AMERICAN BANKRUPTCY INSTITUTE

2017 Southeast Bankruptcy Workshop

Will Your Shipment Come In? How Bankruptcy Affects Transportation Issues on Water and Land

Edward J. Peterson, III, Moderator
Stichter, Riedel, Blain & Postler, P.A.; Tampa, Fla.

Curt S. Friedberg
GGG Partners, LLC; Atlanta

Hon. Kevin R. Huennekens
U.S. Bankruptcy Court (E.D. Va.); Richmond

John F. Isbell
Thompson Hine; Atlanta

Ilana Volkov
Cole Schotz P.C.; Hackensack, N.J.

Maritime Transport Update: Navigating Rocky Waters

ABI SOUTHEAST CONFERENCE

July 2017

Cole Schotz

International Shipping Industry

- Around 90% of world trade is carried by the international shipping industry.
- Without shipping, the import and export of affordable food and goods on the scale necessary for the modern world would not be possible.

Source: International Chamber of Shipping

International Shipping Industry

- Generally, shipping is categorized into two major sectors:
  - (1) bulk shipping (transportation of raw materials such as crude oil, coal, iron ore, and grains); and
  - (2) liner shipping (transportation of final and semi-final products).

Source: *Introduction to Transportation and Navigation*, by Eric Ting

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Liner Shipping

- Container ships - carry most of the world's manufactured goods and products, usually through scheduled liner services.

Source: International Chamber of Shipping

- The liner shipping industry is the portion of the maritime industry that includes all operations and related infrastructure involved in scheduled ocean-borne shipping. It consists of liner vessels and the people working on-board these vessels, ports, shipbuilding operations, longshore dock workers, shipbuilders, and all other on-shore support staff. Liner shippers transport most of the high unit-value consumer and intermediate goods, including ocean containerized cargo, vehicles, and other mobile machinery. The industry operates on all oceans and many of the navigable inland waterways world-wide.

Source: Valuation of the Liner Shipping Industry, IHS Global Insight, December 2009

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Liner Shipping Cont'd

- **Main Maritime Shipping Routes:**
  - There is potentially an infinite number of maritime shipping routes that can be used for commercial circulation, but the configuration of the global system is relatively simple. The main axis is a circum-equatorial corridor linking North America, Europe and Pacific Asia through the Suez Canal, the Strait of Malacca and the Panama Canal.

Source: https://people.hofstra.edu/geotrans/eng/ch3en/conc3en/main_maritime_shipping_routes.html

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Containers

- The vast majority of liner cargo is containerized – it is carried in sealed metal containers from point of origin to destination. These containers come in standard sizes (typically 20', 40', and 45' in length) and may include various specialized technologies, such as refrigeration units for chilled and frozen foods, or internal hanger systems for carrying garments. The standard measure of the volume of containerized cargo is a TEU (twenty-foot equivalent unit). Most of the world's non-bulk cargo travels in marine shipping containers.

Source: *Introduction to Transportation and Navigation*, by Eric Ting

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Containers Cont'd

- **Liner shipping is the most efficient mode of transport for goods. In one year, a single large containership might carry over 200,000 container loads of cargo. While individual ships vary in size and carrying capacity, many container ships can transport up to 8,000 containers of goods and products on a single voyage. Similarly, on a single voyage, some car carrier ships can handle 7,600 cars. It would require hundreds of freight aircraft, many miles of rail cars, and fleets of trucks to carry the goods that can fit on one large liner ship.**
  - Containerships have the capacity to carry several large warehouses worth of goods on a single journey.
  - A large containership engine weighs up to 2,300 tons has about 1,000 times more power than a family car.
  - Large containerships can be operated by teams of just thirteen people utilizing sophisticated computer systems.
  - The ships' computer systems are highly advanced, enabling the precise routing, transport, loading and unloading of thousands of containers for every voyage.
  - If all the containers from an 11,000 TEU ship were loaded onto a train, it would need to be 44 miles or 77 kilometers long.

Source: www.worldshipping.org/benefits-of-liner-shipping

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Containers Cont'd

- In an average year, a large container ship travels three-quarters of the distance to the moon. That means in its lifetime it travels to the moon and back nearly ten times.
- A container of refrigerators can be moved from a factory in Malaysia to Los Angeles -- a journey of roughly 9,000 miles or 14,484 kilometers -- in just 16 days.
- The cost to transport a bicycle from Thailand to the UK in a container is about US$10. The typical cost for shipping a DVD/CD player from Asia to Europe or the U.S. is roughly US$1.50; a kilogram of coffee just fifteen cents, and a can of beer - a penny.

Source: www.worldshipping.org/benefits-of-liner-shipping

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Containers Cont'd

- **In 2006, former finance and economics editor for the Economist, Marc Levinson released a book called *The Box: How the Shipping Container Made the World Smaller and the World Economy Bigger*, which makes the case that the modern global economy would not exist were it not for introduction of the container and the liner shipping industry that moves them. Some of his notable observations:**
  - The container made shipping cheap and changed the shape of the world economy.
  - Consumers enjoy infinitely more choices thanks to the global trade the container has stimulated.
  - The U.S. imported four times as any varieties of goods in 2002 as in 1972, generating a consumer benefit - not counted in official statistics - equal to nearly 3 percent of the entire economy.
  - The ready availability of inexpensive imported consumer goods has boosted living standards around the world.
  - The emergence of the logistics industry ... has led to the creation of new and often better-paying jobs in warehousing and transportation.
  - The container not only lowered freight bills but saved time.

Source: www.worldshipping.org/benefits-of-liner-shipping

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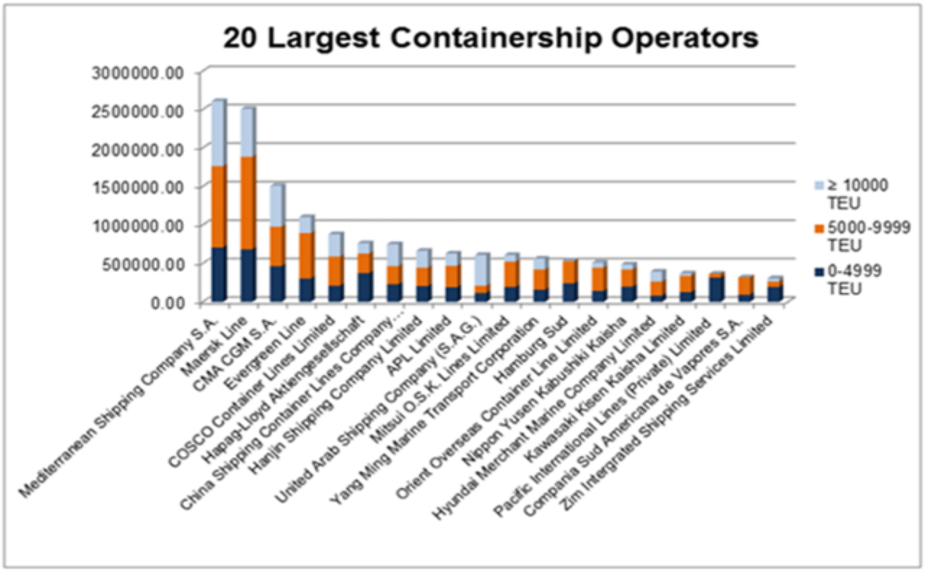
Top 20 Containership Operators



Source: UNCTAD Review of Maritime Transport, 2014

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20 Largest Containership Operators

20 Largest Containership Operators - Table

Largest Containership Operators					
Operator	Vessels	TEU	% 0-4999 TEU	% 5000-9999 TEU	% ≥ 10000 TEU
Mediterranean Shipping Company S.A.	461	2609181	27.14	40.42	32.45
Maersk Line	456	2505935	27.35	47.88	24.77
CMA CGM S.A.	348	1508007	30.83	34.09	35.08
Evergreen Line	229	1102245	27.64	53.49	18.87
COSCO Container Lines Limited	163	879696	24.03	42.9	33.07
Hapag-Lloyd Aktiengesellschaft	159	762613	49.34	33.35	17.31
China Shipping Container Lines Company Limited	134	750644	30.4	31.73	37.87
Hanjin Shipping Company Limited	115	671210	30.54	35.95	32.5
APL Limited	121	629479	30.14	44.42	25.45
United Arab Shipping Company (S.A.G.)	73	610294	19.01	15.6	65.39
Mitsui O.S.K. Lines Limited	119	607562	32.26	53.99	13.75
Yang Ming Marine Transport Corporation	107	561172	28.27	46.78	24.95
Hamburg Sud	112	539793	44.48	53.57	1.95
Orient Overseas Container Line Limited	98	510115	27.88	59.18	12.94
Nippon Yusen Kabushiki Kaisha	104	488848	40.45	46.08	13.46
Hyundai Merchant Marine Company Limited	64	392874	20.83	46.44	32.73
Kawasaki Kisen Kaisha Limited	72	368746	34.46	58.01	7.52
Pacific International Lines (Private) Limited	137	365693	86	14	-
Compania Sud Americana de Vapores S.A.	58	320273	28.94	71.06	-
Zim Intergrated Shipping Services Limited	71	305152	63.48	23.34	13.19

Source: UNCTAD Review of Maritime Transport, 2014

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Strategic Alliances

- Strategic alliances have formed to extend economies of scale, scope and network.
  - Integrating of individual service networks
  - Vessel sharing
  - Slot-chartering
  - Joint ownership and/or utilization of equipment and terminals and similar endeavors on better harmonization of operations.

Source: *Introduction to Transportation and Navigation*, by Eric Ting

- By April 2017, three main alliances, The Alliance, Ocean Alliance and H2M, are expected to operate, representing at least 76.6% of the operational market. Maersk and MSC will constitute the 2M alliance and, recently, for financial reasons, Hyundai Merchant Marine also signed an agreement to form H2M alliance.

Source: www.porteconomics.eu, July 29, 2016

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Containerships

- Largest container ships on order to rise 13 percent by 2020

MSC Oscar, the largest container ship currently in service.

- The largest container vessels on order have more than sextupled since 1975 and that amount is set to expand by at least 13 percent by 2020, according to an IHS Maritime & Trade analysis of the order book.
- The rapid rise in ship sizes reflects the growth of globalization in the last four decades, rise of containerization and carriers' need for greater economies of scale to compete with each other and gain fuel efficiencies.

Source: *Introduction to Transportation and Navigation*, by Eric Ting

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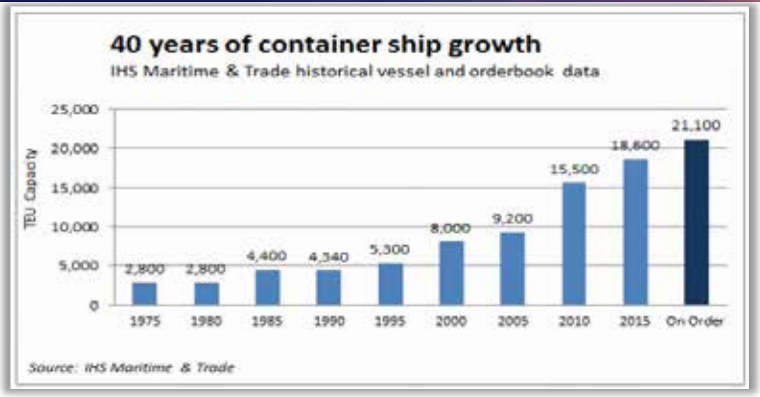
40 Years of Container Ship Growth



- The trend of carriers ordering larger vessels shows no sign of abating.
- The competition between carriers to amass fleets of larger and larger ships is so intense it has been likened to an "arms race."

Source: www.joc.com/maritime-news, July 7, 2015

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40 Years of Container Ship Growth

- While carriers may benefit from the increased economies of scale, mega-ships have been accused of causing problems for ports, terminal operators and shippers.
- Ports have had to increase the depths of their navigable channels, a multi-year, multi-million dollar expense. Ports that don't risk obsolescence, as the growth of mega-ships on the trans-Pacific and trans-Atlantic trades has led to larger and larger ships finding homes on smaller trades. Additionally, mega-ships typically call at fewer ports than their smaller predecessors, causing surges of unloadings.
- To cope with this congestion, terminal operators must make a Sophie's choice between costly automation, estimated at between $200-$500 million, or expensive changes to operations, such extra night and weekend shifts of dock workers. Additionally, many operators must invest in larger cranes capable of reaching across these ships.
- Shippers suffer because of an increased likelihood their products will be delayed due by congestion. And ultimately, someone must pay for the expensive upgrades to infrastructure that these ships necessitate.

Source: www.joc.com/maritime-news, July 7, 2015

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Shipping Industry Impacted By World Economy

- Financial crisis that commenced in 2008 caused dramatic and abrupt reduction in demand for shipping:
  - Oversupply of Ocean Carriers
  - Diminished Demand
  - Low Rates
  - Costly Operations
  - Devaluation of Assets/Collateral

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Hanjin Shipping Co., Ltd. – Korea August 31, 2016

Too Big to Fail?

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Hanjin Headlines

- The bankruptcy of the Hanjin shipping line has thrown ports and retailers around the world into confusion, with giant container ships marooned and merchants worrying whether tons of goods will reach their shelves.

Source: U.S. News & World Report, Sept. 1, 2016

- Hanjin bankruptcy sparks global shipping crisis
  - The bankruptcy of the Cho family-run South Korean shipping company Hanjin has left dozens of gigantic container ships stranded at sea, and merchants worried that the goods they ordered may not reach them.

Source: Deutsche Welle, September 2, 2016

- Hanjin's bankruptcy was the largest for container shipping in 30 years
  - The South Korean liner carrier's bankruptcy, which resulted in hundreds of thousands of shipments around the world being delayed, was the biggest in the container shipping industry since the 1986 bankruptcy of U.S. Lines.... but far more complex.

Source: www.americanshipper.com, 12/30/2016

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Chaotic and Severe Global Impact

- Containership owner Danaos was dragged into the red in Q3 by the impact of the Hanjin Shipping bankruptcy.
  - Danaos was hit by the bankruptcy of Hanjin which it described as one of its largest customers. The ship-owner had three 10,100 teu and five 3,400 teu vessels on long term charter to Hanjin.
  - "As a result of the bankruptcy, we did not recognize any operating revenues for the vessels that had been chartered to Hanjin during the quarter," the company said. Danaos' operating revenues were reduced by $24.8m accordingly.
  - Additionally the company recorded a $15.8m write down on unpaid charter owed by Hanjin up to 30 June.
  - It also resulted in Danaos being in breach of certain financial covenants at the end of Q3, which it has obtained waivers on until 1 April 2017.

Source: Deutsche Welle, September 2, 2016

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Chaotic and Severe Global Impact Cont'd

- Greek owner and operator of container and dry bulk vessels Navios Maritime Partners L.P. saw a net loss of USD 33.86 million due to struggles of two top South Korean container shipping companies. The company's net income for the three months ended September 2016 was affected by a USD 19.4 million loss on the disposal of the Hyundai Merchant Marine (HMM) shares and a USD 20.5 million loss from the non-cash accelerated amortization of the intangible assets relating to the two vessels chartered out to bankrupt Hanjin Shipping. Following Hanjin Shipping's filing for receivership in August 2016, Navios Partners had two Capesize vessels chartered to Hanjin at a net rate of USD 29,356 per day until December 2020. In September, both vessels were redelivered to Navios Partners' commercial management and were rechartered to third parties.

Source: www.wormaritimenews.com, 11/15/2016

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Chaotic and Severe Global Impact Cont'd

Hanjin Shipping's Crisis Is Causing a Trailer Shortage in the U.S.

The bankruptcy of Korea's Hanjin Shipping is causing ripple effects for importers bringing goods from Asian factories to U.S. malls by creating a shortage of trailers to move ocean-shipping containers on U.S. roads.

The world's seventh-largest container carrier has more than 500,000 containers, and many already are clogging up ports and truck yards, tying up trailers that cannot be used to handle other cargo....

Much of the cargo is on more than 100 ships at sea because cargo handlers, tug operators and ports are refusing to work with Hanjin unless they get paid up front....

Shipping executives said there is ample supply of shipping containers, but trailers are limited....

Karen Vellutini, a vice president at Devine Intermodal, a trucking company in West Sacramento that services the Port of Oakland, said she expects the availability of trailer chassis to become a problem as the holiday season nears and as more Hanjin ships arrive in ports and unload containers.

Reuters: Updated: Sep 14, 2016 4:56 AM Eastern

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Chaotic and Severe Global Impact Cont'd

- Key Customer Bankruptcy Sinks Textainer Group Holdings Limited's Q3 Results
- The container leasing company also eliminated its dividend.
  - The global shipping industry was in turmoil during the third quarter after South Korean shipping giant Hanjin filed for bankruptcy protection. That filing had a significant impact on Textainer Group Holdings' (NYSE:TGH) financial results because it had leased 6.4% of its container fleet to the capsized shipper. Because of that, Textainer recorded a deep loss during the quarter, which forced it to eliminate its quarterly dividend.
  - Textainer Group Holdings results - The raw numbers:

Metric	Q3 2016 Actuals	Q3 2015 Actuals	Growth (YOY)
Revenue	$121.2 million	$136.5 million	(11.2%)
Adjusted net income	($52.3 million)	$18.3 million	N/M
Adjusted EPS	($0.92)	$0.32	N/M

Yoy = Year Over Year. Data Source: Textainer Group Holdings Limited

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Chaotic and Severe Global Impact Cont'd

- **The Hanjin bankruptcy hurt results:**
  - Textainer's lease rental income sank 14.8% to $110.9 million due in part to the Hanjin bankruptcy.
  - In addition to the decrease in lease rental revenue, the company noted that the financial impact of the Hanjin bankruptcy during the quarter was $44 million, or $0.78 per share, due to container impairments and a bad debt provision.

Source: www.fool.com, Nov 8, 2016 at 4:00PM

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Chaotic and Severe Global Impact Cont'd

PORTS

The Hanjin bankruptcy and shifting alliance routes have continued to affect the Port of Long Beach (POLB) cargo volumes, resulting in container traffic at 13.8 percent lower in November 2016 than November of 2015. According to the POLB, a total of 534,308 Twenty-Foot Equivalent Units (TEUs) were moved through the harbor last month, imports dropped by 11.8 percent to 270,610 TEUs and exports declined 3.1 percent to 120,897 TEUs. Empty TEUs numbered around 142,801—about 24.2 percent less than the same month on 2015. In November 2015, in contrast, the port witnessed its second-best November ever, part of a six-month run of gains to end the year above 7 million TEUs for the third time in its history. This year, challenges such as the merging of ocean carriers, as well as Hanjin's declaration of bankruptcy in August, have made an impact in port operations. According to the port, Hanjin Shipping represented 12.3 percent of Long Beach's containerized volume and held a stake in Total Terminals International, the operator of Pier T. Port traffic, as of 11 months into 2016, is lagging 5.6 percent behind the same point as last year.

Source: www.lbpost.com, 12/14/2016

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Future Outlook

- **2016 – The most turbulent year in container shipping's 60-year history**
  - Five mergers and acquisitions and one bankruptcy is the final toll of a truly tumultuous year for liner shipping.
  - It was a year of reckoning for an industry that had maxed out its collective credit card, spending billions of dollars in ordering bigger and bigger state-of-the-art containerships in what appeared to be an ego-driven race; and then proceeded to sell container slots from Shanghai to Rotterdam for little more than the price of a city taxi ride.
  - With hindsight, earlier estimates of an industry loss of $5bn-$10bn this year now appear somewhat undercooked. Indeed, market leader Maersk Line saw its $1.3bn profit in 2015 reverse into a negative this year, in what, according to chief commercial officer Vincent Clerc, was a "quite shocking" and "violent" rate war.

Source: www.theloadstar.co.uk, 12/23/2016

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Future Outlook Cont'd

- **Moody's: Global shipping industry's negative outlook due to fall in EBITDA**
  - Moody's Japan K.K. says that its outlook for the global shipping industry over the next 12-18 months is negative.
  - "The negative outlook reflects our expectation that earnings will worsen, with freight rates likely to remain depressed amid ample supply," says Mariko Semetko, a Moody's Vice President and Senior Analyst.
  - "We expect that the aggregate EBITDA of Moody's-rated shipping companies will fall by 7%-10% in 2016," adds Semetko. "Such a result is much worse than the low-single-digit percentage decline we forecast in March 2016, when we changed our outlook for the industry to negative from stable."
  - Moody's analysis is contained in its just-released report titled "Shipping Global: Low Freight Rates and EBITDA Decline Drive Negative Outlook". The report points out that Moody's will consider changing the outlook for the global shipping industry back to stable if shipping supply growth exceeds demand growth by less than 2%, or demand growth exceeds supply growth by up to 2%, and if aggregate EBITDA growth is within a range of -5% to +10% year-over-year.
  - Moody's will consider a positive outlook for the global shipping industry if the oversupply of vessels declines materially and the aggregate year-over-year EBITDA growth for companies that Moody's rates appears likely to exceed 10%.

Source: Moodys.com, June 22, 2016

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Future Outlook Cont'd

- Industry losses will likely range from $8 billion to $10 billion for the full year, according to Lars Jensen, CEO of SeaIntelligence Consulting."

Source: www.morethanshipping.com, 12/5/2016

- Global container shipping is experiencing the worst financial distress since the 2008 financial crisis. Financial distress in maritime shipping is not expected to improve anytime soon. Research shows that shipping downturns like the one we are currently in typically lasts 18-24 months. Some experts believe that this one could take as long as 2-3 years before supply and demand are realigned.

Source: www.creditriskmonitor.com, 8/31/2016

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Future Outlook Cont'd

- **Continued Consolidation/Mergers/Alliances/Co-Management Agreements**
  - The latest merger of liner shipping businesses, revealed by Japan's Big Three shipping companies yesterday, is further evidence of survival mergers and acquisitions sweeping the industry, according to shipping consultancy Drewry.
  - Namely, the agreement between Kawasaki Kisen Kaisha (K Line), Mitsui O.S.K. Lines (MOL), and Nippon Yusen Kabushiki Kaisha (NYK Line), subject to resolution by the board of directors of each company and shareholder/regulatory approval, would form a new joint-venture company which would operate a fleet totaling 1.4 million TEUs. The company is planned to be established on July 1, 2017.
  - Drewry said that, while this is considered to be an important step towards making container shipping an industry that can sustain profitability, the process of integration will be challenging.
  - "Whilst the consolidation that took place in container shipping pre-2008 was driven by a desire for growth, the current wave of M&A activity is more about survival and the need to address structural industry issues by strengthening balance sheets, addressing poor investor returns and adapting to the low growth environment," Drewry said.
  - At the time of acquisitions pre-2008, growth or scale was the primary strategic imperative behind M&A. The industry was still in growth phase fueled by globalization and manufacturers shifting sourcing to Asia.

Source: www.worldmaritimenews.com, 11/1/2016

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Future Outlook Cont'd

- However, Drewry noted that recent acquisitions have been driven by necessity and the promise of synergies from cost saving, economies of scale, improved competitive positioning and better protection from the prevailing weak industry fundamentals.
- "Alliances, along with M&A, have been a response to the low-growth environment, where a significant number of carriers have not made money in the recent past. We anticipate further consolidation activity but the industry may need to wait until the earnings impact of the consolidation become tangible," said Drewry's director of container research Neil Dekker.

Source: www.worldmaritimenews.com, 11/1/2016

SUMMARY
Has Anything Changed Since 2008?

- Continued Uncertainty About Overall Global Economic Activity and Trade
- Need market growth, but global economy stagnating
- Supply vs. Demand
- Persistent Price Pressure
- High Vessel Supply
- Costly Operations
- High Debt Loads
- Consolidation and Competition

Outlook

- Tough market environment likely to continue for at least 2 to 3 years
- Carriers must adapt to oversupplied market even though there appears to be a slight increase in rates

Contact Information

Ilana Volkov
ivolkov@coleschotz.com
201-525-6269

Cole Schotz P.C.

CONTAINER SHIPPING IN TEN STEPS

How Liner Shipping Works. From There to Here in a Container.

Every day, thousands of containers arrive at seaports from countries all around the world. They are carried aboard liner ships, which offer regularly scheduled service on fixed routes - much like a bus or train service does. Each shipment represents a specific supply chain, whether it is patio furniture from Thailand bound for a Milan retailer or shoes shipped from China to an athletic supply store in Europe or North America. Every supply chain is somewhat unique because it involves the timely and accurate transfer of goods between various modes of transport. Goods transported by ocean containers on liner ships can be placed into the container at the factory origin. The container is locked and sealed so the goods can remain safely secured inside the container until it arrives at the purchaser's warehouse, factory or store. For this reason, more than 50 percent of the vaule of goods moved internationally by sea is now moving in containers on liner ships.

1 An athletic supply store is running low on the season’s hot, new shoes, which are manufactured in northern China. The Store places an order for 500 pairs. The shoe company works with a freight forwarder to arrange transport from the Chinese factory for the shipment of shoes.

2 A trucking company arrives at the Chinese factory, loads the order, along with orders from many other retailers, into a 40-foot container, which is bolted shut and fitted with a high-security seal. The container will not be opened again until it arrives at a distribution warehouse in the destination country, unless customs officials decide to open and inspect it.

3 The freight forwarder determines it is most economical to truck the container to the Port of Tianjin. The freight forwarder has contracted with a container shipping line, which must submit documentation about the shipment to government authorities in the exporting and importing countries. This “manifest data” includes information such as exact contents, the exporter, the importer and transporter of the cargo.

CONTAINER SHIPPING IN TEN STEPS

4 Now loaded onto a container ship, the container of shoes is bound for a discharge port on another continent far away.

5 A few days before the ship is scheduled to arrive at the destination port, the captain of the vessel provides a report to the government of the destination country that contains information about the ship, its crew and its cargo.

6 Having received proper clearance to arrive at the port, the container vessel docks at a berth adjacent to large cranes that will be used to unload the containers of cargo.

7 Many dockworkers – sometimes more than 100 per vessel – arrive to work the ship. They include crane operators, lashers, clerks and cargo equipment operators.

8 Customs officials, armed with a careful evaluation of each container's documentation, may select specific containers for further inspection.

9 Once cleared by customs, workers load the container onto a special truck, trailer or chassis. Now the container of shoes can be trucked to the distribution center. Containers are often transported by train when the destination is long distance from the port.

10 The truck arrives at an import distribution center located not too far from the port, where the container is opened and the orders by individual stores are separated and prepared for shipment. The next day, the athletic supply store receives its 500 pairs of the season's most popular athletic shoes.

Trucking Concerns in 2017

Presented By:

Curt Friedberg, Shareholder
GGG Partners, LLC
www.gggpartners.com

Look Around The Room and What Do You See:

Take a look around you today in this conference room and notice that just about everything (except for what you brought here yourself) got here on a truck.

Comments from ATA (American Trucking Association)

The trucking industry is the lifeblood of the U.S. economy. Over 70% of all the freight tonnage moved in the U.S. goes on trucks. Without the industry and our truck drivers, the economy would come to a standstill. To move 10.5 billion tons of freight annually requires over 3.4 million heavy-duty Class 8 trucks and over 3.5 million truck drivers. It also takes over 38 billion gallons of diesel fuel to move all of that freight. Simply – without trucks, America stops.
(www.trucking.org from the American Trucking Association

So What is the Problem:

- There are approximately 3.6 Million trucks in the united states today.
- Roughly 90% of the trucks on the road today are owned by companies running 10 or less trucks
- Much of the data and statistics in trucking is based on publicly traded companies, yet most of the freight is moved by small privately owned fleets that are hard to track.
- Various statistics talk about the average age of a truck driver, that ranges from 55-60 years old
- Estimates of driver shortages range from 50,000 – 100,000 drivers and growing
- Implementation of electronic logs (ELD) systems and electronically calculating hours of services (HOS) will drastically change the utilization of trucks by the end of 2016
- Rates for transportation have remained low while the cost of running freight (trucks, trailers, technology, drivers, insurance, etc) keeps going up
- CONCLUSION: there will be a continued wave of bankruptcies and consolidation of trucking companies

TRUCKING BANKRUPTCY
July 2017 ABI Southeast Conference
By: John Isbell and Douglas Walters[1]

The trucking industry has long been a welcome source of work for bankruptcy practitioners across the country. Trucking company Chapter 11 cases are full of thorny issues and even the "successful" Chapter 11 cases often result in a company that is still unable to thrive in the difficult transportation world, often resulting in "chapter 22" filings. While the traditional trucking issues remain – such as financing difficulties and low margins – new obstacles are emerging to make this industry even more ripe for restructuring. Below are a couple of the newer issues facing the industry, as well as an update on the often litigated "carrier lien's" that occupy the first portion of any trucking Chapter 11 case.

I. Roadblocks Facing the Trucking Industry.

A. <u>National Shortage of Truck Drivers</u>.

The United States trucking industry is estimated to have 50,000 fewer truck drivers than available jobs.[2] If the current trend continues, the American Trucking Association (ATA) estimates that by 2024, the shortage will skyrocket to nearly 175,000 drivers.[3] The driver shortage has significant impact on the trucking industry. Without a steady pool of new drivers,

[1] John Isbell is a partner in Thompson Hine's Atlanta office. Douglas Walters is an associate in Thompson Hine's Cleveland office.

[2] Lisa Katz, *Truck driver shortage could threaten supply chains*, CRAIN'S DETROIT BUSINESS, *available at* http://www.crainsdetroit.com/article/20160810/BLOG107/160819991/truck-driver-shortages-could-threaten-supply-chains.

[3] *Id*. at 2.

motor carriers' growth is restricted.[4] Additionally, shortages can cause the cost of employing a driver to increase, which impacts freight pricing.[5]

While there are several reasons for the shortage of drivers, one of the most significant factors is the imbalance between the amount of retiring drivers and drivers entering the occupation.[6] It is estimated that 55% of truck drivers are over the age of 49, compared to 42 for the average U.S. worker.[7] Additionally, the current age requirement to drive interstate lines is 21.[8] As a result, high school graduates who may have been interested in truck driving instead enter into other occupations from which they rarely leave.[9]

B. Misclassification Litigation.

Several trucking companies operating at the ports of Long Beach and Los Angeles have filed for bankruptcy protection in recent months, citing mounting costs to settle hundreds of legal claims.[10] Since 2011, 799 complaints have been filed against port-trucking companies with the California Labor Commissioner's Office, alleging drivers were misclassified as independent contractors and denied the wages and benefits afforded to full-time employees.[11] A total of more than $35 million has been awarded to drivers in those cases, according to the Labor Commissioner's Office.[12] Litigation with drivers and the higher cost of full-time labor could

[4] Bob Costello & Rod Suarez, Truck Driver Shortage Analysis 2015, Am. Trucking Ass'ns (Oct. 2015),

[5] *Id*. at 2, 10.

[6] *Id*.

[7] *Id*. at 10.

[8] *Id*.

[9] *Id*.

[10] Erica E. Phillips, Port Trucking Company Files for Bankruptcy Protection, THE WALL STREET JOURNAL, https://www.wsj.com/articles/california-port-freight-hauler-files-for-chapter-11-1458169628

[11] *Id.*; *see also,* Lawsuits Push Port Trucking Company Into Bankruptcy, TRUCKINGINFO, http://www.truckinginfo.com/channel/fleet-management/news/story/2016/03/lawsuits-push-port-trucking-company-into-bankruptcy.aspx.

[12] Erica E. Phillips, Port Trucking Company Files for Bankruptcy Protection, THE WALL STREET JOURNAL, https://www.wsj.com/articles/california-port-freight-hauler-files-for-chapter-11-1458169628

force operators to charge more for their services or it could put them out of business entirely, reducing the overall number of carriers and raising costs for shippers.[13]

Courts analyzing misclassification claims consider numerous factors, including: whether the one performing services is engaged in a distinct occupation or business; the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; the skill required in the particular occupation; whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work; the length of time for which the services are to be performed; the method of payment, whether by the time or by the job; whether or not the work is part of the regular business of the principal; and whether or not the parties believe they are creating the relationship of employer-employee. In port trucking misclassification cases, the most important consideration is generally whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired.[14] Recent cases suggest that the ability to control the drivers' rates, schedules, and routes will likely be sufficient to establish the service provider as an employee.[15]

II. The Right to Recover Freight Charges.

In order to ensure payment of freight charges, common carriers are provided with a lien on the goods in their possession that are being shipped – *i.e.*, a "carrier's lien." For a common carrier trucking company, the carrier's lien will arise under either the Uniform Commercial Code ("U.C.C.") or the Federal Bill of Ladings Act (the "FBLA"). If the goods were moved

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[13] *Id*.

[14] *Id*. at 1100.

[15] *Ruiz v. Affinity Logistics Corp*., 754 F.3d 1093, 1101 (9th Cir. 2014); *Estrada v. FedEx Ground Package Sys*., 154 Cal. App. 4th 1, 64 Cal. Rptr. 3d 327, 335 (Cal. Ct. App. 2007) ("The essence of the test is the 'control of details'—that is, whether the principal has the right to control the manner and means by which the worker accomplishes the work … .").

intrastate, U.C.C. § 7-307 (as adopted by the law of the state where the goods are located) will govern the carrier's lien. If the goods were moved *interstate*, the carrier's lien will be governed by the FBLA.[16]

A. Inventory Subject to Carrier's Lien

Pursuant to U.C.C. § 7-307(a), a common carrier is granted a lien on goods covered by a bill of lading arising after the date the carrier received the goods. The lien is possessory – meaning that it continues only so long as the goods remain in the carrier's possession.[17] If the common carrier voluntarily relinquishes possession of the inventory (*i.e.*, delivers it to a customer or another warehouse), the carrier loses its lien on that particular inventory.

The FBLA, like the U.C.C., provides the common carrier with a lien on inventory identified in the bill of lading.[18] The FBLA does not, however, specifically address whether the lien survives the carrier's voluntary delivery of the goods. There is limited case law addressing the Federal Bill of Lading Act or its predecessor law. As a result, this issue remains a grey area of the law for which no definitive answer now exists.

B. Debts Secured by the Carrier's Lien

The U.C.C. and the FBLA both provide a carrier with a lien for the debts associated with the storage or transportation, including demurrage and terminal charges, and for the expenses necessary for preservation of the inventory of the goods incident to their transportation.[19] Additionally, the U.C.C. provides that the carrier's lien secures debts related to the costs reasonably incurred in the carrier's efforts to enforce its lien through a sale of the inventory.[20]

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16 *See* 49 U.S.C. §§ 80102 and 80109

17 U.C.C. § 7-307(c).

18 49 U.S.C. § 80109(a).

19 UCC 7-307(a); 49 U.S.C. 80109.

20 UCC 7-309(a).

The FBLA, while not explicitly providing for security for such costs, does not prohibit it and is written broadly enough that such costs are likely to be secured by the carrier's lien.[21]

The U.C.C. and the FBLA differ, however, on their treatment of expenses not related to the specific goods at issue. Under the FBLA, a carrier can obtain a general lien on the inventory in his possession and subject that inventory to a lien securing charges not related to it.[22] For example, a carrier can have a federal lien on certain inventory within its possession that secures the costs and expenses related to (i) other inventory within its possession; or (ii) inventory that is no longer within its possession.[23] The extent of the debts secured by the carrier's lien is set forth in the bill of lading covering the inventory and is limited only by the requirement that such charges be allowed by law.[24] If there is no grant of a general security interest in the bill of lading, then the lien created by the FBLA is limited to the charges related to the specific inventory (i.e., certain inventory will secure only the charges related to it and will not secure charges related to other inventory).

On the other hand, the state laws applicable to intrastate bills of lading do not provide for a general carrier's lien. Under the state laws, a carrier's lien on certain inventory will secure only the charges related to that inventory.[25] A state law carrier's lien does not secure any charges related to other inventory – regardless of whether such other inventory is in the carrier's possession.

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21 49 U.S.C. 80109.

22 49 U.S.C. 80109(2).

23 49 U.S.C. 80109.

24 49 U.S.C. 80109(2). While the UCC does not provide for a general statutory lien (discussed in the following paragraph), it does not prohibit such liens.

25 UCC 7-309. "The section is intended to give carriers a specific statutory lien for charges and expenses similar to that given to warehouses by the first sentence of 7-209(a) and extends that lien to proceeds of the goods as long as the carrier has possession of the proceeds. But because carriers do not commonly claim a lien for charges in relation to other goods or lend money on the security of goods in their hands, provisions for a general lien or a security interest similar to those in Section 7-209(a) and (b) are omitted)." UCC 7-309, Cmt. 1.

C. Priority of the Carrier's Lien.

The U.C.C, and the state statutes enacting it, provide for a "possessory lien" holder to have priority over prior perfected liens if certain requirements are met. By contrast, nothing in the Federal Bill of Lading Act addresses priority of the lien created by federal law. Absent a provision to the contrary, priority for purposes of federal law is governed by the common-law principal of first in time, first in right. The priority of a federal lien depends on the time that the lien attached to the property in questions and became choate. "Federal law determines choateness, and the federal rule is that liens are perfected in the sense that there is nothing more to be done to have a choate lien – when the identity of the lienor, the property subject to the lien, and the amount of the lien are established."

Even if the U.C.C. priority provisions were to apply to the federally created carrier's lien, the FBLA's lack of an explicit provision requiring the goods to be in the possession of the carrier may affect the carrier's right to claim priority over prior existing perfected secured creditors. The definition of a "possessory lien" requires that such lien's effectiveness depend on the creditor's possession of the collateral.[26] As noted above, the lien created by the FBLA does not make such lien dependent on the carrier's possession of the collateral.[27] Thus, a carrier with a federally created lien for interstate shipping does not obtain a "possessory lien" even when in possession of the inventory and, as a result, should not be able to benefit from the priority provided to "possessory liens."

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[26] UCC 9-333(a)(3).

[27] *See* 49 U.S.C. 80109.

D. Enforcement of the Carrier's Lien

Under the U.C.C., a carrier can enforce its lien through a public or private sale of the inventory within its possession.[28] The carrier has great flexibility in the method of the sale, generally being subject only to the requirement that the sale be commercially reasonable.[29] The carrier meets the commercial reasonableness requirement if it sells the inventory in the usual manner in any recognized market for such goods, sells the inventory at market prices, or otherwise sells the inventory in conformity with practices of dealers in the type of goods sold.[30] Alternatively, the carrier can enforce its lien by meeting the requirements set forth in UCC 9-310(b) (alternative specific requirements for the enforcement of a warehouseman's lien).[31]

The carrier is required to notify all persons known to claim an interest in the inventory prior to the sale.[32] The notice must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale.[33] There is no requirement in the statute regarding the timing of the notice.

Unlike the U.C.C., the FBLA does not identify requirements for the interstate carrier to enforce its lien. The federal law does, however, contemplate that the carrier shall have the right to "lawfully" sell the goods that are subject to its carrier's lien.[34] Furthermore, federal regulation requires the use of a uniform contract terms for bills of lading used for interstate shipments.[35]

[28] UCC 7-308(a).

[29] UCC 7-308(a) (stating that sale may be "in bulk or packages, at any time or place and on any terms that are commercially reasonable").

[30] UCC 7-308(a).

[31] UCC 7-308(g). *See* bullet points in section III(D), *supra*, for identification of alternative specific requirements.

[32] UCC 7-308(a).

[33] UCC 7-308(a).

[34] *See* 49 U.S.C. 80111(d)(2) (stating that a common carrier is not liable for failure to deliver goods if the goods were sold lawfully to satisfy the carrier's lien).

[35] 49 C.F.R. 1035.1 and 1035.2.

The uniform bill of lading terms provide the terms upon which a carrier can enforce its lien on the shipped goods when the goods are not claimed within 15 days or are refused.[36] Goods which are not paid for are may be deemed unclaimed or refused, and thus subject to the sale terms contained in the uniform bill of lading terms. Those terms include the following:

- Carrier may sell the goods at public auction, at such time and place as may be designated by the carrier, to the highest bidder.
- Carrier must give notice to the shipping party that the goods remained unclaimed and that they will be subject to sale under the terms of the bill of lading if disposition is not arranged for.
- Carrier must publish notice in a newspaper of general circulation at the place of sale once a week for two consecutive weeks.
- The published notice must contain (i) a description of the property; (ii) the name of the shipping party or the name of the party that was entitled to notification depending on the terms of the bill of lading; and (iii) the time and place of the sale.

Importantly, there is no provision in the uniform bill of lading terms that requires notice to other parties that may claim an interest (i.e., a security interest) in the goods.

E. <u>Impact of the Automatic Stay</u>

Pursuant to §362(a)(3) of the Code, Common Carrier may not take any act "to exercise control over property of the estate."[37] Numerous courts have found that an entity's willful refusal to turn estate property over to the trustee on account of a pre-petition debt represents an act "to exercise control" over property of the estate, subjecting the creditor to sanctions for violation of

[36] 49 C.R.F. 1035, Appendix B, § 4.

[37] 11 U.S.C. §362(a)(3).

the automatic stay.[38] A few courts, on the other hand, have taken a more narrow view of the automatic stay under these circumstances, finding that §362(a)(3) should not be interpreted to require turnover of property of the estate where turnover would render the creditor unsecured.[39]

Regardless of whether §362(a) should properly be construed to prohibit continued possession of property of the estate where such possession is necessary to preserve Common Carrier's lien, the automatic stay does not prohibit common carrier from retaining possession based upon the statutory exception set forth in 11 U.S.C. § 362(b)(3). It provides that the filing of a bankruptcy petition does not stay "any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title...." Thus, to the extent a trustee's power is subject to an interest perfected under §546(b) of the Code, the automatic stay does not enjoin acts to maintain perfection of that interest.

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38 *See*, *e.g.*, *Perry v. Chase Auto Fin. (In re Perry)*, Nos. 1:09-bk-11476-GM, 1:10-ap-01043-GM, 2014 Bankr. LEXIS 1659, at *36 (U.S. Bankr. C.D. Cal. Apr. 16, 2014); *Caffey v. Jag Autocare, LLC (In re Caffey)*, Nos. 13-31259, 13-3057, 2014 Bankr. LEXIS 3381, at *8 (U.S. Bankr. N.D. Ohio Aug. 8, 2014); *California Empl. Dev. Dep't v. Taxel (In re Del Mission)*, 98 F.3d 1147 (9th Cir. 1996).

39 See *In re Giles*, 271 B.R. 903, 906-07 (Bankr. S.D. Fla. 2002) (citing *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 21 (1995)); *In re Young*, 193 B.R. 620, 625 (Bankr. D.D.C. 1996) ("[T]he [Bankruptcy Code's] prohibition against an act to exercise control does not reach the passive act of continuing to possess property.").