

The Shipping Industry Crisis & Restructuring in Korea

1. Current Situation of Hanjin Shipping and Hyundai Merchant Marine

On March 29, 2016, Hyundai Merchant Marine (“HMM”), the no. 2 player in Korea’s shipping industry, went into a creditor-led conditional workout program in an attempt to restructure its business. Following close behind, on May 4, 2016, Hanjin Shipping (“Hanjin”), the no. 1 player in Korea’s shipping industry, was also approved for a creditor-led conditional workout program. With two of Korea’s largest players both in workout, the global shipping industry is paying close attention on how HMM and Hanjin will restructure their businesses. Following is a summary of the restructuring process for these two companies so far, as reported by the Korean media.

The workout program for each of Hanjin and HMM are both conditioned on the following: (i) successful re-negotiation of charter rates paid to ship owners, (ii) debt-to-equity conversion by regular (non-institutional) bondholders, and (iii) continued participation in global shipping alliances. If any of these conditions are not met, the workout programs will be terminated and both companies will likely commence rehabilitation/bankruptcy proceedings.

Currently, HMM is focusing its energies in negotiating charter rates with twenty-two (22) foreign ship owners. The creditor banks have requested that HMM reduce its current charter rates by 28.4%; as of now, it is difficult to predict whether HMM will be successful in reaching an understanding with the ship owners to lower charter rates.

HMM is also scheduled to convene bondholders’ meetings on May 31, 2016 and June 1, 2016; the aim of these meetings will be to discuss debt-to-equity conversions for bonds that will reach maturity in 2016 and 2017 (par value approximately KRW 800 billion) as well as extensions on repayments. According to HMM’s debt restructuring plan, 50% of publicly-offered bonds would go through a debt-to-equity conversion, with the remaining 50% to be paid back through a three (3) year repayment

plan with a two (2) year grace period (maturity at five (5) years). For the bonds held by creditor banks participating in the workout program, it appears around 50 to 60% will go through a debt-to-equity conversion, and the remaining bonds will be repaid over a five (5) year repayment plan with a five (5) year grace period (maturity at ten (10) years).

HMM was also denied membership in The Alliance, a new shipping alliance, due to concerns that it may soon commence rehabilitation/bankruptcy proceedings (on the other hand, Hanjin joined The Alliance on May 13, 2016). According to a letter sent from HMM to its foreign creditors, HMM anticipates that it will be able to join The Alliance by September, 2016, once it normalizes its business. In light of these circumstances, the negotiation of the charter rates and the outcome of the bondholders' meetings will have a significant impact on the direction of the workout program for HMM.

Since Hanjin applied for workout at a later date than HMM, it has only just commenced charter rate negotiations. It should also be noted that, in the case of Hanjin, only 12.5% of its debts are from financial institutions (as opposed to 23% for HMM); therefore, it is anticipated that the debt restructuring process with Hanjin's regular (non-institutional) bondholders will face significant difficulties. Since state-owned banks such as the Korea Development Bank and the Export-Import Bank of Korea hold most of the creditor bank debt for both Hanjin and HMM, the debt restructuring process for institutional debt is likely to be relatively straightforward depending on the government's decisions; however, it may be considerably more difficult for regular (non-institutional) bondholders, with different, potentially conflicting interests, to reach a consensus.

The financial authorities emphasized that if the negotiations for the charter rates fail, both companies will be subject to rehabilitation/bankruptcy proceedings. Once that happens, the fallout will directly impact the ship owners and foreign investors/creditors of Hanjin and HMM. Therefore, it would be prudent for those potentially affected to pay close attention to the restructuring process for these two companies, and to anticipate and prepare against potential legal risks that could arise if Hanjin or HMM end up commencing rehabilitation/bankruptcy proceedings.

2. Overview of Restructuring and Insolvency Proceedings in Korea

The Korean restructuring and insolvency proceedings can be largely divided into two categories: (a) the formal insolvency proceedings led by the court and (b) the out-of-court restructuring or workout ("Workout"). While all creditors would be affected in case of a court-led formal insolvency proceeding, in case of a Workout, creditors from commercial transactions would not be bound by the Workout procedures and only those financial institutional creditors participating in the Workout would be required to provide additional credits to the company.

There are two types of Workouts: A Workout pursuant to the Corporate Restructuring Promotion Act (a “Statutory Workout”) and a Workout voluntarily agreed among financial institution creditors (a “Voluntary Program”). One major difference between the two types is that a Statutory Workout pursuant to the Corporate Restructuring Promotion Act requires the approval of 75% of the creditors while a Voluntary Program requires the approval of 100% of the financial institutional creditors.

Insolvency proceedings led by the court are subject to the Debtor Rehabilitation and Bankruptcy Act (the “DRBA”). Such insolvency proceedings consist of rehabilitation and bankruptcy. In case of rehabilitation, the insolvent company, in principle, is to continue its business operations by selling unnecessary assets and repaying its debts through future business operations. In case of bankruptcy, the company is required to sell all its assets and distribute proceeds from such sales to its creditors.

Since bankruptcy is a court-led insolvency proceeding in which the company immediately ceases its business operations and all of the company’s assets are sold, there is no prospect of the company being able to emerge from such proceeding to recover its financial strength. For this reason, even if there is a basis for bankruptcy (e.g., the company’s inability to pay its liabilities), the insolvent company and the creditors generally prefer rehabilitation over bankruptcy as long as the going concern value of the debtor company exceeds its liquidation value.

The table below describes certain key features of rehabilitation under the DRBA, a Statutory Workout under the Corporate Restructuring Promotion Act and a Workout under the Voluntary Program.

	Rehabilitation	Statutory Workout	Voluntary Program
Statutory basis	Debtor Rehabilitation and Bankruptcy Act	Corporate Restructuring Promotion Act	None
Mandatory Creditor Participation	All creditors	All financial creditors	Usually financial institution creditors
Applicant(s)	Debtor company or creditors and/or shareholders with claims or shares equivalent to at least 10% of the total equity amount of the debtor company	Debtor company	Debtor company
Credit Appraisal Rating	C (i.e., distressed company with a possibility of normalization) or worse	C (i.e., distressed company with a possibility of normalization) or worse	B (i.e., potentially distressed company)

The workouts programs of Hanjin and HMM both fall under the Voluntary Program category. As mentioned above, both are creditor-led conditional workout programs that require the satisfaction of the following conditions: (i) successful re-negotiation of charter rates paid to ship owners, (ii) debt-

to-equity conversions by regular (non-institutional) bondholders, and (iii) continued participation of both companies in global shipping alliances.

3. Key Issues should Hanjin and/or HMM commence Rehabilitation/Bankruptcy Proceedings

If the workout programs under the Voluntary Program fail, both Hanjin and HMM are likely to apply for the commencement of rehabilitation proceedings. If this should happen, the key problems faced by foreign investors will be the possibility that the receiver may exercise power of avoidance to set aside certain transactions that have been entered into by these companies prior to the rehabilitation proceeding or that the receiver may reject executory contracts of these companies. The DRBA empowers the receiver to avoid and revoke certain actions taken by a debtor company in a rehabilitation proceeding. If it turns out, for example, that Hanjin and/or HMM have disposed of assets or offered assets to existing or new creditors as collateral while being under financial distress, this would be a ground for the receiver to set aside such disposition or provision of assets to creditors. Should Hanjin or HMM apply for a rehabilitation proceeding, an interested party will want to review whether any recent transaction entered into by such party with the company may possibly be subjected to avoidance and how it should best respond to protect its interests.

The receiver also has the power to either assume or reject executory contracts of the debtor company under the DRBA. Since ship charter agreements are also considered executory contracts, they are subject to the risk of rejection, and therefore, a risk assessment of such rejection will need to be carried out, including potential damage claims arising from such rejection. Recent rehabilitation proceedings of other Korean shipping companies (Pan Ocean, Samsun LOGIX Corporation, etc) show that the rejection of ship charter agreements by the receiver and the subsequent problem of determining liability for damages are likely to be the most significant issues once rehabilitation proceedings commence.

4. The Ship Financing Team and the Insolvency & Corporate Restructuring Team at Shin & Kim

Shin & Kim has extensive experience in providing advice on ship financing matters, including those that employ leasing and asset based financing structures. Our clients include major domestic shipping companies, shipping funds as well as domestic and foreign financial institutions and Korean export agencies providing ship financings and related credit supports.

In addition, Shin & Kim maintains strong and vibrant insolvency and restructuring practice which covers all aspects of insolvency and workout proceedings, including cross-border insolvencies. Since

the late 1990s when the Asian financial crisis hit Korea, there has been an ever present demand for legal practitioners who can provide skilled insolvency and workout advice, and Shin & Kim has been consistently recognized as one of the leading Korean firms in this area. Most recently for the shipping industry, Shin & Kim advised on the sale of Pan Ocean and the sale of related NPLs by its creditors as well as acting as legal advisor for Pan Ocean during the charter rate negotiations during 2015.

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