The right to countersecurity from a debtor in bankruptcy

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US maritime law offers a maritime plaintiff two principal means of obtaining security for its claims: Rule B attachment in respect of maritime claims, and Rule C arrest in respect of maritime liens. These rules are superficially similar, but each has different criteria and serves a different purpose. Each also gives the defendant the opportunity to obtain countersecurity on related counterclaims. However, what happens when the plaintiff is in bankruptcy, subject to a bankruptcy court's automatic stay of proceedings against it? Can a debtor be compelled to give countersecurity in such a case? This article discusses a recent decision from a bankruptcy court in (of all places) Colorado that helps answer this question.

The Admiralty Rules of Arrest and Attachment

First the rules: maritime attachment and arrest remedies in the US are as old as the general maritime law, which predates the Constitution, but in present times the applicable rules are contained in special maritime rules that supplement the Federal Rules of Civil Procedure. Rule B of those rules pertains to maritime attachment, which is available where a plaintiff has an *in personam* maritime claim against a party. Rule B allows the plaintiff to attach property belonging to that party in any district where the party is not subject to jurisdiction but where its property can be found. (This quirky jurisdictional rule arises from the notion that Rule B is intended to serve twin aims: allowing a party to obtain jurisdiction over a defendant, at least to the extent of property attached, and also to obtain security for its claim. Thus, it is only available in jurisdictions where the defendant is not otherwise subject to the court's *in personam* jurisdiction.) Establishing a right to a Rule B attachment is quite simple: the plaintiff must show that:

- it has a *prima facie* maritime claim, ie a claim within the court's admiralty and maritime jurisdiction;
- the defendant cannot be found in the district;
- the defendant has property within the district; and
- no statute bars maritime attachment in the circumstances.

Rule C of the Supplemental Admiralty Rules governs maritime arrest, which arises where a party seeks to enforce a maritime lien against an *in rem* defendant. This is most commonly a vessel, but a maritime lien can arise against cargo and other maritime property as well. Maritime liens are themselves a creature of US maritime law and arise, for instance, in cases of maritime tort, such as collision or crew injury, salvage, breach of certain maritime contracts such as charter parties and for nonpayment for 'necessaries' provided to a vessel.

Rules B and C are augmented by Supplemental Rule E, and together the three rules set out the procedures governing maritime attachment and arrest actions. Rule E is essentially a 'mechanics' rule that governs such issues as when and how a party may challenge an arrest or attachment; how and in what amount alternate security may be posted to obtain release of attached or arrested property; and when property may be sold by interlocutory sale before judgment, such as when the attached or arrested property is perishable.

Rule E also grants the defendant the right to seek countersecurity. Specifically, Rule E(7)(a) provides as follows:

> 'When a person who has given security for damages in the original action asserts a counterclaim that arises from the transaction or occurrence that is the subject of the original action, a plaintiff for whose benefit the security has been given must give security for damages demanded in the counterclaim unless the court, for cause shown, directs otherwise. Proceedings on the original claim must be stayed until this security is given, unless the court directs otherwise.'

The premise of Rule E(7) is to place the parties on equal footing with respect to

disputes arising out of the same 'transaction or occurrence,' and though the rule does allow the District Court some discretion where the plaintiff can show 'cause' why it should not be required to post countersecurity (or why countersecurity should be posted in some amount other than the full amount of the counterclaims), an order directing countersecurity is very much the rule rather than the exception

The scenario – a plaintiff in bankruptcy

Now back to our issue: suppose a dispute arises between an owner and a time charterer of a vessel, where the charter is governed by US maritime law. The charterer has various breach of charter claims, but the owner also has a counterclaim for non-payment of hire. Further suppose the charterer files a petition for bankruptcy protection under Chapter 11 of the US Bankruptcy Code, thereby invoking the automatic stay provisions under s 362 of the Bankruptcy Code. That section bars creditors from pursuing claims or process against the debtor and its estate outside the bankruptcy case, including seeking security from the debtor without authorisation under the Bankruptcy Code.

Further assume that the charterer, after commencement of the Chapter 11 case, avails itself of the right under s 365 of the Bankruptcy Code to reject the charter. That section allows a debtor to exercise its business judgment to determine that an executory contract is burdensome to the estate and of no value. Rejection is treated under the Bankruptcy Code as a repudiation of the contract, returning the vessel to the owner's service and giving the owner an accelerated pre-petition damages claim for the balance of the charter period.

Then, following rejection, the charterer arrests the vessel, asserting its maritime lien claim and pressing for a judicial sale. Faced with this whipsaw, the owner wants to pursue countersecurity for its counterclaim, but can it do so in the face of the bankruptcy court's automatic stay?

Those are the basic relevant facts in *In re Haimark Line Ltd*, 15-22180-JGR (Bankr Col 2015), a Chapter 11 bankruptcy case pending in the Bankruptcy Court for the District of Colorado. After commencing its Chapter 11 case, the charterer arrested the vessel in Florida, and Blank Rome's maritime and bankruptcy groups worked together to assist the owner in pursuing the right to seek countersecurity in the Florida arrest action.

The arguments on owner's motion for relief from the automatic stay

To pursue countersecurity, the owner first had to obtain relief from the bankruptcy court's automatic stay. In its motion for such relief, the owner argued that Rule C and Rule E are part and parcel of the same remedy of maritime arrest and that the charterer, having knowingly invoked that remedy, should not be allowed to hide behind the bankruptcy court's automatic stay to avoid the litigation 'cost' associated with the arrest right – namely, the obligation to give countersecurity. The charterer countered by arguing that allowing the owner to obtain countersecurity on its claim would unfairly elevate the claim in status from an unsecured claim to a secured claim, thereby prejudicing other creditors of the bankruptcy estate.

The ruling

The bankruptcy court granted the owner's motion in an oral ruling on 16 March 2016, (transcript at Dkt No 220). In rejecting the charterer's arguments, the judge observed as follows:

> 'Even if it's found somehow that by allowing the stay to be lifted to allow the request for counter-security to be made and counter-security to be ultimately ordered, even if somehow that does convert some sort of unsecured claim to a secured claim, the Court finds that it's difficult for the debtor to make that argument when the pursuit of the Florida [arrest action] was due to its own business judgment.
>
> The debtor initiated the action. And in this Court's view, it's unfair to cut off [the owner's] rights to defend itself in any manner provided by law, especially when the asset seized is a four-million-dollar vessel.' [Tr at pp 13–14]

The charterer thereafter filed a motion for reconsideration, contending that the Court misconstrued the nature of the counterclaims and the countersecurity sought. In an (as yet) unpublished written ruling dated 15 April 2016, (Dkt 246), the bankruptcy court denied the charterer's motion, holding as follows:

> 'The Debtor's present motion is premised upon the argument that this Court held a fundamental misapprehension of "esoteric maritime law concept of countersecurity." The Debtor, in effect, argues that while it [is] proper for this Court to allow the

> Arrest Action initiated by the Debtor to proceed, the District Court should be prevented from considering whether countersecurity is required. The Court respectfully disagrees.
> […]
> The automatic stay under 11 USC § 362(a) should not be used to unilaterally deny [the owner] the benefit of traditional maritime security devises to which it may be entitled.'

Conclusion

This holding – which appears to be a ruling of first impression in the US – represents an important clarification of the scope of protection that should (or should not) be afforded a debtor by the Bankruptcy Code's automatic stay when, post-petition, it seeks to pursue claims against parties who also hold claims against the bankruptcy estate. Any debtor should take this ruling into account when deciding whether to pursue arrest or attachment actions where the target is also a creditor of the estate on a related counterclaim, and any such creditor may take heart that the bankruptcy stay is not an automatic bar to obtaining countersecurity in such circumstances.