

For Official Use

DSTI/DOT/MTC(2003)16



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

19-Dec-2002

English - Or. English

**DIRECTORATE FOR SCIENCE, TECHNOLOGY AND INDUSTRY
MARITIME TRANSPORT COMMITTEE**

**DSTI/DOT/MTC(2003)16
For Official Use**

OECD WORKSHOP ON MARITIME TRANSPORT

TRANSPARENCY OF OWNERSHIP AND THE IMPACT OF SECURITY ON SEAFARERS

Paper submitted by Jon Whitlow, International Transport Workers' Federation (ITF)

Paris, 8-9 January 2003

Contact: Division of Transport, Mr. Danny Scorpecci, tel:+33 1 45 24 94 33; fax: +33 1 44 30 62 57;
e-mail: danny.scorpecci@oecd.org or Mr. Wolfgang Hübner, tel:+33 1 45 24 91 32;
e-mail:wolfgang.hubner@oecd.org

JT00137093

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English - Or. English

TRANSPARENCY OF OWNERSHIP AND THE IMPACT OF SECURITY ON SEAFARERS

Introduction

1. Security issues have become a major concern post 11 September 2001, both in general and in the maritime industry. The issue of maritime security is being addressed in the International Maritime Organisation (IMO), where a new Chapter XI-2 has just been adopted (covering ship and port facility security), and in the International Labour Organisation (ILO) where the revision of Convention No.108 (Seafarers' Identity Documents Convention, 1958) has become an urgent work item. The issue has also featured prominently on the agendas of the G8 and the United Nations General Assembly, where special attention has been paid to the maritime industry.

2. A ship can be used for the transportation of persons and equipment for the purposes of committing an unlawful act; as a weapon in an unlawful act; and in a lawful trade for the purposes of generating funds to finance unlawful acts. The need to implement the United Nations International Convention for the Suppression of the Financing of Terrorism (1999) in a maritime context clearly indicates the need for greater transparency in the beneficial ownership and control of vessels.

3. Flags of Convenience (FOCs) can provide a cover for illicit activity which ranges from a lack of observance of international maritime safety or pollution prevention requirements, to money laundering, cargo fraud, illegal unreported and unregulated fishing and phantom ships. The European Union Fisheries Commissioner, Franz Fischler, stated the following:

“The practice of flags of convenience, where owners register vessels in countries other than their own in order to avoid binding regulations or controls, is a serious menace to today’s maritime world.”(1)

4. The registered owner of almost all FOC ships is a shell company set up for the sole purpose of owning that one ship. That registered owner is often, in turn, owned by another company, which may itself be registered in a country with very liberal company laws. This gives the shipowner the ability to disappear completely from any accountability, whether criminal or civil, which may arise through owning the ship.

5. This ownership structure has profound implications for the work of the OECD MTC as it has an economic dimension. The ship is the only asset of the one ship company and so the liabilities of the company can therefore be limited to the value of the ship. If the ship is insured, then under many circumstances the beneficial owner carries little or no financial risk in owning the ship. The OECD study *“The Costs to Users of Substandard Shipping”* (2001) concluded that the insurance market provides what is in effect a safety net for the operators of sub-standard ships and the corporate veil prevents the effective resolution of negligence claims, or any other claims which would be addressed to the party responsible for the ship.

6. Recently it has been realised that a system where the owners of ships are completely hidden also poses a considerable security risk to the countries where they trade. It is now known that the Tamil Tigers

had about 10 ships under their control at one time (2) and the search for the shipping interests of Al-Qaeda, estimated variously between 10 and 80 ships, continues.

7. The impact upon seafarers is not just legal, but practical. Shipowners may choose to hide behind the corporate veil when faced with legitimate, even contractual, claims from seafarers or their families. A number of flag States market themselves upon the protection that they offer shipowners and the banks who provide mortgages. Protection for seafarers is not a marketing advantage and so is unlikely to be a priority in the commercial world of ship registration.

8. Seafarers now find themselves being treated as a security risk in many of the ports of the world. This results in a further deterioration of the living conditions on board ship, for example the denial of shore leave. Enhanced security measures also have the capacity to make what is already an unpopular occupation, suffering from a chronic lack of skilled personnel, even less attractive.

Transparency

9. Lack of transparency of beneficial ownership has been a concern for regulatory bodies for many years. It has been given a fresh significance following the attacks of 11 September 2001 with the efforts to develop new measures to guard against terrorist attack.

10. Included in the amendments to the International Convention for the Safety of Life at Sea (SOLAS) Chapter XI-1 is provision for a "Continuous Synopsis Record" to be carried on board each ship. This document will include details of the flag State, identification number, name of ship, classification society and registered owner. Any changes to these and other details will need to be shown on this record, so that a history of the ship is developed. The flag State will be responsible for ensuring that it is kept up to date and it will be available for inspection at any time.

11. In a further provision of SOLAS, the company is made responsible for ensuring that information is available on board for port States to know the person responsible for appointing the members of the crew, the person responsible for deciding the employment of the ship and the parties to any charterparty.

12. The US Maritime Transportation Security Act of 2002 lays down a requirement for an annual report to the relevant committees of the House of Representatives and Senate with a list of States: "*whose laws or regulations are not sufficient to allow tracking of ownership and registration histories of registered flag vessels*". (Section 112, (2) (D))

13. "*Behind the Corporate Veil – using corporate entities for illicit purposes*" (OECD 2001), *inter alia*, explored the ability of beneficial owners to remain hidden, and suggested that:

"In order to successfully combat and prevent the misuse of corporate vehicles for illicit purposes, it is essential that all jurisdictions establish effective mechanisms that enable their authorities to obtain, on a timely basis, information on the beneficial ownership and control of corporate vehicles established in their own jurisdictions..."(page 8).

14. The maritime industry is not the only sector to suffer from the lack of transparency, but it is an industry where the use of such corporate structures is well developed and has almost become the norm.

15. The Financial Stability Forum, the Financial Action Task Force on Money Laundering and the OECD Working Group on Bribery in International Business Transactions have all noted that such corporate structures allow the concealment of the identities of those involved in or benefiting from criminal

activities. Corporate vehicles can be misused in order to perpetrate improper self-dealing, to circumvent regulations and to manipulate equity markets and they are closely linked to harmful tax practices.

16. The OECD report *“Behind the Corporate Veil – using corporate entities for illicit purposes”* defines ownership as the person or people who are in control as follows:

*“In this report, **beneficial ownership** refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settler or founder.” (page 14)*

*“In this report, **control** means effective control by an individual or group of individuals over a corporate vehicle. Thus, with respect to the types of corporate vehicles examined in this report, the relevant inquiry will be who exercises effective control (rather than legal control) over the corporate vehicle. In many misuses of corporate vehicles, the beneficial owner or settler/founder controls the corporate vehicle despite outward appearances suggesting control by a third party. For example, directors of a corporation could merely be “nominees” who pass on the duties required of a director to the beneficial owner and accepts instructions from the beneficial owner. With respect to trusts, the settler may continue to exercise effective control over the trustee through the use of a trust “protector” and a letter of wishes.” (page 14).*

*“**Shell companies**” are described in the report as “...entities established not to pursue any legitimate business activity, but solely to obscure the beneficial ownership of their owners and controllers...”(page 17).*

17. The United Nations Convention on the Law of the Sea (UNCLOS) clearly defines the nationality of ships and establishes the duties and responsibilities of the flag State. Article 91 (Nationality of Ships) states that: *“ships have the nationality of the State whose flag they are entitled to fly”* and also stipulates that *“there must exist a genuine link between the State and the ship”*. The convention goes on to explain that ships which sail under the flag of the State: *“shall be subject to its exclusive jurisdiction on the high seas”*.

18. The mechanisms by which shipowners hide their true identity are documented in detail in an OECD paper, *“Ownership and Control of Ships”*. It is the experience of TUAC/ITF that the practices of hiding beneficial ownership and control may be used to deny seafarers and their families their contractual settlement for death, personal injury or wages and that they may also be used as a cover for illegal practices within the maritime industry, such as smuggling arms or illegal immigrants.

19. It is difficult to equate the requirements of UNCLOS for effective control of ships by the State whose flag they fly with the existence of regimes which market themselves on the services that they can provide to shipowners, that is FOCs. The former prime minister of Belize, Manuel Esquivel, stated in 1999 that his government had received many diplomatic complaints about the activities of Belize flagged ships and said about the activities of such shipowners:

“There was little we could do. These people aren’t responsible to anyone. The ships are never seen in Belize. The Belize shipping registry is privatised. There should be proper accountability.” (Sunday Express, UK, 4 April 1999)

20. Lack of transparency does not just pose a problem of security or of tracing assets in a legal case; it also assists in maintaining sub-standard operations in shipping. There are occasions when a ship may be worth considerably less than the debts attached to it, and so it will be easy to abandon the ship when the debts become too great or when there is a cash flow difficulty. Under these circumstances, the true owner of the ship is able to ensure that there are no costs associated with the termination of his commercial operation other than losing the ship. Sometimes, ships are even bought back at auction, free of liens, by their original owner.

21. Apart from non-disclosure of directors and shareholders there are other methods that can be used to avoid detection including bearer shares, nominee shareholders and corporate shareholders. While, for the purposes of obtaining credit or services, shipowners may well imply or demonstrate that they are the owners of the ship concerned, should they wish to hide themselves from any legal liability they are well able to do so. Banks and other parties in the shipping market accept this structure as the laws are tailored to their needs.

22. One corporate investigator involved in the search for Bin Laden assets said in The Times of 8 October 2001:

“Uncovering his bank accounts, bogus charities and front companies is child’s play compared to piercing the veil of secrecy that protects shipping owners. Backwater countries with flags of convenience have watertight secrecy. And, even if you do find a suspicious ownership, how do you prove the company holding the bearer shares of that vessel is linked to his al-Qaeda network?”

A “genuine link” between the ship and flag State

23. TUAC/ITF has repeatedly stressed the importance of Article 91 of UNCLOS, which provides for a “genuine link” between the ship and the flag State. Although the “genuine link” is not expressly defined in UNCLOS, other Articles – especially Articles 94 and 217 – implicitly point to the requirement for at least an “economic link”. This means that there should exist within the flag State a substantial entity which can be made responsible for the actions of the ship and on which penalties of adequate severity can be levied so as to discourage violations of applicable international minimum rules and standards, wherever they occur. Common sense and the inherent problems there are in enforcing administrative penalties in another jurisdiction or in securing the extradition of key personnel within the shipping company indicate that in the absence of a “genuine link” the flag State will not be able to exercise effective control over vessels which fly its flag.

24. The ITF has commissioned an independent study on *“The Meaning of the “Genuine Link” Requirements in Relation to the Nationality of Ships”* by Robin R Churchill and Christopher Hedley. (3)

PRESTIGE

25. The sinking of the tanker PRESTIGE and the claims, which are expected to result from the pollution, illustrate the problems which the present corporate system generate. As in the immediate aftermath of the sinking of the ERIKA three years previously, the beneficial owner of the ship was not readily identified. The vessel flew the flag of the Bahamas, an FOC which, in common with others, provides for a foreign owner a right to fly the Bahamas flag irrespective of the nationality or place of business of the shipowner. The Bahamas does not even require the registered owner of the vessel to be a Bahamian entity and in this instance the registered owner of the ship was a Liberian company. That means that no further information is readily available on the actual owners of this vessel.

26. Following the loss of the ERIKA some charterers moved to newer tonnage while the charterer of the PRESTIGE apparently moved to older tonnage:

“According to Lloyds Marine Intelligence Unit, the average age of ships chartered by the company (Crown Resources) for dirty cargoes- including crude oil and fuel oil- has increased from 11 to 19 in the last three years...The deal between the Prestige’s operator Universe Maritime and Crown was believed to have been arranged by Petrian (broker also for the final voyage of the Erika) at a rate of around USD 13,000 a day when the Clarkson Research Studies average earning for an 11 year old aframax was close to USD 18,000 per day.” (Lloyds List, 27 November 2002)

27. According to news reports, both Repsol and BP chose not to charter the PRESTIGE when it was offered to them and it may therefore be concluded that ships like the ERIKA and the PRESTIGE exist to serve customers for whom obtaining the lowest freight rate is the overriding priority. The insurance liability of the shipowner and the P+I Club is reported to be just over GBP 15 million and when the funds available from international compensation regime are added the total is likely to fall far short of the cost of such an oil spill. The corporate structure and the limited liability regime which is in place is likely to ensure that costs do not pass to any of those with a financial stake in this venture, although they may well be individuals with very substantial assets. This means that the commonly accepted principle that the polluter pays, adopted in Agenda 21 at the 1992 Rio Earth Summit, is negated through lack of transparency.

Other cases of abuse of the current system

28. FOCs provide the flag of choice for a large number of illegal activities which take place on ships which bear their nationality. Tonga has had a number of high profile incidents since the flag was turned into an FOC in 2000. It is interesting to note that the Tonga register was managed from Piraeus by Pelopidas Papadopoulos, who had previously been the franchised operator of the Bolivian shipping register. The poor quality of the ships on the register propelled Tonga on to the Paris MOU blacklist for port State control detentions by the end of 2001.

29. The Tonga flagged ship KARINE A was intercepted by the Israeli forces in January 2002, and found to be carrying 50 tonnes of weapons. The owner could not be traced. The previous owner of the ship was not able to confirm that the ship captured was indeed the ship he had sold. In March 2002 the Tonga flagged ship MONICA was arrested by the French navy carrying 928 Kurdish refugees. Again, no ownership details were available. The ship had previously used 11 different names under 7 different FOCs since 1988. The Tonga flagged ship SARA was detained in Sicily in August 2002 due to carrying 15 suspected terrorists, who are still detained in Italy as at December 2002. Another Tonga flagged vessel BOKA STAR was detained in Croatia in October 2002 as the result of a joint Yugoslav/NATO effort to trace illegal shipments of weapons to Iraq in violation of the UN sanctions. The inspection revealed that the ship was loaded with containers with solid fuel for Scud missiles.

30. Global Witness, in its report *“Logging Off – how the Liberian timber industry fuels Liberia’s humanitarian disaster and threatens Sierra Leone”* (September 2002) lists five ships under Bahamas, Cyprus and Malta flag suspected of shipping arms to Liberia in breach of the United Nations embargo. There are many other instances where FOCs and the lack of a transparent ownership structure have provided cover for illegal operations, many of which are linked to transnational crime. For example in two recent cases (December 2002) the Sao Tome and Principe flagged ship ANASTASIOS IV was arrested in Algeciras after 26 Indian immigrants were found on board and the Honduran flagged ship NOE was arrested in Las Palmas carrying 232 Africans, none of whom had identity papers. The extent of the

problem of people smuggling has caused the United Nations to include a Protocol Against the Smuggling of Migrants by Land, Sea and Air, in the United Nations Convention Against Transnational Organised Crime.

31. During December 2002 two officials of FOC maritime administrations were charged with criminal offences. The Vanuatu maritime Chief Executive, Robert Bohn, was arrested in the USA as part of a syndicate charged with crimes including conspiracy and money laundering. In Bolivia the former director of the ship registry, Yerko Garafulic, was detained by the government prosecutor in La Paz and charged with creating fictitious companies and economic crimes against the State. There are many anecdotal stories of the prevalence of money laundering operations within the shipping industry and some shipowners complain about the unfair competition such activities generate and how they reduce charter rates.

Security issues and their impact on seafarers

32. The security measures taken by States and the impact on the shipping industry have had a considerable effect upon the working conditions of seafarers. There is often an assumption that seafarers are potential terrorists and that until proven innocent they should be treated as such.

33. Shore leave is one of the most time honoured maritime customs and is undoubtedly one of the most vital elements of the seafarer's well being in terms of living and working conditions. However, shore leave is under threat both in law and in practice and you will be aware of the growing problems many seafarers now face while their vessel is in port in the United States. Not only are seafarers being denied shore leave and therefore access to shore based welfare facilities, but there are also frequent instances of armed security guards being posted to ensure that they do not leave the vessel.

34. A valid US visa has now become a prerequisite for a job with many shipping companies and the refusal of a visa causes many seafarers engaged in international trade to be unemployable. The ending of the crew list visa has in practice moved the cost from the shipowner to the seafarers. At the same time the cost for an application has been raised to USD 100 and, given that many seafarers reside some distance from a US Consulate, there are substantial additional costs which fall on seafarers.

35. The new security related amendments to SOLAS and the Ship and Port Facility Security Code will also directly impact on seafarers. Who will pay for the training of the officer designated as the ship's security officer? The implementation of the ship's security plan, especially the regime that will have to be applied while a vessel is in port has the potential to add to the work of already overstretched ship's personnel.

36. The investigation of criminal activity at sea has run into jurisdictional difficulties in the past. Crew accused of murder, for example, whether of stowaways or of fellow crew, find themselves the centre of discussion over which country should try them for their alleged crimes.

37. According to the law of the sea it is the flag State which should have jurisdiction over crimes committed on the high seas. However, when the flag State is, for example, Liberia, the ability of the judicial system to cope can be doubted. In the case of the murder of the second officer of the Japanese owned, Panamanian flagged, ship TAJIMA, weeks were spent with the ship at anchorage in Japan while an application for extradition was awaited from the flag State.

Flag State sovereignty

38. Although flag States like to hide behind national sovereignty whenever 'their' ship gets into trouble, the concept has become devalued by the growth of the FOC system. It is impossible for these flag States to exercise effective control over the vessel and, where required, to levy fines or impose other penalties of adequate severity to ensure compliance. Of course, most of the registers in question also lack both the capacity and the political will to take such measures. Indeed most FOC States lack any real maritime infrastructure or a suitably sized maritime administration, especially given the number of vessels they have registered under their flag. Some of them are little more than a desk and a fax machine.

39. The demise of national flag shipping and the growth and proliferation of FOCs have not only devalued the concept of flag State sovereignty but have also led to many traditional shipping nations becoming port or coastal States rather than flag States. This has implications for the retention of the existing regulatory regime, for example the importance attached to concepts like the freedom of navigation and the rights of innocent passage.

40. TUAC/ITF considers that the moves towards the establishment of a flag auditing system, similar to the ICAO Oversight Programme, are welcome. However, to seek to limit such initiatives to the narrow competencies of the IMO would not only be counterproductive but would also ignore the other obligations on flag States which are established by international law, most notably under UNCLOS. Consideration also needs to be given to adding what is missing from the current legal regime, namely an enforcement mechanism.

Conclusions

41. It is clear that the current regime is incompatible with the overwhelming interests of civil society and is no longer tenable. It is also incompatible with the long-term interests of the shipping industry and to the establishment of a rational and sustainable industry. Current arrangements make it almost impossible to identify the real owners of ships. Therefore, they cannot be held accountable for the way in which they maintain and operate their ships and so irresponsible industry practices continue. It is essential that details of the beneficial ownership and control of ships be fully transparent and that effective liability arrangements are put in place to ensure that the guilty parties are held responsible for the consequences of their actions.

42. The current approach to setting international standards for shipping has tended to be reactive, ponderous and based on industry driven compromises. The long timescales for phasing out old tankers and improving the safety of bulk carriers are obvious examples.

43. A new global agreement is required which eliminates the FOC system and ensures that flag States meet their responsibilities and are held accountable for the enforcement of internationally agreed regulations. This is achievable through a concerted multi-agency approach involving all the international agencies with competence in ocean and seas issues and would include the IMO and the ILO. The process would also require the United Nations Department of Ocean Affairs and the Law of the Sea to be invited to revise the United Nations Convention on Conditions for Registration of Ships (1986) which has not come into force.

REFERENCES

1. “Illegal Fishing – a threat to our common heritage”, Europa website, July 2002.
http://europa.eu.int/comm/commissioners/fischler/illfish_en.htm
2. “The Arms Fixers – Controlling the Brokers and Shipping Agents”, Wood / Peleman, Norwegian Initiative on Small Arms Transfers (NISAT) and others, 1999,
<http://www.nisat.org/publications/armsfixers/>
3. “*The Meaning of the “Genuine Link” Requirements in Relation to the Nationality of Ships*” by Robin R Churchill and Christopher Hedley,
<http://www.icons.org.au/images/ITF-Oct2000.pdf>