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July 22, 2013

Securities and Exchange Commission
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Rule-comments@sec.gov

RE: Release No. 34-69477; File No. 81-939

Application of W2007 Grace Acquisition I, Inc. under Section 12(h) of the Securities Exchange Act of 1934 (f/k/a Equity Inns, SEC CIK # 0000916530)

Dear Securities and Exchange Commission:

Here are my additional comments on the application of W2007 Grace Acquisition I (the "company" or "Applicant") for an exemption from its reporting requirements under the Exchange Act. This letter is in response to the supplemental letter (the "supplement") by the Applicant as well as to alert the Commission to new developments.[2] The company will soon conduct another election for preferred shareholder directors, at which the company may engage in actions that have the effect of

[1] I am also on the boards of directors of the EDGA and EDGX stock exchanges. My comments are strictly my own and don't necessarily represent those of Georgetown University, the University of Pennsylvania, EDGX, EDGA, or anyone else for that matter.

[2] The Applicant's supplemental letter is at http://www.sec.gov/rules/other/2013/34-69477-supplementalletter.pdf . The original application can be found at http://www.sec.gov/rules/other/2013/34-69477-application.pdf .

disenfranchising preferred shareholders and denying the preferred shareholders their legal representation on the board. I call upon the SEC to closely monitor the upcoming election to make sure that the preferred shareholders are not once again disenfranchised. As this case has drawn increasing media scrutiny, the SEC's response is also likely to draw increasing media scrutiny. A visible public failure by the SEC to protect shareholders in this case will seriously damage the SEC's credibility and reputation as an agency that can fulfill its mission "to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation."[3]

This case is especially important in light of the growing number of unregistered and deregistered public companies resulting from the JOBS Act. The SEC needs to figure out how it will protect public investors in public companies that are not yet SEC registrants. The anti-fraud and other provisions of the securities laws also apply to these public non-registrants. The SEC should establish written guidance for such companies that would protect investors and also provide a safe harbor for such public non-registrants. This guidance would compile a list of best practices for dealing with shareholders. It should include that such public non-registrants make appropriate disclosures of financial information on their own and other web sites, adhere to appropriate corporate governance policies, not block the secondary market in its shares, and have appropriate policies and procedures to prevent insider trading based on material nonpublic information.

These comments are in addition to the comments in my original letter, which I still hold and incorporate by reference.[4] The application should still be denied as it is inconsistent with the public interest and the protection of investors. Alternatively, if the Commission upholds the application, it should use it statutory authority to impose terms and conditions on the company to force it to release adequate information to the public to ensure a fair and orderly market in its shares, and to facilitate the filling of the vacant positions on the board of directors that belong to the preferred shareholders.

But first, here is a quick recap on the Equity Inns/ W2007 Grace Acquisition I soap opera for those who are just joining us:

In 2007, a Goldman Sachs-related entity conducted a leveraged buyout of the common, but not the preferred shares, of Equity Inns, Inc., a real estate REIT. The acquisition was named W2007 Grace Acquisition I. The class B and C preferred shares of Equity Inns were delisted from the New York Stock Exchange and replaced with preferred shares of W2007 Grace Acquisition I. The company filed a Form 15 to deregister the preferred shares from the SEC, and the preferred shares trade over the counter. The shares are also no longer eligible for electronic transfer at DTC, making them very difficult and expensive to transfer as all transfers must be done with paper certificates.

The company stopped paying dividends on the preferred shares in 2008. Under the terms of the preferred shares, the preferred shareholders therefore have the right to elect two directors to the company's board of

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[3] http://www.sec.gov/about/whatwedo.shtml.

[4] My original comment letter is at http://www.sec.gov/comments/81-939/81939-26.pdf

directors. The company has gone through only the minimal motions of conducting shareholder meetings for the purpose of these elections. Only minimal information has been given to shareholders about the candidates for the board – far less than one typically gets for board candidates. At the shareholder meetings, the company reported that it did not have the required quorums to conduct an election. The company's board of directors has not fulfilled its fiduciary duty to the shareholders by exercising its powers to fill the vacant board positions, leaving the preferred shareholders without any board representation for over three years. In the meantime, the company continues to engage in a series of anti-shareholder activities.

The company has filed an application with the SEC for exemption from its SEC reporting obligations on the technical grounds that 300 separate trusts (the "JMS trusts") should be counted as one shareholder "of record" instead of 300 for the purposes of whether the Applicant should be required to resume its reporting obligations. To date virtually all of the public comments have been unanimous in requesting that the SEC deny the Application. The company admits to approximately 280 shareholders of record, which is 20 shy of the 300 needed to trigger a resumption of the company's reporting obligations to the SEC. A resumption of reporting obligations means that it would publicly reveal its financial information, and there would be reporting of transactions by officers, directors, and holders of more than 5% of the shares. This additional information would permit existing as well as potential shareholders to make better informed investment decisions.

This case has received attention from media outlets including the *New York Times*, the *Wall Street Journal*, and Reuters. Copies of some of the relevant articles are attached.

Discussion

The supplement, like the original Application, seeks to narrow the issue involved to a technical debate on the number of shareholders of record. Indeed, the supplement blithely dismisses virtually all of the other points made by myself and other commenters as points that "the Company maintains do not relate at all to the Application." Those important points may not relate directly to those mentioned in the Application, but they are directly relevant to the statutory criteria that the SEC is called upon to consider in such cases.

The relevant statute calls for the Commission to consider far more than the number of shareholders "of record."[5] Indeed, the Commission must find that the requested exemption is "not inconsistent with the

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[5] The referenced section of the Securities Exchange Act of 1934 as amended reads:

12(h) The Commission may by rules and regulations, or upon application of an interested person, by order, after notice and opportunity for hearing, exempt in whole or in part any issuer or class of issuers from the provisions of subsection (g) of this section or from section 13, 14, or 15(d) or may exempt from section 16 any officer, director, or beneficial owner of securities of any issuer, any security of which is required to be registered pursuant to subsection (g) hereof, upon such terms and conditions and for such period as it deems necessary or appropriate, if the Commission finds, by reason of the number of public investors, amount of trading interest in the securities, the nature and extent of the activities of the issuer, income or assets of the issuer, or otherwise, that such action is not inconsistent with the public interest or the protection of investors. The Commission may, for the purposes of any of the above-mentioned public interest or the protection of investors." The statute calls on the Commission to consider "the number of public investors, amount of trading interest in the securities, the nature and extent of the activities of the issuer, income or assets of the issuer, or otherwise"

The Applicant makes no serious argument that the requested exemption is consistent with the protection of investors.

The Applicant does not even attempt to meet its legal burden of proof to show that the requested exemption is not inconsistent with the protection of investors. Indeed, the supplement makes the laughably false statement:

> "Further, "imposing Exchange Act reporting obligations on [the Company] solely because of the creation of, and deposit of company shares into, the [JMS Trusts] would not result in an increase in 'the number of investors protected' by such reporting."[3] "

Excuse me? Right now, zero investors are protected because there is no reporting at all. Such a blatantly false statement destroys the Applicant's credibility and is an insult to the Commission and its staff. Reinstating the company's reporting obligations would extend protection to all of the existing shareholders as well as all potential shareholders. Given the company's repeated history of anti-shareholder activities, the shareholders of W2007 Grace Acquisition I seriously need protection by the SEC.

The Applicant makes no serious argument that the exemption is in the public interest.

Likewise, the Applicant does not make any serious argument that it is in the public interest to permit the company to get away with its egregious treatment of its shareholders. The company and its affiliates have engaged in a number of acts that are inconsistent with the public interest. It is not in the public interest to reward the intentional shareholder suppression behavior of the company. These acts, detailed in my first comment letter and not repeated in detail here for brevity, include:

- Suppressing the secondary market in the preferred shares by refusing to release information to the public that is necessary for a fair and orderly secondary market.
- Suppressing the marketability of the shares by not making them eligible for electronic transfer at DTC.
- Disenfranchising preferred shareholders by refusing fill vacant board positions.[6]

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sections or subsections of this title, classify issuers and prescribe requirements appropriate for each such class.

[6] Section 3.3 of the company's by-laws clearly gives the board of directors the ability to fill vacant board positions. No explanation has been given as to why the board has failed to fulfill this basic corporate governance task. The

- Trading on the basis of material nonpublic information by purchasing large blocks of shares in the secondary market (which had no public information whatsoever) just before the share price doubled.
- Secretly engaging in a potentially illegal tender offer for 35% of the shares, in apparent violation of the 9.9% ownership restrictions.[7]

It is in the public interest that the public investors of NYSE- and NASDAQ-listed firms be protected from activities that seek to expropriate the value of their investments. This is one of the reasons why our corporate laws and our securities regulations exist. A lack of adequate shareholder protection will deter investment and thus reduce capital formation and economic growth. These shares were once listed on the NYSE. Shareholders of exchange-listed companies should not be treated like this in a going private transaction.

<u>The company cites the number of NOBOs, not the number of total beneficial holders.</u>

The supplement contains numbers showing the purported number of non-objecting beneficial owners. This understates the number of public shareholders because it does not include the number of objecting beneficial owners. It is quite conspicuous that the company does not display the total number of beneficial holders, both objecting and non-objecting. This number can easily be estimated by looking at the bill that the company gets from Broadridge for distributing materials to shareholders, as I mentioned in my previous comment letter. **It appears that the Applicant may have consciously chosen to display the smaller number of NOBOs in an attempt to make the total number of public investors appear smaller.**

The Applicant argues that there is a declining trend in the number of NOBOs, and that therefore there is no need to protect the remaining shareholders. This argument also makes no sense. To see how absurd this argument is, consider a company with 10,000 public shareholders, in which the number shows a declining trend to 9,999. Does this declining trend imply that the 9,999 remaining shareholders deserve no protection under our securities laws? Of course not. The decline that has occurred in the number of NOBOs can be attributed to the shareholder suppression activities of the company.

The remaining shareholders still need protection, and the Applicant has made no attempt to argue how small the number of public investors needs to be in order for it to be in the public interest to deny them the protection of our securities laws.

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by-laws can be found at http://www.snl.com/Cache/1500031688.PDF?Y=&O=PDF&D=&FID=1500031688&T=&IID=103147 .

[7] The supplement claims, without justification, that the 35% ownership does not violate the 9.9% ownership limit contained in the company by-laws. If the 9.9% limit is no longer valid, why is it still in the company's charter on its web site? Why was no public announcement made of the elimination of this limit? The charter can be found at http://www.snl.com/Cache/1500020372.PDF?Y=&O=PDF&D=&FID=1500020372&T=&IID=103147.

The supplement did not dispute the size of the company.

One of the criteria upon which the statute calls upon the Commission to consider is the nature and extent of the activities of the issuer, and the income or assets of the issuer.

While in the original application the Applicant attempted to misleadingly portray the company as a small entity with "no employees" and a "small economic interest" in some hotels, I rebutted this point in my first comment letter by pointing out that the large size of the firm. For the record, the 2012 financial statements report assets of $1.6 billion and total revenue of $426 million. This is hardly a "small economic interest."

The supplement did not dispute any of the comment letters with respect to the size of the company. Indeed, the supplement is silent on this issue, so it appears that the Applicant concedes the point. W2007 Grace Acquisition I is a very large corporation that easily has the resources to fulfill its reporting obligations.

What is the company hiding?

The company has hired very expensive legal talent to wage this battle before the Commission. It is likely that the company has spent more on this proceeding than it would have to just make the required filings with the SEC. This large expenditure makes it look like the company is trying very hard to hide its activities, which leads to natural suspicions that it is doing bad things. I call upon the SEC to investigate to find out what the company is trying to hide.

The supplement completely ignores the Class D shares, which easily push the company over the 300 shareholder threshold.

The supplement states (with emphasis added):

> "Similar to the circumstances in the BF Enterprises application for exemptive relief, it is **undisputed that the only reason** why the Company would be deemed to have 300 or more record holders is the action of a single beneficial owner to transfer ownership of shares of the Company's common stock to 300 trusts for the sole purpose of attempting to cause the Company's reporting obligations under Section 15(d) to be reinstated."

This statement is clearly false, and its false assertion calls into question the credibility of all of the company's representations in this matter. This statement is false for two reasons. First, in my original comment letter I pointed out that the firm has admitted in its original application to having over 100 Class D preferred shareholders. These Class D shares were admittedly created by the company for REIT compliance purposes, to make sure that the company always had the 100 shareholders needed to retain REIT status. **If one adds the Class D shareholders to the 280 shareholders of record that the**

<u>company admits to for the Class B and Class C shares, then the company clearly has more than enough shareholders to require a resumption of its SEC reporting obligations.</u>

Second, many of the commenters, myself included, came up with different counts of the number of shareholders of record, so the number is in dispute regardless of the SEC's decision with respect to the JMS trusts. I reported in my first comment that the list of shareholders I was shown in conjunction with one of the failed shareholder meetings had more than 300 names. It is thus false that it is undisputed that the only issue here is the counting of the JMS trusts.

<u>Please monitor the upcoming shareholder election.</u>

It appears that the company will once again go through the motions of holding an election for the vacant director positions belonging to the preferred shareholders on August 27, 2013.[8] The company has done this several times in the past and each time claimed that there was no quorum of shareholders, and allowed the positions to remain vacant. The company's charter and bylaws clearly give the board of directors the ability to fill those vacant positions, yet the board has failed to fulfill its fiduciary duties in filling the vacant positions.

The upcoming election is even more interesting given that an affiliate of the company now appears to own 35% of the preferred shares. This could make it very easy for the company to continue its campaign of minority shareholder suppression by not representing the shares at the meeting. This would make it extremely difficult, if not impossible to get a quorum. This could mean that the board positions belonging to the preferred shareholders will continue to be vacant, enabling the controlling party to strip assets from the firm to the detriment of the preferred shareholders. I call upon the SEC to pay close attention to the activities of the company around the election. If the company understands that it is under closer scrutiny by the SEC and the public media, it will be less likely to continue stonewalling the shareholders and may become more shareholder-friendly, which is what we really want.

If you have any questions, feel free to email or call me. You don't need to redact any of my contact information.

Respectfully submitted,

James J. Angel, Ph.D., CFA

[8] See https://central.virtualshareholdermeeting.com/vsm/web.do?pvskey=gracepreferred13 .

http://www.nytimes.com/2013/06/14/business/securities-rules-can-leave-investors-in-the-dark.html?pagewanted=all&_r=0

The New York Times

June 13, 2013

Going Dark, and Putting Blindfolds on Investors

By FLOYD NORRIS

What happens to investors who buy securities issued under the protection of United States securities laws and continue to hold them after many of the protections are removed? Sometimes it is not pretty.

That is happening more and more often as companies avail themselves of the right to “go dark” because they do not have very many public shareholders. They no longer have to file financial information with the Securities and Exchange Commission, but the securities are still publicly traded.

These days, such investors seem to have few friends. Congress is much more interested in making it easier for companies — or “job creators” in the current jargon — than it is in protecting unfortunate investors. The so-called JOBS Act, enacted last year with widespread bipartisan support, included a provision making it much easier for small banks to go dark, and hundreds have done so.

Going dark, it should be noted, is not the same thing as going private. When that happens, securities are purchased from the public investors. They may not like being forced out, but they are out.

Not so when a company goes dark. The investors are in, but they may or may not be told what is going on. Companies that go dark sometimes make audited financial statements public, and sometimes they do not.

There is no better example of the perils of going dark — as well as proof that “preferred” can be a misnomer when it comes to stock — than the former Equity Inns, an owner of hotels, whose common shares were acquired by Goldman Sachs in 2007.

Although the common shares went away, preferred shares remained — or actually, new issues of preferreds replaced old ones. What has happened since then “smells like insider trading,” says James J. Angel, a finance professor at Georgetown University and an investor in the preferred stock. Goldman says that is nonsense.

While Goldman acquired the common stock, for $23 a share, or $1.9 billion, it did not acquire the $146 million of preferred shares in public hands. Those shares were in par values of $25 and had been sold primarily to individual investors interested in collecting a reasonably safe income stream. One series paid 8.75 percent a year, and the other 9 percent.

Before the takeover, those shares had been trading above par, and Goldman could have called them at par value. Instead, it took the preferred shares into the dark. The company assured the S.E.C. that there were fewer than 300 shareholders of record for each series of preferred, giving the company the right to go dark. The securities continued to trade over the counter in what Wall Street calls the "gray market."

Goldman soon halted the dividend payments, and the share prices fell to as little as a penny.

How was the company doing? The financial statements were confidential, but Goldman did agree to let preferred shareholders see them — for a fee — as long as they signed confidentiality agreements that would prevent them from sharing the statements with anyone else, including prospective buyers of the shares.

Someone has, however, violated that confidentiality agreement. After I began calling around for this column, a set of financial statements arrived in an envelope with no return address. Assuming they are accurate, they show that over the three years through 2012, the company had net losses of $315 million on revenue of $1.2 billion. But most of those losses came from $251 million in depreciation. Operating cash flow was a positive $174 million. Told of some of the numbers in the statement, a Goldman spokeswoman did not dispute them.

Those numbers, however, are for the entire company. The preferred shares seem to have an interest in only 1 percent of the assets. If Goldman could find a way to put the 1 percent owner in bankruptcy, while keeping the other 99 percent out, it might be able to largely eliminate the preferred.

Even that might not be necessary. Goldman was also the lender in the deal, and perhaps it could restructure the debt in ways that would essentially give the debt holders — Goldman, that is — the ability to get everything, leaving the preferred shareholders with nothing.

Evidently, few saw any value in the preferred shares. But then prices began to rise, and in September the company disclosed that "a sister company" — presumably another Goldman affiliate — had "recently" acquired "approximately 35 percent" of the outstanding preferred shares. This week Goldman told me that it bought all of the shares in one private transaction from a single seller. It would not identify the seller or the price, but said it had not made any further purchases or sales since then.

The September purchase amounted to about as many shares as had traded in public markets in the previous six months. It is not clear when the seller accumulated them, and Andrea Raphael, a Goldman spokeswoman, denies there was any advance agreement to purchase them. Mr. Angel sees evidence of a violation of insider trading laws, but Ms. Raphael says that is ridiculous.

"We complied with applicable law in all respects," she said. "Any assertions otherwise are based purely on speculation."

If the company — whose formal name is now [W2007 Grace Acquisition I] — were still registered with the S.E.C., and the preferred shares traded on an exchange, we would not have to wonder about this. Anyone who acquired more than 5 percent of the issue would have been required to disclose that fact — as well as the prices paid for recent purchases. But such protections for investors vanish when a company goes dark.

The fact of the purchase breathed new life into the shares. If Goldman, which controls what will happen, saw value in the preferred, surely there was value, or so some traders evidently concluded. The price, which had risen to $4 from about $2 in the months before the disclosure, has now climbed to about $9.

This has become news now because one preferred shareholder, Joseph M. Sullivan, a Sacramento accountant, took it upon himself to assure that the preferred shares had more than 300 owners of record. In December, he set up 301 separate trusts to hold his shares, each of which he said had different beneficial owners but the same trustee — himself. He demanded that the company file its financial statements with the S.E.C.

In April, a lawyer for Goldman, William G. Farrar of Sullivan & Cromwell, asked the S.E.C. to issue an order exempting the company from any need to file with the commission. The issuer of the preferred shares, he explained, was "simply a real estate investment firm with a small economic interest in 130 hotels and no employees" and Mr. Sullivan was engaging in subterfuge to force the company to resume its filings.

The S.E.C. chose to ask for public comment on the request, bringing letters of protest from a number of shareholders, including Mr. Sullivan, who told me he would disclose the identities of the beneficial holders to the S.E.C., but only if it promised not to make them public.

There is no question that the level of 300 owners of record is a magic number in determining whether the company must resume filing with the S.E.C. There is no doubt that there are more than 300 beneficial owners even without counting Mr. Sullivan's trusts. But the rules allow companies to ignore many such owners if all their shares are held at the same brokerage firm. Mr. Sullivan would like the S.E.C. to make it harder for companies to go dark and stay dark.

Even if he prevails in that, it is far from clear what he will have accomplished. Public filings would make it easier to see what was going on, but Goldman would still have all the cards and might find ways to assure that the preferred holders received little or nothing from their investment.

There is one sidelight to this that emphasizes how convoluted it can be when a company has public investors but chooses to keep the public in the dark. The company's charter, available on its Web site, seems to say no one can buy more than 9.9 percent of the preferred shares. But the Goldman affiliate did. The rules do not apply if the company gives up its tax status as a real estate investment trust, or REIT, but nothing I could find on the Web site indicates that happened. In his letter to the S.E.C., Mr. Farrar, the lawyer for Goldman, referred to the company's "REIT sub," short for subsidiary, which sounds as if it is still a REIT.

Not so, Goldman assured me. The company gave up its REIT status years ago and disclosed that in financial statements that are not public.

So why did Mr. Farrar use the language he did?

"Historically it was referred to internally as the 'REIT sub' and we simply continued that reference," Ms. Raphael said. "The reference is not indicative of the company's tax status."

Goldman fund haggles with REIT investors over 10-cent printing fee

June 13, 2013 @ 7:14 pm

By Lauren Tara LaCapra

[1]***A Goldman fund's REIT charges investors 10 cents per page for financial statements.***

Of all the accusations made by an aggrieved group of REIT investors against Goldman Sachs, perhaps the most surprising is how stingy the bank can be.

A Goldman fund that manages the REIT, formerly known as Equity Inns Inc, requires investors to pay 10 cents per page for print copies of its financial reports. Those reports are not available online, nor are they released publicly — a fact that has led this long-running feud to spill into public view in comment letters to the SEC.

"When I asked for financial reports they said, 'Can you send a check?,'" Art Chandler, an investment advisor at Wedbush Securities, said in an interview. "And I said, I would be glad give you $6 out of the $150,000 in accrued dividends you owe me."

Another investor, Joseph Sullivan was not allowed to use a personal check or money order. He was required to get a cashier's check.

Sullivan has been more of a thorn in Goldman's side. He established 300 trusts, each of which holds some amount of preferred shares in the REIT, now known as W2007 Grace Acquisition. His move could force the REIT to start filing annual 10-K statements to the SEC. As it stands, preferred shareholders who want those statements must not only mail in the 10-cent-per-page fee, but sign a confidentiality agreement.

"By restricting the availability of financial information and preventing the holders of the Securities from communicating financial information about the Securities to third parties, Goldman Sachs has acted to depress investor interest, trading activity and the market value of the Securities," Sullivan wrote in his comment letter [2] on May 31. "As described above, these actions have taken place at a time that Goldman Sachs was buying the Securities for its own account."

Letters like Sullivan's poured in after William Farrar, a Sullivan & Cromwell attorney working for W2007 Grace Acquisition, formally applied for exemption [3]from reporting requirements in an April 4 letter to the SEC. Farrar argued that the REIT only has 280 preferred shareholders if all of Sullivan's trusts are counted as one holder. He also argues [4] that his client has acted properly and that as a small company with a handful of lightly traded preferred shares, it shouldn't have to endure the cost and headache of public financial reporting.

The preferred owners are quick to cut holes in this argument. First, they say, W2007 Grace Acquisition can't possibly be a small company with no employees, as Farrar asserts, since it has $1.6 billion in assets and interests in 130 hotels. They also note that a Goldman affiliate scooped up 35 percent of the outstanding preferred stock from investors who threw in the towel, with the effect of shrinking the shareholder base.

Preferred investors also cry foul on the SEC's methodology for tallying them up. Because the applicable rule looks at "holders of record" rather than "beneficial owners," many investors are consolidated into few because their assets are assigned to the brokerage firms where their shares are held. Chandler, for instance, has 40 clients but only 10 are listed as holders because of that definitional quirk.

Technically, Goldman itself does not own W2007 Grace Acquisition or any of the shares; one of its Whitehall real estate funds does. Whitehall Global Real Estate Limited Partnership 2007 bought out Equity Inns' common stock and assumed debt in a $2.2 billion deal in October 2007. Preferred shareholders were left in a sort of limbo: they were given the right to exchange their holdings into a new preferred stock, which soon stopped paying dividends and lost nearly all of its value as the global financial crisis seized markets the following year.

Goldman itself hasn't had a great time with its Whitehall funds either. Some made big acquisitions at the top of the real-estate market that in hindsight looked extremely foolish. Its international fund, for instance, dropped to $30 million by 2010 from about $1.8 billion, according to the Financial Times [5].

But things have turned around for hotel REITs lately, with trusts like Summit Hotel Properties, Host Hotels & Resorts and Ashford Hospitality Trust posting returns of 16 to 81 percent over the past year. As a result, preferred holders of W2007 Grace Acquisition are furious that their shares are trading at just a fraction of their $25 par value and that their dividends have been suspended for the better part of five years, while the Whitehall fund and a separate Goldman loan entity collected fees and exercised an option to acquire 97 percent of the REIT's assets in exchange for forgiving its debt.

"These monetary payments to GS are very troubling," Andrew Siegel, managing member of White Bay Capital Management, said in his comment letter [6]. He also noted that "the practical effect of this recapitalization was the issuance of equity of W2007 Grace to Goldman Sachs that would be structurally senior to the Grace Preferred Stock, to bypass public investors."

A Goldman spokeswoman did not immediately respond to a request for comment on Thursday evening, but told the Wall Street Journal [7] this week that preferred holders should have known about the risks involved with their investment.

The end-game for the preferred holders isn't entirely clear. Even if they win the SEC battle, they may never get their dividends and exiting their positions would be costly. Some have launched a lawsuit over the deal, which is wending its way through court in Tennessee [8], but will likely take years to resolve.

As these things tend to go, it may turn out that a big bad bank gets a black eye for beating up the little guy, but was savvy enough not to break any rules.

[1] Image:**http://blogs.reuters.com/unstructuredfinance/files/2013/06/change.jpg**
[2] Sullivan wrote in his comment letter: **http://www.sec.gov/comments/81-939/81939-25.pdf**
[3] formally applied for exemption:**http://www.sec.gov/rules/other/2013/34-69477-application.pdf**
[4] also argues: **http://www.sec.gov/rules/other/2013/34-69477-supplementalletter.pdf**
[5] according to the Financial Times:**http://blogs.reuters.com/unstructuredfinancewww.ft.com/cms/s/0/84639172-48ef-11df-8af4-00144feab49a.html#axzz2W8Ya8GrC**
[6] his comment letter: **http://www.sec.gov/comments/81-939/81939-12.pdf**
[7] told the Wall Street Journal:**http://blogs.reuters.com/unstructuredfinanceonline.wsj.com/article/SB10001424127887324049504578541603072663338.html**
[8] wending its way through court in Tennessee:**http://blogs.reuters.com/unstructuredfinancewww.bizjournals.com/memphis/news/2013/06/11/years-later-equity-inns-case-still.html?page=all**

- THE WALL STREET JOURNAL.
  WSJ.com

- DEALS & DEAL MAKERS
- June 12, 2013, 4:56 p.m. ET

Hotel Deal Sparks Feud Over Preferred Shares

Value of Equity Inns' Preferred Shares Dropped After Goldman Fund Bought the Hotel Owner

- CRAIG KARMIN
- LIZ MOYER

Some preferred shareholders in hotel owner Equity Inns were hoping that a $2.2 billion acquisition by a Goldman Sachs Group Inc. GS +1.21%real-estate fund would mean a nice payout alongside the common stockholders, who got a hefty premium.

Instead the value of the preferred shares has plunged. Goldman says that is because the preferred shareholders didn't read the small print. The investors say it is because the company and Goldman overstepped their authority.


Claudio Papapietro for The Wall Street Journal

Goldman Sachs headquarters

At the heart of the dispute is a reorganization from the 2007 acquisition. Equity Inns exchanged the publicly traded preferred shares for unlisted ones. Preferred shares get preference over common shares in a liquidation but they usually lack voting rights.

The company also stopped filing financial reports and a few months later, it suspended the dividend paid to preferred shareholders.

Preferred shares were trading above $25 at the time of the merger's announcement and fell as low as 5 cents each in 2009. Now they're worth around $9 each.

A Goldman spokeswoman said the risk was spelled out in the company's preferred shareholders' prospectus. The documents say that these investors could lose their "protection in the event of a highly leveraged or other transaction, including a merger" or sale that "might adversely affect" the preferred shareholders.

Preferred shareholders, however, are crying foul. They say that the hotel company had no authority to convert publicly listed preferred shares to unlisted preferred shares that are worth less because of their illiquidity.

They're also unhappy because a Goldman affiliate purchased two million preferred shares last year when the shares were trading on the OTC Bulletin Board at around $4 per share. They say that is not fair because Goldman has better access to the company's financial information than they do. Goldman declined to comment on those shareholder complaints.

"When shareholders need to sell, the only buyers are the corporate insiders who know what is actually happening inside the company," Georgetown University finance professor James Angel, a preferred shareholder, wrote to the Securities and Exchange Commission.

The issue has heated up in recent weeks because the SEC, at the hotel company's request, is considering whether to instruct the hotel company to start filing financial reports for the benefit of the preferred shareholders. An SEC spokeswoman declined to comment on the status of the case.

The dust-up is the latest example of the hazards that sometimes face preferred shareholders. They typically get paid before common shareholders when things go wrong. But they can find themselves stuck when things go right and the company attracts a new owner.

In 2009, after private-equity firm Green Courte Partners acquired American Land Lease Inc., a manager of residential land-lease properties, it stopped providing financial information to the preferred shareholders. DRA Advisors suspended the preferred shareholders' dividend after taking over CRT Properties Inc., which owned 137 office buildings, in 2005. The companies didn't respond to requests for comment Wednesday.

In the case of Equity Inns, some shareholders acknowledge they should have paid closer attention to the reorganization. "Most of the shareholders were inert," Mr. Angel says. "As long as we're being paid dividends, what's there really to worry about?"

Based in Germantown, Tenn., Equity Inns was founded in 1993 and grew to become the third-largest U.S. hotel real-estate investment trust. With about 130 properties in 35 states, it owned a mix of extended-stay and select-service hotels carrying names such as Marriott Courtyard and Residence Inn.

The REIT issued a series of preferred shares to raise money for acquiring many of these hotels, and at one point the preferred shares accounted for about a third of the company's total shareholder equity.

In June 2007, one of Goldman's Whitehall funds agreed to acquire the company, offering common stockholders 19% more than the share price at the time. A few weeks later, Equity Inns said the preferred shares, which traded on the New York Stock Exchange, were being swapped for unlisted preferred stock in the new company.

Some preferred shareholders sued in Tennessee court in 2007, claiming the board breached its fiduciary duty to the preferred holders by causing their shares to fall in value. They weren't able to block the acquisition. But in April, a Memphis court approved a class-action status for the lawsuit. The company said it believed the lawsuits were without merit.

The company has argued that it doesn't need to submit financial reports to the SEC partly because there is a "limited trading interest in the Company's preferred stock."

This frustrates the preferred shareholders who claim that the limited trading is largely because the company makes it so difficult for the public to obtain financial information. For preferred holders to get data, they have to make a written request, pay a small fee and agree that all company information remain confidential.

Those conditions discourage outsiders from buying shares in a company where basic financial information is unattainable, "either independently or from a shareholder interested in selling," Charles Reaves, an attorney who represents a preferred owner, wrote to the SEC.

The hotel company also has told the SEC that it shouldn't have to file financial reports because the company has fewer than 300 shareholders. That falls below the usual SEC threshold for public filings.

One of the preferred shareholders is responding by creating 300 separate trusts to hold his preferred shares. He argues that should qualify the company for reporting.

A version of this article appeared June 13, 2013, on page C3 in the U.S. edition of The Wall Street Journal, with the headline: Goldman in Flap Over Hotel Deal.

http://dealbreaker.com/2013/06/goldman-made-some-preferred-stock-investors-sad/#more-105343

13 Jun 2013 at 5:49 PM

Goldman Made Some Preferred Stock Investors Sad

By Matt Levine

How shady is this morning's delightful *Journal* story about the travails of Equity Inns preferred stockholders? I think the answer is "just the right amount of shady," but you might disagree. The gist is that Goldman Sachs real estate private equity funds bought out Equity Inns but left almost $150mm of preferred stock outstanding. Once ENN was no longer a public company (because Goldman owned all its common stock and it had fewer than 300 shareholders), it delisted its preferred stock and stopped providing public financial information.[1] This saddened the preferred holders and they expressed their sadness by bidding down the price of the preferred to under 40 cents on the dollar.

Also by complaining to the company, and the SEC, and the *Journal*, and anyone else who will listen. Also by doing this:

One of the preferred shareholders is responding by creating 300 separate trusts to hold his preferred shares. He argues that should qualify the company for reporting.

Should it? I don't know but I love it. You gotta fight silly formalism with silly formalism.

That's the best part but there's a lot of other stuff going on. For instance here is a fun insider trading problem:

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This frustrates the preferred shareholders who claim that the limited trading is largely because the company makes it so difficult for the public to obtain financial information. For preferred holders to get data, they have to make a written request, pay a small fee and agree that all company information remain confidential.

The amazing thing about the request form is not so much that Equity Inns charges 25 cents a page for its information (2012 financials = $6 for 24 pages), or that you can ask for "Other corporate documents that you believe you are legally entitled to" if you can describe them in detail, but the confidentiality acknowledgment:

Furthermore, except as otherwise authorized by the Company, the Shareholder agrees that he/she/it will not at any time, whether during or after the cessation of the Shareholder's status as a shareholder, disclose, distribute, disseminate, or make public any information included in the Shareholder Package or other Company Confidential Information, and that the Shareholder will keep strictly confidential all information contained in the Shareholder Package or other Company Confidential Information.

So there you are with your preferred shares and you think you might want to sell them. To make sure I guess you'd want to look at some financial information, so you write to the company, pay your six bucks, get 2012 financials, examine them, and decide that you do in fact want out. And so you go find a buyer. And now you have a problem: you have material information (2012 financials!) that is not publicly available and that you're not allowed to reveal to anyone. So … what? So you can't sell, I think? If you're a shareholder, your choice is pretty much (1) sell shares without knowing anything about the company or (2) hold on to your shares forever. Or of course sell to an existing holder. Such as:

They're also unhappy because a Goldman affiliate purchased two million preferred shares last year when the shares were trading on the OTC Bulletin Board at around $4 per share. They say that is not fair because Goldman has better access to the company's financial information than they do. … "When shareholders need to sell, the only buyers are the corporate insiders who know what is actually happening inside the company," Georgetown University finance professor James Angel, a preferred shareholder, wrote to the Securities and Exchange Commission.

There are about 5.85mm shares of these preferreds, with a $25 liquidation preference, a B2 rating at Moody's, and 8.00% and 8.75% coupons, meaning that $4 a share is like a 50% yield. Pretty good! (Now the *Journal* says they're at $9-ish, or like a 20-25% yield, which … seems fair for an unlisted junk-rated private REIT preferred?[2])

The Journal has this poignant quote:

[S]ome shareholders acknowledge they should have paid closer attention to the reorganization. "Most of the shareholders were inert," Mr. Angel says. "As long as we're being paid dividends, what's there really to worry about?"

Well but what would they have done? The merger did not require the approval of the preferred shareholders, and the merger proxy made clear that "the surviving corporation's … preferred stock will not be listed on any securities exchange nor registered under the Securities Act or the Exchange Act." And, as Goldman points out, the preferred stock prospectuses do say that preferred holders will not have any "protection in the event of a highly leveraged or other transaction, including a merger or the sale, lease or conveyance of all or substantially all our assets or business, that might adversely affect the holders of the Series C Preferred Stock." Nothing in the preferred stock, or the disclosure documents, or anywhere else, protected the preferred holders, and Equity Inn and Goldman have no fiduciary duty towards them. They were hosed; all they could really do was sell to some greater fool before the merger. Presumably some of them did.

One theory of how LBOs make money for their investors is that they effectively swipe it from pre-existing creditors.[3] A big company is bopping along with $1bn of investment-grade debt, and all of a sudden KKR buys it and levers it up with $4bn of new debt, trashing the credit rating and reducing the value of the existing debt to, say, $800mm. That lost $200 million has to go somewhere,[4] and the natural place for it to go is to the new equity holders. The fact that their money could all of a sudden be stolen like that troubles bond investors, so they tend to build protections into their bonds, though only sometimes. Many investment-grade covenant packages don't protect against this, for instance.

And preferred stock doesn't at all: these poor fools who bought Equity Inns preferred stock (look at that 8.75% dividend!) are more or less locked in forever, unless they want to sell to the investors who bought out their company. And those investors would be happy to buy from them, at pennies on the dollar (and at a 50% yield). Which is a nice way to improve the performance of their buyout at the expense of the often-retail buyers who were seduced by high coupons into buying preferred stock even though it left them open to being hosed exactly like this. And then they were.

Hotel Deal Sparks Feud Over Preferred Shares [WSJ]

1. *The Securities and Exchange Act of 1934 requires exchange listed companies to make public filings, and Section 15(d) of that Act requires anyone who has ever registered securities to file forever except that:*

The duty to file under this subsection shall also be automatically suspended as to any fiscal year, other than the fiscal year within which such registration statement became effective, if, at the beginning of such fiscal year, the securities of each class, other than any class of asset-backed securities, to which the registration statement relates are held of record by less than 300 persons …

2. *I kid, I kid. Random snooping finds me Glimcher Realty Trust's 7.50% preferred stock, which is rated B2/B- and trades with a 7 handle. That's listed, though. And you can get financials. I dunno. Is the not listing worth like 15% a year?*

3. *Not hugely popular as a **main** value driver:*

Also unsupported is the charge that losses to bondholders finance the shareholder gains from takeovers. Although some shareholder gains have come at the expense of bondholders, banks, and other creditors who financed these deals, Michael Jensen estimates that the aggregate amount of these losses between 1976 and 1990 is not likely to exceed $50 billion, a small fraction of the $650 billion gain to target shareholders.

4. *Does it? That's a Modigliani-Miller-ish thing to say.*