So Should You Be A Chapter 11 Debtor Under the U.S. Bankruptcy Code?

I
What's Different This Time?

- Larger companies, many more public companies are now in trouble. More players, more complex financing. More consents and litigation obstacles to a restructuring.

- Destruction or reduction of debt capital markets — Significant overcapacity, too many vessels, values plummeted.
  — Floor on charter rates fallen dramatically.

- Predominance of syndicated loans vs. bilateral loans. With syndication, many original holders of debt have sold into secondary market.

- Many banks, formerly active on the front end, are now not active, or in the position to make new loans. Mandate is to clean up existing mess.

- But like politics so long as the market trends are uncertain and generally negative, tendency is to kick can down the road.

II
Critical Issues

- American Bankruptcy — restructuring with unique set of attributes.

- Jurisdiction — U.S. Bankruptcy Court is one of the few courts that is effective in dealing with international assets. A company filing for Chapter 11 protection automatically obtains a stay from lawsuits and creditor collection efforts pending around the world. This is a powerful shield that judicial systems in other countries do not offer.

- Unlike other countries, a Chapter 11 debtor is generally allowed to keep control of its assets and continue operations globally in the ordinary course through existing management.

- Secured Lenders/Mortgagees — are protected in a Chapter 11 case —
  - — Liens/mortgages must be retained and collateral protected. Concept of "adequate protection" may include cash payments, payment of expenses, additional or replacement liens, or other relief that will realize for Lender the "indubitable equivalent" (§361). Not defined, addressed on a case by case basis;

  - — Relief from the automatic stay — if there is a lack of "adequate protection" or if there is no equity in collateral and no reasonable prospect of reorganization (§362);

  - — Rights to credit bid (§§363, 1129(b)) sale of property or asset by motion or plan, (Lender can also elect to maintain face amount of claim under a plan of reorganization (POR) (§ 1111(b)).

III
How?

- Diligence is required to identify business and financial problems, to determine eligibility for American bankruptcy and to determine how the bankruptcy tool fits and advances a company's restructuring strategy.

- Once that strategy is identified, then preparation for filing begins with a company's eligibility to file in the United States and invoke the bankruptcy court's jurisdiction. Just the beginning as a good deal of preparation to enter Chapter 11 is required. Any successful Chapter 11 is the result of careful corporate, legal, financial and business planning and often pre-negotiation with key stakeholders.

- In international cases, the key first step is access to American bankruptcy, or eligibility to be a Chapter 11 debtor. Many international shipping companies have property or assets located in U.S. or connections where U.S. bankruptcy

protection can be sought — General Maritime, Golden Ocean, TBS, Omega Transportation, Marco Polo,Trailer Bridge.

Jurisdiction – Practical Issues

- Eligibility provisions — Bankruptcy Code §109— residence, domicile, place of business or property in U.S. Eligibility provisions in disjunctive. A foreign corporation can qualify for status as a U.S. debtor if it meets criteria above.

- Other considerations — Flag states of ships
  - — Where are the ships trading?
  - — Future ship itineraries;
  - — Where are the corporate operations headquartered? — transacting business often too slim to establish jurisdiction. Yet, agent conducting business on behalf of debtor may be jurisdictional basis.

- Applicable law of loan documents does <u>not</u> control for jurisdictional purposes.

- Payment of foreign vendors with no business nexus within U.S. generally in first day motions.

- Property in the United States

  — Marco Polo Seatrade B.V. the Amsterdam-based company, whose six vessels fly the Liberian flag and were built in Chinese and Japanese shipyards, had property in the U.S. by virtue of its ownership of interest in OSG pool, even though not segregated funds, and retainer paid to counsel on behalf of all debtor entities.

IV
Why?

- Taking control — use it or lose it. Creating optionality. Importance of avoiding free fall into Chapter 11 (Marco Polo) as compared with pre-negotiated plan (Trailer Bridge, GenMar, TBS).

- Significant worldwide debtor protections and benefits to be obtained under the Bankruptcy Code for debtor.

    - Bankruptcy sales: asset purchasers receive benefit of cleansing order from §363 sale (higher and better) or under POR. Can sell assets free and clear of claims and interests on notice. Highly beneficial to purchaser.

    - POR can bind dissenting class of creditors and equity to fair and equitable treatment. No longer "hand cuffed" by standard requirements in business organizational/bond/other debt documents.
        — Need approval of greater than ⅔ in dollar amount and ½ in number to bind a class in a plan.
        — Bank group collateral agents may have greater freedom to enable restructuring based on authority over collateral in distressed situations such as an American bankruptcy (e.g., capital agent's authority to credit bid without group unanimity).

- Can access new financing with super-priority claims and liens to enable restructuring (§364). Lenders often unwilling to lend new monies without the benefits of super-priority protection under DIP Financing Order. Lenders often couple performance "milestones", filing plan or scheduling sale of assets, in a compacted timeframe.

- Can restructure debt (secured and unsecured) along with equity to enable recapitalization based on the present value of the company so long as reorganization is fair and equitable.

- Can reduce transaction costs associated with that restructuring by enabling issuance of reorganization securities without registration with Securities Exchange Commission (SEC) and by certain tax exemptions. (§1145 exemption).

- Ipso facto clauses in key contracts — not enforceable. Provision providing for termination of agreement upon filing of bankruptcy or like insolvency proceeding not enforceable as a matter of law (§365(e).

- Assignability of executory contracts/leases, even those that contain anti-assignment provisions, similarly unenforceable. Test for assignment of executory contract generally is "adequate assurance of future performance." Conversely, a debtor can reject or breach unprofitable executory contracts post-petition, and use the rejection power to fix such damages as unsecured, prepetition claim. Powerful tool to rid a company of uneconomic and burdensome agreements.

- A debtor can use the bankruptcy power to restructure key pension and collective bargaining contracts and arrangements.

- Can restructure debtor's business affairs based on core economic realities

- Recharacterization - lease v. debt, title of document not controlling;

- Substantive consolidation – treat as one entity a group of companies; all unsecured claims consolidated under one surviving entity.

- Subordination of claims arising from agreements and breaches of contracts for purchase or rescission of securities, or by virtue of inappropriate conduct by creditor.

- Bind creditors to a plan that discharges prepetition claims and replaces them with delivered obligations under POR.

- Value preservation — preserve enterprise value. Worldwide jurisdiction over the estate/automatic stay. Value that has been paid to aggressive creditors prior to bankruptcy while the company is insolvent or undercapitalized may be recaptured under

certain circumstances through Chapter 5 avoidance actions (§§ 544, 547, 548, 549 and 550).

- If restructuring is partially negotiated or better yet pre-packaged, then chapter 11 can move with greater speed. Time lines to enable plan confirmation can be reduced. Rehabilitation can be achieved through a fast moving auction (key strategic transaction in Lehman, sale to Barclays was achieved in a matter of days through Bankruptcy Code § 363).

V
A Cautionary Note or Why Not?

- Transaction costs can accelerate and multiply in Chapter 11. Even a well-organized Chapter 11 essentially accelerates every business, litigation, corporate, financial challenge facing a debtor, yielding a high concentration of professional fees. Further, the estate of the debtor pays for professional fees for creditors committee and for

other stakeholder groups at times. Key here is planning.

- Trade leverage - A maritime business is subject to maritime liens as well as § 503(b)(9) claims (goods sold within 20 days) and reclamation claims under § 546(c) (goods sold within 45 days) and these holders, while subject to the stay, may be insulated from its enforcement because the trade have little or no business nexus to the United States.

- Careful planning is the key to controlling these challenges and "first day" necessity payment motion especially for foreign vendors can ensure that debtors enjoy a "soft" landing in 11 with the support of the trade.

- As noted, company as debtor generally allowed to keep control of assets and continue global operations in the ordinary course under existing management.

- Business decisions that are outside of the ordinary course of business are now subject to bankruptcy court approval.
  - Good news is that any strategy that is implemented with bankruptcy court approval ratifies business judgment of company/debtor in proposing a recapilization, asset sale or some other strategic transaction.
  - Bad news is that the bankruptcy judge along with creditors committee and major stakeholders have opportunity to comment about the strategy that company/debtor wants implemented.

- Transactions between the debtor and "insiders" are subject to higher level of scrutiny.

- Senior secured creditors retain substantial leverage in a Chapter 11. Oftentimes, in exchange for near-term liquidity and as part of DIP Financing, creditors can force market tests of assets, drive the bankruptcy time table in a way advantageous to their own parochial

agendas. The company's value may be at issue from the first day of the case. And the financial and business history of the company will be subjected to substantial disclosure requirements (historical and prospective). The key here is to file with a clear view of goals in Chapter 11 and with a clear plan that the bankruptcy judge can appreciate from the very first day you appear before the court.

- Change in governance by appointment of an independent Chapter 11 trustee, dismissal or conversion to a Chapter 7 liquidation with an independent trustee (creditors can elect a trustee in a Chapter 7) (§ 1112) (generally, dismissal or conversion occurs where a court finds that a reorganization is not in prospect and Chapter 11 will shift risks and losses to creditors). Abstention — dismiss or suspend case. Extra-ordinary relief (§305).

- An underlying premise of a chapter 11 business reorganization is "transparency." Creditors committee will often seek to exert influence as a shadow or second board of directors.

VI
The "Show Me the Money" Questions

- Exit strategy — identify all transactional and business keys to restructuring. Have a plan. President Eisenhower always said that "plans never work, but without one you never get anywhere."

- Liquidity issues are usually the key constraint on achieving a restructuring plan in bankruptcy — adequate protection (§361), Automatic Stay (§362), Use, Sale or Lease of Property (§363), and Obtaining Credit (§364). (Many lenders will not advance new monies without safeguards and benefits of DIP Financing Order). Realistically modeling liquidity in bankruptcy will identify the length of the runway you need to address balance sheet, business and reorganization issues – the plan.

- Stress test the bankruptcy option against non-bankruptcy alternatives, if any, which may be business and cost-advantageous. But never,

never wait until your liquidity situation is desperate as that limits the ability of bankruptcy to work.

The Curious Case of Petrorig 1 Pte Ltd. et al

- Petrorig – Singapore entity with two affiliates filed in SDNY on May 17, 2009.

- Only asset: oil rig in Singapore – under construction. Disputed contractual right to a "riser" in Louisiana.

- Obtained a temporary restraining order/preliminary injunction to prevent a Singapore shipyard exercising its rights to sell the oil rig.

- Unearned retainer deposited into account of New York law firm in a New York City bank account two weeks before that filing. "Manufactured eligibility" to be a debtor?

- Parties disposed of eligibility matter on consent and Bankruptcy Court retained jurisdiction.

- See also, Marco Polo Seatrade discussed above. Omega Transportation and General Maritime (NYSE).