

7-1-1966

## Maritime Finance

Steven H. Grindle

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### Recommended Citation

Steven H. Grindle, *Maritime Finance*, 7 B.C.L. Rev. 891 (1966), <http://lawdigitalcommons.bc.edu/bclr/vol7/iss4/12>

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# CURRENT LEGISLATION

## MARITIME FINANCE

### NEW LEGISLATION AFFECTING FOREIGN INTERESTS IN UNITED STATES SHIPPING

The purpose of the reported legislation, P.L. 89-346,<sup>1</sup> is to cure the problems of ship financing created by the decision in *Chemical Bank N.Y. Trust Co. v. S.S. Westhampton*.<sup>2</sup> That case dealt with an attempted foreclosure of an allegedly preferred mortgage<sup>3</sup> on an American flagship, the S.S. *Westhampton*, by a United States citizen, Chemical Bank N.Y. Trust Co. Chemical had financed the mortgage loan with a bond issued to a German firm, Landesbank, under the provisions of a trust indenture which outlined the rights and liabilities of Landesbank against Chemical and the S.S. *Westhampton*.<sup>4</sup> The transfer of the bond to Landesbank was accomplished without the approval of the Secretary of Commerce which is given through the Maritime Administration of the United States Department of Commerce (hereinafter referred to as Maritime). The circuit court held that the unapproved transfer of the bond to an alien invalidated the preferred status given to the mortgage under the provisions of the Ship Mortgage Act, 1920,<sup>5</sup> because the transfer violated Section 37 of the Shipping Act, 1916.<sup>6</sup> The decision

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<sup>1</sup> Act of Nov. 8, 1965, 79 Stat. 1305 (1965), amending Shipping Act, 1916, §§ 9, 37, 39 Stat. 728, 46 U.S.C. §§ 808, 835, Ship Mortgage Act, 1920, § 300(d), 41 Stat. 1005, 46 U.S.C. § 961 (1964).

<sup>2</sup> Nos. 9637 & 9638, 4th Cir., April 5, 1965, 33 U.S.L. Week 2527.

<sup>3</sup> A preferred ship mortgage is a maritime lien with security priorities far above those of a common law mortgage on a ship; the latter is not a maritime lien. See 1 Benedict, Admiralty § 78 (6th ed. Knauth 1940).

<sup>4</sup> The trust indenture was of standard form. The district court was especially impressed with Chemical's right to enter into possession of the S.S. *Westhampton* upon default and to operate the vessel for its own profit if holders of a majority amount of the bonds so request. Under the indenture, Chemical was also given the right upon default to sell the S.S. *Westhampton* without legal process and Landesbank was given the right to purchase at the sale. *Chemical Bank N.Y. Trust Co. v. S.S. Westhampton*, 231 F. Supp. 284, 287-88 (D. Md. 1964). But it should be noted that § 37 of the Shipping Act, 1916, 39 Stat. 728, as amended, 46 U.S.C. 835 (1964), prohibits the transfer of an American vessel to a noncitizen without approval of the Secretary of Commerce (Maritime).

<sup>5</sup> 41 Stat. 1000 (1920), as amended, 46 U.S.C. §§ 911-84 (1964) [hereinafter all section references in the text are to sections of the original act].

<sup>6</sup> 39 Stat. 728 (1916), as amended, 46 U.S.C. §§ 801-42 (1964) [hereinafter all section references in the text are to sections of the original act]. The 1916 act became law immediately upon the United States' entry into World War I. Its basic purpose was to establish a system of control over American cabotage and international shipping. Congress' concern in enacting it was to preserve and encourage United States citizens' control over the American merchant marine. 56 Cong. Rec. 8025 (1918).

Section 9 of the 1916 act is a peacetime provision which makes it unlawful for any person to agree to or in any manner transfer to any person not a citizen of the United States any vessel or any interest therein without the approval of the Secretary of Commerce. Section 37 regulates the same type of transactions as § 9, but it applies only during a national emergency or wartime as declared by the President. (A national emer-

was clearly contrary to the policy and practice of Maritime,<sup>7</sup> and therefore caused great uncertainty and insecurity in the ship financing community. The reported legislation attempts to remedy this situation by making it possible for shipping investors planning to finance mortgage loans with bond issues to secure all necessary approval of bond transfers by obtaining prior approval of themselves as trustees from Maritime.

The *Westhampton* decision is based on the questionable rationale that the failure of the mortgagee to comply with the provisions of the 1916 act has a fatal effect on the preferred status of the mortgage, which status is governed by the provisions of the 1920 act. It is submitted that not only was the case wrongly decided, but the faulty rationale of the decision also infected Congress' attempt to remedy the problems created by the decision.

#### I. THE *Westhampton* DECISION

Upon default, Chemical attempted to enforce its preferred mortgage against the S.S. *Westhampton*, but certain other lienors intervened and objected to Chemical's mortgage on the ground that it was a mere device by which Landesbank had intended to circumvent the prohibitions contained in the 1916 act against alien control of American flagships. The intervenors emphasized that it was only because Landesbank's counsel advised that, as an alien, it could not obtain a preferred mortgage on the S.S. *Westhampton* that Landesbank engaged Chemical as a trustee-mortgagee and purchased the single bond issued under the trust-mortgage deed. The intervenors further noted that the money was paid directly to the owners of the *Westhampton* by Landesbank. The district court, agreeing with the intervenors, held that Chemical did not have a preferred mortgage.<sup>8</sup> The circuit court, while affirming the district court's decision, rejected its rationale.<sup>9</sup>

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gency, proclaimed by the President in Proc. No. 2914, Dec. 16, 1950, 15 Fed. Reg. 9029 (1950), is still in effect.)

The purpose of the 1920 act was to increase the value of shipping securities in the interest of maintaining and nurturing an American merchant marine. *Detroit Trust Co. v. The Thomas Barlum*, 293 U.S. 21 (1934). It did this by giving ship mortgages which met the requirements of § 30D of the 1920 act the rights of a maritime lien and a high priority among maritime liens. See note 2 *supra*.

<sup>7</sup> Hearings Before the Subcommittee on Merchant Marine and Fisheries of the Senate Committee on Commerce, 89th Cong., 1st Sess., ser. 89-36, at 82 (1965) [hereinafter referred to as Senate Hearings] (statement of Carl C. Davis, General Counsel, Maritime Administration, Department of Commerce):

. . . Maritime has in recent years regarded the United States citizenship of the trustee-mortgagee in trust indenture financing as controlling the preferred status of mortgages under the Ship Mortgage Act without inquiry as to the citizenship of note or bondholders and has regarded approval under sections 9 and 37 of the 1916 act of noncitizen bondholdings to be unnecessary irrespective of the number of holders.

See note 11 *infra*.

<sup>8</sup> 231 F. Supp. 284 (D. Md. 1964). The court wrote a very involved and technical opinion in which it eventually decided that, in fact and in law, Landesbank was the mortgagee and Chemical was a mere façade.

<sup>9</sup> The argument adopted by the circuit court as its rationale was introduced late in the appeal by the trustee in bankruptcy for the S.S. *Westhampton*. Interview with John R. Tankard, Assistant General Counsel, Division of Mortgage and Marine Insurance, Maritime Administration, Department of Commerce, April 2, 1965.

The basis of the circuit court's decision was an integration of the 1916 and 1920 acts. Section 37 of the 1916 act prohibits the transfer of any vessel or any interest therein to a noncitizen without the prior approval of Maritime. With the legislative history<sup>10</sup> and early administrative opinion letters<sup>11</sup> as precedent for the proposition that ownership of stock in a corporation which owns a vessel is an interest in that vessel,<sup>12</sup> the court concluded that a bond issued by a trustee-mortgagee under a trust indenture is also an interest in the mortgaged vessel.<sup>13</sup> In addition, since Landesbank was not a citizen and Maritime had not approved the bond transfer,<sup>14</sup> the transfer violated section 37 of the 1916 act. The effect of this violation, according to the court, was to destroy the preferred status of Chemical's mortgage on the S.S. *Westhampton*, which status comes from the 1920 act.

Section 30D(a) of the 1920 act grants preferred status to "valid mortgages" which comply with five other enumerated qualifications. While Chemical's mortgage met these five requirements, the circuit court seized upon the term "valid mortgage" and arbitrarily concluded that the violation of section 37 of the 1916 act had nullified the preferred status of the mortgage under the 1920 act. The court reasoned that Chemical's mortgage was therefore not preferred. Thus, Chemical became the holder of a non-maritime lien on the S.S. *Westhampton* on an equal basis with other general creditors. It was the potential ramifications of the circuit court's holding which prompted Congress to take legislative action.

## II. PRE-LEGISLATIVE RAMIFICATIONS OF *Westhampton*

Section 30B(5) of the 1920 act states that "the term 'mortgagee', in the case of a mortgage involving a trust deed and a bond issue thereunder, means the trustee designated in such deed." Until *Westhampton*, Maritime had long assumed that this section meant that the citizenship of the trustee-mortgagee was the sole controlling factor in meeting the citizenship requirements for a preferred mortgage specified in section 30D(5) of the 1920 act. Therefore, Maritime had ruled that no approval was needed for sales of bonds to non-citizens.<sup>15</sup> As the General Counsel of Maritime put it:

In ordinary legal language the term "mortgage" includes the bond

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<sup>10</sup> 56 Cong. Rec. 8035 (1918) (remarks of Representative Robbins): "Unless you get the approval of the Shipping Board [replaced by Maritime], it [§ 37] prohibits absolutely the transfer of any interest whatever in any documented ship or stock in a company." (Emphasis added.)

<sup>11</sup> Letter from Chauncey G. Parker, General Counsel, Maritime Administration to Messrs. Denegre, Leovy & Chaffe, April 6, 1927; Letter from Chauncey G. Parker, General Counsel, Maritime Administration to Messrs. Squire, Sanders & Dempsey, Jan. 2, 1924.

<sup>12</sup> Cf. *United States v. Niarchos*, 125 F. Supp. 214 (D.D.C. 1954), which held that stock in a corporation is not an interest in the ship owned by the corporation.

<sup>13</sup> Cf. Letter from James L. Pimper, General Counsel, Maritime Administration, to Robert E. Kline, Jr., Oct. 19, 1960; Letter from E. Robert Seaver, General Counsel, Maritime Administration, to Charles S. Cunningham, May 11, 1959. Both of these letters ruled that a bond is not an interest in a mortgaged vessel.

<sup>14</sup> The Maritime Administration would have told Landesbank and Chemical—had they asked—that approval was not needed. See letters cited note 13 *supra*.

<sup>15</sup> *Supra* note 13.

secured by the mortgage, but the plain language of the Ship Mortgage Act, 1920, is that [in the] case of a bond issue the term mortgagee means the trustee. And that act states no requirements with regard to the citizenship of the bondholders.<sup>16</sup>

*Westhampton* changed all of this.

If the situation of uncertainty created by *Westhampton* had not been changed, the questionable validity of all ship mortgage loans financed by bond issues would have decreased the marketability of such bonds, which are the cheapest method of financing ship construction and reconstruction.<sup>17</sup> Rehabilitating their marketability would have required a higher interest rate of return, which in turn would have caused an increase in the rate of interest on the mortgage payments. At a minimum, the estimated increase in the total cost of ship construction was one half of one per cent.<sup>18</sup>

Although the *Westhampton* decision involved a single bond issue for the entire amount of the mortgage, it is quite possible that a later court would have applied the *Westhampton* rationale to invalidate a mortgage under which only one of many bonds issued thereunder was held by a non-approved noncitizen. The legal conclusion of *Westhampton* is that a bond transfer in violation of section 37 of the 1916 act invalidates the preferred status of the mortgage. The circuit court apparently was not concerned about a situation involving many bonds, only one or a few of which violated section 37 of the 1916 act:

The debt is represented by the bond; the trustee only holds the mortgage for the protection of the bondholder. Chemical has no personal interest in the mortgage. The mortgage and the bond represent one loan. If one falls so does the other.<sup>19</sup>

Consequently, under the *Westhampton* holding in a situation where more than one bond was secured by the mortgage, an individual bondholder would have had to concern himself not only with his own citizenship qualifications and Maritime approval, or both, but also with the status of other bondholders under the same mortgage. This uncertainty would have been very serious because the statutory criteria for determining the citizenship

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<sup>16</sup> Hearings Before the Subcommittee on Merchant Marine of the House Committee on Merchant Marine and Fisheries, 89th Cong., 1st Sess., ser. 89-15, at 5 (1965) [hereinafter referred to as House Hearings] (statement of Carl C. Davis, General Counsel, Maritime Administration, Department of Commerce).

<sup>17</sup> House Hearing at 10 (statement of Robert C. Giles, General Counsel, Maritime Administration, Department of Commerce), wherein this example was given:

. . . [O]n a single ship with an average mortgage balance of \$2,500,000 over a 25-year life with interest at 4 1/4 percent per annum (a representative rate in the past for fully marketable bonds) versus 5 percent per annum (a representative rate in the past for direct mortgage loans) the savings are \$468,750.

<sup>18</sup> S. Rep. No. 686, 89th Cong., 1st Sess. 3 (1965).

<sup>19</sup> *Chemical Bank N.Y. Trust Co. v. S.S. Westhampton*, supra note 2, at 24. This is to be contrasted with the lower court's opinion which emphasized the identity of Landesbank, the sole bondholder under the mortgage, as the actual mortgagee. This rationale does not cast doubt upon the preferred status of a mortgage under which many bonds are issued. 231 F. Supp. 284 (D. Md. 1964).

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of savings banks, states of the United States and state agencies are unclear,<sup>20</sup> and these institutions have been the major purchasers of ship mortgage bonds in the past.<sup>21</sup> More uncertainty would have been created because the effect of prior transfers in violation of section 37 of the 1916 act on a subsequently-approved or citizen purchaser of a bond has not been decided.<sup>22</sup> Moreover, such bonds may be issued in either registered or bearer form. If issued in bearer form, the chain of title would be virtually impossible to trace—thus compounding the uncertainty.

Of particularly great concern to the United States Government was the effect of *Westhampton* on its Title XI insurance on ship financing.<sup>23</sup> This program allows persons purchasing ship mortgage bonds to insure their investment with the Government.<sup>24</sup> Upon default, the insured bondholder may, in effect, sell these bonds to the Government at face value and relieve himself of the risk of not being fully satisfied from the foreclosure proceeds.<sup>25</sup> Although insured bondholders would probably not have been in violation of section 37 of the 1916 act because each insuree must be approved by Maritime,<sup>26</sup> certainly other uninsured bondholders secured under the same mortgage could have been in violation of section 37 as non-approved non-citizens, thereby invalidating the preferred status of the mortgage under the *Westhampton* decision. Were the preferred status of the mortgage so invalidated, then the bonds would be secured by a non-maritime lien and, in the case of default, would probably be satisfied at much less than face value.<sup>27</sup> Under these circumstances, the insuree would probably transfer

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<sup>20</sup> Shipping Act, 1916, § 2, 39 Stat. 728 (1916), as amended, 46 U.S.C. § 802, sets out the circumstances under which a corporation, partnership or association is deemed a citizen. The most important of these circumstances is the citizenship of the board members and stockholders; and for the most part, savings banks, states of the United States and state agencies do not have board members or stockholders. See S. Rep. No. 686, 89th Cong., 1st Sess. 3 (1965).

<sup>21</sup> S. Rep. No. 686, 89th Cong., 1st Sess. 3.

<sup>22</sup> House Hearings at 19:

A mortgage achieves priority under Subsection D of the 1920 act "as of the date of the compliance with all the provisions of this subdivision" and technical deficiencies in citizenship thereafter occurring would be immaterial so long as the mortgage in default was being enforced by a citizen of the United States. (*Collier Advertising Service v. Hudson River Day Line*, 14 F. Supp. 335 [(S.D.N.Y. 1953)]; *The Northern* No. 41, 297 F. 343 [(S.D.N.Y. 1923)]).

If this interpretation is correct, it removes some of the doubts arising out of defects in a bond's chain of title. So long as the defect in title could be characterized as a "technical deficiency" the holder's rights at default would not be affected. Of course, under this interpretation, the initial bondholder would have to be in compliance with the 1916 and 1920 acts.

<sup>23</sup> Merchant Marine Act, 1936, Title XI, 52 Stat. 969 (1938), as amended, 46 U.S.C. §§ 1271-94 (1964) [hereinafter cited by U.S.C. section only].

<sup>24</sup> Merchant Marine Act, 1936, 46 U.S.C. § 1274(b).

<sup>25</sup> Merchant Marine Act, 1936, 46 U.S.C. § 1275(a)(2).

<sup>26</sup> Merchant Marine Act, 1936, 46 U.S.C. § 1274(b)(1). There is a possibility that bondholders, though insured, might have been in violation of § 37 of the 1916 act, which requires the approval of Maritime prior to the purchase of the bond; for the bondholders could have failed to obtain approval prior to their purchase and then insured after their purchase.

<sup>27</sup> *Supra* note 3.

this risk by invoking his contract right to have the bonds purchased at face value by the Government.

### III. THE LEGISLATION

As enacted, the reported legislation amended sections 9 and 37 of the 1916 act and section 300(d) of the 1920 act. Although the *Westhampton* decision relied only on section 37 of the 1916 act, Congress must have thought that it would have to amend all three sections because the phraseology of all three sections was similar.<sup>28</sup>

Initially, the sole purpose of the reported legislation was the rehabilitation of the marketability of ship mortgage bonds.<sup>29</sup> The bill, as introduced, provided substantially that, henceforth, a bond, note or other evidence of indebtedness within the meaning of the two acts would not be deemed an "interest in a vessel" or a "right under a mortgage,"<sup>30</sup> respectively. This bill was widely supported,<sup>31</sup> but the Seafarers International Union objected because the bill would have nullified the general policy considerations against alien control which the *Westhampton* court found within the 1916 act.<sup>32</sup> To meet these objections, the bill was redrafted to provide that (1) transfers of bonds to aliens must be approved unless the trustee-mortgagee is a citizen of the United States and obtains the approval of Maritime, and (2) the trustee cannot operate the vessel without the approval of Maritime.

In its final form the legislation provides five express citizenship qualifications for a trustee-mortgagee:

The Secretary of Commerce shall grant his approval if such trustee is a bank or trust company which (1) is organized as a corporation, and is doing business under the laws of the United States, or any State thereof, (2) is authorized under such laws to exercise corporate trust powers, (3) is a citizen of the United States, (4) is subject to supervision or examination by Federal or State authority, and (5) has a combined capital surplus of at least \$3,000,000.<sup>33</sup>

<sup>28</sup> Section 300(d) of the Ship Mortgage Act, 1920 provides that "no rights under a mortgage of a vessel of the United States shall be assigned to any person not a citizen of the United States without the approval of the Secretary of Commerce." Section 9 of the Shipping Act, 1916, provides that it shall be unlawful to sell, charter, lease, deliver or in any manner transfer or agree to transfer to any person not a citizen of the United States any vessel or any interest therein without the approval of the Secretary of Commerce. For the pertinent part of § 37 of the Shipping Act, 1916, see note 6 supra.

<sup>29</sup> 111 Cong. Rec. 12726 (June 10, 1965) (memorandum in support of proposed legislation).

<sup>30</sup> S. 2118, 89th Cong., 1st Sess. (1965).

<sup>31</sup> Maritime Administration, Commission of American Steamship Lines, American President Lines and several other trust companies, including Chemical Bank N.Y. Trust Co., supported S. 2118 in its original form. S. Rep. No. 686, 89th Cong., 1st Sess. 2 (1965).

<sup>32</sup> S. Rep. No. 686, 89th Cong., 1st Sess. 1 (1965).

<sup>33</sup> 79 Stat. 1305 (1965). These qualifications are based on the present standards of the Maritime Administration for trust indentures under Title XI ship mortgage bond insurance, 46 C.F.R. § 298.4 (1958), and the qualifications for trustees under the Trust Indenture Act, 1939, Title III, § 310, 52 Stat. 1149 (1939), as amended, 15 U.S.C. 77jjj (1964).

These requirements were written into the legislation to clarify any uncertainty with respect to the eligibility of an organization for the position of a trustee-mortgagee. Although there still exists uncertainty as to eligibility, with the help of other statutes after which these qualifications were patterned,<sup>34</sup> greater clarity will obtain than did before.

In addition to the trustee-mortgagee citizenship qualifications, the reported legislation also provides that (1) sales of bonds in violation of these sections are void (transfers in violation of sections 9 and 37 of the 1916 act and section 300(d) of the 1920 act have always been void),<sup>35</sup> (2) bonds held by noncitizens or sold to them before the effective date of this legislation or within one year thereafter are valid and the mortgage is preferred if the trustee is approved by Maritime within such year, (3) if the trustee should ever fail to meet the standards under which he was approved, the approval may be revoked and (4) upon disapproval of a trustee, a substitute trustee may be obtained by the bondholder. The last provision is a disclaimer of any intent or purpose to effect litigation pending as of the date of enactment. This was obviously aimed at any reargument or appeal of the *Westhampton* case.

#### IV. POST-LEGISLATION RAMIFICATIONS

Most of the uncertainty created by the *Westhampton* decision has been eliminated. Bondholders and mortgagee-trustees now may be sure of the preferred status of their mortgage simply by obtaining Maritime approval of the citizen-trustee. By allowing a one year grace period to obtain approval of their trustee, the amendments remove any cause for uncertainty on the part of transferees, who would have needed prior approval of their transfers, under the *Westhampton* decision.

Notwithstanding the foregoing provisions, the legislation did not overrule the *Westhampton* decision entirely. For example, where parties either do not or cannot have the trustee approved,<sup>36</sup> the *Westhampton* decision is still good law. In this situation, the same questions of the chain of title and violative transfers among an issue of many bonds under a single mortgage, discussed *supra*, still remain. If a bondholder realizes or suspects, but cannot be sure that there are bond transfers which need the approval of Maritime, can he force the trustee to seek Maritime approval? May a bondholder, on a mere suspicion of the necessity for approval of the trustee, obtain a substitute trustee with impunity when the present trustee could not or would not obtain Maritime approval? These problems should only arise, however, where a trustee has not been able to obtain approval. Therefore, to voluntarily

<sup>34</sup> *Supra* note 33.

<sup>35</sup> See note 44 *infra*. This provision for voiding transfers in violation of the amendment is indicative of one of two alternatives: Either Congress did not realize that transfers in violation of the three sections were void before the amendment, or Congress wanted to re-emphasize the consequence of violating these sections.

<sup>36</sup> There seems to be a very "small likelihood of substantial corporate trustees ceasing to be qualified and a reasonable assurance of continuity of approval of trustees." House Hearings, *supra* note 16, at 19 (statement of Carl C. Davis, General Counsel Maritime Administration, Department of Commerce).



forego obtaining approval would appear to be foolhardy, particularly since the burden of seeking approval is not difficult.<sup>37</sup>

Under the amended acts two express means of approval exist: individual approval of bondholders under section 37 of the 1916 act or approval of the trustee-mortgagee under the reported legislation. There also might be a third mode of approval by which the trustee-mortgagee seeks prior approval of all his bond *transfers* under a single trust deed. The authority for such approval would have to be implied from section 37 of the 1916 act.<sup>38</sup> Such a procedure would provide relief from the *Westhampton* problems for the trustee-mortgagee who could not obtain approval under the reported legislation.

The major problem with the reported legislation, however, is that Congress has done more than it set out to do. According to the House report, the policy which was to be furthered was the

. . . encouraging [of] low interest private financing for the construction and reconstruction of American flagships while at the same time limiting the possibility of foreign control of such ships.<sup>39</sup>

Indeed, the present legislation has removed the barriers to low interest private financing, but the legislation has also increased the possibility of foreign control.

The roots of the problem lie in *Westhampton*. There the court looked outside the 1920 act in order to determine the validity of the preferred status of Chemical's mortgage; this was a mistake.<sup>40</sup> Section 30D(a) of the 1920 act presents an exhaustive and seemingly exclusive list of requisites for the validity of preferred mortgages, which list is preceded by the introductory phrase, "a valid mortgage which." The *Westhampton* court added an additional qualification of its own: that transfers of bonds by the mortgagee (Chemical) to a third party (Landesbank) to the mortgage must also be valid. The court held these transfers to be governed by section 37 of the 1916 act. This construction seems especially illogical vis-à-vis section 30B(5) of the 1920 act which, in effect, states that, for the purposes of the 1920 act, only the mortgagee-trustee need be considered in qualifying the mortgage for preference.<sup>41</sup> Transactions between bondholders and the mortgagee-

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<sup>37</sup> The procedure for acquiring Maritime approval is found in 30 Fed. Reg. 14994 (1965).

<sup>38</sup> Mr. John R. Tankard, Assistant General Counsel, Division of Mortgage and Marine Insurance, Maritime Administration, Department of Commerce, expressed sincere doubt as to the existence of such authority in § 37 of the 1916 act. He remarked that he would not know how to answer a request for such an approval. Interview, with Mr. John R. Tankard, April 2, 1965.

<sup>39</sup> H.R. Rep. No. 1116, 89th Cong., 1st Sess. 2 (1965).

<sup>40</sup> The Maritime Administration does not believe that a bond is an interest in a ship in any event. *Supra* notes 7 & 13. See also House Hearings, *supra* note 16, at 5.

<sup>41</sup> This section reads: "The term 'mortgagee,' in the case of a mortgage involving a trust deed and a bond issue thereunder means the trustee designated in such deed." Section 30D(a) recites the qualifications for a preferred mortgage; it speaks only in terms of the mortgage and the mortgagee. See also note 7 *supra*.

trustee are clearly not within the concern of the 1920 act with respect to mortgage preferences.<sup>42</sup>

Whatever restrictions and sanctions the 1920 act puts on transfers of bonds under preferred mortgages are contained in section 300(d) of that act which provides that:

No *rights under a mortgage* of a vessel of the United States shall be assigned to any person not a citizen of the United States without the approval of the Secretary of Commerce. Any assignment in violation of any provision of this chapter *shall be void*. (Emphasis added.)

Only by analogy to *Westhampton's* interpretation of "interest in a vessel" would "rights under a mortgage" mean a bond secured by a mortgage. Just as *Westhampton's* construction of this phrase contradicted Maritime's understanding of it, so also would the analogous construction of "rights."<sup>43</sup> Even assuming that a "right under a mortgage" does include a ship mortgage bond, the net result of a transfer in violation of this section would only be that the transfer is *void*. In other words, *Chemical's mortgage on the vessel is not affected at all by the terms of section 300(d) of the 1920 act; only the transfer of the bond to Landesbank is affected.*<sup>44</sup>

The *Westhampton* decision, however, did not rely on section 300(d) of the 1920 act; instead, it relied on section 37 of the 1916 act. This section is penal, and any congressional intent to confer private remedies for its breach is totally absent. A transfer in violation of section 37 of the 1916 act would also appear to be merely *void*;<sup>45</sup> in addition, the violative interest is forfeited to the United States Government, and the breaching parties are subjected to fines, imprisonment or both. Again, it is difficult to see how a transfer of a bond which is *void* by the terms of the statute should have any effect on the preferred status of the mortgage.<sup>46</sup>

While it might be debatable whether the *Westhampton* decision was equitable or not,<sup>47</sup> it is nonetheless unfortunate that the holding involved the 1916 act in any respect. By basing its reasoning on section 37 of the 1916 act, the *Westhampton* court made it very difficult to cure the problems created by the decision without amending that act and section. Congress did in fact amend sections 9 and 37 of the 1916 act. And by amending these

<sup>42</sup> Supra note 6.

<sup>43</sup> Senate Hearing, supra note 7, at 84-85 (statement of Carl C. Davis, General Counsel, Maritime Administration, Department of Commerce).

<sup>44</sup> There is a question here as to when the voiding takes effect: ab initio, or at the initiation of a government suit under §§ 9 and 37 of the 1916 act and § 300(d) of the 1920 act.

<sup>45</sup> Supra note 44.

<sup>46</sup> It is difficult to predict what effect this argument would have had on the outcome if it were presented to the court. Two reasons for not presenting the argument are: (1) The lateness of the argument relating to the § 37 violation, supra note 9, and (2) Landesbank's fear that its bond would be forfeited to the Government.

<sup>47</sup> The general creditors with maritime liens on the S.S. *Westhampton* contracted with the shipowners knowing there was a preferred mortgage on the vessel. If the preferred mortgage fails, the United States will receive a windfall if the ship is forfeited and the general creditors will receive a windfall if the ship is not forfeited.

sections the restrictions on alien control of American flagships were unconsciously liberalized. Now, by use of the mandatory language "shall" in the legislation, Maritime must grant approval to any trustee-mortgagee fulfilling the qualifications listed therein. This approval ipso facto eliminates any subsequent control by Maritime over all bondholders acquiring under the approved trustee-mortgagee. Whether Maritime could revoke its approval of the trustee because of the nature of those holding bonds under it is not known; however, it would be stretching the statutory interpretation to find such a sanction in the amended acts.

It is submitted that only two sections of the 1920 act should have been amended in order to remedy the *Westhampton* problems: First, section 30B(5) should have been changed (as was done in the reported legislation) to eliminate approval of individual bond transfers under a trust mortgage where the trustee-mortgagee has the approval of Maritime. Second, section 30O(d) should have been amended to provide (as did the first bill introduced) that a bond, note or other evidence of indebtedness is not a right under a mortgage.

By so doing, all the uncertainties which were eliminated by the enacted legislation would still be eliminated, and by retaining sections 9 and 37 of the 1916 act in their original form individual noncitizen bondholders would still be within the control of Maritime. This would leave the Government to its own remedies for violations of sections 9 and 37 of the 1916 act, excluding any private remedies related to the priority of maritime liens between preferred mortgagees and other creditors. Violations of sections 9 and 37 of the 1916 act would jeopardize only those bondholders who violate it; as regards other bondholders and the common trustee-mortgagee, the preferred mortgage would remain unaffected. It is submitted that this is the way the law should be and, for all practical purposes, the way the law was before the *Westhampton* decision.<sup>48</sup> As it now stands, the S.S. *Westhampton* is free to sail the Seven Seas, while Congress flounders in the U.S.C.

STEVEN H. GRINDLE

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<sup>48</sup> In his statement to the House and Senate subcommittees on this legislation, Carl C. Davis, General Counsel, Maritime Administration, Department of Commerce, minimized the possibilities of alien control through bondholdings. In fact, the Maritime Administration approved the legislation as introduced, which merely provided that a bond, note or other evidence of indebtedness was not an interest in a ship, and thus allowed unrestricted participation of noncitizen investment through bonds secured by a mortgage on the ship. House Hearings, *supra* note 16, at 16-27; Senate Hearings, *supra* note 7, at 3-17, 79-88.