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Effjohn International Cruise Holdings, Inc. v. A&L Sales, Inc. United States Court of Appeals for the Fifth Circuit 346 F.3d 552 (Decided September 19, 2003)

Brain Bleich, Class of 2004

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SURETY BONDS AS MARITIME CONTRACTS

The Court found passenger vessel surety bonds promising to refund passengers' money for cruises did not give rise to a maritime lien and thus do not get priority over other liens.

Effjohn International Cruise Holdings, Inc. v. A&L Sales, Inc.
United States Court of Appeals for the Fifth Circuit
346 F.3d 552
(Decided September 19, 2003)

In December 2000, New Commodore Cruise Lines and its vessel-owning affiliates filed for Chapter 11 Bankruptcy in the Southern District of Florida. Two of Commodore's cruise ships, the *M/V Enchanted Isle* and the *M/V Enchanted Capri* were then stranded in the port of New Orleans, Louisiana. They became subject to an automatic bankruptcy stay, which the Bankruptcy court in Florida lifted to facilitate the arrest of the vessels. As a result, the district court for the Eastern District of Louisiana acquired admiralty jurisdiction. Each vessel had copious creditors, some of whom were asserting maritime liens.

This case resulted from the consolidation of several interlocutory appeals from the admiralty proceedings arising from the bankruptcy of New Commodore Cruise Lines. There were two primary issues before the court. First, whether the district court judge had abused his discretion by denying intervention by two maritime lien claimants upon one of the two vessels. Second, whether the surety for a passenger vessel surety bond has a maritime lien.

Plaintiff, Effjohn International Cruise Holdings, Inc. ("Effjohn") sought to assert domestic maritime claims it had acquired from other creditors via assignment and subrogation. In late August 2001, Effjohn requested that the bankruptcy court lift the automatic stay for *M/V Enchanted Isle* so that Effjohn could arrest the vessel pursuant to Supplemental Admiralty Rule C of the Federal Rules of Civil Procedure. Effjohn filed a verified complaint and arrested the vessel. Numerous other creditors intervened. In October 2001, Effjohn moved unopposed for an interlocutory sale, which was granted and scheduled for early December. In November, after publishing notice in compliance with Rule 55(a) of the Federal Rules of Civil Procedure, Effjohn requested an entry of default against all non-parties. This order was granted as against "any person, natural or juridical, who has not already intervened or filed a complaint or claim in this action."

Three days before the scheduled December sale of the *M/V Enchanted Isle*, Effjohn sought to amend its complaint to add approximately \$500,000 in acquired subrogated and assigned claims. The district court held a post-sale hearing and afterward denied the motion as "untimely as a matter of law" and provided the following reasons: (1) the court found the motion "an ill disguised motion for leave to intervene" because it asserted claims of parties who had not asserted timely claims; (2) the new claims were being asserted at a "late date"; (3) the entry of default had been at Effjohn's request; (4) a second entry of default had been entered December 11th at the request of another party; (5) the court did not want to permit Effjohn to circumvent the entry of default and deadline for filing of intervention motions; and (6) if it were not for the failure of Effjohn

to produce acceptable security after purchasing the vessel at auction the lien-phase of the action would be well underway.

The Court of Appeals for the Fifth Circuit upheld the district court's denial of Effjohn's motion to amend the complaint. The Fifth Circuit agreed with the district court's finding that permitting Effjohn to amend the complaint this late in the proceedings would be unduly prejudicial to the other parties. Additionally, the Circuit Court held that lower court was fully justified in denying the motion as a matter of discretion when considering the default as one factor in the timeliness inquiry.

Cusimano Produce Co. ("Cusimano"), the second claimant of the three combined interlocutory appeals, is a New Orleans produce company who provided fresh produce to the *M/V Enchanted Isle* between October and December 2000. It claims a maritime lien for necessities based on the supplied produce, and was not permitted to intervene to make this claim. Cusimano received personal notice of the bankruptcy in the cases of *Commodore* and the *Enchanted Capri* and timely filed proofs of claim in those proceedings. It did not receive personal notice involving the *M/V Enchanted Isle* nor did it file a proof of claim in that proceeding, and therefore did not receive notice of the lifting of the bankruptcy stay and the arrest of that vessel.

On February 7, 2002, two months after the sale of the *M/V Enchanted Isle*, Cusimano moved to set aside the entry of default and for leave to intervene. The district court denied the motion, finding that although Cusimano did not receive personal notice it failed to establish good cause for failing to file a timely claim as the legal notice was published. The district court also relied on the fact that Cusimano was present in the other two proceedings and a finding that there would be substantial prejudice to the timely defendants if the default were set aside allowing additional claimants to "straggle into these proceedings." Therefore, the district court found that Cusimano had received actual notice and that the equities weighed against setting aside the default judgment allowing Cusimano's claim. In its appeal, Cusimano maintained this was an abuse of discretion on the part of the district judge.

The Court of Appeals for the Fifth Circuit stated that defaults are generally not favored and should not be strictly enforced. Any doubt should be resolved in the favor of the moving party in the interest of securing a trial on the merits. Therefore, a court may set aside an entry of default for good cause shown. Showing good cause requires at least an examination of three factors: (1) whether the failure to act was willful; (2) whether setting aside the default would prejudice the adversary, and (3) whether a meritorious claim has been presented. These factors, however, are not exclusive and other factors may be considered. Notwithstanding these principles, the Circuit Court held that although entries in default are not generally favored, the district court did not abuse its discretion in denying Cusimano's motion to intervene.

The second issue, whether the surety for a passenger vessel surety bond has a maritime lien, was raised by Swiss Reinsurance America Corp. and Amwest Surety Insurance Co. ("Sureties"). The Sureties issued a Federal Maritime Commission Passenger Vessel Surety Bond ("bond") to *Commodore* to cover its vessels, including the *M/V Enchanted Isle* and *M/V Enchanted Capri*. The bond provided security for passengers who pre-paid for cruises on one of *Commodore*'s vessels but who, through no fault of their own, never sailed. The bond required the Sureties to refund up to \$15 million, if *Commodore* was unable to do so. A passenger vessel operator is required to

post such a bond or otherwise prove financial responsibility in accordance with 46 U.S.C. § 817e. Swiss Reinsurance America Corp. reinsured the bond and was a co-surety with Amwest Surety Insurance Co. The Sureties claim a maritime loan for necessities against both the vessels in this case based on the bond. In the *M/V Enchanted Isle* proceedings, the other parties each moved in January 2002 for summary judgment against the Sureties' claim contending that the bond was not a maritime contract; that the Sureties did not have maritime liens against the *M/V Enchanted Isle* because the bond was not a necessary and was not provided to a particular vessel; that it was instead issued to Commodore to cover the entire fleet; and that the Sureties do not have a maritime lien through the vessel's passengers. Following argument, the district court granted the motions, ruling that the bond is not a maritime contract; the Sureties do not have a maritime lien for necessities; and the Sureties do not have a maritime lien through the passengers because the passengers do not have maritime liens.

On appeal, the Sureties maintain the claims made in the district court. The court found that a maritime lien exists for the bond only if the bond is a maritime contract subject to admiralty jurisdiction and the bond is a necessary provided to a vessel. The court then determined from case law that the true criterion is the nature and subject matter of the contract, and whether it was a maritime contract having reference to maritime service or maritime transactions. The Sureties here urged a broad test for determining whether a contract is a maritime contract, proposing that where the underlying contract is maritime and the controversy arises directly out of a claim for non-performance on that contract, an admiralty court has jurisdiction even when money damages are sought. Under their proposed test the underlying contract for the transport of passengers would be the maritime contract from which their claim arises.

The Court took a far narrower view relying on *Pacific Surety Co. v. Leatham & Smith Towing and Wrecking Co.*, 151 F.440 (7th Cir. 1907) and holding that under a passenger vessel surety bond the Sureties merely agreed to refund passenger monies for unperformed cruises; it was not a maritime contract and could not give rise to a maritime lien, as well as distinguishing maritime insurance from surety bonds as the former had long been a part of world-wide general maritime law covering the risks of navigating a vessel. While a surety bond is not a well-established part of maritime law, it can only be drawn upon in the event there is a failure of a vessel to sail at all. The court went on to find that the bond is a consumer-protection measure, not a maritime service, by making good on the owner's financial obligations to reimburse passengers for non-performance. Therefore, surety bonds do not fall within admiralty jurisdiction.

The Sureties argued in the alternative that they had a maritime lien because they are subrogated to the claims of pre-paid prospective passengers, under the assumption that such passengers have maritime liens. The Court of Appeals found that such contracts for prospective passengers were executory contracts that had not as yet been fully performed, and as such the breach of an executory contract does not create a maritime lien.

The Sureties then argued that the executory contract doctrine was outdated and that the court should create a maritime lien in favor of the passengers, using as their only support the general inclination of Congress toward protecting consumers contracting with cruise ship operators. The court responded negatively to this notion, finding that the enactment of 46 U.S.C. § 817e demonstrated that there is no maritime lien on pre-paid

passenger fares because Congress enacted § 817e to provide the passengers with financial protection without requiring the creation of a maritime lien. Accordingly, the court found that the Sureties, even to the extent they might be subrogated to such claims, still had no claims in admiralty.

Therefore, the court upheld the denial of Effjohn's motion to amend its complaint, the denial of Cusimano's motion to intervene, and the dismissal of the Sureties' claims, and fully affirmed the ruling of the district court.

Brian Bleich
Class of 2004