FOREIGN INVESTMENT RESTRICTIONS IN COASTWISE SHIPPING: A MARITIME MESS

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A federal law known as the Jones Act imposes citizen ownership and control requirements on owners and operators of ships that transport goods between U.S. ports. Scholars have consistently presumed that these requirements are enforceable. This Note demonstrates, however, that limiting foreign ownership in companies with widely dispersed shareholders has become legally and practically infeasible in modern U.S. securities markets. It sheds light for the first time on the Seg-100 program of the Depository Trust Company, which aims to resolve this problem but would ultimately, even with substantial changes, be unable to discern the citizenship of entities that are not natural persons—a vast majority of shareholders. After considering the Jones Act's ownership and control restrictions in the context of U.S. national security and economic interests, the Note finds that both practical considerations and U.S. interests support elimination of the citizen ownership and control requirements. Recognizing that Congress may be unwilling to invite unrestricted foreign investment in coastwise shipping, it also proposes more limited reforms to foreign ownership limitations and administrative actions that could reduce, but not eliminate, unnecessary costs of the current system.

 I would like to thank Professor José Enrique Alvarez and Professor Geoffrey Parsons Miller for their guidance and advice during my research and writing of this Note. At the *New York University Law Review*, I am particularly indebted to Becky Abrams Greenwald for her enormously helpful input at crucial stages in the process, as well as to Michele A. Yankson, Ian K. Bausback, Ish Chhabra, Ankur Mandhania, Amy Michelle Oden, Nikolaus J. Williams, and Benjamin Zhu for their feedback and encouragement. Special thanks go to James B. Ellis II and John D. Kimball for helping educate me about maritime industry regulation and to Lois J. Radisch of the Depository Trust & Clearing Corporation for answering my questions about the U.S. stock transfer system and explaining the Seg-100 program. All errors are my own.

Introduction

In February 2011, the U.S. Coast Guard levied a fine of close to six million dollars[1] on Trico Marine for failing to prove—in the face of "repeated requests"—that it was 75% owned by American citizens, as required by law.[2] Many in the shipping industry were shocked. The Coast Guard demanded shareholder information from Trico that few public corporations would be able to provide.[3] A shipping industry executive observed that "[t]he Coast Guard's [expectations are] . . .

1 Memorandum from Kevin S. Cook, Rear Admiral, Commandant, U.S. Coast Guard, to Nat'l Vessel Documentation Ctr. (Feb. 24, 2011), *available at* http://www.uscg.mil/hq/cg5/nvdc/report/tricoaction.pdf.

2 Memorandum from Timothy V. Skuby, Acting Director, Nat'l Vessel Documentation Ctr., U.S. Coast Guard, to Kevin Cook, Rear Admiral, Commandant, U.S. Coast Guard 19 (Jan. 12, 2011), *available at* http://www.uscg.mil/hq/cg5/nvdc/report/trico.pdf. The Coast Guard was made aware of substantial foreign ownership as a result of an unpleasant proxy contest. *See* Nancy L. Hengen, *Trico Marine and Jones Act Citizenship*, 80 J. Transp. L., Logistics & Pol'y 48, 50–51 (2013) (describing the proxy contest during which Kistefos AS sought to replace two members of the Trico board of directors); Letter from Åge Korsvold, Chief Exec. Officer, Kistefos AS, to Trico Marine Shareholders (May 26, 2009) (arguing that Trico's "[h]ighly questionable management and Board decisions have led to abysmal . . . performance" and advocating replacement of two board members); Skuby, *supra*, at 1, 25 (explaining that the Coast Guard investigation began after receipt of "serious, credibly documented allegations" of improper foreign ownership in a letter from counsel to Kistefos AS dated October 2, 2009).

3 The Coast Guard asked Trico to prove the U.S. citizenship status of a number of institutional and corporate shareholders. Skuby, *supra* note 2, at 14. In order to prove the citizenship of any particular corporate or institutional shareholder under the Coast Guard's regulations, Trico would have needed to prove, among other factors, that 75% of the shareholders *of that shareholder* were U.S. citizens. This requirement would apply recursively for any institutional or corporate shareholders of the institutional or corporate shareholders of the Trico shareholder. For discussion of these issues facing non–natural person holders of stock in Jones Act companies, see *infra* Subpart II.B.2.

based on a stock transfer system that no longer exists."[4] In fact, as this Note explores, the entire statutory framework surrounding foreign investment in shipping is based on a stock transfer system that no longer exists.

The U.S. Congress has long assumed that American citizen control of ships that sail between U.S. ports (known as coastwise or cabotage shipping) is necessary for important national security and economic reasons.[5] Congress has further assumed that limiting foreign ownership of coastwise ships is an effective way to block foreign control of those ships.[6] A restrictive scheme of citizen ownership requirements for coastwise ships has therefore been in place in various forms since 1789, implemented under a law known as the Jones Act since 1920.[7] While in other economic sectors legislators have enacted laws to address foreign control risks using less rigid means than ownership percentage limitations,[8] the cabotage law has been read so strictly that foreigners are even prevented from holding large *nonvoting* stakes in

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[4] Carol Wolf, *Shipping Companies Quizzed on U.S. Ownership Law Called Obsolete*, BLOOMBERG (Nov. 7, 2011, 12:00 AM), http://www.bloomberg.com/news/2011-11-07/shipping-companies-quizzed-on-u-s-ownership-law-called-obsolete.html.

[5] *See, e.g.*, 46 U.S.C. § 50101(a) (2006) ("It is necessary for the national defense and the development of the domestic and foreign commerce of the United States that the United States have a merchant marine . . . owned and operated as vessels of the United States by citizens of the United States."); *infra* Subpart III.B (addressing national security and economic rationales for these restrictions).

[6] The statutory language on citizen control and ownership begins with the premise that an entity is a citizen of the United States based on the percentage of interests in the entity owned by citizens. 46 U.S.C. § 50501(a) (2006).

[7] Merchant Marine Act of 1920, Pub. L. No. 66-261, 41 Stat. 988 (codified as amended in scattered sections of 46 U.S.C.). The Jones Act is the core legislative protection of the U.S. cabotage cargo shipping industry, imposing limitations on foreign ownership and control, foreign crews, and foreign-built ships. This Note discusses only the foreign ownership and control components of the Act. Two sections of the 1920 Act are commonly referred to as the Jones Act, after the Act's principal sponsor, Senator Wesley L. Jones of Washington State. ANDREW GIBSON & ARTHUR DONOVAN, THE ABANDONED OCEAN: A HISTORY OF UNITED STATES MARITIME POLICY 119 (2000). This Note uses the term "Jones Act" exclusively to refer to Section 27, the section on cabotage.

[8] For example, under the Atomic Energy Act of 1954, Congress prohibits the issuance of nuclear utilization and production facility licenses to "an alien or any . . . corporation or other entity if the [Nuclear Regulatory] Commission knows or has reason to believe it is owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government." 42 U.S.C. § 2133(d) (2006). The Commission has developed guidelines that, in practice, allow in some cases majority foreign beneficial ownership of nuclear assets when the arrangement is accompanied by safeguards against foreign domination of the U.S. entity. *See, e.g.*, Constellation Energy Nuclear Grp., Nos. 50-317, 50-318, 72-8, at 2, 21 (Nuclear Regulatory Comm'n Oct. 9, 2009) (safety evaluation) (consenting to a transaction resulting in foreign beneficial ownership clearly exceeding 50%, with relatively direct ownership of 49.99% and indirect ownership in the entity owning 50.01% of the nuclear assets of 8.5% plus $1 billion in convertible stock).

U.S. coastwise shipping companies.[9] However, given the opacity of share ownership in modern U.S. stock markets, it is neither clear that foreign ownership restrictions are generally enforceable nor that they are capable of preventing foreign control. And foreign ownership restrictions contribute little to the underlying national security and economic objectives of U.S. maritime policy.

In this Note, I argue that it is legally and practically infeasible to limit foreign ownership in coastwise shipping companies with widely dispersed shareholders. The primary culprit is the changing nature of stock ownership in the United States. In the 1930s, not long after the Jones Act was passed, only about 10% of shares in U.S. markets were held by an individual or institution on behalf of someone else (the "beneficial owner"). Today, at least 85% of shares are held this way.[10] A variety of legal and practical obstacles now prevent most corporations from gaining access to the identities of beneficial owners without their consent. Scholars have yet to focus on the relevance of federal securities regulations, and of federal and state privacy laws, to the implementation of foreign investment restrictions.[11] In failing to explore the influence of securities regulation and privacy law on the regulation of foreign ownership, scholars have also overlooked the "Seg-100" program of the Depository Trust Company (DTC)" which seeks to enable corporations to meet foreign ownership restrictions in

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9 46 C.F.R. § 67.31(a) (2013).

10 *See infra* Subpart II.A.1 (discussing this trend and its implications).

11 The connection between shareholder anonymity and the implementation of foreign investment restrictions is raised in some practitioner-oriented literature that aims to help businesses navigate citizen ownership requirements; it is also raised in a smattering of older articles. *See, e.g.*, 2 MANUAL OF FOREIGN INVESTMENT IN THE UNITED STATES § 15:12 (J. Eugene Marans et al. eds., 3d ed. 2004) (discussing the Federal Communications Commission approach to this issue); Peter T. Butterfield, *Who Owns America? The Adequacy of Federal Foreign Investment Disclosure Requirements*, 24 COLUM. J.L. & SOC. PROBS. 79, 81–82 (1990) (discussing the impact of increased foreign investment in the United States and cautioning against greater disclosure requirements for foreign investors); Rochelle G. Kauffman, *Secrecy and Blocking Laws: A Growing Problem As the Internationalization of Securities Markets Continues*, 18 VAND. J. TRANSNAT'L L. 809, 810–13 (1985) (addressing the problems facing the SEC in policing international securities transactions and proposing several solutions). Scholars writing about foreign investment restrictions rarely delve into the problem of beneficial ownership, even though it is a major barrier to enforcement of the restrictions. *See, e.g.*, Kirsten Böhmann, *The Ownership and Control Requirement in U.S. and European Union Air Law and U.S. Maritime Law—Policy; Consideration; Comparison*, 66 J. AIR L. & COM. 689, 704, 725 (2001) (mentioning the difficulty of determining the citizenships of shareholders but not stating underlying causes, and noting the approach to this problem taken by Germany in its global share offering of Lufthansa); Linda A. Mabry, *Multinational Corporations and U.S. Technology Policy: Rethinking the Concept of Corporate Nationality*, 87 GEO. L.J. 563, 591 (1999) (raising the difficulty of determining shareholders' identities in only a few sentences and footnotes).

spite of their inability to identify their shareholders. This Note sheds light on the Seg-100 program for the first time, incorporating information obtained through an interview with the managing director and deputy general counsel of DTC's parent corporation. In light of the limits on citizenship information available to the banks and brokers that hold shares on behalf of beneficial owners, however, I conclude that Seg-100 will ultimately remain inadequate as an enforcement and compliance tool, even if improvements are made.

Moreover, this Note aims to contribute to the debate about the future of the Jones Act by squarely addressing its ownership and control restrictions. Existing literature on the Jones Act presumes that the law's foreign ownership provisions are enforceable[12] and generally conflates the issues of foreign ownership and foreign control.[13] In fact, foreign ownership and foreign control are distinct concepts, and it is quite possible to create targeted policies that block foreign control without preventing foreign ownership.[14] The literature also fails to address the desirability of ownership restrictions themselves, separated from other aspects of U.S. maritime policy.[15] Policies that keep foreign investors away are due for more careful consideration, given

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[12] Searches of Westlaw secondary sources for "'beneficial ownership' AND 'Jones Act'" (and for other similar search strings) produce no results mentioning practical barriers to enforcement that stem from the distinction between beneficial and legal ownership. In researching published literature on the Jones Act, I have only encountered one article discussing the issue, which was in the context of the Trico case. *See* Hengen, *supra* note 2, at 54, 57. Practitioners, of course, are well aware of the inherent difficulty. *See, e.g.*, *infra* note 77 and accompanying text (discussing the enforcement fears of Jones Act companies after the Trico case).

[13] The only apparent exception is an excellent article by John McConnell focused on interpretation of the Jones Act statutory language on ownership and control restrictions. John W. McConnell, Jr., *A Corporate "Citizen of the United States" for Maritime Law Purposes*, 25 J. MAR. L. & COM. 159, 161–88 (1994). Even an informative article on Jones Act ownership restrictions that is otherwise highly useful does not address the distinction between foreign ownership and foreign control. *See* Constantine G. Papavizas, *U.S.-Flag Vessel Financing and Citizenship Requirements Update*, 32 TUL. MAR. L.J. 35 (2007).

[14] *See e.g.*, *infra* Subpart III.C (discussing ways of permitting unlimited foreign ownership without permitting foreign control).

[15] Academics and policy experts have focused their discussions about the Act on other elements, especially the requirement that coastwise ships be built in the United States. *See, e.g.*, GIBSON & DONOVAN, *supra* note 7, at 293–305 (outlining the authors' proposals for reforms to the U.S. registry system and the Jones Act, focusing on removal of the U.S.-build requirement); DANIEL GOURE, THE CONTRIBUTION OF THE JONES ACT TO U.S. SECURITY 11 (2011), *available at* http://www.lexingtoninstitute.org/library/resources/documents/Defense/Contribution_of_the_Jones_Act.pdf (advocating for the continuation of current policies). *But see* Wakil Oyeleru Oyedemi, *Cabotage Regulations and the Challenges of Outer Continental Shelf Development in the United States*, 34 HOUS. J. INT'L L. 607, 619–36, 646–51 (2012) (supporting continuation and extension of the Jones Act to the U.S. outer continental shelf and suggesting, without much discussion, limited relaxation of the citizen ownership requirement, perhaps to 60%).

their potential effects on competition, incentives, and financing in the domestic shipping industry.

This Note begins in Part I with an introduction to the ownership and control restrictions currently in place for coastwise shipping companies under the Jones Act. Part II considers difficulties with the implementation of foreign ownership restrictions, beginning in Subpart II.A with an exploration of the shareholder communications problem. Subpart II.B demonstrates that even a complete overhaul of the shareholder communication framework would fail to ensure that Jones Act companies are able to monitor their compliance with the 75% citizen ownership threshold because the identity of a shareholder is only a first step towards determining the shareholder's citizenship. Subpart II.B concludes with a discussion of the unique difficulties associated with determining the citizenships of shareholders that are themselves corporations or institutional investors. This is a critical dilemma because corporations and institutional investors own about 73% of shares in public companies.[16]

Part III explores alternatives to the currently unworkable system. In Subpart III.A, I discuss the Seg-100 program of DTC. This program theoretically allows Jones Act companies to determine their shareholders' citizenships, but I demonstrate that the program is fundamentally flawed. While I suggest that certain changes would improve Seg-100, ultimately even major changes would not provide a reliable window into the citizenship of the owners of three-quarters of public shares that are entities other than individual investors, absent changes to the entire shareholder privacy scheme. In Subpart III.B, I propose the elimination of foreign ownership and control restrictions altogether, considering and rejecting arguments that elimination of the Jones Act's foreign control restrictions would threaten U.S. national security or economic interests. Rather than threatening those interests, opening the cabotage market to competition with foreign-invested and even foreign-controlled companies has considerable potential for advancing national security and economic strength.

I argue in Subpart III.C that even if foreign control restrictions are to be maintained, ownership restrictions are blunt tools that fail to prevent many ways of exercising foreign control while unnecessarily denying the industry access to additional capital. Such restrictions, if they must remain in place, ought to be targeted more effectively by Congress to prevent only control by foreign entities. Finally, in Subpart III.D, I propose corrective actions that the Coast Guard and

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16 Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1026 n.4 (2009).

Maritime Administration could take in the absence of congressional adjustment of the foreign ownership and control restrictions, principally by loosening their strict interpretation of the Jones Act's statutory requirements. Actions shy of complete repeal of the foreign ownership and control restrictions would reduce, but not eliminate, the unnecessary national security and economic costs of the current system of foreign ownership and control restrictions.

I
Foreign Ownership and Control Restrictions

The United States is remarkably open to foreign investors, in contrast to many other major economic powers that block or cap foreign investment across a variety of industries.[17] But there are exceptions to American hospitality. A prominent example is that foreigners are blocked from participating in large swaths of the U.S. transportation sector, particularly airlines and shipping.[18] Barriers in the maritime industry are the oldest of all. The first substantive act of Congress in 1789 imposed discriminatory tariffs on imports based on the ownership and place of manufacture of the importing vessel.[19] Since then, restrictions have varied in severity;[20] however, all along, legislators have consistently assumed that the United States needs a

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[17] The total stock of foreign direct investment in the United States was $2.9 trillion in 2011, more than in any other country (somewhat less, however, than in the countries of the European Union combined). OECD, *Foreign Direct Investment*, *in* OECD Factbook 2013: Economic, Environmental and Social Statistics 87 (2013), *available at* http://dx.doi.org/10.1787/factbook-2013-en. Foreign portfolio investment in U.S. securities adds up to another $13.3 trillion, including $4.2 billion in U.S. equities. Press Release, U.S. Dep't of the Treasury, Preliminary Report on Foreign Holdings of U.S. Securities (Feb. 28, 2013), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1865.aspx.

[18] *See* 49 U.S.C. § 41703(a), (c) (2006) (prohibiting foreign civil aircraft from commercially transporting passengers or cargo within the United States except in emergencies or under lease to U.S. airlines); Christian Westra, *The April 2007 U.S.-EU "Open Skies" Agreement: A Dream of Liberalization Deferred*, 32 B.C. Int'l & Comp. L. Rev. 161, 165–72 (2009) (discussing largely failed European efforts to improve foreign investors' access to the U.S. airline market). U.S. shipping foreign investment restrictions encompass transportation between U.S. ports of both cargo and passengers, though this Note specifically discusses the restrictions applicable to cargo.

[19] Act of July 4, 1789, ch. 2–3, 1 Stat. 24, 27 (repealed 1790).

[20] The restrictions ranged over time from prohibiting most foreign ships' access to American ports in 1817, Navigation Act of 1817, ch. 31, 3 Stat. 351 (repealed in part 1864 and in part 1933), to allowing some foreign ships to operate temporarily as American ships on U.S. coasts during World War I, Act of October 6, 1917, Pub. L. No. 65-73, 40 Stat. 392 (repealed 1920). The 1817 law provided an incentivizing exception for "the vessels of any foreign nation which has not adopted, and which shall not adopt, a similar regulation," but the exception did not extend to coastwise shipping, from which foreign vessels were banned altogether. Ch. 31, 3 Stat. at 351.

nationally built, owned, and manned fleet of merchant vessels—a national merchant marine.

The U.S. shipping industry, with more than 38,000 vessels authorized to sail between U.S. ports representing over $41 billion in private investment,[21] is protected from foreign competition in coastwise transportation under the regime established by the Merchant Marine Act of 1920 (Jones Act). The Jones Act requires that ships transporting goods between U.S. ports be "wholly owned by citizens of the United States for purposes of engaging in the coastwise trade."[22] Corporate entities operating a ship in the coastwise trade must meet several requirements: (1) "the controlling interest [must be] owned by citizens";[23] (2) "at least 75 percent of the interest must be owned by citizens";[24] (3) the corporation must be incorporated under U.S. or state law;[25] (4) its chief executive officer and chairman of the board of directors must be citizens;[26] and (5) less than a quorum minority of directors may be noncitizens.[27]

The 75% citizen ownership requirement has several component parts that aim to ensure that "there is no other means by which control of more than 25 percent of any interest in the corporation is given to or permitted to be exercised by a person not a citizen of the United States."[28] The implementing regulations interpret these requirements expansively, requiring that foreigners be limited to 25% investment in all classes of stock, even nonvoting classes, and that "non-citizens [may not], by any means, exercise control over the entity."[29] Examples of control indicated in the regulations include restricting the discretion

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[21] *U.S.-Flag Waterborne Domestic Trade and Related Programs*, U.S. DEP'T TRANSP. MAR. ADMIN., http://www.marad.dot.gov/ships_shipping_landing_page/domestic_shipping/Domestic_Shipping.htm (last visited Apr. 21, 2014).

[22] 46 U.S.C. § 55102(b) (2006). Under the vessel documentation regulations, shipping companies self-certify that they meet these requirements when they apply for coastwise endorsement, creating a rebuttable presumption that these requirements have been met. 46 C.F.R. § 67.43 (2013). The restrictions discussed here do not extend to international cargo shipping or to companies carrying proprietary cargo, oil spill response vessels, or leasing/financing companies. 46 U.S.C. §§ 12117–19 (2006). On the lease-finance exception, see *infra* note 146.

[23] 46 U.S.C. § 50501(a) (2006).

[24] *Id.* As the Jones Act was originally passed by the Senate, the law would have required 100% U.S. citizen owners. This requirement was subsequently reduced to 75% in conference. *See* Conoco, Inc. v. Skinner, 970 F.2d 1206, 1220–21 (3d Cir. 1992) (summarizing the legislative history of the Jones Act).

[25] 46 U.S.C. § 50501(b)(1).

[26] *Id.* § 50501(b)(2).

[27] *Id.* § 50501(b)(3).

[28] *Id.* § 50501(d)(4). The other provisions cover voting power, title to stock, and the absence of special arrangements providing a foreign person with more than 25% of voting power. *Id.* § 50501(d).

[29] 46 C.F.R. § 67.31(a) (2013).

of an entity's chief executive officer or directing the transfer or operation of any vessel.[30] The Jones Act also mandates that ships be built in the United States and manned by American crews in order to participate in coastwise trade.[31] Under separate laws, the U.S. government also continues to provide subsidies to ships in the Maritime Security Program and Voluntary Intermodal Sealift Agreement Program, and to require that certain government cargo travel on ships on the U.S. government registry (U.S.-flag ships).[32]

Penalties for noncompliance with the citizenship requirements of the Jones Act can be severe. Merchandise transported between U.S. ports in contravention of the Jones Act is subject to forfeiture or a fine equal to the value of the merchandise.[33] Use of vessels in violation of the statute entitles the Coast Guard to levy daily fines of up to \$15,000.[34] A number of situations could even lead to outright seizure of a ship and forfeiture to the U.S. government.[35] Further, the unauthorized transfer of a U.S. vessel to a noncitizen (including through a lease or charter) can result in criminal penalties of up to five years in prison and a fine, in addition to seizure and forfeiture of the vessel.[36]

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30 *Id.* § 67.31(b).

31 46 U.S.C. §§ 8103, 12112 (2006).

32 *See* 10 U.S.C. § 2631 (2012) (U.S. vessels must be used for transporting Army, Navy, Air Force, and Marine supplies); 46 U.S.C. § 55305 (2006) (fifty percent of cargo procured, furnished, or financed by the U.S. government must be transported on U.S. vessels); 46 C.F.R. § 296 (2013) (providing the framework for implementing the Maritime Security Program); *Voluntary Intermodal Sealift Agreement*, U.S. DEP'T TRANSP. MAR. ADMIN., http://www.marad.dot.gov/ships_shipping_landing_page/national_security/vol_intermodal_sealift_agreement/vol_intermodal_sealift_agreement.htm (last visited Apr. 21, 2014) (describing the VISA program, which provides the Department of Defense with "'assured access' to commercial sealift and intermodal capacity" to support U.S. military forces). Shipping companies have also been entitled to various antitrust law exemptions over time. *See generally* Chris Sagers, *The Demise of Regulation in Ocean Shipping: A Study in the Evolution of Competition Policy and the Predictive Power of Microeconomics*, 39 VAND. J. TRANSNAT'L L. 779 (2006) (discussing the history of special antitrust treatment of U.S. shipping carriers).

33 46 U.S.C. § 55102(c) (2006).

34 46 U.S.C.A. § 12151(a) (West 2012) (effective Dec. 20, 2012).

35 The U.S. government may seize a ship if a vessel is operated in the coastwise trade without a proper coastwise endorsement, if a "documented vessel . . . is placed under the command of a person not a citizen of the United States," or if a vessel owner "knowingly makes a false statement or representation" in applying for vessel documentation. *Id.* § 12151(b). Despite this harsh statutory language, the Maritime Administrator's regulations have created a blanket authorization for some types of interest transfers, including allowing foreigners to own mortgages on Jones Act ships and to time charter Jones Act ships, except in wartime. 46 C.F.R. § 221.13 (2013); Papavizas, *supra* note 13, at 53–57. The issues raised here are also likely pertinent to some large nonpublic companies, such as large private equity firms that own shares—sometimes in significant numbers—in Jones Act carriers.

36 46 U.S.C. § 56101(e)(1), (3) (2006). Criminal penalties apply only to transferors knowingly violating the law. *Id.*

II
Challenges in Determining Citizen Ownership

The Jones Act's statutory scheme restricting foreign ownership of U.S. coastwise vessels assumes that it is possible to determine with some degree of certainty the citizenships of at least 75% of the shareholders of the corporations that own or operate such ships. That assumption is seriously flawed. This Part demonstrates that it is currently tremendously difficult, if not impossible, to determine whether a large public corporation's owners meet the citizenship requirement. Subpart II.A addresses impediments to identifying a corporation's owners, who are generally not listed on a corporation's stock ledger (shareholder list) due to the beneficial ownership system, and who cannot be reached due to privacy laws and federal securities regulations. Subpart II.B explores the difficulty of establishing the citizenships of shareholders, even after identification, both because shareholders' names and addresses can be misleading and—far more significantly—because most shareholders are themselves institutions or corporations with diffuse ownership. The focus here is on large public corporations, which are dominant participants in American coastwise shipping and benefit from access to capital from public equity markets,[37] rather than small private operations with clearly distinguishable citizen owners.

A. Beneficial Owners and Their Carefully Guarded Identities

1. Record Ownership Detached from Beneficial Ownership

The identities of the owners of public corporations are shrouded in mystery, even though every corporation is required by law to keep a record of its shareholders.[38] Modern trends in share ownership have created an enormous disconnect between the actual purchasers of corporate shares, called economic or beneficial owners, and the legal owners of the shares under state corporate law, called record

[37] For instance, nearly 40% of large Jones Act cargo vessels are operated by just three public companies: Matson Navigation (NYSE: MATX), Horizon Lines (OTC: HRZL), and Overseas Shipholding Group (OTC: OSGIQ). *United States Flag Privately-Owned Merchant Fleet*, U.S. Dep't of Transp. Mar. Admin., http://www.marad.dot.gov/documents/USFlag-Fleet.xls (last updated Jan. 7, 2014). The issues raised here are also likely pertinent to some nonpublic companies, such as Jones Act carriers that are owned in substantial part by large private equity firms.

[38] This Note refers to shareholders as either "owners" or "shareholders." Unless otherwise indicated, these terms refer to beneficial shareholders rather than shareholders of record, as explained in this subsection of the Note. The term "issuers" is used interchangeably with "corporations" to refer to public corporations that issue stock.

owners.[39] Today, the vast majority of U.S. exchange-traded securities are registered under the names of brokers or nominees of institutions, which hold the securities for the accounts of customers and are the record owners.[40] Record owners forward corporate communications such as proxy solicitations to beneficial shareholders. A single certificate depository, the Depository Trust Company, estimates that it is the record owner for 90% of all U.S. securities, holding the securities in the name of its nominee, Cede & Co.[41] When shares are held by a nominee such as Cede & Co., a corporation's beneficial owners are hidden on the corporate stock list behind an entry for Cede & Co.,

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[39] State laws continue to provide that the record owners are the legal owners of the shareholder rights, though this principle has been softened in some respects. *See, e.g.*, DEL. CODE ANN. tit. 8, § 219(c) (2011) ("The stock ledger shall be the only evidence as to who are the stockholders entitled . . . to vote in person or by proxy at any meeting of stockholders."); *see also* David C. Donald, *Heart of Darkness: The Problem at the Core of the US Proxy System and Its Solution* 1 n.3 (Chinese Univ. of H.K. Ctr. for Fin. Regulation and Econ. Dev., Working Paper No. 1, 2010) (noting similar provisions for other states).

[40] The SEC estimates that about 85% of U.S. exchange-traded securities are held this way. SEC. & EXCH. COMM'N, REPORT ON AUTHORITY TO ENFORCE EXCHANGE ACT RULE 12g5-1 AND SUBSECTION (b)(3), at 8 n.26 (2012), *available at* http://www.sec.gov/news/studies/2012/authority-to-enforce-rule-12g5-1.pdf. Broadridge Financial Solutions, *see infra* note 45 and accompanying text, estimates that just 2% of beneficial shareholders are also owners of record, with the remaining 98% of shares held in the names of entities other than the beneficial owners. PETER E. BREEN, BROADRIDGE, REGISTERED SHAREHOLDERS: HOW TO MANAGE THE MILLENNIAL CHALLENGE 2 (2012), *available at* http://media.broadridge.com/documents/Broadridge_Millennial_Challenge_Report.pdf.

The system under which legal and beneficial ownership are separated for the vast majority of stock owes its existence to a congressional effort to improve the functioning of securities markets by eliminating the costly bottleneck of physical transfers of securities certificates. Securities Acts Amendments of 1975 § 15, Pub. L. 94-29, 89 Stat. 97 (codified as amended in scattered sections of 15 U.S.C.). Transfers of stock now largely take place via book entries instead of the physical movement of certificates. *See* David C. Donald, *The Rise and Effects of the Indirect Holding System: How Corporate America Ceded Its Shareholders to Intermediaries* 9–11 (Inst. for Law and Fin., Working Paper No. 68, 2007) (explaining how the book entry transfer system stemmed from brokers' inability to physically process the rapidly increasing number of paper transactions). *See generally Clearance and Settlement of Securities Transactions: Hearings on S. 3412, S. 3297 and S. 2551 Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous. and Urban Affairs*, 92d Cong. 2 (1972) (discussing legislation for national securities bookkeeping systems and certificate depositories to "protect[ ] investors from the consequences of securities paperwork log jams," in the words of Senator Harrison A. Williams, Jr., subcommittee chairman).

[41] DEPOSITORY TRUST & CLEARING CORP., AN INTRODUCTION TO DTCC'S ISSUER SERVICES 7, *available at* http://dtcc.com/~/media/Files/Downloads/Settlement-Asset-Services/Issuer%20Services/Issuer_Serv_Brochure.ashx. Cede & Co. is the only record holder used by the Depository Trust Company, the clearing agency that handles nearly all U.S. securities purchases. The "Cede" in Cede & Co. stands for "*ce*rtificate *de*pository." Donald, *supra* note 39, at 3.

which then appears as a single record owner for close to all of any given public company.[42]

Record owners have fairly limited rights to the shares they hold, as compared with the beneficial owners on whose behalf they hold shares.[43] Therefore, it is beneficial owners who must be investigated to ensure that Jones Act citizenship requirements are met for shipping companies. Both cost and—more significantly—legal limitations make such investigation problematic. Beneficial owners' identities and addresses must be gathered recursively from the record owners through intermediaries, which can sometimes be several layers deep (with large national banks being the legal owners of stocks held on behalf of smaller banks, which themselves are holding the stocks on behalf of their clients, for example). Public companies are legally prevented from collecting or accessing this information themselves, as discussed below. The cost to a public company for arranging the gathering of this information on its behalf is currently a minimum of tens, and often hundreds, of thousands of dollars.[44] Broadridge Financial Solutions, which identifies beneficial owners for many American public companies, earned close to $1.8 billion in revenue in its 2013 fiscal year from "investor communications solutions," including identifying investors and sending them annual reports and proxy materials.[45]

If a company's management wants to access its shareholders' identifying information, legal hurdles rather than technical ones are most problematic. Since the 1980s, the federal government has allowed shareholders who do not wish to have their identities revealed to issuers to designate themselves as "objecting beneficial owners" (OBOs) by simply informing their banks and brokers.[46] Over thirty

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[42] Some beneficial owners can be identified through federal disclosures of entities holding more than a 5% interest in a public corporation, 15 U.S.C. § 78m(d)(1) (2012), or for institutional investment managers with discretion over $100 million or more in certain types of securities, *id.* § 78m(f)(1).

[43] *See* Thomas Lee Hazen, The Law of Securities Regulation § 10.10 (6th ed. 2009) (describing rules and regulations applicable to broker-dealers and banks for voting shares held for accountholders).

[44] *2011 Transfer Agent Survey to Estimate the Costs of a Market-Based Proxy Distribution System*, Sec. Transfer Assoc. 4 (Oct. 3, 2011), http://www.stai.org/pdfs/sta-survey-proxy-processing-costs-10-3-11.pdf.

[45] Broadridge Fin. Solutions, Inc., Annual Report (Form 10-K), at 39, 40 (Aug. 8, 2013). Broadridge identifies all beneficial owners at least once a year for about 85% of outstanding shares of U.S. public corporations as part of proxy solicitation. *Id.* at 4. For its fiscal year ending in June 2013, the company brought in over $302 million in earnings before taxes from its investor communications business, 24% higher than the previous year. *Id.* at 40.

[46] Facilitating Shareholder Communications Provisions, Exchange Act Release No. 34-20021, 28 SEC Docket 513 (July 28, 1983).

years since the scheme was put into effect, this rule—which in practice prevents corporations from directly contacting many of their shareholders and shareholders from contacting one another—remains controversial from a corporate governance and efficiency perspective. Academics and many practitioners continue to argue for greater direct communication between shareholders and corporations, and some also argue against shareholder anonymity.[47] Though incremental reforms may occur, it is likely that banks and brokers will continue to be essentially blocked from revealing the identities of OBOs to corporate management. For the time being, it is thus impossible for corporations to identify many of their shareholders. The problem is nearly insurmountable because for most corporations, OBOs outnumber NOBOs (nonobjecting beneficial owners, i.e., those who allow corporations to know their identities) by a ratio of three to one.[48]

2. *Privacy Laws Protecting Shareholder Identities*

Federal and state privacy laws also complicate any issuer's effort to ascertain the identities of its beneficial owners. Federal and state laws overlap to provide a significant degree of confidentiality for nonpublic information that financial institutions learn about their clients.[49] Under regulations enacted pursuant to the most relevant federal privacy law, the Gramm-Leach-Bliley Act, a financial institution is required to provide customers an opportunity to opt out of most disclosures to unaffiliated third parties, except where the customer has already been notified of that type of disclosure and chosen not to opt out.[50] The Act also explicitly permits states to maintain or enact privacy schemes that exceed the minimum federal requirements.[51] Several states have implemented statutes or regulations

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47 *See infra* Subpart II.A.3 (discussing the shareholder communication debate).

48 Letter from Steve Odland, Chairman, Corporate Governance Task Force, Bus. Roundtable, to Jonathan G. Katz, Secretary, U.S. Sec. & Exch. Comm'n, n.2 (Apr. 12, 2004), *available at* http://www.sec.gov/rules/petitions/petn4-493.htm.

49 For an overview of privacy laws in the context of financial and insurance companies, including privacy statutes, state constitutional privacy rights, and common law, see Steven C. Bennett & Michele N. Bradley, *Banking, Financial, and Insurance Industries*, *in* Ronald N. Weikers, 2 Data Security and Privacy Law 587–642 (2013).

50 Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, § 502(b), 113 Stat. 1338, 1437 (1999) (codified as amended in scattered sections of 12 and 15 U.S.C.). For some representative regulations, see 12 C.F.R. § 216.10 (2014) (Federal Reserve); 17 C.F.R. § 248.10 (2013) (SEC). The Act does permit disclosure to third parties without customer authorization in some instances, including "to protect against or prevent . . . fraud, unauthorized transactions, claims, or other liability," 15 U.S.C. § 6802(e)(3)(B) (2012), and "to comply with Federal, State, or local laws, rules, and other applicable legal requirements," *id.* § 6802(e)(8).

51 15 U.S.C. § 6807(a)–(b) (2012).

prohibiting financial institutions from disclosing confidential information unless the customer has opted in.[52] The disclosure of accountholder identities can also expose financial institutions to liability for breaches of duties arising from privacy statutes or common law, at least in many states.[53]

Privacy laws and state contract laws thus provide another significant barrier to any effort a Jones Act company might make to ascertain the identities of its beneficial owners, since generally only the financial institutions that manage the accounts of the shareholders know the identities of beneficial owners of stocks.

3. *Long Odds for Piercing the OBO Veil*

One way to help Jones Act companies identify the citizenships of their shareholders would be for the SEC to issue a rule allowing public corporations to access full rosters of their beneficial shareholders regardless of the shareholders' status as OBOs, preempting state privacy laws that would normally prevent such disclosure. Such a change could be enacted for all public corporations, as many advocate,[54] or only for those subject to citizenship ownership restrictions.

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52 *E.g.*, CAL. FIN. CODE § 4052.5 (Supp. 2014); N.D. CENT. CODE § 6-08.1-04 (2006); VT. STAT. ANN. tit. 8, §§ 10201–05 (Supp. 2013); *see also* DANIEL J. SOLOVE & PAUL M. SCHWARTZ, PRIVACY, INFORMATION, AND TECHNOLOGY 387–88 (2d ed. 2009) (discussing California, North Dakota, and Vermont's legal approach to the issue).

53 *See, e.g.*, Taylor v. NationsBank, N.A., 776 A.2d 645, 654 (Md. 2001) (finding an implied duty of confidentiality in the contractual relationship between bank depositors and banks); Burford v. First Nat'l Bank in Mansfield, 557 So. 2d 1147, 1151 (La. Ct. App. 1990) (reading a "duty of confidentiality on the part of financial institutions in favor of their customers" into two state statutes). The California Supreme Court even held that banks must give customers an opportunity to object in court before they may reveal a customer's records pursuant to civil court subpoenas. Valley Bank of Nevada v. Super. Ct., 542 P.2d 977, 980 (Cal. 1975).

54 *See, e.g.*, Donald, *supra* note 39, at 23–38 (discussing the high costs of communication through intermediaries and the potential for an overhaul); Odland, *supra* note 48, at 10 (advocating elimination of OBO status); John C. Wilcox, *Shareholder Nominations of Corporate Directors: Unintended Consequences and the Case for Reform of the U.S. Proxy System*, http://www.law.yale.edu/documents/pdf/cbl/Wilcox_John.pdf (last visited Apr. 28, 2014) (describing elimination of the NOBO/OBO distinction as "critical to simplifying the proxy system and reducing its costs"). Elimination of OBO status could bring several potential benefits for corporate governance, including "lowering information asymmetries" in a way that would "enhance markets' ability to reflect the available information," producing more faithful shareholders willing to provide additional capital to a corporation through rights issues, and facilitating communication among shareholders to "enhance investors' voice or help reach the participation thresholds set for the exercise of corporate rights." Luca Enriques, Matteo Gargantini & Valerio Novembre, *Mandatory and Contract-Based Shareholding Disclosure*, 15 UNIFORM L. REV. 713, 720–29 (2010).

However, this type of dramatic change would be highly controversial and seems unlikely to occur.[55]

Shareholder privacy advocates fear that eliminating OBO status would expose investors to unwanted communications and interfere with investor ability to hold shares in controversial companies.[56] This is in part because, under state laws, once the company has a list of shareholders, any shareholder with a valid purpose is generally entitled to access it.[57] They also express concern that releasing investment position information would compromise investors' trading strategies.[58] From a different perspective, some worry that significant dissemination of shareholder information across equity markets would reduce market efficiency, encouraging some investors to freeride on research by top institutional investors and reducing incentives to conduct research independently.[59]

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55 *See* Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1281 (2008) (concluding that major changes in shareholder voting to involve more direct contact between issuers and shareholders would require "a realignment of our system of securities ownership, a change that is expensive and uncertain"). The SEC has explored the issue many times, without proposing a rule change. *See, e.g.*, Securities & Exchange Commission, Concept Release on the U.S. Proxy System, Release Nos. 34-62495; IA-3052; IC-29340, at 64–77 (2010), *available at* www.sec.gov/rules/concept/2010/34-62495.pdf (summarizing these issues and requesting public comments on "whether we should eliminate the OBO/NOBO distinction, thereby making all beneficial owner information available to the issuer, or require broker-dealers to disclose the consequences of choosing OBO or NOBO status, or whether OBO or NOBO status should be the default choice," along with related questions).

56 ALAN L. BELLER & JANET L. FISHER, COUNCIL OF INST. INVESTORS, THE OBO/NOBO DISTINCTION IN BENEFICIAL OWNERSHIP: IMPLICATIONS FOR SHAREOWNER COMMUNICATIONS AND VOTING 12, 13 (2010), *available at* http://www.sec.gov/comments/s7-14-10/s71410-22.pdf.

57 *See* HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 94TH CONG., FINAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE PRACTICE OF RECORDING THE OWNERSHIP OF SECURITIES IN THE RECORDS OF THE ISSUER IN OTHER THAN THE NAME OF THE BENEFICIAL OWNER OF SUCH SECURITIES 40 n.84 (Comm. Print 1976) ("Brokers . . . argu[ed] that once disclosure[s] were made, it would be impossible, as a practical matter, to preserve the confidentiality of their customer[s] . . . ."). The right of shareholders to inspect shareholder records is found both in common law and in the statutes of most states. JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 13:2 (3d ed. 2013). In New York, the right also extends to NOBO lists that are not in the corporation's possession, as they are obtainable through a "relatively simple mechanical task." Sadler v. NCR Corp., 928 F.2d 48, 53 (2d Cir. 1991).

58 HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, *supra* note 57. Disclosure of identities of beneficial owners could also expose them to additional regulatory enforcement risks. Enriques et al., *supra* note 54, at 729; *see also* J. Robert Brown, Jr., *The Shareholder Communication Rules and the Securities and Exchange Commission: An Exercise in Regulatory Utility or Futility?*, 13 J. CORP. L. 683, 766–68 (1988) (discussing how limiting secrecy could enable increased oversight).

59 Enriques et al., *supra* note 54, at 730–31.

Irrespective of the merits of these considerations, entrenched interests would also certainly oppose elimination of the NOBO/OBO distinction. Brokers and banks fear that they would lose clients if competitors gained access to their customer lists.[60] And the dominant investor communications firm stands to lose nearly $1.8 billion in annual revenue if issuers are able to circumvent it.[61] Given the breadth of these concerns and entrenched interests, and the longstanding debate on this subject, management access to shareholders is unlikely to be obtained quickly.[62] The difficulty of determining the identity of a corporation's shareholders thus remains a serious problem that undermines the viability of ownership restrictions in the Jones Act.

B. Impediments to Determining Shareholder Citizenship

Even if a shipping corporation's directors had the legal right to know the identities of all the corporation's beneficial shareholders, a shareholder name and address list would be of limited use in ascertaining whether the citizen ownership percentage meets Jones Act requirements. This Subsection begins by observing that the name and address of a beneficial owner provides relatively little citizenship information and notes that requiring each shareholder to provide management with proof of citizenship would be impractical. It continues with a discussion of the problem of recursively identifying shareholders where corporations or institutional investors own shares in Jones Act companies. As I then explain, the Coast Guard has suggested a more flexible approach with regard to mutual funds that own shares in Jones Act companies, but it has been unwilling to extend the approach more broadly.

1. Names and Addresses Are Unreliable Indications of Citizenship

Beneficial owners' addresses are likely to be unreliable as indications of their citizenship status. Many foreign corporations maintain offices and hold bank and brokerage accounts in the United States,[63]

60 *See* Donald, *supra* note 40, at 62–64 (discussing the primary interests involved and stating that "[s]taff counsel for the SEC has told the author of this paper that brokers now consider shareholder data their own property").

61 *See supra* notes 44–45 and accompanying text (explaining Broadridge Financial Solution's interest in keeping issuers from directly interacting with their shareholders).

62 For a more detailed treatment of these shareholder communications issues, see BELLER & FISHER, *supra* note 56; Brown, *supra* note 58; and Wilcox, *supra* note 54.

63 Tax statistics provide a general indication of the physical presence of foreign entities in the United States. *See* SOI TAX STATS – TABLE 10 - RETURNS OF ACTIVE CORPORATIONS, FORM 1120-F, INTERNAL REVENUE SERV., http://www.irs.gov/file_source/pub/irs-soi/10co10ccr.xls (last updated July 3, 2013) (indicating that in the 2010 tax year,

and many U.S. citizens have business operations and accounts overseas.[64] It is essentially costless for a foreign company with U.S. stock holdings to obtain a U.S. address. The significant U.S. tax advantages to which nonresident aliens and foreign corporations are entitled, including capital gains tax exemptions and tax treaty benefits, are not linked to the country of the taxpayers' addresses.[65] The Tax Code instead determines nonresident alien status based largely on time spent in the United States, and it determines whether a corporation is foreign based upon place of incorporation.[66]

Some courts and agencies have employed a presumption in other contexts that if a very high percentage of owner addresses are in the United States, the requisite percentage of U.S. citizen ownership exists.[67] While this approach could ameliorate concerns of those companies with an overwhelming percentage of U.S.-address beneficial shareholders, it would be of little use to a Jones Act company with too many foreign-address shareholders to meet the presumption, even if some foreign addresses may ultimately be traceable to U.S. citizens. Perhaps even more problematic, to the extent that the statute is concerned that foreign ownership may be somehow dangerous for U.S.

18,112 foreign entities filed U.S. income tax returns); FOREIGN-CONTROLLED DOMESTIC CORPORATIONS AS A PERCENTAGE OF ALL CORPORATIONS: SELECTED ITEMS FOR SELECTED TAX YEARS 1971–2010, INTERNAL REVENUE SERV., http://www.irs.gov/file_source/pub/irs-soi/10it01fcdc.xls (last updated Feb. 2013) (indicating that in the 2010 tax year, 73,210 domestic corporations filed tax returns on the basis of being majority owned by a single foreign entity). In addition, foreigners had about $3.6 trillion in U.S. bank and brokerage accounts as of the end of 2012. ELENA L. NGUYEN, THE INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES AT THE END OF THE FIRST QUARTER OF 2013 AND YEAR 2012, at 20 (2013), *available at* http://www.bea.gov/scb/pdf/2013/07%20July/0713_international_investment_position.pdf.

64 The vast scale of U.S. citizens' overseas financial assets has been the subject of much recent regulatory activity, but estimates vary widely. *See, e.g.*, Laura Saunders, *Offshore Bank Account Reporting Deadline Nears*, WALL ST. J., June 15, 2013, at B9 (providing tax filing statistics for U.S. citizens with foreign accounts, but acknowledging that many may not file). In addition to the controversies about U.S. residents with offshore holdings, citizens living overseas likely have many foreign bank and brokerage accounts. The State Department estimates that about seven million U.S. citizens live abroad. WHO WE ARE AND WHAT WE DO: CONSULAR AFFAIRS BY THE NUMBERS, U.S. DEP'T OF STATE (Jan. 2013), http://travel.state.gov/content/dam/ca_fact_sheet.pdf.

65 *See* 2 JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION ¶ C3.09 (2006) (discussing exemptions from capital gains for foreign individuals and corporations); *see also id.* ¶ C4 (surveying benefits of tax treaties).

66 *See* I.R.C. § 7701(a)(3)–(4) (2012) (defining domestic and foreign corporations for tax purposes); *id.* § 7701(b) (defining resident and nonresident aliens).

67 *See, e.g.*, Applications of Cellco P'ship, 23 F.C.C. 12463, 12525 (2008) (finding that an analysis indicating that more than 90% of beneficial shareholders of Verizon Wireless have U.S. addresses, conducted partly based on Broadridge beneficial owner address data, is sufficient along with limited other data to indicate 75% domestic ownership for the purposes of an FCC ruling).

national security or the merchant marine, a policy based on addresses would simply encourage foreign investors to establish U.S. addresses.

Without relying on addresses to assume citizenship, a corporation could, in theory, ask every beneficial shareholder to provide it with evidence or affirmation of citizenship. A comprehensive implementation of the Jones Act would thus likely require collecting citizenship information from beneficial owners directly. But many shareholders may not be responsive to such efforts, and a response rate below 75% of shareholders—or below 75% of a statistical sample of shareholders—could altogether prevent the company from establishing 75% citizen ownership. The task could become unruly and expensive, even if regulations limited how often a company needed to collect the identities of all beneficial owners and determine their citizenships.

2. *Delving Deeper: Corporate and Institutional Owners*

Verification of shareholders' citizenships is especially problematic for Jones Act companies with shareholders that are institutions or corporations. Individual retail investors directly own less than 27% of the market value of U.S. equity securities.[68] There is no obvious way to determine citizenship for the three-quarters of shareholders that are not natural persons. Investment companies alone (largely mutual funds) hold a larger percentage of the market than retail investors—29%.[69] At an average of 37,000 investors per mutual fund,[70] it would be cost prohibitive to determine the citizenship of even a substantial majority of a fund's true beneficial owners. As will be discussed shortly, the Coast Guard has indicated some willingness to be flexible with respect to mutual fund ownership, but nearly half of the shareholders in U.S. stock markets are non–mutual fund institutions or corporations, which the Coast Guard continues to treat as rigidly as ever.

In order to prevent foreigners from establishing U.S. subsidiaries to operate Jones Act ships, the Coast Guard has determined that *any* Jones Act company shareholder "must be a citizen eligible to document vessels in its own right" to count towards the 75% citizenship requirement.[71] In other words, if a shareholder is an entity other than an individual, in order to be counted towards the 75% threshold, it must have citizen ownership of at least 75%, a CEO and chairman of the board of directors who are both U.S. citizens, and a limited

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[68] Langevoort, *supra* note 16, at 1026 n.4.

[69] INVESTMENT COMPANY INSTITUTE, 2012 INVESTMENT COMPANY FACT BOOK 12 fig.1.5 (52d ed. 2012), *available at* http://www.ici.org/pdf/2012_factbook.pdf.

[70] *See id.* at 134 tbl.1 (showing that in 2011 there were 7637 mutual funds and 279,715,000 accountholders).

[71] 46 C.F.R. § 67.31(d) (2013).

number of foreign directors.[72] Full proof that a Jones Act company meets the citizenship requirement would thus appear to require a determination of the coastwise eligibility of at least 75% of beneficial owners, including mutual fund investors and corporate shareholders.

This recursive process of finding the shareholders of shareholders (and ascertaining their citizenships) would get out of hand quickly. The only apparent way to avoid this situation would be to require that everyone owning shares of any company on any U.S. stock exchange prove his or her citizenship and then to make that information readily available.[73]

Given these significant challenges related to citizenship for shareholders other than natural persons, the Coast Guard has indicated an initial willingness to move in the direction of loosening citizenship requirements. The Coast Guard stated in one paragraph of the Trico report that it "does not look beyond the citizenship of the mutual fund company to the individual fund account holders' citizenship," observing that the "essential feature" of such funds is "that the individual . . . account holders have no voice in the voting, disposition, or other control" of the Jones Act company.[74] Even though this statement contradicts the Coast Guard's requirement of coastwise eligibility for each beneficial owner, it is an implicit recognition that it would be impractical, and quite unnecessary, to enforce its regulations vis-à-vis mutual fund investors in Jones Act companies. The Coast Guard's reasoning on mutual funds would easily fit pension funds and other institutional investors—though the Coast Guard has indicated no willingness to apply such an approach to this broader set of entities.

Indeed, the Coast Guard's logic would even extend to most corporations (where shareholders are widely dispersed) that may hold stock in a Jones Act company. When a corporation is not closely held and ownership is widely dispersed, the influence of individual foreign investors is minimal. The only shared interest of unrelated foreign individuals holding shares in a corporation is the profitability and share price of the corporation. Even if there were an insidious shared

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72 *See supra* Part I (laying out the foreign ownership and control requirements for Jones Act companies).

73 Even this far-fetched theoretical solution would not fully account for companies that are partly traded on foreign stock exchanges. Many U.S.-incorporated companies also list overseas to raise additional capital from offshore investors. *See* Sergei Sarkissian & Michael J. Schill, Why Are U.S. Firms Listed in Foreign Markets Worth More? (July 11, 2010) (unpublished manuscript), *available at* http://mpra.ub.uni-muenchen.de/27543/1/MPRA_paper_27543.pdf (examining empirical data on differences in valuation for foreign-listed firms, including several hundred U.S. firms listed overseas).

74 Skuby, *supra* note 2, at 18.

interest among foreign shareholders of the corporation, collective action is difficult to organize—not least because most shareholders can never find out the identities of most other shareholders, many of whom are OBOs.[75] Even a large corporation with many foreign shareholders is unlikely to exert a controlling influence over a Jones Act company on behalf of its foreign shareholders. Therefore, there is little harm in imposing less strict citizen ownership requirements for corporate holders of small stakes in Jones Act companies.

Yet, loosening the requirements for corporations, institutions, and similar entities would have the effect of gutting most of the ownership restrictions altogether—since in the present day, as noted earlier, the vast majority of all shareholders are corporate or institutional investors. From the perspective of supporters of foreign control restrictions, the risk remains that U.S. ventures with large controlling foreign interests are hard to distinguish from U.S.-controlled companies without further investigation. In this sense, a substantial relaxation of the citizenship requirements for corporate owners of shares would not be a solution at all. Instead, it would represent a retreat from the project of attempting to block foreign control by restricting foreign ownership.

III
Alternatives

Jones Act shipping companies have been reluctant to raise in public the considerable obstacles to the implementation of foreign ownership restrictions.[76] The Trico investigation, however, left many companies uneasy.[77] At the industry's urging, the Coast Guard issued

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[75] *See generally* Moshe Schwartz, *Corporate Citizens Unite!: The Case for Shareholder Voting Reformation*, 8 N.Y.U. J.L. & Bus. 553 (2012) (discussing the collective action problem of shareholder passivity and also identifying ways that directors "game the system" to protect themselves from shareholder interference).

[76] The most likely reason is that coastwise shipping carriers' self-certifications of U.S. citizen ownership are almost never challenged (even though, as discussed earlier, many public Jones Act companies have little basis for making such self-certifications in the first instance). These companies also presumably have the most at risk if, bowing to practicality, Congress should begin to relax foreign ownership requirements and thereby enable greater competition in the industry.

[77] One law firm commented on behalf of "a variety of clients" that "[t]he frustrations voiced by Trico Marine are equally the frustrations of modern businesses and modern business structures that are owned by U.S. citizens." Letter from Alicia K. Dowdy, Brewer Law Grp., to Commandant, U.S. Coast Guard (Apr. 2, 2012), *available at* http://federal.eregulations.us/rulemaking/document/USCG-2011-0619-0011. The president of the Chamber of Shipping of America described a post-Trico meeting with the Coast Guard with reference to "[t]he angst identified by the meeting participants reflect[ing] their concern with meeting their obligations and how the methods of meeting those obligations may be viewed by the U.S. Coast Guard." Letter from Joseph J. Cox, Pres., Chamber of

a request for comments on implementation of the foreign ownership restrictions several months after the Trico investigation ended.[78] Yet it ultimately declined to make any explicit changes. The Coast Guard merely stated that in any future citizenship investigation it would "give positive consideration to a company's diligent and good faith efforts" to comply with the citizenship requirements.[79] This is likely all that Jones Act companies really wanted. Indeed, none of the few commenters advocated abandoning foreign control restrictions or opening the industry to new competition. Jones Act companies were assured of their ability to maintain their coastwise endorsements without significantly augmenting the minimally effective citizenship measures they already use, including Seg-100.[80]

Other Jones Act companies do not expect to find themselves in the position in which Trico found itself, with "a single foreign shareholder that owned between approximately 18% and 21%" of the company, where even a less "strict standard of proof" would have led to the same result.[81] The Coast Guard thus averted the "great economic harm to the existing public Jones Act companies" that the commenters had feared (in the form of higher costs of compliance),[82] without loosening the requirements that protect the existing Jones Act enterprises from foreign competition.

Still, there remains a need for a change in approach. Supporters of foreign control restrictions ought to be alarmed by the ineffectiveness of the current system, and others should question why it exists at all. This Part begins to wrestle with these issues and explores alternatives to the current system of ownership restrictions. In Subpart III.A, I introduce the "Seg-100" program developed by DTC, which would appear to circumvent the need for Jones Act companies to gain access to shareholder identities. Ultimately, however, the program fails to

Shipping of America, to Timothy Skuby, Dir., Nat'l Vessel Documentation Ctr. (Oct. 17, 2012), *available at* http://federal.eregulations.us/rulemaking/docket/uscg-2011-0619.

78 76 Fed. Reg. 68,203 (Nov. 3, 2011).

79 77 Fed. Reg. 70,452, 70,453 (Nov. 14, 2012). The Coast Guard noted that such efforts might include participation in Seg-100, a Depository Trust Company effort discussed *infra* Subpart III.A; monitoring of SEC filings; stock transfer restrictions/dual certificates; communications with NOBOs; and analysis of registered stockholder lists. These approaches are so seriously hindered by the beneficial ownership system that even a company using them all would have little insight into shareholder citizenships. But the Coast Guard went no further than recognizing that "no single measure or combination of measures may always provide direct proof of the citizenship of every shareholder." 77 Fed. Reg. 70,453.

80 This is discussed in Subpart III.A.

81 Letter from David L. Carrigee, Baldwin Haspel Burke & Mayer LLC, to U.S. Dep't of Transp. (Mar. 30, 2012), *available at* http://federal.eregulations.us/rulemaking/document/USCG-2011-0619-0009.

82 Cox, *supra* note 77, at 10.

address the most salient practical difficulty with ownership restrictions: ascertaining the citizenships of shareholders that are not natural persons. In Subpart III.B, I critically assess the assumption that U.S. national security and economic interests are incompatible with foreign control of U.S. coastwise shipping companies and suggest that restrictions on both foreign ownership and foreign control of Jones Act corporations should be completely eliminated. Subpart III.C then shows that given the ineffectiveness and costs of foreign ownership restrictions, foreign ownership restrictions should, at a minimum, be lifted and replaced with more targeted ways of preventing foreign control. Finally, Subpart III.D proposes steps that the Coast Guard and Maritime Administration could take even without new legislation to reduce some of the unnecessary burden created by the foreign ownership and control restrictions of the Jones Act.

A. Seg-100: A Partial Solution?

In June 1988, DTC introduced a program designed to monitor foreign citizen beneficial ownership of shares deposited with DTC and registered under the legal ownership of DTC's nominee.[83] Until that time, DTC policy did not allow member-participants (banks and brokerages) to deposit with DTC shares of companies with alien ownership restrictions held on behalf of foreign beneficial owners.[84] In its 1988 announcement, DTC stated that it would begin allowing such shares to be deposited so long as they were designated by participants as belonging in "Segregation Account #100" (Seg-100). The rules underlying this designation allow DTC and the issuer's transfer agent[85] to know in real time whether a company risks breaching a

[83] Memorandum from the Depository Trust Co. to All Participants 3 (June 16, 1988), *available at* http://dtcc.com/~/media/Files/pdf/2008/5/14/3487-08.ashx; *see also* Depository Trust Company Proposed Rule Change, 53 Fed. Reg. 30,893 (proposed June 30, 1988) (establishing rule underlying the Seg-100 system). For background on the Depository Trust Company as the legal owner of around ninety percent of all U.S. equity shares, through its nominee Cede & Co., see *supra* note 41 and accompanying text.

[84] It is difficult to know whether participants had actually refrained from allowing foreign citizens to buy DTC-held shares in these companies prior to 1988. DTC participants were required to execute "Certificates as to Citizenship" assuring that they would not hold noncitizen-owned shares of certain types of issuers at DTC. These certificates were periodically revised to encompass additional types of issuers. *See, e.g.*, Depository Trust Company Proposed Rule Change, 41 Fed. Reg. 35,587 (proposed Aug. 4, 1976) (proposing that new certificates as to citizenship be executed by all DTC participants to "deal[ ] more specifically with the requirements of [applicable law] . . . restricting alien ownership of radio station licensees' capital stock"). DTC never had any way of knowing whether or to what extent participants complied.

[85] The transfer agent is the entity that acts on behalf of the issuer to perform obligations such as registration of transfers of stock ownership. 15 U.S.C. § 78c(a)(25) (2012).

foreign ownership limitation and facilitates ordering DTC participants to take remedial steps (such as withdrawing shares from DTC).[86] The program now includes eighteen maritime securities.[87] In essence, Seg-100 attempts to shortcut both the OBO problem and the difficulty of getting citizenship information from beneficial owners by holding DTC participants responsible for identifying their accountholders' citizenships.

However, two elements of this system severely limit its value as a legal tool. First, it not only relies on brokers and banks to make legal judgments about the citizenship status of clients and to take the practical steps to designate shares when appropriate, but also lacks any way of verifying compliance. From the beginning, DTC has insisted that the issuers and their transfer agents on one side, and the DTC participants and investors on the other, are responsible for complying with the Seg-100 program and the relevant legal requirements—Seg-100 is simply a helpful "tool."[88] DTC requires issuers to indemnify it against any liability arising from restrictive ownership statutes before it will allow them to participate in Seg-100.[89] In its only compliance measure, DTC warns participants that it will inform regulators and may impose disciplinary sanctions in the event that any participant fails to comply with a request to withdraw shares after a Seg-100

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[86] The mechanics of Seg-100 are as follows. DTC's electronic Participant Terminal System allows participants to designate certain securities holdings as foreign owned. The participants are required to determine citizenship themselves based on the relevant statutes. Depository Trust Co. Memorandum, *supra* note 83. DTC periodically reports the Seg-100 holdings of an issuer to that issuer's transfer agent, which verifies that foreign ownership limitations are not exceeded. *Id.* In the event that restrictions are exceeded due to trades made through DTC, DTC "immediately reverse[s] credits made by Participants to their Seg 100 accounts on a 'last in – first out' basis" until the number of shares designated under Seg-100 is below the limit, and participants are required to respond by withdrawing the foreign-owned shares from DTC. Memorandum from the General Counsel's Office of the Depository Trust Co. to All Participants (May 14, 2008), *available at* http://dtcc.com/~/media/Files/pdf/2008/5/14/3487-08.ashx (numbered B3487-08).

[87] *DTC Securities Subject to Ownership Certifications*, Depository Trust & Clearing Corp., http://dtcc.com/~/media/Files/Downloads/client-center/DTC/DTC_Issues_Subject_To_Certifications.ashx (last visited Apr. 21, 2014).

[88] Depository Trust & Clearing Co., Operational Arrangements (Necessary for Securities to Become and Remain Eligible for DTC Services) 8 (2012), *available at* http://dtcc.com/~/media/Files/Downloads/Settlement-Asset-Services/Underwriting/operational-arrangements.ashx.

[89] *See id.* (identifying requirements for issuers and transfer agents participating in Seg-100); *Letter Required for Equity Issues Subject to Share Ownership Threshold Restrictions by U.S. or Non-U.S. Citizens*, Depository Trust & Clearing Corp., http://164.109.172.95/downloads/legal/rules_proc/eligibility/Seg-100_Letter.pdf (last visited Apr. 21, 2013) (form indemnification letter for issuers).

designation is reversed.[90] In other words, there is no attempt to enforce whether participants are properly designating shares as being foreign owned in the first place.[91] There is only a means to shape how participants behave after shares have been so designated.

Second, Seg-100 places brokers and banks in the impossible position of judging the citizenship composition of corporate clients that own shares in shipping companies. Given the prevalence of corporate and institutional ownership of shares, even a Seg-100 program with perfect compliance by brokers and banks with respect to their human clients could easily allow for significant hidden violations of the 25% foreign shareholder cap in light of the Coast Guard's approach to corporate and institutional shareholders. In the Trico Marine case, the Coast Guard was unwilling to rely upon the company's Seg-100 Foreign Segregation Detail Reports to rebut evidence that it was not 75% owned by U.S. citizens.[92] Those Seg-100 reports indicated that Trico was abiding by the ownership restrictions and had never reached or exceeded 24.9% foreign ownership. The overwhelming evidence of far greater foreign ownership, at one point exceeding sixty percent,[93] suggests that banks and brokers had failed to designate many shares of Trico owned by foreign businesses as belonging in the Seg-100 account—a mistake by DTC members likely repeated across the board with other Jones Act companies.

Some measures could be taken that would improve the effectiveness of the Seg-100 program, both on occasions when DTC participants actually can determine the citizenship of their customers and when such knowledge is unavailable. Currently, even when participants know their clients' citizenships, only the banks and brokers themselves are able to verify that Seg-100 designations are properly made.[94] DTC participants could be required to provide DTC with spe-

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[90] *See* Depository Trust Co. Memorandum, *supra* note 83 (indicating the possibility of consequences only for failure to remove shares after designating them but not for failure to designate shares in the first place).

[91] Telephone Interview with Lois J. Radisch, Managing Dir. and Deputy Gen. Counsel, Depository Trust & Clearing Corp. (Apr. 19, 2013).

[92] The Coast Guard memorandum on Trico quoted from DTC's procedures: "DTC does not represent the accuracy, adequacy, timeliness, completeness, or fitness for any particular purpose of any information" in DTC's Foreign Segregation Detail Reports. Skuby, *supra* note 2, at 19. It then criticized Trico for not acting "independently [to] verify the information it received from DTC" beyond consulting with its transfer agent. *Id.* at 20. The Coast Guard failed to recognize the virtual impossibility of verifying the information due to the confidentiality of beneficial owners' identities, even though Trico explained this difficulty. In spite of these flaws in its analysis, the Coast Guard was correct that reliance on Seg-100 is likely to yield flawed information about the actual citizen ownership of a corporation.

[93] Skuby, *supra* note 2, at 8.

[94] Telephone Interview with Lois J. Radisch, *supra* note 91.

cific information on their compliance procedures, which would be made available for inspection by Seg-100 issuers and their regulators, increasing the chance that citizenship determinations will be incorporated into stock trading and clearance procedures by DTC members. A further improvement would be for DTC to require that a foreign- or U.S.-citizen designation be placed on *all* shares of Seg-100-participating issuers—for instance, by allowing shares into a general pool for only a brief period before requiring that DTC participants remove them either from DTC altogether or designate them as foreign or domestic.[95] This would help ensure that a DTC participant either has an electronic system automatically making specific determinations of citizenship with respect to each transfer or that human intervention (however cumbersome) occurs for each trade in a Jones Act corporation security. DTC would also need to impose some mechanism for auditing DTC participants and enforcing compliance.

The above assumes that DTC participants know the citizenships of their clients, a difficult task under current legal and practical constraints. Banks and brokers are already required to gather and update certain types of information about their clients—but generally not citizenship information—under "Know Your Customer" rules: rules that are partly established by self-regulatory organizations and partly by courts and government agencies.[96] If "Know Your Customer" (KYC) rules were expanded to require proof of citizenship from certain clients, then authorities could be reasonably confident that DTC members have the client information they need to segregate the securities holdings of clients whose Jones Act citizenship can be easily determined through documentary evidence (i.e., individual retail investors). However, even after this change, citizenship determinations for the remaining three-quarters of corporate and institutional shareholders

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95 The current practice only allows DTC participants to place a special designation on foreign-held shares, and the rest are included in the general pool of all shares and effectively assumed to be U.S. citizen held. *Id.*; *see also supra* note 86 and accompanying text (providing an overview of the mechanics of Seg-100).

96 *See* Genci Bilali, *Know Your Customer—or Not*, 43 U. Tol. L. Rev. 319, 320–21 (2012) (providing a history of "Know Your Customer" (KYC) rules in the banking and securities industries). KYC rules currently have a dual purpose. First, they help ensure that advice provided to clients reflects the clients' actual needs, deriving from the fiduciary duty of due care. *See, e.g.*, Sollberger v. Wachovia Sec., LLC, No. SACV 09–0766 AG (ANx), 2010 WL 2674456, at *8 (C.D. Cal. June 30, 2010) (stating that KYC rules "are appropriate indicia of the standard of conduct required of a stock broker in the practice of his profession" (internal quotation marks omitted)). Second, they help banking institutions detect suspicious transactions or customers that may need to be reported to the federal government. *See, e.g.*, Linde v. Arab Bank, PLC, 269 F.R.D. 186, 197 (E.D.N.Y. 2010) (ordering a bank to reveal its KYC information on certain customers designated by the U.S. government as being Foreign Terrorist Organizations, Specially Designated Terrorist Entities, or Specially Designated Global Terrorist Entities).

would remain out of reach of banks and brokers, and hence out of reach of Seg-100.

B. Eliminating Foreign Ownership and Control Restrictions

This section steps back from the discussion of implementation to analyze whether blanket foreign ownership and control restrictions in coastwise shipping are necessary in light of the intended objectives behind U.S. maritime policy: national security and economic strength. I argue here that these restrictions are unnecessary, or even counterproductive, and that the best solution to the obstacles identified in Part II is to eliminate the restrictions altogether.[97] Even without the blanket restrictions, the United States would certainly maintain the ability, on a case-by-case basis, to investigate and block particular foreign investments in the coastwise shipping on national security grounds—something it is authorized to do for any industry under existing law.[98] I begin in Subpart III.B.1 by addressing the national security considerations that Jones Act proponents often raise as justifications for the restrictions of the Act, including military requirements and protection from environmental threats. Subpart III.B.2 then considers economic arguments, including the strength of the U.S. maritime industry and fears that far-flung states and territories would be ill served by foreign-invested shipping companies. Instead of protecting national interests, ownership and control requirements appear to protect only a small number of U.S. shipping carriers from foreign competition, at the expense of both naval capabilities and U.S. consumers.

1. National Security Interests Would Not Be Compromised

Commercial maritime policy is deeply intertwined with national security policy.[99] The United States is a maritime trading nation: Cal-

[97] The focus here is on control and ownership restrictions. I do not address other policies such as the 75% U.S. citizen requirement for crews or the U.S.-build requirement for coastwise vessels.

[98] National security reviews by the Committee on Foreign Investment in the United States are available for any investment activity that may result in foreign control of a U.S. interest. 50 U.S.C.A. app. § 2170(b) (2012). The president is authorized to suspend or prohibit transactions, or, in certain circumstances, to direct the Attorney General to seek divestment. *Id.* § 2170(d)(1), (d)(3). Analysis of the possibility of foreign control is made on a case-by-case basis, but such reviews are not available for transactions leading to ownership interests of below ten percent, when the transactions are "solely for the purpose of passive investment." 31 C.F.R. § 800.302(b) (2013).

[99] This link is definitively established in federal law, as described *supra* note 5, and is also widely recognized in the national security community. *See, e.g.*, *Maritime Transportation: The Role of U.S. Ships and Mariners: Hearing Before the H. Subcomm. on Coast Guard and Maritime Transportation of the Comm. on Transportation and*

culated by weight, 78% of all U.S. international trade (counting even trade with Mexico and Canada) is seaborne.[100] About 1.4 billion metric tons of U.S. freight travels by sea each year, close to one-fifth of total global maritime shipping.[101] A powerful U.S. Navy is needed to guarantee the United States unfettered access to global resources and markets over the high seas.[102] Many also argue that U.S. maritime forces—which have an array of crucial strategic sea power objectives, including deterring major power conflict, protecting the homeland from attack, deploying power to address regional conflicts, and maintaining freedom of navigation[103]—depend upon a strong national maritime industrial base for ship manufacture and repair and for a supply of qualified mariners to operate reserve ships.[104] In addition, the commercial merchant marine provides safe and reliable transportation for goods, whether for civilian or military uses, particularly in wartime.[105]

Infrastructure, 113th Cong. 49 (May 21, 2013) (statement of General William M. Fraser III, United States Air Force, Commander, United States Transportation Command) (describing the merchant marine as "a vital national asset"); Admiral Michael Mullen, Chairman, Joint Chiefs of Staff, Commencement Speech at the U.S. Merchant Marine Academy (June 21, 2010) (calling the merchant marine "a vital resource upon which our nation has long depended in peacetime and in war"), *in* Archive of News Listings, U.S. Merch. Marine Acad. Alumni Ass'n & Found., http://www.usmmaaf.com (click "All News," scroll down, click on "6/20/2010 Admiral Mullen's Commencement Speech") (last visited Apr. 21, 2014).

100 IHS Global Insight, An Evaluation of Maritime Policy in Meeting the Commercial and Security Needs of the United States 8 (2009), *available at* http://www.ihsglobalinsight.com/gcpath/MARADPolicyStudy.pdf.

101 *Id.* at 10.

102 *See, e.g.*, Goure, *supra* note 15, at 3 (describing the role of U.S. naval power in maintaining global maritime trade as part of a larger discussion of the need for a strong U.S. Navy and merchant marine). For another example of this argument for the Jones Act, along with supporting quotes by U.S. military officials, see Brief for Transportation Institute & Overseas Shipholding Group, Inc. as Amici Curiae Supporting Petitioners at 11–14, Exxon Shipping Co. v. Baker, 554 U.S. 471 (2008) (No. 07-219).

103 U.S. Marine Corps, U.S. Navy & U.S. Coast Guard, A Cooperative Strategy for 21st Century Seapower 8–12 (2007), *available at* http://www.navy.mil/maritime/Maritimestrategy.pdf.

104 *See* Goure, *supra* note 15, at 9 (linking the strength of the U.S. Navy with "a strong and well-functioning shore establishment," consisting of both physical infrastructure and an experienced workforce); David G. Harris & Richard D. Stewart, *US Surge Sealift Capabilities: A Question of Sufficiency*, Parameters, Spring 1998, at 67, 72, *available at* http://www.carlisle.army.mil/USAWC/parameters/Articles/98spring/harris.htm (stating that abolishing passenger and cargo cabotage laws would "virtually eliminate any surplus pool of certified and licensed US merchant mariners" able to crew sealift ships in emergencies); Defense Programs, Transp. Inst., http://www.trans-inst.org/defense-programs.html (last visited Apr. 21, 2014) (describing U.S. maritime industry involvement in national defense, including seven companies that provide ship maintenance for the Ready Reserve Fleet).

105 The U.S. Navy's Military Sealift Command (MSC), for example, sustains forward-deployed Navy fleets in the Middle and Far East, operating 146 government-owned ships, and chartering an additional twenty from the private sector. Military Sealift Command, The U.S. Navy's Military Sealift Command: 2012 In Review A10,

In the context of these policy arguments, the inclusion of foreign-controlled shipping companies in the coastwise trade would likely strengthen rather than weaken U.S. naval power. An increase in the number of companies interested in buying Jones Act ships (which must be built in the United States[106]) and hiring coastwise-eligible crews (75% of whom have to be U.S. citizens[107]) would increase demand for U.S. shipyards and mariners. U.S. shipping companies already lack the kinds of ships most needed for global transportation of U.S. military cargo,[108] as well as the financing to build them—but foreign companies have proven to be reliable alternatives. For example, the Maritime Security Program (MSP), a fleet of active, commercially viable, militarily useful, privately owned vessels subsidized to be available for national defense and other security requirements, has been a crucial source of ships in the Iraq and Afghanistan campaigns; yet the vast majority of MSP ships are built abroad and owned by foreign parent companies, operating through domestic subsidiaries under the U.S. flag.[109] Those foreign companies employ more than 2000 U.S. citizen merchant mariners.[110] This experience suggests that foreign-controlled entities are already relied upon, and have performed well, both in providing these critical overseas transportation services in wartime and in keeping U.S. mariners trained and operationally ready. While the lack of sufficient domestic coastwise transportation was a substantial concern in World War I (though not as great a concern as the lack of sufficient international shipping

available at http://www.msc.navy.mil/annualreport/2012/MSCAnnual12.pdf. These ships are primarily operated by about 5700 government civil service mariners and 1700 commercial mariners. *Id.* at A8.

106 46 U.S.C. § 12112 (2006).

107 *Id.* § 8103.

108 Even many supporters of the Jones Act acknowledge "the reality . . . [that] the Jones Act fleet, the majority of which are tug and barge[,] are seldom used to support the military outside the US." Bruce Richards, Presentation at ASBA Annual Cargo Conference: In Defense of the Jones Act 6 (Sept. 26–28, 2012), http://www.asba.org/wp-content/uploads/2012/10/Bruce-Richards-2012-ASBA-Conference.pdf (unpublished presentation). "The vessels most critical to the military are tankers, ro-ro [roll-on/roll-off] ships and container [ships,] which are for the most part . . . built in foreign yards . . . ." *Id.*

109 Eric Lichtblau, *American Carriers Are Left Behind in Cargo Program*, N.Y. TIMES, Nov. 20, 2012, at A13; *see also* U.S. DEP'T OF TRANSP. MAR. ADMIN., MARITIME SECURITY PROGRAM: MEETING NATIONAL SEALIFT NEEDS (2014), *available at* http://www.marad.dot.gov/documents/MSP_Brochure_February_2014.pdf (providing an overview of the Maritime Security Program); *Maritime Security Program Fleet*, U.S. DEP'T TRANSP. MAR. ADMIN., http://www.marad.dot.gov/documents/MSP_Fleet_2-1-14.pdf (last updated Feb. 2014) (listing the ships of the fleet and their owners). MSP ships can be built abroad and owned by foreign parent companies because they do not sail between U.S. ports, and therefore, do not fall under the Jones Act.

110 Lichtblau, *supra* note 109.

capacity),[111] in the modern era, coastwise shipping would hardly be affected by the extent of foreign control of the shipping vessels. It would be a mistake to assume that citizens are inherently that much more likely to act in the nation's interest.[112] Further, it is unrealistic to expect that foreign investors would order ships to be made unavailable for U.S. domestic transportation—at considerable cost to the foreign investor—when a domestic investor would have acted differently. The only exception would be if the owner of the ships were actually engaged in an armed conflict with the United States, but even this slight risk could be adequately mitigated by a requirement that all cabotage ships sail under the U.S. flag.[113]

Proponents of the citizenship requirements also suggest that foreign-controlled ships are more likely to pose security threats to major port cities.[114] But as of 2011, over 89% of port visits (calls) in the United States were from foreign-flag ships, which sailed into the most important and largest international ports such as Houston, New York, and Los Angeles/Long Beach.[115] Allowing some of the remaining 11% of port calls to be from foreign-controlled ships would seem to add little or no extra risk to the port security system.[116]

National security necessarily includes protecting the U.S. homeland from both acute and long-term environmental threats. The environmental considerations some raise as arguments for maintaining the

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111 The Merchant Marine Act of 1936 calls for a merchant marine that is of a size sufficient to "maintain[ ] the flow of the waterborne domestic and foreign commerce at all times." Merchant Marine Act of 1936 § 101(a), 46 U.S.C. § 50101(a)(1) (2006). The statutory language on maintaining the flow of commerce reflects the desire to prevent a repeat of the collapse in U.S. exports that occurred at the beginning of World War I, when it was for a time nearly impossible to secure ships for carrying cargo overseas. For a discussion of World War I shipping availability, see PAUL MAXWELL ZEIS, AMERICAN SHIPPING POLICY 81–114 (1938).

112 For an excellent discussion of the fallacy of the assumption that citizens can be expected to make decisions that benefit their countries of citizenship rather than their companies, see Mabry, *supra* note 11, at 587–92.

113 Current law already allows the U.S. government to prevent transfers of U.S.-flag ships to other flags or otherwise into foreign control. 46 U.S.C. §§ 56101–02 (2006). The United States has exclusive and complete jurisdiction (prescriptive, adjudicatory, and enforcement) over U.S.-flag ships when they are in U.S. waters, and complete, but not exclusive, jurisdiction otherwise. *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 502, cmt. d (1987) (describing the jurisdiction of the flag state over its ships).

114 *See, e.g.*, GOURE, *supra* note 15, at 19 ("Via the inland waterways, a terrorist could reach America's heartland and many of its largest and most important urban centers.").

115 *See* U.S. DEP'T OF TRANSP. MAR. ADMIN., VESSEL CALLS SNAPSHOT, 2011, at 8 (2013), http://www.marad.dot.gov/documents/Vessel_Calls_at_US_Ports_Snapshot.pdf (calculating the percentage of total vessel calls that originated from U.S.-flag vessels).

116 Senator John McCain points out that already "[t]housands of foreign ships put into our ports and don't present a problem to our national security." John Bussey, *Oil and the Ghost of 1920*, WALL ST. J., Sept. 14, 2012, at B1.

restrictions of the Jones Act primarily relate to the problem of U.S. jurisdiction over foreign-flag ships,[117] a problem not to be dismissed lightly. Under international law, while all ships operating within U.S. territorial waters would be clearly subject to U.S. environmental jurisdiction, foreign-flag ships traveling between U.S. ports through international waters (for instance, between coasts through the Panama Canal) probably would not be subject to U.S. environmental regulations while they are in international waters.[118] At a minimum, U.S. jurisdiction over ships using U.S. territorial waters and ports is sufficient to enable the United States to insist that ships meet regulatory requirements that protect U.S. shores and waterways directly and to impose penalties for noncompliance.[119] But so long as the United States continues to require coastwise ships to operate under the U.S. flag, the ships would be squarely under U.S. law jurisdiction wherever they are in the world, and regulations would be equally applicable to the coastwise ships of current Jones Act companies and any foreign-controlled coastwise shipping companies. Another reason to be less concerned about this issue is that the current Jones Act fleet is aging and inefficient, and newer ships with newer technologies are likely to be more fuel efficient and less environmentally damaging.[120] Additional foreign involvement in the industry would likely lead to a

[117] *See, e.g.*, *Industry Profile/Jones Act - Domestic Shipping*, TRANSP. INST., http://www.trans-inst.org/jones-act.html (last visited Apr. 21, 2014) ("[Without the Jones Act, the] nation's precious environment would be even more vulnerable to those whose operating systems are not up to our standards or within our control.").

[118] *See* Craig H. Allen, *Federalism in the Era of International Standards: Federal and State Government Regulation of Merchant Vessels in the United States (Part II)*, 29 J. MAR. L. & COM. 565, 569 (1998) ("Within its territorial sea a coastal State has jurisdiction to prescribe regulations for the prevention, reduction, and control of marine pollution from foreign vessels, including vessels exercising the right of innocent passage."); Michael W. Reed, *Port and Coastal State Control of Atmospheric Pollution from Merchant Vessels*, 3 SAN DIEGO J. CLIMATE & ENERGY L. 205, 209, 213–23 (2011) (exploring possible avenues for port states to use in asserting jurisdiction over the environmental emissions of foreign-flag ships, including customary international law rights of port states and international agreements).

[119] Congress would likely need to legislate explicitly to apply such regulations to foreign-flag ships due to the Supreme Court's jurisprudence on international comity. For a discussion of the Supreme Court's comity concerns as they would apply to federal regulation of foreign ships, particularly as affected by *Spector v. Norwegian Cruise Line Ltd.*, 545 U.S. 119 (2005), see Constantine G. Papavizas & Bryant E. Gardner, *Is the Jones Act Redundant?*, 21 U.S.F. MAR. L.J. 95, 119–21 (2008); Asia N. Wright, Note, *Beyond the Sea and* Spector*: Reconciling Port and Flag State Control over Cruise Ship Onboard Environmental Procedures and Policies*, 18 DUKE ENVTL. L. & POL'Y F. 215, 233–37 (2007) (considering the applicability of U.S. environmental laws to foreign-flag ships absent a "clear statement").

[120] The average age of Jones Act ships per port call in the United States in 2011 was 18.3 years, compared with 8.8 years for foreign-flag vessels. VESSEL CALLS SNAPSHOT, *supra* note 115, at 9.

higher pace of construction of newer ships, even assuming no possibility of importing ships. Newer, more efficient ships—or simply less expensive service—would draw domestic trade away from highly polluting truck transportation. On average, sea freight emits just 16% of the carbon dioxide per ton-mile that is emitted by truck transport.[121]

2. *The U.S. Economy Would Benefit*

From an economic perspective, advocates for policies protecting the U.S. merchant marine usually emphasize the number of individuals employed in shipping-related industries in the United States and the important role of shipping in the U.S. economy. According to the Transportation Institute, an industry association supporting the Jones Act, about 73,787 jobs were attributable directly to the Jones Act fleet in 2006, covering shipbuilding, maintenance, repair, and shore-side support, with another 425,889 attributable indirectly to the Jones Act fleet, including jobs created in industries that provide goods and services to Jones Act businesses and their employees.[122] Proponents of the Jones Act argue that without the Act in its current form, little or no private sector shipbuilding would occur in the United States, and that skilled shipbuilding jobs in the industry would be lost to competitors like China, South Korea, and Japan.[123] Many contend that foreign

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[121] U.S. Envtl. Protection Agency, Climate Leaders: Greenhouse Gas Inventory Protocol Core Module Guidance 11–12 tbls.6 & 8 (2008), *available at* http://www.epa.gov/climateleadership/documents/resources/commute_travel_product.pdf (indicating emissions of 0.297 kg CO_2 per ton-mile for freight transport by truck, as compared with 0.048 kg CO_2 per ton-mile for waterborne craft).

[122] Transp. Inst., *supra* note 117. The Institute's website does not disclose the methodology behind these estimates, but the author was able to obtain from the Institute the report it commissioned that appears to be the source of these figures. At the core of the estimates is an economic model developed by the Minnesota IMPLAN Group, using data from 2006, particularly employment data from the U.S. Bureau of Economic Analysis (BEA), covering both passenger and cargo transportation. *See* PricewaterhouseCoopers, Contribution of the American Domestic Maritime Industry to the U.S. Economy (unpublished report) (on file with the New York University Law Review). Going to the underlying 2006 BEA data, which is publicly available, one is immediately struck by the small size of the employment figures for water transportation compared with other means of transportation (recall that the study pointed to 73,787 Jones Act jobs). In the primary category of transportation and warehousing, water transportation accounted for 63,000 jobs, while truck transportation accounted for 1,476,000 jobs and air transportation for 485,000 jobs. Manufacturing of transportation (aside from motor vehicles) equipment accounted for 695,000 jobs, of which some very small portion was included in the PricewaterhouseCoopers estimate of Jones Act jobs (in shipbuilding). Full-Time and Part-Time Employees by Industry, Bureau of Econ. Analysis, http://www.bea.gov/itable/ (follow "GDP-by-industry" hyperlink; follow "Begin using the data. . ." hyperlink; expand "Employment"; then follow "Full-Time and Part-Time Employees by Industry" hyperlink) (last revised Jan. 23, 2014).

[123] *See Maritime Transportation: The Role of U.S. Ships and Mariners: Hearing Before the Subcomm. on Coast Guard and Maritime of the H. Comm. on Transp. and*

shipping companies allowed to operate in U.S. cabotage shipping would outcompete U.S. companies and hire mariners from overseas, resulting in layoffs of American mariners.[124] Some Jones Act proponents even suggest that U.S. companies pay taxes and foreign-owned companies do not.[125]

These concerns do not justify foreign ownership or control restrictions, however, since the removal of such restrictions need not affect the laws on the location of construction and citizenship of mariners. Indeed, as noted above, foreign-controlled shipping companies are more likely to bring new jobs to the coastwise trade, particularly as long as the existing 75% U.S. citizen requirement for vessel crews remains in place. And the suggestion that tax revenues would be any different with foreign-owned cabotage carriers is misleading. Foreign-owned corporations operating U.S.-flag ships domestically would pay the same taxes as American ones on their U.S. earnings, and they would be subject to the same tax laws as their American counterparts.[126]

Another frequent claim is that distant states and territories, particularly Hawaii, Alaska, and Puerto Rico, benefit from reliable service provided by U.S. operators, while foreign shipping companies

Infrastructure, 113th Cong. (2013) (statement of Fred Harris, President, General Dynamics, NASSCO) ("If the Jones Act was repealed today, foreign-built ships would be brought into the US trade immediately, supporting the heavily subsidized foreign shipyards and resulting in the demise of the American shipbuilding industry."). The global shipbuilding market is in fact already dominated by China, South Korea, and Japan. By deadweight tonnage, China makes up 41% of the market, South Korea 33%, and Japan another 20%. The United States has well below 1%. Steve Gordon, Clarkson Research Servs. Ltd., Presentation at Cargotec Capital Markets Day: Shipbuilding Market Overview, slide 14 (Nov. 17, 2011), *available at* http://www.clarksons.net/archive/research/freestuff/Cargotec%20Presentation%20November%2017th%202011.pdf.

124 *E.g.*, C. James Patti, *Jones Act Jobs in the Crosshairs*, 48 MASTER, MATE & PILOT 11, 11 (Jan.–Feb. 2012), *available at* http://www.bridgedeck.org/mmp_mags/2012/Jan_Feb.pdf.

125 The Transportation Institute claims that while "[f]reight revenues earned by domestic carriers, shipyards, and repair yards are subject to taxes[,] [f]oreign owned carriers and shipyards are not!" TRANSP. INST., *supra* note 117. Using a very expansive approach, the Institute calculates that annual tax revenues resulting from direct, indirect, and induced impact of the Jones Act add up to $11.4 billion. *Id.*

126 One important study identifies ambiguities in the extent to which U.S. domestic laws would apply to *foreign-flag* ships if they were allowed to operate in the U.S. cabotage trade. The simplest way to short-circuit these ambiguities would be to require foreign-owned shipping companies operating coastwise in the United States to register their cabotage ships under the U.S. flag. Nevertheless, even under foreign flags, if the Jones Act were rescinded, "foreign-flag carriers operating in the U.S. domestic trades, and the nonresident alien crews sailing their ships, would likely be subject to U.S. tax on net income (i.e., gross income less allowable deductions) at graduated tax rates." Papavizas & Gardner, *supra* note 119, at 128.

would be less reliable if they operated in the coastwise trade.[127] But there is little evidence suggesting that service to isolated states and territories would become less regular or more expensive if foreign-controlled companies were allowed to participate in the trade. The contrary is likely true, given the lack of serious competition in cabotage shipping today. For instance, just two companies, Horizon Lines and Matson Navigation, own twenty-three of the twenty-four Jones Act-eligible container ships.[128] Puerto Rico's shipments to and from the mainland United States and Puerto Rico are carried by only four companies,[129] and Hawaii's by three.[130] There is a history of anticompetitive behavior by Jones Act companies. For instance, in 2011, Star Line LLC pleaded guilty to conspiring to fix rates in the Puerto Rico trade for at least six years until 2008.[131] Overall, Jones Act shipping rates are far less responsive to oil price changes or the state of the shipping market than are foreign carriers' rates.[132]

A report from the Federal Reserve Bank of New York recently suggested that Jones Act restrictions may be putting Puerto Rico's ports at a competitive disadvantage and preventing it from becoming a major international transshipment port, while nearby Jamaica—with an economy less than one-third the size of Puerto Rico's—has overtaken Puerto Rico's port of San Juan in total container volume.[133] Despite (or because of) the Jones Act restrictions, Puerto Rico already has twice as many port visits from foreign-flag vessels as from U.S.-flag vessels, and many of the foreign-flag vessels are considerably

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[127] *E.g.*, Stacy Yuen, *Keeping Up with the Jones Act*, HAW. BUS. (Aug. 2012), http://www.hawaiibusiness.com/Hawaii-Business/August-2012/The-pros-and-cons-of-the-Jones-Act/ ("Relying on foreign shippers that can easily decide a stop in Hawaii is not profitable, or who would charge us big fees to veer off their major routes, doesn't guarantee that our hotels and shops have the food and goods they need to support our economy and communities." (quoting then-Congresswoman Mazie Hirono)).

[128] U.S. DEP'T OF TRANSP. MAR. ADMIN., *supra* note 37.

[129] FED. RESERVE BANK OF N.Y., REPORT ON THE COMPETITIVENESS OF PUERTO RICO'S ECONOMY 13 (2012), *available at* http://www.newyorkfed.org/regional/puertorico/report.pdf.

[130] Yuen, *supra* note 127.

[131] Press Release, Dep't of Justice, Florida-Based Sea Star Line LLC Agrees to Plead Guilty and Its Former President Is Indicted for Price Fixing on Coastal Freight Services Between the Continental United States and Puerto Rico (Nov. 17, 2011), *available at* http://www.justice.gov/atr/public/press_releases/2011/277501.htm.

[132] FED. RESERVE BANK OF N.Y., *supra* note 129, at 13; *Record Matson Fuel Surcharge Not Justified by Oil Prices, Analysis Shows*, HAW. REP. (June 16, 2011), http://www.hawaiireporter.com/record-matson-fuel-surcharge-not-justified-by-oil-prices-analysis-shows/123.

[133] FED. RESERVE BANK OF N.Y., *supra* note 129, at 13, 22.

larger than the U.S. ships.[134] These facts suggest that Puerto Rico is not well served by the current arrangement. Hawaii's recent example also demonstrates the value of greater competition. In 2005, Pasha Hawaiian Transport Lines began regular service between Hawaii and San Diego, challenging the two other companies providing similar service. The result was an immediate and significant drop in shipping rates.[135] Contrary to the arguments of some Jones Act proponents, then, it appears that farther-flung U.S. states and territories—including Guam, which is already exempted from one of the Jones Act requirements (the U.S.-build requirement[136])—would not be harmed by a relaxation of U.S. citizen ownership requirements.

Foreign companies would likely rush at the opportunity to invest in Jones Act shipping, to the overall benefit of the U.S. merchant marine. Even as global shipping rates are plummeting, U.S. cabotage shipping rates have risen steeply, particularly for tanker business.[137] The history of the lease-finance exception,[138] which for a brief time allowed foreign shipping companies to own U.S. ships on long-term lease to the U.S. cabotage industry, strongly suggests that the United States is an attractive market for foreign shipping companies. The lease-finance exception became effective in October 1996. From early 1997 until the end of 2000, at least eighty-seven entities were able to access financing from foreign investors through the program.[139] Foreign investors would, if given the opportunity, again seek to invest in both existing and new coastwise shipping ventures in the United States.

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134 U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-260, PUERTO RICO: CHARACTERISTICS OF THE ISLAND'S MARITIME TRADE AND POTENTIAL EFFECTS OF MODIFYING THE JONES ACT 11–12 (2013).

135 *See* Stephanie Nall, *Hawaii Spurs a Building Boom—for US Shipyards*, PAC. SHIPPER, Apr. 8, 2005, *available at* 2005 WLNR 25310291 (noting that rates for Hawaii carriers dropped by about 10% as soon as Pasha Hawaiian Transport Lines entered the market).

136 46 U.S.C. § 12111(b) (2006).

137 *See* Rob Sheridan & Isaac Arnsdorf, *Blackstone to OSG Win Record Tanker Rates on Export Ban: Freight*, BLOOMBERG (Feb. 13, 2013), http://www.bloomberg.com/news/2013-02-13/blackstone-to-osg-win-record-tanker-rates-on-export-ban-freight.html ("Rates for Jones Act tankers, the only kind permitted to haul domestic fuel cargoes, jumped 87 percent to $85,978 a day in the past year . . . amid the worst slump in global crude-shipping rates for more than a decade."); Anna Louie Sussman, *U.S. Jones Act Tanker Rate Hits Record $110,000/Day*, REUTERS, Dec. 17, 2013, *available at* http://www.reuters.com/article/2013/12/17/shipping-oil-jonesact-idUSL2N0JW0SJ20131217 (reporting that ExxonMobil renewed a tanker charter agreement for six months at a record rate of $110,000 per day, almost 50% higher than the previous rate from just six months earlier, "the latest sign of how surging U.S. crude production is squeezing the niche market").

138 *See infra* note 146 (outlining the lease-finance exception).

139 Papavizas, *supra* note 13, at 48.

Further, to the extent that additional foreign capital would allow new competitors to enter the market or strengthens existing smaller players in the industry, competition is likely to encourage efficiency increases and to drive down prices; this would reduce the costs paid by U.S. consumers for restrictive cabotage laws. At the same time, allowing greater foreign investment reduces artificial caps on the share prices of Jones Act companies. Keeping foreign investors out of certain stocks has depressed their value, making it harder for them to raise capital by issuing new shares.[140] This phenomenon explains why, historically, the United States aggressively welcomed foreign investment in railroads: The railroads required massive capital investments and foreign capital was seen as beneficial, even necessary.[141] Foreign investment in the maritime industry could be viewed in the same way.

Because the foreign ownership and control restrictions of the Jones Act do not meet their stated goals of protecting national security and economic interests—and as a practical matter are already largely unenforceable in their current form—Congress should eliminate these restrictions.

C. Reforming Foreign Ownership Restrictions

While the most logical response to the policy and practical concerns raised in this Note would be congressional action to completely eliminate the foreign ownership and control limitations of the Jones Act, Congress's willingness—and ability—to take such a bold step is doubtful. However, even if foreign control restrictions are maintained, at least foreign ownership rules should be changed. In this section, I propose that the 25% aggregate foreign ownership cap be replaced by restrictions on holdings by any one foreign entity or affiliated group, or that the government engage in case-specific reviews of foreign investments to guard against foreign control.

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140 It has been established empirically that opening formerly closed equity markets to foreign investment increases returns for all investors in that market. *See generally* Geert Bekaert et al., *Equity Market Liberalization in Emerging Markets*, FED. RES. BANK OF ST. LOUIS REV., July/Aug. 2003, at 53 (surveying multiple studies on the topic, showing significant increases in U.S. investment in foreign countries' equity markets after their liberalization, and finding "highly significant" investment growth effects of 3.3% after introduction of foreign investors into previously closed equity markets). The principles that stock prices rise when foreign investment rules are liberalized should extend to developed markets in opening up investment in restricted securities.

141 *See* MIRA WILKINS, THE HISTORY OF FOREIGN INVESTMENT IN THE UNITED STATES TO 1914, at 190–228 (1989) (tracing the history of substantial foreign investment in U.S. railway securities, both stocks and bonds, between 1875 and 1914, and determining that in the 1890s, majorities of stock in key U.S. railroads were held by foreign investors).

The 25% foreign ownership limitation is difficult to defend. Even a strong proponent of foreign control restrictions could doubt its utility. Much smaller interests than 25% could easily raise the prospect of foreign control and much larger aggregate foreign interests than 25% might create no foreign control concerns at all. Even a shareholder with five to ten percent ownership can yield outsized influence, particularly in a large corporation with widely dispersed ownership. For example, activist hedge funds[142] between 2001 and 2006 sought median ownership stakes at their highest point of only 9.1% of their targets, and many ownership stakes were below 6.5%.[143] The funds that sought business strategy changes in their targets were successful (partially or entirely) between 44.4% and 72% of the time, depending on the nature of the change requested; the firms that sought to oust the chairman or chief executive officer were successful 39.7% of the time.[144] The 25% restriction is, in this sense, too narrow to prevent foreign entity influence over Jones Act companies.

The restriction is also too broad in that it prevents dispersed foreign owners from contributing to a firm's ability to raise capital. It is highly unlikely that many foreign shareholders with very small holdings would, or even could, band together in sufficient numbers to exert any meaningful control over a Jones Act company.[145] Even assuming that it is worthwhile to prevent foreign control of coastwise shipping, the 25% ownership restriction thus fails to prevent foreign control because it is both too narrow and too broad.[146]

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142 Activist hedge funds are those seeking to compel corporations to make changes that would lead to speedy profits for the hedge funds.

143 Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1747 tbl.2 (2008).

144 *Id.* at 1742 tbl.1. For more on activist shareholders and how they can leverage relatively small positions to influence corporations, see Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021 (2007). Another study similar to Brav et al., *supra* note 143, found similar indications of activist shareholder success but a larger average percentage stake, because the authors used a data set that included only stakes above five percent. *See* April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 211–16 (2009) (finding, among other indications of success, that activist shareholders were successful in 73% of their attempts to secure board seats for themselves).

145 *See supra* note 75 and accompanying text (noting the reasons shareholder coordination among widely dispersed shareholders is quite difficult). In the unlikely possibility that these foreigners banded together to bid for foreign control of a Jones Act company, regardless of the ownership percentage, the Jones Act still authorizes the government to seize coastwise-endorsed ships if they are being transferred to foreign control. 46 U.S.C. §§ 56101–02 (2006).

146 Additional developments since the late 1990s have further undermined the relevance of ownership restrictions, since foreigners have been able to benefit from ownership-type benefits. Most importantly, under a special vessel lease-financing exception as clarified in

There are a number of more effective ways of preventing foreign control than a blanket foreign ownership percentage limitation. The simplest way is to prohibit any single foreign entity, individual, or affiliated group from owning more than a given percentage of a Jones Act company. This threshold ought to be above 5% in order to be administrable and to reduce compliance costs, since 5% beneficial ownership (including by interests acting in concert) already triggers disclosure obligations for shareholders under the Williams Act.[147] Failure of a group to report its holdings in violation of the Williams Act would entitle the issuer to injunctive relief, likely blocking the involved investors' ability to vote or make shareholder proposals, on the ground that irreparable harm would otherwise result.[148]

Alternatively, the federal government could engage in a case-specific review of such foreign investments, whether by the Committee on Foreign Investment in the United States that already exists for such

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2004, limited classes of foreign financers can own Jones Act *ships* (though not Jones Act companies) so long as the ships are demise-chartered to Jones Act companies. (Demise charters are ship leases with "[a]n essential characteristic . . . that the entire command and possession of the vessel be turned over to the charterer. Although the owner retains legal title, the charterer is considered the temporary owner . . . ." THOMAS J. SCHOENBAUM, ADMIRALTY AND MARITIME LAW § 8-3 (5th ed. 2011).) This policy was introduced in order to attract foreign financing to an industry that has had trouble raising capital. In addition, foreigners currently are able to hold debt in Jones Act companies (even when the loan is secured by a coastwise-endorsed ship), and this practice is very common. Constantine Papavizas, Winston & Strawn LLP, Foreign Vessel Mortgages – "Loophole" or Legitimate Financing Mechanism, slide 12 (unpublished presentation) (on file with the New York University Law Review); *see also supra* note 35 (discussing the mortgage exception). To a substantial degree, creditors benefit at less risk than do shareholders from a company's earnings. When a Jones Act company goes bankrupt, the U.S. equity owners might be "wiped out" (recovering no value for their shares), while the foreign creditors are entitled to the company's assets, subject to limited Jones Act–related conditions. In fact, in the Trico Marine context, one of the largest foreign equity shareholders identified by the Coast Guard (owning some 22.8% of the company) actually had been a bondholder whose bonds were then exchanged for a large equity interest as part of Trico's earlier Chapter 11 bankruptcy reorganization. Hengen, *supra* note 2, at 51 n.16.

147 The Williams Act "requires a group that has acquired, directly or indirectly, beneficial ownership of more than five percent of a class of registered equity securities, to file a [Schedule] 13D." Hallwood Realty Partners, L.P. v. Gotham Partners, L.P., 286 F.3d 613, 617 (2d Cir. 2002). Beneficial owners include "any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares . . . [v]oting power which includes the power to vote, or to direct the voting of, such security." 17 C.F.R. § 240.13d-3(a) (2013).

148 As the D.C. federal district court noted in granting a preliminary injunction, "[t]he Courts of Appeals are in widespread agreement that [the Williams Act] creates an implied private right of action for injunctive relief." Bender v. Jordan, 439 F. Supp. 2d 139, 159 (D.D.C. 2006) (enjoining defendant from holding shareholders meetings until further court instructions due to violations of the Williams Act likely to cause irreparable harm to another shareholder).

reviews,[149] or by the Secretary of Transportation, who already reviews transfers of U.S.-flag vessels.[150] Moreover, foreign interests should no longer be prohibited from owning unlimited quantities of nonvoting shares in Jones Act companies, as they are under current regulations.[151] To the extent that national security requires the assurance that the U.S. government is able to commandeer these ships in the event of an emergency, the law should continue to insist that these ships fly under the U.S. flag, since the flag of the ship is far more important than the citizenship of the owners in establishing the U.S. jurisdiction required to take over a ship.[152]

D. Administrative Options

There are also useful actions that the Executive Branch—particularly the Coast Guard (in the context of vessel documentation) and the Department of Transportation's Maritime Administration (in the context of transfers of ownership interests) can take even absent congressional action. More flexible statutory interpretation and less daunting evidentiary standards would clarify the current law, assist Jones Act companies in complying with foreign control requirements, and somewhat increase the amount of potential foreign investment in the industry. First, the Coast Guard and Maritime Administration should institute, by rulemaking, additional presumptions and evidentiary standards to clarify the current law and ease the burden on Jones Act companies. To begin with, they should allow foreigners to own nonvoting shares in excess of 25%.[153] They should adopt a rule affirming the Coast Guard's statement in Trico that the citizenship of mutual funds is determined based on the mutual fund company's citizenship rather than the citizenships of accountholders[154] and then apply this principle to other types of investment companies and even corporations that own shares of Jones Act companies. The agencies

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149 *See supra* note 99 (discussing this general foreign investment national security review authority).

150 46 U.S.C. § 56101 (2006). The application process by which the Maritime Administrator, on behalf of the Secretary of the Department of Transportation, reviews all transfers of larger U.S.-flag vessels to foreign ownership, flag, or registry is outlined on the Maritime Administration's website. *See Foreign Transfer (U.S. Flag Vessels)*, U.S. DEP'T OF TRANSP. MAR. ADMIN., http://www.marad.dot.gov/ships_shipping_landing_page/national_security/foreign_transfer/foreign_transfer.htm (last visited Apr. 21, 2014).

151 46 C.F.R. § 67.31(a) (2013).

152 *See supra* note 113 (discussing the U.S. government's rights vis-à-vis U.S.-flag ships).

153 This is arguably consistent with the law since foreign control is not possible on the basis of nonvoting shares. *See supra* notes 28–29 and accompanying text (discussing the relevant statutory text and current regulations).

154 *See supra* note 74 and accompanying text (discussing the Coast Guard's suggestion about the treatment of mutual funds' shareholders in the Trico case).

could institute a strong presumption in favor of the citizenship breakdowns produced under the Seg-100 program, despite its inherent inaccuracy. They could shift burdens of persuasion for all U.S.-incorporated Jones Act carriers, so that the *government* is required to prove at least 25% foreign ownership in order to issue any penalties for violating the Act, instead of demanding the impossible—that the Jones Act company prove the citizenships of 75% of its shareholders.

Second, the Coast Guard and the Maritime Administration should relax the requirement that parent companies of Jones Act companies be coastwise-eligible citizens in their own right, and instead, allow them to be mere citizens under the Act. Reading the Act literally, the citizenship requirements for a corporation *operating* a coastwise ship are described differently than for a corporation *owning* a coastwise ship. In the case of a coastwise ship owner (but not operator), one can plausibly argue that the statute only requires citizens to hold a "controlling interest"—majority control—as distinct from a 75% interest.[155] A coastwise ship could thus be operated by a subsidiary of the parent company, and the subsidiary would be 100% owned by a U.S. citizen, since the parent company meets the majority-ownership requirement for U.S. citizenship in every context besides operating ships. This interpretation has a reasonably high chance of surviving judicial review under *Chevron* deference.[156]

Finally, the Department of Defense and the Department of Homeland Security could invoke the national security exception to allow foreign shipping companies to participate in coastwise trade using U.S.-flagged, U.S.-manned, and perhaps even U.S.-built ships. After finding that a blanket waiver is "necessary in the interest of national defense"—for example, because greater demand for shipbuilding is needed to increase business for U.S. shipbuilders that might otherwise shut down—the Secretary of Homeland Security would be authorized to waive the navigation laws "to the extent, in the manner, and on the terms the [Secretary], in consultation with the

[155] *See* 46 U.S.C. § 50501(a), (c) (2006) (describing ownership requirements in the context of the Jones Act).

[156] This interpretation rests on the literal words of the Jones Act, under which a "corporation, partnership, or association [that] is *operating* a vessel in the coastwise trade" must be 75% U.S. citizen owned, 46 U.S.C. § 50501(a) (emphasis added), whereas in all other contexts "a corporation, partnership, or association is deemed to be a citizen of the United States only if the controlling interest [(generally understood to be a majority)] is owned by citizens." *Id.* For a more detailed argument on this subject, see McConnell, *supra* note 13, at 161–82. *But see* Conoco, Inc. v. Skinner, 970 F.2d 1206, 1216–23 (deferring to the Maritime Administrator's interpretation contrary to the one advanced here).

[Maritime] Administrator, acting in that capacity, prescribes."[157] This is a less attractive option than the rulemakings mentioned above. Such action would be especially politically controversial, and controversy could deter foreign shipping companies from relying upon a waiver. The government has been highly reluctant to employ the national security exception, even on a case-by-case basis.[158] Nevertheless, if used, it could spur—for the first time in nearly two decades—a real conversation about the direction of the merchant marine.

Conclusion

In general, the U.S. government does not seriously scrutinize the citizenship composition of coastwise shipping companies. The Coast Guard's recent attempt at enforcement in the Trico case demonstrated that the Jones Act restrictions on foreign ownership and control do not fit with the realities of modern markets, particularly due to the beneficial ownership problem but also the outsized role of corporate and institutional investors. Radical changes would be required to improve the implementation of ownership restrictions: specifically, complete overhaul of the shareholder communications framework, or alternatively, implementation of new Know Your Customer rules along with new compliance measures for DTC's Seg-100 system. The Seg-100 program provides some hope of ascertaining the citizenships of beneficial owners, but only to the extent that brokers and banks comply with it, and not for corporate and institutional shareholders. Enforcement would be greatly simplified through the exclusion of corporate and institutional shareholders from foreign ownership restrictions, but this would threaten the entire concept of foreign ownership restrictions by limiting the inquiry to the 27% of shareholders that are individuals.

In light of these major barriers to enforcement, the foreign ownership restrictions should be seriously reconsidered, and ideally removed altogether. As this Note makes clear, allowing additional foreign investment—even foreign control—is more likely to be an opportunity rather than a threat to national security and the economy.

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157 46 U.S.C. § 501(b) (Supp. I 2011). The Secretary of Homeland Security can only issue a waiver after a determination by the Maritime Administrator of "the non-availability of qualified United States flag capacity"; the Secretary of Defense can issue a waiver without this determination. *Id.* § 501(b).

158 *See, e.g.*, Corey Kilgannon & Marc Santora, *40,000 Tons of New Jersey Salt, Stuck in Maine*, N.Y. Times, Feb. 19, 2014, at A13 (describing the failure of the U.S. government to apply the exception to allow a shipment of road salt by a foreign-flag ship already available in Maine when, in the midst of massive winter storms, the salt "shortage ha[d] grown so acute that local officials had contemplated closing roadways and curtailing public bus routes").

Foreign ownership and control restrictions are weakly related to the underlying goals of U.S. maritime policy, are divorced from the reality of the role foreign-built and foreign-controlled ships already play in providing cargo transportation for military purposes, and reduce competition for consumers and the size of the job market for mariners.