Shipping

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CHAPTER 11: LIBERATION OR SUSPENDED SENTENCE?

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2011 has seen the insolvency of several shipping concerns. The boards of companies holding tankers and containerships in particular have watched their earnings decline to a level insufficient to service debt, leaving in prospect but one apparent alternative: wholesale repossession, foreclosure and liquidation.

In many jurisdictions the survival of an enterprise in such circumstances is neither realistic nor possible without the unanimous support of creditors. In the mid 1980s, a time of similar crisis in the shipping industry, there were some bold and dramatic restructurings having as their ultimate and fortunate result the full payout of the institutions and investors concerned. Those rescues were, however, entirely consensual.

In recent months a number of highly leveraged shipping concerns have turned to another potential survival strategy by making applications to US federal bankruptcy courts for their reorganisation under Chapter 11 of the US Bankruptcy Code: including as part of the relief provided the immediate and complete protection from further creditor action. Filings by Omega Navigation (in Houston on 8 July 2011) and Marco Polo Seatrade (in New York on 29 July 2011) have been among the most widely reported instances of this strategy.

Another of the most recent filings, that of General Maritime Corporation (in New York on 17 November 2011), is notable by reason of the apparent support of the major commercial bank lenders: recognising that reorganisation and an orderly liquidation of assets is the only viable option, in a scheme that has all the hallmarks of careful planning and a pre-arranged debtor-in-possession interim financing facility to allow continued normal operation. Other proposals have, however, met with strong opposition from the secured lenders involved and have caused shipowners and banks to consider the implications for ship financing projects.

So, you may ask, is it just US based concerns that can call for such protection and if not

what is the extent of the required US connection? Read on...

Marco... Polo...

The Marco Polo court ruling on 21 October 2011 restated the minimum threshold for qualifying for Chapter 11 protection. The statute requires the debtor to have a "domicile, place of business or property" in the US. The ruling confirmed that this could be fulfilled with reference to, amongst other things, deposit accounts and retainers in the US (even where such deposits and retainers are for the purposes of instructing US bankruptcy counsel!).

Similarly, the dismissal of a Chapter 11 filing on the grounds of 'bad faith' remains a challenging task in most cases and was an argument which Credit Agricole and the Royal Bank of Scotland were unable to maintain in relation to Marco Polo.

At the time of writing a ruling in the Omega case is still awaited, although it is widely expected that the US jurisdiction test will be satisfied, not least by reason of the fact of Omega's shares being publicly listed in the US. Nevertheless, the filing remains heavily contested by HSH Nordbank on behalf of the senior lenders who are aiming for the case to be dismissed or converted to a Chapter 7 liquidation and for the automatic stay to be lifted.

Show me the money!

The progression of the Marco Polo, Omega and Genmar cases has led to renewed focus on bankruptcy and insolvency proceedings at a time when inaction over covenant breaches, bank recapitalisation, looming repayment dates and imminent expiration of waiver letters have left banks and borrowers looking purposefully at default and enforcement provisions.

Work-out restructurings and private enforcements have continued to gather momentum, with vessel sales and fleet reduction seen as a first step to reducing debts for highly leveraged owners. Most of these, reflecting the intensely private nature of shipping, have taken place discreetly, but there have been some high profile cases: notably the substantial injection of cash into Frontline, another substantial tanker operator, by John Fredriksen's private vehicle, Hemen Holdings[1]. However, with depressed market values and dwindling freight rates set to continue for the immediate future, the very best of intentions between banks and borrowers may be about to hit the rocks, as analysts and financial advisers assess what real value is left within the balance sheets of their borrowers.

Negotiations and relatively short term restructurings look like they are set to continue. However, the methodology which banks utilise to value the underlying assets in the current state of the market is a critical factor and one of considerable debate beyond the scope of this article. The reality of the balance sheet insolvent borrower and an imminent cash drought leaves parties no other option than to sit down and investigate the procedures available for a full scale (and potentially public) enforcement situation.

The multi-jurisdictional nature of the shipping business has, historically, developed a widely understood set of rules allowing for secured lenders to predict with reasonable certainty the outcome of an enforcement strategy. There are a number of "mortgagee friendly" jurisdictions around the world, for example Gibraltar, in which specialist procedures and courts can be relied on to order a prompt sale of the vessel and a return of the proceeds to the mortgagee, respecting its priority position (certain maritime lien claims excepted). However, the development of US and EU cross-border insolvency regimes in the last decade has woken up advisers to the need for coordination of differing insolvency procedures throughout the world – a concept which may have been lacking in global industries such as shipping.

Out at sea

The globalised nature of shipping can quite easily present a Liberian ship owning company, a vessel flagged in Greece, a holding company and corporate guarantor incorporated in the Marshall Islands (but listed in the US). Not to mention an affiliated Singaporean management company, a German financing bank lending US Dollars through its London branch all with loan and security documents governed by English law. No wonder the affidavits supporting the various Chapter 11 applications have to go to such lengths explaining such apparently complex structures.

We, as lawyers, are responsible for documenting the relevant security interests and attending to the due satisfaction of the required elements to obtain the required result for the relevant jurisdiction, obtaining an opinion in most cases from a lawyer in the jurisdiction concerned. But how

1. See Articles "'Bad' Frontline still has long way to go" by Terry Macallister, TradeWinds 9/12/11 and "Fredriksen wins in a tale of two owners" by Robert Wright, Financial Times 7/12/11.

often do we (or our clients) address the possibility of a multiplicity of insolvency procedures in different jurisdictions?

The wide variety of jurisdictions in play, however, will inevitably present complications when dealing with a group of companies especially with a fleet trading around the world. Creditor groups and debtor companies are often left to assess what insolvency laws and procedures might be applicable and how they might best be administered and enforced. When a bankruptcy court gets involved in such matters, as parties have found, decisions regarding enforcement strategy and timing move out of their hands. Those powers offered by the duly registered mortgage, conferring (as it purports to do) the right to possess, manage and sell, all go by the board. It is uncharted territory.

They tried to make me go to rehab...

Cases such as Marco Polo have underlined the minimal threshold required to qualify for insolvency proceedings in the US – and most obviously Chapter 11 protection for debtors (as they are referred to in the US Bankruptcy Code). The benefits of such protection have attractions for operators in the international industry that is shipping, where a filing could, amongst other things: (i) give rise to an automatic stay of proceedings with extra-territorial (i.e. international) effect; and (ii) offer the 'debtor-in-possession' status which allows the debtor and its existing management to continue their business as a going concern (and obtain debtor-in possession financing) whilst a restructuring plan is hammered out with its creditors. However, without any workable reorganisation plan which creditors and debtors could envisage themselves accepting, the likelihood is that both parties could be left in a Mexican standoff. That possibility of rehabilitation will look as remote as ever.

Despite the potential attractions to debtors, a note of caution is raised for those who seek the protection of Chapter 11 merely as a tactical filing. Chapter 11 filings for debtors which are hopelessly insolvent and do not have demonstrable creditor support for a reorganisation plan, could easily metamorphose into full form liquidation proceedings under Chapter 7 of the US Bankruptcy Code.

In addition, the development of Chapter 15 as part of the US Bankruptcy Code, provides a mechanism whereby on-going insolvency or bankruptcy proceedings in a non-US jurisdiction can gain control over assets (including US assets) of a non-US debtor. Importantly, any such non-US proceedings would be recognised by the US Bankruptcy Court. This would allow the company's global assets to be brought under the framework of one jurisdiction, with the aim of a much more coordinated approach for multi-jurisdictional businesses. Provided that proceedings in the non-US jurisdiction are considered to be "main" proceedings, a stay in respect of the US bankruptcy proceedings would be attainable.

The centre of attention

As with the Cross Border Insolvency Regulations in the UK, Chapter 15 gives effect to the Model Law on Cross Border Insolvency of UNICITRAL (United Nations Commission on International Trade Law) and draws on the principle of "centre of main interest" ("COMI").

A company's COMI will be the jurisdiction with which it is most closely related. Whilst there is a presumption that the COMI will be the location of the company's registered office, this can be rebutted by a company having the majority of its assets and/or operations in another location. Conversely, however, where the objectively ascertainable management and supervision are in the same place as the registered office the COMI presumption will be irrebuttable – as shown in the recent ECJ judgment of *Interedil Srl v Fallimento Interedil Srl and another*. Both the US Courts and the ECJ have been shown to take a similar approach when applying such principles.

An important factor to note, however, is that the Model Law does not address the issue of 'where' insolvency proceedings should be commenced. Instead it provides a framework of recognition when insolvency proceedings have commenced in a variety of jurisdictions.

First to pull the trigger

Cross border insolvency regimes continue to evolve throughout the world. As increasing numbers of global businesses are forced to deal with insolvency proceedings, it is clear that those jurisdictions with developed insolvency laws will attract more support from creditors and the insolvency "profession", confident in the greater likelihood for coordination and consequent orderliness of the

ensuing reorganisation (or liquidation) of the company's affairs. However, as jurisdictions in Europe and the US acclimatise to this trend towards greater coordination, both creditors and shipping companies will retain significant scope to 'forum shop' for a jurisdiction which best suits their needs.

The choice of jurisdiction may then ultimately be left to the party who acts first. A secured creditor establishing 'main' insolvency proceedings in England and Wales, for example, may have a strong case for a stay of US bankruptcy proceedings – especially where the debtor company has questionable justification for a filing in the US and limited US creditors. Cases such as Cenargo[2] would certainly support this position.

2. Cenargo Limited was an English company which had raised funds in the New York Capital markets. It operated ferries across the English channel as well as other operations. The US investors (bondholders) arranged for Cenargo to go into Chapter 11. Lombard (a subsidiary of RBS) originally consented to the Chapter 11 and agreed to be on the creditors committee. Subsequently because of the perceived bias of the Chapter 11 proceedings towards the bondholders the RBS board got involved and Lombard applied to have the same company put into provisional liquidation by order of the English Court. The English Court also made anti-suit injunctions against the directors of Cenargo forbidding them to proceed with the Chapter 11 process. This resulted in a stand-off between the New York Court (Judge Drain) and the English judge. Lombard in fact owned the ships under a lease finance arrangement and eventually Judge Drain accepted that the centre of operations was in Europe and that it was more appropriate for the company to go into administration under English law than to be under the Chapter 11 process. As a result the Chapter 11 process was terminated by agreement of the New York Court and the matter proceeded as an English administration.

Outcome-focussed action

Prompt and decisive action by a bank or borrower when default or the threat of default arises will often have the greatest impact on the outcome in an insolvency situation. If formal insolvency proceedings (whether in the nature of Chapter 11 creditor protection, UK style administration or general liquidation) are in prospect, first mover advantage is key. In an environment that is anything but certain, and with shipping companies as diverse as the individuals behind them, the best course of action for any bank or borrower is prompt action supported by a careful risk/benefit analysis of the applicable insolvency procedures on a case by case basis. Meanwhile a new generation of battle-hardened ship financiers and their lawyers will adapt and evolve....

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