

# THE UNITED STATES CAPITAL MARKETS ADJUST TO SHIPPING

## WHY THE SEC HAS MADE IT EASIER FOR PUBLICLY TRADED SHIP OWNERS TO ADAPT TO SARBANES-OXLEY

By Gary J. Wolfe, Seward & Kissel LLP

Publicly traded shipping companies have been living with the Sarbanes-Oxley Act of 2002 ("SOX") since its adoption in reaction to the Enron, Worldcom and Adelphia scandals. SOX mandated that the United States Securities and Exchange Commission ("SEC") adopt new rules that would change the corporate governance of many public companies. When SOX was adopted and as the SEC began to consider and propose regulations to implement SOX, foreign shipping companies were concerned that SOX would impose new regulatory burdens that would outweigh the benefits of participating in the highly liquid U.S. public equity markets. In fact, pressure from the New York Stock Exchange ("NYSE") and Nasdaq Stock Market ("Nasdaq") to attract and maintain foreign listings has resulted in the relaxation of many SOX corporate governance requirements applicable to foreign publicly traded companies, including foreign ship owners, that operate abroad. As the rules have developed, very few of the changes mandated by SOX apply to "foreign private issuers", that is, public companies that file annual reports on Form 20-F. In addition, as discussed below, as a result of competition with the NYSE, Nasdaq has relaxed many significant corporate governance requirements for foreign private issuers to conform them to the previously more flexible NYSE standards.

### Publicly Traded Shipping Companies that are Foreign Private Issuers

Many of the shipping companies that are listed in the U.S. are foreign private issuers, exempt from the vast majority of the SOX corporate governance requirements. In most cases, they are foreign corporations not managed from the United States and whose boards of directors and executive officers are majority non-U.S. Such companies include Frontline (NYSE: FRO), Ship Finance International (NYSE: SFL), Tsakos Energy (NYSE: TNP), Nordic American (NYSE: NAT), Teekay (NYSE: TK) and the two Teekay sponsored Master Limited Partnerships, TK Offshore and TK LNG, Diana Shipping (NYSE: DSX), Aegean Marine Petroleum (NYSE: ANW) (not really a shipping company but rather a



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bunker supplier to ships in various ports), Seaspan (NYSE: SSW); Excel Maritime (NYSE: EXM); Knightsbridge Tankers (Nasdaq: VLCCF), Ultrapetrol (Nasdaq: ULTR), Golar LNG (Nasdaq: GLNG); TOP Tankers (Nasdaq: TOPT), Aries Maritime (Nasdaq: RAMS); Torm (Nasdaq: TRMD), DryShips (Nasdaq: DRYS) and Omega Navigation (Nasdaq: ONAV). Remember, the easiest way to identify a foreign private issuer is by looking at its filings. If it files Form 20-F and Form 6-K, it is a foreign private issuer. We discuss the various exemptions and accommodations from SOX for Form 20-F filers below. The other companies, those companies that are managed from the United States and file their annual reports on Form 10-K have found that they already met many of the new SOX requirements. These companies include: OMI (NYSE: OMI), Overseas Shipholding (NYSE: OSG), General Maritime (NYSE: GMR), Eagle Bulk Shipping (Nasdaq: EGLE), Genco Shipping and Trading (Nasdaq: GSTL), Double Hull (NYSE: DHT), Horizon (NYSE: HRZ), Quintana (Nasdaq: QMAR), Stealth Gas (Nasdaq: GASS), Euroseas (Nasdaq: ESEA), K-Sea (NYSE: KSP), Arlington (NYSE: ATB) and TBS International (Nasdaq: TBSI).

### New Corporate Governance Requirements for Form 10-K Filers

Here are the new corporate governance

requirements that the stock exchanges and the SEC have imposed as directed by SOX:

- o Majority independent Board
- o Audit Committee consisting of at least three members, one of whom is a "financial expert", and all of whom are independent under strict standards including "look-back" periods
- o Compensation Committee consisting of at least three independent members
- o Nominating and Corporate Governance Committee consisting of at least three independent members
- o Concept of "Presiding Director" who is independent
- o Periodic "executive session" meetings of the independent directors
- o Annual reports by management on the company's system of internal controls over financial reporting, and an annual attestation on that report from the company's auditors (known commonly as "SOX 404" compliance)
- o Establishment of procedures for allowing "whistleblowers" to contact the Audit Committee for complaints relating to a company's financial reporting; protection of whistleblowers from retaliation
- o Prohibition on loans to executive officers and directors.

In addition, in the same atmosphere surrounding the adoption of SOX, the stock exchanges imposed a requirement for shareholder approval of equity incentive plans and material changes to those plans.

### The Exemptions and Accommodations for Foreign Private Issuers

As a result of the competitive pressures on listings, here is how the rules

have been relaxed for foreign private issuers:

- o No requirement for independent directors
- o Audit committee may have as few as one member who need not be a financial expert and for whom the definition of independent is relaxed, with no "look-back".
- o No requirement for Compensation Committee
- o No requirement for Nominating and Corporate Governance Committee
- o No requirement for "Presiding Director"
- o No requirement for periodic "executive

session” meetings of the non-executive directors

o Requirements for SOX 404 annual reports by management on the company’s system of internal controls over financial reporting, and the annual attestation on that report from the company’s auditors have been delayed twice. Currently, companies with an unaffiliated market capitalization of less than \$700 million need only provide a management’s report. For companies with a calendar fiscal year, the requirement for an attestation has been delayed to the annual report on Form 20-F to be filed in 2009 for the 2008 fiscal year .

o The “whistleblowers” procedure has been maintained, but some U.S. courts have held that whistleblowers in foreign countries are not covered by the anti-retaliation provisions.

o No requirement for shareholder approval of equity incentive plans or material changes to those plans.

#### **The prohibition on loans to executive officers and directors has been maintained.**

In addition, in the process of exempting foreign private issuers from the SOX corporate governance requirements, Nasdaq has joined the NYSE in exempting foreign private issuers

from previously existing corporate governance provisions such as the requirement to obtain shareholder approval if a company proposes to increase its outstanding voting shares by 20% or more by way of a private issuance. Nasdaq has also joined the NYSE by making the corporate governance exemptions for foreign private issuers more or less automatic. Previously, Nasdaq had required the submission of an application for the exemption meeting strict standards that most foreign companies could not satisfy.

All in all, the only significant SOX corporate governance burdens that public shipping companies that are Form 20-F filers have had to meet are: (1) SOX 404, the most expensive part of which, auditor attestation, has been delayed for companies with less than a \$700 million market capitalization, and (2) Audit Committee, but which may consist of as few as one member. Insofar as SOX 404 is concerned, most publicly traded ship owning companies are engaged in one line of business—operating ships. They charter out (or charter in) their vessels, receive income, pay expenses. Some of the independent ship managers who have sought business from the publicly traded shipping companies have made themselves “SOX 404 friendly”. Therefore, the requirement to monitor

and report on systems of internal controls should not overwhelm public shipping companies. Complying is much more difficult for industrial companies, companies with complicated operating structures and branches, and conglomerates. If they wish, foreign shipping companies can voluntarily submit to one or more of the enhanced SOX corporate governance standards. Otherwise, corporate governance for a foreign shipping company that files its annual reports on Form 20-F will be very much what it was pre-SOX.

#### **Conclusion**

The most significant area of regulation for foreign public shipping companies, whether they file annual reports on Form 10-K and are subject to the full panoply of SOX corporate governance requirements or whether they file on Form 20-F and are exempt from most of those requirements is not SOX. The Oil Pollution Act of 1990, the various European Union shipping related directives, the International Maritime Organization and ISM have imposed far more momentous obligations on the shipping industry than SOX. The dramatic increase in the number of publicly traded ship owners since SOX was adopted proves that public shipping companies can live with SOX.

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  - » 24 senior research analysts covering over 320 companies
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- ▶ One of the broadest and most robust retail distribution platforms among investment banks focused on Small-Cap companies
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- ▶ Publicly traded on the New York Stock Exchange – (“OPY”)
- ▶ 2006 Revenues - \$801 million; Net Profit - \$45 million

