MEMORANDUM

TO: Council, AP and SSC Members

FROM: Clarence G. Pautzke
Executive Director

DATE: January 7, 1991

SUBJECT: Foreign Ownership

ACTION REQUIRED

Review GAO report on Anti-Reflagging Act and recent changes in U.S. marine financing laws.

BACKGROUND

Originally, three foreign ownership topics were to be covered under this agenda item: (1) the General Accounting Office's report on the Anti-Reflagging Act, (2) recent changes in marine financing laws, and (3) the GAO report on foreign ownership requested by the Council in September 1989. GAO has completed a draft report on item 3, but it's not yet available to the Council.

Anti-Reflagging Act of 1987

The GAO's report to Senator Packwood, evaluating the effects of the Anti-Reflagging Act of 1987, is under this tab as C-9(a). The Act had three main provisions:

1. American control requirements were increased for ownership of U.S. vessels,

2. Processing vessels that enter the fisheries after the Act must be U.S. built, and

3. Owners are prohibited from using vessels rebuilt abroad in U.S. fisheries.

GAO concludes that the Act's greatest impact was on stopping the foreign rebuilding of U.S. vessels. The Act grandfathered vessels that already had been contracted for rebuilds in foreign yards. About 15 factory trawlers were rebuilt in foreign yards after the Act because of these grandfather exemptions, but all had to be delivered by July 28, 1990. So, with the possible exception of one additional vessel seeking an exemption, the GAO concludes that further rebuilding in foreign yards will cease.

American control is another matter. Before the Act, there were about 29,000 vessels licensed or being purchased to operate in the fisheries. All are subject to the following, less stringent, pre-Act American control provisions:

1. Company's stock could be totally owned by foreigners.
2. CEO and Chairman of the Board had to be U.S. citizens.
3. Number of foreigners on Board of Directors could be no larger than a minority of the number of directors necessary for a quorum.

Only about 2,000 vessels, new since the Act, are subject to the following, more stringent control provisions:

1. Majority of voting stock has to be owned by U.S. citizens.
2. U.S. citizens have to have majority of voting power.
3. No contract or understanding or other means could allow voting power to be exercised in favor of a foreigner.

All vessels in the fisheries before the Act were exempted from the new control provisions, and will remain so, because the Coast Guard has interpreted the grandfather rights to run with the vessel, not the owner. Therefore, a vessel can be bought and sold many times, and through periodic rebuilding in the U.S., remain in the fisheries almost indefinitely under the less stringent, pre-Act American control requirements.

The Coast Guard has been challenged on its interpretation of the legislation, but remains resolved to continue it as shown in the final rule, published December 12, 1990, on documentation of vessels and controlling interest (item C-9(b)). The Coast Guard contends that the Anti-Reflagging Act and its intent were very clear in allowing the grandfather rights to run with the vessel. The Coast Guard does not intend to change this position until Congress changes the legislation.

U.S. Marine Financing Laws

The Marine Digest article under C-9(c) says that new financing laws passed in January 1989 allow a foreign mortgage holder to assume ownership of a vessel in which it had interest, that is auctioned as a result of bankruptcy proceedings. According to the article, before 1989, if a ship mortgage was foreclosed, the foreign beneficiary of the mortgage could not buy the vessel at a Marshal's sale. Since January 1, 1989, the new federal ship mortgage laws allow a foreign mortgagee to buy a fishing vessel and hold it for resale. The foreign mortgagee may then sell the vessel to a U.S. corporation whose stock is owned entirely by foreign citizens. The article concludes that as a result foreign investment in the U.S. fishing fleet is now easier, cheaper, and less visible.

NOAA GC-AK has been asked to review and comment on the conclusions of the article at this Council meeting.

United States General Accounting Office

GAO

Report to the Honorable Bob Packwood, U.S. Senate

COAST GUARD

Anti-Reflagging Act Has Mixed Impact on U.S. Fishing and Ship Rebuilding

GAO/RCED-91-27

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-237971

October 25, 1990

The Honorable Bob Packwood
United States Senate

Dear Senator Packwood:

On June 13, 1989, you asked that we evaluate the effect of specific provisions of the Commercial Fishing Industry Vessel Anti-Reflagging Act of 1987. In general, this act, implemented by the Coast Guard, was enacted to help ensure control by Americans of the U.S. fishing industry in U.S. coastal waters. As requested, this report provides our evaluation of the impact of the act's provisions for

- ensuring American control of fishery operations by establishing more stringent U.S. vessel ownership requirements and
- prohibiting vessels rebuilt in foreign countries from participating in U.S. fisheries.

We have also gathered information regarding your specific interest in (1) the act's impact on the groundfish[1] industry off the coast of Alaska and (2) the Coast Guard's procedures for enforcing certain of the act's prohibitions. This information is contained in appendix I.

During our review, litigation was initiated against the Coast Guard challenging, in part, whether its interpretations used to implement the act's grandfather provisions are consistent with the intent of the Congress. These provisions, discussed in sections below, exempt vessels from meeting the act's ownership and vessel-rebuilding requirements, if certain conditions are met. In view of this litigation, we agreed with your office not to evaluate the issues that are before the court.

Results in Brief

The act's American control provisions have had little impact on ensuring increased American control of the U.S. fishing industry. This results from the Coast Guard's interpretation of the act's grandfather clauses, which exempt vessels from meeting the American control provisions if the vessels were licensed under U.S. law and operating in U.S. coastal waters before July 28, 1987—about 6 months before the act was passed. The Coast Guard has interpreted that the grandfather exemptions

[1]Groundfish are fish that are caught on or near the sea floor. Some examples of groundfish stocks off the coast of Alaska are Pacific cod, sablefish, flounders, Alaska pollock, and various types of rockfish.

remain with the vessels even if the vessels are subsequently sold to foreign-owned companies. This interpretation gives foreign-owned companies continued access to U.S. fisheries.

By contrast, the act's prohibitions against foreign rebuilding of vessels used in U.S. fisheries are likely to have a significant impact. This is so because the grandfather exemptions that allowed foreign rebuilding are tied to specific deadlines, all of which have passed. Generally, vessels rebuilt in a foreign country were required to be delivered to the owners before July 28, 1990, in order to be eligible for U.S. fishery privileges. Because the deadlines have passed, owners who desire to rebuild their vessels and who wish to participate in U.S. fisheries will likely rebuild in U.S. shipyards.

Background

Unregulated fishing and concern for depletion of fish stocks relied upon by coastal fishermen across the nation resulted in attempts to ensure control of the U.S. fishing industry by Americans (i.e., Americanize the industry) as early as 1971. These Americanization efforts continued under the Magnuson Fishery Conservation and Management Act, which was passed in 1976. The Magnuson Act established exclusive U.S. management of fisheries out to 200 miles off our shores and gave priority to U.S. fishermen and vessels for receiving fish quotas within the 200-mile limit.

Although the Magnuson Act led to increasing American control of our fishing industry through U.S. fishery management, several concerns developed among fishermen, shipbuilders, and others over some remaining barriers to the Americanization process. One concern was that the existing American control requirements for licensing a corporate-owned vessel under U.S. flag were minimal. These requirements allowed, for example, a company's stock to be totally owned by foreigners. A second concern was that foreign owners could merely reflag[2] their foreign-built fish-processing vessels[3] as "vessels of the United States" and operate within the U.S. fishery, thus gaining first priority to process fish caught by U.S. fishing vessels. Third, although

[2]To reflag, a vessel gives up its foreign registry and becomes licensed (documented) under U.S. laws to participate in trades, such as the fishery. (See app. I for details on the documentation process.)

[3]We discuss three basic types of fishing industry vessels in this report: fish-catching only; fish-processing vessels, which are at-sea factory ships that only process fish caught by other vessels; and factory trawlers, which catch fish using trawling nets and process them on board. Before the Anti-Reflagging Act, fish-processing vessels could be foreign built and still process fish within the U.S. fisheries.

before the act any vessels catching fish had to be built in the United States, these vessels retained their U.S.-built status and resulting fish-catching privileges even if they were later substantially rebuilt abroad so that they were essentially new vessels. Fishermen and others told us that many owners were rebuilding vessels abroad because doing so was less costly than rebuilding in the United States.

To address these concerns, the Anti-Reflagging Act was signed into law on January 11, 1988. Its provisions included the following:

- It established more stringent American control requirements for corporations licensing vessels under the U.S. flag by requiring that the controlling interest in the vessel, as measured by a majority of voting stock, be owned by U.S. citizens. In assessing if a vessel is in fact controlled by Americans, it also required that a variety of factors be considered from the Shipping Act of 1916[4] that could lead to foreign control, such as the existence of foreign financing.
- It required fish-processing vessels entering the fisheries after the act was passed to be U.S. built. Foreign-built fish-processing vessels already operating in the fisheries must be licensed to process fish only and are not permitted to catch or harvest fish. This action eliminated the ability of new entrants to reflag foreign-built or foreign-owned fish-processing vessels so as to gain priority access to U.S. fishery resources.
- It prohibited owners from participating in the U.S. fishing industry with vessels rebuilt abroad.

The act also contained several grandfather clauses to protect the financial interests of owners who had become involved in U.S. fisheries under the previous conditions of law. For example, the grandfather clauses allowed an owner, if certain conditions were met, to operate fish-processing vessels used in the fisheries prior to the act without regard to where the vessels were built or to the new stock ownership requirement. Also, under certain conditions, an owner could continue with foreign-rebuilding plans without jeopardizing the vessel's right to participate in the fisheries. (The conditions of these grandfather clauses are explained in later sections of this letter.)

[4]The Anti-Reflagging Act requires that, in determining controlling interest in a partnership or corporation, the criteria in section 802(b) of the Shipping Act of 1916 (46 App. U.S.C. 802(b)) be applied. The Shipping Act conditions for vessel ownership by U.S. citizens include (1) clear title to a majority of the stock, (2) majority of the voting power, (3) no contract or understanding that would allow the voting power to be exercised in favor of a noncitizen, and (4) no other means by which control of the corporation is permitted to be in favor of a noncitizen.

The Coast Guard is responsible for enforcing the Anti-Reflagging Act. Its procedures for doing so, explained in more detail in appendix I, fall into three categories—licensing (called "documentation"), at-sea boarding of vessels, and investigations. If it finds violations, the Coast Guard can impose civil penalties. Actions triggering the imposition of criminal penalties or the seizure and forfeiture of vessels to the United States are referred to a U.S. Attorney.

The Act's American Control Provisions Have Had Little Impact

The act's American control provisions have had little effect on ensuring U.S.-citizen control of fishery operations. Under the Coast Guard's interpretation of the act's grandfather clauses, vessels that meet applicable conditions are permanently exempt from the act's American control provisions. According to the Chief of Vessel Documentation, nearly all of the vessels licensed for the U.S. fishery at the time the act was passed could likely be grandfathered and, as a result, could be resold to foreign-owned companies that do not meet the new, more stringent conditions. The Coast Guard's interpretation was challenged in court at the time of our review by several U.S. fishing and shipbuilding groups.[5]

Prior to the Anti-Reflagging Act, for a vessel to be documented to fish in American waters, corporate ownership had to meet several citizenship standards. For example, the chief executive officer and the chairman of the board of directors had to be U.S. citizens. Also, the number of non-citizens on the board of directors could be no larger than a minority of the number of directors necessary to constitute a quorum. Notwithstanding these requirements, however, the law allowed 100 percent of the corporation's stock to be foreign owned.

The Anti-Reflagging Act made the American control requirements more stringent for fishery participation by requiring that the majority of voting stock be owned by U.S. citizens. As discussed above, it also added the American control conditions of the Shipping Act of 1916. But under the Anti-Reflagging Act's grandfather clauses, vessels are exempt from these requirements if either of two conditions was met before July 28, 1987: (1) The vessel was licensed under U.S. law and operated as a fishing, fish-processor, or fish-tender vessel in the navigable waters of the United States or the 200-mile zone established by the Magnuson Act, or (2) the vessel was being purchased for such purposes. Thus, a foreign-owned company whose vessel was operating in U.S. waters prior

[5]Southeast Shipyard Association v. United States of America. Filed on May 16, 1990, in the U. S. District Court for the District of Columbia. (Civil Action No.90-1142.)

to July 1987, or that had a contract to buy a vessel to do so, could continue to operate or carry out its plans after passage of the act.

The Coast Guard believes that under the act's wording these grandfather exemptions apply to the vessel, not to the vessel owner. Under that interpretation, a vessel that meets the grandfather conditions has a permanent exemption from the new American control requirements. This means that the vessel can be bought and sold repeatedly without losing fishery privileges, regardless of whether the new owner is a corporation with totally foreign-owned voting stock or other arrangements that offer potential for foreign control.

This interpretation is significant for the U.S. fishing industry because of the large number and percentage of vessels that apparently meet the act's grandfather exemptions. According to the Chief of Vessel Documentation, a total of about 29,000 vessels were licensed for catching fish, and were therefore U.S. built, at the time the act was passed in 1987; and nearly all of them could likely be grandfathered for American control requirements under the act by virtue of the past fishing within the 200-mile limit. By contrast, he estimated 2,000 new vessels constructed and documented for the fisheries in the 2 years following passage of the act are subject to the new American control conditions.

This interpretation is also significant for the groundfish industry off the coast of Alaska. About 86 percent of the vessels we reviewed (see app. II for a description of vessels selected for review) would likely meet the American control grandfather exemptions. According to the Coast Guard's Chief of Vessel Documentation, the lives of these vessels could be extended almost indefinitely by periodic rebuilding in the United States.

In addition, the Chief estimated that about 800 of the 29,000 vessels in the United States, licensed for fish catching when the act was passed, meet the grandfather exemptions and are well suited for rebuilding or conversion into factory trawlers or other types of relatively large vessels that now dominate groundfish operations in Alaska.[6] Thus, any number of these vessels could, at any time in the future, enter the Alaska groundfish fleet without needing to meet the new American control provisions.

[6]U.S.-built vessels can be converted for different fishery activities. For example, a fish-catching vessel could be converted into a factory trawler.

Several U.S. fishing and shipbuilding groups have filed a lawsuit to overturn the Coast Guard's interpretation. These groups contend, in part, that the grandfather clauses should apply to the vessel's owner, not to the vessel itself. Under this interpretation, vessels that were sold would continue to be eligible for participation in U.S. fisheries only if the new owners met the American control requirements.

The Act Is Likely to Eliminate the Foreign Rebuilding of U.S. Fishing Vessels

In contrast to the Anti-Reflagging Act's American control provisions, which may have little impact on U.S. control of the fishing industry, its prohibitions against foreign rebuilding are likely to have a significant effect. While much foreign rebuilding continued after the act under its grandfather clauses, the period for delivering rebuilt ships to the owners ended on July 28, 1990. Because future rebuilding in foreign shipyards will result in the vessels' ineligibility for U.S. fishery privileges, owners who desire to rebuild their vessels will likely choose to do so in U.S. shipyards.

The act prohibited the Coast Guard from licensing a foreign-rebuilt vessel for use in U.S. fisheries unless certain grandfather conditions were met. Coast Guard regulations provide that a vessel is rebuilt when any considerable part of its hull or superstructure is built upon or is substantially altered.[7] Under the grandfather exemptions, a vessel could be rebuilt overseas without loss of fishing privileges if all of the following conditions were met: The vessel was (1) built originally in the United States and contracted for purchase before July 28, 1987, for use in the U.S. fisheries, (2) contracted to be rebuilt before July 12, 1988, and (3) delivered to the owner before July 28, 1990. If a vessel owner wants an exemption under the grandfather clauses, the Coast Guard requires that the owner request a decision in writing and provide the necessary documentation to show the vessel meets all three of these conditions.

We found that some of the vessels participating in the groundfish industry off the coast of Alaska were apparently rebuilt under the grandfather exemptions. For example, of the 52 factory trawlers that participated in the Alaska groundfish industry between January 1989 and February 1990, 15 vessels, or 29 percent, appear to have been

[7]The regulations are based on rebuilding requirements in the Merchant Marine Act of 1920, as amended in 1960 (46 U.S.C. App. 883). In 1988, the Anti-Reflagging Act (46 U.S.C. 12101(a)(2)) adopted the same rebuilt standard by referencing the Merchant Marine Act.

rebuilt in foreign countries since the act's passage and had received exemptions from the Coast Guard under the act's grandfather clauses.

No more foreign rebuilding of U.S. fishing vessels seems likely under the definition used for rebuilding. The act stipulated that rebuilt vessels must be delivered by July 28, 1990, to be eligible for grandfathering. While the act also allowed extensions past this time in the event of delays caused by circumstances beyond the control of the owner, the Chief of Vessel Documentation at Coast Guard headquarters told us that only one request for extension had been made as of August 1990 and the decision is pending. The Chief explained that this case involves a situation in which the shipyard closed for a period of time.

Matters for Consideration by the Congress

The Anti-Reflagging Act's American control provisions have had little impact on ensuring that U.S. fishery operations are controlled by U.S. citizens. This is a result of the Coast Guard's interpretation allowing the grandfather exemption to remain with a vessel even if the vessel is subsequently sold to a foreign-owned company. Consequently, should the Congress desire another result, it may wish to consider changes to the existing legislation.

Scope and Methodology

We conducted our audit work between November 1989 and August 1990. During that time, we interviewed Coast Guard headquarters and field office officials with responsibility for enforcing the Anti-Reflagging Act. We also met with members of the Alaska groundfish industry, and we developed data on that industry's factory trawlers and other processing vessels from Coast Guard documentation files and vessel listings provided by the National Marine Fisheries Service. Appendix II of this report discusses our objectives, scope, and methodology in further detail.

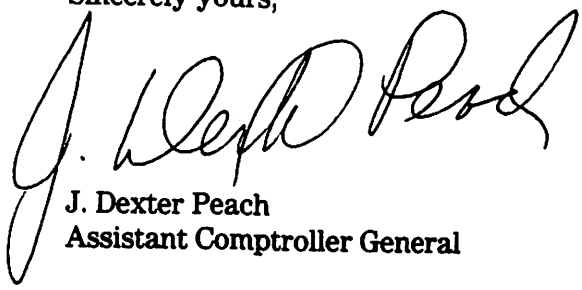
We discussed our findings and conclusions with Coast Guard officials who generally agreed with the facts contained in this report. As you requested, however, we did not obtain formal agency comments. We performed our work in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary

of Transportation, the Commandant of the Coast Guard, and other interested parties.

This work was performed under the direction of Kenneth M. Mead, Director, Transportation Issues, (202) 275-1000. Other major contributors to this report are listed in appendix III.

Sincerely yours,



J. Dexter Peach
Assistant Comptroller General

Contents

Coast Guard Procedures for Enforcing the Act's Prohibitions

As requested, we obtained information on how the Coast Guard enforces certain of the Anti-Reflagging Act's prohibitions. We did not assess the adequacy of the Coast Guard's procedures.

The Coast Guard enforces the Anti-Reflagging Act's foreign-built, foreign-rebuilt, and foreign-control prohibitions through several activities carried out in support of other laws and maritime missions. In general, its procedures fall into three broad categories—documentation (licensing), at-sea vessel boarding, and investigations. In addition, when the Coast Guard finds violations, it can impose civil penalties or refer matters to a U.S. Attorney for criminal or forfeiture action. The Coast Guard has also started actions aimed at strengthening certain of its procedures.

Vessel Documentation

Through its vessel-documentation function, the Coast Guard licenses (documents) vessels to participate in U.S. fisheries. Vessel owners can apply for documentation at 15 Coast Guard documentation offices throughout the country. If an application to document a fishing vessel shows compliance with the Coast Guard regulations, the field office will issue a "certificate of documentation" with an endorsement authorizing the vessel's use in the fisheries. The certificate, which must be available for inspection at all times on the vessel, expires after 1 year; and it is routinely renewable if no changes have occurred. The Coast Guard otherwise requires owners to apply for new documentation under certain conditions, such as changes in the vessel's ownership or dimensions.

According to the Chief of Vessel Documentation, for vessels that fall under the Anti-Reflagging Act's foreign-built, foreign-rebuilt, and foreign-control prohibitions, the Coast Guard will not issue documentation for fishery privileges unless the vessel owners can show compliance with the act's grandfather clauses. To help ensure consistency in these determinations at the field office level, the Chief of Vessel Documentation at Coast Guard headquarters has ruled on whether specific cases involving foreign rebuilding or ownership meet applicable grandfather exemptions.

The Coast Guard relies on a variety of owner-supplied information in making decisions on grandfathering and documentation. For example, in applying for documentation, owners submit an application, which they certify as accurate, showing citizenship information. For corporate owners, this information includes the extent to which stock is owned by

U.S. citizens. Owners often are required to provide information in addition to what is contained on the application form in order to demonstrate compliance with other aspects of the act. To demonstrate that grandfather exemptions on rebuilding are met, for example, owners have provided shipyard contracts verifying that prior to the act's passage the owner had plans to rebuild a vessel in a foreign shipyard for use in the U.S. fishing industry. Similarly, to show that grandfather exemptions dealing with American control have been met, owners have provided certified statements from past owners or crew members that the vessel was used in the U.S. fisheries prior to the passage of the act. According to the Chief of Vessel Documentation, the Coast Guard does not verify the authenticity of the documents or statements prior to issuing documentation except for verifying that the vessel was documented at a specific time.

Because the documentation process relies on the owner to initiate the application and does not verify the accuracy of the information the owner submits, the process by itself cannot fully ensure that all vessels participating in the U.S. fisheries comply with the act, according to the Chief of Vessel Documentation. He stated, however, that some violations can be identified through vessel boarding and following up on tips from the public and that potentially severe penalties can be imposed on owners who do not document a vessel when required or who provide inaccurate information during the documentation process.

Vessel Boarding and Investigations of Potential Violations

The Coast Guard can identify and enforce violations of the Anti-Reflagging Act by boarding vessels at sea and carrying out investigations of potential problems identified from boardings, tips, or other means. Some limitations, however, are associated with these procedures.

The Coast Guard conducts at-sea boarding to detect violations of applicable maritime laws, not just the Anti-Reflagging Act. With regard to that act, Coast Guard officials said boardings are more suited to identifying some types of violations than others. For example, according to one Coast Guard law enforcement official, boardings were more suited to identifying vessels fishing in Alaska waters with documentation that restricted fishing but not to identifying vessels that violated American control prohibitions. The latter, he said, would involve examining documents—such as corporation records—not normally found on board the vessel.

To determine the merit of potential violations identified through tips or other means, the Coast Guard may conduct more detailed follow-up investigations. Coast Guard investigations and law enforcement officials said investigations can involve such steps as interviewing vessel owners and crew and reviewing financial or other records associated with the control or operation of the vessel. According to the Chief of Vessel Documentation, the lack of staff resources in the Coast Guard severely limits the extent that investigations can be done. Additionally, he said that some violations, such as those involving American control, as noted above, are difficult to detect and prove.

Penalties

If violations are identified, the Coast Guard may impose civil penalties up to $500 for each day for each violation of documentation requirements. When a vessel is participating in a trade not covered by its documentation, seizure of the vessel for forfeiture to the United States is authorized and the matter is referred to a U.S. Attorney. Criminal penalties include (1) fines of up to $10,000 and/or imprisonment of up to 5 years for providing false information and (2) seizure and forfeiture of a vessel and its equipment for knowingly concealing information or providing false information. Coast Guard operations and documentation officials told us that, to their knowledge, penalties have never been imposed for the foreign-built, foreign-rebuilt, and foreign-control prohibitions because violations have not been identified and proved.

Actions Proposed by the Coast Guard to Strengthen Procedures

As agreed with your office, we did not evaluate the adequacy of the Coast Guard's actions in implementing the act's grandfather clauses. However, in its efforts to strengthen its procedures, the Coast Guard advised us that it is addressing two main areas.

- First, the Coast Guard acknowledges that the application form for obtaining documentation needs to be updated to provide additional information for determining whether a vessel and its owners meet the act's requirements. For example, while the form does ask for information about U.S. ownership of all corporate-owned stock, it does not ask for information on "voting" stock, a majority of which the act requires be owned by U.S. citizens. Similarly, the form does not ask for any information on or certification of the four Shipping Act's American control requirements or information on the location of any vessel rebuilding.
- Second, Coast Guard officials do not view existing penalties as a sufficient deterrent to violations. Coast Guard officials at different branches and geographical locations said the easiest penalty to impose (a fine of

up to $500) is too small to be a deterrent, and criminal penalties cannot be imposed without proving that the violation was done intentionally—a difficult effort requiring substantial resources.

The Coast Guard advised us that it has recently taken the following steps to address these issues.

- It is updating the application form to more fully obtain information needed to enforce the act's provisions. For example, the form will call for information on voting stock ownership, the American control conditions, and the location of rebuilding.
- It has asked the Congress for changes to strengthen its penalty process. For example, to better ensure that fines are paid, the Coast Guard is asking for authority to withhold or withdraw a vessel's documentation.

We did not address the extent to which the contemplated actions will fully resolve the concerns the Coast Guard has expressed.

Major Contributors to This Report

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DEPARTMENT OF TRANSPORTATION

Coast Guard

46 CFR Part 67

[CGD 88-031]

RIN 2115-AC99

Documentation of Vessels; Controlling Interest

AGENCY: Coast Guard, DOT.

ACTION: Final rule.

SUMMARY: The Coast Guard is amending its vessel documentation regulations regarding citizenship requirements for vessel owning individuals, or entities, applying to document vessels or qualify for certain trade endorsements. The amended regulations implement the American control provisions of the Commercial Fishing Industry Vessel Anti-Reflagging Act of 1987, and conform the controlling interest requirements for partnerships to those for corporations. Other amendments will result in regulations which are more informative and will assist vessel owners in understanding the applicable citizenship requirements.

EFFECTIVE DATE: January 11, 1991.

FOR FURTHER INFORMATION CONTACT: Mr. Thomas L. Willis, Chief, Vessel Documentation Branch, Merchant Vessel Inspection and Documentation Division, Office of Marine Safety, Security, and Environmental Protection, (202) 267-1492.

SUPPLEMENTARY INFORMATION: The Coast Guard published a Notice of Proposed Rulemaking (NPRM) on October 20, 1988 (53 FR 41211), proposing to amend the vessel documentation regulations to implement the American control provisions of the Commercial Fishing Industry Vessel Anti-Reflagging Act of 1987 (Pub. L. 100-239, 101 Stat. 1778 (1988)) (the "Anti-Reflagging Act"). The rulemaking also proposed conforming controlling interest requirements for partnerships to the Anti-Reflagging Act's requirements for corporations. A total of 7 comments were received in response to the NPRM. Based on those comments, and its own administrative experience, the Coast Guard determined that a complete revision of subpart 67.03, concerning citizenship requirements for vessel documentation, was needed. The proposed revision of subpart 67.03, and related amendments, were published on October 13, 1989 (54 FR 41992), in a Supplemental Notice of Proposed Rulemaking (SNPRM), followed by a comment period through December 12, 1989. The Coast Guard has received 9 comments in response to the SNPRM, eight of which were received during the comment period. A public hearing was not held, nor was one requested.

Drafting Information

The principal persons involved in drafting this regulation are Commander Robert Bruce, Project Manager, and Lieutenant Commander Don M. Wrye, Project Counsel, Office of Chief Counsel.

Background

Documentation of vessels under federal law is a type of national registration which, among other things, serves to establish a vessel's nationality and qualification to be employed in specified trades. The evidence of nationality is the Certificate of Documentation. One or more endorsement on the Certificate of Documentation serve as evidence of the vessel's qualification to engage in the specified trade. The Coast Guard is the agency which (a) accepts applications for documentation of vessels; (b) determines whether a vessel which is the subject of application is eligible for documentation generally and eligible for the endorsement or endorsements requested; and (c) issues Certificates of Documention to eligible vessels.

Eligibility requirements for documentation are set out at 46 U.S.C. Chapter 121. One of the eligibility requirements for documentation is United States citizenship. For corporation and partnerships, citizenship requirements include certain American control provisions. For example, the earliest American control provisions applied to corporations seeking to document vessels for coastwise trade. A requirement that at least 75 percent of its stock be owned by U.S. citizens, found in 46 U.S.C. app. 802, was made applicable to such corporations by 46 U.S.C. app. 883. Coastwise trade is, more or less, domestic transportation of passengers and merchandise.

Until 1982, this American control requirement had little practical effect on partnerships because unless all of the partners, general or limited, were U.S. citizens the partnership was not eligible to document vessels. This requirement was relaxed by section 10 of the Coast Guard Authorization Act of 1982 (Pub. L. 97-136) which amended 46 U.S.C. 12102(a)(3), permitting partnerships to document vessels if all general partners were U.S. citizens and the controlling interest in the partnership was owned by U.S. citizens. The 75 percent American control requirement for a coastwise endorsement remained and, to this extent, the American control requirements for corporations and partnerships were already alike. As a matter of administrative practice, the Coast Guard took the position that, when it was reasonable to do so, the same meaning would be given to "controlling interest" in both the corporate and partnership contexts. A final rule was published (53 FR 17469, May 17, 1988) revising 46 CFR 67.03-5 to implement the American control requirements for partnerships in 46 U.S.C. 12102(a)(3).

On January 11, 1988, the President signed the Anti-Reflagging Act into law. Among other things, this law adds a new American control provision for corporations seeking to document fishing vessels. The new requirement is retroactively effective from July 28, 1987, but includes savings provisions exempting many vessels operating, or under contract for purchase, as fishing industry vessels prior to that date. The statue superseded certain regulations in 46 CFR part 67 that were directly in conflict with it and, to carry out the purpose of the statute, the Coast Guard has been applying the standards in the statute as a matter of administrative practice. All of the changes to documentation regulations mandated by the Anti-Reflagging Act, not relating to controlling interest, have been implemented by prior rulemaking (53 FR 41166, October 20, 1988).

Discussion of Comments

Eight comments regarding the SNPRM were received during the comment period. Comments were received from an association of fishing vessel owners, members of the committee on marine financing of an association of maritime lawyers, a shipping company, and five law firms. None of the comments expressed dissatisfaction with the rulemaking as a whole. All the comments focused on one or more specific items of concern to the submitter. The comments related to (1) the way "control" is defined in § 67.03-2(a)(1); (2) the practice explained in § 67.03-2(b) of counting only the share of an entity's stock or equity and belongs to citizens capable of documenting a vessel in their own right, with the trade endorsement sought, toward meeting the stock or equity requirements for citizenship; (3) the difference between the controlling interest requirements in § 67.03-5 for a partnership seeking to document a vessel for recreation or registry and a partnership seeking to document a vessel for the fishery trade; (4) the meaning of "minority" in § 67.03-9(a)(4); (5) the requirement in § 67.03-9(d)(2)

that more than 50 percent of all the stock, not just voting stock, be owned by citizens; (6) the exceptions in § 67.03–9(f) to the requirement for evidence of Maritime Administration approval in § 67.03–9(e); (7) the Coast Guard's position that the citizenship savings provision for fishing vessels in § 67.03–15 should run with the vessel; (8) possible modification of the requirements for qualification by partnerships for the citizenship savings provisions in § 67.03–15; and, (9) the statement in § 67.17–9(d) of the circumstances under which a vessel may temporarily lose fishery privileges.

a. *Section 67.03–2(a)(1).* Comments from members of the committee on marine financing of an association of maritime lawyers, and from a law firm, expressed concern that the Coast Guard's explanation of control in proposed § 67.03–2(a)(1) is inconsistent with the definition of control in 46 CFR 221.13(a)(2)(i), which was published by the Maritime Administration (MARAD) as an interim final rule (54 FR 5389, February 2, 1989), and will deter non-citizen lenders from investing in the U.S. flag merchant marine. Both comments cite common covenants included in loan agreements for the protection of the lender that might be construed as granting a non-citizen lender control.

The Coast Guard does not agree that the regulation should be changed. The Coast Guard and MARAD have differing statutory responsibilities with respect to documented vessels. As a result, each agency must define control in a way suggested by its experience and expertise in carrying out its own responsibilities.

The definition of control, for purposes of the Coast Guard regulations, properly encompasses control of the vessel owning entity and not just control of the vessel. The Coast Guard must be concerned with whether the vessel owning entity meets the American control requirements. The citizenship provisions in 46 U.S.C. chapter 121 require that vessel owning entity be American controlled to be eligible to document vessels or to qualify for certain trading privileges. Therefore, control of the entity itself, and not just the vessels it owns, is relevant for purposes of the Coast Guard rule.

On the other hand, the Coast Guard's definition of control generally applies only to parties with an ownership interest in a vessel. For purposes of documentation, citizenship requirements apply to those parties having an ownership interest in a vessel or the entity that owns the vessel. Agreements that vessel owners may have with third parties without any ownership interest are not normally of concern to the Coast Guard, unless the agreement grants so many incidents of ownership to the third party that it must be considered a *de facto* owner. The MARAD definition of control, however, may apply to non-citizens whether or not they have an ownership interest in a vessel because, for certain U.S. vessels, any transfer of control over the vessel to non-citizens may require MARAD approval.

The Coast Guard definition of control will not prevent non-citizen lenders from including common covenants for their protection in loan agreements, unless the lender has an ownership interest in a vessel or a vessel owning entity. The Coast Guard must be concerned about agreements which grant control over the vessel or the vessel owning entity to non-citizens have an ownership interest. In some cases this may mean that certain covenants that grant control to protect the non-citizen's investment will be inconsistent with the non-citizen's participation in the ownership of vessels. However, that limitation is what the law requires.

b. *Section 67.03–2(a)(1).* Comments from members of the committee on marine financing of an association of maritime lawyers, and from a shipping company, suggested that the Coast Guard adopt the "fair inference" test of 46 CFR part 335—pursuant to which MARAD permits corporations to establish that they meet the citizen stock ownership requirements of 46 U.S.C. app. 802—or some similar rule. They assert that it would be difficult for corporations whose stock is publicly traded to establish that 75 percent or more of their stock is owned by U.S. citizens.

The Coast Guard does not agree that a "fair inference" test should be adopted for purposes of vessel documentation. Minimizing the paperwork burden associated with documentation of vessels is a goal supported by the Coast Guard. Accordingly, vessel owning corporations are not routinely required to provide evidence that their stock is owned by U.S. citizens, even to establish eligibility for coastwise or fisheries endorsements. The application for documentation (Form CG–1258), requires only that a vessel owner state, within broad ranges, the amount of stock owned by U.S. citizens.

In the relatively few cases where corporations are required to provide evidence establishing their eligibility, because the Coast Guard has reason to suspect they do not meet stock interest requirements, a presumption in favor of eligibility would not fully satisfy the purpose of the documentation laws. Those laws are meant to be restrictive; they are intended to limit the persons who are eligible to document vessels under U.S. flag and acquire trading privileges. The restrictive purpose of law would not be well served by a presumption or inference that a corporation is eligible for documentation although it cannot establish that it actually meets all the statutory requirements. Corporations can make proof of citizenship less difficult, for instance by restricting sale of their stock to U.S. citizens, and any corporation that is unwilling to subject itself to the possibility of having to prove that it qualifies for coastwise or fisheries privileges can choose not to seek them. The Coast Guard should not be bound by any presumptions or inferences in making eligibility determinations for documentation purposes, and none have been incorporated in the final rule.

c. *Section 67.03–2(b).* Two law firms commented that the Coast Guard should modify its practice of counting only the share of an entity's stock or equity that belongs to citizens capable of documenting a vessel in their own right, with the trade endorsement sought, toward meeting the stock or equity requirements for citizenship. They assert that the statutory citizenship requirements do not expressly require the Coast Guard to follow the practice described in § 67.03–2(b). Additionally, House Report 101–487, 101st Congress, 2d Session at 11–12, contains a statement questioning the legal basis for the Coast Guard's practice as it applies to partnership stockholders of a vessel owning corporation.

The comments and the statement in House Report 101–487 only take issue with the rule in question as it applies to corporations seeking to document vessels for the coastwise trade. The comments suggest that the citizenship requirements of proposed subpart 67.03 should be applied only to corporations which own vessels directly, and not to corporations or partnerships which own stock in the vessel owning corporation. With respect to the corporations or partnerships without a direct ownership interest in the vessel, they suggest that only the applicable requirement for citizen ownership of stock or equity should apply.

These suggestions are based on the fact that, for purposes of documenting vessels for coastwise trade, a corporation must meet two distinct statutory citizenship tests. In order to document vessels for any purpose, a corporation must meet the citizenship requirements of 46 U.S.C. 12102. By virtue of provisions in 46 U.S.C. 12106 and 46 U.S.C. app. 883, to document

vessels for coastwise trade the corporation must also meet the citizenship requirements of 46 U.S.C. app. 802. House Report 101-487 asserts that 46 U.S.C. 12102 applies only to the vessel owning entity, but that the proposed rule improperly mixes the requirements of 46 U.S.C. 12102 with the requirements of 46 U.S.C. app. 802. The comments take essentially the same position.

One of the comments states, in effect, that a corporation, 75 percent of the stock of which is owned by U.S. citizens as 46 U.S.C. app. 802(c) requires, but which otherwise does not meet the citizenship requirements for documentation of vessels for coastwise trade in 46 U.S.C. 12102 and 46 U.S.C. app. 802(a), should be able to own stock in a vessel owning corporation that would count toward meeting the vessel owner's controlling interest requirements. The other comment states that a partnership which is owned 75 percent by citizens, as required by 46 U.S.C. 802(a), but does not qualify to document vessels for coastwise trade because its general partners are not all citizens as required by 46 U.S.C. 12102(a)(3), should be able to own stock in a vessel owning corporation that would count toward meeting the vessel owner's controlling interest requirements.

The Coast Guard does not agree with the assertion that it should not require the corporations owning stock that counts toward meeting American control requirements of a vessel owning corporation to meet citizen officer and director requirements. The Coast Guard does not agree with the assertions that it should not require the partnerships owning stock that counts toward meeting American control requirements of a vessel owning corporation to meet citizen general partner requirements. The Coast Guard does not agree that its practice in this respect is contrary to either 46 U.S.C. 12102 or 46 U.S.C. app. 802.

The fact that, under Coast Guard practice, the citizenship requirements based on 46 U.S.C. app. 802 are essentially the same as the citizenship requirements based on 46 U.S.C. 12102, for corporations documenting vessels for coastwise trade, does not mean that one of the statutes is being misapplied. This is equally true with regard to the citizenship requirements for partnerships documenting vessels for coastwise trade. Although the terms of the two statutory provisions are different, each provides authority for the citizenship requirements contained in the Coast Guard's implementing regulations, which apply equally to a vessel owning corporation and to the owners of the corporation's stock that is counted toward meeting American control requirements. With respect to corporate stockholders, 46 U.S.C. app. 802 expressly requires that they meet officer and director requirements that are the same as those in 46 U.S.C. 12102(a)(4), in addition to the controlling interest test. Regarding partnership stockholders, 46 U.S.C. app. 802 does not expressly require that all general partners of a partnership be citizens of the United States, as 46 U.S.C. 12102(a)(3) does, but it includes general provisions that authorize such a requirement.

According to 46 U.S.C. app. 802(a), no corporation or partnership "shall be deemed a citizen of the United States unless the controlling interest therein is owned by citizens of the United States." Moreover, "no corporation * * * shall be deemed a citizen of the United States * * * unless its president or other chief executive officer and the chairman of its board of directors are citizens of the United States and unless no more of its directors than a minority of the number necessary to constitute a quorum are non-citizens." Therefore, the terms of 46 U.S.C. app. 802(a) clearly support application of the officer, director, and controlling interest requirements to the parent corporation of a vessel owning corporation. Accordingly, for the controlling interest in a subsidiary corporation to be owned by a citizen of the United States, the parent corporation must meet both the controlling interest and the officer and director requirements. That is exactly the result achieved by the Coast Guard regulation at issue.

With respect to partnerships, 46 U.S.C. app. 802(a) provides less detailed guidance than it does for corporations. It specifies only a controlling interest test. The controlling interest test for partnerships is not defined as it is for corporations in 46 U.S.C. app. 802 (b) and (c). Therefore, the statute grants the administrating agencies considerable discretion to decide how the controlling interest test should be applied to partnerships, to ensure American control. Although not expressly applicable to partnerships, 46 U.S.C. 802 (b) and (c) are generally helpful in determining how the controlling interest requirements should be applied to partnerships.

In its discretion, the Coast Guard has determined that the factors which may appropriately be considered in deciding if a partnership meets the controlling interest test are not limited to legal ownership of equity. A partnership that, as a matter of form, meets the requirement for 75 percent ownership of equity by citizens may still fail the controlling interest test because, in substance, control is vested in non-citizens. As with the definition of controlling interest for purposes of corporations in 46 U.S.C. app. 802(c), which affirmatively requires consideration of factors other than legal ownership of stock, the definition of controlling interest for purposes of partnerships may properly include consideration of factors other than legal ownership of equity. In the case of a corporation, the Coast Guard must consider "if, through any contract or understanding, it is so arranged that more than 25 per centum of the voting power in such corporation may be exercised, directly or indirectly, in behalf of any person who is not a citizen of the United States" or "if by any other means whatsoever control of any interest in the corporation in excess of 25 per centum is conferred upon or permitted to be exercised by any person who is not a citizen of the United States." 46 U.S.C. app. 802(c). The Coast Guard construes the controlling interest requirement for partnerships in 46 U.S.C. app. 802(a) as similarly limiting noncitizen control. Considering the degree of control general partners can exercise in a partnership, there is a rational basis for the Coast Guard's rule that a partnership with a noncitizen general partner exceeds these limits on noncitizen control.

The rule that a partnership, even a partnership that only owns stock in a vessel owning corporation, does not qualify as a citizen if there are any noncitizen general partners, is not a new Coast Guard position. A final rule published May 17, 1988 (53 FR 17467) stated that a partnership would qualify to document vessels for coastwise trade if "all its general partners are citizens and the controlling interest in the partnership is owned by citizens of the United States" and "at least 75 per cent of the equity in the partnership is owned by and under the control of a partner or partners who, if applying for a license to engage in (that trade), would each qualify as a citizen under this subpart." 53 FR 17470. In substance, that regulation—which is presently in effect (see 46 CFR 67.03-5(a) (1989))—is identical to the rule in question. The preamble to that rulemaking states:

> The final rule makes it clear that a coastwise or Great Lakes license will not be granted for a vessel owned by a partnership unless all of the general partners are U.S. citizens and at least 75 per cent of the equity

in the partnership is owned by and under the control of a partner or partners who could each qualify for a coastwise license in their own right. This approach does not detract from the requirements of 46 app. U.S.C. 802 in any way and *reflects the same policy which the Coast Guard and its predecessor agency have followed since the Shipping Act of 1916, as amended, was enacted.*

53 FR 17468 (emphasis added). This final rule, therefore, is consistent with the Coast Guard's longstanding construction of 46 U.S.C. app. 802 and is the same, in substance, as the regulation it supersedes.

In addition to the fact that these citizenship requirements are consistent with longstanding practice and are not contrary to 46 U.S.C. app. 802, they prevent easy circumvention of the requirements of 46 U.S.C. 12102. Were the Coast Guard to adopt the position the comments suggest, a corporation with 75 percent of its stock owned by citizens, that is ineligible to document vessels for any purpose because it does not meet the citizen officer and director requirements of 46 U.S.C. 12102(a)(4), would be able to document vessels for coastwise trade by the simple expedient of setting up a wholly owned subsidiary corporation that meets the citizen officer and director requirements. Similarly, a partnership with 75 percent of its equity owned by citizens, that is ineligible to document vessels for any purpose because all of its general partners are not citizens as required by 46 U.S.C. 12102(a)(3), would be able to document vessels for coastwise trade by the simple expedient of setting up a wholly owned subsidiary corporation that meets the requirements of 46 U.S.C. 12102. Such a loophole would make the citizenship requirements of 46 U.S.C. 12102(a)(3) and 12102(a)(4) so easy to evade that they would be virtually meaningless as a practical matter. Neither the comments nor the statement in House Report 101–487 provides good reasons for the Coast Guard to change ist longstanding practice in favor of a practice which would render these provisions largely ineffective.

The final rule will continue to adhere to the Coast Guard's practice of counting only the share of an entity's stock or equity that belongs to citizens capable of documenting a vessel in their own right, with the trade endorsement sought, toward meeting the stock or equity requirements for citizenship.

d. *Section 67.03–5.* A comment from a law firm questioned the small difference between the controlling interest test partnerships must meet to qualify as a citizen for documentation purposes generally, and the controlling interest test partnerships must meet to qualify as a citizen that may document vessels for the fisheries. As § 67.03–5(a)(1) states, at least 50 percent of the equity in a partnership must be owned by citizens for it to be eligible to document vessels for any purpose. However, to document vessels for the fisheries, § 67.03–5(a)(3) requires that more than 50 percent of the equity in the partnership be owned by citizens. The comment suggests that there is no good reason for this small difference.

The Coast Guard considered changing the controlling interest requirement for partnerships generally to more than 50 percent in this rulemaking. It is a change the Coast Guard is likely to propose in the future. However, the at least 50 percent controlling interest rule is an existing rule that has been in effect since May 17, 1988 (53 FR 17469). This rulemaking was intended to make only substantive changes required, or suggested, by the Anti-Reflagging Act. The Anti-Reflagging Act suggested the more than 50 percent controlling interest test for partnerships seeking to document vessels for the fisheries, because it prescribed a similar test for stock ownership of corporations. It did not address the broader issue of controlling interest beyond eligibility for a fisheries endorsement. Therefore, the Coast Guard determined not to propose other changes to the controlling interest tests for partnerships in this rulemaking.

e. *Section 67.03–9(a)(4).* An association of fishing vessel owners commented that under one meaning of the word "minority" § 67.03–9(a)(4) might be construed to permit up to one-half the total number of directors to be non-citizens. The comment encourages the Coast Guard to change the rule to avoid any possibility of misinterpretation. The Coast Guard does not agree that the rule should be changed. A corporation will qualify as a citizen if it meets other requirements and, as § 67.03–9(a)(4) states, "[n]o more of its directors are non-citizens than a minority of the number necessary to constitute a quorum." This language was taken verbatim from 46 U.S.C. 12102(a)(4) and is sufficient to inform the public of what the statute requires. The statute and the regulation are both based on the premise that the board of directors, and any quorum, will consist of a group of citizens and a group of non-citizens. When a quorum is made up from these two groups, the group which is smaller in number will constitute a minority. If the two groups are equal there is no minority. Therefore, whatever number is required for a quorum, less than half that number will constitute a minority of the number required for a quorum. For example, if the number required for a quorum is six, a minority of the number required for a quorum is two. If there were three directors in each group their number would be even and there would be no minority. Consequently, for the citizenship requirments to be met in such a case, no more than two directors of the corporation could be non-citizens. In the context in which it applies, the rule is clear.

f. *Section 67.03–9(d).* A comment from a law firm states that § 67.03–9(d) is confusing because while it emphasizes the requirement for citizen ownership of a majority of voting stock, it also requires citizen ownership of a majority of all categories of stock; voting and non-voting. Addtionally, § 67.03–2 states that the stock interest requirements apply to all categories of stock. The comment asserts that only voting shares should be subject to the requirement for majority ownership by citizens, in this instance.

The Coast Guard does not agree. Section 67.03–9(d) is intended to require that more than 50 percent of the stock interest in the corporation be owned by citizens, and it states this requirement clearly. In accordance with § 67.03–2(a), stock interest includes all classes of stock as a whole, not just voting stock. As the comment suggests, 46 U.S.C. 12102(c)(1) and (2)—the provisions this regulation implements—are contradictory on this point. Section 12102(c)(1) suggests that the requirement for majority ownership of stock applies only to voting stock. However, section 12102(c)(2) requires application of restrictions on non-citizen stock ownership that include all classes of stock as a whole. The Coast Guard has concluded that the intent of sections 12102(c)(1) and (2) can be effectuated by requiring that both a majority of voting stock and a majority of the stock of the corporation as a whole be owned by citizens. The Coast Guard recognizes that Congress could have achieved this result without including the parenthetical language in section 12102(c)(1), which suggests a type of qualified controlling interest that only requires citizen ownership of a majority of voting stock. On the other hand, the Coast Guard would not be applying "the restrictions on controlling interest in (46 U.S.C. app. 802(b))", as section 12102(c)(2) requires, if it read out the provisions dealing with ownership of all stock. The Coast Guard has determined that 46 U.S.C. 12102(c) can reasonably be interpreted to require compliance with both the qualified controlling interest standard of section 12102(c)(1) and the longstanding controlling inter-

standard of 46 U.S.C. app. 802(b). Proposed § 67.03–9(d) reflects this determination and no change is made in the final rule.

g. *Sections 67.03–9(e) and (f).* A comment from a law firm stated that the exceptions in § 67.03–9(f) to the requirement for evidence of MARAD approval in § 67.03–9(e) give little guidance and leave many issues unresolved. The intent, of § § 67.03–9(e) and (f), is to ensure that statutory requirements for MARAD approval of certain vessel transactions are being complied with. MARAD has regulations in 46 CFR part 221 which fully explain these requirements. Therefore, the Coast Guard has determined that it is more appropriate to reference the MARAD regulations than to try to restate them. Moreover, the requirements for MARAD approval are not limited to transactions involving corporations. The Coast Guard's policy of obtaining evidence of MARAD approval, whenever required, is better served by a rule applicable to all types of vessel ownership. Accordingly, in the final rule § § 67.03–9(e) and (f) have been combined, revised, and moved to a new § 67.03–17.

h. *Section 67.03–15.* Comments from two law firms agreed with the Coast Guard's position that the citizenship savings provision for fishing vessels in 67.03–15 should run with the vessel. Comments from another law firm disagreed with that position. The comments are similar to those received on this subject in response to the NPRM published October 20, 1988 (53 FR 41211). The Coast Guard's reasons for adhering to its position were explained at length in the SNPRM published October 13, 1989 (54 FR 41992, 41993–94), and are still valid. The Coast Guard is continuing to adhere to its position, because it remains convinced that the straightforward language of the Anti-Reflagging Act's citizenship savings clause correctly reflects Congress' intent and is determinative of the issue. In addition to being disputed in the rulemaking process, the Coast Guard's position has been challenged in court and is the subject of on-going litigation.

The plain language of the American control savings provision provides no basis for concluding that its protection should terminate because of a change of ownership or control, but the comment which disagrees with the Coast Guard's position asserts that the Coast Guard should not be guided by the provision's plain meaning. Instead, the Coast Guard is urged to read between the lines and administratively adopt a rule that the savings provision's protection terminates when there is a change of ownership or control. The comment states that the Coast Guard's interpretation of the American control savings provision is not a permissible construction because it makes no sense in light of the legislative purpose; that being to increase domestic control over U.S. fisheries resources and encourage displacement of foreign fishing activity. The comment also suggests that the legislative history does not permit the Coast Guard's position.

There are several reasons why the Coast Guard is unpersuaded by these arguments. In the first place, it is not proper to invoke the broad purposes of a statute to overrule a specific provision of that statute. This should be particularly true in the case of a grandfather provision. Grandfather provisions are intended to mitigate new statutory requirements and, by their nature, typically conflict with the broad purposes of the statutes they affect. Moreover, even if the Coast Guard had determined that it could not accurately discern the intent of Congress from the plain language of the American control savings provision, but needed to consider the legislative history as well, its position would still be reasonable. The legislative history does not compel the conclusion that Congress intended the protection of the savings provision to terminate when there is a change of ownership or control. The Coast Guard could also reasonably conclude from the legislative history that the protection should run with the vessel, in keeping with the plain language of the American control savings provision.

Although the Coast Guard has based its position on the plain language of the American control savings provision, it is very familiar with the legislative history of the Anti-Reflagging Act. The Coast Guard responded to questions at Senate Hearings on April 28, 1987, testified at House Hearings on April 29, 1987, and followed the progress of this legislation through to final enactment. The purpose of the Anti-Reflagging Act is not as clear cut as the comment which disagrees with the Coast Guard's position would make it seem. As Congressman Young of Alaska, one of the sponsors of the Anti-Reflagging Act stated, "this bill is a carefully crafted compromise between diverse interests in the fishing and maritime industries." 133 Cong. Rec. H9811 (daily ed. Nov. 9, 1987). There certainly were differences of opinion about what "Americanization" of the fishing industry meant and how it could best be achieved.

The need for an American control provision for fishing vessels was one of the most controversial issues. The bill considered in the Senate Hearing contained no American control provision. At the House Hearing, on a bill that included an American control provision which did not apply to vessels documented before November 1, 1986, the testimony included strong reservations about the need for an American control provision. Since the legislative history shows that the Anti-Reflagging Act was a carefully crafted compromise, the Coast Guard does not agree with the assertion that the plain language of the American control savings provision is necessarily inconsistent with the broad purposes of the statute, even though it would permanently exempt many existing U.S. fishing vessels from the new American control requirement.

The legislative history of the Anti-Reflagging Act does not require the Coast Guard to change its position. While it is true that the House Report states in one place that exemption from the American control requirements should terminate on a change of ownership or control, H.R. Rep. 423, 100th Cong., 1st Sess. 17 (1987), the legislative history also contains material which supports the plain language of the American control savings provision. For instance, the House Report states that a "Date Certain" Amendment was adopted which essentially established the effective date of the Anti-Reflagging Act as July 28, 1987. All of the savings provisions in the Anti-Reflagging Act reflect the choice of that date as the time from which the new law would take effect. Congressman Young described the purpose of the "Date Certain" Amendment as follows: "The Committee on Merchant Marine and Fisheries chose the date of July 28, 1987, as a cutoff in order to avoid any semblance of a taking of a vessel-owner's privileges under the law." 133 Cong. Rec. H9812 (daily ed. Nov. 9, 1987).

The original purpose of the Anti-Reflagging Act was to prevent foreign-built fish processing vessels from changing from foreign flag to U.S. flag, but the "Date Certain" Amendment makes it clear that the prohibition against documentation of foreign-built fish processing vessels only applies to vessels newly documented after July 27, 1987. Foreign-built processing vessels which were documented prior to July 28, 1987 are exempt from the new U.S.-built requirement, and that exemption does not terminate on a change of ownership or control. In this instance it is clear that when Congress limited the application of the new U.S.-built requirement to "newly documented" vessels it intended to include only vessels documented

under U.S. law for the first time after July 27, 1987. Vessels which had previously been documented under U.S. law, even if they were redocumented later—because of a change of ownership for example—are not subject to the new U.S.-built requirement. Similarly, the new American control requirements should be understood as applying only to "newly documented" vessels, and not to vessels that have qualified for grandfathering but later change ownership.

Statements made on the House floor, after the House Report was issued, indicate that, despite the contrary language in the House Report, the American control requirement would only apply to vessels that were newly documented after July 27, 1987. Congressman Young stated that the American control provision "requires as a condition of new documentation that a fishing industry vessel be owned in the majority by individuals who are citizens of the United States." 133 Cong. Rec. H9812 (daily ed. Nov. 9, 1987). Congressman Jones stated that "as a condition of new documentation [H.R. 2598] requires majority ownership of fishing industry vessels by individuals who are citizens of the United States." *Id.* at H9813.

The clearest exception to the "Date Certain" Amendment's rule that vessels documented before July 28, 1987 are exempt from the provisions of the Anti-Reflagging Act is the provision penalizing foreign rebuilding. In that case, there is support, both in the text of the rebuilding savings provision and in the legislative history, for the position that the new rebuilding requirements apply to all fishing vessels regardless of when they were first documented under U.S. flag, and only grandfathered rebuilding projects are exempt. The suggestion that there is an unexplained disparity between the Coast Guard's position on the rebuilding savings provision and the American control savings provision is answered by the fact that, in the case of the rebuilding savings provision, there is clear support in both the plain language of the provision and its legislative history for the limited scope of the exemption. That is not the case with the American control savings provision, and the difference in interpretation is, therefore, justified.

The explicit and detailed limitations on grandfathered rebuilding projects contained in the text of the rebuilding savings provision contrasts starkly with the lack of explicit language in the American control savings provision indicating that its protection is limited. Moreover, the legislative history for the rebuilding savings provision clearly limits its protection to "those who have relied on current laws and who have made certain identifiable commitments toward rebuilding fishing, fish processing, and fish tender vessels in foreign yards." H.R. Rep. 423, 100th Cong., 1st Sess. 12 (1987). This limiting language does not apply to the American control savings provision, although the comment disputing the Coast Guard's position seems to imply that it does.

Based on the plain language of the American control savings provision the Coast Guard's position that the exemption from the new American control requirement runs with the vessel is reasonable. It would be reasonable, even if the intent of Congress could not be accurately discerned from the plain language of the American control savings provision. Neither the broad purpose of the legislation, nor the legislative history, compels a different position. Therefore, it remains the Coast Guard's position that the citizenship savings provision for fishing vessels in § 67.03–15 runs with the vessel, and does not terminate because of a change in ownership or control.

1. *Section 67.03–15.* A comment from a law firm suggested that the criteria for eligibility for the savings provision in § 67.03–15 should be modified for vessels owned by partnerships, to reflect the date of publication of the final rule. If the suggestion were adopted, a vessel owned by a partnership would qualify for grandfathering under the regulation if it was documented and engaged in the U.S. fishery, or under contract for purchase for that use, when the final rule was published rather than as of July 28, 1987.

The Coast Guard does not agree that the regulation should be modified. Unlike corporations, partnerships seeking to document vessels for any purpose are required to meet a controlling interest test. This controlling interest requirement for partnerships pre-dates the Anti-Reflagging Act. Therefore, the controlling interest requirement for partnerships seeking to document vessels with a fisheries endorsement is not something newly imposed by the Anti-Reflagging Act. It is true, however, that with the Anti-Reflagging Act in mind the Coast Guard is changing the required citizen ownership of equity in a partnership for purposes of eligibility for fisheries endorsements from 50 percent to more than 50 percent. The Coast Guard has also proposed to exempt partnerships which own grandfathered vessels from the new requirement in the same manner that the Anti-Reflagging Act provides an exemption for corporations.

Since the controlling interest requirement for partnerships is not new, and the Coast Guard is merely reinterpreting a requirement that has been imposed on partnerships since 1982, there is no requirement for grandfather protection. The agency decision to reinterpret this statutory requirement in light of subsequent legislative developments is nothing so extraordinary that the new interpretation should not be applied to partnerships generally. The new regulatory requirement properly can, and will, apply from the effective date of this final rule. However, because the new requirement involves a change of less than one percent, the Coast Guard expects very few partnerships to have to restructure or surrender vessel documents as a result of the change. Partnerships, generally, will have to meet the requirements of the new controlling interest regulations. Only partnerships owning a vessel that qualifies for grandfathering under § 67.03–15 will be exempt from the new requirement.

Another law firm commented that a partnership owning a vessel that qualifies for grandfathering under § 67.03–15 should be able to document that vessel for the fisheries, even if one of the entities contributing to the equity interest requirements is a corporation whose stock is 100 percent foreign owned. The comment suggests that § 67.03–2(b) be changed to explicitly address this situation. The Coast Guard does not agree that this change is needed. Section 67.03–2(b) already states that an entity which is a citizen eligible to document a vessel in its own right with the endorsement sought can contribute to meeting equity interest requirements. In the case of a vessel grandfathered under § 67.03–15, the corporation certainly could be a citizen eligible to document the vessel with a fisheries endorsement. If it is, the corporation can contribute to meeting the partnership's equity interest requirements.

The final rule includes a minor change to § 67.03–05. This regulation was never intended to permit vessels to be documented without establishing that the vessel qualifies for the exemption. The change makes it clear that the section only applies if the Secretary of Transportation or the Secretary's delegate has determined that the vessel meets the specified requirements.

j. *Section 67.17–9(d).* A comment from law firm stated that § 67.17–9(d) could be made more specific. That section is intended to describe the circumstances under which a vessel may temporarily lose its eligibility for a fisheries endorsement. That occurs when the vessel is owned by an entity which does not meet the citizenship requirements for documenting a vessel for the fisheries trade. However, the proposed regulation referred generally to the citizenship requirements of subpart 67.03, which include other unrelated citizenship requirements. The Coast Guard agrees that § 67.17–9(d) should be changed to more specifically identify the citizenship requirements to which it refers, and the final rule incorporates such a change.

k. A comment was received well after the comment period closed, from an attorney whose practice includes maritime issues. This comment asserts that the Coast Guard has provided no reason for its decision to propose a complete revision of subpart 67.03, and that the revision constitutes a reconsideration by the Coast Guard of all the citizenship requirements. The comment states that this raises questions about why the revision is needed, and requires review of all of the laws on which the citizenship requirements are based. The comment also suggests that in many instances the citizenship regulations do not properly interpret or implement statutory requirements. The comment also proposes several specific changes. This comment has been considered even though it was not received during the comment period.

Regarding the comment's general assertions, the Coast Guard has previously explained why a revision of subpart 67.03 was needed. In the SNPRM (54 FR 41992, 41995, October 13, 1989), the Coast Guard stated in response to a comment on the NPRM (53 FR 41211, October 20, 1988) that it had "determined that a thorough revision of subpart 67.03 is needed to better explain the American control requirements." Subpart 67.03 has not been comprehensively revised since 1982 (47 FR 35488, August 16, 1982), although there have been several statutory changes in the intervening period. The comments received in response to the NPRM, and the Coast Guard's own administrative experience, indicated that revision of the subpart could make the rules more informative and uniform.

By and large, the Coast Guard did not consider or make substantive changes to existing regulations. The changes made, and the reasons for them, were fully explained in the preamble to the SNPRM. The substantive changes made are those necessary to implement the Anti-Reflagging Act and some conforming changes suggested by the Anti-Reflagging Act's new requirements. Non-substantive revisions were made so that the regulations would better explain the Coast Guard's existing practice, to improve the organization of the subpart, and to make the regulations more uniform. Therefore, the broad assertion that the Coast Guard has reconsidered and changed citizenship requirements without any corresponding statutory changes is incorrect. The Coast Guard does not agree with the assertion that in many instances the proposed regulations do not properly interpret or implement the underlying statutes.

The comment suggests that § 67.03–1 should be changed to refer to "citizen of the United States" rather than "United States citizens" and to more clearly indicate that in subpart 67.03 "citizen" means a "United States citizen." The Coast Guard does not agree that the regulation needs to be changed. The documentation laws establish unique citizenship requirements. Those requirements are defined in subpart 67.03. If a person or entity meets the applicable requirements of subpart 67.03 it will be eligible to document vessels and obtain certain trading privileges, regardless of whether it is labelled a "citizen of the United States", a "United States citzen" or a "citizen." In fact, general use of the term "citizen of the United States" in this context might create confusion with other laws. For instance, a corporation whose stock is owned 100 percent by non-citizens may be a citizen for documentation purposes, although it would not qualify as a "citizen of the United States" for purposes of 46 U.S.C. App. 802. "Citizen" is generally used throughout subpart 67.03 to indicate a person or entity which meets the requirements of subpart 67.03.

The comment raises several objections to the guidance in § 67.03–2. The Coast Guard does not agree that this section needs to be changed. Some of the comments are similar to comments regarding the definition of control in § 67.03–2(a)(1) received during the comment period that have previously been addressed. Another comment is based on the mistaken impression that the guidance in § 67.03–2 would be repeated in other sections.

The definition of control in § 67.03–2(a)(1) does not simply repeat the pertinent parts of 46 U.S.C. chapter 121 verbatim, because the regulation is intended to give a fuller explanation of the controlling interest requirements. The Coast Guard interprets controlling interest, to the extent it reasonably can, in a manner that is consistent with 46 U.S.C. app. 802. That interpretation is properly reflected in the definition of control in § 67.03–2(a)(1).

The comment suggested changing § 67.03–3 to eliminate the catch-all phrase "or otherwise qualifies as a United States citizen" and replace it with other specific instances in which an individual may be a citizen of the United States. The Coast Guard prefers the current rule. The catch-all language permits the Coast Guard to determine, on a case-by-case basis, if an individual qualifies as a citizen, otherwise than as a native-born, naturalized or derivative citizen.

The comment raises several objections to the requirements of § 67.03–5. The comment suggests that equity owned by limited partners should not be considered in determining if the partnership meets American control requirements. That would be inconsistent with § 67.03–2(a) which states that the stock or equity interest requirements encompass ownership of equity, without exceptions. The Coast Guard does not agree that § 67.03–5 should be changed. The Coast Guard's interpretation of controlling interest is proper.

The comment suggests eliminating the requirement that the beneficiaries of a trust be citizens for the trust to qualify as a citizen. The Coast Guard does not agree. This has been Coast Guard's position on trusts since at least 1982 (47 FR 27490, 27496; 46 FR 56318, 56319). The comment presents no persuasive reasons for changing this longstanding rule.

The comment approves § 67.03–9(a)(2) but not the Coast Guard's position that if a corporation has both a president and a chief executive officer both must be citizens. This requirement is based on 46 U.S.C. 12102(a)(4) which is properly construed as encompassing both the corporation's president and its chief executive officer, if there is a chief executive officer other than the president. The comment states that the regulation does not clearly encompass both. The Coast Guard agrees that the final rule should be changed to clearly state that if a corporation has both a president and chief executive officer, then both must be citizens for the corporation to meet citizenship requirements.

The comment suggests that § 67.03–9(b)(2) be changed to specifically include voting stock in the stock interest requirement. However, § 67.03–2(a)

already defines stock interest as including voting stock. Therefore, the suggested change would be redundant. The comment includes suggested changes to the stock interest requirements of § 67.03-9(d)(2) which are similar to changes suggested in comments received during the comment period that have previously been addressed.

The comment suggests adding to §§ 67.17-5(c)(1) and § 67.17-7(c)(1) language regarding the effect of placing a vessel under foreign registry. However, the additional language would be redundant with §§ 67.17-5(c)(2) and 67.17-7(c)(2). Otherwise, the suggested changes do not improve these sections and they have not been incorporated in the final rule.

E.O. 12291 and DOT Regulatory Policies and Procedures

The Coast Guard considers this rulemaking to be non-major under Executive Order 12291 and nonsignificant under the DOT regulatory policies and procedures (44 FR 11034, February 26, 1979). The economic impact of this rulemaking has been found to be so minimal that further evaluation is unnecessary. The only significant substantive changes in this rulemaking are changes in American control requirements for vessel documentation mandated by statute.

Federalism

The Coast Guard has analyzed this rulemaking in accordance with the principles and criteria contained in Executive Order 12612 and has determined that these regulations do not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

Regulatory Flexibility Act

Since the impact of this rulemaking is expected to be minimal, the Coast Guard certifies that it will not have a significant economic impact on a substantial number of small entities. It is recognized that a substantial number of small entities are involved in the commercial fishing industry and other vessel operations within the ambit of these regulations. There is no significant economic impact, however, because this rulemaking implements the Anti-Reflagging Act's American control savings provisions. The savings provisions protect those who were operating fishing industry vessels under documentation in the United States fisheries, or who made verifiable commitments to purchase vessels for use as fishing industry vessels in the United States fisheries, based on the laws and regulations in existence prior to enactment of the Anti-Reflagging Act.

Paperwork Reduction Act

This rulemaking contains no collection of information requirements.

Environmental Assessment

The Coast Guard has considered the environmental impact of this rulemaking and concluded that under section 2-B-2.1. of Commandant Instruction M16475.1B this rulemaking is categorically excluded from further environmental documentation. This rulemaking involves administrative and procedural regulations which clearly have no environmental impact. A Categorical Exclusion Determination has been prepared and placed in the rulemaking docket.

List of Subjects in 46 CFR Part 67

Vessels.

For the reasons set out in the preamble, 46 CFR part 67 is amended as follows:

PART 67—DOCUMENTATION OF VESSELS

1. The authority citation for part 67 continues to read as follows:

Authority: 31 U.S.C. 9701; 42 U.S.C. 9118; 46 U.S.C. 2103; 46 U.S.C. App. 841a, 876; 49 U.S.C. 322; 49 CFR 1.46.

2. Subpart 67.03 is revised to read as follows:

Subpart 67.03—Citizenship Requirements for Vessel Documentation

Sec.

Subpart 67.03—Citizenship Requirements for Vessel Documentation

§ 67.03-1 Requirement for citizen owner.

Certificates of Documentation are available only to vessels which are wholly owned by United States citizens. For purposes of obtaining a Certificate of Documentation, the persons and entities discussed in §§ 67.03-3 through 67.03-9 of this subpart are citizens.

§ 67.03-2 Stock or equity interest requirements.

(a) The stock or equity interest requirements for citizenship under this subpart encompass: Title to all classes of stock as a whole; title to voting stock; and ownership of equity. An otherwise qualifying corporation or partnership may fail to meet stock or equity interest requirements because: Stock is subject to trust or fiduciary obligations in favor of [non-citizens; non-citizens exercise, directly or indirectly, voting power; or non-citizens, by any means, exercise control over the entity. The applicable stock or equity interest requirement is not met if the amount of stock subject to obligations in favor of non-citizens, non-citizen voting power, or non-citizen control exceeds the percentage of the non-citizen interest permitted.

(1) For the purpose of this section, control includes an absolute right to direct corporation or partnership business, to limit the actions of or replace the chief executive officer, a majority of the board of directors or any general partner, to direct the transfer or operations of any vessel owned by the corporation or partnership, or otherwise to exercise authority over the business of the corporation or partnership, but not the right to simply participate in these activities or the right to receive a financial return, i.e., interest or the equivalent of interest, on a loan or other financing obligations.

(b) For purposes of meeting the stock or equity interest requirements for citizenship under this subpart where title to a vessel is held by an entity comprised, in whole or in part, of other entities which are not individuals, each entity contributing to the stock or equity interest qualifications of the entity holding title must be a citizen eligible to document vessels in its own right with the trade endorsement sought.

§ 67.03-3 Individual.

An individual is a citizen if he is a native-born, naturalized, or derivative citizen of the United States, or otherwise qualifies as a United States citizen.

§ 67.03-5 Partnership, association, or joint venture.

(a) A partnership is a citizen if all its general partners are citizens, and:

(1) For the purpose of obtaining a registry or a recreational endorsement, at least 50 percent of the equity interest in the partnership is owned by citizens;

(2) For the purpose of obtaining a coastwise or Great Lakes endorsement, at least 75 percent of the equity interest in the partnership is owned by citizens

(3) For the purpose of obtaining a fishery endorsement, more than 50 percent of the equity interest in the partnership is owned by citizens.

(b) An association is a citizen if each of its members is a citizen.

(c) A joint venture is a citizen if each of its members is a citizen.

§ 67.03-7 Trust.

A trust arrangement fulfills the citizenship requirements if each of its trustees and each of its beneficiaries is a citizen.

§ 67.03-9 Corporation.

(a) A corporation is a citizen for the purposes of obtaining a registry or a recreational endorsement if:

(1) It is incorporated under the laws of the United States or of a State;

(2) Its president and, if the president is not the chief executive officer, its chief executive officer, by whatever title, is a citizen;

(3) Its chairman of the board of directors is a citizen; and

(4) No more of its directors are non-citizens than a minority of the number necessary to constitute a quorum.

(b) A corporation is a citizen for the purposes of obtaining a coastwise or Great Lakes endorsement if:

(1) It meets all the requirements of paragraph (a) of this section; and

(2) At least 75 percent of the stock interest in the corporation is owned by citizens.

(c) A corporation which does not meet the requirements of paragraph (b) of this section may qualify for limited coastwise trading privileges by meeting the requirements of subpart 68.01 of this subchapter.

(d) A corporation is a citizen for the purposes of obtaining a fishery endorsement if:

(1) It meets all the requirements of paragraph (a) of this section; and

(2) More than 50 percent of the stock interest in the corporation including a majority of voting shares in the corporation is owned by citizens.

§ 67.03-11 Governmental entity.

A governmental entity is regarded as a citizen if it is a government of the United States as defined in § 67.01-1 of this part.

§ 67.03-13 Evidence.

An original Form CG-1258 establishes a rebuttable presumption that the applicant is a United States citizen.

§ 67.03-15 Citizenship savings provision for fishing vessels.

A corporation that meets the requirements of paragraph (d)(1) of § 67.03-9 of this subpart but does not meet the requirements of paragraph (d)(2) of that section, or a partnership that meets the requirements of paragraph (a)(1) of § 67.03-5 of this subpart but does not meet the requirements of paragraph (a)(3) of that section, may nonetheless be eligible to obtain a fishery endorsement for a vessel if the Secretary of Transportation, or the Secretary's delegate, determines that, prior to July 28, 1987, the vessel:

(a) Was documented under 46 U.S.C. chapter 121 and operating as a fishing, fish processing, or fish tender vessel in the navigable waters or the Exclusive Economic Zone of the United States, as defined by 46 U.S.C. 2101(10a); or

(b) Was contracted for purchase for use as a fishing, fish processing, or fish tender vessel in the navigable waters or the Exclusive Economic Zone of the United States, as defined by 46 U.S.C. 2101(10a), if the purchase is shown by the contract or similarly reliable evidence to have been made for the purpose of using the vessel in the fisheries.

§ 67.03-17 Evidence of Maritime Administration Approval.

Although meeting the citizenship requirements of this subpart, a vessel's owner may not document a vessel which is documented, or was last documented, under the laws of the United States if, since the vessel was last documented, any transaction requiring Maritime Administration approval in accordance with 46 CFR part 221 has occurred, unless it evidences that the Maritime Administration has approved the transaction.

3. Section 67.17-5 is amended by revising paragraph (c)(1) to read as follows:

§ 67.17-5 Coastwise license.

* * * * *

(c) * * *

(1) It is thereafter sold in whole or in part to an owner that is not a citizen as defined in §§ 67.03-3; 67.03-5(a)(1), (b), (c); 67.03-7; 67.03-9(a); or 67.03-11 of this part;

* * * * *

4. Section 67.17-7 is amended by revising paragraph (c)(1) to read as follows:

§ 67.17-7 Great Lakes license.

* * * * *

(c) * * *

(1) It is thereafter sold in while or in part to an owner that is not a citizen as defined in §§ 67.03-3; 67.03-5(a)(1), (b), (c); 67.03-7; 67.03-9(a); or 67.03-11 of this part;

* * * * *

5. Section 67.17-9 is amended by adding a new paragraph (d) to read as follows:

§ 67.17-9 Fishery license.

* * * * *

(d) A vessel otherwise eligible for a fishery endorsement under paragraph (b) of this section loses that eligibility during any period in which it is owned by any entity which does not meet the citizenship requirements of subpart 67.03 of this part for purposes of obtaining a fishery endorsement, except that a vessel eligible for a fishery endorsement in accordance with § 67.03-15 of this part does not lose its eligibility for a fishery endorsement during any period it is owned by an entity that fails to meet the stock or equity interest requirements of §§ 67.03-5(a)(3) or 67.03-9(d)(2) of this part but otherwise qualifies as a citizen.

6. Section 67.23-9 is amended by revising paragraph (a)(3) to read as follows:

§ 67.23-9 Requirement for deletion.

(a) * * *

(3) Any owner of the vessel ceases to be a citizen within the meaning of §§ 67.03-3; 67.03-5(a)(1) (b), (c); 67.03-7; 67.03-9(a); or 67.03-11 of this part;

* * * * *

Dated: June 18, 1990.

J.D. Sipes,

Rear Admiral, U.S. Coast Guard Chief, Office of Marine Safety, Security and Environmental Protection.

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The new financing regime for U.S. Fishing Vessels

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THE COUNTERBALANCE OF INSTANT CREDIT AND ARREST POWER THAT HAS TRADITIONALLY KEPT COMMERCIAL VESSELS OPERATING HAS CHANGED DRAMATICALLY DURING THE LAST YEAR

Traditionally, necessary services and supplies have been furnished on the credit of a vessel, with the assurance that such advances of credit were automatically secured by maritime liens. Since the first American commercial vessel operated in colonial waters, these maritime liens have arisen instantly and have remained attached to the vessel until full payment was made for the goods and services provided. Then, as now, if the vessel owner does not pay, the vessel can be arrested anywhere in the world.

Although arrest of a vessel for an unpaid bill may seem like a heavy penalty today, the power to seize a vessel and sell it has traditionally made it economically feasible for maritime vendors to extend instant credit to a vessel needing supplies, fuel or immediate repairs. This counterbalance of instant credit and arrest power has changed dramatically during the last year. Due in large part to increased foreign investment and the first major change in U.S. marine financing laws in 70 years, the provision of goods and services on the credit of a fishing vessel may become a thing of the past.

The Fishing Vessel as Floating Credit Card: Is She Over Her Credit Limit?

A converted state-of-the-art factory trawler calls from the Bering Sea and asks for a diver and ship repairer to meet it at the dock in Dutch Harbor, Alaska, to replace a bent propeller. Its time on the fishing grounds is worth roughly $100,000 a day. It wants instant service and instant credit. While the propeller repair is being made, it will take on $150,000 to $300,000 worth of fuel and $100,000 worth of groceries and other ship supplies, also on credit. When it pulls away from the dock, it may have obtained as much as $500,000 worth of goods and services, all on credit.

What are the chances that these bills will be paid? Will the maritime lienors have to arrest her for failure to pay? If they do, will they recover anything from her sale?

The chances are good that this vessel has mortgage debts greater than its current market value and far greater than its distress sale value. If it is one of hundreds of U.S. fishing vessels that have been purchased, outfitted, or converted with foreign mortgage money, it may well not be worth the debts against it. Foreign lenders are not subject to the same cost-benefit checks and balances that prevent U.S. lenders from making bad loans. Depending on the country involved, investments in U.S. fisheries may be subsidized by foreign governments to secure access to U.S. fishing grounds. Foreign investors may also enjoy tax advantages by investing outside of their country. Even if a vessel's market value exceeded the loan amount at the time of the loan, because of the currently declining market for fishing vessels, that vessel's mortgage debt may now greatly exceed her value.

This matters to marine vendors because maritime liens for services and supplies are normally subordinate to the mortgage lien, so long as the mortgage is valid and was filed with the U.S. Coast Guard before the maritime services or supplies were furnished to the vessel. Certain other maritime liens will also rank ahead of the maritime supplier's liens. Claims for seamen's wages, for personal injury, for collision, for salvage, for general average, for stevedore's wages, and certain other claims enjoy "preferred" status and are paid ahead of the ship mortgage and the subsequent maritime liens

New Marine Financing Laws: De-Americanization of the U.S. Fishing Fleet?

On January 1, 1989, new marine financing laws that make it easier for foreign investors to control, profit from and own controlling interests in U.S. fishing vessels went into effect. Before 1989, foreign lenders could not take a preferred ship mortgage on a U.S. vessel. A federally-approved U.S. trustee could, however, hold a preferred ship mortgage in trust for a foreign lender who was the beneficiary of the trust. As of January 1, 1989, foreign investors were allowed to take ship mortgages on fishing vessels, pleasure craft and all vessels under 1,000 gross tons without federal approval and without obtaining a U.S. trustee. Thus, foreign investment in the U.S. fishing fleet is now easier, cheaper, and less visible.

Before 1989, if a ship mortgage was foreclosed, the foreign beneficiary of the mortgage could not buy at a Marshal's sale. Since Jan. 1, 1989, the new federal ship mortgage laws allow a foreign mortgagee to buy a fishing vessel and hold it for resale. The foreign mortgagee may then sell the vessel to a U.S.corporation whose stock may now be owned entirely by foreign citizens. Thus, the foreign mortgagee may loan an American fishing venture more than its fishing vessel is worth, and, if the venture fails, buy the vessel back at a Marshal's sale on a credit bid, cleared of all debts.

The new ship financing laws are extremely favorable to mortgagees in general, both domestic and foreign. The 1989 recodification of the Ship Mortgage Act of 1920 not only perpetuates the maritime lien status for mortgages but also eliminates many of the technical requirements. "Substantial compliance" is sufficient to give a ship mortgage top priority (or "preferred") status. As of January 1, 1989, any documented vessel can be subject to a preferred ship mortgage, including any towboat, barge or harbor craft under 25 gross tons. As a result of these statutory changes, foreign lenders are now pouring preferred ship mortgage money into an already over-capitalized U.S. fishing fleet.

An Unhappy Drama

A recent case in federal district court in Seattle,Wash., provides a fair warning to fishing vessel owners and suppliers. In the summer of 1988, a foreign bank, using a U.S. bank as its trustee, loaned over two million dollars to a vessel-owning corporation to purchase a fishing vessel, the *Alaskan Harvester*, converted in Norway. The loan was secured by a preferred ship mortgage. Before the loan was made, the foreign lender knew the corporation that owned the vessel was financially weak and could not afford to operate the vessel, although the principal was a capable and experienced U.S.fisherman. From the outset of the loan, the bank abandoned its mortgage payment schedule and allowed the vessel to continue to be operated for months after the owners were in default. No mortgage payments were ever made, yet the fishing vessel operated in Washington and Alaska waters for nearly a year, often on a credit basis.

While the foreign bank watched the fishing venture fail, maritime suppliers kept the vessel operating, assuming that its fishing revenues were being used to pay down the mortgage and that the company was a "going concern." During its eleven months of operation, the vessel ran up nearly a million dollars in maritime debts. When the foreign bank seized the vessel, foreclosed the mortgage and bought the vessel at a U.S. Marshal's sale on a credit bid, all of these maritime liens were wiped out.

The court ruled in favor of the mortgagee bank and denied the marine suppliers and repairers of the

THIS NEW NEED FOR DILIGENT INQUIRY WILL HAMPER THE EXTENSION OF INSTANT CREDIT, BUT THOSE SERVICING FISHING VESSELS UNDER THE CURRENT SHIP FINANCING REGIME HAVE LITTLE CHOICE.

vessel any recovery. The U.S. fisherman and his American partners lost their boat. The foreign bank was then able to sell the vessel privately to a corporation formed for that purpose. The foreign bank or the foreign-owned purchaser thus benefitted from the repairs,services and supplies on board — improvements for which no one will ever have to pay.

A Clear Lesson on Diligent Inquiry

The clear lesson from this is that diligent inquiry is essential. Maritime suppliers must inquire with the U.S. Coast Guard as well as with the vessel owner or manager about the mortgage debt and other encumbrances on fishing vessels seeking credit. On request, the Coast Guard Vessel Documentation Offices will provide a documented vessel's certificate of ownership for a fee of one dollar. This certificate should reflect outstanding ship mortgages and may also reflect other recordable liens. However, if a ship mortgage has been filed with the Coast Guard but not yet recorded, a manual search through the records of the Vessel Documentation Office in the vessel's home port will be necessary.

This new need for diligent inquiry will hamper the extension of instant credit, but those servicing fishing vessels under the current ship financing regime have little choice. Maritime suppliers have always had to deal with cycles of boom and bust in the fishing industry. As the next bust approaches following what is generally recognized as extensive overcapitalization of the North Pacific fishing fleet, marine vendors must be more cautious than ever about extending ready credit to fishing vessels.

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