OCEAN CARRIER CLAIMS IN BANKRUPTCY

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INTRODUCTION

This article will discuss various types of claims that may be asserted by an ocean carrier in the bankruptcy case of its customer, such as a shipper, or another entity liable for freight charges or related charges.

WHAT IS A CLAIM?

As defined in the United States Bankruptcy Code, a "claim" means a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or, right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

Generally, claims in bankruptcy are paid according to their priority of distribution. The priorities of distribution of a debtor's assets in a Chapter 11 (reorganization) or chapter 7 (liquidation) bankruptcy case are established in Section 507 of the Bankruptcy Code. In a Chapter 11 case, a plan of reorganization is only confirmable pursuant to Section 1129 if it passes the absolute priority test. According to the absolute priority test, no junior class of creditors may receive any distribution under the plan unless all senior classes are paid in full, unless the senior class(es) agree(s) to a different treatment.

Recently, the United States Supreme Court held that a structured dismissal of a Chapter 11 case that violates the absolute priority rule is invalid.[1]

A creditor in bankruptcy can be either secured, unsecured, administrative or priority. Creditors who hold collateral for their claims are secured. Unsecured creditors do not have collateral for their claims. Administrative claims are claims for post-petition goods or services. Administrative claims are given first priority of distribution. Priority claims are pre-petition claims that Congress has decided should have priority over general, unsecured claims, for various policy reasons.

Some of the most common priority claims in corporate bankruptcies are the following: taxes or penalties owed to governmental units; employee claims for unpaid wages, salaries or commissions (up to $12,475) earned within 180 days before the case was filed or the debtor's business ceased, whichever is earlier; and, contributions to an employee benefit plan.

FILING OF CLAIMS

To assert a pre-petition claim in a Chapter 7 case, whether for a general, unsecured claim or a priority claim, a creditor must usually file a proof of claim. In a Chapter 11 case, a creditor does not have to file a proof of claim if the debtor scheduled the claim in the correct amount and type, unless the debtor scheduled the claim as disputed, contingent or unliquidated. The timely filing of a proof of claim is *prima facie* evidence of the validity, priority and amount of the claim. The burden then shifts to the debtor or trustee to object to the claim, for whatever reason the claim is allegedly objectionable.

Recently, the United States Supreme Court held that the filing in a bankruptcy case of a proof of claim that is barred by the applicable statute of limitations does not violate the Fair Debt Collection Practices Act.[2]

In bankruptcy, a fully secured creditor is entitled to receive its collateral or the present value of the collateral. A fully secured creditor that is scheduled by the debtor as secured for the correct value of the debt and the value of the collateral does not have to file a proof of claim; however, if there is a deficiency claim, the secured creditor must file a claim for the unsecured portion of the debt. Also, if the debtor disputes the value of the collateral securing the debt, the creditor will have to prove the value of its collateral. This is usually done by objecting to the claim or by filing an adversary proceeding to determine the extent, validity and priority of a lien.

ALLOWANCE OF CLAIMS

Claims in bankruptcy are paid through the allowance process, whereby parties in interest with standing have the opportunity to challenge or object to filed or scheduled claims. The claims allowance process is accomplished through a process known as claims objections.

OBJECTIONS TO CLAIMS

A party in interest with standing may object to a claim that is either filed by a creditor or scheduled by a debtor. The party objecting to the claim must serve a notice of objection to the claim on the creditor or other party that filed or scheduled the claim. The objection to claim commences a contested matter, similar to an adversary proceeding in bankruptcy, which is like a lawsuit within the bankruptcy case. A timely filed claim is *prima facie* evidence of the amount and validity of the claim. The party objecting to the claim has the burden to rebut the claim. Ultimately, the creditor has the burden of proof to establish the right, type and amount of a claim.

TYPES OF CLAIMS

I. ADMINISTRATIVE CLAIMS

An administrative claim for post-petition goods or services has the highest priority of distribution of the debtor’s assets in bankruptcy. The reason or policy behind this Congressional

decision is to encourage creditors to continue to do business with a distressed debtor in bankruptcy, in order to foster the debtor's rehabilitation and increase the chance of a successful reorganization.

Generally, a request for allowance and payment of an administrative expense claim pursuant to Section 503 of the Bankruptcy Code is made by motion or application. The administrative claimant must prove that the goods or services constituted actual, necessary costs and expenses of preserving the debtor's bankruptcy estate.

Some common examples of administrative claims in a corporate bankruptcy case are the debtor's and other estate professional's fees, including any creditors' committees' attorneys, accountants, and financial consultants; goods or services provided to the debtor post-petition; and, the value of any goods (not services) received by the debtor within 20 days before the date of commencement of the case in which the goods were sold to the debtor in the ordinary course of the debtor's business.

II. FREIGHT CHARGE AND DEMURRAGE CLAIMS

If a shipper, consignee or other party with an interest in cargo that is liable for freight charges files for bankruptcy, an ocean cargo carrier may assert a claim for unpaid freight charges, as well as demurrage that may be charged by a marine terminal operator or warehouseman to the carrier, due to the failure of the consignee to take delivery of the cargo. Although demurrage is not payable to the carrier, if the carrier is liable for the charges, it may file a claim against the debtor in bankruptcy for the demurrage charges that the carrier has to pay.

As a general rule, ship owners have a lien upon cargo for freight charges. Consequently, ship owners may retain the goods after the arrival of a ship at the port of destination until payment of the freight charges is made. Such a lien is regarded in the jurisprudence of the United States as a maritime lien, because it arises from the usages of commerce, independently of the parties, and not from any statutory regulations. Legal effect of such a lien is that the shipowner, as carrier by water, may retain the goods until the freight is paid.

The parties to a maritime contract may also employ words in their credit agreement, service contract or bill of lading to affirm the existence of the maritime lien, or even to extend its reach. Further, the intervening insolvency of either party to a maritime contract cannot change the terms of the parties' agreement.

The ocean carrier's maritime lien on cargo is a possessory lien that is relinquished upon delivery or release of the cargo. If the lien has been extinguished, then any claim for unpaid freight charges would be an unsecured claim. If the cargo is still in the carrier's possession, however, the carrier may be able to assert secured party status. A secured party in bankruptcy is entitled to receive its collateral or the value of the collateral. Thus, if freight and other charges are not paid, the ocean carrier may be able to execute its maritime lien on the cargo, after obtaining relief from the automatic bankruptcy stay, to satisfy any unpaid freight and demurrage. Further, any freight charges or demurrage due for the post-petition period would constitute an administrative claim that is subject to priority of distribution, if not paid in the ordinary course of business of the debtor.

Recently, the Third Circuit Court of Appeals, which includes Delaware, New Jersey and Pennsylvania, held that delivery of cargo without intent to relinquish the possessory lien that was deemed to belong to a non-vessel operating common carrier (NVOCC) does not relinquish the NVOCC's lien on the cargo for unpaid freight charges.[3] Presumably, if an NVOCC does not lose its lien on cargo which it never actually had in its physical possession, then a vessel operating common carrier (VOCC) would also not lose such a lien merely by delivering the cargo, if the VOCC did not in fact intend to relinquish the lien.

III. DEAD FREIGHT CLAIMS

Under the Bankruptcy Code, a debtor in possession or a trustee may reject an executory contract or unexpired lease. A situation that an ocean carrier might encounter in a manufacturing or retail debtor bankruptcy case is rejection of a minimum quantity commitment (MQC) service contract by a shipper, as debtor, or its trustee in bankruptcy. An unexpired service contract, including an MQC contract, is arguably an executory contract. The liquidated damages flowing from failure to fulfill an MQC service contract are sometimes called "dead freight."

Section 365(a) of the Bankruptcy Code states that "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." An executory contract is usually defined in bankruptcy as a contract under which the obligations of both the debtor and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. This test is generally known as the "Countryman" test, named after Professor Vern Countryman, the author of a law review article, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 460 (1973), that first advocated that test.

The Countryman test is the majority test for executoriness, and was adopted in the Third Circuit, which includes Delaware and New Jersey. No circuit has actually rejected the Countryman test, although not all circuit courts of appeals have explicitly adopted that test. Although the Second Circuit, which includes the SDNY, has not actually adopted the Countryman definition of executory contracts, recent decisions from the Second Circuit and the SDNY bankruptcy court have relied on the Countryman test for executoriness of a contract.

The damages flowing from rejection of an executory MQC service contract, which rejection is considered a breach of the contract, not termination of the contract, are deemed a pre-petition, general, unsecured claim. Although the contract rejection actually occurs after the bankruptcy filing, or post-petition, the breach occasioned by the rejection is deemed to have occurred immediately prior to the filing, or pre-petition, pursuant to Section 365(g) of the Bankruptcy Code. The deadline to file a rejection damages proof of claim is 30 days from the order rejecting the contract, or the general bar date for pre-petition claims, whichever is later.

By filing a proof of claim for MQC service contract rejection liquidated damages, the ocean cargo carrier creditor can share *pro rata* in distribution of the debtor's assets to pre-petition, general, unsecured creditors, assuming that there is any such distribution. Also, the carrier may assert the unpaid rejection damages claim as an offset against any claim by the debtor's estate

representative for avoidance or recovery of a preferential payment or a constructively fraudulent transfer. Thus, the rejection damage claim may have use as leverage.

IV. PER DIEM CLAIMS

An ocean carrier may have a claim against a drayage company or other entity that files for bankruptcy for detention of containers, also known as per diem charges, since the charges accrue on a daily basis. An ocean carrier that has a claim for per diem charges against a drayage company or other entity that files for bankruptcy may file a claim for the per diem charges. The ocean carrier should attach an exhibit to the proof of claim or request for allowance and payment of an administrative expense stating the daily charge for each container, the number of containers detained, the number of days, and the total per diem charges. Like other claims in bankruptcy, per diem charges for the pre-petition period are general, unsecured claims and per diem charges for the post-petition period are administrative claims.

TRANSFER OF CLAIMS

Claims in bankruptcy can be transferred, sold or assigned. The transferee takes the claim subject to all defenses to the claim, including the right to payment, amount, type of claim, etc. Generally, claims traders try to obtain claims in order to control the outcome of the bankruptcy case, or to take control of the debtor after confirmation of a plan of reorganization.

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[1] Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).
[2] Midland Funding v. Johnson, 2017 U.S. Lexis 2949 (May 15, 2017).
[3] In re World Imports, Ltd. v. OEC Group N.Y., 820 F.3d 576 (3d Cir. 2016).