THE SHIP FINANCE PUBLICATION OF RECORD

MARINE MONEY

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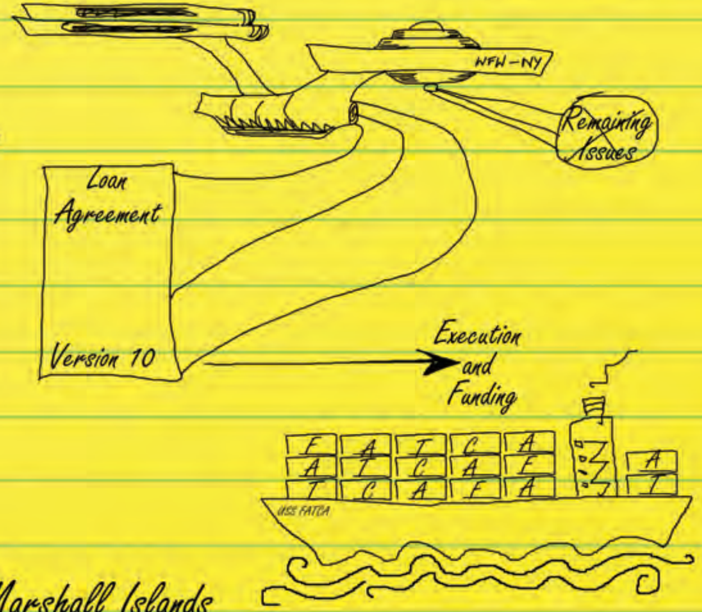
OCTOBER/NOVEMBER 2014 VOLUME 30, NUMBER 6

LNG? January 1, 2015 !!!
0.1% sulphur in all ECA/SECA areas
LSMGO? Fit scrubber? Do ~~nothing~~
Explore liability

And the term sheet provides?

F-4/F-1 - submit to SEC @ 9-20-2014

WHITHER SANCTIONS?



Governing Law

- NY?
- English?
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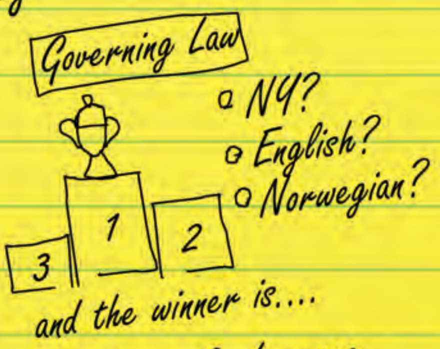

and the winner is....

Oh dear......

- Book Marine Money Conference
- Speak to Jim

Marshall Islands

PwC | E+Y | D+T | KPMG

Whilst readers may not find such things as amusing as us, I suspect all we lawyers had plenty of fun ruminating on our core values, key life principles and other burning issues that occupy our days, like "MM's Legal Issue".....

WHY WE NEED EXITS.

By Gary Wolfe, Partner, Seward & Kissel LLP

If you land at Athens Airport, the first sign that you see contains a symbol that shows a man who seems to be rushing out of an open door. Or is he running into that door? The symbol could be interpreted either way. It means either "exit" or "entrance".

In private shipping investments, there is no entrance without an exit. So, when we negotiate funding or entrance dates we need also to have exit dates in mind. That brings to mind the simple truism: without a secondary market, there is no primary market. Without liquidity, an investor's ability to realize an investment is limited. That is why we refer to an illiquidity discount. The expectation of illiquidity can make a prospective investment less attractive.

So, if a ship owner is negotiating a joint venture with a private equity investor, he needs to understand that it is perfectly normal for the investor to insist on provisions that will enable the investor to exit the investment. By the same token, it is perfectly normal for the ship owner to try to limit the investor's ability to cash out. This is because the ship owner well understands how volatile the shipping markets are. If an investor can exit at will, he may be doing so at a time when the ship owner believes the right strategy is to do just the opposite: Stay cool and await the inevitable turn around. The ship owner, however, may be forgetting that the investor is likely to be a fund manager with its own investors, who expect to benefit from the performance of the fund and to whom the manager owes a whole set of fiduciary duties. For them, sitting tight on a shipping investment may not be the best thing to do.

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What are the ways in which an investor who is making a private investment in shipping can try to assure himself an exit from that investment?

As a starting point, it is easy to figure out which sort of provisions will hinder an investor from realizing an exit strategy. Ironically, those same provisions may enable the ship owner to keep the investor's money locked up while he awaits the market upswing that the owner believes is sure to come:

No limit on investment period. No limitation on the investment period may tie the investor to investing "forever". A private equity investor is definitely going to want a time limit on its commitment to invest in the venture.

Commitment to invest no matter what the vessel type. Suppose the ship owner had convinced the investor that the time was ripe to invest in Panamax tankers. Now, the ship owner has changed his mind because capsize dry bulk carriers are the way to go. The owner would want to tie up the investor to participate no matter which segment the owner chooses. The investor, on the other hand, has likely invested based on the perceived Panamax tanker market opportunity, and that is where the investor's money should go. The compromise is for the investor to commit to invest in types of vessels with agreed financing and chartering parameters.

No deadline to liquidate the investment. If there is no deadline to liquidate, then the investor can stay tied up for years. Again, the investor is going to want the ability to unwind the investment even though the ship owner believes that the time is wrong to do so.

No payment in kind. Again, an investor may be tied up unless it can realize not only cash but also liquid securities as a return on an investment. Going public and receiving marketable securities can be a great way to realize on an investment. The capital markets may not mind the volatility of the shipping industry so long as investors are convinced that such volatility will lead prices higher.

What are the alternatives? (1) liquidate and sell the fleet at what may be the bottom of the market, or (2) keep operating at what may possibly be a loss.

No corporate governance provisions. Ship owners tend to be shocked at the amount of control on which their private equity investors insist. If the ship owner has free rein, he can make major decisions and enter

into contractual arrangements without the consent of his major investors. That will tend to tie up the investor while the ship owner enters into special arrangements that make the joint venture investment entity less liquid.

For example, a loan agreement with a "no change in vessel management" convenant can serve as a poison pill against a private equity investor who wishes to change vessel management.

That brings to mind the very ***provisions of the management agreements.*** The best type of management agreement for a ship owner who wants to assure that he will remain in control of the operation of the vessels in the joint venture, is to insert provisions that do not permit the joint venture to terminate the agreement without some high level of culpability, guilt or misbehavior. In fact, if the private equity investor fails to assure itself that it can either control or police the performance of the ship owner, the investor may find itself needing to exit the investment just when prospects in the market seem good.

So, what else is there? An investor and ship owner can negotiate ***tag along and drag along rights*** as an enhancement of an exit strategy. This way, each side can take advantage of the other's receipt of an offer for its stake. On the other hand, a tag along or a drag along (and the related concepts of ***right of first refusal and right of first offer***) only have value if the investor has found a party to which he can sell. Since the transaction is likely to be private, assuming the investor can sell, it will be facing the same illiquidity discount that makes the lack of a good exit strategy problematic.

Which brings us back to IPOs. An IPO can be the best exit strategy both for an investor and the ship owner with whom it has partnered. An IPO can give both of the parties liquidity while placing the ship owner in the vessel management role which he performs best. At the same time, even if the investor does not sell for cash as the "secondary" portion of an IPO, the investor gets a market valuation for its shares in the public entity for the simple reason that an IPO company's shares trade in the open market. This will be useful for the investor in dealing with its own investors. The ship owner is likely also to benefit from an IPO, as he may be able to use the shares of the IPO entity in place of cash for acquisitions and other sorts of incentives. The investor and the ship owner may also realize profits from their stakes in the IPO company if the market improves.

So, every entrance needs an exit. Without the exit, the investment will not quite work.

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