



# Maritime Developments Advisory

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## Coast Guard Request for Comments on Mechanisms used by Publicly Traded Jones Act Companies to Prove Citizenship Following the Trico Investigation

### New Development

On November 3, 2011 the Coast Guard published a Notice in the Federal Register (76 Fed. Reg. 68,203) requesting information regarding the mechanisms that publicly traded companies employ to ensure compliance with the U.S. citizenship requirements for U.S.-flag vessels with coastwise and fisheries endorsements (together referred to as “coastwise endorsements” in this advisory). Comments are due on or before February 1, 2012. The following is a link to this Notice: <http://www.gpo.gov/fdsys/pkg/FR-2011-11-03/pdf/2011-28447.pdf>.

### Background

The U.S. citizenship requirements for ownership of U.S.-flag vessels that have coastwise endorsements include that at least 75% of the stock or other equity ownership interests in the shipowner must be owned by “citizens of the United States” within the meaning of 46 U.S.C. § 50501 (such persons are described in this advisory as “coastwise citizens”). These citizenship requirements must be met at all levels in the chain of ownership of the company that owns a vessel operated in the coastwise trade. Thus, each entity contributing to the shipowner’s eligibility to be a coastwise citizen must itself be a coastwise citizen eligible to document U.S.-flag vessels with coastwise endorsements, and this test must be satisfied by each entity that contributes to the coastwise citizen eligibility at each tier in the ownership chain. 46 C.F.R. §67.31(d).

The Coast Guard’s process for determining the citizenship of applicants seeking to document vessels with coastwise endorsements relies on self-certification. As stated in the Notice, when an instance of possible non-compliance by a person is found, that person bears the burden of establishing that it satisfies the applicable citizenship requirements. As discussed below, following the results of an investigation earlier this year regarding Trico Marine Services, Inc., a publicly traded company, and its subsidiaries and affiliates (collectively, “Trico”), the Coast Guard decided to publish the Notice. See the following link for the results of the investigation and final action memorandum relating to Trico: <http://www.uscg.mil/hq/cg5/nvdc/nvdcreport.asp>.

### The Trico Investigation

In short, in the Trico investigation, the Coast Guard found that the publicly traded parent company was not able to provide proof that at least 75% of its stock was held by persons satisfying the requirements to be coastwise citizens. The investigation was initiated as the result of allegations made by one of Trico’s own stockholders, who had engaged in a public battle with the then management of Trico over the direction Trico was taking, although this was not mentioned in the Coast Guard’s report. The Coast Guard decided to investigate those allegations because they were credibly documented. Its investigation report made certain findings

of fact as to when Trico's vessels were operated in the coastwise trade. Given that Trico was publicly traded and that hence its stock ownership changed frequently, the Coast Guard analyzed Trico's citizenship based on specific dates and lined up its findings with the dates of its U.S.-flag vessel operations.

In reviewing the information concerning Trico's citizenship, the Coast Guard requested Trico to provide evidence that proved that at least 75% of the equity in Trico was owned by persons who satisfied the requirements to be coastwise citizens under 46 U.S.C. § 50501. With respect to each date on which the Coast Guard analyzed the citizenship data provided by Trico, the Coast Guard concluded that Trico failed to establish that at least 75% of its equity was owned by coastwise citizens.

Trico noted that it had protections in its certificate of incorporation to treat as "excess shares" any shares owned by non-coastwise citizens that would exceed a certain threshold and strip those shares of rights to vote and receive dividends. However, the Coast Guard responded that Trico never determined that there were any such excess shares and hence had never activated those protective provisions.

The Coast Guard's analysis of the U.S. citizenship rules began by noting that the Coast Guard relies on self-certification by applicants as to citizenship, but that the Coast Guard may require the applicant to establish its U.S. citizenship. This is in contrast to the approach taken by the U.S. Maritime Administration ("MarAd"), which requires companies seeking to participate in certain subsidy and other programs to submit affidavits of U.S. citizenship proving that they satisfy the requirements to be coastwise citizens.

Early in its analysis of Trico's citizenship, the Coast Guard emphasized that it does not accept MarAd's so-called "fair inference rule," which has generally become a mainstay of U.S. citizenship affidavits for publicly traded companies. The Coast Guard repeated its reasoning against the use of the fair inference rule as it first appeared in a Federal Register notice in 1993:

The documentation laws are meant to be restrictive and are intended to limit the persons who are eligible to document vessels under U.S. law and acquire trading privileges. Corporations can make proof of citizenship less difficult, for instance by restricting sale of their stock to U.S. citizens, or using a transfer agent to administer a dual stock certificate system. **Of course, any U.S. corporation that is unwilling to subject itself to the possibility of having to prove that it qualifies for coastwise or fisheries privileges can choose not to seek them. The Coast Guard will not be bound by any presumptions or inferences in making eligibility determinations for documentation purposes.**

58 Federal Register 60,256, 60,259 (Nov. 15, 1993) (emphasis in the Coast Guard's quote in its report).

The Coast Guard continued that Trico was given repeated opportunities to provide any evidence or support that 75% of its ownership interest was held by coastwise citizens, but failed to do so. The evidence offered by Trico consisted of information, to the best of its knowledge, that the owners of its equity contributing to the 75% requirement were owned by U.S.-organized entities and that in some cases the voting power for such entities was exercised by a U.S. citizen. This information did not satisfy the requirements of 46 U.S.C. § 50501 and the regulations promulgated thereunder. The Coast Guard therefore concluded that Trico could not satisfy the U.S. citizenship requirements for operation of U.S.-flag vessels in the coastwise trade.

In response to Trico's submissions that being publicly traded limited its ability to provide evidence of its U.S. citizenship, the Coast Guard responded in its report that:

It is the corporate vessel owner's obligation, if it chooses to issue equity securities which are traded on national exchanges, thus subjecting it to SEC regulation, and if it wishes to have the privilege of engaging in the coastwise trade under the Jones Act, to structure itself and its equity securities in such a way, and to put in place procedures and mechanisms by which it can satisfy its obligations under the Jones Act. ... [I]f the corporation has structured itself such that the identity of the owner of one or more securities, representing a controlling interest of all or any part of the 75 percent necessary for, and by which the corporation seeks to establish its privilege to engage in the coastwise trade, is a beneficial owner, and that beneficial owner objects to revealing his / her / its identity, and that identity is a necessary element of the vessel owner corporation satisfying its obligation of establishing that the security is owned by a U.S. citizen, then the Coast Guard would deem that vessel owner to have failed to demonstrate, "that at least 75 percent of the interest in the corporation is owned by citizens of the United States." 46 U.S.C. § 50501; and 46 C.F.R. § 67.31. ....

The Coast Guard continued that a company may not rely on the fact that 75 percent of its equity securities are held through The Depository Trust Company ("DTC") and that its securities are entered in the DTC's Seg-100 program (a program maintained by DTC that allows DTC participants to specify that the purchaser of stock in a company covered by the program is a non-coastwise citizen) to satisfy the requirements to prove that it is a coastwise

citizen. The Coast Guard noted the possible use of provisions in a company's organizational documents that would restrict ownership of its equity to coastwise citizens or that would prevent transfers to non-coastwise citizens of equity interests greater than 25 percent.

Trico indicated that it had done all that it could to verify the U.S. citizenship of the holders of its stock. It argued that its use of DTC's Seg-100 program reflected its compliance with the requirements to maintain its U.S. citizenship. Trico further argued that it was not legally possible to satisfy the Coast Guard's requirements for evidence of U.S. citizenship because the Objecting Beneficial Owner ("OBO") rules of the Securities and Exchange Commission prevented Trico from obtaining information concerning the identities of its equity holders that chose to be on the OBO list. (See 17 C.F.R. § 240.14b-1.) Furthermore, Trico argued that if it was not in compliance, no publicly traded coastwise company would be in compliance and that the Coast Guard would in effect be prohibiting publicly traded companies from engaging in the coastwise trade.

The Coast Guard was not persuaded by these arguments. It stated in its report that the coastwise trade is restrictive and that operating in that trade "is a privilege dependent on strict observance of the requirements that, among other things, not more than 25% of the control or equity shares be held by aliens, and, more critically for the present analysis, that the issuer of shares traded on a public exchange must take steps to ensure that its shares never fall into non-compliance ...." It further stated that a company may not rely on DTC and the Seg-100 program as the only method to satisfy the citizenship requirements. Importantly, the Coast Guard stated that "it bears emphasis that the Coast Guard has by both regulation and by long-standing policy insisted that entities (in this case corporate hedge funds and other business entities) that contribute to the 75% U.S. citizenship required to be eligible for an owned vessel to be documented with a coastwise endorsement must themselves be eligible to document vessels with coastwise endorsements in their own right."

The Coast Guard concluded that Trico had failed in its obligations to prove that it satisfied the requirements to be a coastwise citizen. Given "the privileged and restrictive nature" of the coastwise trade, it found that Trico should have taken more action to ensure that its equity securities were owned by coastwise citizens, notwithstanding the SEC's OBO rules.

## Coast Guard Recommendations as a Result of the Trico Investigation

Based on its analysis of Trico's citizenship, the Coast Guard concluded that the Certificates of Documentation for Trico's vessels were improperly issued and recommended that those Certificates of Documentation be cancelled immediately. The Coast Guard then analyzed whether to assess a civil penalty for violations of the vessel documentation laws under 46 U.S.C. § 12151(a). The Coast Guard believed that its snap-shot analyses of Trico's citizenship only revealed some of its violations, but it also noted that Trico had filed for bankruptcy. Hence, the Coast Guard sought to recommend civil penalties that might realistically be collected, and it settled on a minimum civil penalty of \$1,000 per violation. After calculating those penalties both on a per vessel basis (which came to \$5,978,000) and on a per owner basis (which came to \$1,096,000), it recommended the per vessel basis because otherwise owners of large fleets held through single shipowning entities that violate these laws would be favored by determinations made on a per owner basis.

The Coast Guard then considered whether to recommend the seizure and forfeiture of the Trico vessels under 46 U.S.C. § 12151(b). The Coast Guard decided to reserve on this point subject to possible further findings of the *mens rea* of Trico in violating the vessel documentation laws.

Finally, in light of Trico's arguments that its citizenship compliance mechanisms were no different than any other publicly traded company and that finding Trico non-compliant would mean that no such company could operate in the coastwise trade, the Coast Guard recommended that consideration be given to publishing a notice in the Federal Register to solicit ideas from the industry as to how publicly traded companies comply with the Coast Guard's U.S. citizenship requirements.

## Final Coast Guard Action

The Coast Guard's report was submitted to the Director of Prevention Policy for Marine Safety, Security, and Stewardship (CG-54) for action, who on February 24, 2011, approved the assessment of the civil penalties on a per vessel basis and the preparation of the Notice. However, due to subsequent changes with respect to Trico's situation and apparently further internal discussion at the Coast Guard, the recommendations concerning cancellation of the Certificates of Documentation and the seizure and forfeiture of the vessels was not approved. Although it is not stated, these

latter two actions may not have been approved because by that date, Trico's bankruptcy had converted to a liquidating Chapter 11 and Trico was no longer operating in the coastwise trade and had sold or was in the process of selling all of its U.S.-flag vessels.

### MarAd's Review and Action on the Trico Investigation

In an addendum to the Coast Guard's investigation report, MarAd indicated that Trico would not have been able to use the fair inference rule given that a single Norwegian entity owned well in excess of 5% of Trico's shares. MarAd recognized the "appropriateness of the measures" that the Coast Guard had taken under its regulations. However, MarAd declined to impose any penalties in addition to those assessed by the Coast Guard. First, it was not clear that a foreign transfer had occurred in violation of 46 U.S.C. § 56101 (which prohibits certain transfers of U.S.-flag vessels to non-U.S. citizens without MarAd approval). Second, although there appeared to be a "technical default" under Trico's U.S. government-guaranteed loans, MarAd would take any enforcement action under those loan documents in Trico's bankruptcy proceedings. It is noteworthy that by the date of this addendum the vessels financed by those loans were no longer operating in the coastwise trade and had been or were in the process of being sold as part of Trico's bankruptcy.

### The Federal Register Notice

Following up on the suggestion in its report on the Trico investigation, the Coast Guard published the Notice. The specific purpose of the Notice is to solicit information regarding:

- the mechanisms that publicly traded companies employ to ensure compliance with the U.S. citizenship requirements for U.S.-flag vessels with coastwise endorsements; and

- the manner in which such mechanisms function to protect the citizenship of publicly traded companies and enable them to provide proof of their compliance with these U.S. citizenship requirements.

The Coast Guard specifically states in the Notice that it "will not retaliate against commenters that question or complain about citizenship requirements or any policy or action of the Coast Guard."

### Conclusions and Recommendations

The Coast Guard's actions with respect to Trico clearly raise potentially significant issues for publicly traded companies operating U.S.-flag vessels with coastwise endorsements and for companies that invest in or do business with them. Underlying some of those potential issues is whether the Coast Guard's analysis is based on an incorrect understanding of how stocks are traded publicly over the national exchanges and through DTC and how the SEC's rules work.

Accordingly, publicly traded companies that operate U.S.-flag vessels with coastwise endorsements, companies that invest in them, and other stakeholders should review the Trico investigation report and final action memorandum and the Notice and consider making comments on the Notice by February 1, 2012. If it is decided that comments are appropriate, commenters should consider including information as to how the stock trading systems work today, particularly in the global capital markets. In addition, although the Coast Guard indicates that it will not retaliate against commenters, commenters may want to consider relying on and encouraging industry or trade associations to provide comments on their behalf.

#### For Additional Information

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