STEAMSHIP MUTUAL

Sea Venture

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Chapter 15 Bankruptcy in the U.S.

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Owners, Charterers, bunker suppliers, or other creditors may hear the bad news from a P&I Club, an industry broker, the press – their contractual counterparty just filed for insolvency protection. A mad dash of information gathering and plotting ensues:

1. Confirm how in arrears the debtor is to you;
2. When does the time charter expire?; and most significantly
3. What are your rights?

Your rights and strategy moving forward depend largely on the type of bankruptcy relief sought by the debtor. For the purposes of this article, the focus is on a debtor filing for insolvency relief in a non-U.S. jurisdiction and then filing an ancillary bankruptcy proceeding in the U.S. Why is an ancillary proceeding in the U.S. necessary? Usually the debtor seeks to marshal assets under restraint in the U.S. or prevent arrests of its fleet. During the last year, the U.S. courts have issued important decisions concerning ancillary proceedings which impact the maritime industry significantly. Before addressing them, a short primer on Chapter 15 protection is necessary.

U.S. Ancillary to Foreign Bankruptcy Proceedings Overview

In 2005, the U.S. adopted the United Nations Commission on International Trade Law (UNCITRAL), Model Law of Cross-Border Insolvency. Under the law, a Chapter 15 proceeding is brought by a "foreign representative" who is typically appointed by the foreign court. The key consideration for the foreign proceeding's recognition in the U.S. (and typically in the New York bankruptcy courts where the overwhelming majority of admiralty proceedings are filed), is whether the foreign insolvency proceeding is a "main" or "non-main" proceeding.

If it is deemed a "main" proceeding by the U.S. court, because it is found to be the "center of main interest" or "COMI" of the debtor, then it is deemed "recognised" and it gains powerful leverage over creditors. Of particular import, an automatic stay is available for assets and actions that affect the debtor within the U.S. The broad range of relief also includes seeking turnover of assets, commencing actions based on foreign law against creditors in the U.S., obtaining discovery in the U.S. concerning assets, and the ability for the U.S. judge to communicate with the foreign "main" insolvency proceeding judge to confirm their actions are consistent.

U.S. bankruptcy judges will not rubber stamp foreign court decisions but it will show a proper level of deference using principles of comity (mutual recognition of the validity of the executive, legislative and judicial acts of another nation or jurisdiction out of courtesy). The average length of a Chapter 15 case varies greatly depending on the assets in the U.S., lawsuits already filed, or affirmative suits seeking assets brought by the foreign representative. The Chapter 15 proceeding will remain open until the foreign proceeding is concluded.

Important Rulings Impacting the Maritime Industry

During the last few years courts have clarified what factors should be considered to determine if a foreign proceeding is a "main" proceeding, the scope of lawsuits that can be brought by a foreign representative, whether Charterer's interests are protected in vessels owned another, and asset discovery that can be obtained from New York banks involving shipping interests.

a) COMI and shipping – why is recognition of a foreign insolvency proceeding easier?

Shipping companies are often incorporated in "offshore" jurisdictions such as the BVI and the Marshall Islands but operated from mainland jurisdictions. Where are these companies' centers of main interests (COMI)? Will foreign bankruptcy proceedings in such entities' jurisdiction of incorporation be recognised under Chapter 15? *In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d. Cir. 2013), is a non-maritime case with important maritime implications which answered these questions. In Fairfield, the appellate court upheld the recognition of a BVI liquidation of a Connecticut-based Bernie Madoff feeder fund as a foreign main proceeding using a COMI analysis. The feeder fund was heavily dependent on Madoff securities and when his fraud was uncovered, the feeder fund was decimated. The feeder fund had registered offices and agents in the BVI but its decision makers were in New York. Ten shareholders sought the appointment of a liquidator in the BVI to marshal assets and the liquidator in turn sought Chapter 15 protection in New York while winding up matters in the BVI.

When a creditor opposed the Chapter 15 recognition arguing that the center of main interest was in New York because this is where the decision makers resided, the appellate court confirmed the proper analysis. It found that the correct question is whether, as of the date of the Chapter 15 filing in the U.S., the foreign debtor is being managed by a liquidator or court-appointed professional from the place of incorporation (the registered office), the assets of the company are under the control of the foreign proceeding and preferably located in the foreign-incorporation jurisdiction, and whether the creditors have looked to the foreign proceedings and place of incorporation to submit their claims. The Court found the BVI met these considerations and recognition was granted. For shipping purposes, the location of the submission of a claim is particularly notable. Take the Marshall Islands for example. It has no established insolvency rubric. U.S. based Delaware law is followed for corporate matters, but that does not address the full panoply of issues in an insolvency matter. For Marshall Islands shipping companies, the COMI analysis is more complicated and obtaining recognition in the U.S. for the Chapter 15 less assured.

b) Affirmative Use of Chapter 15 by Foreign Representative:

In *In re The Containership Company* (TCC), 466 B.R. 219 (2012), a New York bankruptcy judge explored the scope of a foreign representative's powers. TCC was a Danish liner service from a small port in China to Long Beach, California whose operations did not last a year. The foreign main proceedings were filed in Denmark and the Danish court-appointed trustee obtained Chapter 15 recognition in New York. It then filed 77 adversary proceedings against shippers alleging breaches of service contracts for failure to meet MQC in the Federal Maritime Commission ("FMC") approved contracts. Claims varied from as little as US$10,000 to over $1 million – $24 million in total claims was sought. The shippers filed a motion to have the suits transferred from the bankruptcy court to the FMC because they alleged in counterclaims that TCC committed violations of the U.S. Shipping Act of 1984 and said claims fell within the jurisdiction of the FMC. In the first decision of its kind, the bankruptcy court rejected the shippers' request and the claims proceeded in bankruptcy court. It is an important ruling to consider because it shows the tools a foreign representative can use to obtain monies for the foreign insolvency proceeding with the expectation of paying creditors of the now defunct shipping company.

c) Are chartered vessels "property" capable of protection under the U.S. Bankruptcy Code?

In July 2013, at least one bankruptcy Judge recently said "yes." In *In re STX Pan Ocean*, the foreign representative in the Chapter 15 proceeding successfully applied for a "stay" order that extended to STX's

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chartered interest in vessels. The unpublished recognition order enjoined all persons from arresting or attaching any vessel that was owned, or under charter to STX Pan Ocean. The implications of a charterer obtaining the order are significant. If a third party has a claim against the Owner of the vessel or the cargo interests, it cannot simply arrest the vessel. The lien holder or Rule B attachment seeker would have to seek relief from the Court to lift the stay where the Charterer's interests would be assessed. So much for the element of surprise in a vessel arrest…

Separately, an important lesson was learned in this case by the parties that rushed to arrest STX vessels in the U.S. after the foreign insolvency proceeding was commenced. The U.S. court upheld the well-established rule that arrests post foreign insolvency proceedings by pre U.S. ancillary Chapter 15 proceedings will be summarily vacated. The arresting or attaching party will then be left with paying custodia legis fees for a failed vessel arrest. It is important to weigh these considerations with the P&I Club and counsel before undertaking an arrest because if the target company faces too many actions in the U.S., it will surely seek Chapter 15 recognition to eviscerate the vessel arrests.

d) New filing requirements in the U.S.

In *In re Barnet*, 737 F.3d 238 (2d Cir. 2013), the appellate court limited the eligibility of foreign bankruptcy proceedings by requiring that the conditions of 11 U.S.C. s.109 were met for a foreign debtor. That is, the foreign debtor must have a place of business or property in the U.S. at the time of filing. Courts outside of New York have disagreed with the ruling and the U.S. Supreme Court may well have to decide the issue in the years to come.

The ruling has implications for the maritime industry because during the last few years, there have been a handful of Chapter 15 proceedings filed primarily for the purposes of obtaining discovery in the U.S. A benefit is the foreign representative, through subpoenas of New York banks which acted as intermediaries of wire transfers, can trace the activities of the debtor to discern if fraudulent transfers were made to shell companies which could then be clawed back against said recipients of those transfers. The other important issue from this ruling is it calls into question the concept of preemptive Chapter 15 filings. Unless property is transferred or is already located in the U.S., the debtor may well need to wait until one of its ships is arrested or attached to be eligible for Chapter 15 relief, including the important automatic stay.

In sum, the insolvency practice in the U.S. is busier than it has ever been. This is a reflection of the global economy and the tightening of asset bases to prop up wobbly shipping companies. There are a number of considerations a soon-to-be-debtor or creditor of the debtor must undertake based largely on the contractual relationships in place and these recent decisions address some of these critical issues to address with counsel. ■

Anticipatory Breach and Third Party Conduct

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The "Bulk Uruguay" was chartered by disponent Owners, Geden Operations Ltd, to Charterers, Dry Bulk Handy Holdings Inc, on an amended NYPE charterparty, which contained a Conwartime 2004 clause and an amended BIMCO Piracy clause. The latter had been specifically amended by deletion of paragraphs (a) and (b), so that the vessel could transit the Gulf of Aden without disponent Owners' consent.

Disponent Owners were aware that this 'GOA OK' status was of significance to the Charterers in fixing business for the vessel. Under the terms of the head charter, however, disponent Owners required the consent of the head Owners for such GOA transit.

At the time the charterparty was concluded the vessel was still under construction in the Philippines. When the vessel was about to be delivered, Charterers informed disponent Owners that the vessel's maiden voyage from the Philippines to the Atlantic would be via the Gulf of Aden, and enquired as to the amount of additional premium that would be payable. Disponent Owners sought the permission of head Owners who, having initially refused permission for the GOA transit, subsequently granted permission but stressed that this would be a 'one-off' permission and would not form a precedent for future voyages. Disponent Owners asserted that the charterparty terms required their permission to transit GOA, and advised Charterers that their position in relation to giving permission would be dictated by the position taken by head Owners.

Charterers took the position that disponent Owners' insistence that prior consent would have to be obtained on each occasion was a repudiatory breach, which they purported to accept as terminating the charterparty. In their turn disponent Owners accepted the Charterers' purported termination as a repudiatory breach, and brought a claim for damages.

At arbitration a majority of the tribunal held that on its true construction, the Geden / Dry Bulk charterparty did not make GOA transit subject to disponent Owners' consent. In asserting that permission to transit GOA was subject to the position of head Owners, it did not follow that disponent Owners had thereby evinced an intention not to perform their obligations under the charterparty, nor were Charterers substantially deprived of the whole benefit of the contract. Disponent Owners were not in anticipatory breach, Charterers were not entitled to terminate, and Charterers' purported termination was itself a repudiation which had been accepted by disponent Owners, entitling them to damages of over US$6.5 million.

The Charterers appealed. Popplewell J had to consider the correct test for anticipatory breach by renunciation in a situation where a party makes it clear that its ability to perform is wholly dependent on the actions of an independent third party. The two questions which the Judge had to consider were:

a) Did disponent Owners by their words or conduct evince an intention not to perform, or expressly declare that they would be unable to perform, their obligations under the charterparty?

b) If so, did such refusal have the effect of substantially depriving the Charterers of the whole benefit which it was the intention of the parties they should obtain from the contract?

The Judge held that there is no principle of law that a party who has made his performance dependent on a discretion to be exercised by a third party is deemed to be evincing an intention not to perform. He rejected Charterers' submissions that, by the very fact of not being back-to-back, disponent Owners had put it out of their power to perform the charterparty, and had thereby evinced an intention not to perform. The correct test, he held, involved assessing the likelihood of whether or not head Owners would give consent. The arbitration tribunal had concluded that head Owners might or might not refuse an order to transit GOA, and that disponent Owners had not renounced the contract. As this was a finding of fact, Charterers' appeal under s.69 of the Arbitration Act was dismissed.

Since question (a) was answered in the negative, the Judge did not have to decide question (b), but he did observe briefly that the findings of the majority of the tribunal supported the factual conclusion that Charterers had not been deprived of substantially the whole benefit of the charterparty. ■

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