

Seward & Kissel LLP

Surviving a Distressed Shipping Market: Loan Restructuring Strategies

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 - Our basic practice areas are Corporate Finance and Capital Markets, Investment Management, Litigation and Bankruptcy, Real Estate, Tax and Employee Benefits, Individual Client Matters and Legislative and Regulatory Representation.

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- While part of the Corporate Finance Department of the firm, the Maritime Group is composed of partners, counsel and associates from a variety of the firm's practice areas. The Group's attorneys have experience in all aspects of the financing of ships, offshore oil rigs, barges, shipping containers and other marine equipment.
- In addition to the core financing practice, the Maritime Group comprises attorneys whose practices embrace maritime and commercial litigation, taxation, banking, structured finance, the capital markets, swaps and derivatives, mergers and acquisitions, creditors' rights, bankruptcy and securities.

PLANNING AND PREPARATION – EVALUATING ALTERNATIVE COURSES OF ACTION

- Review of Credit Documentation; assess covenant compliance; determine relief needed
- Know Your Lender: Banks or Funds
- Operating Expenses: Do your freight rates cover it? What are your payment terms?
- Review Charters and other third party contracts: is your revenue stream safe?
- Do you have unencumbered assets?
- Restructuring: Can it be out of court?

Review of Credit Documentation

- Time to clear the dust off the closing binder – the documentation does matter
- For the lender, it is important to review all credit documents to confirm that the collateral is effectively secured and that documentation is otherwise in order
- For the borrower, it is important to understand your obligations and assess your risk of default and understand your creditor's rights
- Do you risk covenant breach?
Lona to value? Minimum
Liquidity?



Know Your Lenders

- This is essential for borrowers
- Are your lenders experienced shipping banks?
- Have your bank lenders sold to distressed debt funds?
- Are you partners or adversaries?
- What levels of consent are required for what actions, e.g., consents or collateral sales?
- Do you have bond debt?

Operating Expenses

- Understand your trade debt; can payment terms be stretched? Focus on creditors likely to take enforcement actions on unpaid obligations and possible lien claims that may prompt a mortgagee to act; attempt to restructure legacy debt promptly
- Whether a restructuring - in court or out of court – will ultimately depend on whether the vessels earn enough to pay their operating expenses or whether the owner has sufficient liquidity to cover a shortfall during the market trough

Review Charters

- Both borrowers and lenders should take a hard look at their charters, contracts of affreightment and other commercial contracts and their counterparties to determine their strength in a difficult market and to see what impediments to a restructuring they may contain
- How secure is the cash flow?

Unencumbered Assets

- If a borrower is going to ask its lender for either amortization deferrals or covenant relief it will need to offer something in return and as a practical matter lenders look for one (or both!) of two things: loan prepayment or additional collateral

Restructuring or Bankruptcy?

- Even after considering the items addressed above, the big questions remain-

Can this borrower, this transaction survive the downturn? Can new equity be raised? Can the debt be consensually restructured? Is bankruptcy an option?

Impediments to Consensual Restructuring

- Lack of liquidity – Lenders are reluctant to engage in discussions regarding amortization deferrals without new equity commitments from owners
- Lender reluctance to grant long term covenant relief – Even with new liquidity lenders are reluctant to grant long term relief of key covenants

Is Chapter 11 an Option?

- The basic premise - Most creditors, whether they are senior mortgage holders, trade creditors or unsecured debt holders fear a bankruptcy of their customer. In some cases, the fear is warranted; in other cases it is not. In either case, the threat of bankruptcy can serve as leverage for a borrower.

Bankruptcy Basics

- Who are the typical creditors in a shipping restructuring?
- The Mortgage Banks – All of the shipping companies who have sought Chapter 11 protection in the current cycle have had bank creditors holding first mortgages.
- Bondholders/Mezzanine Debt – Some, though not all, private and public shipping companies (fortunately, not all of whom are insolvent or who have filed for bankruptcy) have unsecured bondholders or mezzanine debt providers in their capital structure.
- Trade Debt – Some trade debt is secured as the providers of the services represented by such debt hold maritime liens; some is not.
- Unsecured (and under-secured) Creditors – Think vessel owners, pools or charterers.

The Automatic Stay

- Access to collateral is denied – the “automatic stay” 11 U.S.C. §362(a)
- But . . . The right to “adequate protection” 11 U.S.C. §361 - e.g., relief from the stay, additional or replacement liens, adequate protection payments

A Key element of Plan Approval

- Secured creditors are favored in a reorganization plan – “impaired” vs. “unimpaired” classes of creditors
- At least one class of impaired creditors must vote to approve a plan for it to become effective; this is usually a class of senior creditors – unless they are unimpaired

“Under-secured” Creditors

- Unsecured vs. “under-secured”
- Bondholders and Mezzanine Lenders are likely to be under-secured or in this market, unsecured.

Entitlement to Vote

- Entitlement to vote in a plan of reorganization – even if “impaired” the vote of a class creditors may not be needed to approve a plan of reorganization if the class is receiving under the plan “property of a value, as of the effective date of the plan, that is not less than the amount that such holder would receive or retain if the debtor were liquidated under chapter 7”
11 U.S.C. §1129(a)(7)

“Cram down”

- “Cram down” - unsecured or under-secured creditors are also subject to plans of reorganization being approved over the objections of an impaired class of creditors so long as it does not discriminate unfairly and is fair and equitable with respect to the claims of the dissenting class. 11 U.S.C. §1129(b)

Trade Creditors in Chapter 11

- Some trade debt is secured as the providers of the services represented by such debt hold maritime liens; some is not. The holders of trade debt, however, sometimes find themselves unusually favored, not at law, but in practicality in the days proceeding and following a bankruptcy. Vessels cannot operate without the support of the many suppliers to those vessels. Whether a supplier has a lien superior to or subordinate to that of a mortgage holder, if that supplier is crucial to the operation of a vessel (e.g., a bunker supplier) or beyond the reach of the bankruptcy court's jurisdiction (e.g., foreign port agent), those bills that will get paid.

Treatment of Charters

- Rejection of Executory Contracts - Under the Bankruptcy Code, a debtor has the right to assume (i.e., perform) or reject (i.e., breach/terminate) executory contracts and unexpired leases (those contracts/leases under which both the debtor and the non-debtor counterparty continue to have material performance obligations). Vessel charters generally have been treated as executory contracts and/or leases under the Bankruptcy Code. Consequently, a debtor charterer (or even a debtor shipowner) under a charter may decide that the terms of a charter are unfavorable and “reject” the charter, resulting in a claim for damages arising from the breach of the charter in favor of the non-debtor counterparty.

The Finance Charter

- Certain types of charters (e.g., “bareboat” charters) are often used in the shipping industry in connection with sale lease-back transactions as a means of vessel financing. If a charterer under such an arrangement files for chapter 11 protection, the bankruptcy court may be asked to evaluate whether the charter represents a “true” lease or a disguised financing See *American President Lines, Ltd. v. Lykes Bros. Steamship Co.* (In re *Lykes Bros. Steamship Co.*) 196 B.R. 574, 580 (Bankr. M.D. Fla. 1996).