New Horizons: An Analysis of Public Markets Financing of Shipping Ventures and the Impending Wave of Shipping Securities Litigation

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Over the past one hundred years, the scope and variety of financial instruments used in the maritime field have evolved profoundly, and markedly so, over the past decade. IPOs, high-yield debt offerings, and SPACs are among some of the financing products shipping companies are relying on today to grow and maintain their businesses. The following traces the historical development of these products and their current usage in the shipping world. This Article then looks at the securities law implications upon the shipping industry, its new investors, and maritime law in general.

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I. INTRODUCTION

Over the past one hundred years, the scope and variety of financial instruments used in the maritime field have evolved, and there have been particularly profound changes over the past decade. From traditional loan financings secured by the hard assets of ship-owning borrowers to high-yield debt offerings and initial public offerings (IPOs) launched by shipping companies in the United States and global capital markets, a great variety of financial instruments have become available. This impacts not only shipowners, financiers, and ship-finance lawyers, but also maritime litigation attorneys as the securities and maritime litigation areas are beginning to overlap.

The following traces the historical development of the ship-finance products available to shipowners from traditional bank finance to public market finance. This Article then looks at the securities law implications of shipping transactions from a litigation point of view, specifically assessing what might happen if securities litigators and maritime litigators are forced to cross paths in the context of a securities class action lawsuit against a foreign shipping company.

II. CORPORATE FINANCE OF SHIPPING VENTURES: FINANCIAL INSTRUMENTS

A. *Secured Lending: The Traditional Approach*

Throughout the twentieth century and thus far into the twenty-first century, the range of available financing instruments in the shipping industry has grown considerably. Earlier, vessel acquisitions were financed by wealthy individuals or from the retained earnings of older, established owners.[1] As the demand for ships increased, vessel owners began seeking financing in the form of loans from banks and credit from shipbuilding yards.[2] As a result, legislation was passed to encourage investment in shipping, including, in the United States, the Ship Mortgage Act passed in 1920.[3] This Act encouraged maritime lending by providing for a preferred ship mortgage in favor of lenders, thus creating a maritime lien against the vessel and greatly enhancing the security of lenders who could now enjoy the status of a lienholder under federal maritime law.[4] Bank loans have developed a great deal since then and still constitute the primary financing methodology in the shipping industry.

Regardless of whether a lender is financing a single vessel purchase or a fleet acquisition or a syndicate of banks is funding a billion-dollar maritime transaction, the loan documentation utilized will generally be very similar. The basic terms of the transaction are typically negotiated by the lender and the borrower and set out in a term sheet that is executed by both parties.[5] While the term sheet will

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1. Alan Brauner & Peter Illingworth, *The Banker's Perspective*, *in* SHIPPING FINANCE 67, 68 (Stephenson Harwood ed., 3d ed. 2006).
2. *Id.*
3. *See* Ship Mortgage Act, 1920, ch. 250, § 30, 41 Stat. 988, 1000-06 (codified as amended at 46 U.S.C.A. §§ 31321-31330 (2007)). The statutory sections contained in this Article reflect the 2006 recodification of the U.S.C.; however, at the time of publication, the U.S.C. was not yet in print.
4. *See* 46 U.S.C.A. §§ 31322, 31325.
5. *See id.* § 31321.

not set out all of the terms of the transaction, it will identify the amount of the loan, the interest rate being offered by the lender, basic representations, warranties, and covenants to be included in the documentation, and the collateral securing the loan.[6] Once the term sheet has been executed, lender's counsel will begin drafting the loan documentation, including a loan agreement and promissory note, and will advise the lender on the manner in which to properly secure the various collateral and, if necessary, to perfect the lender's interest in such security.[7]

In traditional marine finance, in almost all cases the largest and most valuable collateral is the vessel or vessels owned by the borrower. A typical financing package may include requirements that, as a condition to the lender making the loan available, the borrower execute and record a mortgage with the flag state with respect to each of its vessels in favor of the lender, as well as execute an assignment of each vessel's earnings and insurances. The loan documentation will also contain submissions by the parties to the laws and courts of a chosen jurisdiction in the event that a claim must be litigated. Because vessels are by their nature movable objects that can easily traverse different jurisdictions around the world, it is of great concern to lenders that their interest in such collateral be properly secured and enforceable upon an event of default.

In considering how to properly secure a lender's interest in a vessel, lender's counsel will need to look at the laws of the flag of each vessel involved in a transaction, consulting foreign counsel as necessary. Vessels are commonly flagged in jurisdictions that allow commercial vessels to be registered under their laws by entities beneficially owned by parties resident elsewhere.[8] These flags are distinguished by relatively low vessel-registration fees, low or no taxes, and the freedom to employ non-nationals as crew on the registered vessels.[9] The vast majority of the international fleet, that is, those vessels not owned in the fleets of the traditional maritime nations, are registered under these flags.[10] In the international fleet, the leading flag jurisdictions (measured by cargo carrying capacity) are Panama,

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6. *See id.*
7. *See* Brauner & Illingworth, *supra* note 1, at 79.
8. *See* GRANT GILMORE & CHARLES L. BLACK, JR., THE LAW OF ADMIRALTY 698 (2d ed. 1975).
9. THOMAS J. SCHOENBAUM, 1 ADMIRALTY AND MARITIME LAW § 2-21, at 50-51 (4th ed. 2004).
10. Graham Burns, *Introduction* to SHIPPING FINANCE, *supra* note 1, at 1, 3 (1991).

Liberia, Cyprus, the Bahamas, and the Marshall Islands.[11] Another distinguishing factor of these registries is that they have adopted maritime laws that are modeled after those of either the United States (for example, Panama, Liberia, the Marshall Islands, and Vanuatu) or England (for example, the Bahamas, the Cayman Islands, and Cyprus).[12] Therefore, the rights of a mortgagee, such as the right to repossess or foreclose, the lien status of a mortgage and its priority in the distribution of sales proceeds upon foreclosure, and the method of enforcement in each of these jurisdictions are substantially similar to those found under U.S. or English law.[13]

Typically, the laws of the flag state of a vessel require that the mortgage be governed by the laws of such jurisdiction[14] but allow the underlying debt instrument secured by the mortgage to be governed by a law other than that of the flag (for example, a Marshall Islands mortgage can secure obligations under a loan agreement governed by New York law).[15] Additionally, the other security documents in the financing transaction, including the assignment of each vessel's earnings and insurances, can also be governed by a law other than that of its flag.[16] While all flag states permit vessel owners to grant a mortgage with respect to a vessel in favor of a lender,[17] the form and the contents of the mortgage, as well as the method for perfecting the lender's security interest, may vary from flag state to flag state. In most cases, the lender will be able to record its mortgage with respect to a vessel with a public registry, thus placing future lienholders on notice of its mortgage and establishing its priority as of the date of the recordation of the mortgage. With respect to the means of perfecting a security interest in the other vessel collateral, namely its earnings and insurances, the laws of the flag state or of the jurisdiction of incorporation may differ. In the United States, the lender can secure its interest in a vessel's earnings and insurances by filing a financing statement pursuant to article 9 of the Uniform Commercial Code in the

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11. *See id.*

12. *Id.*

13. Graham Burns et al., *The Ship Mortgage*, *in* SHIPPING FINANCE, *supra* note 1, at 73, 73 (1991). Of course, the ultimate rank and priority of liens, including the mortgage lien, will depend upon the jurisdiction where the vessel is seized if an event of default occurs and is continuing under the loan documents. *Id.* at 73-74.

14. Lucy French et al., *The Ship Mortgage*, *in* SHIPPING FINANCE, *supra* note 1, at 125, 125.

15. Preferred Ship Mortgage and Maritime Liens Act, 47 MARSH. IS. REVISED CODE [M.I.R.C.] § 309 (2006) (Marsh. Is.).

16. French et al., *supra* note 14, at 126-27.

17. *See, e.g.*, 47 M.I.R.C. § 309.

relevant state of incorporation of each borrower and guarantor.[18] For borrowers and guarantors incorporated outside of the United States, a filing may be made in the District of Columbia.[19]

The state or country of incorporation of each borrower and guarantor is of great importance to a lender for many other reasons as well. The laws of the jurisdiction of incorporation will govern the ability of a company to enter into a transaction, including its ability to grant a security interest over its collateral in favor of a lender or guarantee the obligations of another company. The laws of the jurisdiction of incorporation, as well as articles and bylaws, or equivalents thereof, will set forth the corporate requirements a company must follow in order to participate in a ship-finance transaction. Additionally, many tax considerations will be affected by the laws of the jurisdiction of incorporation. For these reasons, it is essential that lender's counsel involve appropriate foreign counsel with maritime and tax expertise in each jurisdiction of incorporation early in a transaction.

Finally, in a syndicated loan, a lender may choose to act with or on behalf of a group of lenders during or after the documentation of a loan transaction. In such cases, a lender may hold the security in its capacity as agent or security trustee for the lenders. Lenders' counsel must ensure during the preparation of the loan documentation that the laws of the relevant flag state and jurisdictions of incorporation permit a lender to hold the security in its capacity of agent or security trustee.

B. High-Yield Debt Offerings: Shipping's First Major Foray into the Public Markets

As ship prices increased over time, shipping companies increasingly looked to public markets to raise capital.[20] High-yield debt offerings became popular with the shipping community as a way to enter the U.S. capital markets in the late 1990s.[21] Thirty-four high-yield, maritime-related deals raised $8.1 billion, and half of that amount was issued solely in 1997 and 1998.[22] High-yield notes or "junk bonds" are noninvestment grade debt securities, usually bonds, that have a higher yield (compared to investment-grade debt) because

18. *See, e.g.*, U.C.C. § 9-301 (2000).

19. *See id.* § 9-307.

20. *See* Robert E. Lustrin, High Yield Notes: The Sequel? 1 (Sept. 2002) (unpublished manuscript, on file with the *Tulane Law Review*).

21. *Id.*

22. Mark Brown, *Shipping Catches a Rising Tide*, EUROMONEY, Aug. 2003, at 52, 53.

of a high perceived credit risk (default risk), typically having credit ratings lower than BBB (from Standard & Poor's) or BAA (from Moody's Investors Service).[23] The benefit of high-yield debt offerings is that they offer "non-investment-grade shipowners access to the sort of long-term unsecured finance that banks tend only to make available to investment-grade companies."[24]

High-yield offerings, like any public debt offering, can take many different forms: they can be secured or unsecured, subordinated or unsubordinated, and they may be accompanied by credit enhancements or an "equity kicker," such as warrants.[25] The issuer of high-yield notes will work with its counsel and its underwriters to structure an offering that permits the company to achieve both its growth goals and its marketability to investors.[26] In drafting the indenture, the governing document in a high-yield offering, one important determination is whether such offering will be secured by the company's collateral or will be unsecured. In a secured offering by a shipping company, the collateral and security documents will look very similar to that of a loan financing as described in Part II.A; however, the security interest in the collateral will be held by a trustee (usually a major financial institution) on behalf of the note holders, rather than by a lender.[27]

The Securities Act of 1933 (1933 Act) requires that all public offerings of securities must be registered with the United States Securities and Exchange Commission (SEC), unless an exemption exists.[28] High-yield offerings are typically issued under exemptions from the registration and prospectus requirements of the 1933 Act pursuant to SEC Rule 144A, which exempts from registration initial private placements for immediate resale to qualified institutional buyers (QIBs) and permits a market for trading unregistered securities to exist among QIBs.[29] While the informational requirements under

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23. GLENN YAGO, JUNK BONDS: HOW HIGH YIELD SECURITIES RESTRUCTURED CORPORATE AMERICA 3-4 (1991); *see* AMCOR LTD., MOODY'S INVESTOR SERVICE RATING DEFINITIONS, *available at* http://amcor.com/content/investorinformation/downloads/Moody's_Investor_Service_Rating_Definitions.pdf (last visited May 31, 2007); STANDARD & POOR'S, WHAT IS STANDARD & POOR'S RATINGS SERVICES? (2007), *available at* http://www2.standardandpoors.com/spf/pdf/media/credit_ratings_fact_sheet_020507.pdf.

24. Brown, *supra* note 22, at 53.

25. *See* Lustrin, *supra* note 20, at 1.

26. *See* YAGO, *supra* note 23, at 9.

27. Additionally, it is not uncommon for an issuer of high-yield securities to have entered into separate loan transactions.

28. *See generally* 15 U.S.C.A. §§ 77d-77e (2007).

29. Mary Wolfe, *The US Capital Markets*, *in* SHIPPING FINANCE, *supra* note 1, at 109, 120; *see* Private Resales of Securities to Institutions, 17 C.F.R. § 230.144A (2006).

Rule 144A are relatively simple, requiring only a brief statement of the nature of the issuer's business and the products and services it offers along with certain financial information, "the industry convention is for the issuer to distribute a confidential offering memorandum" mirroring the SEC disclosure requirements for a public offering.[30]

In order to entice QIBs to purchase high-yield notes, the terms of the private placement offering will usually require that the issuer register the notes with the SEC within a certain period of time after issuance, typically 150 to 180 days.[31] Purchasing high-yield notes that will be registered at a later date is appealing to purchasers as they will then be able to sell on the open market rather than just to other QIBs.[32] In the event that the issuer is required to register the notes, the issuer will need to file a registration statement with the SEC, fully satisfying the SEC disclosure requirements, and the process for registration will be very similar to that set out below.[33]

High-yield offerings have certain advantages over traditional bank loan financings. While a typical loan financing will require principal amortization over the life of the loan, a high-yield offering requires periodic payment of interest but defers repayment of principal until the maturity of the loan, thus freeing up the company's cash flow.[34] Additionally, the covenants contained in indentures are typically standard throughout the industry and will not include traditional financial maintenance covenants, such as maintaining certain levels of net worth, earnings, or debt service.[35] Finally, the size of the offering is often larger than that of a traditional bank loan and therefore enables the company to make large purchases, such as a fleet acquisition, more easily than entering into several loan facilities for the same purpose.[36]

There are certain disadvantages to entering into a high-yield offering, most notably that it will be very difficult for a company to amend the governing documents in the future if it finds itself unwilling or unable to abide by the covenants contained therein. As the notes will be held by a trustee on behalf of the note holders, the company will typically need to obtain note-holder approval in order to amend the governing documents.[37] Additionally, because the high-yield notes

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30. Lustrin, *supra* note 20, at 2; *see* 17 C.F.R. § 230.144A.
31. Lustrin, *supra* note 20, at 2.
32. *Id.*
33. *See infra* Part III.C.2.
34. Lustrin, *supra* note 20, at 2.
35. *Id.*
36. *Id.*
37. *Id.*

pose a larger credit risk to investors than exists in a loan financing, interest rates will typically be high, usually between eight and ten percent.[38] In the shipping industry, where vessel values and charter rates can experience wide fluctuations, locking into long-term restrictive covenants can be quite dangerous, as seen from 1998 to 1999 when many shipping companies were unable to live up to the covenants contained in their offering documents.[39] In 1999, ten shipping industry high-yield debt issues defaulted.[40] "'Of the high-yield deals that were done in 1997/98 all bar one went into Chapter 11 or got restructured . . . .'"[41]

C. Public Offerings: Shipping's Current Public Market Approach

1. Initial Public Offering

During the mid-1990s, the international shipping industry became more interested in gaining access to U.S. markets via public offerings on U.S. stock exchanges. During the early twenty-first century, public offerings of shares of shipping companies became much more common and appealing to the international shipping community; at that time, shipping was said to have "entered into a long-awaited 'golden age' with the U.S. public equity markets."[42] "As of March 2006, over 20 international shipping companies have raised money in the US through initial public offerings."[43] While initial public offerings (IPOs) have become particularly popular recently, it is not uncommon for a company to participate in an IPO when it is already involved in a high-yield debt offering and has lending transactions in place.[44]

From start to finish, the process of an IPO usually takes four to six months and entails a great deal of interaction between the company, called the "issuer" for securities law purposes, and the

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38. Brown, *supra* note 22, at 53.
39. *Id.* at 54.
40. *See* Lustrin, *supra* note 20, at 1.
41. Brown, *supra* note 22, at 53 (quoting Gary Wolfe, Partner, Seward & Kissel LLP).
42. Alan Ginsberg, *So You Want To Go Public*, MARINE MONEY INT'L, Sept. 2004, at 2, 2.
43. Wolfe, *supra* note 29, at 109.
44. *See, e.g.*, Ultrapetrol (Bah.) Ltd., Prospectus (Form F-1) (Oct. 12, 2006), *available at* http://www.sec.gov/Archives/edgar/data/1062781/000095013606008564/file1.htm.

SEC.[45] Some advantages of participating in an IPO include: (1) raising large amounts of capital through the offering; (2) improving the financial position of the company and, thus, enhancing the company's ability to raise additional capital; (3) increasing the company's credibility with customers and vendors; and (4) encouraging employee retention and productivity through employee benefit programs, including options and stock awards.[46] On the other hand, going public does have some disadvantages for shipping companies, including: (1) required public disclosure of the issuer's operations and financing; (2) increased demands on the issuer's management to respond to shareholders, brokers, security analysts, journalists, and government regulators; (3) decreased amount of control retained by the original owners; (4) increased legal exposure under the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), as discussed in greater detail below, and other regulatory regimes; and (5) the substantial monetary expense of going public.[47]

First, when an issuer begins the process of offering its shares in a public U.S. offering, the issuer must become intimately familiar with the requirements of the 1933 Act and the Securities Exchange Act of 1934 (1934 Act). The 1933 Act requires the filing of a registration statement with the SEC that contains the form of prospectus that must be delivered to investors,[48] and the 1934 Act requires any issuer that lists on a securities exchange to register as a reporting company with the SEC.[49] The form of registration statement required will differ depending on whether the issuer is a U.S. company, in which case a registration on SEC Form S-1 must be filed, or a foreign private issuer, in which case a registration on SEC Form F-1 must be filed.[50]

In the international shipping industry, the bulk of recent IPOs have been by foreign private issuers that therefore have utilized a Form F-1 registration statement.[51]

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45. *See* David Huntington, *Public Offerings of Securities in the United States by Mexican Companies: U.S. Securities Law*, 9 U.S.-MEX. L.J. 127, 128 (2001).

46. Francis T. Nusspickel & John Young, *Going Public: A Primer*, MARINE MONEY INT'L, Oct. 2004, at 37, 37.

47. *Id.*; *see* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

48. Securities Act of 1933 (1933 Act) § 6, 15 U.S.C.A. § 77f (2007).

49. *See* Securities Exchange Act of 1934 (1934 Act) § 6, 15 U.S.C.A. § 78f.

50. Nusspickel & Young, *supra* note 46, at 39; *see* Form S-1, 17 C.F.R. § 239.11 (2006); Form F-1, 17. C.F.R. § 239.31.

51. *See* Wolfe, *supra* note 29, at 110 ("Public shipowning companies that are foreign private issuers currently include Diana Shipping, Inc. (NYSE: DSX), Frontline Ltd (NYSE: FRO), Ship Finance International Ltd (NYSE: SFL), Golar LNG Ltd (NasdaqNM: GLNG), Torm (NasdaqNM: TRMD), Top Tankers Inc. (NasdaqNM: TOPT), Aries Maritime

> The term foreign private issuer means any foreign issuer other than a foreign government except an issuer meeting the following conditions:
> (1) More than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and
> (2) Any of the following:
> (i) The majority of the executive officers or directors are United States citizens or residents;
> (ii) More than 50 percent of the assets of the issuer are located in the United States; or
> (iii) The business of the issuer is administered principally in the United States.[52]

Shipping companies who "go public" often do not change dramatically in terms of their corporate form—they generally tend not to issue more than fifty percent of their voting securities to investor "outsiders." Therefore, the first prong of section 240.3b-4(c) will rarely take these companies outside of the purview of the "foreign private issuer" designation. As such, an analysis of the second prong is generally unnecessary. Notably, though, because these companies (1) tend to remain controlled by the pre-IPO owners (i.e., non-U.S. citizens), (2) tend to keep their assets (i.e., their vessels) outside of the United States, and (3) tend to manage their vessels from offshore locations (rather than from within the United States), the essence of a shipping company, except one headquartered in the United States, would most likely remove it from characterization as anything but a foreign private issuer.

Form F-1 requires detailed information in the prospectus about the issuer and the proposed offering.[53] The SEC, whose primary focus is protecting investors and maintaining the integrity of the security markets,[54] will review the filed registration statement containing the offering prospectus to determine whether the disclosure meets the requirements of the registration form, but the SEC will not evaluate a transaction or its participants on their merits. The review process by the SEC will begin with the filing of the Form F-1 and will generally continue for several months during which the SEC will comment on the Form F-1 and the issuer will respond via filing amendments to the

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Transport Limited (NasdaqNM: RAMS), DryShips Inc. (NasdaqNM: DRYS), Knightsbridge Tankers Ltd (NasdaqNM: VLCCF), Omega Navigation Enterprises, Inc. (NasdaqNM: ONAV) and Nordic American Tanker Shipping Ltd (NYSE: NAT).").

52. 17 C.F.R. § 240.3b-4(c).

53. *See* 15 U.S.C.A. § 77j; 17 C.F.R. § 239.31.

54. Nusspickel & Young, *supra* note 46, at 38.

form.[55] Once the issuer and the SEC have resolved all of the disclosure issues, the SEC will declare the registration effective and the issuer, through its underwriters, will be allowed to make sales of the offered shares.[56] The issuer must also obtain listing approval from the relevant exchange (e.g., the New York Stock Exchange (NYSE), NASDAQ, or the American Stock Exchange (AMEX)).[57] Each listing entity will also have its own application and disclosure requirements, as well as its own listing qualifications.[58]

The disclosure requirements of the Form F-1 are extensive and may be rather daunting for some private companies to adjust to as the company's operating and financing data are required to be disclosed and thus are open to public scrutiny.[59] In the international shipping industry, where many companies are family run and traditionally have been privately held, the SEC requirements of transparency in the business operations of the company typically require some getting used to. The Form F-1 contains detailed disclosure about the issuer, including information related to the offering and underwriting,[60] as well as a description of the issuer's: (1) assets, business, and operations; (2) shares and their voting rights under the applicable corporate laws of its home country and its corporate governance; (3) shareholdings by officers and directors, as well as identities of all five-percent beneficial shareholders; (4) outstanding debt, if any, that it may have from lending transactions, as well as a general description of mortgages and liens on its assets; (5) pending litigation; (6) tax structure, including possible withholding; (7) related-party transactions; (8) intentions for the use of the proceeds of the offering; (9) capitalization; and (10) any dilution to new investors in the offering.[61]

Accounting disclosure is a large part of the Form F-1 and may take an issuer significant time to prepare, depending on its previously used accounting methods. A foreign private issuer will be required to

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55. *Id.*

56. *Id.*

57. *See id.*

58. Nora Huvane, *The NASDAQ Emerges as the New Amex*, MARINE MONEY INT'L, Oct. 2004, at 21, 23 (stating that the NYSE requires listed companies to have global market capitalization in the $500 to $750 million range and a market value of publicly held shares of at least $60 million, while the NASDAQ requires stockholders' equity of $15 to $30 million and the market value of a listing of a company's publicly held shares to be between $8 and $20 million).

59. Nusspickel & Young, *supra* note 46, at 39.

60. *Id.*; *see* 17 C.F.R. § 239.31 (2006).

61. Wolfe, *supra* note 29, at 110; *see* 17 C.F.R. § 239.31.

include income statements for its three most recent fiscal years and balance sheets for its two most recent fiscal years, and these financial statements must either be prepared according to the United States Generally Accepted Accounting Principles (U.S. GAAP) or be reconciled to U.S. GAAP.[62] Additionally, the Form F-1 requires the inclusion of selected financial data for the issuer's past five fiscal years and a management discussion and analysis of financial condition and results of operations, including liquidity and capital resources, which are intended to help investors understand the financial statements included in the Form F-1.[63]

The Form F-1 also requires inclusion of a section in the registration statement entitled "Risk Factors," which discusses the most significant factors that make the offering speculative or risky.[64] For each identified risk, the issuer must explain how the risk affects the issuer or the securities being offered.[65] Typical risk factors included in the offering of shares of an international shipping company usually relate to (1) the volatility of the shipping market; (2) the expenses and dangers associated with shipping, including damages and repairs to vessels, as well as national and international safety, classification, environmental, and pollution requirements; and (3) the risks involved in investing in a company with limited assets, usually consisting of vessels that may be mortgaged in favor of secured lenders and little to no real property.[66] A foreign private issuer will also need to explain risks associated with the fact that the issuer is incorporated and does business in a jurisdiction other than the United States, and such risks will vary depending on the respective jurisdictions involved.[67] Each of the risks must be set out clearly in order to make investors aware that they may lose money if they purchase shares in the offering.

Finally, in connection with an offering of shares of stock, the issuer's counsel and the underwriters' counsel will conduct an extensive due diligence review of the issuing company and its assets.[68] In connection with the offering of a shipping company, the issuer will be required to produce copies of all existing loan agreements, security documents relating to the vessels, material contracts, incorporating documents, resolutions, evidence of all liens and/or lawsuits,

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62. Nusspickel & Young, *supra* note 46, at 38.
63. 17 C.F.R. § 239.31; *see, e.g.*, Ultrapetrol (Bah.) Ltd., *supra* note 44.
64. 17 C.F.R. § 229.503.
65. *Id.*
66. *See, e.g.*, Ultrapetrol (Bah.) Ltd., *supra* note 44.
67. 17 C.F.R. § 229.503.
68. *See* Nusspickel & Young, *supra* note 46, at 38.

documents relating to vessel compliance, and a great deal of other information supporting the statements in the registration statement.[69] Counsel for both the underwriters and issuer will typically visit the issuer's place of business and interview members of its management team.[70] Additionally, each officer and director will be required to complete a directors and officers questionnaire detailing their experience, role, and ownership in the company and setting out their knowledge relating to the company.[71] This due diligence process is typically quite time-consuming and can at times seem rather invasive to privately owned shipping companies.

2. Alternative Access to Public Markets

Recently, smaller international shipping companies have sought access to U.S. public markets using alternative means to IPOs, including reverse mergers with public shell companies and special purpose acquisition companies (SPACs) transactions. Each of these methods have been used to assist smaller private companies to meet the requirements of the U.S. public markets, namely the minimum share price and those of shareholders of respective public markets.

In a reverse merger, a company that wishes to go public merges with a publicly listed shell company, which has no assets or liabilities, thus allowing the private company to go public but avoid the typically lengthy and complex registration process.[72] The result of the reverse merger is that the acquiring company will have gained access to the U.S. public market without going through the underwriting and registration process.

SPACs are shell or blank-check companies with no operations that "purchase an undervalued private company within a specific field—like shipping—and then run it successfully as a public company."[73] The SPAC raises money from investors who receive a shareholder interest in the acquired company postmerger.[74] Like a reverse merger, the acquired company receives the benefit of the SPAC's public listing without undergoing the time consuming and

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69. *See, e.g.*, Ultrapetrol (Bah.) Ltd., *supra* note 44.

70. *See* Nusspickel & Young, *supra* note 46, at 38.

71. *See id.*

72. *See* InvestorWords.com, Reverse Merger Definition, http://www.investorwords.com/5772/reverse_merger.html (last visited May 22, 2007).

73. Kit R. Roane, *When Hungry Investors Want To Make a Meal of a Company, They Can Pool Their Millions in Something Called a SPAC*, U.S. NEWS & WORLD REP., Jan. 22, 2006, *available at* http://www.usnews.com/usnews/biztech/articles/060130/30spacs.htm.

74. *Id.*

costly process of going public and, additionally, receives the SPAC's cash acquired from investors. SPACs have been used to a limited extent in the shipping industry, permitting the acquired shipping company to raise money and enter the U.S. public markets as a publicly traded company after its merger with the SPAC.[75]

In determining whether either of these alternative methods is appropriate for an individual company, the company will need to consider many of the same issues as set out above in the discussion regarding IPOs, particularly including the disclosure requirements of the SEC and the relevant exchange. The expanding use of these alternative methodologies for gaining access to U.S. public markets is a further indication that the face of shipping is continuing to change.

III. LITIGATION IMPLICATIONS OF SHIPPING'S NEW PUBLIC MARKET STRUCTURES

A. *Overview*

Shipping companies—and the corporate lawyers representing those companies—have been remarkably successful in implementing the innovative financings discussed above. However, the pessimistic stepsister of the corporate lawyer—the litigator—knows that although "a rising tide lifts all the boats," that tide must eventually ebb.[76] This Part presents a scenario utilizing a hypothetical shipping company, ABC Shipping Company, and attempts to analyze what might happen if and when the paths of securities litigators and maritime litigators intersect in the context of a securities class action lawsuit against a foreign shipping company, assuming the current shipping boom lapses.

On a macro level, these new financing structures have reallocated some traditional shipping company debt from private markets (i.e., preferred mortgagees) to the public debt and equity markets. Traditionally, preferred mortgagees—those institutions typically with the largest financial stake—have been well-protected by admiralty

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75. *See, e.g.*, FreeSeas Inc., Registration Statement Under the Securities Act of 1933 (Form F-1) (May 11, 2005), *available at* http://www.sec.gov/Archives/edgar/data/1325159/000095014405005377/g94740fv1.htm.

76. President John F. Kennedy, in advocating his economic policies, stated: "[T]hey say on my own Cape Cod, a rising tide lifts all the boats." John F. Kennedy, Address in the Assembly Hall at Paulskirche in Frankfurt (June 25, 1963), *in* PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES 516, 519 (1964).

law.[77] As noted above, the Ship Mortgage Act was created specifically to protect lenders.[78] As bond and equity holders take on new risks in shipping, will admiralty law evolve to protect the new sources of capital to shipping in the same manner it has traditionally protected preferred mortgagees? At present, these investors have nothing like that sort of protection.

Other questions arise. Will securities law plaintiffs be granted any rights in rem against a vessel? Shipping-related securities litigation is wholly uncharted waters in the maritime area—as such, this Part reflects the authors' attempt to assess whether traditional maritime litigation would hinder or, alternatively, facilitate an action by shareholders against a shipping company.[79]

The following Parts attempt to address some of these questions utilizing our hypothetical shipping company. We are assuming that ABC Shipping Company has a fleet of twelve vessels—four are secured by traditional bank mortgages, four were purchased with funds generated from a high-yield debt offering in January of 2005 (two debt offerings were secured, two were not), and the remaining four vessels were purchased with cash about two months after ABC Shipping Company's June 2005 IPO. Prior to ABC Shipping Company's IPO, ABC Shipping Company was a closely held company organized under the laws of the Marshall Islands and was family managed (including both technical and commercial management). The family still owns a controlling interest in the company.

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77. *See, e.g.*, Detroit Trust Co. v. The Thomas Barlum, 293 U.S. 21, 47-48, 1934 AMC 1417, 1432 (1934). Congress passed the Ship Mortgage Act

> so as to enable the admiralty courts to take cognizance of mortgages on ships, and to regulate priorities of liens, in order to promote investment in shipping securities and thus to advance the maritime interests of the United States. . . .
>
> . . . The existence of the ship, the investments which make that existence possible, is the necessary postulate of maritime liens. We cannot fail to regard the encouragement of investments "in shipping and shipping securities"—the objective of the Ship Mortgage Act—as an essential prerogative of the Congress in the exercise of its wide discretion as to the appropriate development of the maritime law of the country. The regulation of the priorities of ship mortgages in relation to other liens, and the conferring of jurisdiction in admiralty in order to enforce this regulation, are appropriate means to that legitimate end.

Id.

78. *See id.* at 31-32, 1934 AMC at 1419-20. Prior to the enactment of the Ship Mortgage Act, admiralty courts did not have jurisdiction over suits to foreclose a mortgage on a vessel. *Id.* at 32, 1934 AMC at 1420.

79. While this Article was being written, the first class action lawsuits alleging violations of the securities laws by a publicly listed shipping company were filed in the United States District Court for the Southern District of New York. *See, e.g.*, Bhojwani v. Pistiolis, No. 06 CV 13761 (S.D.N.Y. filed Dec. 5, 2006).

In our hypothetical, in late 2007, freight rates plummet in ABC Shipping Company's sector of the shipping market. It cannot service its debt obligations. It is embroiled in an accounting scandal with respect to certain off-balance sheet transactions. ABC Shipping Company has also announced its intention to restate its financials for the last three fiscal quarters. Within a week of the announcement, a shareholder files a class action lawsuit alleging violations of federal securities laws, naming ABC Shipping Company and its principals as defendants. At the same time, holders of its secured bank debt move against certain of its vessels that are subject to preferred ship mortgages.

B. Recently Enacted Securities Legislation—A Primer for the Nonsecurities Litigator

The securities laws are complicated, and, as such, the descriptions provided below are reasonably simplistic and intend to provide the reader with a basic understanding of the backdrop relevant to our hypothetical. As the heading indicates, this Subpart is probably most useful for those practitioners unfamiliar with the securities laws. The 1934 Act is the mainstay of federal securities legislation.[80] Implemented in 1934 and amended numerous times since then, the 1934 Act, among other things: (1) created the SEC,[81] (2) regulates the securities industry,[82] (3) prohibits manipulative stock market practices,[83] (4) requires periodic disclosure by public companies,[84] and (5) regulates insider trading in public companies.[85]

Over the past decade or so, Congress has implemented a number of important pieces of securities-related legislation, most noteworthy being the Private Securities Litigation Reform Act of 1995 (PSLRA)[86] and Sarbanes-Oxley,[87] to supplement the 1934 Act.

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80. *See* 15 U.S.C.A. § 78a (2007).
81. *See id.* § 78d.
82. *See id.* § 78b.
83. *See id.* §§ 78i-j.
84. *See id.* §§ 78l-m.
85. *See id.* § 78p.
86. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.).
87. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 15 and 18 U.S.C. (2006)).

1. The PSLRA

The PSLRA reflects Congress's attempt to discourage frivolous securities litigation.[88] Among other things, the PSLRA: (1) sets forth the procedures for appointing a lead plaintiff (defined as "the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members"),[89] (2) sets forth heightened pleading requirements applicable to securities class action cases,[90] (3) stays discovery while any motion to dismiss is pending,[91] (4) permits sanctions for abusive litigation,[92] and (5) sets forth a proportionate liability scheme.[93] Whether the PSLRA will ultimately succeed in accomplishing Congress's goals is a matter of academic debate.[94] Nonetheless, securities litigators—on behalf of both plaintiffs and defendants—must be familiar with the provisions of the PSLRA.

2. Sarbanes-Oxley

Seven years after passage of the PSLRA, and in the wake of a number of high-profile, accounting-related scandals, Congress enacted Sarbanes-Oxley.[95] In pertinent part, Sarbanes-Oxley established the Public Company Accounting Oversight Board (PCAOB), which aims to

> oversee the audit of public companies that are subject to the securities laws . . . in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and

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88. *See, e.g.*, *In re* Salomon Analyst Litig., 373 F. Supp. 2d 252, 254 (S.D.N.Y. 2005) (citing the legislative history of the PSLRA and noting that "[t]he purpose of the statutory stay is to prevent abusive, expensive discovery in frivolous lawsuits by postponing discovery until 'after the Court has sustained the legal sufficiency of the complaint'"); Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 915 ("[T]he PSLRA was intended to reduce the costs that securities class actions impose on the capital markets by discouraging the filing of nonmeritorious suits.").

89. *See* 15 U.S.C.A. § 78u-4(a)(3)(B)(i) (2007).

90. *See id.* § 78u-4(b).

91. *See id.* § 78u-4(b)(3).

92. *See id.* § 78u-4(c).

93. *See id.* § 78u-4(f).

94. *See, e.g.*, Perino, *supra* note 88, at 915.

95. *See* Maria Camilla Cardilli, *Regulation Without Borders: The Impact of Sarbanes-Oxley on European Companies*, 27 FORDHAM INT'L L.J. 785, 786 (2004) ("The Sarbanes-Oxley Act of 2002 . . . approved in the House of Representatives by 422 votes to 3 and in the Senate by 99 to 0, attempts to restore investor confidence in U.S. capital markets after the corporate scandals of 2001.").

> independent audit reports for companies the securities of which are sold to, and held by and for, public investors.[96]

Sarbanes-Oxley also directed the SEC to promulgate a number of rules relating to, among other things, management's reporting of its internal controls[97] and professional responsibility requirements for attorneys representing securities issuers.[98] Additionally, Sarbanes-Oxley requires that all auditors of public companies register with the PCAOB (and disclose specified information relating to their provision of audit services),[99] prohibits most personal loans from a company to executives,[100] requires that the company's chief executive officer certify the company's financial statements,[101] and provides for criminal penalties for corporate fraud.[102]

C. SEC Regulation of Foreign Private Issuers

1. SEC Regulation of Foreign Private Issuers

By reason of the regulations cited above, ABC Shipping Company would be viewed by the SEC as a "foreign private issuer."[103] This characterization is important because, among other things, a foreign private issuer is treated differently by the SEC and might be viewed differently in the context of securities litigation.

The SEC acknowledges that the interests of U.S. investors are served by permitting them to diversify their holdings and, among other things, invest in foreign-issued securities.[104] The SEC is therefore motivated to ensure that its regulations do not chill foreign issuers from entering U.S. capital markets.[105] On the other hand, the SEC is

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96. *See* 15 U.S.C.A. § 7211.

97. *See id.* § 7262.

98. *See id.* § 7245.

99. *See id.* § 7212.

100. *See id.* § 78m.

101. *See* 18 U.S.C.A. § 1350 (2007).

102. *See, e.g.*, *id.*

103. *See supra* text accompanying note 52.

104. Integrated Disclosure System for Foreign Private Issuers, Securities Act Release No. 6360, Exchange Act Release No. 18,274, Investment Company Act Release No. 677, 46 Fed. Reg. 58,511, 58,515 (proposed Dec. 2, 1981); *see* Donald T. Nicolaisen, Chief Accountant, Sec. & Exch. Comm'n, Statement by SEC Staff: A Securities Regulator Looks at Convergence (Apr. 2005) (transcript available at http://www.sec.gov/news/speech/spch040605dtn.htm).

105. The SEC has been reluctant to subject foreign registrants to the exact same requirements as domestic registrants because of the concern that foreign private issuers would be dissuaded from entering the U.S. capital markets. *See* Integrated Disclosure System for Foreign Private Issuers, 46 Fed. Reg. at 58,513. "An implication . . . is that the imposition on foreign issuers of the same disclosure standards applicable to domestic issuers could

congressionally mandated to protect U.S. investors and cannot permissibly allow the treatment of foreign issuers to differ so dramatically from domestic issuers in a world where both are offering securities to U.S. investors.[106] The SEC is constantly attempting to balance these conflicting notions. As an example, although financial reporting under U.S. GAAP "is the norm" for domestic issuers,[107] the SEC permits foreign private issuers to file financial reports using International Financial Reporting Standards (IFRSs)[108] or, alternatively, national accounting standards accompanied by a reconciliation to U.S. GAAP.[109]

By the same token, U.S. investors have not traditionally had the same panoply of options open to them when suing a foreign private issuer as they do when suing a domestic issuer.[110] For example, SEC

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discourage offerings of foreign securities in the United States, thereby depriving United States investors of the opportunity to invest in foreign securities." *Id.*; *see* Letter from Stanley Keller, Chair, Fed. Regulation of Sec. Comm., and John J. Huber, Chair, Subcomm. on Sec. Regulation, to the Sec. & Exch. Comm'n (Sept. 28, 1999) (available at http://www.sec.gov/rules/proposed/s73098/keller1.htm).

> Since the mid-1980s, the Commission has actively pursued a policy of regulatory accommodation in order to facilitate and encourage access to the US capital markets by foreign issuers, both governmental and private. In part, that policy reflects a recognition that US investors (particularly larger institutional investors) increasingly desire to acquire the securities of foreign issuers, notwithstanding that the securities regulatory systems and disclosure requirements in most foreign markets are less "strict" than in the United States. It also reflects a recognition that US issuers have been accorded relatively facile access to offshore markets for capital-raising purposes.

Letter from Stanley Keller and John J. Huber to the Sec. & Exch. Comm'n, *supra*.

106. *See* Letter from Todd M. Malan, Executive Dir., Org. for Int'l Inv., to Jonathan G. Katz, Sec'y, Sec. & Exch. Comm'n (Aug. 19, 2002) (available at http://www.sec.gov/rules/proposed/s72102/tmmalan1.htm).

107. *See, e.g.*, Statement of Donald T. Nicolaisen, *supra* note 104.

108. The European Parliament and the Council of the European Union now require that all listed European Union companies prepare their consolidated financial statements using IFRSs. Parliament and Council Regulation 1606/2002, art. 4, 2002 O.J. (L 243) 1 (EC).

109. 17 C.F.R. § 210.4-01(a)(2) (2006).

> In all filings of foreign private issuers . . ., except as stated otherwise in the applicable form, the financial statements may be prepared according to a comprehensive body of accounting principles other than those generally accepted in the United States if a reconciliation to United States generally accepted accounting principles . . . is also filed as part of the financial statements. Alternatively, the financial statements may be prepared according to United States generally accepted accounting principles.

Id.

110. *See, e.g.*, Letter from Todd M. Malan to Jonathan G. Katz, *supra* note 106.

> The Commission has for many years, as a matter of policy, encouraged foreign private issuers to enter the U.S. capital and securities markets as "reporting

Rule 3a12-3 exempts securities offered by a foreign private issuer from sections 14(a), 14(b), 14(c), 14(f), and 16 of the 1934 Act.[111] Section 14 of the 1934 Act regulates the form of proxy statements. As such, plaintiffs who attempted to bring securities actions against foreign issuers, e.g., for issuing a materially misleading proxy statement, saw their cases dismissed out of hand.[112]

Plaintiffs have faced similar fates when asserting claims based on section 16 of the 1934 Act, which sets forth reporting requirements for directors, officers, and principal stockholders who own more than ten percent of any class of equity security.[113] In general, when plaintiffs initiate lawsuits pursuant to section 16(b) of the 1934 Act, they can obtain recovery (on behalf of the company)[114] by disgorging any short-swing profits (defined as any profits made by an individual who both purchases and sells shares of the company's securities within a six-month period) made by the individuals subject to the section 16

> companies" under the [1934 Act]. The Commission has implemented this policy by providing foreign private issuers with a number of accommodations to foreign practices and policies where such accommodations would not be inconsistent with the protection of U.S. investors. These accommodations include:
>
> - interim reporting on the basis of home country and stock exchange practice rather than mandated quarterly reports;
> - exemption from the proxy rules and the insider reporting and short swing profit recovery provisions of Section 16;
> - aggregate executive compensation disclosure rather than individual disclosure, if so permitted in an issuer's home country;
> - use of home country accounting principles with a reconciliation to U.S. generally accepted accounting principles, with acceptance of certain International Accounting Standards; and
> - acquiescence in [NYSE] and National Association of Securities Dealers corporate governance standards that are tailored to the needs of foreign private issuers.
>
> As of the end of 2001, more than 1300 foreign private issuers from 59 countries had become reporting companies in reliance on the Commission's accommodations.

Id.

111. 17 C.F.R. § 240.3a12-3.

112. *See, e.g.*, Schiller v. Tower Semiconductor Ltd., 449 F.3d 286, 291 (2d Cir. 2006). Upon dismissing a § 14(a) claim against a foreign issuer, the Second Circuit noted: "The rule exempting foreign private issuers from § 14(a) is nearly as old as § 14(a) itself. The Commission originally promulgated Rule 3a12-3 in 1935, one year after Congress enacted the Exchange Act." *Id.*

113. *See* 1934 Act § 16(b), 15 U.S.C.A. § 78p(b) (2007).

114. *See id.* Recovery pursuant to a § 16(b) suit solely goes to the corporation. The real incentive in bringing § 16(b) suit is to collect attorneys' fees. Notably, an asserted defense that the sole motivation for bringing the suit was to obtain attorneys' fees is insufficient to defeat a cause of action brought pursuant to § 16(b). *See* Magida v. Cont'l Can Co., 231 F.2d 843, 848 (2d Cir. 1956).

reporting requirements.[115] As indicated, securities registered by foreign private issuers are exempt from section 16(b).[116] Therefore, transactions engaged in by a director of a foreign private issuer would not be subject to a suit to recover short-swing profits.[117] Whether these differences will withstand the passage of Sarbanes-Oxley, however, is yet to be seen.

2. The Impact of Sarbanes-Oxley on Foreign Private Issuers

As discussed above, foreign private issuers are treated differently by the SEC in some respects, e.g., as regards potential liability pursuant to sections 14 and 16 of the 1934 Act. However, as compared with those carve outs, Sarbanes-Oxley does not make a distinction between domestic and foreign private issuers.[118] As a result, some have criticized Sarbanes-Oxley as an overextension of U.S. law,[119] while others have argued that the compliance costs associated with Sarbanes-Oxley make the U.S. capital markets less attractive.[120] Still others have gone so far as to note that Sarbanes-Oxley will disparately impact foreign issuers[121] and chill their willingness to enter the U.S. capital markets.[122]

In response to some of this criticism, as this Article is being written, the SEC is reproposing new rules that will govern the process by which a foreign private issuer may deregister its securities under the

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115. *See, e.g.*, Gryl v. Shire Pharms. Group PLC, No. 00 CV 9173(HB), 2001 WL 1006628, at *4-5 (S.D.N.Y. Aug. 31, 2001), *aff'd*, 298 F.3d 136 (2d Cir. 2002).

116. *See id.* at *10 (citing 17 C.F.R. § 240.3a12-3).

117. *See id.*

118. *See* Kenji Taneda, *Sarbanes-Oxley, Foreign Issuers and United States Securities Regulation*, 2003 COLUM. BUS. L. REV. 715, 735.

119. *See* Eric Cafritz & Omer Tene, *Article 113-7 of the French Penal Code: The Passive Personality Principle*, 41 COLUM. J. TRANSNAT'L L. 585, 585 (2003).

120. *See* Paul S. Atkins, Comm'r, Sec. & Exch. Comm'n, Remarks Before the Portland Directors Institute at Lewis & Clark Law School (Oct. 27, 2006) (transcript available at http://www.sec.gov/news/speech/2006/spch102706psa.htm); *see also* Chester S. Spatt, Chief Economist & Dir., Sec. & Exch. Comm'n, Speech by SEC Staff: Regulatory Competition, Integration and Capital Markets (Oct. 23, 2006) (transcript available at http://www.sec.gov/news/speech/2006/spch102306css.htm).

121. Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 CONN. L. REV. 915, 943 n.97 (2003). The Sarbanes-Oxley Act "[p]rovisions are best suited to large-cap domestic companies, for the pre-existing rules the Act codifies mostly apply to that cohort. The effect on small cap and foreign private issuers is likely to be significant in comparison. As with many poorly reasoned or drafted provisions of the Act, the SEC becomes the technician to tailor the reach and fix the oversights and weaknesses of Congress's work." *Id.*

122. *See* Letter from Todd M. Malan to Jonathan G. Katz, *supra* note 106 ("[F]oreign concern about Sarbanes-Oxley is undoubtedly having a chilling effect on foreign private issuers' willingness to enter the U.S. capital and securities markets.").

1934 Act and cease making filings with the SEC.[123] Specifically, the SEC intends to recommend deregistration thresholds based on the trading volume of a registered company.[124] These new deregistration[125] rules reflect, in part, the SEC's attempts to balance the competing interests inherent between regulating securities for the protection of U.S. investors and "'promoting capital formation in the U.S. and making [the U.S.] markets more attractive to foreign companies.'"[126]

Those foreign issuers who either do not want to deregister or who cannot comply with the deregistration requirements are now gearing up to comply with Sarbanes-Oxley. As compared with domestic companies and domestic accounting firms, the integration of foreign companies and their foreign accounting firms into the Sarbanes-Oxley regime has been somewhat slower. For example, the SEC recently issued a final rule (effective September 14, 2006) that extended the time for a foreign private issuer who is not a large "accelerated filer."[127] These foreign private issuers file their annual reports on Form 20-F or Form 40-F to comply with the SEC's requirement to provide the "auditor's attestation report" on internal control over financial reporting in the annual report filed for its first fiscal year ending on or

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123. *See* Press Release, Sec. & Exch. Comm'n, Commission To Consider Recommendation To Repropose Deregistration Rules for Foreign Private Issuers (Dec. 6, 2006) (available at http://www.sec.gov/news/press/2006/2006-202.htm).

124. *Id.*

125. "Deregistration," an SEC term of art, refers to the set of rules that enable foreign issuers to exit the U.S. capital markets. *See* Remarks of Paul S. Atkins, *supra* note 120.

126. Press Release, Sec. & Exch. Comm'n, *supra* note 123 (quoting John White, Dir., Div. Corp. Fin., Sec. & Exch. Comm'n); *see also* Termination of a Foreign Private Issuer's Registration of a Class of Securities Under Section 12(g) and Duty To File Reports Under Section 15(d) of the Securities Exchange Act of 1934, Exchange Act Release No. 53,020, 70 Fed. Reg. 77,688 (proposed Dec. 30, 2005); Press Release, Sec. & Exch. Comm'n, Commission Announces Schedule for Action Regarding Section 404 of the Sarbanes-Oxley Act of 2002, Foreign Private Issuer Deregistration, Internet Availability of Proxy Materials, and Securities Exchange Act Rule 14A-8 (Oct. 11, 2006) (available at http://www.sec.gov/news/press/2006/2006-172.htm).

127. An "accelerated filer" is defined by the SEC as any issuer with a public float of $75 million or more, but less than $700 million. 17 C.F.R. § 240.12b-2 (2006). InvestorWords.com defines public float as the "portion of a company's outstanding shares that is in the hands of public investors, as opposed to company officers, directors, or controlling-interest investors." InvestorWords.com, Public Float Definition, http://www.investorwords.com/3936/public_float.html (last visited May 23, 2007). Note that this is a term of art and not a phrase appearing in Rule 12b-2. The auditor's attestation report is an obligation pursuant to Rule 2-02(f) of Regulation S-X. 17 C.F.R. § 210.2-02. Rule 2-02(f) requires that every registered public accounting firm that issues or prepares an accountant's report that is included in an annual report filed by an Exchange Act reporting company "attest to, and report on, [its] assessment" of management's own assessment of the company's internal control over financial reporting. *Id.*

after July 15, 2007.[128] Issuers subject to this extension will only be required to comply with the section 404 requirement to include management's report in the Form 20-F or Form 40-F annual report filed for their first fiscal year ending on or after July 15, 2006.[129]

For purposes of our hypothetical, these new developments might assist in a defense for ABC Shipping Company. For example, assume that ABC Shipping Company is an accelerated filer and therefore is not required to file its auditor-attestation report until 2007. Moreover, assume that ABC Shipping Company's auditors did not file such a report in the most recent annual report filed (most likely for the year 2005). If a plaintiffs' complaint alleges that the defendant shipping company's internal controls were improperly reported, would it be fair to hold that defendant liable for a violation of the federal securities laws? Specifically, did the SEC intend to require a foreign issuer to bear responsibility alone for potentially problematic internal controls, i.e., without any review by its "expert" auditors? Is not the purpose of the "relief" to provide the company with time to come up to speed with section 404 requirements? Is it fair to punish a company before that time runs, i.e., before financial statements are filed for their first fiscal year ending on or after July 15, 2007? Moreover, to the extent a foreign company desires to take advantage of soon-to-be-finalized deregistration rules, is it fair to permit a lawsuit to proceed during a transitional period in which the laws were not particularly cognizable?

3. Sarbanes-Oxley and Foreign Private Issuers' Accountants

In addition to impacting the foreign private issuers registering with the SEC, Sarbanes-Oxley extends to "foreign public accounting firms," defined as "a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof."[130] Notably, when foreign clients are involved, they frequently have foreign accountants who are likely associated with one of the "Big 4" U.S. accounting firms. As such, understanding what obligations and liabilities are faced by those foreign accountants is important.[131] Sarbanes-Oxley specifically requires these foreign

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128. 17 C.F.R. § 210.2-02.

129. *See id.*; Press Release, Sec. & Exch. Comm'n, SEC Offers Further Relief from Section 404 Compliance for Smaller Public Companies and Many Private Issuers (Aug. 9, 2006) (available at http://www.sec.gov/news/press/2006/2006-136.htm).

130. 15 U.S.C.A. § 7216(d) (2007).

131. Notwithstanding the passage of Sarbanes-Oxley, the SEC has implicit authority to sanction foreign accountants who audit the financial statements of foreign private issuers. *See, e.g.*, *In re* Stewart, Exchange Act Release No. 46,157, 77 SEC Docket 3087 (July 2,

public accounting firms to register with the PCAOB.[132] Although a foreign firm's registration with the PCAOB does not, in and of itself, subject a foreign firm to the jurisdiction of federal or state courts in the United States, a foreign firm is (1) required to produce its audit work papers for the PCAOB or the SEC in connection with any investigations regarding that audit report and (2) subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for the production of such work papers.[133]

D. Litigation Involving Foreign Shipping Companies—Practical Problems and Concerns

In addition to SEC regulation, foreign issuers must be wary of U.S. securities litigators.[134] Some SEC employees have acknowledged that litigation has a deterrent effect on foreign investors wanting to invest in the U.S. capital markets.[135] Implicitly, there is a presumption in that philosophy that a U.S. court would have jurisdiction over any such litigations. The following is an analysis of whether that presumption is sound.

A press release is issued announcing that ABC Shipping Company will be restating its financials. A class action suit initiated against ABC Shipping Company follows immediately. One need only refer to ABC Shipping Company's initial filing with the SEC, its Form F-1 Registration Statement Under the 1933 Act, to understand why jurisdictional concerns are significant. On the first page of the inside cover of the prospectus, the following language appears:

ABC Shipping Co. is a Marshall Islands company and our executive offices are located outside of the United States in Athens, Greece. All of our directors, officers, and some of the experts named in this prospectus reside outside the United States. In addition, a substantial portion of our assets and the assets of our directors, officers, and experts are located outside the United States. As a result you may have difficulty serving legal process within the United States

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2002), *available at* http://www.sec.gov/litigation/admin/34-46157.htm (imposing SEC sanctions on foreign accountants).

132. 15 U.S.C.A. § 7216.

133. *Id.*

134. *See, e.g.*, Paul S. Atkins, Comm'r, Sec. & Exch. Comm'n, Remarks Before AMCHAM EU (Sept. 27, 2006) (transcript available at http://www.sec.gov/news/speech/2006/spch092706psa.htm).

135. *See id.* ("Regardless of the number of companies that could deregister under current rules, it is likely that uncertainty about the litigation and regulatory climate has dissuaded non-U.S. companies from going to the U.S. to raise capital.").

upon us or any of these persons. You may have difficulty enforcing, both in and outside the United States, judgments you may obtain in U.S. courts against us or these persons in any action, including actions based upon the civil liability provisions of U.S. federal or state securities laws.

Furthermore, there is substantial doubt that the courts of the Marshall Islands or Greece would enter judgments in original actions brought in those courts predicated on U.S. federal or state securities laws.

The foregoing language raises some of the more obvious issues a lawyer must consider when prosecuting or defending suits involving foreign individuals or entities. Fundamentally, these include whether a party can effectively serve process upon a named defendant and whether a judgment can be executed on foreign assets. The above disclaimer could be transformed into a law school final exam question: "Identify how a putative class action plaintiff could initiate a suit as against the company and the individual officers and directors." Luckily, the focus of this exercise is not to explore every possible jurisdictional question, but rather to remind the practitioner that these types of issues must be considered, especially where the issuer is foreign. The following subparts address some select issues relevant to personal jurisdiction and subject matter jurisdiction in connection with foreign private issuers.

1. Direct Suits Against Foreign Private Issuers[136]

In the complaint against ABC Shipping Company, plaintiffs allege that the misrepresentations in ABC Shipping Company's financial statements constituted violations of section 10-b of the 1934 Act[137] by all defendants and violations of section 20 of the 1934 Act by the individual insider defendants.[138] Rule 10b-5,[139] promulgated under the authority of the 1934 Act, is the SEC's principle antifraud rule, and federal courts have implied a private cause of action for securities fraud under the Rule since 1946.[140] Any action alleging a 10b-5 violation must be brought in federal court pursuant to section 27 of the

136. The claims in our hypothetical complaint are direct (as opposed to derivative claims, which are discussed *infra*) because they are asserted by shareholders on their own behalf and any recovery goes directly to the shareholders, as opposed to the corporation.

137. *See* 1934 Act § 10, 15 U.S.C.A. § 78j (2007).

138. *See id.* § 20, 15 U.S.C.A. § 78t.

139. 17 C.F.R. § 240.10b-5 (2006).

140. *See* Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946).

1934 Act,[141] and any class action—whether based on federal or state law—must also be brought in federal court pursuant to the Securities Litigation Uniform Standards Act of 1998 (SLUSA).[142]

"'To state a cause of action under section 10(b) and Rule 10b-5, a plaintiff must plead that the defendant made a false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused plaintiff injury.'"[143] Detailed allegations of a deceptive off-balance sheet transaction that made financial statements unreliable, paired with allegations that defendants were aware the transactions were deceptive, might be able to satisfy the heightened pleading requirements of the PSLRA and survive a motion to dismiss.[144] However, to the extent the plaintiffs cannot obtain personal jurisdiction over the company, the analysis of the viability of the 10b-5 claim is irrelevant. Therefore, without passing judgment on the validity of the allegations in the complaint against ABC Shipping Company, this Article assumes that the plaintiffs would be able to satisfy the heightened pleading requirements of the PSLRA.

Courts have grappled with jurisdictional issues relating to foreign issuers, and "[i]t is well recognized that the [1934 Act] is silent as to its extraterritorial application."[145] An "admixture," or combination, of two jurisdictional tests, the "conduct test" and the "effects test," has been applied by courts to determine whether there is sufficient domestic involvement to justify exercising personal jurisdiction over a company

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141. 1934 Act § 27, 15 U.S.C.A. § 77v.

142. Securities Litigation Uniform Standards Act of 1998 (SLUSA), Pub. L. No. 105-353, 112 Stat. 3227 (codified at 15 U.S.C. § 78bb(f)(1)(A)). SLUSA generally "provides that '[n]o covered class action' based on state law and alleging 'a misrepresentation or omission of a material fact in connection with the purchase or sale of a security' 'may be maintained in any State or federal court by any private party.'" Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 126 S. Ct. 1503, 1506-07 (2006) (quoting SLUSA, 15 U.S.C. § 78bb(f)(1)(A)).

143. Kalnit v. Eichler, 264 F.3d 131, 138 (2d Cir. 2001) (quoting San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 808 (2d Cir. 1996)).

144. Analyzing whether a valid 10b-5 claim has been asserted goes beyond the purview of this Article. A court would have to analyze the specific allegations to ascertain whether the plaintiff satisfies the heightened pleading requirements pursuant to the PSLRA. For purposes of this Article, we are assuming that the plaintiff can satisfy this threshold and survive a motion to dismiss. For example, to the extent the actions of the individuals constituted a deliberate scheme to inflate ABC Shipping Company's earnings, a court would not likely dismiss a complaint. However, to the extent plaintiffs fail to plead the requisite scienter, and thus fail to allege that defendants acted with the intent to deceive or acted recklessly in making certain filings with the SEC, they would most likely not survive a motion to dismiss.

145. Itoba Ltd. v. LEP Group PLC, 54 F.3d 118, 121 (2d Cir. 1995) (citing Alfadda v. Fenn, 935 F.2d 475, 478 (2d Cir. 1991)).

or individual.[146] The fact that ABC Shipping Company: (1) registered its common shares with the SEC,[147] (2) listed its common stock on the NASDAQ,[148] and (3) resultantly, issued shares of common stock to U.S. investors might satisfy a federal court that personal jurisdiction should lie.[149]

2. Section 20 Violations

Section 20 of the 1934 Act provides: "Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person."[150] Moreover, "[l]iability under Section 20(a) is derivative and must be predicated upon an independent violation of the '34 Act."[151] As such, plaintiffs must sufficiently plead a violation of section 10b-5 as a predicate to establishing a section 20 violation.

With respect to the individual shareholders, officers, and directors of ABC Shipping Company, the disclaimer language seems to indicate that the section 20 allegations might not provide the shareholders with any relief to the extent they cannot exercise jurisdiction over the alleged "control persons." Does that language have any teeth? One recent case, *In re Baan Co. Securities Litigation*, seems to indicate that it does.[152] In the *Baan* action, the court refused to exercise personal jurisdiction over a foreign director of the board of a foreign company with minimal forum contacts.[153] The district court cited United States

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146. *Id.* at 122.

147. "SEC filings generally are the type of 'devices' that a reasonable investor would rely on in purchasing securities of the filing corporation. When these United States filings include substantial misrepresentations, they may be a predicate for subject matter jurisdiction." *Id.* at 123. There is no doubt that the SEC has jurisdiction over a foreign private issuer who registers shares of its common stock with the SEC and whose common stock is traded on the NASDAQ market system. *See In re* The Cronos Group, Securities Act Release No. 7771, Exchange Act Release No. 42,139, 71 SEC Docket 107 (Nov. 15, 1999), *available at* http://www.sec.gov/litigation/admin/34-42139.htm.

148. *See, e.g.*, *Itoba*, 54 F.3d at 124 (acknowledging that listing of common shares on a U.S. exchange satisfies the "effects test").

149. A different result might lie to the extent a derivative suit is being brought on behalf of a corporation, however, discussed *infra* Part IV.C.

150. 1934 Act § 20, 15 U.S.C.A. § 78t(a) (2007).

151. *In re* Digital Island Sec. Litig., 357 F.3d 322, 337 (3d Cir. 2004).

152. No. 98-2465 (ESH/JMF), 2002 WL 1284295 (D.D.C. June 10, 2002), *report rejected*, 245 F. Supp. 2d 117 (D.D.C. 2003).

153. The court found that no "general jurisdiction" could lie where the defendant did not have "such a pervasive personal presence in the forum that the exercise of jurisdiction does not offend fundamental fairness." *Id.* at *4. In the *Baan* case, the defendant was a

Supreme Court authority for the proposition that a U.S. court does not have jurisdiction over individual officers and employees of a company simply because the employer company is subject to jurisdiction.[154] The district court also reasoned that the complaint failed to allege that the named individual had any involvement with the transaction alleged to form the basis for securities fraud.[155] The court concluded:

> [T]he fact that American securities law may subject an individual to liability when she controls a corporation that violates that law does not mean that American courts may necessarily subject a foreign investor to its jurisdiction solely because she has the capability by virtue of stock ownership to control that non-American corporation or is a member of its Board of Directors.[156]

In the ABC Shipping Company hypothetical, plaintiffs would have to plead that the individual defendants had sufficient contacts with the United States *and* were personally involved in order to survive a motion to dismiss. To the extent plaintiffs could not make this showing, they would not be able to recover pursuant to section 20.

Notably, the court in *Baan* also dismissed a foreign parent company that was a beneficial owner of the subsidiary alleged to have engaged in securities fraud.[157] The court reasoned that "mere ownership of a beneficial interest in a corporation, no matter how controlling an interest, does not in itself serve as a premise for the exercise of jurisdiction over the beneficial owner, whether the owner is a human being or a corporation."[158] As discussed above, shipping companies are often held by controlling corporations (as opposed to individuals). Therefore, attorneys must at the very least consider the *Baan* jurisdictional analysis to the extent they are naming as a defendant, or defending, a foreign corporate shareholder in the context of a section 20 claim.

European citizen who traveled to the United States "sporadically and briefly on company business and who otherwise has absolutely no personal contacts with the United States." *Id.*

154. *Id.* at *5 (citing Keeton v. Hustler Magazine, Inc., 465 U.S. 770, 780 n.13 (1984); Wiggins v. Equifax Inc., 853 F. Supp. 500, 503 (D.D.C. 1994)).

155. *Id.* at *4. The court found that there was no "special jurisdiction" over the foreign defendant because there was no evidence that the defendant "personally participated or approved of the transactions complained to be fraudulent." *Id.*

156. *Id.* at *6.

157. *Id.* at *7-8.

158. *Id.* at *7.

3. Derivative Suits

When a plaintiff shareholder alleges an injury to the company, she does not have standing to sue in her individual capacity.[159] Therefore, any action brought on behalf of a company "must be brought as a derivative action—'an equitable remedy in which a shareholder asserts on behalf of a corporation a claim not belonging to the shareholder, but to the corporation.'"[160] Examples of derivative suits include, among others, suits alleging breach of fiduciary duties by a corporation's directors or officers, "waste of corporate assets, abuse of control, constructive fraud, [and] mismanagement."[161]

The rights of U.S. shareholders invested in a foreign company, including the right to sue derivatively, are determined by the law of the country of incorporation pursuant to the internal-affairs doctrine.[162] Within the United States, state law, and not federal law, provides the basis for a derivative cause of action.[163] This distinction is important where, for example, a plaintiff relies on a section in the 1934 Act to assert a direct claim for securities fraud as against a foreign issuer, where the nature of the cause of action is really derivative in nature.[164] When defending a securities suit, a practitioner must therefore not only understand the nature of the claims being asserted, but must also question whether or not the plaintiffs' characterization of the claim is correct.

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159. *See In re* Sagent Tech., Inc., Derivative Litig., 278 F. Supp. 2d 1079, 1085 (N.D. Cal. 2003).

160. *Id.* at 1086 (quoting 13 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5939 (perm. rev. ed. 2004)).

161. Batchelder v. Kawamoto, 147 F.3d 915, 917 (9th Cir. 1998).

162. *Id.* at 920 (citing Hausman v. Buckley, 299 F.2d 696, 702 (2d Cir. 1962); McDermott Inc. v. Lewis, 531 A.2d 206, 214-17 (Del. 1987); Levine v. Milton, 219 A.2d 145, 147 (Del. Ch. 1966); *cf.* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987) ("This beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.")).

163. *See, e.g.*, Barsky v. Arthur Andersen, LLP, No. Civ.A. H-02-1922, 2002 WL 32856818, at *2 (S.D. Tex. Aug. 16, 2002) ("Because '[c]orporations are creatures of state law,' to the extent that state law is consistent with federal policy, federal courts should apply state law in deciding the power of corporate directors to discontinue shareholder derivative suits alleging violations of federal law." (citing Burks v. Lasker, 441 U.S. 471, 478-79 (1979); Cort v. Ash, 422 U.S. 66, 84 (1975); Popkin v. Jacoby (*In re* Sunrise Sec. Litig.), 916 F.2d 874, 879 (3d Cir. 1990))).

164. *See, e.g.*, Abbey v. Control Data Corp., 603 F.2d 724, 731 (8th Cir. 1979) (affirming dismissal of a section 13(a) claim made pursuant to the 1934 Act where allegations of the violation were based on illegal foreign payments, because these payments "clearly involve[d] state law questions of breach of fiduciary duties" and "should not be dealt with under the general disclosure provisions of the federal securities laws").

In our ABC Shipping Company example, no derivative claims have been asserted. However, an argument could be made that the suit, although characterized as a direct claim, is actually derivative in nature. Were the claims derivative in nature, the laws of the country of incorporation, here, the Republic of the Marshall Islands, would apply.[165]

IV. WOULD A SECURITIES LITIGATOR BE ABLE TO UTILIZE ADMIRALTY LAW AGAINST A PUBLIC SHIPPING COMPANY?

The above Parts have demonstrated that securities litigation initiated in the United States against a foreign shipping company would not differ procedurally from, for example, a comparable shareholder suit against a foreign widget manufacturer listed on the NASDAQ. The same limitations on the applicability of certain securities regulations, as well as potential jurisdictional concerns, abound.

However, what happens if the shareholders obtain a judgment against the company and/or its individual officers, and the company and/or individual officers either refuse to pay, hide assets, or cannot pay? Would a shareholder be permitted to "arrest" a vessel in order to collect on a judgment?

A. *Overview of Maritime Enforcement of Liens—Attachment and Arrest of Vessels*

Any litigator faced with a maritime proceeding must familiarize himself with the *Federal Rules of Civil Procedure, Supplemental Rules for Certain Admiralty and Maritime Claims*. Suits involving an arrest of the vessel are in rem actions, meaning that the action is against a "thing" rather than a person (i.e., an in personam action).[166] In the United States, a vessel is arrested when it is served with an arrest warrant and a complaint.[167] A U.S. Marshal will generally board the

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165. Adopted in 1990, the Marshall Islands Associations Law is modeled after the corporate laws of New York and Delaware. Maritime and Corporate Administrator of the Republic of the Marshall Islands, Corporate Services, http://www.register-iri.com/content.cfm?catid=2 (last visited May 24, 2007).

166. *See, e.g.*, FED. R. CIV. P. Supp. C. However, Rule C(1) does permit a party to simultaneously proceed in personam. "Except as otherwise provided by law a party who may proceed in rem may also, or in the alternative, proceed in personam against any person who may be liable." FED. R. CIV. P. Supp. (C)(1).

167. *See* FED. R. CIV. P. Supp. C(3)(a):

> (ii)(A) . . . [T]he court must review the complaint and any supporting papers. If the conditions for an in rem action appear to exist, the court must issue an order

vessel and take charge of it.[168] A complaint and petition to the court for an arrest warrant must take place in the jurisdiction in which the vessel is located.[169] In order to have a right in rem against a vessel, and thus be able to seize the vessel to enforce that right, one must have a maritime lien.[170]

While shareholders holding stock in shipping companies may have numerous rights against issuers of stock under the securities laws, their rights under maritime law are limited. Accordingly, the shareholders may obtain a judgment against the issuer of the stock and perhaps individual insiders but are unlikely to succeed in arguing that they have a maritime lien enforceable by an action in rem against the vessel—there is no precedent for such an action by shareholders.

B. Arguments

1. Statutory Subordination

A creative lawyer might attempt to argue that a diminution in share price caused by corporate fraud is analogous to a mortgage default—in the former case, the value of the shareholder's investment is being diminished by virtue of the shipowning company's fraudulent actions; in the latter, the value of the mortgagee's collateral is also being diminished by virtue of the shipowning company's actions (regardless of the motivation underlying that default). Nonetheless, the lien and priority of the preferred ship mortgagee's lien is provided by statute,[171] and a court would be hard-pressed to stretch the legislative

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directing the clerk to issue a warrant for the arrest of the vessel or other property that is the subject of the action.

(B) If the plaintiff or the plaintiff's attorney certifies that exigent circumstances make court review impracticable, the clerk must promptly issue a summons and a warrant for the arrest of the vessel or other property that is the subject of the action. The plaintiff has the burden in any postarrest hearing under Rule E(4)(f) to show that exigent circumstances existed.

168. *See, e.g.*, U.S. MARSHALS SERV., W. DIST. OF WASH., U.S. DEP'T OF JUSTICE, PROCEDURES TO ARREST A VESSEL (last visited May 24, 2007), *available at* http://www.usmarshals.gov/district/wa-w/admiralty/pdf/admiralty.pdf.

169. *See* FED. R. CIV. P. Supp. E(3)(a) ("In admiralty and maritime proceedings process in rem . . . may be served only within the district.").

170. *See, e.g.*, FED. R. CIV. P. Supp. C(1) ("An action in rem may be brought: (a) To enforce any maritime lien . . . ."); Rainbow Line, Inc. v. M/V Tequila, 480 F.2d 1024, 1028, 1973 AMC 1431, 1436 (2d Cir. 1973) ("[I]n rem jurisdiction in the admiralty exists only to enforce a maritime lien."); *see also* Bunn v. Global Marine, Inc., 428 F.2d 40, 48 n.10, 1970 AMC 1539, 1549 n.10 (5th Cir. 1970) ("[A] maritime lien is the foundation of a proceeding in rem . . . .").

171. *See* 46 U.S.C.A. § 31322 (2007).

intent of the Ship Mortgage Act to extend to shareholders, even if they viewed this analogy as compelling.[172]

2. Provision of "Necessaries"

A lawyer might attempt to argue, in the alternative, that the capital they provided constituted "necessaries." Necessaries are defined as "repairs, supplies, towage, and the use of a dry dock or marine railway."[173] Notably, that list is not exhaustive, and contemporary admiralty cases have interpreted necessaries broadly as encompassing "anything that facilitates or enables a vessel to perform its mission or occupation."[174] In relevant part, necessaries constitute maritime liens and could therefore provide shareholders with maritime recovery to the extent their capital infusion constituted a necessary.[175] To constitute a valid maritime lien, the necessaries must be furnished "to a vessel,"[176] which means that the lien attaches only to the specific vessel to which services were provided.[177]

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172. *See, e.g.*, Mullane v. Chambers, 438 F.3d 132, 137, 2006 AMC 467, 471 (1st Cir. 2006). A party first attempted to argue that their discharge of a mortgage on a vessel was a maritime lien. *Id.* at 136, 2006 AMC at 470. When the court rejected that theory, they later attempted to argue that the discharge was an "equitable lien." *Id.* at 137, 2006 AMC at 471. The court held that equitable liens do not give rise to maritime liens and noted that maritime liens are *stricti juris* and "'cannot be conferred on the theory of unjust enrichment or subrogation.'" *Id.* at 136-37 n.5, 2006 AMC at 471 n.5.

173. 46 U.S.C.A. § 31301(4).

174. Ventura Packers, Inc. v. F/V Jeanine Kathleen, 305 F.3d 913, 923, 2002 AMC 2248, 2259 (9th Cir. 2002) (citing Equilease Corp. v. M/V Sampson, 793 F.2d 598, 603, 1986 AMC 1826, 1833 (5th Cir. 1986)).

175. *See* 46 U.S.C.A. § 31342(a), establishing that

> a person providing necessaries to a vessel on the order of the owner or a person authorized by the owner—
> (1) has a maritime lien on the vessel;
> (2) may bring a civil action in rem to enforce the lien; and
> (3) is not required to allege or prove in the action that credit was given to the vessel.

176. *See id.*

177. *See, e.g.*, *id.* ("[A] person providing necessaries to a vessel on the order of the owner or a person authorized by the owner—(1) has a maritime lien on the vessel . . . ."); Piedmont & Georges Creek Coal Co. v. Seaboard Fisheries Co., 254 U.S. 1, 4, 2001 AMC 2692, 2687 (1920) ("[O]ne vessel of a fleet cannot be made liable under the [Federal Maritime Lien Act] for supplies furnished to the others, even if the supplies are furnished to all upon orders of the owner under a single contract . . . ."); PNC Bank Del. v. F/V Miss Laura, 381 F.3d 183, 185-86, 2004 AMC 2314, 2316 (3d Cir. 2004) ("[T]he law of maritime liens has consistently recognized that a maritime lien attaches only to the specific vessel to which services are provided."); *In re* Container Applications Int'l, Inc., 233 F.3d 1361, 1365-66, 2001 AMC 967, 971-74 (11th Cir. 2000) (following *Piedmont* and denying a maritime lien because the purported lienholder did not provide necessaries to any particular vessel). "The vessel-specific character of maritime liens results from the legal fiction that a vessel

An attorney might argue that the public shareholders' equity infusion was a necessary in that it facilitated the success of the entire business by, among other things, permitting the company to purchase additional vessels and expand. This argument most likely would not pass muster, however. First, as indicated, a necessary must be furnished to a specific vessel, and the furnishing of an equity infusion to the company does not fit within this framework. Second, even if the equity infusion could be tied to one specific vessel, recent case law indicates this theory would not survive judicial scrutiny. In 2006, the United States Court of Appeals for the First Circuit affirmed the district court's finding that a party's discharge of a bank's preferred ship mortgage did not constitute a necessary.[178] To the extent shareholders desire to be viewed as "equitable" preferred mortgagees, which would likely be the rationale behind a claim for necessaries, this precedent would indicate that theory is not viable.

3. "Rule of Advances" and Recovery Preclusion Based on Ownership

Notably, in that same First Circuit action, the court rejected the discharging party's alternative argument that they were entitled to relief "pursuant to the rule of advances."[179]

The court explained the rule of advances as follows:

> The rule of advances, like the doctrine of necessaries, facilitates reimbursements of those who allow a vessel to perform its functions. The difference is that the rule of advances provides protection not to the person furnishing "necessaries," but rather to a third person who pays for the goods and services that would have given rise to a statutory maritime lien, on an assurance that the vessel will be responsible for the debt.[180]

The court based its holding that the dischargers were not entitled to a maritime lien because the rule of advances and all other theories upon

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receiving services 'is considered to be a distinct entity responsible only for its own debts.'" *PNC Bank*, 381 F.3d at 186, 2004 AMC at 2316 (citing Foss Launch & Tug Co. v. Char Ching Shipping U.S.A., Ltd., 808 F.2d 697, 701, 1987 AMC 913, 919-20 (9th Cir. 1987)).

178. *See* Mullane v. Chambers, 438 F.3d 132, 137, 2006 AMC 467, 472 (1st Cir. 2006) ("On appeal, the Mullanes do not quibble with the district court's conclusion that their discharge of the Eastern Bank mortgage did not constitute a 'necessary . . . .'").

179. *Id.* The rule of advances has three significant requirements: (1) that the money be advanced to a ship, (2) that it be advanced on the order of the master or someone with similar authority, and (3) that the money be used to satisfy an outstanding or future lien claim. Tramp Oil & Marine, Ltd. v. M/V "Mermaid I," 805 F.2d 42, 45, 1987 AMC 866, 868-69 (1st Cir. 1986).

180. *Mullane*, 438 F.3d at 137, 2006 AMC at 472.

which maritime liens are created "are intended to safeguard the interests of 'strangers to the vessel,' not vessel owners or those who can control the vessel's affairs."[181] That is because

> maritime liens and the admiralty jurisdiction that comes with them are a way of making the provision of services to vessels as safe and predictable as the provision of services to land-based businesses. . . . The overarching goal is keeping the channels of maritime commerce open—by ensuring that people who service vessels have an efficient way of demanding reimbursement for their labor and are thus willing to perform the services necessary to keep vessels in operation.[182]

Shareholders are owners of a company, although they play a limited role in the corporate management. And, as intimated above, there is authority for the proposition that a person with an ownership interest in a shipping company is precluded from enforcing a claim against a vessel.[183] Therefore, it is unlikely that a judgment for securities fraud would be viewed as a maritime lien under any theory.[184]

4. Rule B Attachment

Nor would a shareholder with a securities claim be able to seek maritime attachment pursuant to Rule B. Rule B claims are in personam (or quasi in rem) attachment actions brought against a

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181. *Id.* (citing Sasportes v. M/V Sol de Copacabana, 581 F.2d 1204, 1208, 1980 AMC 791, 794 (5th Cir. 1978)).

182. *Id.* at 138, 2006 AMC at 473.

183. *See, e.g.*, Bavely v. Wandstrat (*In re* Harbour Lights Marina, Inc.), 146 B.R. 963, 969 (Bankr. S.D. Ohio 1992) (holding that a shareholder and co-owner of a vessel was not eligible for a maritime lien and reasoning that "[o]wners may not assert maritime liens against their vessels under maritime law" (citing The Kongo, 155 F.2d 492, 494-95, 1946 AMC 1200, 1202 (6th Cir. 1946) (holding co-owner barred from asserting maritime lien against boat by paying seaman's lien claim and taking an assignment))).

184. However, one case seems to indicate that stock ownership on its face might not defeat a lien to the extent it was maritime in nature. The President Arthur, 25 F.2d 999, 1001, 1928 AMC 1377, 1380 (S.D.N.Y. 1928) ("Shareholders in a corporate owner of a ship have sometimes been denied maritime liens because of their relations to the vessel, but the mere fact of stock ownership is not enough to defeat a lien which otherwise would be enforceable."). Again, though, we are faced with the problem that a judgment against the corporation does not fit neatly within the maritime-lien regime; as such, the dicta in the *President Arthur* case is most likely not applicable to our hypothetical. Nonetheless, although a judgment for securities fraud might not be a maritime lien (as there is no authority from any court in the United States indicating that shareholders would have such a lien), shareholders might have a remedy (outside of the context of a securities claim) to recover from the sale of a vessel funds infused into the corporation that were used to purchase specific items that would normally give rise to a maritime lien. From a practical standpoint, the rule of advances might be difficult to apply, though, in that shareholders would have to prove that money raised from an offering (which is obviously fungible) explicitly went towards a maritime lien item—an impossible feat.

debtor (i.e., a shipping company), rather than in rem against a vessel.[185] Rule B permits courts to exercise jurisdiction over defendants in admiralty or maritime cases by attaching the defendant's property.[186] Rule B attachment can only be utilized when the "defendant is not found within the district when a verified complaint praying for attachment" is filed.[187] That language means that the court can exercise jurisdiction even where the "defendant is neither subject to the jurisdiction of the district court nor amenable to service of process within the district."[188]

As intimated, the fundamental requirement for a Rule B attachment is that it relate to a maritime claim.[189] A judgment based on a securities claim, even if it is against a shipping company, simply is not maritime, and it is unlikely that any court will find it to be so.[190]

5. Bankruptcy Proceedings

Nor would a shareholder fare any better in a bankruptcy context. Following the wave of public market debt financings in the shipping business in the late 1990s, there was a wave of shipping bankruptcies, most of which were filed in New York or Delaware bankruptcy courts.[191] Distributions in those bankruptcies, and any subsequent bankruptcy of a publicly held shipping company, would be conducted pursuant to the United States Bankruptcy Code. The Bankruptcy Code

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185. FED. R. CIV. P. Supp. B.

186. Submersible Sys., Inc. v. Perforadora Cent., S.A. de C.V., 249 F.3d 413, 421, 2001 AMC 1873, 1881 (5th Cir. 2001) (citing Great Prize, S.A. v. Mariner Shipping Pty., Ltd., 967 F.2d 157, 159, 1993 AMC 72, 73-74 (5th Cir. 1992)).

187. FED. R. CIV. P. Supp. B(1)(a).

188. *Submersible Sys.*, 249 F.3d at 421, 2001 AMC at 1881-82 (citing Heidmar, Inc. v. Anomina Ravennate di Armamento Sp.A. of Ravenna, 132 F.3d 264, 268, 1998 AMC 982, 986-87 (5th Cir. 1998); LaBanca v. Ostermunchner, 664 F.2d 65, 67, 1982 AMC 205, 206-07 (5th Cir. Unit B Dec. 1981)).

189. *See, e.g.*, Contichem LPG v. Parsons Shipping Co., 229 F.3d 426, 433-34, 2001 AMC 13, 22 (2d Cir. 2000) ("Rule B(1) provides that '[w]ith respect to any admiralty or maritime claim in personam a verified complaint may contain a prayer for process to attach the defendant's goods and chattels, or credits and effects in the hands of garnishees . . . if the defendant shall not be found within the district.'" (quoting FED. R. CIV. P. Supp. B(1))).

190. Courts have permitted judgment creditors to attach a vessel pursuant to Rule B, but in those circumstances the underlying judgment related to maritime claims. *See, e.g.*, Oil Transp. Co. v. Hilton Oil Transp., 1994 AMC 2817, 2819 (S.D. Tex. 1994) (permitting the party to attach a vessel pursuant to FED. R. CIV. P. Supp. B to obtain jurisdiction over and ensure funding for a future judgment based on an arbitration award).

191. *See, e.g.*, *In re* Navigator Gas Transp., No. 1:03-BK-10471 (Bankr. S.D.N.Y. voluntary petition filed 1/27/2003); *In re* Millenium Seacarriers, Inc., No. 1:02-BK-10180 (Bankr. S.D.N.Y. voluntary petition filed 1/15/2002); *In re* Amer Reefer Co., No. 1:01-BK-11301 (Bankr. S.D.N.Y. voluntary petition filed 3/12/2001); *In re* Golden Ocean Group, Ltd., No. 1:00-BK-00099 (Bankr. Dist. Del. voluntary petition filed 1/14/2000).

gives secured creditors priority in any plan of reorganization or distribution in the case of liquidation.[192] Secured creditors would include lenders (who in this hypothetical would have sought the seizure and sale in rem of the bankrupt's vessels, either prior to or following the commencement of the bankruptcy). Case law in the bankruptcy context indicates that maritime lienors will be given secured creditor status in a bankruptcy.[193] This is limited, however, to maritime liens that arose before the petition.[194] From a strategic perspective, parties with maritime liens would fare better by arresting a vessel prior to the initiation of any bankruptcy proceedings.

V. CONCLUSION

Despite shareholders' rights under the securities law, holders of common stock need to realize that they sit at the bottom of the capital structure. In the event of a bankruptcy[195] or dissolution,[196] holders of

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192. *See, e.g.*, Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 859 (1996) ("[A] fundamental and longstanding feature of bankruptcy law [is] the principle that a secured creditor is entitled to receive the entire amount of its secured claim—the portion of its bankruptcy claim that is fully backed by collateral—before any unsecured claims are paid."); *see also* 11 U.S.C.A. § 506 (2007).

193. *See* Kongsberg N. Am., Inc. v. Underwater Completion Team, Inc. (*In re* Underwater Completion Team, Inc.), 34 B.R. 206, 211 (Bankr. W.D. La. 1983) (providing necessaries to a vessel "entitled [party] to secured status pursuant to a maritime lien against the vessel"); *see also In re* H & S Transp. Co., 42 B.R. 164, 165 (Bankr. M.D. Tenn. 1984) (stating that the trustee for the debtor may not avoid prepetition maritime liens that attached to the vessel and were created pursuant to statute).

194. *See, e.g.*, *In re* Seaescape Cruises, Ltd., 131 B.R. 241, 242-43 (Bankr. S.D. Fla. 1991).

> [T]he claims of maritime lien holders are not so readily classified as "secured" claims, especially in the context of a bankruptcy case such as this, where the vessels have not been arrested and where the automatic stay imposed by Section 362 of the Bankruptcy Code precludes the seizure of the vessels or the enforcement of those liens, at least within the jurisdiction of this Court. Virtually every creditor who provided necessary services to the vessels may have a basis for asserting maritime liens. However, whether a maritime lien is enforceable depends on a number of factors, such as the value of the vessel in which the lien arose, the ranking of the maritime lien vis a vis other maritime liens, the law of the jurisdiction in which the vessel is seized, the particular terms of the applicable charter agreement and numerous other variables which must be considered under applicable bankruptcy and maritime law. Whether any of the members of the Committee who claim potential maritime liens are actually "secured" creditors cannot be determined with any degree of certainty at this time.

Id.

195. *See, e.g.*, Charles W. Adams, *New Capital for Bankruptcy Reorganizations: It's the Amount that Counts*, 89 NW. U. L. REV. 411, 421 n.42 (1995) ("[U]pon dissolution, a

common shares are paid last. Accordingly, even if the shipping company and its insiders have committed securities fraud, and shareholders obtain a judgment against them, if a company is in trouble, the shareholders probably will have difficulty enforcing in rem any judgment they may obtain in personam.[197]

In conclusion, in the event a publicly held shipping company such as ABC Shipping Company suffers in a falling market, it will be subjected to securities suits as its share price drops and, perhaps, allegations of securities fraud are made. In that scenario, if the transaction involves bank debt, the bankers and trade creditors will proceed against the vessels, foreclosures and/or bankruptcies may ensue, and, whether there is anything to recover, either in the admiralty or bankruptcy context, those recoveries are more likely to made by secured creditors, and the shareholders may be the least likely to recover.

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corporation must satisfy its liabilities before distributing any remaining assets among its shareholders . . . ." (citing MODEL BUS. CORP. ACT § 87(b) (1971))).

196. *See, e.g.*, Melanie J. Schmid, Note, *A Congressional Montage of Two Systems of Law—Mandatory Subordination Under the Code*, 13 AM. BANKR. INST. L. REV. 361, 361 (2005) ("The 'Absolute Priority Rule' governs the distribution of the estate such that shareholders are precluded from recovering any property on account of their shareholder stake until all creditor claims have been satisfied in full." (footnote omitted)).

197. Recent bankruptcies have addressed the issue of whether a section 363 sale of assets (in the case of a shipping company, a sale of the ships) would cleanse those ships of maritime liens as an admiralty sale conducted pursuant to the supplemental rules would. *See, e.g.*, Universal Oil Ltd. v. Allfirst Bank (*In re* Millenium Seacarriers, Inc.), 419 F.3d 83, 87, 2005 AMC 1987, 1989-90 (2d Cir. 2005); *see also In re* Millenium Seacarriers, Inc., 275 B.R. 690, 693, 2002 AMC 1343, 1345-46 (S.D.N.Y. 2002). It is the view of the authors that if a shipping company is in bankruptcy, buyers of vessels from the bankrupt's estate are far better served by seeking a sale of the vessel in an admiralty court, rather than having a bankruptcy sale, where it is questionable whether courts worldwide will recognize that sale as having cleansed the vessel of liens.