Bankruptcy wave boosts legal fees

US lawyers get busier as freight rates tumble

> **"We're only at the end of the beginning,"** Blank Rome partner Jeremy Harwood told *Fairplay*, when asked how far along the 'restructuring cycle' shipping has come.

"We're still right in the middle of it," echoed Al Yudes, head of the New York office of Watson, Farley & Williams (WFW). "Restructurings done a year ago are now being re-restructured. From what I have seen, the industry is still keeping up with its trade debt – usually at the expense of the senior lenders," he added.

WFW senior associate Neil Quartaro explained: "Owners know that if they stop paying their bunker suppliers, word is going to spread fast and they'll be put on 'cash only', which only further restricts their cash-flow. So the overwhelming temptation is to keep the ships moving by satisfying trade creditors."

When the secured debt burden becomes too onerous, owners are increasingly opting for Chapter 11 bankruptcy protection, bringing more business to US law firms.

In some cases, such as TBS International, these filings are 'pre-packs', wherein creditors and debtors agree to a restructuring plan and use Chapter 11's global stay to avert ship arrests. In other cases, such as Marco Polo Seatrade (MPS), they are 'freefall' filings spurred by a breakdown between creditors and debtors.

"What's really happening now is that people are running out of cash," AMA Capital Partners MD Paul Leand told the recent NACC/HACC conference in New York. Leand predicted another five to seven Chapter 11s this year. "The only question is how many are freefalls versus pre-packs," said Leand.

Judge approvals of the Chapter 11 filings of MPS and Omega Navigation Enterprises (ONE) reaffirmed two precepts: that it's very easy for foreign filers to establish US jurisdiction and that a restructuring plan is not necessary at the onset.

Lawyers speaking to *Fairplay* differed on the real significance of the MPS and ONE rulings. Harwood and Seward & Kissel partner Bruce Paulsen expressed no surprise at those decisions, given historical precedents. "This isn't a recent invention," argued Harwood.

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> US shipping bankruptcies 2008-12

Chapter 7 (liquidation): **Eastwind (2009), AHL Shipping (2010)**
Chapter 11 (restructuring): **US Shipping, Hawaii Superferry, Global Container Lines (2009); Trico Marine (2010); Ambassadors International, Omega Navigation Enterprises, Marco Polo Seatrade, General Maritime, Trailer Bridge (2011); TBS International (2012)**
Chapter 15 (ancillary to foreign filing): **Britannia Bulk, Britannia Bulkers (2008), Atlas Bulk Shipping, Atlas Shipping, Armada (Singapore), Britannia Bulk Holdings, Daewoo Logistics, Samsun Logix (2009); Transfield (2010); Korea Line, The Containership Company, Farenco Shipping, PT Arpeni Pratama Ocean Line (2011)**
Total by filing type: **Chapter 7 (2), Chapter 11 (10), Chapter 15 (13)**
Total by year: **2008 (2), 2009 (10), 2010 (3), 2011 (9), Jan-Feb 2012 (1)**

But Jim Hohenstein, who heads the US maritime practice of Holland & Knight, was startled that the judges found "the bar as low as they have.

"I think that changes the calculation, which has an incredible impact on the market because when a shipowner tells a bank 'If you don't co-operate I may go to Chapter 11', that argument now has more leverage," said Hohenstein.

The profile of US shipping bankruptcies has changed significantly over the period from 2008 to 2012. Initially, filings were dominated by Chapter 15s, which are ancillary filings to primary foreign proceedings. While 15s are expected to continue, Chapter 11, which is a primary proceeding, has grown more dominant. "The first phase involved the 'paper' companies with charter-ins. We're now into the bricks-and-mortar aspect of the business, which would portend more Chapter 11s," explained Hohenstein.

The earlier Chapter 15 surge was specifically designed to protect foreign filers from Rule B attachments of electronic funds transfers (EFTs) in New York. The subsequent drop in Chapter 15s is partially because of the landmark *Shipping Corp of India v Jaldhi* decision by the 2nd Circuit in October 2009, which forbade EFT attachments.

That decision is still having repercussions today. EFT attachments had allowed for cheap, easy pre-arbitration security. Thus, while 2012 rates are hovering around 2009 lows, the arbitration equation is different today. Rule B can still be used to attach physical assets but the enforcement cost is higher.

"It's more expensive to arrest a ship or seize bunkers [than attaching EFTs], so are you going to do that for a small claim? Probably not," noted Paulsen.

"It changes the leverage, so parties may be more amenable to working something out," said Yudes, with Quartaro adding, "especially for under-million-dollar claims".

Nevertheless, Yudes still believes there will be more arbitration in London and New York this year as a consequence of weak rates.

The demise of EFT attachments has also pushed more Rule B attachments outside New York, where the banks are, to port jurisdictions on the Gulf and West Coasts – particularly Texas and Louisiana.

Harwood was told by a non-New York admiralty lawyer that *Jaldhi* "was the best thing that ever happened for firms located where the ships actually go, because there is a huge increase in business as parties try to secure claims by attachment of bunkers".

This has led to an interesting twist in a time-honoured defence against attachments. Rule B can only be used against defendants "not found in the district". Back when EFT Rule Bs surged in 2009, foreign shipping firms stampeded to apply for a New York business licence.

This is now happening in coastal states to protect against physical attachments at the ports, according to Holland & Knight partner Chris Nolan. "If you're getting your products from the Houston shipping channel, it makes a lot of sense to register in Texas," said Nolan, who confirmed that such registrations were already under way.

The other big 2012 trend for US attorneys, particularly in New York and Washington, is sanctions advice. "We are now answering sanctions questions at least on an every-other-day or every-third-day basis," said Yudes. "It comes up constantly. Clients are very concerned."

"It's a minefield," added Harwood. "Clients just have to be diligent. You can't plead ignorance."

The sanctions issue has already changed the nature of maritime contracts, confirmed Paulsen. Owners and lenders are inserting sanctions-related clauses for protection.

"Previously, companies used to leave cargo off in Qatar and say they're not responsible for what happens after that," noted Nolan. "That sort of gamesmanship is not tolerated as much any more."

Thus, from sanctions to contract enforcement and bankruptcies, 2012 is shaping up to very busy year for US maritime lawyers. As Yudes put it: "Bad markets make for good business for lawyers." F

> *Deepwater Horizon* fallout

The entire maritime sector – not just offshore – should heed recent rulings in the *Deepwater Horizon* case, continuing in New Orleans, according to Holland & Knight partner Chris Nolan.

"You've got Judge [Carl] Barbier down there issuing groundbreaking decisions every few months that will affect maritime law around the country," he emphasised.

Nolan pointed to by Barbier's decision on contractual indemnity. In the *Deepwater Horizon* case, the judge ruled that BP had contractually indemnified Transocean even in the case of gross negligence.

"In other maritime cases, you've had courts say: 'We don't care what you put in the contract, we don't think it's good public policy for risk-allocation purposes to allow a party to be indemnified for negligence'," explained Nolan.

But Barbier ruled that indemnification stands even for gross negligence if "very sophisticated parties carefully negotiated a contract".

The entire maritime sector is urged to watch for legal ramifications of the *Deepwater Horizon* case

US Navy

25

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