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THE GOOD, THE BAD, AND THE UGLY OF SHIPPING CHAPTER 11s

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A TROUBLED MARKET

From 2000 to 2007, the international freight market was flooded with rising commercial and consumer demand for maritime shipping, which resulted in record-setting charter hire rates. To keep pace with demand, the shipping community acquired existing vessels at significant premiums, and built new vessels at equally high prices. In 2008, when a worldwide global recession severely depressed demand, vessel charter rates plummeted to historic lows, and shipping companies lacked the vital cash needed to fund daily vessel operating expenses, meet their new-build contract obligations, or service their existing debt. By 2010, shipping companies were regularly defaulting on their funded debt.

In response, shipping companies initiated discussions with their lenders to extend or restructure the terms of their loans. Out-of-court restructurings remain the less expensive option, and should be the first choice scenario, followed only by more extreme measures if the lenders leave no other choice. In some instances, the lenders ultimately declined to extend forbearance arrangements in order to facilitate discussions. Consequently, under the threat of default and acceleration, some shipping companies were left with no choice but to commence insolvency proceedings. Many companies are organized in jurisdictions where insolvency proceedings are simple liquidations conducted by a court-ordered trustee. The focus ultimately shifted overseas to the United States because Chapter 11 provides a meaningful opportunity to reorganize a business and the threshold for jurisdiction over non-US companies is very low. Since 2011, foreign shipping companies have filed for Chapter 11 with varying degrees of success.

THE FIRST WAVE OF CURRENT CHAPTER 11 FILINGS: DEBTOR ELIGIBILITY DEFINED

In the summer of 2011, two international shipping companies — Marco Polo Seatrade and Omega Navigation Enterprises — faced aggressive secured lenders, and turned to Chapter 11 as a last resort.

On July 8, 2011, Omega and nine affiliates filed Chapter 11 petitions in the Southern District of Texas, Houston. The debtors' senior facilities agent promptly filed a motion to dismiss the debtors' cases or convert them to liquidating Chapter 7 cases, followed shortly by a motion for an order lifting the automatic stay to exercise its rights in the collateral. In December 2011, the bankruptcy court issued its order denying the motions. The bankruptcy court also issued, *sua sponte*, an order requiring the senior lenders, their counsel and others to show cause as to why they should not be sanctioned for potentially improper actions taken by them in prosecution of the motions. (As part of a global settlement later in the case, the order to show cause was consensually vacated.)

After a 6-month court-ordered mediation, Omega and its senior lenders agreed to a plan of reorganization to restructure the senior lenders' loans and continue Omega's shipping businesses as going concern. By all measures, this was a successful result. Unfortunately for Omega, the market worsened and Omega approached its senior lenders with a request to modify the plan in order to adjust to the revised, lower revenue projections. The senior lenders declined and, instead, the parties eventually agreed on a consensual liquidation.

On July 29, 2011, Marco Polo and three affiliates filed Chapter 11 petitions in the Southern District of New York. In September 2011, the debtors' secured lenders moved to dismiss the debtors' Chapter 11 cases. The lenders contested, among other things, the eligibility of the debtors to commence Chapter 11. In ruling for the debtors, the bankruptcy court found that the funds held by Marco Polo's counsel in New York and those in a pooling account were sufficient to satisfy the debtor eligibility requirements under the Bankruptcy Code.

Marco Polo and its secured lenders were unable to come to

an agreement on a consensual plan and, because Marco Polo's vessels were worth less than the lenders' debt, Marco Polo concluded that it would be unable to reorganize on a going-concern basis. As a result, the case ended in confirmation of a liquidating plan with the secured lenders ultimately having their collateral (the ships) turned over to them.

Importantly for Omega and Marco Seatrade, and for later Chapter 11s, both courts accepted the concept that a foreign debtor need only have minimal property in the US in order to be eligible for Chapter 11. In both cases, the primary US property was a retainer paid to US counsel by each of the debtors.

ADDITIONAL CHAPTER 11 SHIPPING CASES WITHOUT LENDER CONSENSUS

Taiwan-based TMT Shipping Company and 22 of its affiliates filed Chapter 11 in the Southern District of Texas, Houston, on June 20, 2013, after failed mediation efforts under the auspices of the Government of Taiwan. TMT faced two substantial challenges. First, TMT's 16 vessels were subject to 16 different financings with different lenders who were not cross-collateralized. Accordingly, TMT would need to effect 16 different lender agreements (in addition to plans for the non-vessel owning debtors) in order to restructure the business as a whole on a consensual basis. Second, there was an exceptional level of animosity between the lenders and TMT management, based on the history of their interactions prior to the Chapter 11 filing. This made it substantially harder to reach consensual agreement due to a high level of mutual distrust.

TMT's lenders immediately moved to terminate the Chapter 11 filings on various grounds, including lack of US jurisdiction over the Taiwan-based debtors and an alleged lack of good faith on TMT's part in commencing Chapter 11. After multiple lengthy hearings and extensive testimony from TMT management, the court concluded both that it had jurisdiction over the debtors and that the debtors had commenced Chapter 11 in good faith. The basis for jurisdiction was a fee retainer paid by the debtors to their financial advisers.

However, given the level of animosity and distrust among the parties, among other factors, the debtors were unable to succeed in negotiating consensual restructurings. TMT ultimately agreed to sell its vessels, either directly or through admiralty auctions, for the benefit of its lenders. This was coupled with a consensual replacement of TMT management with a director of TMT's financial adviser in order to conclude the winding-up of the Chapter 11 cases, which is still ongoing.

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Belgium-based Sobelmar Shipping and five of its affiliates commenced Chapter 11 proceedings in the District of Connecticut, Hartford, on March 17, 2015. As with Marco Polo Seatrade, Omega Navigation and TMT, the cases started with motions by Sobelmar's secured lender to dismiss the cases on various grounds, including lack of jurisdiction. In the case of Sobelmar, the debtors alleged jurisdiction was based on a fee retainer paid to Sobelmar's counsel and on bank accounts funded by the debtors shortly before the Chapter 11 filings.

The Sobelmar fleet consisted of only four vessels, causing both the debtors and the secured lenders to seek a consensual resolution rather than to incur disproportionate professional fees in litigation. After a two-day mediation, the parties agreed on a term sheet for a consensual reorganization, again demonstrating the viability of Chapter 11 as a restructuring vehicle. Unfortunately, as in Omega Navigation, the market worsened and the debtors sought renegotiated terms. When the secured lender declined to renegotiate, the debtors (with court approval) turned over the vessels to the lender and ultimately dismissed their Chapter 11 cases in favor of insolvency proceedings in Belgium.

CHAPTER 11 SHIPPING CASES WITH LENDER CONSENSUS

Several shipping companies have successfully reorganized in Chapter 11. These cases highlight the importance and value of lender consensus to the ultimate outcome.

On November 17, 2011, General Maritime Corporation Inc., a Marshall Islands corporation, and certain affiliates filed for Chapter 11 in the Southern District of New York. The debtors had entered into a restructuring support agreement with their secured lenders prior to filing for Chapter 11. With an agreement in place prepetition, the debtors were able to file a prepackaged Chapter 11 plan of reorganization on January 31, 2012. The plan provided that the debtors' prepetition senior lenders would receive a significant pay down of their existing prepetition obligations and provide exit financing to the debtors. A US-based private equity manager would receive 98 percent of the equity in the reorganized company in exchange for providing $175 million of new equity capital and converting $175 million of secured claims against the debtors. After some plan modifications, the debtors confirmed their Chapter 11 plan of reorganization on May 7, 2012 with support from all of their creditor classes.

On February 5, 2012, Ireland-based TBS Shipping Services Inc. and certain of its affiliates filed for Chapter 11 in the Southern District of New York for the second time (the first time was in 2000). The debtors filed a prepackaged Chapter 11 plan of reorganization on the petition date, which was later modified slightly. Under the plan, TBS restructured amounts it owed to its secured lenders into new post-petition loans and, in certain cases, equity interests in the reorganized company. In March 2012, the bankruptcy court entered an order confirming the plan less than two months after the cases were filed.

On July 1, 2013, Excel Maritime Carriers Ltd., a Greek shipping group, along with several affiliates, filed for Chapter 11 in the Southern District of New York. The debtors had reached an agreement with their senior lenders prior to filing, and the debtors filed a pre-negotiated Chapter 11 plan consistent with the agreement on the first day of the cases. Following mediation with the creditors' committee and other parties, the restructuring terms were substantially revised and the debtors confirmed a plan of reorganization in January 2014 less than seven months after filing.

On April 21, 2014, Genco Shipping & Trading Ltd. and certain affiliates filed for Chapter 11 in the Southern District of New York. The debtors filed a prepackaged plan of reorganization the day the cases were commenced. On July 2 2014, the bankruptcy court entered an order confirming the plan following a four-day trial on the proposed valuation of the reorganized debtors. The plan converted the outstanding senior secured debt into equity in the reorganized debtors, paid general unsecured trade creditors in full, and provided a small recovery existing equity holders.

LESSONS LEARNED

Five lessons can be learned from the Chapter 11 filings by non-US shipping companies discussed above.

First, a shipping company should seek an out-of-court resolution with its lenders if at all possible. Chapter 11 is expensive, and the results of any Chapter 11 filing are uncertain. The glare of the Chapter 11 spotlight can also harden the parties' positions and make it more difficult to reorganize when every aspect of the Chapter 11 case is part of the public record.

Second, Chapter 11 for foreign shipping companies is here to stay. The courts have consistently upheld de minimis US contacts — such as fee retainers — to support US jurisdiction. And, because almost all global banks and other financial institutions have their own US contacts — typically a branch in New York — the banks cannot ignore US jurisdiction even though their loans were made overseas and secured by non-US vessels.

Third, sometimes Chapter 11 is essential to clean up the balance sheet, including effecting a conversion of some of the debt to equity in the reorganized business. In that event, reaching agreement with lenders before the Chapter 11 filing will maximize the prospects for a successful reorganization while minimizing the expense of Chapter 11. This can be accom-

plished by a "pre-packaged plan," in which the debtors and their lenders agree and vote on a full restructuring plan prior to the Chapter 11 filing. If time is short, this can also be accomplished by a "restructuring support agreement," which is not a plan in itself but an agreement by the debtors' lenders that they will support a consensual plan of reorganization after Chapter 11 is commenced.

Fourth, "size matters." Marco Polo had six vessels, Omega Navigation had eight vessels, TMT had 16 vessels and Sobelmar had four vessels. The more vessels a shipping company has, the more cash flow it can generate to support the expense of Chapter 11 while a reorganization is attempted. And, although both Omega Navigation and Sobelmar were able to reach mediated agreements on a restructuring, once the market worsened neither had sufficient cash flow for a second attempt at a consensual or non-consensual restructuring. In contrast, General Maritime, TBS Shipping, Excel Maritime and Genco Shipping each had larger fleets, which not only enabled them to have more funding for Chapter 11 expenses, but also provided for the ability to raise new capital and provided their lenders with a greater incentive (with more funded indebtedness at stake) to reorganize the businesses with an equity upside for future recoveries.

Fifth, relationships matter. Of course, defaulting shipping companies and their vessel lenders have adversarial interests and can be expected to pursue their own interests in an aggressive way. However, in (or in anticipation of) Chapter 11, if the parties can put aside their animosities, they can work more quickly and less expensively towards a restructuring that benefits all parties or, if that is not possible, towards a consensual liquidation that enhances vessel recoveries compared to one-off admiralty sales in many jurisdictions where it can take years and very substantial expense to achieve a non-consensual arrest and sale.

THE GOOD, THE BAD AND THE UGLY OF SHIPPING CHAPTER 11s: THE SHIPPING COMPANY'S PERSPECTIVE

The good of Chapter 11s from the perspective of a shipping company is that it provides a final chance to rescue its business if all out-of-court attempts at a consensual restructuring have failed. In effect, when faced with the certainty of arrests and admiralty sales, the shipping company has nothing left to lose by grasping the straw of Chapter 11. While in Chapter 11, all creditor actions — including by secured lenders as well as unsecured creditors — are stayed, which gives the

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company a "breathing spell" in which to attempt reorganization. And this can be accomplished with only a de minimis relationship to the US, such as a fee reserve paid to the company's counsel.

The bad of Chapter 11s from the company's perspective is that it is a very expensive process. The company is required to pay not only for its own legal and financial advisers, but also for the legal and financial advisers of the official committee that is appointed to represent the interests of other unsecured creditors. The company also needs to be prepared to give up substantial equity in the reorganized business to its lenders as a potential cost of a consensual reorganization. And, of course, it is harder for a shipping company to do business while in Chapter 11 because charter counterparties and trade creditors can be leery of doing business with a company that is under the supervision of a foreign court.

The ugly of Chapter 11s from the company's perspective is that, absent lender support or in the face of a worsening market, it is very difficult to reorganize successfully. Obtaining court approval of a Chapter 11 plan without lender support is possible, but it is a difficult, expensive and time-consuming process that will be fought every step of the way. And, even if the company is able to force a restructuring on its lenders, challenges remain. The company will still need to deal with its lenders after the Chapter 11 is concluded, and it is seldom good business to have an adversarial relationship with lenders in the shipping arena.

THE GOOD, THE BAD AND THE UGLY OF SHIPPING CHAPTER 11s: THE LENDERS' PERSPECTIVE

The good of Chapter 11s from the lenders' perspective is that, if the lenders are prepared to support a reorganization but the balance sheet needs to be cleaned up, Chapter 11 can be used as a business tool to position the company for a sustainable capital structure going forward. Chapter 11 also presents the opportunity for lenders to acquire substantial equity in the reorganized business. While this is not typically an objective of traditional market lenders, many private investment funds and other investors will often be willing to buy out a lender's position at a discount with the express objective of converting a substantial portion of that debt into new equity — a so-called "loan to own" strategy.

The bad of Chapter 11s from the lenders' perspective is that it is an expensive and time-consuming process that serves to delay the lenders at substantial cost from realizing the value of their assets. If, due to animosity and mistrust, it is unlikely the parties will reach agreement, Chapter 11 can cause substantial pain and value-loss to frustrated secured lenders who are troubled by their foreign shipping borrower commencing a US Chapter 11 proceeding.

The ugly of Chapter 11s from the lenders' perspective is that, while sharing in the equity upside is nice, lenders may have difficult owning vessels over the long haul. And even if a reorganization will never be agreed to, the process can last years, with the lenders usually funding their own substantial fees along the way. This suggests that the parties should place an increased emphasis on resolving their issues either out-of-court, through a pre-negotiated Chapter 11 process, or through a mediated Chapter 11. Stated differently, even if the lenders consider a consensual resolution to be "bad," it can be better in hindsight than a Chapter 11 process that proves to be "ugly."

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