The issue as to whether and to what extent the arbitration agreement entered into by a company may extend to the directors, officers and employees, etc., of the company is often discussed in the U.S. in the context of the contractual theory related to "third party beneficiary". The concept of third party beneficiary under Japanese contract law is probably different from that under common law, and the above-mentioned issue has been analyzed by Japanese courts without referring to the third party beneficiary concept under Japanese contract law.

In 1997, the Supreme Court of Japan rendered a judgment on the issue of whether the arbitration agreement made between a company and the other party shall also be binding upon a representative of the company (*Ringling Circus Case*, September 4, 1997, Minshu 51-8-3657). This Supreme Court decision is one of the most well known Japanese court decisions on international arbitration agreements.

In that case, there was an arbitration clause in the contract between a Japanese company (Company J) and an American circus company (Company A) for the latter's

performing circuses in Japan, which stated that "disputes including those on interpretation or application of this contract shall be referred to arbitration … in accordance with the Rules of the International Chamber of Commerce on Commercial Arbitration. Arbitration initiated by Company A shall all be conducted in Tokyo, and arbitration initiated by Company J shall all be conducted in New York, NY."

Disputes arose where Company J was unsatisfied with the allegedly poor performance by Company A in the second year. Instead of requesting arbitration in New York against Company A for breach of contract, Company J filed a lawsuit in Tokyo District Court against an individual "R", who was a company representative of Company A. In that lawsuit, Company J asserted that the company representative R committed a fraud in the process of negotiating and executing the circus contract between Company A and Company J. Specifically, Company J alleged that R defrauded it by stating that Company A would provide circus performances of the highest quality while R allegedly knew that Company A intended to cut corners in the second year.

R raised as a defense the arbitration clause, alleging that the arbitration clause in the contract between Company J and Company A also applied to R, and asked for the dismissal of the lawsuit.[3] The Supreme Court upheld the lower court's dismissal of the lawsuit for the following reasons:

With respect to the issue of the governing law of the arbitration agreement, the Supreme Court held that in light of the fundamental nature of arbitration, i.e., dispute resolution procedure based upon the parties' agreement, the creation and effect of an arbitration agreement in international arbitration shall be determined under Article 7(1) of the *Horei* (Japanese statutory conflict of laws rules) [which provides that the governing law of a contract is determined by agreement of the parties, if any, and absent such agreement, by the place of making of the contract], and primarily in accordance with the parties' intention. The Supreme Court said that even where the arbitration agreement did not explicitly refer to its governing law, where an implied agreement on the governing law can be found in light of the parties' agreement on the place of arbitration, the main contract and other related facts, such governing law must be applied. In the present case, the Supreme Court held that the arbitration clause as mentioned above suggested that with regard to arbitration to be initiated by Company J, there was an implied agreement that the law applied in New York, the agreed place of such arbitration, shall be the governing law of the arbitration.

The Supreme Court further held that the arbitration law applicable to arbitration

---

[3] Model Law, Article 8(1) provides that the court "shall refer the parties to arbitration" where an action is brought in court despite the existence of a binding arbitration agreement and where a party so requests. Under the Arbitration Law, Article 14 (1), the court would simply dismiss the action, rather than referring the parties to arbitration.

initiated by Company J, the place of which shall be New York, shall be the U.S. Federal Arbitration Act, and in light of that law as well as the interpretation of the objective and subjective scope of arbitration agreements shown by U.S. federal court precedents related to that law, it shall be appropriate to interpret the scope of the arbitration agreement in the present case to include Company J's damages claim against R. Finally, the Supreme Court held that since the scope of the disputes that shall be referred to arbitration initiated by one party and the scope of the disputes for which the other party filed a lawsuit and to which the opposing party can raise as a defense the arbitration clause shall be identical, R's arbitration clause defense shall be sustained, and the action before the court dismissed.

It is interesting to note that the Supreme Court rejected Company J's argument that the issue of the subjective scope of the arbitration agreement for the purpose of determining if there is a valid defense of arbitration agreement shall be governed by Japanese law, which is the procedural law of the forum of the present lawsuit. The Supreme Court did not indicate its view as to whether under Japanese arbitration law the scope of arbitration agreement entered into by a company may extend to the individual representative.

However, it appears that the argument that under Japanese arbitration law, the scope of the arbitration agreement entered into by a company shall extend to individual representatives of the company, where permitting a court action against the individual representative could undermine the spirit of the arbitration agreement to resolve all the disputes arising in connection with the contract, is gaining increasing support in Japan.

There is also at least one relatively recent lower court decision holding that the arbitration clause in the contract entered into by a company shall extend to individuals closely associated with the company (Nagoya District Court, October 27, 1995, Kaijiho Kenkyu 150-33).

In that case, a Japanese company X entered into a distributor agreement with a UK distributor company Y, which later failed to pay the purchase price of the goods. The arbitration clause under the distributor agreement provided that "any and all disputes, controversies, and differences in views between the Parties arising from or in connection with this Agreement or the breach thereof shall be finally resolved in accordance with the Conciliation and Arbitration Rules of the ICC and by the panel of three arbitrators appointed in accordance with the said Rules. Arbitration shall be conducted in England, if [X] files the request for arbitration, and in Japan, if [Y] files the request for arbitration." Instead of initiating arbitration in England, the Japanese company X filed a lawsuit against company Y as well as two of its directors (director A, who was also president of company Y, and director B). X's claims against the individual defendants A and B were based upon alleged fraud on the part of those individuals, who allegedly acted on behalf of company Y to induce company X to enter into the contract, while knowing that

company Y had no intention of paying the purchase price from the beginning. X named Y as co-defendant, alleging that Y shall also be liable for such fraud. Defendant Y and Defendants A and B raised as a defense the arbitration agreement. In connection with Y's arbitration agreement defense, X argued that the products in question were not covered by the distribution agreement in which the arbitration agreement was contained, which argument was flatly rejected by the court. With regard to X's court action against the individual defendants A and B, the Nagoya District Court held that although defendants A and B were not party to the distributor agreement, X's claims against Y, A and B are technically based upon the same alleged fraud, and it is desirable to resolve those disputes in a unified manner. The court further held that since the substance of the disputes was X's claim for the unpaid purchase price against Y, the same dispute resolution mechanism applicable with respect to Y shall apply to A and B, and that therefore, under the rule of reason (*jori*), both defendants A and B shall be bound by the arbitration agreement.

(2) Guarantor

It has been held that an arbitration agreement entered into by the principal debtor shall not extend to the guarantor (Kobe District Court, September 30, 1957, Kaminshu 8-9-1843). Commentators argue, however, that there may be circumstances where the guarantor shall be bound by the arbitration agreement entered into by the principal debtor. For example, where the principal debtor is a closely held corporation that is an alter ego of its owner, who has signed a guarantee, the owner may be bound by the arbitration agreement entered into by the corporation because of the piercing of the corporate veil, or by application of the general duty of good faith.

4. Other categories

(1) Group of Companies

The "Group of Companies" doctrine, where applicable, would extend the effect of an arbitration agreement entered into by one company to other companies in the same group. According to a recent article by John Leadley & Liz Williams, "Peterson Farms: There is no Group of Companies Doctrine in English Law"[4], this doctrine appears to have been first publicly formulated in an interim award in an ICC arbitration case, *Dow Chemical -v- Isover Saint Gobain*[5], followed by a number of tribunals in ICC arbitration cases. The authors, however, point out that although this doctrine was accepted by the French courts

[4] http://www.bakernet.com/NR/rdonlyres/ewutekqyrdhhe3dhw7gehhbqiixiel5q32dxr5tcl3m5yxcwt2sne2ugrsxt6zzxliq6ydlwogatyf/peterson+farms.pdf

[5] ICC Interim Award of September 23 of 1982 in No. 4131.

in *KIS France SA -v- SA Société Générale (France)*[6], it was rejected by the English courts in *Caparo Group Ltd -v- Fagor Arrastate Sociedad Cooperative*[7]. It appears that the English courts take the position that where an arbitration agreement is governed by English law, the Group of Companies doctrine, which has been developed in ICC arbitration, and which several ICC tribunals have apparently considered to be a part of ICC "case law", shall not apply. However, the English courts may still extend the arbitration agreement to other companies in the same group under certain circumstances based upon agency theory or other theories applicable under English law.

In Japan, there has been no published court decision dealing with the Group of Companies doctrine. It appears that the Japanese courts will likely rely on other theories, such as implied agreement, agency, piercing the corporate veil and general duty of good faith, in extending the effect of an arbitration agreement entered into by one company to other companies in the same group.

(2) Bankruptcy Trustee

There are debates among commentators as to whether and to what extent a trustee in bankruptcy shall be bound by the arbitration agreement entered into by the bankrupt debtor. Some argue that the bankruptcy trustee shall always be bound by the arbitration agreement entered into by the debtor prior to the adjudication of the bankruptcy. Others argue that the trustee may elect whether or not the bankruptcy estate shall be bound by the arbitration agreement. A more recent view is that depending upon the nature of the dispute, the trustee may or may not be bound by the arbitration agreement (e.g., disputes concerning the assets that belong to the estate will be subject to the arbitration agreement, while voidance and the determination of the objected claim will not be subject to arbitration).

---

[6] Cour d'Appel, Paris, 31 October 1989.

[7] Commercial Court, Queen's Bench Division, 7 August 1998.

Recent Reforms in Japanese Company Law

Yosuke Tanaka[*]

1. Introduction

For the past 10 years, Japanese Company Law has been amended in many aspects. It is, on the one hand, because we have been faced with rapid change in the financial aspect in Japanese companies, from the long-term depression to the recent recovering situation. On the other hand, the reform has been promoted by the understanding among lawmakers that Company Law had to response to such changes in the society and the market and the requests from the businessmen who had to deal with such difficult situation.

Most of the lawyers, academics and businessmen in Japan have welcomed the reform in Company Law, however, some academics complained that the basic principles in Company Law can not be understood easily after many words and clauses in the law were changed.

This report is intended to summary the recent reform in Japanese Company Law and to introduce it to foreigners for their reference, with hopes that we can obtain some constructive opinions from them to help the proper enforcement of the new Japanese Company Law in Japan.

In the next chapter, the main aspect in the recent reform is described chronologically, and the latest amendment which is now discussed in the Diet is also summarized after the next, for all of which some comments are made in the last chapter.

2. Summary in the recent reform

(1) Amendment in 1997

(a) In this amendment, the system of "**Stock Option**" was introduced for the first time into Japanese Company Law.

This system is understood to give the directors and employees the preferential right to subscribe for new shares of the company in order to give them incentives for their business activity in the company. The price for the directors and employees to obtain the shares from the company can be fixed at the certain price beforehand irrespective of the actual market price at the time when they resort to their right for shares. Therefore, the better the company achieves, the more the directors and employees can get the profit between the fixed price and the increased market price of the shares. This system was

---

* Attorney-at-Law, L&J Law Office, LPC, Tokyo, LL.M. at University College London (e-mail: y.tanaka@shiplaw.jp)

amended some times after this amendment and it is now provided that the option to be given to directors and employees is the right to subscribe for new shares as the same right is given to the holders of bonds with warrants.

(b) The procedure for merging another company was simplified in this amendment.

With respect to the **amalgamation procedure**, Japanese Company Law provides for the “merger” and the “consolidation” procedures. In the former procedure, one company is merged into another and its entity does not exist afterwards. In the latter procedure, two companies agree to establish a new company together and the legal entities of both companies extinguished. In each procedure, the companies concerned had to report the amalgamation to the Fair Trade Commission and it took a long time to complete the procedure in the Commission. In this amendment, the procedure was changed to take shorter time, and the simple procedure in which the report to the Commission is not needed was introduced.

(2) Amendment in 1999

The methods of **Exchange of Shares** and **Transfer of Shares** were introduced for affiliation of companies in this amendment.

Both methods are intended to be used when companies want to make their relationship in which one company becomes another company’s wholly owned subsidiary. For example, in Exchange of Shares, a company “A” which wants to become subsidiary owned by another company “B” exchanges all of their shares with shares of “B”, which results that “B” holds all of shares of “A”. On the other hand, in Transfer of Shares, a company “A” establishes another company “B” and transfer all of their shares to “B”, which results that newly-established company “B” holds 100% of shares of “A”. The effect of these methods is similar to the situation in which “B” merges “A”, however, the difference is that a company “A” still remains after Exchange of Shares and Transfer of Shares.

(3) Amendment in 2001

(a) In this amendment, Japanese stock company is permitted to obtain their **own shares**.

Before this amendment, companies can obtain their own shares only in a limited situation in which some requirements with respect to the purpose, the amount and the period for holding their own shares are satisfied. In this amendment, these conditions for obtaining own shares were abolished.

(b) The rule for the **unit of shares** in the company was also changed in this amendment.

Before this amendment, the law required all of stock companies to have the unit of shares so that each unit represents more than 50,000 yen in the company’s asset and such unit can accompany the right to vote in shareholder’s meeting. After this amendment, this

kind of mandatory rule was abolished and companies can decide the amount of shares as one unit which has the right to vote voluntarily in their article of association.

(c) The system of **par-value stock** was also abolished in this amendment.

Before this amendment, Japanese company law has par-value stock and no-par-value stock. If the company issued such par-value stock, it had the effect that the price for subscription of such stock can not be less than the value described on the face. However, the value had remained at very low price, for example, 50 yen or so, and such meaning of the least price of the stock was inconvenient for companies. Considering these inconvenience and uselessness, the system of par-value stock was abolished. Japanese Company Law had the system of bearer stock, in which the name of the holder was not shown, however, it had not been used by many companies, so such system was also abolished in 1990. Therefore, Japanese Law currently has the system of par-value and named stock with respect to the description on the face of stock.

(d) The procedure of **issuing new shares** in the "Closed Company" was also changed in this amendment.

Under Japanese Law, stock companies which do not want their shares to be freely transferred in the market can make the rule in the Article of Incorporation that the shares can be transferred only by approval of the board of directors. These stock companies are sometimes called as "Closed Company" or "Limited-Transferable-Stock Company". On the other hand, listed companies or other companies which do not have such rule for limiting transfer of shares are sometimes called as "Open Company".

In both of "Closed Company" and "Open Company", the number of shares which can be issued at the time of incorporation should be 1/4 (one forth) or more than the total number of shares as the authorized capital as provided for in the Article of Incorporation. In other words, companies can decide the total number of their authorized shares to be issued in the future should be at most 4 times of the numbers of shares which can be issued at the time of incorporation. However, "Closed Company" was permitted in this amendment to issue less than 1/4 of the authorized capital, which means that the small venture company, for example, can issue their shares more than 4 times of the shares which they can issue at the time of incorporation as they expand their business after incorporation.

With respect to issuing shares to the third party other than shareholders, Japanese law has required companies to make special resolution in the shareholders' meeting if the price of shares to the third party is specially low or favorable for the third party. However, after this amendment, companies can regard such special resolution to be effective for one year after the resolution in the shareholders' meeting and issue their shares to the third party only by the resolution in the board of directors within the year and the amount resolved by the shareholders' meeting.

(e) New **classes of shares** were introduced into Japanese Company Law in this amendment.

One of such new classes is a class of share which can not accompany the right to vote in the shareholders' meeting or can be limited in respect of the vote. Before this amendment, the limit to the vote could be justified by preferred allotment of the profit to such certain class of shares, however, this amendment enabled companies to make such limit to the vote freely irrespective of the allotment of profit.

Another is a class of share which is issued under the terms of compulsory conversion of classes, which means that the share is compulsorily converted into another class of shares in a certain situation as provided for beforehand.

(f) Some category of documents was permitted to be made in the **electronic form**, using the computer system.

(g) The power of **auditors** was strengthen in this amendment. Under Japanese Law, stock companies had to have three "organs" as their basic internal parts, namely, shareholders' meeting, board of directors and auditors. The shareholders' meeting is the highest body to decide the fundamental matters in the company, however, the management of the company is regarded to be assigned to the board of directors, who are to be appointed by the shareholders' meeting. The auditors are also appointed by the shareholders' meeting and assigned the audit of the company and monitoring the management of the company by directors.

In this amendment, the term of office for auditors was made longer to be 4 years. The "Board of Auditors" in "Large Company", which amount of the capital is more than 500 million yen or which amount of the liability in the latest balance sheet is more than 20 billion yen, was also required to consist of majority of "Outside Auditors", who can be regarded to be independent persons to the company, for example, who have never been employed by the company.

(h) With respect to "**Representative Action**" (derivative lawsuit), in which shareholders claim against directors for damages to the company, the companies were permitted to take part in the litigation procedure to assist the directors. It was also permitted for claimants (shareholders) and defendants (directors) to make compromised settlement in the court procedure, even if all of shareholders had not taken part in the procedure.

(4) Amendment in 2002

(a) In this amendment, the constitution of **organization for management** or the **corporate governance** in the company was fundamentally changed.

Before this amendment, management of the company is mainly decided by the board of directors and the shareholders' meeting decides a few fundamental matters as provided for in the law and the Articles of Incorporation. Therefore, a lot of matters should be

decided in the board of directors which had been composed by many directors, which had caused the delay of decision making in the Japanese companies.

Considering these bad influence, this amendment allowed the Japanese stock company to appoint the "**Executive Officer**" and assign to them to decide some matters which had been required to be decided in the board of directors before. On the other hand, if the company wants to establish the system of the "Executive Officer", the company is required to hold 3 **committees**, namely, the nomination committee, the remuneration committee and the audit committee and those 3 committees should consist of the majority of the "Outside Directors". If the company holds these committees, it does not need to appoint the auditor. The company which selects this new formation is sometimes called as "Company Maintaining Committees" and the company which selects the former organization is sometimes called as "Company Maintaining Auditor".

(b) Some changes were made to the system of **shares** in this amendment.

"Closed Company" was permitted to establish the rule in which holders of certain class of shares can appoint or dismiss directors or auditors. The system to invalidate shares was introduced for shareholders who lost their shares. The system for the company to sell shares which had been owned by some persons but the company had not been able to contact them for more than 5 years.

(c) Some procedures in the **shareholders' meeting** were changed.

The quorum for the special resolution in the shareholders' meeting was decreased to 1/3 (one third). The shareholders who exercise their proposal right to the shareholders' meeting have to notice their proposals to the company 8 weeks before the date of the meeting.

(d) **Combined financial statement** was introduced as the system in Company Law.

(5) Amendment in 2003

(a) In this amendment, companies was permitted to **purchase their own shares** only by the resolution of the board of directors.

(b) The value of the claim in **Representative Action** was newly defined as 1,600,000 yen and the court fees for the action was changed to be 13,000 yen.

(6) Amendment in 2004

(a) In this amendment, the company can use **the Internet for their public notice**. Before this amendment, Japanese companies had to make their public notice of their final financial statement or other documents in the newspapers or the public gazette.

(b) This amendment also allowed companies to select not to issue the **certificate of shares**. Before this amendment, Japanese companies can only select not to issue the certificate when each shareholder voluntarily agrees not to hold the certificate. However,

after this amendment, companies can select not to issue the certificate from the time of its incorporation by the provision in the Article of Incorporation.

(c) Before this amendment, Japanese stock companies had two **methods to confirm the shareholders** who have the right to vote in the shareholders' meeting. One is that the company could close the list of shareholders for a certain period and it can reject to change the shareholders in the list during such period. Another is that the company could decide particular date on which companies could confirm their shareholders and give the notice of the meeting only to them. This amendment abolished the former method and the company can use the latter one under the current law.

3. Summary in the latest amendment

(1) After reforms as described above, further amendment is now discussed in the Diet. It is expected that the proposal for further amendment as described below is to be approved in the Diet this year and come to effect in the next year. The main aspect in this new amendment is as follows.

(2) In the current law, there are two **formations of companies** in which the members or investors want to obtain the benefit of the limited liability against the creditors, namely, the stock company and "Limited Liability Company". The stock company is equivalent to the company limited by shares. On the other hand, "Limited Liability Company" is designed to be used by the small number of investors, i.e., 50 persons or less.

In the new amendment, it is proposed that "Limited Liability Company" should be abolished and the form of the company for limited liability should be unified to be the stock company.

(3) In the current law, the **minimum of capital amount** is provided for, namely, 10,000,000 yen for the stock company and 3,000,000 yen for "Limited Liability Company".

In the new amendment, the abolishment of this requirement is proposed.

(4) It is also proposed that the **organization for management and governance** in the company should be more flexible in the new amendment. According to the proposal, companies can decide their inside organization as they wish subject to the certain rules. Stock companies are allowed to hold directors, the board of directors, auditors, the board of auditors, "Financial Advisory" (newly introduced) and committees etc as far as the following rules are complied

(i) All stock companies should have shareholders' meeting and directors.

(ii) If the stock company holds the board of directors, the company should hold auditors or the 3 committees as described in the above "2(4)(a)". Notwithstanding this rule, "Closed Company" which is not "Large Company" can select "Financial Advisory" instead of auditors and committees.

(iii) Sock companies which are not "Closed Company" should have the board of directors.
(iv) Auditors (or the board of auditors) and the 3 committees can not be held in one company at the same time.
(v) If the company does not have the board of directors, the company can not have the board of auditors and the 3 committees.
(vi) The company needs to have auditors (or the board of auditors) or the 3 committees to establish "Independent Auditors", which is provided for in the current law to be assigned the external auditing of the financial statement and is required to be qualified accountants.
(vii) If the company does not establish "Independent Auditors", the company can not establish the 3 committees.
(viii) "Large Company" needs to establish "Independent Auditors".

(5) The procedure in the **shareholders' meeting** is also proposed to be simplified.

It is proposed that the shareholders' meeting can decide more matters than under the current law in the company which does not have the borad of directors. The method to vote in the meeting using emails is also proposed for all kinds of companies.

(6) Some matters relating to the **directors** or the **board of directors** are also proposed to be changed as follows.

(i) The term of office for the directors is now provided to be less two years or shorter, however, it should be one year, provided that "Closed Company" should be able to decide the term to be 10 years at longest.
(ii) The quorum for the resolution to appoint or dismiss directors in the shareholders' meeting should be more than 1/3 (one third), however, directors should be appointed or dismissed by the ordinary resolution (majority votes).
(iii) The "Internal Control System", which is introduced in the amendment in 2002 to serve the corporate governance, should be decided in the board of directors in companies and "Large Company" is obliged to decide it.
(iv) Directors should be allowed to vote by submitting the paper or fax without attending the board of directors.
(v) The nature of liability of directors to the company should be unified to be based on their negligence. Under the current law, some categories of their liability are understood to be strict liability.

(7) Some matters relating to the **auditors** are also proposed to be changed as follows.

(i) In "Closed Company", except those which have the board of auditors or Independent Auditor, the power of the auditors can be limited to auditing the financial matters.

Under Japanese Law, the power of auditors have been understood that they have

the power to audit both of the financial matters and those relating to the business in principle. With respect to auditing the business maters, the auditors have been assigned to monitor the business conducted by directors and advice them if their activity may violate some laws. However, in "Closed Company" as relatively small companies, auditors should not be required to audit business matters in addition to the financial matters.

(ii) In the companies which do not have the auditors who have the right to audit the business matters nor the audit committees, shareholders should have the right to audit the business matters directly.

(iii) "Financial Advisory" should be introduced to be assigned the financial matters including booking or making some statements. "Financial Advisory" should have the qualification as the accountant or tax accountant.

(8) Some matters relating to the **shares** are proposed to be changed as follows.

(i) Companies should have the right to decide the system of share more widely. For example, Companies should be able to put the limitation of transferability only to certain class of shares.

(ii) Companies should have the option to sell their own shares in the market.

(iii) The procedure to issue new shares should be more simplified. The way to invest for subscribing new shares some properties other than money, including loans should be more simple than under the current law.

(iv) Certificates of shares should be issued only when companies provides to issue them in Articles of Incorporation.

(9) A **new formation of company** is proposed to be introduced into Japanese Law.

This new formation is intended to be equivalent to "Limited Liability Company" in US Law or "Limited Liability Partnership" in UK Law. It is expected that the investors can design organization of directors or meeting of members as they like and they can enjoy the benefit in the limited liability at the same time.

4. Comments

(1) After summarizing the recent reforms in Japanese Company Law, it can be said that these reforms have been intended to give benefits or convenience to companies. This intention can be justified when we take into our account the recent circumstances around Japanese companies, including long-term depression. In such circumstances, companies have to contemplate their reforms in their organization. The system of Exchange of Shares and Transfer of Shares was, for example, introduced to provide companies with easy ways for consolidation of companies for their re-organization.

(2) It has been complained for a long time that the decision making in Japanese companies tend to be delayed because a lot of matters were provided for by laws to be

decided in the board of directors and it had taken time to convene the board and make the resolution for a lot of matters. The new formation of companies as “Company Maintaining Committee” was introduced to make their decision making faster by assigning many matters, including issuing new shares to a few “Executive Officers”.

(3) However, it should be noted that the owner of the company is, as the principle in Japanese Company Law, shareholders, not directors or officers.

Moreover, Japanese companies have started to release to the market shares which they had retained mutually in order to maintain good relationship between each other. In this situation, each company has to think much of each shareholder.

In this meaning, we should make great account of the right of shareholders in Japanese companies when the new rule is to be enforced.

Summary of TOMAC Arbitration

Warranty or due diligence to nominate a safe berth

Claimants: Disponent Owners (Japan)
Respondents: Voyage Charterers (Japan)
Tokyo, June 5, 2003

Under the voyage charter party on the Baltimore Form C (hereinafter referred to "the Charter") dated 8 February, 1993, between the disponent owners, Claimants, and the voyage charterers, Respondents, for the carriage of soybean from U.S. Gulf to Japan, the Vessel was discovered to be aground during loading of the cargo.

Facts and Discussions

Claimants stated as follows:

The Charter provided that the Vessel … proceed to one or two safe berth(s), one safe port, U.S. Gulf excluding Brownsvill Mississippi River port … and there load, always safely afloat, … a full and complete cargo … of Heavy Grain and/or Soybeans and/or Sorghums in bulk, 52,000 tons of 2,240 lbs. 5 % more or less at Owners' option.

In accordance with the Charter, the Respondents nominated the loading berth Mobil port, Alabama State Docks Grain Elevator, River D berth (hereinafter referred to as "the Berth") on 23 February, 1993, while the Claimants notified the Respondents cargo amount to be loaded as 54,600 metric tons.

The Vessel arrived at the Berth at 10.18 am. on 6 March, 1993 and commenced loading of soybean at 2.00 p.m. on the same day. Around 9.00 a.m. on 9 March before completion of loading, the Vessel was aground the bottom of the Berth and stopped loading.

As the administrator of the Berth notified the Vessel that it would arrest her for fear of damage owing to her occupation of the Berth, the Claimants delivered to the administrator a letter of indemnity issued by their P and I Club and avoided such arrest. As a result, the Vessel was towed by tugboats and commenced the voyage to Japan leaving further 1,310.419 metric tons of cargo on 19 March, 1993.

The Vessel suffered damage to her bottom shell plating in way of number 1 double bottom tank as a result of her grounding. The Respondents were against their obligation to nominate a safe berth.

The provision concerning safe port and berth means that the charterers who nominates

a port and berth are held to warrant that the particular vessel can proceed to the port and berth without being subjected to the risk of physical damage. The charterers are not relieved of responsibility for the consequences of their breach.

The Claimants got to the amicable settlement with the original owners and the head charterers during the arbitration commenced by the original owners in London. The Claimants proposed to the Respondents to join the negotiation for such amicable settlement, but they rejected the Claimants' proposal. The Claimants suffered damage, i,e. dead freight, hire lost by staying at the loading port, repairing cost, and so on. Then the Claimants applied for an arbitration to TOMAC claiming that the Respondents should pay to the Claimants Yen49,794,214 and interest thereon on the ground of the breach of safe port warranty by the Respondents.

<u>Respondents stated as follows:</u>

As the Vessel was not aground, but merely resting on soft silt or mud at the Berth, the Mobil Port was a safe port. Even if the Berth had not been safe, the Claimants and the Master were negligent as follows:

(1) He did not refuse her berthing;

(2) He did not sound the depth of water;

(3) The Vessel did not depart earlier from the Berth.

The governing law of this Charter shall be United States law. The safe berth provision imposes upon the charterer the obligation to exercise due diligence to select a safe berth. It does not make a charterer warrantor of safety of a berth, namely, does not impose absolute liability on the charterer.

The Respondents made due diligence concerning the voyage to Mobil. It is normal practice for the Master to take routine soundings and slacken his ship's lines, as necessary during the course of loading. Although the Claimants and the Master of the Vessel were informed that the depth of water of the Berth was 40 feet with silt of soft mud, they did not take care to avoid the accident. Accordingly, it is the Claimants' fault and the Respondents are not liable for any alleged damage.

Decision and Reasoning

1. Was the Vessel aground the Berth?

According to the documentary evidence, the Vessel was aground the river bottom alongside the Berth and was heavily scraped to bare metal.

As the Charter provides that the Vessel shall proceed to "one or two safe berth(s), one safe port, … always safely afloat …", the Vessel shall be always afloat irrespective of the nature of the bottom of the river. Accordingly, it cannot be said that the Berth was a safe one.

2. Warranty or due diligence

The parties agreed that the disputes shall be decided in accordance with United States law.

The clause concerning nomination of a loading port and berth provides that the Charterers shall nominate them within the wide range of ports. According to U.S. law, it is generally accepted that if the charter names the loading ports and the owners can gather information on such ports, the safe port warranty will have been waived. However, where the charterers nominate a particular port within the wide range of ports, they are held to warrant to nominate a safe port.

The Respondents stated that the charterer's obligation to nominate a safe port and berth is not a warranty but due diligence, citing the judgment, Orduna v. Zen-Noh Grain, 913 F.2d 1149,(5th Cir. 1990). In this case, a steel loading arm fell from a grain elevator on the Mississippi river onto the deck of the vessel which was loading cargo in the berth below. This incident damaged the ship and delayed its departure. The shipowner sued its voyage charterer, the owner and operator of the grain elevator and others. The 5th Circuit held that a charter party's safe berth clause did not make a charterer the warrantor of the safety of a berth. Instead, it held, the safe berth clause imposed upon the charterer a duty of due diligence to select a safe berth. The Court said that such a warranty could discourage the master on the scene from using his best judgment in determining the safety of the berth. However, it is doubtful for the master to have avoided such accident with his good navigation and seamanship.

As this judgment is an exceptional one in the United States and it has not been found that the parties agreed to adopt such exceptional decision, the Tribunal considers that it should follow the majority of judgments.

3. Whether there was intervening negligence of the Claimants causing the damage.

Needless to say, the master who notices that the port is not safe, he is not imposed to enter it. However, if he enters such port without protest, the owners cannot argue charterers' warranty. If the master arrived at the berth knowing the risk of accident, he would be held waived his right to object when damage did occur.

Since it is not proved that the Master should have deemed the Berth unsafe before berthing, the Tribunal does not hold the Claimants should have rejected to enter the Berth.

When the charterers warrant the safety of the port, the master should depend upon the charterer's information. The Tribunal could not find any negligence of the Claimants and the Master which broke the chain or causation between the breach of warranty and the damage. Therefore, the Respondents are liable.

The Claimants are awarded Yen34,437,312 with interest.

TOMAC Arbitrators: Takakuni Miyake, Koji Tsubaki and Tsuyoshi Hayasaka

The Conundrum of the Role and Jurisdiction of U.S. Bankruptcy Courts in Admiralty Cases*

Jeremy J.O. Harwood **

A leading American admiralty judge wrote twenty years ago:

> . . . "the single most vexing current problem in United States admiralty and bankruptcy law: [is] the interaction between admiralty and bankruptcy jurisdiction." "Current Developments In The American Law of Maritime Liens And Mortgages," ("Current Developments") 9 Mar. Law. 1, 12 (1984) Charles S. Haight, Jr., U.S.D.J. Id. at 12.

That remains true today. We have seen that "interaction" in many recent voluntary and involuntary bankruptcy cases of shipowning and operating companies, such as Royal Olympic Cruises in 2003, Millenium Seacarriers 2002, American Classic Cruises, New Commodore Lines, Regency Cruises, Lykes Lines, etc. in the Nineties and earlier. Complex principles of admiralty law, usually decided by a District Court with familiarity with admiralty law, are by virtue of the U.S. legal system and court structure remitted upon a bankruptcy filing to the United States Bankruptcy Court which while specialist in U.S. bankruptcy law is unfamiliar with admiralty law. That law is markedly different from general notions of "secured" claims under U.S. bankruptcy law, especially when it comes to maritime liens. The purpose of this paper is to provide an introduction to the "vexing current problem." A starting point is an explanation of U.S. maritime lien laws and how, contrary to what may be thought and the rules in England and many other countries, protection is provided to a broad category of suppliers of "necessaries."

A. THE NATURE OF U.S. MARITIME LIENS

A leading treatise, The Law of Admiralty, G. Gilmore and C. Black (2d ed. 1975) memorably said of U.S. maritime liens: "[The U.S. maritime lien] is therefore often referred to as a 'secret' lien. It is also said to be 'indelible': that is, since the maritime

---

* An address to the Maritime Law Seminar held by JSE in Tokyo, on 22 November, 2004

** Jeremy J.O. Harwood's education includes: Charterhouse School, England; R.M.A. Sandhurst, 2nd Lt. B.A.O.R., West Germany; University of North Carolina, 1980 B.A. (Morehead Scholar); Oxford University, England, B.A., M.A. (Master of Moots), 1982; admitted to the Bar of the Supreme Court of England and Wales, 1986; Member, The Honourable Society of the Inner Temple; Admitted to the New York Bar and U.S. Supreme Court. (e-mail: jharwood@healy.com)

lien can be executed only by the admiralty court acting in rem, it is, until that court has so acted, good 'against the world', including the good faith purchaser of the ship without notice of the lien's existence. On the same principle the maritime lien is not affected by bankruptcy or reorganization." Id. at 588.

In America, maritime liens are created by operation of the general maritime law, unlike, for example, England's very limited category of lien. American law provides that certain transactions or events give rise to a maritime lien or, indeed, can be contracted to give rise to a maritime lien, such as a lien on cargo, freights or sub-freights.

In addition, liens are created by statute such as the U.S. Ship Mortgage Act and the Federal Maritime Lien Act. The U.S. does not, however, recognize the International Conventions of 1926 and 1967 for the unification of liens and mortgages so that foreign lien creditors and shipowners and mortgagee banks may be surprised how their rights differ under U.S. law.

(a) The Case Law

A maritime lien under U.S. law is a special property right in a vessel that "developed as a necessary incident of the operation of vessels."[1] The lien secures creditors who provide "supplies which are necessary to keep the ship going."[2] It "arises in favor of the creditor by operation of law... and grants the creditor the right to appropriate the vessel, have it sold, and be repaid the debt from the proceeds."[3] In addition, a maritime lien "affords special protection to [a] party who has been injured by a breach of [maritime] contract ..."[4] In arresting any vessel in U.S. waters, lienors' rights under U.S. law are implicated. That choice is often made by mortgagee banks against shipowners who may be close to insolvency to prevent other creditors from obtaining security by arrest of a vessel in other waters (as permitted under Admiralty Rule B for U.S. in personam actions) to secure their in personam claims, without resort to any assertions of a maritime lien in rem.

---

1 Silver Star Enterprises, Inc. v. SARAMACCA MV, 82 F.3d 666, 668 (5th Cir. 1996)(quoting Piedmont & Georges Creek Coal Co. v. Seaboard Fisheries Co., 254 U.S. I, 9, 65 L. Ed 97, 41 S. Ct. I (I920)).

2 Id. (quoting Dampskibsselskabet Dannebrog. et al. v. Signal Oil & Gas Co., 310 U.S. 268, 280, 84 L. Ed 1I97, 60 S. Ct. 937 (1940)); see also Wilkins v. Comm'l Inv. Tr. Corp., 153 F.3d 1273, 1276 (11th Cir. 1998).

3 Silver Star, 82 F.3d at 668 (quoting Equilease Corp. v. M/V SAMPSON, 793 F.2d 598, 602 (5th Cir. 1986)(en bane); see also Noramco Shipping Corp. v. Bunkers Int'l Corp., No. 6:02-cv-515, 2003 U.S. Dist. LEXIS 20169, at *10 (M.D. Fla. Apr. 30, 2003) (unpublished proposed findings and conclusion of magistrate judge).

4 E.A.S.T., Inc. of Stamford, Conn. V. M/V ALAIA, 876 F.2d 1168, 1174 (5th Cir. 1989); see also Cardinal Shipping Corp. v. MIS Seisho Maru, 744 F.2d 461, 466 (5th Cir. 1984) (noting that a maritime lien "arises by operation of law to provide security to the victims of certain maritime ... contract breaches.").

In general, the following categories and priority ranking of maritime liens is provided for under the FMLA, 46 U.S.C. § 31342 and/or general maritime law:

1. "Custodia legis" expenses,
2. Wages of the Ship's master and crew,
3. Salvage operations including under contract,
4. Cargo's claim for General Average Claims,
5. Tort claims for collision, death and personal injury, as well as cargo damage or loss and property damage,
6. Contract claims for "necessaries,"
7. Preferred ship mortgages.

Of particular interest in the insolvency context, where the mortgagee bank is usually seeking to outrank the "contract" lien claims is the question of whether a foreign supplier has a priority lien for provision of "necessaries."

(b) The U.S. Connection

A maritime lien for necessaries arises "when the goods or services are supplied or performed in the United States." Gulf Trading & Transportation Co. v. The Vessel Hoegh Shield, 658 F.2d 363, 367 (5th Cir. 1981) cert denied, 457 U.S. 1119, 102 S. Ct. 2932, 73 L. Ed 2d 1332 (1982). Courts construe "necessaries" broadly and have held that goods and services which were necessary to enable the vessel to perform give rise to a maritime lien. See, e.g., In Re: Seascape Cruises Ltd., 191 B.R. 944, 1995 AMC 2363 (S.D.Fla. 1995), *aff'd without opinion*, 9 F.3d 1353 (11th Cir. 1996).

A foreign corporation qualifies for a maritime lien under the FMLA for necessaries provided in the United States. Swedish Telecom Radio v. M/V Discovery I, 712 F. Supp. 1542 (S.D.Fla. 1989).

For example, travel services provided by a Greek travel agent to crew members traveling to or from or within the United States while a Greek-flagged vessel is docked and operating in the United States are necessaries that entitle the foreign travel agent to a maritime lien under the FMLA. See J.P. PROVOS Maritime, S.A. v. M/V Agni, 1999 U.S. Dist. Lexis 12012 (E.D.La.1999); Gulf Marine & Industrial Supplies, Inc. v. M/V Golden Prince, 1999 AMC 2807 (E.D.La. 1999).

(c) Choice of Law Considerations

Where the "necessaries" are physically provided in the United States, the choice of law analysis issue becomes largely irrelevant. In Wardley International Bank, Inc. v. Nasipiti Bay Vessel, the Ninth Circuit Court of Appeals analyzed the issue of whether the location of the **supplier** should determine where necessaries were provided, and held unequivocally that it did not. The Court stated that the "statute's language is plain and

unambiguous. It refers only to where the "**supplies were delivered** or services performed." Wardley International Bank, Inc. v. Nasipiti Bay Vessel, 841 F.2d 259 (9th Cir. 1988) (emphasis added). Conversely, in Mobil Sales and Supply Corp. v. The Vessel PANAMAX VENUS, 804 F.2d 541 (9th Cir. 1986), the Court rejected the argument that an American supplier could be held to have supplied necessaries within the United States solely because it was based in the United States.

(d) The Lien Is Recognized In The Contracted Amount

In Galehead, Inc. v. M/V ANGLIA, 183 F.3d 1242, 1246-47 (11th Cir. 1999) the vessel argued that the fuel supplier could only obtain a lien for the "reasonable value of necessaries," not "commission, or profit." The Court "disagree[d]" stating:

> Anglia cites no case law that supports its contention that these profits are of a non-maritime nature and thus outside the maritime jurisdiction of the courts. There seems to be good reason for this dearth of precedent. If profit on necessaries supplied to a vessel were considered non-maritime, we worry that there could be no such thing as a maritime contract for necessaries. Very few suppliers, repairers, or fuellers, we suspect, are going to supply goods or services to a vessel at cost (that is, without profit or mark-up). And those that did would likely not be in business long.

183 F.3 at 1247.

B. THE DIFFICULTIES ARISING FROM SEEKING RECOGNITION OF ADMIRALTY PRINCIPLES IN THE BANKRUPTCY COURT

Incredibly to many, the U.S. Bankruptcy Court has, under U.S. law, jurisdiction over a debtor's property anywhere in the world. In the shipping context this entails the referenced "conundrum" of, for example, the New York Bankruptcy Court asserting jurisdiction over the entire fleet of Millenium Seacarriers, even when three of its ships where under arrest in foreign jurisdictions.

Again, basic principles must be examined:

1. In Rem Jurisdiction Is A Fundamental Necessity Both To Permit Foreclosure On A Ship's Mortgage And Enforcement Of Maritime Liens

Maritime liens do not exist apart from their ability to be enforced or adjudicated in rem in admiralty cases. 8 Benedict on Admiralty § 7.01[A] (7th Edition, rev. 2000). In The ROCK ISLAND BRIDGE, 73 U.S. (6 Wall.) 213, 215 18 L. Ed. 753 (1867), Mr. Justice Stephen Johnson Field stated for the Court:

> The lien and the proceeding in rem are, therefore, correlative—where one

> exists, the other can be taken, and not otherwise. Such is the language of the Privy Council in the decision of the case of The Bold Buccleugh. "A maritime lien," says that court, "is the foundation of the proceeding in rem, a process to make perfect a right inchoate from the moment the lien attaches; and whilst it must be admitted that where such lien exists a proceeding in rem may be had, it will be found to be equally true, that in all cases where a proceeding in rem is the proper course, where a maritime lien exists, which gives a privilege or claim upon the thing to be carried into effect by legal process.

See also Rainbow Line v. M/V Tequila, 480 F.2d 1024, 1028 (2d Cir. 1973) ("in rem jurisdiction in the admiralty exists only to enforce a maritime lien." [citations omitted].)

2. The Bankruptcy Court's Admiralty Jurisdiction To Adjudicate Maritime Liens

Judge Sweet was one of the first judges of the Southern District of New York to consider the "power of the bankruptcy court to adjudicate the validity and priority of maritime liens" and the "competing policies of admiralty and bankruptcy" in "Hellenic Lines I," modified, 585 F. Supp. 1227 (S.D.N.Y. 1984) ("Hellenic Lines II"); 593 F. Supp. 1004 (S.D.N.Y. 1984) ("Hellenic Lines III"). These cases were examined in the Haight Decision.

Hellenic Lines I involved separate groups of creditors, both of whom asserted the exclusive jurisdiction of this Court sitting in admiralty. The first group, CTI and ICS, asserted a lien against two of the debtor's vessels, and their freights after lift of the stay by the bankruptcy court to permit such action. Judge Sweet held that "[t]o prevent any cloud upon the title of the INNOVATOR, and the SPIRIT, I conclude that this court, sitting as a court in admiralty, should administer the freights incident to those vessels and distribute them to the maritime lien claimants with the proceeds from the sale of those vessels." 38 B.R. at 792.

Another group of creditors ("ITO") however, asserted that the District Court should retain jurisdiction over freights, etc. of "Hellenic vessel which have not been arrested in this jurisdiction" and against which the stay had not been lifted. Judge Sweet recognized that the freights "appear to be property within the jurisdiction of both courts." Having noted the jurisdictional conflict, Judge Sweet ruled on the argument raised by all moving creditors that the Bankruptcy Court could not determine the validity and priority of maritime liens. He concluded:

> There seems little doubt today that the Bankruptcy Court can and will adjudicate the validity and priority of maritime liens asserted against

> Hellenic vessels and freights.

Hellenic Lines I, 38 B.R. at 996.

However, because "[o]nly an admiralty court can without question deliver a vessel free and clear of all liens," the District Court retained jurisdiction of the four vessels within its in rem jurisdiction. However, the freights attached which were "essentially accounts receivable" were left to the Bankruptcy Court to adjudicate. Hellenic Lines II was prompted by the conversion of the case to a Chapter 7 liquidation and also provided Judge Sweet's further explanation of why he had not asserted jurisdiction over them because "Hellenic was attempting to reorganize." 585 F. Supp. at 1229. Accordingly, applying the doctrine of custodia legis, he ordered the freights to be paid into this Court's registry for adjudication of and identification of ITO's maritime liens. Hellenic Lines III involved the District Court's adjudication of a variety of expenses as priority "custodia legis" expenses.

More recently a New York Judge wrote in In re Millenium Seacarriers, Inc., 275 B.R. 690, 698 (S.D.N.Y. 2002):

> It is well settled that a district court's admiralty in rem jurisdiction depends upon the arrest of the res under court process. "The foundation for the effective exercise of jurisdiction in rem is the taking of the vessel or other property that is the subject of the action into the custody of the court." 2 Benedict on Admiralty § 22 at 2-6 (7th ed. rev. 2000). "Jurisdiction is the power to adjudicate a case upon the merits, and dispose of it as justice may require. As applied to a suit in rem for the breach of a maritime contract, it presupposes, first, that the contract sued upon is a maritime contract; and second, that the property proceeded against is within the lawful custody of the court." The Resolute, 168 U.S. 437, 439 (1897). "It is axiomatic that in rem jurisdiction exists in an action only where the subject matter of the action, or an appropriate substitute thereof, is within the jurisdiction of the court in which the action lies. Thus, where a vessel is the target of an in rem action in admiralty, it must be both within the territorial jurisdiction of the court hearing the cause and subject to the order of the court through process of arrest." American Bank of Wage Claims v. Registry of the District of Court of Guam, 431 F.2d 1215, 1218 (9th Cir. 1970). "As a general matter, a court cannot make orders relating to or in aid of an in rem claim unless the res is within the court's jurisdiction." Rolls Royce Industrial Power (India) v. M.V. FRATZIS M., 905 F.Supp. 107, 108 (S.D.N.Y. 1995) (in admiralty

> action in personam, district court lacked jurisdiction to direct defendant shipowner to submit to expedited discovery for the sole purpose of ascertaining the whereabouts of the vessel so that in rem jurisdiction could be obtained by arresting her). In Impala Trading Corp v. Hawthorne Lumber Co., 200 F. Supp. 261 (S.D.N.Y. 1961), District Judge Feinberg (as he then was) held that this Court lacked jurisdiction to order the sale of a cargo aboard ship in Puerto Cortez, Honduras, in order to conserve assets as security to satisfy plaintiff's asserted maritime lien against the cargo. Judge Feinberg regarded the basic issue as one of jurisdiction, and concluded that he lacked the power to make the order since neither the vessel nor the cargo were in this district.

That, then, is the nub of the issue - it is "one of jurisdiction." A U.S. bankruptcy court cannot validly purport either to permit foreclosure of a mortgage or then proceed to rank maritime liens under U.S. law if in rem jurisdiction has never been obtained. In recent maritime bankruptcy cases, however, this fundamental principle of admiralty jurisdiction has been lost to the expediency of the U.S. bankruptcy court's desire to "streamline" the insolvency and restructuring process.

CONCLUSION

The very different realms of admiralty and bankruptcy law are in conflict and when they meet experience has shown that the latter will not gladly yield precedence to the former. This collision of jurisdictional principles has far reaching effects on mortgagee banks, shipowners, and creditors - as well as any party believing that it has purchased a vessel "free and clear" of all liens in an auction of an ocean-going vessel conducted by a U.S. bankruptcy court.

THE JAPAN SHIPPING EXCHANGE, INC.
(Nippon Kaiun Shukaijo)
Wajun Building, Koishikawa 2-22-2,
Bunkyo-ku, Tokyo 112-0002, Japan
Tel: 81 3 5802 8363
Fax: 81 3 5802 8371
Website: www.jseinc.org