Whatever Happened to Cenargo?

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The Cenargo Group of companies traded as a transport group specializing in shipping, ferry and chartering businesses together with a logistics business. The business was an old privately owned affair with its origins in the tanker trade. In recent years the sole shareholder, who was also the chief executive, had shifted his focus to ferry operations in the Irish Sea together with a time charter business. The fleet of over a dozen vessels of varying age and specifications had been funded by debt and capital leases in excess of USD 300 million. Parts of the shipping businesses were profitable but, coupled with a downturn in the Irish Sea business and loss-making logistics operations, the debt was no longer sustainable by late 2002. This led to the start of formal restructuring proceedings.

Choice of jurisdictions

In 2003 this transaction gained notoriety as a case involving a significant jurisdictional conflict in respect of the US and the UK insolvency regimes.

Briefly, at a time when the Group had breached financial covenants and was under pressure from its financial creditors for information and explanation, it applied for bankruptcy protection under Chapter 11 in the US Bankruptcy Court. On 28 January 2003 a leasing creditor, Lombard, applied to the High Court for the appointment of joint provisional liquidators on the basis that the company was insolvent and that although it had filed under Chapter 11 all of the group's business and assets were based in countries other than the US, predominantly England, Ireland and other EU countries, with the notable exception of secured note holders who were based in the US. As a result the Court appointed officers from Ernst & Young LLP as provisional liquidators. There then followed some inter-Court jurisdictional issues that led to the provisional liquidation being discharged and the administration orders being placed over the majority of Group companies.

In effect, management in this case was seen as trying to keep control of a restructuring process by filing for a Chapter 11, whilst a significant financial creditor, on the other hand, wanted any insolvency proceedings to be based in the location of the debtor's business and where all transactions were originated: namely the UK jurisdiction.

The US Court finally acknowledged the position and discharged the US proceedings to allow the UK process to continue unhindered. In this we were helped by demonstrating the fact that the UK process was already well underway, that it was capable of achieving a similar objective to one that a Chapter 11 would, and that it had wider creditor recognition and a more effective European Union-wide moratorium. As a result, on 14 February 2003 the US Court suspended the Chapter 11 proceedings and ultimately they were dismissed on 23 September 2003.

The case is likely to remain a significant landmark for future reference as regards cross-border proceedings, in particular as regards considerations necessary when non-US debtors choose to file in the US in non-consensual circumstances.

Momentum for the restructuring exercise

Alongside the jurisdiction issues, Cenargo's restructuring and re-organization exercise itself represents a useful case study of a successful turnaround. The core shipping business continues to operate, without the taint of administration, with improved liquidity and balance sheet position. The successful outcome was co-developed with the management and creditor collaboration, notwithstanding that creditors lost a significant portion of the pre-petition claims. This collaboration led to trade creditors accepting a significant loss, secured creditors and lessors signing up new arrangements, management accommodating some key changes and the note holders giving up their security interest and re-investing significant sums which they could have otherwise withdrawn.

It was early in the initial discussions around the appropriate jurisdiction that Steve Adams of Wayland Securities (then an affiliate of Cargill), who held approximately 45% of the secured notes, indicated that Wayland was prepared to consider a restructuring of the Group. Additionally Steve Adams indicated that as one of the note holders with substantial sway he and his advisors would be looking to persuade other note holders. This was subject to there being a business case, to relinquish their security for the

equity in the business and there was some certainty that the process could achieve such a result within a reasonable timeframe.

The business case for restructuring

It was clear to the administrators at the outset that, if a meltdown were to be avoided, a robust case for financial restructuring and a strategy to achieve this had to be established early. Followed by an agreement in principle obtained from all key financial creditors to support the plan. The essential elements of the initial due diligence and consultation process involved:

- Business review to identify the core, viable business;
- Enterprise value-break assessment and liquidation outcome analysis;
- Focus on improvement in trading and working capital performance;
- Disposal of non-core assets to facilitate fund-raising;
- Outline business plan, exit group structure, projected balance sheets and liquidity assessment.

This process commenced immediately after the appointment of the administrators. It was an iterative process with regular disclosures and discussions with the key stakeholders. Timely flow of information was important to create confidence in the process. The complicated manner in which the Group's financial records and reports were maintained meant that it took longer than anticipated to assemble the first set of detailed accurate information.

Once the outline financial information and modelling exercise was available, we were able to secure the agreement of an ad hoc committee of note holders, representing the vast majority of the notes, in early May 2003. This covered certain fundamental concepts, namely that:

- No cash will be returned to the note holders;
- 100% of their debt positions would be equitized;
- Secured and leasing creditors will be made whole and may require new terms; and
- A small dividend will be paid to unsecured creditors at an improved rate compared to the estimated liquidation outcome.

Liquidity was a key issue for us to concentrate on. A significant cash pile was required both for funding the restructuring-related settlements and for the working capital needs of the post-restructuring business. We achieved this through a combination of cash preservation and the sale of surplus assets.

Interim management

At an early stage there was general acceptance that we needed to simplify what had been an unfocused group, by severing the logistics business and creating an autonomous management and reporting function for the core shipping, ferry and vessel chartering business.

The next stage in the administration was to ensure that the management information provided relevant and timely information in respect of the re-organized operating performance. It became clear that the ferry business was suffering in the Irish Sea from depressed selling prices and was in need of an increased revenue/capacity yield. As a result of competition, local management had been wary of raising prices. Prior attempts to increase prices were 'ignored' by big customers who kept settling accounts at the old rates! However the rising oil costs in the early part of 2003 assisted us in persuading management that price increases were necessary and would have to be adhered to. They set about persuading the customer base of the need for these changes that were then put through. A sustainable price increase was successfully implemented across the board.

In addition we encouraged management to make a significant effort to bring credit terms back in line, to focus on key transport accounts to increase sales per customer, and to improve the loading and turnaround efficiency of the vessels in port. Local management were also encouraged to bring forward ideas and proposals as part of a business planning exercise. Some of these concepts, and the style of management deployed, were new to local management as, in the past, head office management had taken on the responsibility for establishing profit centres not 'visible' to local management and generally determining future operating strategy.

While this was going on, the administration team were in constant dialogue with the note holders who were to be the new owners and who were consulted throughout on the key issues and decision that were being made. Also involved were the secured lenders who were kept appraised of changes and informed through regular financial reporting.

We also amended the administration orders which had been obtained on the basis of a restructuring of the company so that we could sell the logistics businesses, which provided a better realization than would have been achieved on a liquidation. At the same time the head office in the south of England was phased out, with accounting and other administration being moved to the team in Belfast. The head office property was then sold for a significant sum.

Planning for an exit

A major consideration during the planning for a new restructured group was the issue of taxation. Essentially the current legislation does not allow us to easily restructure the capital and debt structure of the ultimate parent. Generally, shareholder involvement

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is required even where the old equity has little or no economic value in an enterprise. This results in inefficiencies and potential conflicts that necessitate the transfers of assets to a new internediate holding company, which is where tax issues might start to arise. Timely tax planning is essential, for example, to ensure that historically accrued gains or gains held over into present shipping asset or subsidiaries would not crystallize into actual liabilities when the substance of the transaction was clearly not meant to effect asset disposals.

Another significant issue that arose was that of historic pension fund liabilities. A process was implemented which sought to compromise the contingent claim of the fund and to offer a new arrangement for existing employee members of the final salary scheme.

The negotiations with the banking syndicate, leasing creditor and the port authorities took time to crystallize into formal agreements. When agreements were reached, it signified a turning point for the prospects of a successful outcome.

During the administrations, the prospective 'new owners' recognized a need for an additional senior executive to steer the group post-restructuring. A suitable candidate for the role of CEO was identified, who accepted the position as it became clearer that the restructuring was going to succeed.

Coming out of administration

In essence this revolved around the provisions of Section 19.5 of the Insolvency Act 1986, which to some extent creates ambiguities and uncertainties. It is clear that the direct costs of the administration, by which we mean the purchase orders that were put in place and the day-to-day utility bills, would always fall within Section 19.5.

However the commercial difficulties of an exit where legal entities, business and assets move on to a re-organized group was a real issue here. Cenargo exits split into three categories:

(i) Continuing companies where the estate effectively split into two: first the run-off CVA in the hands of the supervisors and second the ongoing operating company in the hands of the new directors once the administration orders were discharged;

(ii) Closure companies with a CVA similar to the above but where the legal entity was placed in compulsory liquidation, as part of our tax planning, after all assets were either transferred to the CVA estate and/or to one of the new group companies, principally involved key parent or intermediate holding companies;

(iii) Liquidating companies, which were placed in a voluntary liquidation, principally former corporate shells of operations and assets, which had been sold or transferred out.

The group of companies in category (iii) above were the most straightforward. However (i) and (ii) above were not so. Two fundamental issues arose:

For the outgoing administrator, who had to allow most of the operating assets and some of the cash to transfer to the re-organized group to allow the business to carry on, before administration period liabilities could be finalized.

For the new owners: they did not want to be faced with contingent or unascertained liabilities arising from the administration period, which effectively still encumbered their re-organized assets due to s19.5.

For our part this created issues where the contingent liabilities, in particular around tax, insurance claims and maritime liens, were not entirely resolved before the handover date. To provide in full for every contingency would have blocked much-needed cash from the business. At the same time administrators were under an obligation to provide adequately for these expenses. We have managed this situation by taking advice as to the most likely outcome and generally to provide for that. Further, we sought and gained indemnities from the ongoing business to cover administration expenses in case of need. There is additionally an agreement as regards the handling of taxation matters. The CVA run-off cash funds we hold and corresponding reserves etc. are regularly reviewed with management to ensure adequate funds are being maintained. This commercial solution often led to some robust discussions about the likelihood of liabilities being laid at the door of the administrator.

Conclusion

In the case of Cenargo, administration, together with the CVA, has delivered a solution that, we would suggest, is very close to one which might have been delivered under a US Chapter 11 process. We achieved a degree of consolidation of estates in terms of pooling funds, which generally tends to be difficult. Post-petition funding was put in place for the duration of the administration by agreement with the secured creditors. Debt to equity conversion was achieved in a tax-efficient manner. An effective cross-border moratorium meant that business disruption could be minimized. Senior secured lenders were persuaded to continue the relationship, as were critical port authorities. through greater participation in the process. Overall the process was largely a consensual one and helped rehabilitate many of the companies in the group. It is also encouraging that, notwithstanding the unplanned and non-consensual start, the exit was achieved within 12 months of the commencement of proceedings.

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Our afterthought on this matter is that cases such as Cenargo require a lot more planning and prior inter-creditor discussions before launching formal proceedings. With Cenargo, it seems there was a window of opportunity and the willingness on part of the creditors for this to happen before filing was absolutely essential. In our view, the degree of consensus achieved around key issues such as post-petition funding requirements, protection of security interests, flow of information, interim management plus plans to improve performance and anticipated exit strategy, can significantly enhance a debtor's choice and timing of proceedings and their ability to influence the outcome.

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