



CMA CGM hails a CABS structured deal and diversifies its ship funding sources

This briefing looks at a recent groundbreaking corporate asset-backed securitisation (CABS) deal in the shipping industry. This article first appeared in *Lloyd's List* on 15 March 2006.

CMA CGM's successful completion on February 7 of the Vega ContainerVessel 2006-1 corporate asset-backed securitisation (CABS) deal breaks new ground for shipping companies looking to diversify their funding sources. The transaction tapped into the ABS capital markets, the syndicated bank loan market and the corporate bond market to secure the funding for up to 12 new panamax containerships to be operated by CMA CGM.

At the core, the securitisation transaction is a typical secured loan/lease structure that the shipping legal community is familiar with, but with added structural enhancements, such as the liquidity and enforcement costs facilities that can be drawn down to service interest payments or pay for repossession and enforcement costs in case of default. Compared to a more conventional structure using bank debt, legal issues concerning the bankruptcy remoteness of special purpose entities and the robustness of the security structure in case of the charterer's insolvency take on heightened importance in order to satisfy stringent rating agency legal requirements.

Under the CABS structure, a special purpose issuer, Vega ContainerVessel 2006-1 plc (incorporated in Ireland) issued \$253.7m of senior notes in the capital markets, wrapped by XL Capital Assurance and rated triple-A by Moody's and Standard & Poor's. The unrated mezzanine tranche consists of a \$283.3m syndicated bank loan made by leading shipping banks. The equity tranche of the CABS structure consists of subordinated notes to be purchased by CMA CGM using the proceeds of a \$283m corporate bond which it issued simultaneously with completion of the CABS.

Vega will use the funds to make loans to 12 separate Irish special purpose entities who will use the funding to purchase four 1,700 teu vessels from Hyundai, two 4,400 teu vessels from Hanjin and six 5,100 teu vessels from Hyundai during a delivery period of three years. The vessels will then be placed on bareboat charter to CMA CGM for use on its extensive global network. Although the CMA CGM deal is a first for the shipping market, similar structures have been used in the aircraft market by flag carriers Iberia (in 1999, 2000 and 2004) and Air France (in 2003).

Those transactions were rated by Moody's, but not S&P's. Freshfields Bruckhaus Deringer, having advised on three of the aircraft deals and knowing the pressure points for S&P's in those deals, is delighted that the rating agency has agreed to rate the CMA CGM transaction.

One of the principal concerns for S&P's on previous transactions was the exchange rate risk inherent in a structure in which debt was raised in euro but the underlying assets (ie the aircraft) were traded in dollars. This currency issue was not present in the CMA CGM transaction, since the funding and assets are both dollar-denominated. In the CMA CGM transaction the main legal issue for the rating agencies centred on the impact of French insolvency legislation on a timely repossession and sale of the vessels in the event of an operator default. The change in French bankruptcy law (in effect since January 2006) was helpful in this respect.

The new legislation confirmed the position that, in case of bankruptcy, the French insolvency *administrateur* is

required, within a maximum of three months after his appointment, either to continue executory contracts (such as the bareboat charterparties in the CMA CGM transaction) in accordance with their terms, or cancel the contracts and return the equipment to their owners. Some experts say that the new French law creates a US Chapter 11-style regime, *à la française*.

The repossession analysis in the jurisdictions where the vessels will be trading also played an important part in the sizing of the liquidity line. Unlike aircraft, containerhips may trade on routes that do not always include stops at the home base of the operator. So for example, the 4,400 teu vessels are expected to be operated on lines with scheduled ports of call in jurisdictions such as China, US and Australia, but not France, where the headquarters of CMA CGM are located.

Therefore, in addition to the impact of French bankruptcy legislation on the ability of creditors to repossess vessels in case of default, it was necessary to obtain legal advice in certain identified ports of call regarding the process and, more importantly, the time required in that jurisdiction to arrest, repossess and sell (by judicial sale or otherwise) a vessel in case of default.

This legal analysis resulted in the rating agencies sizing the liquidity facility for the transaction at 36 months. This facility would be available to Vega to enable it to continue to service interest on the senior notes for a period not exceeding 36 months while the vessels are being repossessed, remarketed and sold after a default under the bareboat charters.

The road shows for the senior notes and the corporate bond attracted a great deal of investor interest for this new asset class in the capital markets in the US, Europe and Asia. So much so that the senior notes were fully subscribed and the corporate bond had to be upsized from \$250m to its final level of close to \$300m.

Another recent example of a successful capital markets placement for the shipping industry is the EU 1bn cross-over bond and EU300m hybrid bond issued by Tui in December 2005 to fund its acquisition of CP Ships. The Tui paper was placed throughout Europe and was equally oversubscribed. These recent successes demonstrate that there is true appetite from institutional investors, such as insurance companies and pension/investment funds, for buying paper issued by shipping industry players and/or backed by shipping assets.

Should one conclude from these transactions that there will be a rush to the bond markets by containerhip operators looking to finance their new acquisitions (or even to refinance existing fleet)? We would very much hope so, although the continued availability of bank lines with attractive pricing for operators may delay some from tapping the capital markets or opting for a structured finance solution.

We should also add that, at least for the purposes of a CABS, the originator (ie the shipping company) should ideally have an investment grade credit rating (or a shadow rating at an equivalent level). This being said, shrinking availability of tax-enhanced structures (although we await the final rules in the UK in this regard) and the impact of continuing consolidation in the container vessel operator industry (in the sense that the funding of corporate acquisitions may use up bank lines otherwise available for asset acquisitions) may lead operators to consider diversifying their funding sources and then possibly to test the capital markets.

The CABS structure might also be attractive to other sectors of the shipping industry, such as the liquefied natural gas sector. With the growing number of LNG fields coming on stream around the world and the sheer magnitude of the investment that will be required to finance the ever-increasing fleet of LNG carriers, operators and sponsors should no doubt consider the possibility of a capital markets issue to secure at least a portion of their funding requirements.

Now that rating agencies and capital markets investors alike have been 'educated' to the ways of the container vessel sector in particular and the shipping industry in general, they should also be receptive to investment in the LNG sector; and quite possibly other shipping sectors as well.

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