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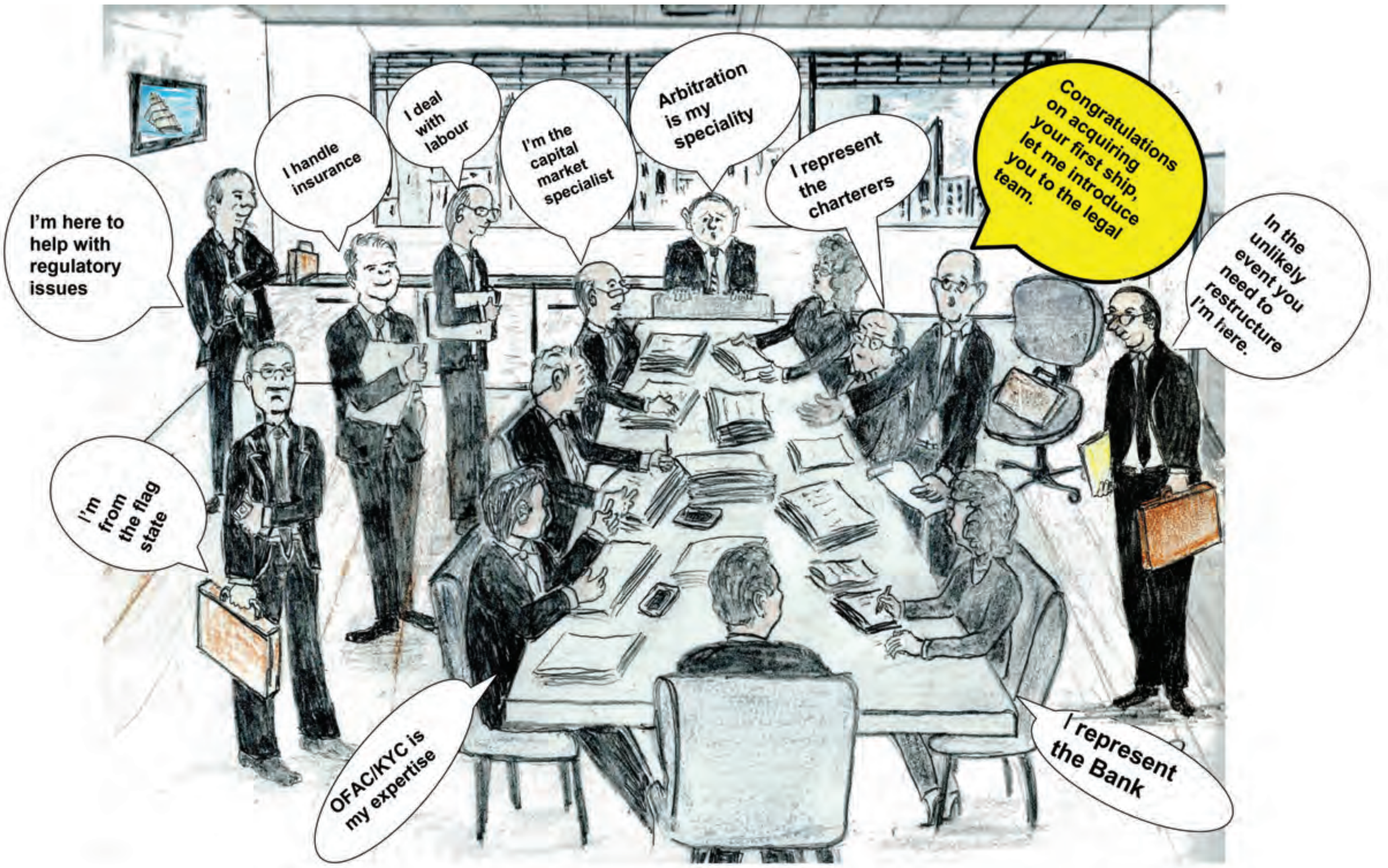

Can't Live Without…The Team

The Legal Issue

SHIPPING: BUYING SHIPS FROM SELLERS IN FINANCIAL DIFFICULTIES

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BACKGROUND

A spate of recent shipping insolvencies has given bargain hunters the opportunity to buy a large number of second-hand ships cheaply from insolvent owners.

In particular, the Korean bankruptcy of Hanjin Shipping led to many Hanjin-owned or operated ships being off-loaded onto the market. German administrators of insolvent KGs have for some time, and increasingly since 2010, been concluding second-hand ship sales apace.

Ship owners tend to be very cautious about the risks and uncertainties perceived to be inherent in such transactions. However, it should be possible to identify and to resolve such risks. A number of key considerations arising in such transactions are set out below.

IS THERE A RISK OF THE SALE BEING CHALLENGED AND SET ASIDE?

Insolvency regimes usually permit courts, on the application of liquidators or administrators, to set aside or 'unwind' undervalue transactions or those intended to 'prefer' one creditor over others, or to defraud creditors generally. If the registered ship owning company has entered a formal, court supervised, liquidation or corporate rehabilitation process (such as a US Chapter 11 or a UK administration), the liquidator or administrator will be empowered to sell the ship.[1] Accordingly, the buyer can contract with and take delivery of the ship from the insolvency practitioner or bankruptcy trustee, who will be authorised to act in the seller's name, without fear of the transaction later being challenged. Just as with any second-hand sale, the contract or memorandum of agreement (MOA) will typically be on suitably amended standard terms, such as the BIMCO approved Norwegian Saleform ("NSF") 2012 or 1993 edition.

However, for buyers purchasing from sellers in financial difficulties, but outside of a formal insolvency process, there will be a risk of the sale being avoided if the seller later enters into a formal liquidation process within a 'hardening' period, usually ranging from three to 24 months. To protect against such a risk, a buyer first needs to have in mind which insolvency regime may later affect its seller. This may be the country of the seller's incorporation or, if that is an 'offshore' flagging jurisdiction like Liberia or the Marshall Islands where the seller has no physical presence, the place of the seller's COMI (centre of main interests). Or it may be the USA, where bankruptcy courts accept jurisdiction over foreign companies with the flimsiest of connections to the USA, and where some ship owners in financial difficulties perceive themselves to gain advantage by filing for Chapter 11 protection to pressurise their secured lenders to accept an unfavourable debt restructuring. Secondly, the buyer would be well-advised to protect itself by obtaining evidence to demonstrate that the price it pays and other sale terms are commercially sustainable and do not involve any diversion of the sales proceeds from the seller's creditors. Where the buyer pays the price to the seller's bank, believing it will be used to pay down a bank loan, this should not be an issue. However, care should be taken by buyers not to involve themselves in any conduct that might appear to assist sellers to leave their creditors unpaid. For example, in Greece, s.479 of the Greek Civil Code imposes direct responsibility on buyers purchasing all the property of a seller managed and controlled in Greece to ensure that the seller's debts are paid.

WHAT CLAIMS CAN SURVIVE A SALE?

'Maritime liens' are preferred claims that 'run with the ship,' meaning that they may be enforced by arrest of the ship in the hands of future owners. MOAs typically address this risk by having the seller warrant the ship to be free from all liens, debts and encumbrances on delivery (e.g. the warranty in NSF Clause 9). Then, if the warranty is breached, the buyer has recourse to the seller.

[1] In the UK, the powers of liquidators are set out in ss. 165-7 of and Schedule 4 to the Insolvency Act 1986 and those of administrators in s. 14 and Schedule 1 of the Act.

However, the warranty of an insolvent seller is worth little or nothing. Liquidators will almost certainly warrant no more than that the ship is delivered free of registered mortgages and encumbrances. German administrators, for example, would expose themselves to personal liability by giving any wider indemnity. This being so, can a buyer accept to proceed without no or limited warranty? The answer is that a buyer may, depending on the circumstances, be able to live with the risk of hidden liens, for the following reasons.

First, the liquidator may be able to give the buyer some comfort, even if not a formal warranty, as to the existence of pending maritime claims, especially if the liquidator has had an opportunity to review the insolvent seller's books and records (and to enter into dialogue with its ship managers) and to establish its liabilities. So, the risk is one on which, depending on the circumstances and comfort given, the buyer may be able to take a view (with appropriate due diligence), especially if the price is favourable.

Secondly, in practice, unpaid maritime creditors usually waste little time to 'come out of the woodwork' by notifying and securing their claims, whether by ship arrest or by proving in the liquidation, so the risk of hidden liens will diminish over time, especially in the case of a well-publicised insolvency.

Thirdly, the seller's trade debts will usually not give rise to 'maritime liens.' Under English law, aside from collision and salvage claims which are usually insured and bonded at the time of the incident, only claims for unpaid crew wages that should be paid when the crew is discharged on or prior to delivery, attract a maritime lien. The right to arrest a ship for other maritime claims, such as for unpaid bunkers and claims under charters, is lost on a change of ownership. Some countries to which the ship may trade, however, define 'maritime liens' more widely. In particular, the USA treats 'necessaries' claims (i.e. claims for the supply of goods and services to a ship) as maritime liens that are not lost on a change of ownership but only if the creditor fails to bring them for an inordinate period of time.[2] Further, countries that have ratified the Maritime Liens and Mortgages Convention 1926 (including Algeria, Argentina, Belgium, Brazil, France, Italy, Portugal and Turkey) accept claims for supplies contracted for by the master[3] in the previous six months[4] as maritime liens. Nowadays, masters seldom contract directly for supplies, but local courts will often accept delivery notes, e.g. for a bunker stem, signed by the master as evidencing the former master's involvement. A buyer in such a case is unlikely to have available to it evidence to show the contract having been placed by the seller or its managers.

Fourthly, a buyer may further protect itself by placing maritime liens insurance, that is readily available in the London market or from P&I insurers.

Aside from maritime liens, a brief mention should be made of the practice that exists in England and UK Commonwealth jurisdictions, such as Singapore, Hong Kong and Australia, of issuing a 'protective' writ, so called because it protects against a later change of ownership, to enable a maritime creditor to arrest a ship that calls post-sale in the jurisdiction where the writ was issued, as if the ship were still owned by the seller. This procedural device works because the law looks to the date of writ issuance, not the later date of arrest, in determining the ownership position. However, MOA buyers may acquaint themselves with such risks by searching the relevant court register for protective writs. Given the volume of marine traffic passing through Singapore, protective writs are most frequently issued — and most searches conducted — there. If a writ were discovered, the buyer would be well-advised to insist on the seller settling or bonding it or agreeing to an appropriate price reduction.

INSOLVENCY OF FORMER CHARTERERS

Sometimes, the buyer's concern is the solvency of the seller's former bareboat or time charterer, rather than of the seller itself. So, for example, after Hanjin filed for bankruptcy protection in Korea in 2016, it redelivered a large number of container ships early to their owners who, finding no profitable follow-on charters for such ships, had little choice but to sell them. These sellers were understandably unwilling to warrant such ships' freedom from Hanjin's debts. Interested buyers were, for their part, understandably concerned about the risk of a Hanjin creditor arrest post-delivery. Such an arrest could only validly be made on the basis that the claim attracted a maritime lien. Indeed, Hanjin creditors could not, unless they had a maritime lien, arrest, or issue a protective writ against owners of ships merely time chartered by Hanjin.[5] However, as already explained, the existence of maritime liens must be considered in terms of any country to which the ship may trade post-sale. As it turned out, Hanjin Shipping eventually paid most of the OPEX of ships it had chartered in, with the exception of some bunker invoices, prob-

[2] Under the doctrine of laches, by which the right to attach may be lost in the case of undue delay in bringing a claim. If the ship has not traded to the USA since the claim arose, that will usually excuse the delay.

[3] Article 2(5).

[4] Article 9.

[5] See **The Yuta Bondarovskaya [1998] 2 Lloyd's Rep. 357** which deals with position of bunker suppliers.

ably because Hanjin had redelivered these ships with some bunkers remaining onboard, for which the owners, with far larger early redelivery claims against Hanjin, understandably refused to repurchase. But, in the early stages of Hanjin's insolvency, this was not known to the market, and many owners and their lenders determined that the best way to complete market sales of these potentially indebted assets was through a court sale process. After some time, when it became clearer that this tonnage was not as encumbered with trade debt as previously feared, a number of owners were prepared to purchase such ships by MOA, protecting themselves with insurance against the risk of arrest post-sale.

SALES BY ADMINISTRATORS OF INSOLVENT GERMAN KGs

In this decade alone, around 600 KGs (i.e. German limited partnerships *(Kommanditgesellschaft)*) in the maritime sector have filed for German insolvency. This in part reflects the onerous personal liabilities faced by KG directors if they do not file for administration within 21 days of their becoming aware of an anticipated insolvency event. In the case of an impending loan default, this usually means that KG directors must file unless there is a formal loan waiver or moratorium in place. Were a lender or creditor to take precipitate action, such as to arrest the KG's ship, the directors would also file for the insolvent KG to be wound up through a formal process, in which case, in practice, secured lenders will agree to fund the administrator's costs as the price for his cooperation in assisting the mortgagee to realise its security. In the shipping space, a secured lender will usually conclude a formal funding agreement with the administrator, who will typically be a lawyer, rather than an accountant.

Ship sales in German insolvencies can take place in the course of three different processes. First, the practice of some courts (for example, Bremen) is to permit the sale of assets during preliminary insolvency proceedings. At this stage, the managing directors *(geschäftsführern)* of the KG's 'general partner' through which the KG ordinarily acts remain in office but must act with the approval of an interim administrator. Secondly, the practice of other courts, such as Hamburg, is for the preliminary stage to be an investigative stage in which the administrator determines the KG's best interests, with asset sales to take place once formal insolvency proceedings have been opened. In this 'opened' insolvency process is the second process, in which the administrator, who acts alone in the name of the KG ship owner, replaces the KG's managing directors. Thirdly, in the case of large shipping companies, of which the Rickmers group is a topical example, the insolvency may be conducted by the company's BOD, together with a court-approved, independent administrator who joins the BOD in a supervisory capacity.

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From the buyer's perspective, these differences will mainly impact upon the stage of the relevant insolvency process at which the asset is sold. Like insolvency administrators elsewhere, German administrators adopt a commercial approach to ship sales, usually consulting closely with secured lender creditors, who will have the primary interest in the recovery and may, on occasion, offer finance as a sweetener to buyers, with S&P brokers used where appropriate, and usually contracting on NSF or similar standard forms, with no or very limited warranties as to debts and physical condition.

INSPECTIONS/ PHYSICAL CONDITION

It might be thought that a buyer from an insolvent seller would be expected to rely solely on its pre-MOA inspection of the ship and to purchase her "*as is, where is*" without any recourse to the seller. This is broadly correct, but of course there is no reason why a liquidator need to deny a buyer the right to conduct a diver's inspection or for the ship to be drydocked prior to delivery, because the price may always be adjusted before delivery to reflect the cost of any damage discovered that affects the ship's class, leaving the liquidator with no post-delivery liability. However, the liquidator will clearly want to ensure that no further claims may be brought after delivery. Indeed, a buyer will know that claims brought after delivery would only ever be satisfied from cash held in escrow to secure such claims, which may be liable to attachment by other creditors of the seller. In cases where liquidators sell ships by competitive tender, they will usually not permit the complication of underwater inspections that may affect the price and delay delivery, and this was certainly the approach of liquidators in many sales of Hanjin ships.

CONCLUSION

Inevitably, purchasers from insolvent sellers will tend to believe that they are in a position to drive a hard bargain. However, whatever the commercial bargaining position of the parties may be, the legal risks that such buyers run in entering such transactions that are not significantly different to most commercial MOA transactions are largely containable. Accordingly, ship owners ought not to be deterred from exploring and pursuing ship sale and purchase opportunities of this kind – either by way of an asset deal or a purchase of an enforceable loan claim against an insolvent ship-owner.