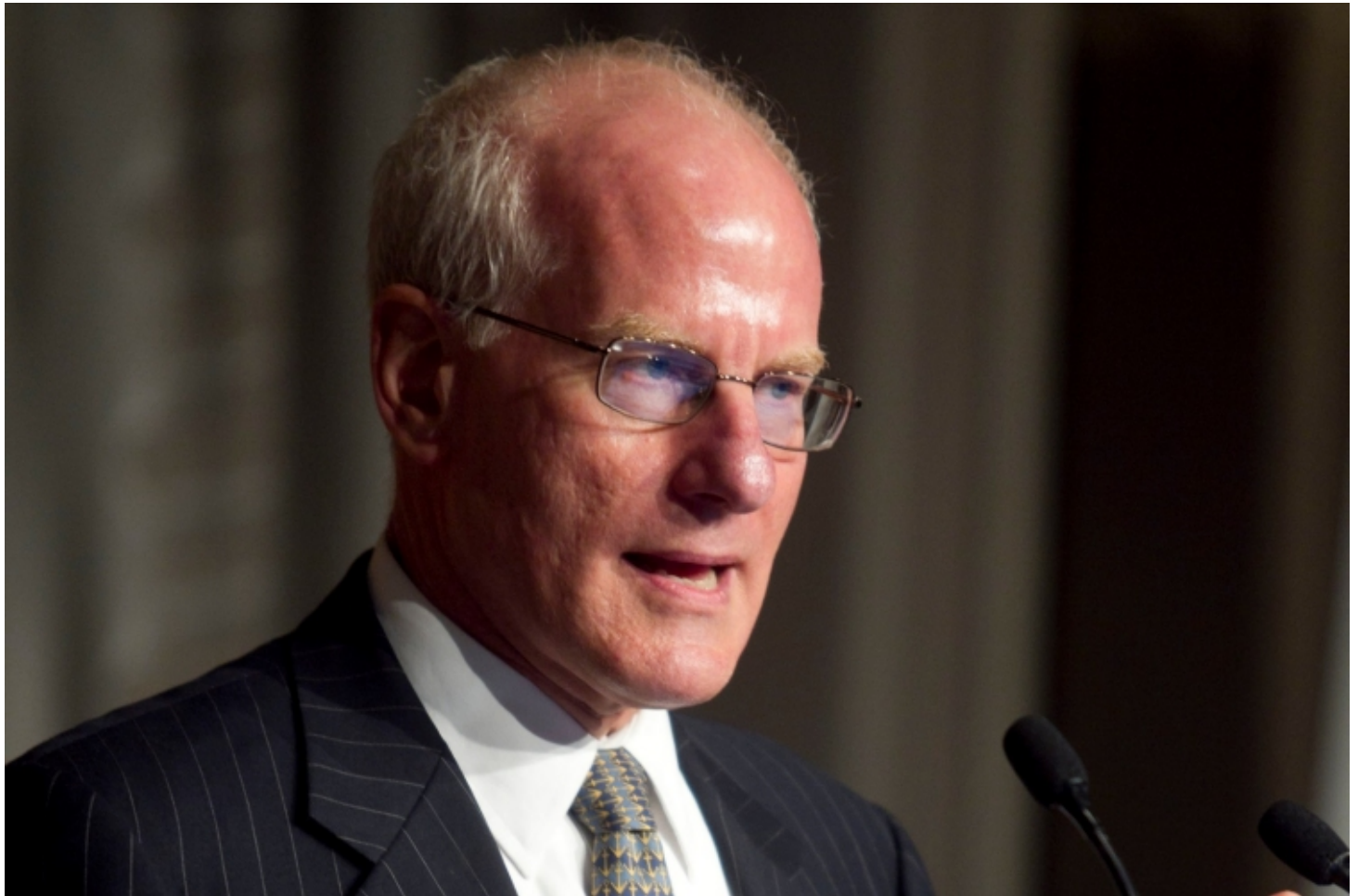


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Wolfe on Wall Street, Trump's SEC, and related-party deals

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[Greg Miller, Senior Editor](#) | 28 July 2017



Seward & Kissel's Gary Wolfe: more shipowners plan to go public in New York

Frontline, DryShips, Nordic American Tankers, General Maritime, Navig8, Knightsbridge, Aegean Marine Petroleum Network, Top Ships, Torm, Star Bulk, Euroseas, Stelmar, Genco, Excel, Diana Shipping, Eagle Bulk, Ultrapetrol, Oceanfreight, Omega Navigation, Quintana, DHT, Ship Finance International, TBS, TEN, Paragon – it is a very long list. Each has raised capital on Wall Street on multiple occasions, and in each case, Seward & Kissel partner Gary Wolfe has been counsel, whether for the company or the investment bank.

Over the past three decades, Wolfe's ubiquitous presence as a rainmaker, dealmaker, and fixer in the US public shipping arena has provided him with an insider's view of how shipping's market access has

evolved. On 26 July, *Fairplay* sat down with Wolfe at his downtown Manhattan office to get his take on a wide range of topics related to public markets. The following is an edited version of that conversation:

Greg Miller: I spend a lot of my time reading financial reports and prospectuses filed by US-listed shipping companies, and correspondences between these companies and the Securities and Exchange Commission (SEC) – and your name seems to be on most of these documents.

Gary Wolfe: “I want my name to be on all them. We want to represent everybody.”

What’s your competitive advantage? Why don’t shipowners that go public just hire a general securities lawyer at whatever law firm they use for other services?

“Because shipping is esoteric. It really is, in the way the industry works and in terms of the maritime laws, so it gives us an advantage. And when you do a lot of deals, it helps you do more deals, because people come to believe – and we hope it’s true – that we understand the industry and can help them get through the SEC process and help them in dealing with investors.

“You also have to get along with people from all over the world, because of where shipping is located. I deal with Scandinavians, Greeks, some Americans, some from Singapore. The whole arc of my practice has been about helping foreigners understand the American legal system, especially our system of securities law, which is really arcane.”

You’ve now been doing shipping securities law for over 30 years, since the attempted initial public offering (IPO) of Loews’ Majestic Shipping in 1985. As a result, you really have a unique insider’s view of how the public shipping markets have evolved from the beginning.

“I was lucky to be there at the right time, when an industry that had been very closed off from outside capital – that had used family money and self-earned cash flow and commercial lenders – started to offer common shares. What happened with Majestic is we went through the whole process and the SEC review, which took five or six months, and the deal didn’t price. I still remember being told it wouldn’t price: it was 1 or 2 am and I was at the [prospectus] printer.

“I would date the modern era of shipping in the capital markets to the Nordic American Tankers offering in 1994. That one we did in four months and at the time, the SEC was really unfamiliar with shipping, so we actually had to go down to Washington and explain to them – and to NASDAQ – how the Nordic American structure worked, and later with Knightsbridge [which IPO’d in 1995] we did the same thing.”

Shipping was so new to the public markets that you actually had to educate the regulators?

“Yes, we had to educate the SEC and we had to educate the NASDAQ. What was sort of ironic was that the backer of Nordic American was BP and the backer of Knightsbridge was Shell, two of the largest and most creditworthy companies in the world, yet NASDAQ still called us down and said, ‘You have to prove this is real. How do we know it’s all real so that we deign to list it?’

“And then after that, we had the junk bonds [the high-yield shipping bonds in the late 1990s and early 2000s, most of which defaulted] and then the IPOs started in 2001 with Stelmar and then there was General Maritime and DryShips and Top – that was the beginning of ‘IPO mania’. You had bankers going to Greece and telling owners, ‘Do an IPO! It’s like selling your ship for twice the price!’

“That IPO market came to a close in 2008, but even so, I looked back at the work we were doing and 2008 was a record year for us, and 2009 was the same – because of follow-on offerings, which is a different market.”

How would you characterise the changes in the landscape for capital raising in the US markets since the mid-1980s?

“My experience with the shipping industry [in public markets] has changed over time, but part of what changed is a reflection of what was going on with the capital markets themselves.

“With the junk bonds, for example, that was a reflection of what was happening in the American market – it’s just that shipping suffers a time lag. Michael Milken was developing the junk bond market in the 1970s. If you’d gone to the shipping market back then, they would have had no idea what a junk bond was. What happened was that [in the late 1990s] some banker got the idea to import high-yield bonds into the shipping industry.”

In the past decade, we’ve had public shipping companies branching out and obtaining funding not just from common equity sales and junk bonds, but also from convertibles, ‘baby’ bonds, master limited partnership structures, perpetual preferred equity, and more recently, Term Loan B deals. These products were developed in other sectors, and as you said, they found their way into shipping. Do you think there are other financing structures and products out there that will make their way to our industry?

“I think there will be more. It’s just that there’s always a time lag before they hit shipping.”

On a related note, Fairplay’s data shows a high volume of proceeds being generated this year – US-listed owners could even top the all-time record set in 2014 for total proceeds – but relatively little of it is ‘plain vanilla’ common equity sales. It’s a lot of private placements, convertibles, preferred shares, Term Loan B issuances, etc. Why is the mix so different than, for example, 2010 or 2011, when it was mostly common equity offerings? Why are we seeing all these complex transactions?

“I know this is going to confirm what people think of us lawyers when I say this, but there is nothing better for a lawyer than extremely complicated sets of documents and transactions, which is what we have with all these warrants for convertible notes, convertible preferred, and classes of preferred. And the reason we’re seeing it is because these are the structures used by investors in the micro-cap world.”

So it’s a function of how low the market capitalisations of listed shipping companies have fallen?

“That’s right. If you’re Microsoft, you can just offer shares. This will go on, for, well I don’t know ...”

I guess it depends on how long shipping’s cap remains so ‘micro’...

“That’s right. It will depend on the market.”

You mentioned educating the SEC back in the 1990s. Shipping is now obviously very much on the radar of the SEC. What issues are of concern to the SEC today, and have you seen any changes in the SEC’s direction under President Donald Trump?

“The thing that they’re very interested in now is revenue recognition: how you account for timecharters, how you account for the spot market, how you account for voyage charters. And they are looking at lease accounting [the changes due to take effect in 2019 regarding how leases are booked].

“Trump has appointed the head of a Wall Street law firm [Jay Clayton] as the head of the SEC. One of the first things he has done is to extend the confidential review period to all companies that are doing IPOs [not just ‘emerging growth companies’] and also to companies that are not doing IPOs but are just doing listings here. That is very helpful. So far, what they’ve done [following Trump’s election] has been positive.”

Do you interact with the SEC a lot, and how would you characterise that interaction?

“We do. I’d say someone in my group is interacting with the SEC 40 weeks out of 52. It’s not confrontational. We try to be nice. We have worked with the SEC staff in the shipping area for many years and have gotten to know them well.”

Let’s turn to shipping IPOs. There have been none for two years. Are there still private shipowners out there who want to go public, or have they looked at what’s happened over

recent years with valuations, and decided it's not worth the effort?

"I have seen companies with both points of view, but in the first category, it would depend on the market. Those people are sitting there saying, 'If the market gets good, I'll do it.' I think the bankers have delivered the message to some of these guys that they can access the market when the market allows it, so they should get themselves ready. But the owners are saying, 'Well, why should I put out the money for the lawyers and accountants if I have no idea when the market will be ready?'"

But to confirm, there are shipping companies interested in going public in the United States?

"There are."

A broader question is whether shipping really belongs in the public sphere in the first place. It has been argued that private families take money out at the top, and have that money available to support themselves at the bottom, but public companies dividend the money out at the top to 'fair-weather-friend' investors who will not be there at the bottom. It has also been said that public companies are incentivised to buy high-priced assets at the top, which is when private companies are selling. In other words, shipping works better if it's private.

"But if that were true – and maybe it is – it would apply across industries. It would apply to everybody, not just shipping people."

The other broader topic of debate on public shipping focuses on the future evolution of listed companies. There's this idea that the public shipping companies of the future will be huge, large-cap, highly liquid entities – sector 'champions' coveted by the big long-only funds in Boston. But when I look at the state of the public shipping sector today, I see the exact opposite. I see a large number of very small companies – as we were saying before, micro-caps ...

"... that all used to be big. And how many reverse splits have they done?"

I think the record for reverse splits is still held by NewLead Holdings. I once calculated that if you had hypothetically owned 100% of the shares of NewLead in 2010, back when it owned 16 vessels, and you held all those shares through all the reverse splits that followed, then by early 2016, your holdings would be worth less than a single vodka tonic.

"It's like Weimar Germany."

But no matter how low the capitalisations become, everyone seems to really try to hold onto their listings, don't they?

"There's a perceived value in a listing. There's a perceived liquidity. You don't see that many delistings. They believe it will help them stay liquid."

With that in mind, do you think the public shipping field of the future will be dominated by much larger players?

"I actually don't think so. Not too quickly anyway. And that's because there are very strong personalities in this industry. It's an industry of entrepreneurs, so in order [for two companies] to merge, it would have to be an absolute takeover. I have my doubts that there's going to be this kind of gigantic growth [in public company size] that people are expecting or hoping for."

Let's talk about global public shipping venues. There's New York, Oslo, the exchanges in Asia, and several smaller regional exchanges in Europe. Do you think New York will always remain as dominant as it is today?

"I believe – and of course I'm prejudiced – that the United States is the most liquid market and you will get a better valuation for your business than you will get anywhere else, and that's the prime reason to come here. People put out information, which is not true in my view, that it's harder to stay listed in

terms of regulations in the United States. I would say that yes, we are a litigious people, that's true of Americans, but in terms of regulations, for example regulation of related-party transactions, they are much lighter here than in Oslo. The entire US system of securities law is pointed at disclosure. It's about accurate disclosure, not 'is my deal good?' The SEC doesn't regulate that [how good a deal is for investors]."

When I read the 'risk factors' section of a shipping prospectus, it reminds me of those TV ads for pharmaceuticals we have in the United States, where most of the ad's running time is taken up with warnings such as: 'Side effects may include nausea, pain, suicidal thoughts, and death.' In the same way, in US public market, as long as you say it in the prospectus, it seems it's OK.

"You can say, 'I'm a crook and I'm going to steal all your money'."

This brings up a subject that's always been a hot topic, and I think you'd be the perfect person to explain it...

"I don't like the sound of that. Now you're frightening me."

The topic is related-party transactions and perceptions of conflict of interest in shipping, and how you square disclosure with fiduciary duty. There are those who say the image of the entire industry has been tarred by the self-serving related-party deals of the private sponsors of public entities.

"Right, as if this doesn't happen in other industries."

At the same time, I look at the prospectuses and it's all there for investors to see, in black and white: the disclosures in the 'risk factors' section and related-party transaction section. It's all fully explained.

"Which is what we do. That's our job."

And in addition to the disclosures, some owners have argued that related-party deals can be helpful to the public entity and actually offer better and more flexible terms than could be obtained from a third party.

Still, the CEO or chairman of a public shipping company has legal fiduciary duties to the shareholders, so I'm trying to understand where the 'line' is when simultaneously dealing with the CEO's private company and the public entity. How do you as a lawyer or adviser handle this? How does a public shipping company CEO maintain his or her fiduciary duties with so many related-party transactions?

"As lawyers, when we deal with these issues, we are very focused on structure, by way of independent directors approving transactions, and things like that."

"I do want to say though that over time, the message from bankers has changed, and it didn't just change once. It has changed again and again, depending on how the market is. So way back when we had 'IPO mania' [in the early 2000s], nobody was complaining about having [technical and commercial] management outside, meaning in the hands of the family. When things changed in the market, the bankers then told the companies, 'No, you can't do that. You have to have your transactions take place inside [the public company].' And then it flipped over again, and again."

One of the concerns is that the related private entity is getting better charters than the public entity.

"This comes up especially with the private equity people, who are very sensitive to conflicts of interests. They'll say, 'Here's how things should be divvied up if one ship competes with another for the same business.' And we, the people in shipping, will say to the private equity people, 'Wait a minute. It's really

hard to talk about ships competing with each other [for charters] because the way it works, it depends on where the ships are located [in relation to the available spot cargo].”

Another scenario is if the private sponsor has the yard relationship and places speculative orders, he could keep the newbuilds in his private arm if the market goes in favour of that vessel type, but sell them to his public company if it doesn't.

“You can owe fiduciary duties to more than one person involving the same subject matter, and the only way to deal with it is to be aware that you owe a duty to both, and that results in the ‘risk factors’ section of prospectuses that we hope people read. For example, you may be the head of a private fund that owes a fiduciary duty to your investors, but you may also be a member of a board and you owe a fiduciary duty to the shareholders of that company.”

Let's say you're a shipowner that has a private company and two public companies. You owe fiduciary duties to shareholders of all three and there's one deal that could go to only one of the three. How does that work in practice?

“I think you have to make yourself go through a process where you don't steal the corporate opportunity from one to give it to the other, but of course, it doesn't mean you forgo an opportunity completely. I mean, somebody has to get it. The way to deal with it is by way of independent directors approving transactions. Somebody can complain that there are related-party transactions and you picked this one over here versus that one over there, but if your only other choice is nobody's going to do it, what's the worth?”

Let's say somebody does sue, and let's say your company is under Delaware law or something that mirrors Delaware law, like Marshall Islands law, and you've fully disclosed your risk factors and related parties. Have public entities facing this scenario been generally protected against legal challenges from shareholders?

“They have been. And the number-one protection is to assign matters like that to your independent directors.”

But you do agree that public shipping has an image issue as a result of the perceptions of conflict of interest with the private sponsors, don't you?

“Yes, there is an image issue. But the question is whether investors care. Some investors do care, and some don't. And if you're at different points in the economic cycle, capital market cycle, or shipping capital market cycle – which are all different – people may care or they may not.”

I'd also point out that John Fredriksen has a lot of related-party deals, and despite that, Frontline has traded at a premium to its net asset value, so it does seem selective.

OK, last question. The past 10 years have seen some huge swings. We had the super-boom, then the crash, then the entry of private equity and the 'eco' ship newbuild craze, then last year's historic collapse in dry bulk, and this year, we have at least some normalcy and relative calm. Given your ring-side seat on all this, do you think there have been 'lessons learned' by the industry's decision-makers that will allow them to make better choices in the future?

“I don't think so. I hate to give you such a straightforward answer, but no.

“I've gone to clients and I've asked them, ‘Why do people buy ships when the market is so horrible? Why do they do it?’ My clients have explained it, and I'm a lawyer, not a finance person, but I've never been able to get an answer that makes me understand why people do it – why they buy ships in bad markets. And I think they'll just keep doing it.”

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