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Foreign Shippers: Weighing the Benefits Presented by Chapter 11

BY EDWARD J. ESTRADA

The global shipping industry continues to navigate rough waters due to an increase in shipping supply and a decrease in shipping rates that continue month after month. With such economic conditions expected to continue for some time, many major players in the industry are succumbing to the distress and are choosing to avail themselves of the restructuring or insolvency laws of their home jurisdictions (often with parallel proceedings elsewhere in the world), but are now more commonly also exploring the debtor-friendly protections afforded to entities filing for bankruptcy under Chapter 11 of the United States Bankruptcy Code.

Most, if not all, of these companies have undoubtedly had ongoing rounds of negotiations with their lenders, in an attempt to secure better loan terms for credit facilities that began in the past few years, often with non–traditional lenders that filled the credit vacuum created by the absence of more traditional lenders in the market. Facing limited options, these ship owners can attempt to secure new funding, renegotiate existing terms, or explore in-court restructuring or liquidation alternatives in their home jurisdictions or elsewhere. Realistically, the credit markets are providing fewer opportunities for borrowers to restructure their debt, especially as borrowers' slim equity cushions begin to erode. Further, after months or years of distress, lenders have begun to take on more aggressive positions when negotiating with their borrowers—at times resulting in the voluntary turnover of assets. The last option for many such companies is exploring court supervised liquidations or bankruptcy.

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Over the past year, numerous foreign shipping companies have sought to wind down their business in their home jurisdictions or have sought to reorganize in the United States to afford themselves the pro-debtor provisions not available under most foreign restructuring schemes. By way of example, foreign companies seeking relief in the United States under Chapter 11 have included *TBS International PLC*, Case No. 7:12-bk-22225, Bankr. SDNY; *General Maritime Corp.*, Case No. 1:11-bk-15285, Bankr. S.D.N.Y.; *Marco Polo Seatrade BV*, Case No. 11-bk-13634, Bankr. S.D.N.Y.; and *Omega Navigation Enterprises Inc.*, Case No. 4:11-bk-35927, Bankr. S.D. Texas. In addition, the last year has seen Humpuss Sea Transport file for bankruptcy in Singapore, and a subsequent Chapter 15 parallel proceeding filed in the U.S. Bankruptcy Court for the Southern District of New York; Korea Line Corp., which filed a Chapter 15 proceeding in the U.S. Bankruptcy Court for the Southern District of New York in support of its receivership filing in Korea; Swee Joo Bhd filed for a Restraint Order and commenced voluntary liquidation in Malaysia.

From these cases one can identify some of the key reasons that the United States bankruptcy system is becoming the preferred forum for foreign shipping companies. Trends in how such cases are being handled by the courts, and potential pitfalls for both debtors and creditors in such cases are discussed below.

The Benefits of a Chapter 11 Filing

Significant differences exist between United States bankruptcy laws and the insolvency laws of other countries. Principally, the United States' debtor friendly emphasis on rehabilitation makes U.S. bankruptcy courts attractive to financially distressed companies worldwide. It has been said that due to the globally dispersed nature of the companies' assets the U.S. bankruptcy system may be the only judicial system that can effectively reorganize such companies under court supervision.

Current Management Stays in Control

In Chapter 11 cases, a debtor's current management may stay in control, maintaining assets and continuing regular operations. Upon the filings, the debtor is referred to as a debtor in possession (''DIP'') and assumes the management of the entity. In cases where dishonesty or mismanagement by the debtor is shown, the court may order appointment of a trustee to displace current management.

Although the debtor in possession maintains control of the business, that control is limited to ordinary business operations. Transactions outside the ordinary course of the business, such as selling off a division of the company, require court approval.

In addition to controlling the daily operation of the business, the debtor in possession can avoid certain payments made prior to the petition date, represent the estate in avoidance litigation, and file a restructuring plan. This control over the course of the reorganization makes Chapter 11 an attractive option, especially in contrast to Chapter 15 which does not provide the debtor with all of the benefits available under Chapter 11.

DIP Financing

Post-petition, the debtor in possession most often requires additional loans to fund its daily operations and restructure its financial base. Without the protections given to lenders providing financing to a debtor in possession in the Bankruptcy Code, few lenders would extend additional funds to a company in financial distress. The Bankruptcy Code provides special creditor rights to post-petition lenders, incentivizing lenders to provide funds sufficient for a successful reorganization. Lenders providing these post-petition loans, referred to as DIP financing loans, obtain superior seniority and enhanced security, including complete repayment, available only to DIP financing lenders. It is not uncommon to see a pre-petition lender acting as the DIP lender in a case.

Broad Applicability of Automatic Stay

Upon filing a Chapter 11 petition in bankruptcy, an injunction in favor of the debtor immediately and automatically arises by operation of law, regardless of notice. This injunction, called the automatic stay, imposes prohibitions on activity that can adversely impact the debtor's interests. Activity against the debtor, such as requesting payment, initiating a lawsuit, pursuing litigation activities in a pending lawsuit or enforcing a judgment against the debtor, and repossessing collateral that is property of the bankruptcy estate, are all precluded by the automatic stay, and a creditor must obtain court approval before taking any such action.

In the shipping context, the applicability of this stay is of the utmost importance. Section 541(a) of the Bankruptcy Code states that the commencement of a bankruptcy proceeding creates an estate, comprised of the debtor's property ''wherever located and by whomever held.'' Reading this section together with the automatic stay provisions, it has been concluded that the automatic stay protects a bankruptcy court's jurisdiction extraterritorially, prohibiting enforcement of claims against the debtor and its property worldwide whether or not the stay is consistent with relevant foreign laws. Creditors who have appeared in the bankruptcy case and who pursue the debtors' assets, even those located outside of the United States, may face damages for violation of the stay if they then seek alternative relief in a foreign court. The automatic stay is wide-ranging and far reaching, affording the debtor an immediate calm upon filing for bankruptcy protection in the midst of stormy financial difficulties.

However, the breadth of the automatic stay is limited in Chapter 15 cases. In *In re JSC BTA Bank*[1] the court interpreted the Bankruptcy Code to limit the scope of the automatic stay in Chapter 15 cases to assets located within the territorial jurisdiction of the United States. Thus, the broader automatic stay provided in Chapter 11 cases is particularly attractive to foreign shipping debtors with property, operations, or creditors in several jurisdictions.

Legal and Strategy Issues Emerging From Early Cases

United States Bankruptcy Eligibility

An entity is eligible to file for Chapter 11 bankruptcy in the United States, pursuant to Section 109 of the Bankruptcy Code, if the company resides, has a place of business, or has property in the United States. A key factor allowing United States jurisdiction is property located in the United States. For shipping companies, this may allow for jurisdictional flexibility because the companies' major assets, their vessels, travel and dock around the globe.

U.S. bankruptcy courts have held that foreign companies can satisfy this initial eligibility barrier by maintaining bank accounts in the United States. For example, in *Marco Polo*, the unearned portion of a retainer held by Marco Polo's bankruptcy counsel in a separate New York account, created shortly prior to bankruptcy filing, was held a sufficient basis for the exercise of United States bankruptcy jurisdiction.

United States bankruptcy jurisdiction has also been found where an employee of a foreign company maintains an office in the United States. In the *Omega Navigation* case, the chief financial officer of Omega worked in New Jersey, although the company was headquartered in Greece and incorporated in the Marshall Islands. The court found that the office in New Jersey was sufficient to satisfy the jurisdictional requirements of the Bankruptcy Code.

However, this is not a departure from precedent, even in cases where there have been limited assets in the United States, courts have found jurisdiction. In *Global Ocean Carriers*[2], a maritime shipping company headquartered in Greece filed in the U.S. Bankruptcy Court for the District of Delaware in 2000. There, various bank accounts, an unearned portion of a legal retainer held in escrow, and one affiliate incorporated in Delaware were deemed sufficient for the foreign company to file in the United States.

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[1] *In re JSC BTA Bank*, 434 BR 334 (Bankr. S.D.N.Y. 2010)

[2] *In re Global Ocean Carries, Ltd, et al.*, Case No. 00-956, U.S. Bankruptcy Court for the District of Delaware.

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Applicability of U.S. Bankruptcy Orders in Foreign Jurisdictions

Even when a foreign company is eligible to commence proceedings in the United States, a critical consideration is whether the company can enforce U.S. bankruptcy orders against creditors and assets in foreign jurisdictions. As previously discussed, the bulk of a foreign shipping company's assets are likely located outside of the United States and in multiple foreign jurisdictions.

In the Chapter 11 context, while the bankruptcy estate includes assets ''where located,'' the applicability of orders to parties not under court jurisdiction and enforcement of orders against worldwide assets may require assistance from local courts which can result in varying level of effectiveness dependent upon the jurisdiction. Foreign creditors who do not submit to the jurisdiction of the U.S. bankruptcy court, and who are not precluded from acting against the debtor in a foreign forum may chose to do so, leaving the U.S. debtor with limited real recourse, if any, against them.

Expeditiously Proceeding With Case

Although the automatic stay gives debtors a temporary haven from creditors, shipping companies can not rely upon the respite while waiting for the troubled industry to recover. Judge Peck in *Marco Polo* was very clear when he instructed the debtors to expeditiously proceed with reorganization or otherwise face the potential of dismissal of the case, specifically warning the debtor against unfair delays to creditors.

Potential Pitfalls for Creditors and Debtors

Creditors

Creditors may benefit from the United States reorganization by recovering more of their debt than if winding-up proceedings were initiated in foreign courts, as value can be maximized in the U.S. system through ongoing operations, strategic asset sales, or balance sheet restructuring.

On the other hand, there are potential drawbacks for creditors. By submitting to U.S. court jurisdiction, creditors open themselves up to the possibility of litigation or enforcement of sanctions in the United States. *See In re Lykes Bros. S.S. Co.*, 207 B.R. 282 (Bankr. M.D. Fla. 1997) (The filing of a claim by the creditor conferred *in personam* jurisdiction to enforce sanctions against a German corporation who caused post-petition seizure of Belgium debtor's ship). Additionally, creditors that file a claim in the United States proceeding are subject to those rulings and cannot seek redress in a foreign court against the debtor. *See In re Simon*, 153 F.3d. 991 (9th Cir. 1998) (by filing a claim, a foreign bank forfeited any right to claim that the bankruptcy court lacked power to enjoin it from proceedings against assets in Hong Kong).

Debtors

As with creditors, by initiating proceedings in the United States the debtor submits to the jurisdiction of U.S. courts—a judicial system that might not otherwise have had jurisdiction over it. In the shipping context, this may be of no event. However, due to the differences between the U.S. system, which does not have a loser pays scheme, and which has permissive class action standards, this can be a very real consideration that must be analyzed prior to filing.

Furthermore, the debtor in possession could lose control of the proceedings. Pursuant to Section 1112(b) of the Bankruptcy Code, upon request of a party in interest, a Chapter 11 case will be converted to a Chapter 7 case if the court determines it is in the best interest of the creditors and the estate and for cause. Cause for conversion exists if the debtor commenced the bankruptcy case in bad faith or if there are excessive delays or mismanagement in the case. Upon the conversion, several of the strategic benefits of Chapter 11 expire. Most notably, a trustee is appointed to liquidate the assets and the pre-petition management are no longer in control of the debtor.

Courts have also applied Section 1112(b) to dismiss voluntary Chapter 11 proceedings filed by foreign debtors. Illustrative of this application of 1112(b) is *In re Yukos Oil Company*[3] where upon request of a bank creditor, the court dismissed Yukos Oil's voluntary Chapter 11 petition. Although the court held that Yukos Oil, a large Russian energy company, was eligible to file for bankruptcy in the United States under Section 109 (due to one bank account containing a retainer for legal services and the CFO working in Houston), the court dismissed the case for cause, citing the totality of the circumstances. In particular, the court noted that the commencement of the proceedings was not a financial reorganization but an attempt to impede an auction of Yukos Oil's assets in Russia and that Russia was a more appropriate forum for resolution of Yukos' disputes.

Recent cases have shown that these risks are very real. In *Omega*, senior creditors argued for dismissal or conversion of the case pursuant to Section 1112(b) of the Bankruptcy Code stating that ''cause'' existed because, due to minimal contacts with the United States, Omega filed its Chapter 11 case in bad faith. After days of hearings, the court ultimately denied the creditors' motion. Also, in *Marco Polo*, principal lenders argued for dismissal on the grounds that Marco Polo's filing was made in bad faith and that exercise of the court's abstention under Section 305(a) was in the best interests of creditors. The court denied the motion concluding the creditors' arguments were without merit. The court held that the debtor's payment of the retainer fee was not a bad faith attempt to ''manufacture jurisdiction.'' The court also found that abstention was not in the best interest of creditors and the Chapter 11 case should continue. However, in these cases the risks to the debtor were made apparent.

Conclusion

The United States Bankruptcy Courts provide shipping companies with breathing room from creditors and the opportunity to restructure their financial obligations without liquidation, all while maintaining control over the course of the company. Although Chapter 11 proceedings provide several benefits, foreign debtors will need to be cognizant of and understand the possible difficulties and risks. As recent cases demonstrate, with proper guidance, foreign shipping companies can benefit from Chapter 11, which will likely result in more companies seeking Chapter 11 protection.

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[3] *In re Yukos Oil Company*, 321 B.R. 396 (Bankr. S.D.Tex. 2005).