



# ShipArrested 2018 Meeting

Gary Seitz

Gellert Scali Busenkell & Brown, LLC

Curtis Center, Suite 750 West, 601 Walnut Street, Philadelphia, PA 19106

1201 N Orange Street, Wilmington, DE 19801

Tel: 215-238-0011 | Mobile: 610-500-4067 | [gseitz@gsbblaw.com](mailto:gseitz@gsbblaw.com)

[www.gsbblaw.com](http://www.gsbblaw.com)

# Ship Arrest vs. Shipowner's Bankruptcy / Cross-border Insolvency Issues United States Perspective



## AGENDA

1. Recurrent Tensions Between Admiralty and Insolvency
2. Starting Proceedings
  1. Chapter 11
  2. Chapter 15 -
  3. Chapter 7
3. Dealing with Claims
  1. Nature of maritime claims
  2. Priority of distribution on claims
4. Dealing with arrests and attachments
  1. Pre-petition
  2. Post-petition
5. Dealing with Contracts

# Admiralty and Insolvency – Recurrent Tensions



U.S. bankruptcy laws have objectives that are inconsistent with the objectives of admiralty law:

U.S. bankruptcy laws give the debtor a “breathing spell” and the opportunity for a “fresh start,” and ensure equitable treatment of creditors.

In contrast, admiralty law is creditor-oriented, generally permitting aggressive individual creditor remedies such as the seizure of assets.

Under admiralty law, creditors possessing liens are generally able to seize vessels or other property, actions expressly prohibited under the Bankruptcy Code.

The Bankruptcy Code permits debtors to recover assets seized by or transferred to creditors, as well as obtain the nonconsensual release of liens granted or obtained, near the bankruptcy filing date.

This discourages creditors from racing to the courthouse or taking other action that could worsen the debtor’s financial position or disadvantage other, less aggressive creditors. In contrast, admiralty law rewards creditors for aggressive enforcement of their claims against the debtor.

# Admiralty and Insolvency – Recurrent Tensions



Admiralty law would allow the creditor to proceed against the shipowner's assets where they were seized, notwithstanding the existence of insolvency proceedings in the debtor's home country.

Insolvency law, per the "golden thread" of universalism calls for courts in other countries to cooperate with the courts in the country of the debtor's insolvency to ensure that all of its assets are distributed to its creditors under a single, orderly, system of distribution.

If insolvency prevails, the admiralty proceedings must be discontinued so as to ensure all creditors participate equally in the insolvency proceedings.

Maritime lawyers prefer the first alternative: this is, after all, why admiralty procedures have existed for hundreds of years.

Insolvency lawyers prefer the second alternative: to them, the right to proceed against the debtor's assets in admiralty amounts to little more than an illegitimate form of preference.

This appears to be a zero sum game.

# Admiralty and Insolvency – Recurrent Tensions



U.S. Bankruptcy Courts have broad jurisdiction to consider claims against and relating to a debtor and its assets. Depending on the degree to which a dispute or claim arising under admiralty law is related to a given bankruptcy proceeding, the bankruptcy court may determine the issue or decide that it should defer to another court or tribunal.

For instance, a bankruptcy court will give consideration to applicable admiralty law in determining the validity and priority of any claims (including lien claims) with respect to the debtor's vessels, including the distribution of the sale proceeds to lien creditors, and rarely would yield jurisdiction to an admiralty court to determine such issues.

In order for a bankruptcy court to abstain from hearing a given dispute, the proceedings must typically hinge on substantive nonbankruptcy issues of law and have only the most tangential connection to the bankruptcy case (e.g., an insurance dispute).

# Starting Proceedings



In the USA

Chapter 7 for liquidation,

Chapter 11 for Reorganization and

Chapter 15 for Ancillary and Cross-Border Issues.

The majority of cases filed for reorganization under chapter 11 are  
rejected or  
converted to a chapter 7.

# Starting Proceedings



In the USA there is the Chapter 7 for liquidation,  
Chapter 11 for Reorganization and  
Chapter 15 for Ancillary and Cross-Border Issues.

The cases filed for reorganization under chapter 11 in their majority are rejected or converted to a chapter 7.

## Chapter 11

The debtor must have or develop a real plan to improve the financial situation of his company.

Depict a well structured plan which will combine increasing income and decreasing expenses.

Ultimately, the debtor must obtain approval of his creditors through a balloting process.

Typically debtor will propose the reorganization plan including the available assets and he needs the court's approval and the vote of his creditors affirming the plan.

# Starting Proceedings



## Chapter 11

The plan must have a structure and should illustrate the future actions of the company in order to show that the proposed plan is sustainable.

The debtor in order to achieve the success of his plan it is crucial to have the consent of the majority of his creditors.

This can be obtained by the creation of classes of claims where the debtor has the chance to allocate the creditors in the classes in such a way in order for each class to approve his plan.

However, the claims cannot be dissimilar between them and if the debtor tries to manipulate the classes profoundly, the court possibly will not approve the plan. If on the other hand he succeeds and the majority of each class approves the plan, then it will be imposed by the court to the dissenting creditors.

Under § 362 of Code the automatic stay prevents action taken against the debtor's property.



# Starting Proceedings



## Chapter 15 -

The US Bankruptcy Code seeks to facilitate coordinated foreign filings through Chapter 15, which enables the bankruptcy court to recognize and aid foreign insolvency proceedings.

Chapter 15 of the United States Bankruptcy Code is based on the U.N. model law on cross-border insolvency that has been adopted by many jurisdictions where a shipping insolvency may occur.

Chapter 15 provides that if the foreign proceeding is located in the country where the debtor has the center of its main interests, then the proceeding is dubbed a “foreign main proceeding.”

Shipping companies have frequently commenced Chapter 15 proceedings to stay asset seizure in the United States.



# Starting Proceedings

## Chapter 15 -

The benefits of Chapter 15 do not commence immediately upon the filing of a petition.

Typically, such relief is only granted upon the actual recognition of the foreign main proceeding by the bankruptcy court.

The foreign representative may, however, seek emergency relief during the gap period between filing date and date of recognition, including a stay of actions against the debtor's assets, the suspension of third parties' rights against the debtor's property, or the turnover of the debtor's property in the U.S. to the foreign representative.

A bankruptcy court will grant the foreign representative such gap period protections if the representative demonstrates that the standards for a preliminary injunction are met. A showing the debtor or its property will suffer irreparable injury if the requested protections are denied.

In Chapter 15 cases involving shipping companies, this relief has been routinely granted.



# Starting Proceedings

What is Chapter 7 Bankruptcy?

Some companies are so far in debt or have other problems so serious that they can't continue their business operations. A business bankruptcy lets the owners turn their business over to the trustee for an orderly liquidation. The business stops operating, and the court liquidates its assets and pays what it can to business creditors.

The entire company is liquidated under Chapter 7.

Their assets are sold for cash by a court supervised trustee.

Administrative and legal expenses are paid first, and the remainder goes to creditors.

Secured creditors will have their collateral returned to them. If the value of the collateral is not sufficient to repay them in full, they will be grouped with other unsecured creditors for the rest of their claim.

Bondholders, and other unsecured creditors, will be notified of the Chapter 7, and should file a claim in case there's money left for them to receive a payment.

# Dealing with Claims



Shipping creditors that file claims in a bankruptcy case are deemed to consent to the equitable jurisdiction of the bankruptcy court, such that the bankruptcy court will assume jurisdiction to adjudicate (or even extinguish) those claims.

One U.S. appellate court decision indicates that, even where an arrest of a ship occurred outside the U.S., when shipping lienholders submit their claims in the bankruptcy proceeding, they consent to the bankruptcy court's jurisdiction, and the bankruptcy court may order the sale of vessels free and clear of such liens (albeit with the liens attaching to the proceeds of the sale and distribution thereof to be determined by the bankruptcy court).

Even so, for the reorganized debtor or purchasers of the debtor's assets relying on a bankruptcy court's order, the risk remains that foreign courts may not recognize that certain maritime liens have been extinguished by a U.S. bankruptcy court sale of a vessel (as opposed to a U.S. admiralty court).

Admiralty court sales, unlike bankruptcy court sales, are universally recognized as cleansing a ship of liens.

# Dealing with Claims



U.S. commercial law requires transparency with regard to the interests creditors may hold in a debtor's property. It therefore requires that security interests be recorded in order to be effective against other creditors.

Generally, the first creditors to record their security interests against the property of the debtor enjoy the primary right to payment from the proceeds of such property — a “first in time, first in right” system. This system makes it easy for bankruptcy courts to make determinations as to the nature, extent, validity and priority of liens.

Preferred ship mortgages are also recorded under a first-in-time, first-in-right system; thus, they are easy for bankruptcy courts to address.

# Dealing with Claims



Maritime liens, on the other hand, are secret liens that arise by operation of law.

Maritime liens, which may arise, among other ways, in connection with the provision of necessities to a vessel (crew wages, repairs, towage, maintenance, etc.), need not be recorded.

Such secret liens are often prioritized in the opposite manner of typical U.S. commercial liens — a “last in time, first in right” basis.

Consequently, it is possible that an unrecorded maritime lien can be recognized as valid and senior to all other liens, and be unknown to all creditors except the one creditor holding the lien and the debtor.

The lack of transparency of maritime liens creates a host of problems in a bankruptcy proceeding.

Additionally, caution must be taken by lenders negotiating post-petition financing with a maritime debtor, as unknown maritime liens may survive the bankruptcy and enjoy priority to the security interests granted to such lenders as part of the bankruptcy proceeding.

# Dealing with Arrests and Attachments



1. Pre-petition
  1. The debtor/trustee avoidance powers may result in vacating an arrest or attachment
    1. Within 90 days pre –petition or one year for insiders
2. Post-petition
  1. The automatic stay or Chapter 15 injunction prevent the arrest of attachment of debtor assets
  2. Where ever located worldwide
  3. Court may sanction creditors that ignore the automatic stay / injunction
  4. Enforcement, preservation or perfection of lien rights may be sought with debtor and court approval

# Dealing with Contracts



Under the Bankruptcy Code, a debtor has the right to assume or reject executory contracts and unexpired leases (those contracts/leases under which both the debtor and the nondebtor counterparty continue to have material performance obligations).

Vessel charters generally have been treated as executory contracts under the Bankruptcy Code.

Consequently, a debtor charterer (or a debtor ship owner) 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 nondebtor counterparty.

Generally, outside of the bankruptcy context, a breach of a charter by the ship owner will result in a maritime lien in favor of the charterer.



# Dealing with Contracts



Rejection would typically enable the charterer to attach and arrest the vessel as security for payment.

Consequently, it has been suggested by one court that a damages claim arising from the debtor's rejection of a charter in bankruptcy may constitute a maritime lien, which might be entitled to higher priority than certain other lien claims coming into existence after commencement of the charter and before rejection of the charter.

In addition, 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. If the charter is recharacterized as a financing, the bankruptcy court may deem the vessel the property of the debtor charterer, not the owner.

Under such circumstances, the charterer would be able to retain possession of the vessel without performing its obligations under the relevant charter, and claims by the ship owner against the charterer would be treated as general unsecured claims.

# Conclusion



The recurring controversy between Admiralty and Bankruptcy law in the US creates uncertainty and is difficult to resolve. The differing goals of maritime law and bankruptcy cause a great deal of conflict when both regimes coexist in the same case.

Maritime law has been steadily losing the battle with bankruptcy law in the United States because bankruptcy courts are given broad powers to take jurisdiction in cases related to bankruptcy

There are no common rules globally in use for the recognition of the maritime liens, although there are three conventions. There is no a global recognized bankruptcy legal regime.

A compromise solution between all these different rules about their priority can be characterized not only difficult but also ambitious.

Vessel arrest and attachment actions are the primary, effective means of enforcing the rights created by maritime liens. If the vessel arrest and attachment actions, or the maritime lien they guarantee, are not protected, the already beleaguered U.S. shipping industry will be irrevocably damaged.