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## Public Company Jones Act Citizenship

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## I. INTRODUCTION

U.S. cabotage laws, popularly and generally referred to as the Jones Act,<sup>1</sup> limit access to the U.S. domestic maritime trade to U.S.-flag vessels owned and operated by qualified U.S. citizens. One of the citizenship requirements is the maintenance of at least 75% U.S. citizen beneficial ownership of the ultimate parent and intervening subsidiaries of the vessel-owning company. The law is apparently unyielding, for there is no *de minimis* exception and compliance in principle must be continuous. Public companies can find it difficult to qualify as Jones Act citizens and maintain that citizenship. Most publicly traded securities are held in “street name”<sup>2</sup> where the securities issuer does not have access to the identity of the ultimate owners, and publicly listed securities are traded daily. Jones Act companies and securities institutions have come up with

1. In this Article, the term “Jones Act” refers to section 27 of the Merchant Marine Act, 1920, 46 U.S.C. § 50101 (2012), rather than section 33 of that Act, also commonly referred to as the “Jones Act,” which governs mariner injury compensation, *id.* § 30104.

2. The Securities and Exchange Commission defines “street name” to mean where a brokerage firm holds securities “in its name or another nominee” rather than in the name of the “real or ‘beneficial owner.’” *Street Name*, U.S. SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/answers/street.htm> (last visited Apr. 6, 2015).

mechanisms that ameliorate the difficulty. However, government-sanctioned compliance tools have lagged and do not provide Jones Act companies that are intent on compliance with the ability to obtain the assurance they deserve. We examine the current Jones Act citizenship standard, the nature of contemporary public securities trade settlement and ownership, current public company strategies for Jones Act compliance, the latest Coast Guard guidance on the subject, and suggest several compliance improvements to alleviate the problem.

## II. THE JONES ACT CITIZENSHIP STANDARD

The Jones Act restricts the transportation of “merchandise” between points in the United States (referred to as the “coastwise trade”) to vessels owned and operated by qualified U.S. citizens (with certain exceptions).<sup>3</sup> A business entity must comply both with structural criteria—such as being organized in the United States—and a facts and circumstances assessment of U.S. citizen control in order to qualify as a U.S. citizen. These structural and control citizenship requirements are set forth in statutes, regulations, and administrative and judicial precedents.

Before reviewing those requirements, it is important to note that two federal agencies in two separate departments—the United States Coast Guard in the Department of Homeland Security and the United States Maritime Administration (MARAD) in the Department of Transportation—deal with maritime citizenship matters.<sup>4</sup> The Coast Guard derives its authority as the federal registrar of vessels.<sup>5</sup> MARAD has authority,<sup>6</sup> pursuant to section 9 of the Shipping Act, 1916,<sup>7</sup> over the transfer of U.S.-registered, that is, U.S.-flag, vessels or interests in such vessels to foreign flag or to foreign control. The Coast Guard’s regulations reference the MARAD function by requiring MARAD’s approval for certain transactions including the “[s]ale or transfer of an interest in or control of the vessel from a citizen . . . to a person not a citizen.”<sup>8</sup> MARAD also takes citizenship positions in administering its

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3. 46 U.S.C. § 55102. Similar restrictions apply to the transportation of passengers as well as dredging and towing in U.S. waters. *See id.* §§ 55103, 55109, 55111, 55118, 80104.

4. “Although decisions concerning documentation of vessels is a Coast Guard function, MARAD has responsibility under 46 App. U.S.C. 808[, 46 U.S.C. § 56101, or section 9 of the Shipping Act, 1916] for regulating the transfer of documented vessels to noncitizens or to foreign registry or authority.” 54 Fed. Reg. 5382, 5385 (Feb. 2, 1989).

5. 46 U.S.C. § 2104.

6. 49 U.S.C. § 109 (2012); 49 C.F.R. § 1.66(a) (2011); *see also* Dist. No. 1, Pac. Coast Div., Marine Eng’rs’ Beneficial Ass’n v. Mar. Admin., 215 F.3d 37, 2000 AMC 2362 (D.C. Cir. 2000).

7. 46 U.S.C. § 56101.

8. 46 C.F.R. § 67.47 (2013).

U.S.-flag promotional programs, such as its Capital Construction Fund program.<sup>9</sup> Although the agencies usually coordinate their definitions and interpretations, they are not always congruent.<sup>10</sup>

#### A. *Structural Requirements*

A business entity must satisfy two structural requirements in order to qualify as a U.S. citizen eligible to own and operate a vessel in the U.S. coastwise trade. First, a business entity must be eligible to document a vessel in the United States with the U.S. Coast Guard.<sup>11</sup> Such an entity can be referred to as a “documentation citizen.” Second, a documentation citizen must be owned at least 75% by U.S. documentation citizens eligible to own and operate a vessel in the coastwise trade.<sup>12</sup>

##### 1. Vessel Documentation Requirements

The common theme for the qualification of a business entity as a documentation citizen, regardless of the type of entity, is that it must be U.S. domiciled and must be managed by U.S. citizens.

Specifically, for a corporation to document a vessel in the United States: (1) it must be incorporated under the laws of the United States or a state; (2) its chief executive officer, by whatever title, and the chairman of the board of directors, must be U.S. citizens; and (3) no more than a minority of the number of directors necessary to constitute a quorum can be noncitizens.<sup>13</sup> A documentation citizen corporation, which does not seek the right to engage in the coastwise trade or to participate in certain U.S.-citizen-restricted government programs,<sup>14</sup> can be 100% owned by noncitizens.

For a general partnership to document a vessel, each and every general partner must be a documentation citizen.<sup>15</sup> In addition, unlike a corporation, U.S. citizens must own at least 50% of the “equity interest in

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9. See, e.g., *id.* § 390.2(a)(2)(i). MARAD regulations provide a form of citizenship affidavit to be utilized by program participants in establishing eligibility for U.S.-citizen-restricted programs. See *id.* pt. 355.

10. See Gordon L. Poole, Barbara B. Powell & Donald T. Gray, *Financing of United States-Flag Vessels*, 56 TUL. L. REV. 1171, 1178 (1982) (“While the agencies usually cooperate with one another and often defer to the judgment of the agency most directly involved in a particular issue, the agencies do not always concur in statutory interpretations.”).

11. 46 U.S.C. § 55102(b)(2).

12. *Id.* §§ 12112, 50501, 55102(b)(2).

13. *Id.* § 12103(b)(4); 46 C.F.R. §§ 67.39(a), 221.3(c)(2).

14. U.S. government maritime promotional programs in which there is a citizenship element include the Maritime Security and the Capital Construction Fund programs. See 46 U.S.C. chs. 531, 535.

15. *Id.* § 12103(b)(3); 46 C.F.R. §§ 67.35, 221.3(c)(3).

the partnership” for a general partnership to document a U.S.-flag vessel.<sup>16</sup> Like many ownership concepts in the applicable regulations, the phrase “equity interest” is not defined.

For a limited liability company, the requirements depend—informally, for there is no regulation for such entities<sup>17</sup>—on whether the entity is organized either as a corporation or as a partnership.<sup>18</sup> A limited liability company is generally considered to be organized like a corporation if it is managed by a board of managers rather than directly by the members. The Coast Guard requires limited liability companies that are managed directly by their members to meet partnership documentation requirements.

## 2. Beneficial Ownership Requirements

A documentation citizen qualifies to own or operate a Jones Act vessel if it is also owned at least 75% by U.S. citizens (absent an exception).<sup>19</sup> It is this requirement in particular that creates potential difficulties for public companies seeking to comply with the law.

The 75% requirement has its origins in the Shipping Act, 1916,<sup>20</sup> adopted by the U.S. government to deal with World War I-related shipping shortages.<sup>21</sup> The Shipping Act, 1916, established the United States Shipping Board<sup>22</sup> and authorized the Board, among other things, to order the construction of cargo and passenger vessels.<sup>23</sup> Section 2 of the

16. 46 C.F.R. § 67.35; *see also* 46 U.S.C. § 12103(b)(3); 46 C.F.R. § 221.3(c)(3).

17. *See* Leonard Egan, James B. Ellis II & R. Anthony Salgado, *Federal Restrictions on Foreign Investment in the United States Maritime Industries*, in 2 *MANUAL OF FOREIGN INVESTMENT IN THE UNITED STATES* § 18:3-4 (J. Eugene Marans et al. eds., 3d ed. 2013).

18. The basic Coast Guard form for vessel documentation—CG-1258—requires all members of a limited liability company to be U.S. citizens like a general partnership. However, the National Vessel Documentation Center website requests that persons documenting manager-managed limited liability companies or limited liability companies organized like corporations contact the Coast Guard regarding documentation requirements. *See Application for Initial, Exchange, or Replacement of Certificate of Documentation; Redocumentation*, U.S. COAST GUARD, <http://www.uscg.mil/nvdc/forms/cg1258.pdf> (last visited Apr 7, 2015).

19. 46 U.S.C. §§ 55102(b)(2), 12112, 50501. For a description of the exceptions, *see* Constantine G. Papavizas, *U.S.-Flag Vessel Financing and Citizenship Requirements Update*, 32 *TUL. MAR. L.J.* 35 (2007).

20. *See* ch. 451, 39 Stat. 728 (Sept. 7, 1916).

21. *See* SAMUEL A. LAWRENCE, *UNITED STATES MERCHANT SHIPPING POLICIES AND POLITICS* 38-40 (1966).

22. *See* UNITED STATES SHIPPING POLICIES AND THE WORLD MARKET 51 (William A. Lovett ed., 1996) (“The U.S. Shipping Board was created in 1916 with a mandate to build, buy, and operate a greatly enlarged U.S. merchant fleet.”).

23. *See* ANDREW GIBSON & ARTHUR DONOVAN, *THE ABANDONED OCEAN—A HISTORY OF UNITED STATES MARITIME POLICY* 109 (2000).

1916 Act set forth a definition of citizenship at that time that only applied to the Shipping Board's activities as follows:

no corporation, partnership, or association shall be deemed a citizen of the United States unless the controlling interest therein is owned by citizens of the United States and . . . the corporation itself is organized under the laws of the United States or of a State, Territory, District, or possession thereof.<sup>24</sup>

This definition was subsequently strengthened in 1918<sup>25</sup> and 1920. In 1920, it was also extended to the coastwise trade.<sup>26</sup> Prior to 1920, the general coastwise citizenship requirements, unchanged since 1858,<sup>27</sup> permitted a U.S. corporation under U.S. citizen management that was entirely owned by non-U.S. citizens to own a U.S.-documented vessel engaged in the U.S. coastwise trade.<sup>28</sup>

Congress determined that the Shipping Act, 1916, was deficient under wartime conditions and amended it in 1918. In particular, Congress found that there had been systematic efforts by foreign interests to gain control of U.S.-flag vessels because of the general worldwide shortage of vessels.<sup>29</sup> In response, Congress amended the section 2 citizenship test to prevent "every possible device by which foreign interests could obtain control in law or fact over corporations formed under American law."<sup>30</sup> The 1918 Act added the following critical citizenship tests:

The controlling interest in a corporation shall not be deemed to be owned by citizens of the United States (a) if the title to a majority of the stock thereof is not vested in such citizens free from any trust or fiduciary obligation in favor of any person not a citizen of the United States; (b) if the majority of the voting power in such corporation is not vested in citizens of the United States; or (c) if through any contract or understanding it is so arranged that the majority of the voting power may be exercised, directly or indirectly, in behalf of any person who is not a citizen of the United States; or (d) if by any other means whatsoever control of the

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24. Shipping Act, 1916 § 2, 39 Stat. at 729 (codified as amended at 46 U.S.C. § 50501 (2012)).

25. Act of July 15, 1918, ch. 152, § 2, 40 Stat. 900 (1918); *see also* Meacham Corp. v. United States, 207 F.2d 535, 542, 1953 AMC 1771, 1782 (4th Cir. 1953) (noting that section 2 "was amplified and strengthened so as to prevent evasion of its intent" in 1918).

26. *See* Merchant Marine Act, 1920, ch. 250, §§ 27, 38, 41 Stat. 988, 999, 1008 (1920).

27. Act of June 11, 1858, ch. 145, 11 Stat. 313 (1858); *see also* 29 Op. Att'y Gen. 188, 193 (1911) (confirming that a New York state corporation owned by Canadians with Canadian officers could lawfully own a U.S.-flag vessel with coastwise trading privileges).

28. *See* S. REP. NO. 85-2145, at 2 (1958), *reprinted in* 1958 U.S.C.C.A.N. 5190, 5191.

29. H.R. REP. NO. 65-568, at 4 (1918); S. REP. NO. 65-536, at 2 (1918).

30. H.R. REP. NO. 65-568, at 4.

corporation is conferred upon or permitted to be exercised by any person who is not a citizen of the United States.<sup>31</sup>

Even the 1918 amendments were deemed to be not stringent enough. The Shipping Board proposed in the lead up to the Merchant Marine Act, 1920, that the citizenship standard be tightened again with regard to corporate ownership.<sup>32</sup> The Shipping Board reported to Congress:

Subjects of foreign Governments, and even foreign Governments themselves now own and operate vessels of the United States in our domestic coasting trades. This is accomplished through the medium of corporations of the United States, the actual ownership of all or a majority of the securities of which are vested in foreign subjects, so that the corporations are in fact but ‘dummies,’ ostensibly held by American citizens but in reality a ‘camouflage’ to the foreign ownership.<sup>33</sup>

The Board recommended a 100% U.S. citizen ownership requirement for corporations owning vessels in the coastwise trade to combat this perceived problem.<sup>34</sup>

The Shipping Board gave two reasons for tightening citizenship restrictions. First, it asserted a mercantile reason, namely to achieve similar national economic benefits as had been achieved by Great Britain with respect to its merchant fleet.<sup>35</sup> Second, the Board gave a national security reason:

Unless our coasting fleet be wholly and unequivocally owned by loyal United States citizens, it can not be rated a dependable unit in time of national emergency. We must insure that it will always be dependable by repairing the breaches made in our coasting laws so that 100 per cent bona fide American ownership shall be the only key to our coasting trades . . . .<sup>36</sup>

Although the U.S. Senate adopted the 100% requirement, it was changed in conference to the current 75% requirement.<sup>37</sup> Even in 1920 with direct stock ownership, it was recognized that a 100% U.S. citizenship requirement would preclude public companies from owning

31. Act of July 15, 1918, ch. 152, § 2, 40 Stat. 900, 900 (1918).

32. S. REP. NO. 66-573, at 7 (1920).

33. *Id.*

34. *Id.*

35. *Id.* (“Only by such provisions can the United States realize benefits from its shipping akin to that which the British Government described as ‘Great Britain’s invisible exports’ . . . .”); see also *Alaska Excursion Cruises, Inc. v. United States*, 608 F. Supp. 1084, 1087 (D.D.C. 1985) (“To assuage this fear [of noncitizen control], and, at least in part, to protect American shipping interests from foreign competition, Congress determined that only U.S. citizens could own U.S.-flag vessels operating in the domestic trade . . . .”).

36. S. REP. NO. 66-573, at 7.

37. See H.R. REP. NO. 66-1093, at 35 (1920).

Jones Act qualified vessels.<sup>38</sup> In the Senate debate, one senator argued, “When we require 100 per cent of the stock of a shipping corporation to be owned at all times by American citizens, we know perfectly well that we are making innocent violators out of every corporation in the country.”<sup>39</sup>

The 75% requirement enacted in 1920 remains the law today. As codified in 2006, the 75% requirement provides:

[A] corporation, partnership, or association is deemed to be a citizen of the United States only if the controlling interest is owned by citizens of the United States. However, if the corporation, partnership, or association is *operating* a vessel in the coastwise trade, at least 75 percent of the *interest* must be owned by citizens of the United States.<sup>40</sup>

Section 2 of the 1916 Act, as amended, provides guidance on the meaning of “interest” with respect to corporations. Section 2 provides that the 75% interest exists only if, among other things, at least 75% of “title” to stock and “voting power” in the corporation are each owned by U.S. citizens.<sup>41</sup> Neither “title” nor “voting power” are defined in the statute.

The applicable Coast Guard regulations, adopted in 1990,<sup>42</sup> provide additional guidance. The regulations indicate that the 75% requirement is only met if “at least 75 percent of the stock interest in the corporation . . . is owned by citizens.”<sup>43</sup> The regulations further indicate that “stock or equity interest requirements for citizenship . . . encompass: title to all classes of stock; title to voting stock; and ownership of

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38. See 59 CONG. REC. 7045-47 (1920).

39. *Id.* at 7045.

40. 46 U.S.C. § 50501(a) (2012) (emphasis added). It has been argued that the word “operating” limits the application of the 75% requirement to persons operating a vessel in the coastwise trade and not necessarily to the person *owning* the entity “operating” a vessel. See, e.g., *Sun Chem. Corp. v. Dainippon Ink & Chem. Inc.*, 635 F. Supp. 1417, 1424 (S.D.N.Y. 1986); John W. McConnell, Jr., *A Corporate “Citizen of the United States” for Maritime Law Purposes*, 25 J. MAR. L. & COM. 159, 182 (1994) (“Any entity in the tier of ownership above the corporation . . . owning the vessel is required to meet only the general rule of citizenship of § 2(a), that of controlling interest, and *not* either the citizenship requirement for the *owner* of a vessel operating in the coastwise trade . . . or the requirements for an entity to document a vessel in its own right with a coastwise endorsement as required by the Coast Guard.”). The United States Court of Appeals for the Third Circuit in *Conoco, Inc. v. Skinner* rejected this argument in connection to a challenge of the MARAD regulations (46 C.F.R. § 221.3(c)) that indicate otherwise. 970 F.2d 1206, 1222, 1999 AMC 2816, 2838 (3d Cir. 1992). The court concluded that MARAD’s “interpretation of section 2 [of the Shipping Act, 1916, codified at 46 U.S.C. § 50501.] is not only ‘permissible,’ but indeed it is the best reading of section 2.” *Id.* The Coast Guard’s regulations are to the same effect. See 46 C.F.R. pt. 67, subpart C.

41. 46 U.S.C. § 50501(d).

42. 55 Fed. Reg. 51,244 (Dec. 12, 1990).

43. 46 C.F.R. § 67.39(b)(2).

equity.”<sup>44</sup> As in the statute, “title” and “ownership of equity” are not defined in the regulations.

The Coast Guard has indicated that it believes that more detailed regulations would not be useful. In 1989, during the process where it promulgated its current citizenship regulations, the Coast Guard stated that “detailed rules addressing specific factual situations would be of limited value to the general public and probably could not improve on the statute itself in terms of informing interested parties of what the law requires in any particular case.”<sup>45</sup>

#### a. Tracing Rule

One citizenship aspect that has been refined over time is the application of the 75% requirement above the direct vessel owner through corporate layers of ownership. The result is the current “tracing rule” applied by the Coast Guard and MARAD through tiers of corporate ownership to the ultimate, human owners.

In a precursor to the tracing rule, the United States Supreme Court decided in 1935 that the 75% requirement could not be evaded through the expedient of corporate layers.<sup>46</sup> Specifically, the Supreme Court found, as an aside, that a Maine corporation owned by a Vermont corporation in turn owned entirely by a Canadian corporation could not qualify as a coastwise citizen.<sup>47</sup>

Both the Coast Guard and MARAD refined and expanded this rule over time<sup>48</sup> culminating in regulations issued in 1990 and 1992, respectively.<sup>49</sup> The tracing rule is critical to dealing with multitiered

44. *Id.* § 67.31(a).

45. 54 Fed. Reg. 41,992 (Oct. 13, 1989) (“Providing more detailed guidance about specific terms such as ‘voting shares’ . . . poses the same problems. No regulation could possibly encompass every conceivable application of these terms to the virtually endless variety of situations which present themselves.”).

46. *Cent. Vt. Transp. Co. v. Durning*, 294 U.S. 33, 1935 AMC 9 (1935).

47. *Id.* at 37, 1935 AMC at 11-12.

48. Petitioner in the case of *Conoco, Inc. v. Skinner* alleged that the tracing rule was consistent with neither the applicable statutes nor certain precedents up until that time and cited *Sun Chemical Corp. v. Dainippon Ink & Chemicals, Inc.*, 635 F. Supp. 1417 (S.D.N.Y. 1986), 970 F.2d 1206, 1219, 1992 AMC 2816, 2833 (3d Cir. 1992); see Opening Brief of Petitioners-Appellants at 18-27, *Conoco*, 970 F.2d 1206, 1992 AMC 2816 (No. 91-122-JLL). MARAD’s tracing rule was also criticized in submissions to the rulemaking proceeding leading to the adoption of the existing rule. See, e.g., 57 Fed. Reg. 23,470, 23,471 (June 3, 1992).

49. 55 Fed. Reg. 51,244 (Dec. 12, 1990); 57 Fed. Reg. 23,470. In its rulemaking, MARAD indicated that it was “longstanding policy of MARAD that when an owner or operator of a documented vessel is a direct or indirect subsidiary of, or is controlled by, one or more ‘upstream’ persons, each such person must meet the citizenship criteria . . . applicable to the vessel owner or operator.” 55 Fed. Reg. 14,040, 14,041 (Apr. 13, 1990).

corporate structures within one corporate family as well as dealing with public companies where many if not most of the shareholders are business entities in turn owned by other business entities or individuals.

The Coast Guard tracing rule is as follows:

For purposes of meeting the stock or equity interest requirements for citizenship under this subpart where title to a vessel is held by an entity comprised, in whole or in part, of other entities which are not individuals, each entity contributing to the stock or equity interest qualifications of the entity holding title must be a citizen eligible to document vessels in its own right with the trade endorsement sought.<sup>50</sup>

The “endorsement sought” refers to endorsements on a vessel’s certificate of documentation issued by the Coast Guard.<sup>51</sup> A vessel engaged in the U.S. coastwise trade must have a “coastwise endorsement” on its certificate of documentation.<sup>52</sup>

A key aspect of the requirement to look to parent entities and further up an organizational ownership chain to the ultimate owning persons is the requirement that each relied-upon entity be “eligible to document vessels in its own right with the trade endorsement sought.”<sup>53</sup> This aspect mandates that entities upon which a vessel relies for its citizenship must first be documentation citizens and, if a coastwise endorsement is sought, also be eligible for that endorsement. For example, a corporation satisfying all of the documentation citizen requirements is not a coastwise eligible citizen if it is owned 75% by another corporation organized in the Bahamas. That is the case even if the Bahamian corporation is 100% owned and controlled by U.S. citizens because the Bahamian corporation cannot be a documentation citizen.

MARAD’s similar tracing rule was affirmed by the United States Court of Appeals for the Third Circuit in 1992.<sup>54</sup> The MARAD rule was primarily challenged on the basis that it misinterpreted the portion of the statute imposing the 75% requirement on the person “operating any

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50. 46 C.F.R. § 67.31(d) (2013). The Coast Guard application form references “percentage of stock owned by U.S. citizens eligible to document vessels in their own right, with the endorsement(s) sought on this application.” *Application for Initial, Exchange, or Replacement of Certificate of Documentation; Redocumentation*, *supra* note 18. For MARAD’s tracing rule, see 46 C.F.R. § 221.3(c).

51. 46 U.S.C. §§ 12101(b)(2), 12112 (2012). A documentation citizen is eligible to document a vessel with a certificate of documentation (the vessel also must be eligible); a coastwise citizen is eligible to document a vessel with a coastwise endorsement.

52. *See* 46 C.F.R. § 67.19.

53. *Id.* § 67.31(d); *see also id.* § 221.3(c).

54. *Conoco, Inc. v. Skinner*, 970 F.2d 1206, 1222, 1992 AMC 2816, 2838 (3d Cir. 1992).

vessel in the coastwise trade.”<sup>55</sup> Petitioners argued that parent entities of coastwise qualified vessel owners need only satisfy the “controlling interest” ownership test because they were not operating any vessel but were simply owners of the stock of the vessel operator.<sup>56</sup>

The Third Circuit rejected these arguments and determined that the MARAD rule was a permissible interpretation of the statute, finding that section 2 of the Shipping Act, 1916, did “not address whether the parent of the subsidiary must also meet [the 75%] citizenship requirement.”<sup>57</sup> The court was persuaded in part by the “strong protectionist sentiment” motivating the citizenship requirements and in part by the fact that the 75% requirement could be easily evaded if only a controlling interest requirement was required for parent companies of subsidiary vessel-owning entities.<sup>58</sup>

#### b. Fair Inference Rule

Although maritime citizenship law does not directly provide a mechanism for dealing with a corporation with widely dispersed ownership, a rule has arisen over time for ameliorating the burden of proving 75% citizen ownership for a public company, namely the “fair inference rule.”

That rule can be traced to the 1936 federal district court case of *Collier Advertising Service v. Hudson River Day Line* in which a vessel mortgage held by Bankers Trust Company was challenged on the basis that Bankers Trust did not qualify as a coastwise eligible citizen.<sup>59</sup> At the time, mortgagees of coastwise eligible vessels had to be coastwise citizens.<sup>60</sup> The court accepted, as proof of 75% beneficial ownership, evidence from Bankers Trust that 96% of its 3,660 shareholders had U.S. addresses. The court found that despite the lack of “direct proof of the citizenship of the stockholders,” the “proof sufficed to show that the mortgagee was a citizen of the United States” because “it is a fair inference that persons holding more than 75 per cent of the stock were citizens.”<sup>61</sup>

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55. *Id.* at 1217, 1992 AMC at 2830; *see also* McConnell, *supra* note 40 (noting other examples where the argument has been advanced).

56. *Conoco, Inc.*, 970 F.2d at 1217, 1992 AMC at 2830.

57. *Id.*

58. *Id.* at 1222-23, 1992 AMC at 2838-39.

59. 14 F. Supp. 335, 1936 AMC 206 (S.D.N.Y. 1936).

60. *See* Constantine G. Papavizas, *New Developments in U.S. Flag Vessel Financing and Citizenship Requirements*, 24 TUL. MAR. L.J. 205, 215 (1999).

61. *Collier Adver. Serv.*, 14 F. Supp. at 339, 1936 AMC at 212.

MARAD subsequently adopted, with specific reference to the *Collier* decision, a “fair inference rule” as a mechanism for proving citizenship;<sup>62</sup> the Coast Guard did not.<sup>63</sup> Specifically, the MARAD form of citizenship affidavit published in its regulations permits corporations with more than thirty shareholders to prove 75% U.S. stock ownership by showing that at least 95% of the shareholders have U.S. addresses.<sup>64</sup> As phrased in the affidavit, the affiant must provide evidence with respect to the “registered addresses of owners of record” as “shown on the stock books and records of the Corporation as being within the United States.”<sup>65</sup> The affidavit does not permit complete reliance on the fair inference rule in that it requires affiants to list all 5% or greater shareholders and indicate the citizenship of such shareholders, and the inference does not pertain when “one or more” shareholders “actually owns the . . . 75 percent interest.”<sup>66</sup>

c. Documentation Presumption

Although the Coast Guard has rejected the fair inference rule as an administrative matter, its regulations do provide a presumption of vessel documentation regularity.<sup>67</sup> Coast Guard regulations provide that “[w]hen received by the Coast Guard, properly completed,” a vessel documentation application “establishes a rebuttable presumption that the applicant is a United States citizen.”<sup>68</sup>

B. Actual Control Requirements

Even if all of the structural citizenship requirements are satisfied, there are also control-in-fact requirements that must be met. In this regard, it is useful to note the purpose of the citizenship requirements. The Merchant Marine Act, 1920, declared that the policy of the United States is “to do whatever may be necessary to develop and encourage the maintenance of” a merchant marine for commercial and national security purposes.<sup>69</sup> In the words of one court: “Like all maritime

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62. MARAD has utilized the “fair inference rule” since at least 1960. See 25 Fed. Reg. 5293, 5294 (June 14, 1960) (publication of MARAD’s “General Order 89”).

63. See, e.g., 58 Fed. Reg. 60,256, 60,259 (Nov. 15, 1993).

64. 46 C.F.R. § 355.2 (2013).

65. *Id.*

66. *Id.* §§ 355.2, 355.3(b).

67. See Michael P. Drzal & Phyllis D. Carnilla, *Documentation of Vessels: The Fog Lifts*, 13 J. MAR. L. & COM. 261, 266 (1982).

68. 46 C.F.R. § 67.43.

69. Ch. 250, 41 Stat. 988, 988 (1920) (codified as amended at 46 U.S.C. § 50101 (2012)); see also *Ingram Barge Co. v. United States*, 691 F. Supp. 474, 476-77, 1989 AMC 195, 198

nations in the world, the United States treats its coastwise shipping trade as a jealously guarded preserve. In order to participate in this trade, a vessel's credentials must be thoroughly American."<sup>70</sup>

It is little surprise, therefore, that section 2 of the Shipping Act, 1916, as amended contains the broad rules governing actual control quoted above including that "there is no other means by which control of more than 25 percent of any interest in the corporation" is held by a noncitizen.<sup>71</sup> These requirements are echoed in the Coast Guard regulations: "An otherwise qualifying corporation or partnership may fail to meet stock or equity interest requirements because: [s]tock is subject to trust or fiduciary obligations in favor of non-citizens; non-citizens exercise, directly or indirectly, voting power; or non-citizens, by any means, exercise control over the entity."<sup>72</sup> The Coast Guard regulations further provide that control includes the "absolute right to," among other things, "[d]irect corporate or partnership business" but does not include "the right to simply participate" in such business.<sup>73</sup>

The leading decision on the issue of actual control is the 1954 case of *Meacham Corp. v. United States*.<sup>74</sup> The case arose as a result of the transfer of war surplus vessels, which by law were required to be transferred to U.S. citizens. One purchaser of vessels presented the apparently correct citizenship structure, but was prosecuted for being under the actual control of noncitizens. As the court noted, "One has only to be told that the Chinese raised six million dollars and the Americans six dollars in order to conclude, at least tentatively, that the Chinese dominated the enterprise; and when the details of the picture are filled in the conclusion becomes irresistible."<sup>75</sup> Thus, the court was "compelled to observe the substance rather than the form of the

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(D.D.C. 1988) ("The context within which this [citizenship] scheme is to be interpreted is set by Congress' express statement . . . of the purpose for which domestic maritime activities are protected . . .").

70. *Marine Carriers Corp. v. Fowler*, 429 F.2d 702, 703, 1970 AMC 1408, 1408-09 (2d Cir. 1970).

71. 46 U.S.C. § 50501(d).

72. 46 C.F.R. § 67.31(a). "[T]he Coast Guard has the authority to refuse documentation of a vessel if the foreign control over that vessel is so complete as to constitute de facto foreign ownership." *Alaska Excursion Cruises, Inc. v. United States*, 608 F. Supp. 1084, 1087 (D.D.C. 1985).

73. 46 C.F.R. § 67.31(b).

74. 207 F.2d 535, 1953 AMC 1771 (4th Cir. 1953). Other contemporaneous cases examined similar aspects of foreign control. See, e.g., *United States v. Niarchos*, 125 F. Supp. 214 (D.D.C. 1954); *United States v. Onassis*, 125 F. Supp. 190 (D.D.C. 1954).

75. *Meacham Corp.*, 207 F.2d at 543, 1953 AMC at 1783.

transaction” and to uphold the U.S. government’s libel of the subject vessel.<sup>76</sup>

### C. Penalties

A range of severe penalties potentially apply to Jones Act citizenship and related vessel documentation violations.<sup>77</sup>

In the first instance, vessels that cease to be owned by qualified coastwise citizens cease to be eligible to operate in the U.S. coastwise trade.<sup>78</sup> The Coast Guard has the authority to cancel vessel documents and demand their return.<sup>79</sup> Vessels that are operated in the coastwise trade where the owner is ineligible, and therefore their documentation is invalid, are subject to a civil penalty of not more than \$15,000 per day for each day of a violation.<sup>80</sup> The U.S. government may also seize and forfeit any cargo transported in violation of the Jones Act or assess a fine equal to the actual cost of transporting merchandise in violation of the Act.<sup>81</sup> The fine may be recovered from any person transporting the merchandise or “causing the merchandise to be transported.”<sup>82</sup>

All of the foregoing penalties are assessable on a strict liability basis. In addition, the vessels themselves are liable to seizure and forfeiture if, among other things, “the owner of the vessel or the representative or agent of the owner knowingly falsifies or conceals a material fact, or knowingly makes a false statement or representation, about the documentation of the vessel or in applying for documentation of the vessel.”<sup>83</sup>

Criminal sanctions are also potentially applicable. Vessel owners must certify that they are qualified to own a U.S.-documented vessel and

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76. *Id.*

77. In addition to the documentation and false statement penalties described herein, penalties may also apply for violations of section 9 of the Shipping Act, 1916, which is administered by MARAD and restricts transfers of U.S.-flag vessels or interests in U.S.-flag vessels to noncitizens. *See, e.g.*, 46 U.S.C. § 56101(e) (2012).

78. 46 C.F.R. §§ 67.167, .171.

79. *Id.* § 67.173; *see, e.g.*, U.S. Coast Guard, *Letter to MV One, L.L.C.—Notice of Intent to Cancel Certificates of Documentation*, 28 SHIPPING REG. REP. 773 (2000); U.S. Coast Guard, *Letter to Paragon Marine Services, Inc.—Notice of Intent to Cancel Certificate of Documentation for the Vessel*, 28 SHIPPING REG. REP. 775 (2000).

80. 46 U.S.C. § 12151(a). The original statutory amount has been adjusted for inflation. *See Egan, Ellis & Salgado, supra* note 17, § 18.3 n.13.

81. 46 U.S.C. § 55102(c); *see Furie Operating Alaska, LLC v. U.S. Dep’t of Homeland Sec.*, No. 3:12-CV-00158 JWS, 2013 WL 1628639 (D. Alaska Apr. 15, 2013) (involving assessment of \$15 million fine, the alleged value of the item transported, for violation of the Jones Act).

82. 46 U.S.C. § 55102(c).

83. *Id.* § 12151(b)(1).

for any endorsements sought upon acquisition of the vessel.<sup>84</sup> False statements made to the U.S. government like those made in a vessel documentation application are potentially subject to punishment under the False Statements Act.<sup>85</sup> The Coast Guard's standard form for vessel documentation reminds applicants that statements and representations made in the application are subject to prosecution in the event they are false.<sup>86</sup> Vessel owners must also certify on an annual basis that the vessel remains qualified for its documentation and endorsements.<sup>87</sup> As with initial documentation, the annual renewal form contains a certification to the effect that the representations made to the Coast Guard remain valid.<sup>88</sup>

Finally, the Coast Guard has considered permanently invalidating a vessel's coastwise eligibility if its owner ceases to be a documentation citizen.<sup>89</sup> The theory advanced is that the first proviso of the Jones Act—which renders vessels “sold foreign” permanently ineligible—is invoked when the owner ceases to be a citizen.<sup>90</sup>

### III. PUBLIC SECURITIES TRADE SETTLEMENT AND OWNERSHIP

The mechanisms for public securities trade settlement and ownership have changed dramatically in the last forty-five years. Three changes have occurred that are critical to an understanding of public company Jones Act citizenship. First, the exchange of paper stock certificates recorded on the books of the stock issuer, the predominant model in 1970, has all but disappeared and been replaced by “netted settlement arrangements and accounting entries on the books of a multi-

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84. *Application for Initial, Exchange, or Replacement of Certificate of Documentation; Redocumentation*, *supra* note 18.

85. *See* 18 U.S.C. § 1001 (2012).

86. *Application for Initial, Exchange, or Replacement of Certificate of Documentation; Redocumentation*, *supra* note 18 (“The law provides severe penalties for false statements against both the person (including agents) making the statement and against the vessel for which it is made.”). The MARAD form of citizenship affidavit similarly reminds affiants of the penalties for false statements. *See* 46 C.F.R. § 355.2 (2013).

87. 46 C.F.R. § 67.163.

88. U.S. Coast Guard Form 1280, Vessel Renewal Notification Application for Renewal, U.S. COAST GUARD, <http://www.uscg.mil/hq/cg5/nvdc/forms/cg1280.pdf> (last visited Apr. 13, 2015).

89. The first proviso is codified at 46 U.S.C. § 12132. *See* Petition for Review at 1-2, *Westlake CA&O Corp. v. Dep't of Transp.*, No. 99-1211 (D.C. Cir. 1999) (stating that the Coast Guard had alleged that documentation of vessels with a noncitizen Chairman of the Board constituted a “sale foreign”).

90. *See* 66 Fed. Reg. 47,431 (Sept. 12, 2001) (requesting public comment on application of “sold foreign” proviso). *But see* Egan, Ellis & Salgado, *supra* note 17, § 18:5 (“If a company, however, simply ceases to be a coastwise citizen, or even a documentation citizen, without a transfer of the vessel, the vessel regains its coastwise eligibility if the company later qualifies as a coastwise citizen.”).

tiered pyramid of securities intermediaries.”<sup>91</sup> Second, the Securities and Exchange Commission (SEC) has adopted shareholder communications rules that preserve the right of beneficial owners to maintain their privacy. Third, individual, self-directed company stock ownership has been substantially replaced with pooled investment vehicles directed by professional managers including mutual funds and hedge funds.

These changes have profoundly affected the ability of any public company to ascertain the identities and citizenship of its ultimate owners. Before we turn to the mechanisms that have been adopted by public companies to respond to these changes, it would be useful to understand how the public market has changed and continues to evolve.

#### A. *Indirect Holding*

Until the early 1970s, the trading of public securities was still largely accomplished on a paper-based method where actual stock certificates and other paperwork was exchanged to effect stock purchases and sales.<sup>92</sup> Eventually the volume of trading overwhelmed the paper-based process, and according to the SEC, the “entire machinery for the delivery and transfer of securities and the concomitant remittance of funds became clogged.”<sup>93</sup> “Although this is not remembered as one of the more important market crises of U.S. financial history, it was the largest challenge to the securities exchanges since the crash of 1929 . . . .”<sup>94</sup>

Two basic approaches were available to respond to this paperwork problem: stock “immobilization” and stock “dematerialization.”<sup>95</sup> With immobilization, physical stock certificates are created and maintained by a depository, and changes of ownership are then recorded by the depository by using “book entry” accounting methods.<sup>96</sup> With dematerialization, physical stock certificates are dispensed with, and all changes of ownership are recorded by a person, such as a custodian or the issuer, by “book entry” accounting methods.

Because dematerialization probably seemed too radical a departure from the world of paper certificates at the time, a consensus coalesced

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91. Prefatory Note I(D), U.C.C. § 8 (2014).

92. U.S. SEC. & EXCH. COMM’N, STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS 13 (1971).

93. *Id.*

94. David C. Donald, *The Rise and Effects of the Indirect Holding System: How Corporate America Ceded Its Shareholders to Intermediaries*, INST. FOR L. & FIN. (Sept. 2007), [http://www.ilf-frankfurt.de/fileadmin/\\_migrated\\_uploads/ILF\\_WP\\_068.pdf](http://www.ilf-frankfurt.de/fileadmin/_migrated_uploads/ILF_WP_068.pdf).

95. *Id.* at 3.

96. See Depository Trust Co., et al.; Order, 48 Fed. Reg. 45,167, 45,170 (Sept. 23, 1983).

around immobilizing stock certificates.<sup>97</sup> In principle, any number of persons can serve as the locus of securities immobilization, including the issuer. In practice, a central depository was preferred,<sup>98</sup> and in 1968, the New York Stock Exchange established the Central Certificate Service,<sup>99</sup> which was succeeded by the Depository Trust Company (DTC) in 1973.<sup>100</sup> Since then, DTC has become the world's largest securities depository, and virtually all U.S. publicly traded securities are DTC-eligible.<sup>101</sup> The total value of securities transactions handled by DTC and its affiliates in 2014 was \$1.6 quadrillion and the total number of securities transactions settled was 323.0 million relating to 1.3 million active issues of securities.<sup>102</sup>

DTC holds securities registered with the stock issuer in name of "Cede & Co.,"<sup>103</sup> DTC's nominee name.<sup>104</sup> DTC in turn maintains its records by DTC "participants," the many brokerage firms, banks, and other financial institutions that have met DTC criteria to trade securities held by DTC and have agreed to abide by DTC's regulations and policies.<sup>105</sup> Shares so owned are referred to as being owned in "street

97. *Id.* at 45,168. Moving to a certificateless system also would have had to take into account state corporation law, which was premised by and large on a certificate-based system. *See* Egon Guttman, *Toward the Uncertificated Security: A Congressional Lead for States to Follow*, 37 WASH. & LEE L. REV. 717, 731 (1980).

98. The U.S. Congress sanctioned the move to immobilization in 1975. *See* Pub. L. No. 94-29, 89 Stat. 97 (1975). As amended, section 17A(e) of the Securities Exchange Act of 1934 required the SEC to "use its authority . . . to end the physical movement of securities certificates in connection with the settlement . . . of transactions in securities in interstate commerce." 15 U.S.C. § 78q-1(e) (2012). The Securities Act Amendments of 1975 also required all "clearing agencies" to register with the SEC. *See id.* § 78q-1(b).

99. *Timeline*, N.Y. STOCK EXCHANGE, [http://www1.nyse.com/about/history/timeline\\_technology.html](http://www1.nyse.com/about/history/timeline_technology.html) (last visited Apr. 13, 2015).

100. *See Our Capabilities*, DEPOSITORY TR. & CLEARING CORP. 4, [http://www.dtcc.com/~media/Files/Downloads/About/DTCC\\_Capabilities.pdf](http://www.dtcc.com/~media/Files/Downloads/About/DTCC_Capabilities.pdf) (last visited Sept. 24, 2014). DTC became a wholly owned subsidiary of the Depository Trust and Clearing Corporation in 1999.

101. *See, e.g.*, Issuer Restrictions or Prohibitions on Ownership by Securities Intermediaries, 69 Fed. Reg. 32,784, 32,789 (June 10, 2004) ("The vast majority of securities trading on exchanges or Nasdaq are already subject to market rules requiring depository eligibility of securities and mandating members' use of depositories."). The SEC approved the rules of a number of exchanges, including the New York Stock Exchange, requiring use of a securities depository for book-entry settlement in 1993. *See* 58 Fed. Reg. 33,679 (June 11, 1993).

102. *2014 Annual Report*, DEPOSITORY TR. & CLEARING CORP. 8, 9 (2014), <http://www.dtcc.com/annuals/2014/pdfs/DTCC-Annual-Report-2014.pdf>.

103. "'Cede' being short for 'certificate depository.'" David C. Donald, *Heart of Darkness: The Problem at the Core of the U.S. Proxy System and its Solution*, 6 VA. L. & BUS. REV. 41, 46 (2011).

104. "DTC registers securities in the name of its nominee, Cede & Co., which makes it the registered owner of the securities." 69 Fed. Reg. at 32,786 n.32.

105. *See DTC Participant Report*, DEPOSITORY TR. & CLEARING CORP., <http://www.dtcc.com/~media/Files/Downloads/client-center/DTC/alpha.pdf> (last updated Feb. 27, 2015).

name” in that they appear on DTC’s records in the names of mainly Wall Street banks, brokers, and other firms that are the DTC participants.<sup>106</sup>

DTC’s participants maintain account holder records showing securities ownership under street name registration.<sup>107</sup> The account holders could be business entities, such as mutual funds that have their own account holders. Thus, under the DTC system, there are multiple securities custodians—none of which is related to the securities issuer and none of which is the ultimate owner or registered shareholder.<sup>108</sup>

Although Cede & Co. may be the nominee for DTC and listed as the owner of stock, it is merely a conduit of stock rights to the ultimate beneficial owner.<sup>109</sup> Each custodian in the chain connecting with the ultimate owner of the securities is under a legal obligation to pass along requests and information from the issuer, such as proxy solicitation materials and annual reports.<sup>110</sup>

The current stock ownership system continues to evolve as the securities industry has been moving steadily to dematerialization.<sup>111</sup> As a result of these efforts, there was a 94% reduction in certificate withdrawal volume with DTC from 2000 to 2012, and DTC proposed additional steps in July 2012 to achieve total elimination of paper certificates.<sup>112</sup>

Probably the most important aspect of the indirect holding system for Jones Act citizenship purposes is the separation of issuers from their

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106. See Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982, 42,985 (July 22, 2010) [hereinafter Proxy System Concept Release]. “In accordance with its rules, DTC accepts deposits of securities from its participants (i.e., broker-dealers and banks), credits those securities to the depositing participants’ accounts, and effects book-entry movements of those securities.” *Id.* at 42,986 n.33.

107. See *id.* at 42,985-96.

108. SEC rules define these securities custodians as “securities intermediaries” being either a “clearing agency” registered with the SEC, like DTC, or a bank, broker, dealer, or other entity that in the ordinary course of business maintains securities accounts for others, like DTC participants. See 17 C.F.R. § 240.17Ad-20 (2013). The Uniform Commercial Code definition is similar. See U.C.C. § 8-102(14) (2014).

109. See Proxy System Concept Release, 75 Fed. Reg. at 42,986-87.

110. See U.C.C. § 8-507.

111. See Sam Mamudi, *Papering Walls with Stock Imperiled as Bourses Mull Digital-Only*, BLOOMBERG BUS. (Jan. 11, 2014), <http://www.bloomberg.com/news/articles/2014-01-11/papering-walls-with-stock-imperiled-as-bourses-mull-digital-only>; Matt Krantz, *Electronic Records Are Replacing Paper Stock Certificates*, USA TODAY (May 25, 2010), [http://usatoday30.usatoday.com/money/markets/2010-05-25-certificates19\\_ST\\_N.htm](http://usatoday30.usatoday.com/money/markets/2010-05-25-certificates19_ST_N.htm).

112. *A Proposal To Fully Dematerialize Physical Securities, Eliminating Costs and Risks They Incur*, DEPOSITORY TR. & CLEARING CORP. (July 2012), [http://www.dtcc.com/~media/Files/Downloads/WhitePapers/Dematerialize\\_Securities\\_July\\_2012.pdf](http://www.dtcc.com/~media/Files/Downloads/WhitePapers/Dematerialize_Securities_July_2012.pdf). It has been argued that securities trading and settlement should evolve to reintroduce direct ownership of securities without the intermediaries given the now available technology. Donald, *supra* note 94, at 65-66.

ultimate owners.<sup>113</sup> When stock was traded and recorded on the books of the issuers, issuers had a direct mechanism for keeping track of stock ownership and of making citizenship inquiries of their shareholders. That ability no longer exists for any publicly traded security in the DTC system. As a result, issuers have no direct visibility on stock trades and therefore cannot easily keep track of stock positions.

Issuers also lack a contractual relationship with the companies that deal directly with the shareholders, namely the DTC participants.<sup>114</sup> Those participants have a contractual relationship with DTC and, of course, their customers who are their account holders. Issuers have a contractual relationship with DTC, but not with DTC's participants. As a result, issuers may have difficulty in seeking information from their ultimate owners.

### *B. Shareholder Communications*

Closely related to the shift away from paper and the creation of a chain of custodial ownership were the U.S. government decisions made to affirm certain shareholders' privacy rights, which shield the identity of many shareholders from the issuer. Although there are also state law and other federal requirements relating to shareholder privacy, the primary connection between issuers and their shareholders occur under the federal proxy solicitation rules.<sup>115</sup>

Those rules arise from the fact that state corporation law grants shareholders the right to vote their shares to elect directors and to approve or disapprove other actions of the corporation as provided in its charter and under law.<sup>116</sup> State laws also provide a mechanism whereby shareholders can vote at shareholder meetings but not be in attendance—namely by appointing a proxy to vote their shares.<sup>117</sup> The SEC was given

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Once a corporation's shares are registered in the name of 'Cede & Co.,' the issuer no longer has a list of its 'real' (i.e. economically interested, property-holding) shareholders. Moreover, because corporate law provides that the registered shareholder is the only legitimate shareholder, the people who invest in U.S. corporations are no longer shareholders, legally speaking. Issuers no longer know who owns them, and owners no longer have legal legitimacy as such.

Donald, *supra* note 103, at 46.

114. Courts continue to struggle with the "street name" system. *See, e.g.,* Kurz v. Holbrook, 989 A.2d 140 (Del. Ch. 2010).

115. *See* Proxy System Concept Release, 75 Fed. Reg. 42,982, 42,982-85 (July 22, 2010).

116. *See, e.g.,* DEL. CODE ANN. tit. 8, § 219(c) (2009).

117. *See, e.g., id.* § 212(b).

authority in the Securities Exchange Act of 1934 to regulate the proxy solicitation process with respect to registered securities.<sup>118</sup>

As indirect ownership of securities took hold, the SEC began to struggle with how to ensure that issuers could communicate with their ultimate beneficial owners and how to regulate how intermediaries handled shareholder communications.<sup>119</sup> At the time, “the reconciliation of interests proved difficult,”<sup>120</sup> which has remained the case.<sup>121</sup>

In the course of its examination, the SEC appointed an “Advisory Committee on Shareholder Communications,” which issued its report in June 1982.<sup>122</sup> The Committee indicated that “the method of obtaining consent from beneficial owners must safeguard the privacy interests of brokerage customers but not be so burdensome as to deter beneficial owners who do not object from responding.”<sup>123</sup> The Committee therefore recommended that

the Commission adopt a rule requiring broker-dealers to determine whether customers with securities registered in street or other nominee name consent to disclosure of their identity to issuers, and, upon request and assurance of appropriate reimbursement, to promptly provide issuers with a list of the names, addresses and shareholdings of consenting beneficial owners as of the record date of each meeting of security holders.<sup>124</sup>

The SEC accepted this recommendation. The Commission noted that it had considered adopting a “direct communication system” where

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118. See 15 U.S.C. § 78n (2012).

119. See SEC. & EXCH. COMM’N, FINAL REPORT ON THE PRACTICE OF RECORDING THE OWNERSHIP OF SECURITY IN THE RECORDS OF THE ISSUER IN OTHER THAN THE NAME OF THE BENEFICIAL OWNER OF SUCH SECURITIES (1976) (known as the “Street Name Study”); Facilitating Shareholder Communications, Exchange Act Release No. 34-19291, 26 SEC Docket 1150, 1154 (Dec. 2, 1982) (“Over the years, the Commission, as well as others, has explored the possibility of beneficial owner identification to the issuer as a means of overcoming the effects of nominee registration on shareholder communication.”).

120. *Report of the SIFMA Proxy Working Group on the Shareholder Communications Process with Street Name Holders, and NOBO-OBO Mechanism*, SIFMA 2 (June 10, 2010), <http://www.sifma.org/issues/item.aspx?id=8589936936>.

121. See, e.g., *Request for Rulemaking Concerning Shareholder Communications*, SEC. & EXCH. COMM’N (Apr. 12, 2004), <http://www.sec.gov/rules/petitions/petn4-493.htm>.

122. See Memorandum from Advisory Comm. on S’holder Commc’ns to Div. of Corp. Fin., SEC. & EXCH. COMM’N (June 10, 1982), <http://www.sec.gov/comments/s7-14-10/s71410-29.pdf>; Alan L. Beller & Janet L. Fisher, *The OBO/NOBO Distinction in Beneficial Ownership: Implications for Shareowner Communications and Voting*, SEC. & EXCH. COMM’N 12 (Feb. 2010), <http://www.sec.gov/comments/s7-14-10/s71410-22.pdf> (“Privacy is an interest often cited as important to investors. Indeed, the OBO/NOBO distinction was driven in significant part by this interest, and a policy decision on the part of the SEC that investors wishing to preserve anonymity should be allowed to do so.”).

123. Memorandum from Advisory Comm. on S’holder Commc’ns to Div. of Corp. Fin., *supra* note 122, at 70.

124. *Id.*

intermediaries would be required to disclose the names of beneficial owners to issuers, but that on balance “the Committee has recommended a reasonable solution to a difficult issue” given privacy interests and “substantial questions about the workability and cost of direct proxy communication.”<sup>125</sup> And so the SEC adopted rules in 1983 that effectively divide shareholders into two groups—“nonobjecting beneficial owners” (NOBOs) and “objecting beneficial owners” (OBOs).<sup>126</sup>

These rules permit direct issuer communications only with shareholders who are NOBOs.<sup>127</sup> SEC rules require brokers or their nominees to provide an issuer (upon request and payment of reasonable expenses) with the names, securities positions, and addresses of NOBOs. SEC rules preserve the privacy of OBOs as long as the objection is raised affirmatively—the default position is for a shareholder to be a NOBO.<sup>128</sup> In practice, “Most brokers and banks delegate this responsibility to an agent, in almost all cases Broadridge Financial Solutions Inc. (Broadridge), the leading provider of U.S. outsourcing services . . . in connection with proxy procedure.”<sup>129</sup> Broadridge, as agent to DTC participants, has access to OBO address information and thus can provide a geographic analysis to issuers upon request for purposes of determining how many such persons list a U.S. address.<sup>130</sup> Issuers can only communicate with OBOs via brokers and have no mechanism to ascertain even the names of such shareholders.<sup>131</sup>

The NOBO/OBO rules are critical to any citizenship analysis because OBOs are such a large proportion of the shareholding market.<sup>132</sup> It has been estimated that between 50% and 60% of all shares are held by OBOs.<sup>133</sup> It has also been estimated that most institutional investors—

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125. Facilitating Shareholder Communications, 26 SEC Docket at 1155.

126. See Facilitating Shareholder Communications, Exchange Act Release No. 34-20021, 28 SEC Docket 513 (July 28, 1983).

127. 17 C.F.R. §§ 240.14a-13, 204.14b-1, 240.14b-2 (2013).

128. *Id.* §§ 240.14b-1(b)(3), 240.14b-2(b)(4)(ii)(B).

129. Beller & Fisher, *supra* note 122, at 5.

130. See Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Governance*, 96 GEO. L.J. 1227, 1245 (2008).

131. *Id.*

132. Examination of the SEC deliberations did not reveal any consideration on the part of the Commission of the impact its NOBO/OBO rule would have on issuers with citizenship or other reasons to have restricted securities.

133. *Request for Rulemaking Concerning Shareholder Communications*, *supra* note 121, at 2.

about 70%—are OBOs accounting for almost 90% of institutionally held shares.<sup>134</sup>

### C. Pooled Investment

The third fundamental feature of today's public securities market that impacts Jones Act citizenship is the substantial penetration of pooled investment.<sup>135</sup> Trillions of dollars are now invested in public securities through companies that pool the money of many investors and make those investments by direction of professional investment managers.<sup>136</sup> The presence of these companies adds another layer of complication for Jones Act public companies seeking to verify their U.S. citizenship.

Over time, several distinct types of pooled investments have arisen. Pooled investments sold to the public are usually referred to as “investment companies” and can be divided into three types: (1) an open-ended investment company or mutual fund, (2) closed-end funds, and (3) unit investment trusts.<sup>137</sup>

Mutual funds issue redeemable shares that investors purchase directly from the fund instead of purchasing from other investors in a secondary market such as the New York Stock Exchange.<sup>138</sup> In contrast, a closed-end fund fixes the number of shares to be issued at one time, and then those shares typically trade in a secondary market.<sup>139</sup> Unit investment trusts are similar to closed-end funds in that they issue a specific number of shares, but the trust terminates as of a definite date (although that may be far in the future), and such trusts do not actively trade their investments.<sup>140</sup>

U.S. investment companies had total net assets of \$17.1 trillion at the end of 2013.<sup>141</sup> Most of those assets—\$15.0 trillion—were held by mutual funds.<sup>142</sup> The \$15.0 trillion in net assets was held in about 17,000

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134. *Report of the SIFMA Proxy Working Group on the Shareholder Communications Process with Street Name Holders, and NOBO-OBO Mechanism*, *supra* note 120, at 7.

135. Pooled investing reportedly dates from the late 1700s in Europe probably originating in Holland. The first “mutual” or “open-end” fund in the United States, the Massachusetts Investor Trust, was introduced in 1924. See K. Geert Rouwenhorst, *The Origins of Mutual Funds* (Yale Int'l Cen. for Fin., Working Paper No. 04-48, 2004).

136. *2014 Investment Company Fact Book*, INVESTMENT CO. INST., 9 (2014), [http://www.ici.org/pdf/2014\\_factbook.pdf](http://www.ici.org/pdf/2014_factbook.pdf) (stating that investment companies had total net assets of approximately \$17 trillion at the end of 2013).

137. *Mutual Funds: A Guide for Investors*, SEC. & EXCH. COMM'N 4 (Aug. 2007), <http://www.sec.gov/investor/pubs/sec-guide-to-mutual-funds.pdf>.

138. *Id.*

139. *Id.* at 24.

140. *Id.* at 28.

141. *2014 Investment Company Fact Book*, *supra* note 136, at 8.

142. *Id.* at 9.

investment companies with the vast majority (about 15,000) being mutual funds.<sup>143</sup> Perhaps most tellingly for any Jones Act citizenship analysis, U.S. investment companies owned approximately 29% of U.S. corporate equities at the end of 2013.<sup>144</sup>

Investment companies are usually organized under state law either as corporations or trusts.<sup>145</sup> Most investment companies have boards of directors elected by the fund's shareholders to provide oversight over the fund.<sup>146</sup> Investment companies are typically managed on a day-to-day basis by a separate entity that directs investments of the fund.<sup>147</sup> Investment companies are also subject to various levels of oversight by the SEC, securities exchanges, and state authorities among others.<sup>148</sup>

Hedge funds are another type of pooled investment, which are usually private funds that, at least traditionally, were limited to sophisticated wealth investors.<sup>149</sup> The term "hedge fund" is not a legal term and can be used to apply to a variety of investment vehicles and investment styles or objectives.<sup>150</sup> To complicate things, some pooled investments invest in multiple pooled investments, such as a hedge fund that invests in multiple hedge funds, and are often organized outside the United States as part of their tax strategy.<sup>151</sup>

Mutual funds, among other investment vehicles,<sup>152</sup> are not easily accounted for by Jones Act citizenship requirements. When organized as a corporation or trust, it would appear that they would have to be organized in the United States, meet U.S.-citizen-management requirements, and be owned 75% by U.S. citizens to qualify as Jones Act citizens. Yet, as the Coast Guard has impliedly recognized,<sup>153</sup> mutual funds may need their own special citizenship rules because, among other things, shareholders of mutual funds do not generally have the power to direct the voting of shares owned by mutual funds. But that recognition has not yet been reflected in any formal policy or regulation leaving

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143. *Id.*

144. *Id.* at 13.

145. *Id.* at 225.

146. *Id.* at 240.

147. *Id.*

148. *Id.* at 236-41.

149. *Hedge Funds*, SEC. & EXCH. COMM'N (Dec. 4, 2012), <http://www.sec.gov/answers/hedge.htm>.

150. *Invest Wisely: An Introduction to Mutual Funds*, SEC. & EXCH. COMM'N (July 2, 2008), <http://www.sec.gov/investor/pubs/inwsmf.htm>.

151. *Hedge Funds*, *supra* note 149.

152. Various pension investment vehicles, such as defined benefit plans, present their own complications.

153. Memorandum from Timothy V. Skuby to Kevin S. Cook, U.S. COAST GUARD 18 (Jan. 12, 2011), <http://www.uscg.mil/hq/cg5/nvdc/report/tricoaction.pdf> [hereinafter Trico Memorandum].

companies owned in part by mutual funds in a quandary as to how to treat such ownership.

#### IV. PUBLIC COMPANY STRATEGIES FOR JONES ACT COMPLIANCE

Public companies have adopted a variety of strategies for ensuring that they remain in compliance with the Jones Act. There are three types of measures. First, companies review sources of information available to them that are indicative of citizenship. Second, companies have adopted protective measures in their articles and bylaws useful in making citizenship assessments and maintaining citizenship compliance. Third, companies have registered their publicly traded securities with DTC under the Segregation Account 100 System (Seg 100), which is both a source of shareholder information and a compliance mechanism.

##### A. *Sources of Information Indicative of Citizenship*

Public companies have several sources of information available that help them judge whether noncitizens control in excess of 25% of the company's publicly traded securities including Williams Act reports filed by large shareholders, the NOBO list, shareholder addresses, and a list of shareholders of record.

##### 1. Williams Act Reports

One of the primary sources of information available to public Jones Act companies regarding the beneficial ownership of their stock are Williams Act public reports. The federal Williams Act,<sup>154</sup> enacted in 1968 to curb perceived abuses in tender offer practices, requires that a number of reports be filed by shareholders with the SEC, the issuer, and each exchange where the security is traded.<sup>155</sup>

Specifically, the Williams Act added section 13(d) to the Securities Exchange Act of 1934, which requires any person who acquires "beneficial ownership" of 5% or more of any publicly traded equity security to file a Schedule 13D or a Schedule 13G<sup>156</sup> and institutional

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154. Pub. L. No. 90-439, 82 Stat. 454 (1968). Another source of information are reports required to be filed by issuer insiders and 10% shareholders under section 16 of the Securities Exchange Act of 1934. See 15 U.S.C. § 78p (2012).

155. See H.R. REP. NO. 1711 (1968), reprinted in 1968 U.S.C.C.A.N. 2811. The purpose of the disclosure rules is to "alert investors in securities markets to potential changes in corporate control and to provide them with an opportunity to evaluate the effect of these potential changes." *Wellman v. Dickinson*, 682 F.2d. 355, 365-66 (2d Cir. 1982) (citing *GAF Corp. v. Milstein*, 453 F.2d 709, 717 (2d Cir. 1971)).

156. See 15 U.S.C. § 78m(d).

investment managers exercising investment discretion of more than \$100 million to file periodic reports on Form 13F.<sup>157</sup>

Schedules 13D/13G must be filed within ten days after the purchase of at least 5% of a voting class of equity securities registered under section 12 of the Securities Exchange Act of 1934.<sup>158</sup> Both schedules report, among other things, the citizenship of the beneficial owner of the securities purchased (if a natural person) and the place of organization of the purchaser if it is a business entity.<sup>159</sup> Form 13F applies to institutional investment managers who are required to disclose once every quarter in a single filing each publicly traded security that they manage, whether they exercise sole investment discretion over such securities or share such discretion and, similarly, whether they have sole, shared, or no voting authority over such securities.<sup>160</sup>

A key concept underlying section 13(d) and these filings is a definition of “beneficial ownership.”<sup>161</sup> Only the “beneficial owner” of securities is required to file a Schedule 13D or 13G.<sup>162</sup> A beneficial owner “includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares . . . voting power . . . and/or . . . investment power which includes the power to dispose, or to direct the disposition of, such security.”<sup>163</sup> SEC rules deem a person who has the right to acquire a security within 60 days through an option, warrant, or other right to be the “beneficial owner” of that security.<sup>164</sup> A pledgee of a security, however, is not deemed a “beneficial owner” until such time as steps are taken necessary to declare a default and take possession or control of the securities.<sup>165</sup>

Although the purpose of the Williams Act is unrelated to maritime citizenship, Williams Act reports provide useful information for Jones Act public companies. Such reports identify major shareholders and might contain information that could lead to further inquiries, for example, in instances when a filer is organized outside the United States. Some Jones Act public companies have improved on this information flow, as indicated below, by giving their board of directors the express

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157. *See id.* § 78m(f).

158. 17 C.F.R. §§ 240.13d-1(a)-(b) (2013).

159. *Id.* §§ 240.13d-101, .13d-102.

160. *Id.* § 240.13f-1.

161. *See* Proposed Rule Regarding Beneficial Ownership Reporting Requirements and Security-Based Swaps, 76 Fed. Reg. 15,874, 15,876-77 (Mar. 22, 2011).

162. 17 C.F.R. § 240.13d-1.

163. *Id.* § 240.13d-3.

164. *Id.* § 240.13d-3(d).

165. *Id.* § 240.13d-3(d)(3).

right to seek citizenship information from shareholders and even to require Williams Act reporting persons to provide citizenship certifications.<sup>166</sup>

## 2. NOBO List

As indicated above, stock issuers are permitted to obtain a list of nonobjecting beneficial owners of their stock pursuant to SEC rules.<sup>167</sup> Specifically, issuers are permitted to obtain the names, holdings, and addresses of NOBOs.<sup>168</sup> Broadridge, the leading provider of proxy-solicitation-related outsourcing services, will produce a list of NOBOs as of a given record date typically within two business days of the request.<sup>169</sup> Although citizenship is not indicated on the NOBO address list, stock issuers can use the NOBO list to make further inquiries of shareholders.

## 3. Shareholder Addresses

Although issuers cannot obtain the addresses of OBOs, they can initiate a search to determine whether beneficial shareholders have U.S. or foreign addresses. As indicated above, MARAD, but not the Coast Guard, accepts evidence of U.S. residency with respect to proving 75% U.S. citizen beneficial ownership.<sup>170</sup> It has been suggested that the Coast Guard reexamine this position.<sup>171</sup>

Broadridge will provide a geographic analysis to an issuer, termed a “geographic survey,” which is a report of share holdings in each state, province, and country by the number of shareholders and number of shares held.<sup>172</sup> Other companies, such as Nasdaq Corporate Solutions,<sup>173</sup> provide shareholder residence information through statistical sampling and survey techniques.<sup>174</sup>

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166. See, e.g., Amended and Restated Cert. of Incorporation of Horizon Lines, Inc., art. V, § 10(a)(i) (Dec. 7, 2011).

167. See 17 C.F.R. §§ 240.14b-1, .14b-2.

168. *Id.*

169. *NOBO Lists Requests*, BROADRIDGE, <http://www.broadridge.com/corporate-issuer-solutions/shareholder-communications/shareholder/nobo-list-requests#> (last visited Apr. 14, 2015).

170. See *supra* Part II.A.2; *infra* Part V.A.

171. See, e.g., *infra* Part V.A.

172. *Corporate Issuer Services 2014*, BROADRIDGE 34, [https://materials.proxyvote.com/Approved/RICST1/20140304/INFST\\_194622/INDEX.HTML#/1/](https://materials.proxyvote.com/Approved/RICST1/20140304/INFST_194622/INDEX.HTML#/1/) (last visited Apr. 14, 2015).

173. See *Special Situation & Transactional Analysis*, NASDAQ, <http://business.nasdaq.com/intel/ir-management/advisory-services/special-situations-and-transactional-analysis/index.html> (last visited May 11, 2015).

174. See Juliane L. Keppler, *Selecting the Right Target Basis Calculation for Your Basis Transfer Transaction*, 2011 TAX EXECUTIVE 431.

#### 4. Shareholders of Record

The last available regular source of information for issuers regarding the citizenship of shareholders is their list of shareholders of record.<sup>175</sup> For most public companies, Cede & Co. is usually the owner of record, as a nominee for others, of the vast majority of shares.<sup>176</sup> But a few shareholders continue to own shares as of record and in a few cases in paper form.<sup>177</sup> Issuers that have dual stock certificate systems, as described below, require shareholders of record to prove that they are U.S. citizens in order to be classified as such and hold U.S. citizen denominated shares.<sup>178</sup>

#### *B. Measures Contained in Articles and Bylaws*

A number of public Jones Act companies have adopted provisions in their organizational documents that assist the company in making citizenship assessments and in maintaining compliance with citizenship requirements.<sup>179</sup>

##### 1. Making Citizenship Assessments

With regard to making citizenship assessments, companies have (1) adopted citizenship policies, (2) granted the Board of Directors the authority to determine citizenship, (3) required shareholders to provide the issuer information needed to determine citizenship, and (4) established dual stock certificate authority.

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175. “Registered owners can hold their securities either in certificated form or in electronic (or ‘book-entry’) form through a direct registration system (‘DRS’), which enables an investor to have his or her ownership of securities recorded on the books of the issuer without having a physical securities certificate issued.” Proxy System Concept Release, 75 Fed. Reg. 42,982, 42,985 (July 22, 2010).

176. *See, e.g.,* Apache Corp. v. Chevedden, 696 F. Supp. 2d 723, 726 (S.D. Tex. 2010). According to DTCC, in 2007, transactions in certificated securities only accounted for about 0.01% of the daily trading volume. *See* Donald, *supra* note 103, at 48 n.21.

177. Registered ownership based on a paper certificate is gradually being replaced by an electronic direct registration system. *See* Proxy System Concept Release, 75 Fed. Reg. at 42,985 n.29.

178. *See, e.g.,* Amended and Restated Articles of Incorporation of Alexander & Baldwin Holdings, Inc., § 7.3 (June 29, 2012). The company’s name was subsequently amended to be Matson, Inc.

179. Public companies with citizen restricted securities have adopted similar measures in other industries. *See, e.g.,* Restated Certificate of Incorporation of American Airlines Group Inc., art. IV, § 5 (Dec. 9, 2013). The airline requirement is that 75% of the “voting interest” must be “owned or controlled” by U.S. citizens. *See* 49 U.S.C. § 40102(a)(15) (2012).

## a. Citizenship Policies

When a public company adopts Jones Act-related provisions in their organizational documents, they usually include a provision making it the company policy to remain a Jones Act citizen and defining terms associated with citizenship. A typical formulation is as follows: “It is the policy of the Corporation that Non-Citizens should beneficially own, individually or in the aggregate, no more than the Permitted Percentage of each class or series of the capital stock of the Corporation.”<sup>180</sup> In the case of this Certificate of Incorporation, the “Permitted Percentage” for purposes of the Jones Act is 19.9%.<sup>181</sup> It is also typical for companies to select a permitted percentage for noncitizens that is less than 25.0%, which is the noncitizen ownership percentage permitted by law,<sup>182</sup> and to provide for some formula for determining which shares have exceeded the permitted percentage and therefore are considered “excess shares.”<sup>183</sup>

Such policies also define citizenship usually with reference to the applicable citizenship law without restating the test for U.S. citizenship. For example, one company’s certificate of incorporation defines a “U.S. Citizen” to “mean any Person that meets the definition of a citizen of the United States under U.S. Maritime Law applicable to a U.S. Maritime Company eligible to operate a vessel in the coastwise trade” with ““U.S. Maritime Law”” being broadly defined to include various maritime laws, rules, regulations and other sources of law.<sup>184</sup>

Some companies have sought to meld the SEC definition of “beneficial ownership” with the Jones Act citizenship standard for purposes of determining which person must be a U.S. citizen.<sup>185</sup> For example, one company defines an “owner,” subject to the citizenship requirement, as someone who “holds, directly or indirectly, of record or beneficially owns . . . as determined under Regulation 13D . . . under the Securities Exchange Act of 1934 . . . shares . . . *provided* that a Person shall not be deemed to be the ‘Owner’ . . . if the Board of Directors

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180. Restated Certificate of Incorporation of Horizon Lines, Inc., art. V, § 2 (Dec. 7, 2011).

181. *Id.* art. V, § 1(o).

182. *See, e.g.*, Restated Certificate of Incorporation of Hercules Offshore, Inc., div. B(h)(viii) (Oct. 31, 2005) (defined as 5% less than the percentage required to maintain citizenship).

183. *See, e.g.*, Articles of Incorporation of Alexander & Baldwin Holdings, Inc., § 7.5 (June 29, 2012).

184. *Id.* § 7.1.

185. Companies have also utilized SEC beneficial ownership concepts without express reference to SEC Rule 13(d)(3). *See, e.g.*, Restated Certificate of Incorporation of Seacor Holdings, Inc., ¶ 8(g)(3) (Nov. 7, 1989).

determines, in good faith, that such Person is not an owner of such shares in accordance with and for purposes” of the Jones Act citizenship laws.<sup>186</sup>

b. Board Authority

Many Jones Act companies expressly provide their board of directors citizenship-related authority. Such authority tends to include the power to make citizenship determinations binding on the shareholder,<sup>187</sup> to request citizenship-related information from shareholders as described below, and generally to make determinations and administer the protective measures (such as forced share redemption) described *infra* Part IV.B.2. In giving the directors the right to make citizenship determinations, it is also common to find organizational documents which grant the directors the right to rely on information provided by shareholders or third parties such as financial intermediaries.<sup>188</sup>

c. Requiring Shareholders To Provide Information

Another common citizenship-related requirement is a provision which mandates shareholders to provide the company citizenship related information to aid the company in making its own citizenship assessment and in maintaining that citizenship. This formulation is typical:

To the extent necessary to enable the Company to determine the percentage of the outstanding capital stock of any class owned or Controlled by Foreigners . . . the Company may require that record holders and owners of shares of stock confirm their citizenship (by submitting such documentary and other evidence thereof as the Company (or its transfer agent) may reasonably require or request) . . . .<sup>189</sup>

Some organizational documents also require shareholders to advise the issuer affirmatively if their citizenship status changes.<sup>190</sup> Some public

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186. Certificate of Incorporation of New Gulfmark Offshore, Inc., art. IX, § 1 (Oct. 13, 2009).

187. *See, e.g.*, Restated Certificate of Incorporation of Horizon Lines, Inc., art. V, § 9 (Dec. 7, 2011) (“The Corporation shall have the power to determine, in the exercise of its reasonable judgment, the citizenship of the beneficial owners of any class or series of the Corporation’s capital stock . . .”).

188. *See, e.g.*, Amended and Restated Articles of Incorporation of Alexander & Baldwin Holdings, Inc. §§ 7.2(b), 7.4(b) (June 29, 2012).

189. Restated Certificate of Incorporation of Seacor Holdings, Inc., ¶ 8(e) (Nov. 7, 1989). There is also recognition in certain organizational documents that the information may have to come from a nominee or other intermediary. *See, e.g.*, Certificate of Incorporation of New Gulfmark Offshore, Inc., art. IX, § 4(b) (Oct. 13, 2009).

190. *See, e.g.*, Certificate of Incorporation of Hercules Offshore, Inc., div. B, § 4(c)(ii) (Nov. 1, 2005).

Jones Act companies have taken this a step further and required 5% beneficial owners filing Williams Act reports to provide automatically, without being asked by the company, citizenship evidence to the issuer.<sup>191</sup> At least one company has a provision that requires that every “beneficial owner” must “authorize such beneficial owner’s broker, dealer, custodian, depository, nominee or similar agent” to provide “to the Corporation such beneficial owner’s address.”<sup>192</sup>

d. Dual Stock Certificate Authority

A number of public Jones Act companies’ organizational documents provide authority to establish dual stock certificate systems. As described by one company, it would be a system “under which different forms of stock certificates representing outstanding shares of Class A Common Stock are issued to U.S. Citizens and Non-U.S. Citizens.”<sup>193</sup> Companies also have adopted authority to include restrictive legends on stock certificates.<sup>194</sup> The efficacy of such a system and legends, as will be discussed further *infra* Part V.A is in doubt since most shares are not certificated.

2. Maintaining Citizenship Compliance

A number of public Jones Act companies have included in their organizational documents mechanisms for maintaining compliance with U.S. Jones Act citizenship requirements including (1) suspension of voting and other shareholder rights, (2) excess share transfer nullification, (3) transfers to trusts, and (4) redemption rights.

a. Suspension of Rights

Once a public Jones Act company is aware that it has exceeded a citizenship threshold, often defined in terms of “excess shares,”<sup>195</sup> the organizational documents may automatically deny such shares ordinary

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191. See, e.g., Certificate of Incorporation of Horizon Lines, Inc., art. VI, § 10(a)(i) (Sept. 21, 2005); Amended and Restated Certificate of Incorporation of Overseas Shipholding Group, Inc., art. IV(D)(2)(a) (Dec. 26, 2006).

192. Amended and Restated Certificate of Incorporation of Great Lakes Dredge & Dock Holdings Corp., art. 5, § 8(a)(iv) (Dec. 26, 2006). The company was later renamed Great Lakes Dredge & Dock Corporation.

193. Certificate of Incorporation of New Gulfmark Offshore, Inc., art. IX, § 3 (Oct. 13, 2009).

194. See, e.g., Amended and Restated Articles of Incorporation of Alexander & Baldwin Holdings, Inc., § 7.3 (June 29, 2012).

195. See, e.g., Certificate of Incorporation of Hercules Offshore, Inc., div. B, § 4 (Nov. 1, 2005).

shareholder rights including the rights to vote and receive dividends.<sup>196</sup> One commentator has referred to this as “sterilization of voting rights.”<sup>197</sup>

b. Excess Share Transfer Nullification

Some organizational documents go further and expressly nullify the transfer of any shares to any person who is a noncitizen in excess of the permitted percentage for noncitizens.<sup>198</sup> Some authority is also provided to the effect that automated settlements of share purchases do not control, although it has also been recognized that such authority may conflict with the trading rules of the applicable exchange.<sup>199</sup> Organizational documents usually accomplish nullifications by prohibiting the company and its transfer agent from recognizing transfers in excess of the permitted noncitizen percentage.<sup>200</sup>

c. Transfers to Trusts

Some companies have provisions that automatically transfer shares in excess of the permitted noncitizen percentage to a trust with U.S. citizen trustees.<sup>201</sup> The trustees then have the power to sell the shares at fair market value for the benefit of the noncitizen shareholder.

d. Redemption Rights

Finally, many Jones Act public companies provide that excess shares shall be redeemed by the issuer either automatically or at the

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196. See Restated Certificate of Incorporation of Horizon Lines, Inc., art. V, § 4(a) (Dec. 7, 2011). Suspension of voting rights has occurred in other citizenship contexts. See News Corp., Report (Form 8-K) (Apr. 18, 2012) (announcing temporary suspension of voting rights of certain non-U.S.-citizen shareholders).

197. Jesse A. Finkelstein, *Stock Transfer Restrictions Upon Alien Ownership Under Section 202 of the Delaware Corporation Law*, 38 BUS. LAW. 573, 584 (1983).

198. See, e.g., Second Restated Certificate of Incorporation of Hornbeck Offshore Services, Inc., art. 12, § 2 (Mar. 5, 2004).

199. See, e.g., Certificate of Incorporation of New Gulfmark Offshore, Inc., art. IX, § 10 (Oct. 13, 2009). This takes into account securities exchange or automated quotation system requirements, but provides, “The fact that the settlement of any transaction occurs shall not negate the effect of any provision of this Article IX [restricting foreign ownership] and any transferee in such a transaction shall be subject to all of the provisions and limitations set forth in this Article IX.” *Id.*; see also Amended and Restated Certificate of Incorporation of Great Lakes Dredge & Dock Holdings Corp., art. 5, § 10 (Dec. 26, 2006).

200. See, e.g., Certificate of Incorporation of Hercules Offshore, Inc., Div. B, § 4(c) (Nov. 1, 2005).

201. See, e.g., Amended and Restated Articles of Incorporation of Alexander & Baldwin Holdings, Inc., §§ 7.6(a) & 7.7 (June 29, 2012).

discretion of the board of directors.<sup>202</sup> Some organizational documents contain the following sequence of remedies: (1) any transfer in excess of the permitted noncitizen percentage is void; (2) if such transfer occurs anyway, then such shares are transferred to a trust; and, finally, (3) if, for any reason, the trust mechanism fails, then the shares are subject to redemption.<sup>203</sup>

Companies sometimes indicate that the redemption price will be paid in cash or, at the discretion of the board of directors, in the form of a promissory note.<sup>204</sup> Companies also usually have some mechanism for determining the order in which shares should be redeemed.<sup>205</sup>

### C. DTC Segregation Account 100 System

Prior to 1988, “Foreign-owned shares of communications and maritime issues could not be deposited with DTC due to alien ownership restrictions . . . and the inability to identify the amount of foreign-owned holdings registered in the name of Cede & Co., DTC’s nominee.”<sup>206</sup> DTC addressed this problem by establishing a segregated account system referred to as the “Segregation Account System 100.”<sup>207</sup> In essence, Seg 100 shifts the burden of evaluating citizenship from the issuer and the transfer agent, who do not have direct contact with beneficial owners, to DTC participants, who have such owners as their customers. A number of public Jones Act companies have their publicly traded securities subject to Seg 100.<sup>208</sup> Moreover, Seg 100 has been cited in several

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202. See, e.g., Restated Certificate of Incorporation of Horizon Lines, Inc., art. VI, § 8 (Dec. 7, 2011).

203. See, e.g., Amended and Restated Articles of Incorporation of Alexander & Baldwin Holdings, Inc., § 7.7(c) (June 29, 2012).

204. See, e.g., Second Restated Certificate of Incorporation of Hornbeck Offshore Services, Inc., art. 12, § 4 (Mar. 5, 2004).

205. See, e.g., Amended and Restated Certificate of Incorporation of Great Lakes Dredge & Dock Holdings Corp., art. 5, § 4 (Dec. 26, 2006).

206. Notice B# 4335-88, DEPOSITORY TR. & CLEARING CORP. 3 (June 16, 1988), <http://www.dtcc.com/~media/files/pdf/2008/5/14/3487-08.pdf>. But see Depository Trust Co. Proposed Rule Change, 41 Fed. Reg. 35,587 (Aug. 23, 1976) (proposing that the DTC enable radio station licensees to have DTC listed securities and comply with broadcaster citizenship requirements).

207. Depository Trust Co. Proposed Rule Change, 41 Fed. Reg. 35,587; see also Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by Depository Trust Corporation, 53 Fed. Reg. 30,893 (Aug. 16, 1988) (giving notice of DTC-proposed rule change filed with the SEC permitting for the first time DTC participants to deposit foreign-owned shares of restricted issuers in segregated accounts).

208. See *DTC Securities Subject to Ownership Certifications*, DEPOSITORY TR. & CLEARING CORP., [http://www.dtcc.com/~media/Files/Downloads/client-center/DTC/DTC\\_Issues\\_Subject\\_To\\_Certifications.pdf](http://www.dtcc.com/~media/Files/Downloads/client-center/DTC/DTC_Issues_Subject_To_Certifications.pdf) (last visited Apr. 14, 2015).

instances to the SEC by issuers seeking regulatory approvals as the method for monitoring the citizenship of shares held in “street name.”<sup>209</sup>

DTC established Seg 100 pursuant to the Securities Exchange Act of 1934’s permission to such self-regulatory organizations to promulgate their own procedures. DTC indicated at the time to the SEC that the purpose of Seg 100 was “to permit foreign-owned shares of United States communication and maritime issues to be eligible for DTC’s book-entry services” and that Seg 100 “would promote the prompt and accurate clearance and settlement of transactions in units of communications and maritime securities.”<sup>210</sup> DTC also indicated that Seg 100 “would conform with the requirements of the said Shipping Act,” although the SEC indicated that it was “taking no position on whether this proposal meets the requirements of the Shipping Act.”<sup>211</sup>

Seg 100 is a special account maintained at DTC for each issuer that has notified DTC that it is subject to citizenship restrictions.<sup>212</sup> DTC then notifies its participants of the citizenship restrictions and the requirements to ascertain the citizenship of participants’ customers and to segregate the shares owned by noncitizens in that participant’s Seg 100 account. Participants are also required by DTC to file a “Certificate as to Citizenship for Shipping Companies” in which they acknowledge the Jones Act citizenship standard if they wish to participate in the trading of a restricted security.<sup>213</sup> The effect of Seg 100 “is to prohibit participants

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209. See Letter from Skadden, Arps, Slate, Meagher & Flom LLP, SEC. & EXCH. COMM’N (Apr. 3, 2012), <http://www.sec.gov/divisions/corpfin/cf-noaction/2012/alexanderbaldwin040312-12g3-incoming.pdf>; Letter from Kirkland & Ellis LLP, SEC. & EXCH. COMM’N (Oct. 3, 2011), <http://www.sec.gov/divisions/corpfin/cf-noaction/2011/horizonlines100311-13e4-incoming-ke.pdf>; Letter from Cravath, Swaine & Moore LLP, SEC. & EXCH. COMM’N (Dec. 15, 2009), <http://www.sec.gov/divisions/corpfin/cf-noaction/2010/gulffmarkoffshore011110-12g3-incoming.pdf>.

210. See Self-Regulating Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by Depository Trust Company, 53 Fed. Reg. at 30,893-94.

211. *Id.*; see also Notice of Filing and Immediate Effectiveness of Proposed Rule Change Clarifying Procedures Relating to the Deposit of Foreign-Owned Shares of U.S. Communications and Maritime Issuers, 54 Fed. Reg. 43,010, 43,010 n.3 (Oct. 19, 1989).

212. See *Form Letter to Underwriting Dep’t*, DEPOSITORY TR. & CLEARING CORP. (2010), <http://www.dtcc.com/~media/files/downloads/legal/issue-eligibility/special-letters/seg100-letter.pdf>. This form letter requires the issuer to indemnify DTC for any loss “arising out of or based upon any action taken, or omitted to be taken” by the issuer with respect to compliance with the applicable citizenship restriction. DTC requires all participants to indemnify it in other situations as well. See *Rules, By-Laws and Organization Certificate of the Depository Trust Company*, DEPOSITORY TR. & CLEARING CORP. r. 2 § 1(k) (June 2013), [http://www.dtcc.com/~media/Files/Downloads/legal/rules/dtc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/dtc_rules.pdf).

213. See *About Deposits*, DEPOSITORY TR. & CLEARING CORP. 24 (2013), <http://www.dtcc.com/~media/Files/Downloads/legal/service-guides/Deposits.pdf>. DTC participants are bound by such guidance. See *Rules, By-Laws and Organization Certificate of the Depository Trust Company*, *supra* note 212, r. 27.

from maintaining foreign-owned securities of these issues in their general accounts.<sup>214</sup>

There is also a mechanism for policing Seg 100 accounts to prevent an issuer from exceeding the permitted noncitizen ownership percentage. “DTC periodically reports to the transfer agents of issues with specialized ownership restrictions . . . the total holdings in Participants’ Seg 100 accounts for each involved CUSIP.”<sup>215</sup> As indicated in DTC’s “About Settlement” guide to DTC participants:

In the rare instance in which total alien holdings in an issue may exceed statutory limitations, and the increase in foreign-owned shares registered in the name of Cede & Co. caused the statutory limitation to be exceeded, a [transfer agent] will advise DTC of the amount by which those foreign-owned shares must be reduced. According to the Seg 100 procedures, you are required to immediately withdraw from your general free account any foreign-owned shares that cannot be credited to your Seg 100 account because of foreign ownership limitations. DTC will cooperate with the issuer and its TA to facilitate the withdrawal and will disclose to the issuer your name and the number of shares to be withdrawn. You should be aware that issuers may place restrictions on such shares.<sup>216</sup>

These requirements are backed by potential DTC sanctions. According to DTC guidance, following advice from a transfer agent that a permitted percentage has been exceeded:

DTC will immediately reverse credits made by Participants to their Seg 100 accounts on a “last in—first out” basis. These actions will be communicated to Participants. *Upon such notification from DTC, Participants are required to immediately withdraw from their accounts any such shares. Failure to do so will result in notification by DTC to the Participant’s Regulator, and may result in DTC imposing certain disciplinary sanctions, including fines, and/or operational limitations.*<sup>217</sup>

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214. See *About Deposits*, *supra* note 213, at 25.

215. *Notice B# 3487-08*, DEPOSITORY TR. & CLEARING CORP. (May 14, 2008), <http://www.dtcc.com/~media/files/pdf/2008/5/14/34887-08.pdf>. CUSIP stands for Committee on Uniform Securities Identification Procedures, and a CUSIP number is a unique nine-character identified applicable to most U.S.-registered securities. *CUSIP Number*, SEC. & EXCH. COMM’N, <http://www.sec.gov/answers/cusip.htm> (last visited May 8, 2015).

216. *About Settlement*, DEPOSITORY TR. & CLEARING CORP. 87-88 (2013), <http://www.dtcc.com/~media/Files/Downloads/legal/service-guides/Settlement.pdf>. Issuer restrictions on shares are described *supra* Part IV.B.

217. *Notice B# 3487-08*, *supra* note 215. The “Participant’s Regulator” refers to the government agency having primary jurisdiction over the participant whether it be a broker-dealer, domestic bank, foreign bank, or other entity. See *Notice B# 1262-14*, DEPOSITORY TR. & CLEARING CORP. 4 (Aug. 5, 2014), <http://www.dtcc.com/~media/Files/pdf/2014/8/5/1262-14.pdf>.

Not surprisingly, given DTC's intermediary role, DTC also notes that Seg 100 is "elective" and is "available as a tool for compliance," but that "DTC is not responsible for and does not monitor Issuer, Agent, Participant or beneficial owner compliance but offers the service to support such compliance by the responsible parties."<sup>218</sup>

## V. TRICO MARINE

### A. *Coast Guard Decision*

The difficulties the Jones Act citizenship standard posed for public companies have been well known to maritime lawyers, public company counsel, and others as the current market for public securities trade settlement and ownership developed.<sup>219</sup> The Committee on Admiralty of the New York City Bar Association indicated in a 1994 report:

Establishing the requisite citizen ownership of a corporation's stock is not simple. The statute seems unsuited for application to the case of the widely held public corporation where the corporate secretary is unlikely to know the citizenship or even the identity of the corporation's shareholders. In such circumstances, the ability of the corporation to gather accurate information to establish its citizenship is, at best, doubtful.<sup>220</sup>

These known difficulties,<sup>221</sup> however, were not crystallized until the Coast Guard's decision to commence a penalty process against Trico Marine Services, Inc. (Trico), a public Jones Act company, in 2011.<sup>222</sup>

The Trico situation began with a demand in 2007 by one of its foreign shareholders for the right to nominate two directors to serve on the Trico Board of Directors.<sup>223</sup> Trico's Board of Directors, then consisting of seven persons with a quorum requirement of five and an existing noncitizen director, offered to agree to permit the foreign

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218. *Operational Arrangements*, DEPOSITORY TR. & CLEARING CORP. 8 (Jan. 2012), <http://dtcc.com/~media/Files/Downloads/Settlement-Asset-Services/Underwriting/operational-arrangements.pdf>.

219. *See, e.g.*, Discussion of Rulemaking Text, 56 Fed. Reg. 30,655 (July 3, 1991) ("It will make difficult or impossible the establishment of coastwise eligibility for most public corporations.").

220. Comm. on Admiralty, *Unnecessary Citizenship Requirements Imposed on Maritime Industries*, 49 REC. ASS'N B. CITY N.Y. 703, 708-09 (1994).

221. The difficulties have been recognized in other industries, like the communications industry, where there are citizenship limitations. *See* Michael O'Rielly, *Affirmatively Expand Permissible Foreign Ownership*, FED. COMM. COMMISSION (Mar. 3, 2015), <https://www.fcc.gov/blog/affirmatively-expand-permissible-foreign-ownership> ([L]ike all publicly traded companies generally, it cannot establish the identity, let alone the nationality of the majority of its shareholders.').

222. Trico Memorandum, *supra* note 153, at 15-16.

223. *See id.* exhibit 2/E.

shareholder to nominate a single director and thereby preserve the company's Jones Act eligibility.<sup>224</sup> The foreign shareholder insisted on the ability to nominate two directors.<sup>225</sup> During this process, the foreign shareholder sent numerous letters to the Coast Guard, MARAD, and the SEC alleging that Trico no longer qualified as a Jones Act citizen due to percentage ownership issues.<sup>226</sup> Coast Guard and MARAD investigations followed.<sup>227</sup>

After an investigation, the Coast Guard internally approved commencing a civil penalty process against Trico seeking penalties of \$5,987,000.<sup>228</sup> The approval was in response to the recommendations of the Coast Guard National Vessel Documentation Center dated January 12, 2011—the “Trico Memorandum.” At the time, Trico was already subject to a Chapter 11 bankruptcy proceeding in the United States Bankruptcy Court for the District of Delaware.<sup>229</sup> Because the civil penalty process was never commenced,<sup>230</sup> Trico was never given an opportunity to respond to the Trico Memorandum except to object to the Coast Guard's bankruptcy claims.<sup>231</sup>

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224. See *Trico Marine Rejects Kistefos' Director Nominations*, MAR. EXECUTIVE (Mar. 12, 2009), <http://www.maritime-executive.com/article/trico-marine-rejects-kistefos-director-nominations>.

225. *Id.*

226. See Trico Memorandum, *supra* note 153, exhibit 3/A—3/O (explaining that the letter prompting the investigation was sent on November 11, 2009). The Trico-Kistefos situation also resulted in state court litigation. See *Kistefos AS v. Trico Marine Servs., Inc.*, No. 4497-CC, 2009 WL 1124477 (Del. Ch. Apr. 14, 2009).

227. The Coast Guard investigation commenced on December 1, 2009. Trico Memorandum, *supra* note 153, exhibit 1.

228. Memorandum from Kevin S. Cook to Nat'l Vessel Documentation Ctr., U.S. COAST GUARD (Feb. 24, 2011), <http://www.uscg.mil/hq/cg5/nvdc/report/tricoaction.pdf>. MARAD did not impose any penalties because there was “inadequate evidence in this case to prove a violation” of section 9 of the Shipping Act, 1916, although there was sufficient evidence to find a “technical default” in Trico Marine's federal ship financing loan guarantee obligations. Trico Memorandum, *supra* note 153, addendum A.

229. *In re Trico Marine Services, Inc.*, 450 B.R. 474 (Bankr. D. Del. 2011).

230. Several recommendations contained in the Trico Memorandum were approved including “commencing the civil penalty process.” The recommendations that the Certificates of Documentation of the Trico Marine Jones Act vessels be invalidated and cancelled and that criminal proceedings be considered were not accepted “[b]ased on recent changes related to Trico Marine.” Memorandum from Kevin S. Cook to National Vessel Documentation Center, *supra* note 228. The civil penalty process was never, by all appearances, in fact commenced. Liquidating Debtors' Objection to Claims 113, 114, and 115 Filed by the United States of America on Behalf of the United States Coast Guard ¶ 14, *In re Trico Marine Servs., Inc.*, (Bankr. D. Del. June 5, 2012) (No. 10-12653 (BLS)) [hereinafter Trico Objection].

231. Trico Objection, *supra* note 230, ¶¶ 49-53. In its objection, Trico Marine argued, among other things, that the citizenship standard as enforced by the Coast Guard was impermissibly vague and that Coast Guard actions were arbitrary and capricious as evidenced by its lack of understanding of the public securities markets. *Id.* ¶¶ 27-29, 44-48.

The Coast Guard found, based on “snap shots” at seven successive quarters,<sup>232</sup> that Trico did not comply with the 75% beneficial ownership test at those points in time. The Coast Guard further found that the foreign shareholder that had instigated the investigation owned between 18.10% and 22.55% of the company at those points in time.<sup>233</sup> Other major shareholders identifiable via Williams Act reports owned substantially more stock than was necessary to exceed 25% of the total ownership when combined with the identified foreign shareholder.<sup>234</sup> The other shareholders included hedge funds, mutual funds, and banks. Ultimately, Trico was not able to prove to the Coast Guard’s satisfaction that it was owned at all times at least 75% by U.S. citizens.

The Trico Memorandum is significant because it was one of the only (if not the only) instances in which the Coast Guard has applied the Jones Act citizenship standard to a public company since indirect share ownership became the predominant model for U.S. public companies.<sup>235</sup> In the Trico Memorandum, the Coast Guard gave notice that the Jones Act citizenship standard was meant to be stringent by quoting a portion of a 1993 regulatory preamble:

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.*<sup>236</sup>

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232. Trico Memorandum, *supra* note 153, at 4 (“As a publicly traded company, the ownership interests in [Trico] can and will be subject to frequent change. Consequently, this investigation elected to take ‘snapshots’ of TMSI’s ownership interests . . .”).

233. *Id.* at 7-11.

234. *Id.*

235. The only administrative precedent cited by the Coast Guard in the Trico Memorandum was a nonpublic letter sent to Textron, Inc. in 1991 in which it stated that “the Coast Guard requires an unequivocal affirmation regarding stock ownership” and that the “mere fact that a corporation or individual has an address in the U.S. does not necessarily mean that that person is a citizen” even though the Coast Guard recognized the issues faced by Textron “are no different than the problems faced by any other publicly traded corporation which owns vessels engaged in coastwise trade.” Letter from Thomas L. Willis to Charles LeBlanc (Nov. 21, 1991) (on file with author).

236. Trico Memorandum, *supra* note 153, at 14 (quoting 58 Fed. Reg. 60,256, 60,259 (Nov. 15, 1993)).

The Coast Guard continued in this manner without giving much regard to the nature of the public securities trading system:

[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 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.”<sup>237</sup>

Trico Marine explained to the Coast Guard that the Coast Guard’s view of these requirements was not consistent with barriers all DTC-listed public companies faced in accessing information regarding their ultimate owners.<sup>238</sup> Although the Coast Guard rejected this explanation as the “so-called ‘doomsday’ scenario,”<sup>239</sup> it was recommended that the Coast Guard “solicit ideas from industry as to how they comply with the Coast Guard’s citizenship standard for publicly traded companies,”<sup>240</sup> which did in fact occur.<sup>241</sup>

In the course of the investigation, Trico Marine asked for clarification of the Coast Guard’s regulations and, in particular, how the Coast Guard interprets the terms “title,” “ownership of equity,” and “beneficial ownership” from its regulations—none of which are defined.<sup>242</sup> The Coast Guard responded that it preferred “not to define those terms individually in the regulations because such would have the disadvantage of not being able to stay current with evolving financial and control structures.”<sup>243</sup> Rather, the Coast Guard would continue to apply a “practical approach” to applying the citizenship laws.<sup>244</sup>

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237. *Id.* at 17-18 (quoting 46 U.S.C. § 50501 (2012)). The Coast Guard also disparaged the inability of Trico Marine to obtain information from its OBOs. *Id.* at 20. The Coast Guard appears to have been under the impression that public companies can readily restrict sale of their stock to U.S. citizens or can ensure citizenship through a dual stock certificate system. As discussed *infra* Parts V.B.1 and VI.A, that is not the case.

238. *See id.* exhibit 2/E.

239. *Id.* at 22.

240. *Id.* at 23.

241. *See* Mechanisms of Compliance with U.S. Citizenship Requirements for the Ownership of Vessels, 76 Fed. Reg. 68,203 (Nov. 3, 2011).

242. Trico Memorandum, *supra* note 153, at 15-18.

243. *Id.* at 15-16.

244. *Id.* at 16.

Nevertheless, the Coast Guard did provide guidance in the Trico Memorandum to some extent on how the citizenship regulations might be applied in the context of indirect shareholding. With respect to mutual funds “such as Vanguard, Fidelity or any of the other thousands of funds, or similar investment structure,” the Coast Guard offered that it “does not look beyond the citizenship of the mutual fund company to the individual fund account holders’ citizenship.”<sup>245</sup> Moreover, the Coast Guard indicated that the “SEC regulatory definition of ‘beneficial ownership’ . . . appears consistent with the description of ‘controlling interest’” in U.S. citizenship law.<sup>246</sup>

Lastly, the Coast Guard indicated that Seg 100 was insufficient alone as a mechanism for citizenship compliance. The Coast Guard specifically indicated that a “Jones Act company may not delegate its Jones Act compliance responsibilities to DTC.” The Coast Guard also noted the DTC disclaimer to the effect that DTC, as a mere intermediary, does not stand behind activities of its participants.<sup>247</sup>

Subsequent to the issuance of the Trico Memorandum, in Trico Marine’s Chapter 11 bankruptcy proceeding, the U.S. government filed claims seeking recovery of the Trico Memorandum penalty amount.<sup>248</sup> The Trico Plan Administrator objected on various grounds, including that the Coast Guard was seeking penalties based on an impermissibly vague standard resting on undefined terms and that the Coast Guard’s actions were arbitrary and capricious based on misunderstandings of the public securities market evident in the Trico Memorandum.<sup>249</sup> The parties settled on the basis of an allowed unsecured claim of \$75,000.

## *B. Subsequent Activity*

### 1. Public Comments

Following through on the proposal in the Trico Memorandum, the Coast Guard requested comments from the public on November 3, 2011, regarding “mechanisms that publicly traded companies have chosen to employ in order to assure compliance with [U.S.] citizenship

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245. *Id.* at 18.

246. *Id.* at 16; *see also* 17 C.F.R. § 240.13d-3 (2013) (defining “beneficial owner”).

247. Trico Memorandum, *supra* note 153, at 18. With regard to delegation, the Coast Guard did not appear to understand that some delegation is unavoidable by every stock issuer that is not closely held as, for example, with transfer agents and stock registrars.

248. *See* Trico Objection, *supra* note 230, ¶¶ 11-13.

249. *Id.* ¶¶ 27-48.

requirements.”<sup>250</sup> The Coast Guard also requested information as to how such mechanisms “offer proof of compliance.”<sup>251</sup>

The Coast Guard received several comments including comments from trade associations effectively representing all Jones Act public companies.<sup>252</sup> Each of the trade association comments expressed concern about the Trico Memorandum and the ability of public companies to comply with the unyielding formulations in that Memorandum.<sup>253</sup> For example, the American Petroleum Institute (API), the leading national oil and natural gas industry trade association, indicated:

One of the most troubling statements in the Trico Decision is the Coast Guard’s statement to the effect that publicly traded companies . . . should stay out of the coastwise trade if they are not able to prove their citizenship in the same manner as a closely held company that has a limited number of direct and beneficial owners.<sup>254</sup>

The Coast Guard was also taken to task with regard to the lack of understanding of the public trading markets reflected in the Trico Memorandum. Again, API stated, “Another of API’s key concerns with the Coast Guard’s analysis in the Trico Decision is that it is based on incorrect assumptions of how today’s securities markets work . . . .”<sup>255</sup> Notably, the Coast Guard did not appear to fully take into account the SEC’s NOBO/OBO rules that have the effect of “preventing publicly traded companies from directly contacting their shareholders that are OBOs.”<sup>256</sup>

The Coast Guard’s suggestion that public companies adopt dual stock systems also came under criticism.<sup>257</sup> The Chamber of Shipping of

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250. Mechanisms of Compliance with United States Citizenship Requirements for the Ownership of Vessels Eligible To Engage in Restricted Trades by Publicly Traded Companies, 76 Fed. Reg. 68,203, 68-203.

251. *Id.* at 68,205.

252. The Coast Guard received comments from the American Waterways Operators, the American Petroleum Institute, and the Chamber of Shipping of America, among other persons. *Mechanisms of Compliance with United States Citizenship Requirements for the Ownership of Vessels Eligible To Engage in Restricted Trades by Publicly Traded Companies*, REGULATIONS.GOV, <http://www.regulations.gov/#!documentBrowser;rpp=25;po=0;D=USCG-2011-0619> [hereinafter *Trico Docket*].

253. *Id.*

254. *American Petroleum Institute Comment*, REGULATIONS.GOV 4 (Apr. 2, 2012), <http://www.regulations.gov/#documentDetail;D=USCG-2011-0619-0010> (follow “PDF Attachment” link).

255. *Id.* at 5.

256. *Id.*

257. Two Jones Act companies submitted comments indicating that they utilized a dual stock certificate system. In each instance, the dual stock certificates appear to apply only to registered shareholders, which are usually only a small percentage of any public company’s shareholdings. *See id.*; *American Waterways Operators Comment*, REGULATIONS.GOV 8 (Mar. 31,

America, representing thirty-six U.S.-based companies that own, operate, and charter vessels, indicated that a dual stock registry was of “very limited application” because it can only apply to “registered holders of securities and not to the beneficial owners holding through DTC participants.”<sup>258</sup>

The Coast Guard’s suggestion that public companies merely restrict the sale of their stock to U.S. citizens was also criticized.<sup>259</sup> API indicated that it would be “extremely difficult in the current trading market to practically preclude a non-citizen from purchasing the securities of a publicly traded Jones Act company on the open market or to limit such purchases to a set percentage.”<sup>260</sup>

Virtually all the commenters suggested that the Coast Guard adopt a holistic approach in which public companies are permitted to utilize a variety of methods of assessing the extent of noncitizen beneficial ownership and of maintaining compliance with the 25% noncitizen Jones Act limitation. The available methods suggested were (1) regular review of the NOBO and registered shareholder lists and Williams Act reports, (2) participation in Seg 100, (3) adoption of protective provisions in organizational documents, (4) regular review of shareholder addresses, (5) use of market intelligence, and (6) shareholder sampling.<sup>261</sup> No commenter suggested that the Coast Guard modify its rules with respect to requiring that shareholders who are relied upon for their citizenship qualify to document a U.S.-flag vessel.<sup>262</sup>

Several commenters came to the defense of Seg 100, although the comments did not dispute the Coast Guard’s view that the system relied on third party (broker) diligence. As API indicated, Seg 100 is the

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2012), <http://www.regulations.gov/#documentDetail;D=USCG-2011-0619-0008> (follow “PDF Attachment” link).

258. *Chamber of Shipping of America Comment*, REGULATIONS.GOV 9 (Mar. 29, 2012), <http://www.regulations.gov/#documentDetail;D=USCG-2011-0619-0006> (follow “PDF Attachment” link).

259. It has been implied that such a restriction would be effective even in the face of the current stock trading system and the NOBO/OBO rules. See Egan, Ellis & Salgado, *supra* note 17, § 18.10.

260. *American Petroleum Institute Comment*, *supra* note 254.

261. See, e.g., *American Waterways Operators Comment*, *supra* note 257, at 5-8.

262. *But see Brewer Law Group Comment*, REGULATIONS.GOV 3-4 (Apr. 2, 2012), <http://www.regulations.gov/#documentDetail;D=USCG-2011-0619-0011> (follow “PDF Attachment” link) (advocating effectively, but not expressly, for such a change in recommending that the Coast Guard permit public companies to rely on income tax reporting rules for determining residency).

“closest thing to . . . a mechanism to definitively prevent a non-citizen from purchasing a publicly traded company’s securities.”<sup>263</sup>

## 2. Coast Guard Response

The Coast Guard responded to the public comments by notice dated November 26, 2012.<sup>264</sup> In effect, that response has served as the last word with regard to the issues highlighted in the Trico Memorandum.

In that notice, the Coast Guard indicated that the “current paperless securities trading market” is “more complex than the system that existed when the Coast Guard issued its 1993 final rule.”<sup>265</sup> Noting the various compliance measures set forth in the comments, the Coast Guard indicated:

Companies that employ, and diligently administer and adhere to, measures such as those identified above in an active system of monitoring stock ownership may use these as a sufficient basis to file an Application for Initial Issue, Exchange, or Replacement of Certificate of Documentation . . . to document a vessel with a coastwise endorsement.<sup>266</sup>

The Coast Guard also indicated that “it will be realistic about acceptable measures in the current trading environment” and that, in any investigations, “the Coast Guard will give positive consideration to a company’s diligent and good faith efforts to timely and effectively monitor the ownership of its stock and take prompt action where necessary so as to maintain compliance with the statutory requirements.”<sup>267</sup> At the same time, the Coast Guard also indicated that if an investigation is commenced based on the receipt of evidence of noncompliance with citizenship requirements, “the burden will be upon the vessel owner to establish compliance.”<sup>268</sup>

## VI. PROPOSED COMPLIANCE IMPROVEMENTS

The Trico Memorandum made the preexisting difficulties facing public Jones Act companies seeking to comply with U.S. citizenship

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263. *American Petroleum Institute Comment, supra* note 254, at 7. It is noteworthy that a leading Jones Act shipowner with a dual stock certificate system nevertheless relied on Seg 100 to ascertain the citizenship of nonregistered shareholders. *See Overseas Shipholding Group, Inc., Comment*, REGULATIONS.GOV 2-3 (Mar. 29, 2012), <http://www.regulations.gov/#documentDetail;D=USCG-2011-0619-0007> (follow “PDF Attachment” link).

264. Mechanisms of Compliance with U.S. Citizenship Requirements for the Owner of Vessels, 77 Fed. Reg. 70,452 (Nov. 26, 2012) [hereinafter Mechanisms of Compliance].

265. *Id.* at 70,453.

266. *Id.*

267. *Id.*

268. *Id.*

requirements more difficult.<sup>269</sup> The Coast Guard's November 2012 response to the public reaction to the Trico Memorandum alleviated some of this difficulty<sup>270</sup>—but some of the preexisting difficulty remains. The Coast Guard should consider taking additional measures within the bounds of the existing law that would further alleviate the inherent difficulties facing Jones Act public companies seeking to comply with the law.

Access to public capital is essential to the Jones Act trade. This is a point agreed upon by all the commenters including each of the major trade associations that participated in the Trico Docket.<sup>271</sup> For example, the American Waterways Operators, a staunch defender of the Jones Act, indicated, “We believe strongly that companies of all sizes and structures have a place in the Jones Act trade, provided they abide by the U.S. citizen ownership requirements.”<sup>272</sup> The Coast Guard agreed, acknowledging “that it does not seek to unnecessarily restrict access to legitimate capital markets, which it recognizes to be essential to the maintenance of a strong and vibrant coastwise shipping industry.”<sup>273</sup>

Undoubtedly, the Coast Guard could do a number of things to help Jones Act companies access the capital markets and remain U.S. citizens.<sup>274</sup> Here, we focus on three actions the Coast Guard can take

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269. See Nancy L. Hengen, *Trico Marine and Jones Act Citizenship*, 80 J. TRANSP. L. LOGIST. & POL'Y 48, 57 (2013) (“The Trico Finding and subsequent public comments suggested increasing divergence between the reality of common practices in today’s public markets . . . and the assumptions underlying the early twentieth century Jones Act.”).

270. *Id.* at 55 (“[T]o its credit, in the [November 2012 *Federal Register* notice] the Coast Guard seems subsequently to have retreated from its initial Trico Decision hard line . . .”).

271. See, e.g., *American Petroleum Institute Comment*, *supra* note 254, at 5 (“[P]olicies that may drive publicly traded companies out of the Jones Act trade without taking into account other key national interests are clearly contrary to the overall energy and national security interests of the United States.”).

272. *American Waterways Operators Comment*, *supra* note 257, at 2.

273. Mechanisms of Compliance, 77 Fed. Reg. 70,452, 70,453 (Nov. 26, 2012).

274. The Coast Guard could, for example, formalize its view that the citizenship of the account holders in a widely held mutual fund can be irrelevant to the citizenship of that mutual fund. See Trico Memorandum, *supra* note 153, at 18. The Coast Guard could also reexamine its tracing rule to determine whether the statute or the intent of the law require imposing a vessel documentation eligibility requirement at each level of the chain of ownership. The result of this rule is the treatment of certain entities—particularly U.S.-based hedge funds—as noncitizens because of foreign organization even if the shares are controlled and owned 100% by U.S. citizens. The Coast Guard implied receptivity to such a reexamination in the Trico Memorandum where it indicated that the SEC “beneficial ownership” standard was consistent with Jones Act citizenship requirements. See *id.* at 16. The barrier to equating Jones Act citizenship and the SEC “beneficial ownership” standard is the principal requirement that shareholders be documentation citizens even if they are U.S. citizen owned and controlled.

without statutory change:<sup>275</sup> (1) adopt a shareholder address rule, (2) seek improvements in Seg 100 to make it an even more viable system of assessing the citizenship of ultimate beneficial owners, and (3) make provision for express approval of public company citizenship programs designed to ensure compliance with Jones Act citizenship requirements.

*A. Adopt a Shareholder Address Rule*

One simple change the Coast Guard can make is to adopt a shareholder address rule<sup>276</sup>—termed the “fair inference rule” by MARAD—which would provide additional comfort to public companies and would help achieve the goal of aligning Coast Guard and MARAD citizenship interpretations.<sup>277</sup> As already noted,<sup>278</sup> the MARAD fair inference rule arose in the context of the 1936 *Collier Advertising* decision.<sup>279</sup> MARAD adopted the concept;<sup>280</sup> the Coast Guard rejected it.<sup>281</sup> The Coast Guard should reconsider.

In its 1990-1993 vessel documentation rulemaking process, the Coast Guard indicated that the fair inference rule was unneeded. The Coast Guard’s reasoning was that the rule gave public companies no more comfort than the documentation presumption of regularity because it was only an “inference” and a public company could readily adopt a “dual stock certificate system” to protect itself in the event that the

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275. The fact that the beneficial ownership test was written in 1918 may be argument enough to reexamine whether it accomplishes its intended purpose in light of the public securities market and other changes that have occurred since then.

276. See Documentation of Vessels, Controlling Interest, 55 Fed. Reg. 51,244, 51,245 (Dec. 12, 1990); Documentation of Vessels, Recording of Instruments: Fees, 58 Fed. Reg. 60,256, 60,258 (Nov. 15, 1993).

277. This is certainly not a new idea. See, e.g., Documentation of Vessels, Controlling Interest, 55 Fed. Reg. at 51,245 (“Comments from members of the committee on marine financing of an association of maritime lawyers, and from a shipping company, suggested that the Coast Guard adopt the ‘fair inference’ test . . .”). It was also recommended in response to the Coast Guard’s November 2011 request for comments. See, e.g., *Notes of Meeting Held at Beacon Hotel, Washington, DC, September 13, 2012, Regarding Mechanisms of Compliance with United States Citizenship Requirements for the Ownership of Vessels Eligible To Engage in Restricted Trades by Publicly Traded Companies*, REGULATION.GOV 2 (Sept. 13, 2012), <http://www.regulations.gov/#!documentDetail;D=USCG-2011-0619-0012> (follow “PDF Attachment” link) (“MARAD and Coast Guard should align their positions about the fair inference rule.”).

278. See *supra* Part II.A.2.b.

279. See *Collier Adver. Serv., Inc. v. Hudson River Day Line*, 14 F. Supp. 335, 1936 AMC 206 (S.D.N.Y. 1936).

280. See Requirements for Establishing U.S. Citizenship, 25 Fed. Reg. 5293, 5294 (June 14, 1960).

281. See Documentation of Vessels, Controlling Interest, 55 Fed. Reg. at 51,245; Documentation of Vessels, Recording of Instruments: Fees, 58 Fed. Reg. at 60,258.

documentation presumption was overcome.<sup>282</sup> The record no longer supports this reasoning.<sup>283</sup>

As indicated by the public comments in the Trico Docket, a “dual stock certificate” system does not work as the sole proof of citizenship in today’s public securities market.<sup>284</sup> Very few shares are registered directly with the issuer’s transfer agent. Dividing that small subset into citizens and noncitizens for the purpose of issuing “citizen” and “non-citizen” stock certificates is not a meaningful exercise. Such division leaves unanswered the question as to how to treat the citizenship of Cede & Co., which will almost always be the largest registered shareholder.<sup>285</sup> In the words of the American Waterways Operators and the American Petroleum Institute, respectively, “dual stock registries are of limited value to public companies because they are limited to registered stockholders”<sup>286</sup> and “[i]n reality, a dual stock system is not practical in the case of publicly traded companies.”<sup>287</sup> So, focusing attention on a dual stock remedy simply leads the analysis back to the issues of how to square Jones Act citizenship law with the realities of the public securities marketplace—in other words, not to the easy solution to the 75% compliance problem as portrayed by the Coast Guard in its dismissal of the fair inference rule.

That term—“fair inference rule”—also does not fully capture its role in proving citizenship. The fair inference rule can be more than a presumption—it can generate positive proof of citizenship. As first advanced in *Collier Advertising*, shareholder addresses were “proof” that “sufficed to show that the mortgagee was a citizen of the United States.”<sup>288</sup> And as interpreted by MARAD, addresses are provided “in order to prove U.S. citizen ownership in the required percentages” for a controlling interest or 75% interest as the case may be.<sup>289</sup> Indeed, the

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282. See Documentation of Vessels, Controlling Interest, 55 Fed. Reg. at 51,245; Documentation of Vessels, Recording of Instruments: Fees, 58 Fed. Reg. at 60,258.

283. See Carol Wolf, *Shipping Companies Quizzed on U.S. Ownership Law*, BLOOMBERG (Nov. 7, 2011), <http://www.bloomberg.com/news/articles/2011-11-07/shipping-companies-quizzed-on-u-s-ownership-law-called-obsolete> (“‘The Coast Guard’s understanding of what takes place is based on a stock transfer system that no longer exists,’ Cox said. ‘The stock market has changed a lot since this rule was made.’” (quoting Joseph J. Cox, President, Chamber of Shipping of America)).

284. See, e.g., *American Waterways Operators Comment*, *supra* note 257, at 8.

285. See *supra* Part III.A.

286. *American Waterways Operators Comment*, *supra* note 257, at 8.

287. *American Petroleum Institute Comment*, *supra* note 254, at 5; see also *Chamber of Shipping of America Comment*, *supra* note 258, at 9 (stating that a dual stock registry is of “very limited value to public companies because it is limited to registered stockholders”).

288. 14 F. Supp. 335, 339, 1939 AMC 206, 212 (S.D.N.Y. 1936).

289. 46 C.F.R. § 355.3 (emphasis added).

MARAD citizenship affidavit circa 1960 expressly reserved to MARAD the right to reject the “inference,” an express reservation that no longer appears in the form of affidavit in MARAD’s regulations.<sup>290</sup>

The Coast Guard also appeared concerned that it would be bound by shareholder address proof despite contrary evidence.<sup>291</sup> That is not the way that MARAD has interpreted the rule despite the removal of the express reservation in the regulations. Despite the general acceptance by MARAD of shareholder addresses, MARAD has not hesitated in a variety of situations to reject similar evidence and find that a person is effectively under the control of noncitizens.<sup>292</sup> Moreover, the MARAD affidavit form is a modified *Collier Advertising* rule—it requires proof of citizenship for each beneficial owner holding 5% or more of a class of shares of the issuer.<sup>293</sup> The Coast Guard can just as readily preserve its discretion while according weight to shareholder addresses.

The Coast Guard should also take comfort in the acceptance by the Federal Communications Commission (FCC) of mailing address proof in its oversight of similar citizenship requirements.<sup>294</sup> Historically, the FCC in certain circumstances would only accept a survey of all shareholders or a “statistically valid sampling” of shareholders as proof of compliance.<sup>295</sup> In the last ten years, the FCC has accepted an analysis or sampling of the addresses of the beneficial owners of companies in a number of cases.<sup>296</sup>

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290. See Requirements for Establishing U.S. Citizenship, 25 Fed. Reg. 5293, 5294 (June 14, 1960). MARAD also considered relaxing the required percentage of U.S. addresses (currently set at 95% to prove 75% U.S. ownership) but rejected that idea in 1985. See Requirements for Establishing U.S. Citizenship, 50 Fed. Reg. 29,440 (July 19, 1985).

291. See Documentation of Vessels; Controlling Interest, 55 Fed. Reg. 51,244, 51,245 (Dec. 12, 1990).

292. See, e.g., *Action of the Maritime Administration re Argent Marine I-III, Inc.—Sale of LNG Vessels*, 25 SHIPPING REG. REP. 789, 800 (1990); *Maritime Administration Letter to Lykes Bros. Steamship Co., Inc.—Asset Purchase Agreement*, 27 SHIPPING REG. REP. 1094 (June 20, 1997).

293. 46 C.F.R. § 355.2.

294. A similar 75% beneficial ownership requirement applies to certain FCC licensees. See 47 U.S.C. § 310(b)(4) (2012). The FCC has apparently considered the utility of shareholder addresses since at least 1974. See Memorandum from Chief, Research Branch, FCC, to Chief, Renewal & Transfer Div., FCC (June 25, 1974) (on file with author).

295. Christina H. Burrow, J.G. Harrington, John C. Jost & John S. Logan, *Foreign Investment in the United States Communications Industry*, in 2 MANUAL OF FOREIGN INVESTMENT IN THE UNITED STATES, *supra* note 17, § 15.12 n.9.

296. *Id.* § 15.12 (“The FCC now has permitted some version of the Verizon Wireless survey of shareholder addresses to be used by a number of other applicants owned by entities with widely held stock.”). With respect to broadcast licenses (versus nonbroadcast licenses), the FCC has required a greater showing of citizenship than merely shareholder addresses, namely the same measures presented to the Coast Guard in the Trico proceeding (including participation in Seg 100, review of Williams Act reports, and changes in articles and bylaws). See *Pandora Radio*

For example, the FCC accepted address proof in 2008 with respect to Cellco Partnership (d/b/a Verizon Wireless) as being reasonable evidence because the affected companies were “widely held, publicly traded companies with a very large number of issued and outstanding shares.”<sup>297</sup> The FCC indicated that “it would be difficult and costly, even using a survey methodology, for Vodafone and Verizon to determine the citizenship or principal place of business of their beneficial owners, other than using the beneficial owner’s address of record.”<sup>298</sup>

The difficulties in assessing the citizenship of beneficial owners of publicly traded securities have become even more evident as a result of the Trico Memorandum and the Trico Docket than they were before. The Coast Guard has indicated a willingness to evaluate the process of establishing citizenship.<sup>299</sup> That willingness should extend to giving analyses or surveys of shareholder addresses the same weight given by MARAD to such evidence.<sup>300</sup> The commercial market already makes geographic or address analyses or surveys available for a fee. The two agencies should work together to examine the available methods of assessing shareholder addresses and provide guidance to the industry as to an approved method or methods.<sup>301</sup>

There are not many practical tools available to assist public companies in ascertaining the citizenship of their ultimate owners given the nature of the public market for securities and the current Jones Act statute and regulations. An analysis of shareholder addresses is one of those few tools and therefore merits a second look by the Coast Guard.

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*LLC*, FED. COMM. COMMISSION 8-9 (May 4, 2015), [http://transition.fcc.gov/Daily\\_Releases/Daily\\_Business/2015db0504/FCC-15-52A1.pdf](http://transition.fcc.gov/Daily_Releases/Daily_Business/2015db0504/FCC-15-52A1.pdf).

297. *In re Applications of Cellco P’Ship*, 23 F.C.C. Rcd. 12,463, 12,525 (2008).

298. *Id.* at 12,525-26. The method used was as follows: “With respect to Verizon shares held through brokerage accounts (i.e. in ‘street name’), Verizon obtained from Broadridge Financial Solutions, Inc. (Broadridge) aggregate information regarding the beneficial owner’s address of record.” *Id.* at 12,525.

299. *See Mechanism of Compliance*, 77 Fed. Reg. 70,452, 70,453 (Nov. 26, 2012) (“The Coast Guard will continue to listen to industry and the public . . . . We anticipate refining our enforcement policy . . .”).

300. Broadridge makes shareholder address analyses, termed a “geographic survey,” readily available to public companies. *Corporate Issuer Services 2014*, *supra* note 172, at 34. Nasdaq Corporation Solutions Global Tax and Regulatory Services also provides a range of sampling, survey, and other shareholding address and identification services. *Special Situation & Transactional Analysis*, NASDAQ, <http://business.nasdaq.com/intel/ir-management/advisory-services/special-situations-and-transactional-analysis/index.html> (last visited May 11, 2015).

301. The MARAD interpretation of the shareholder address rule also bears reexamination because it focuses on the “registered addresses” of the “owners of record . . . shown on the stock books and records of the Corporation.” *See* 46 C.F.R. § 355.2 (2013).

*B. Improve the DTC Segregation Account 100 System*

Another practical tool developed to deal with the separation of issuers from their beneficial owners is Seg 100.<sup>302</sup> That system was expressly developed by DTC in 1988 to permit companies—including Jones Act companies in particular—to participate fully in the public securities markets despite the inability of issuers to connect directly with beneficial owners.<sup>303</sup> Maligned by the Coast Guard in the Trico Memorandum,<sup>304</sup> Seg 100 nevertheless operates on a sound principle of shifting some of the citizenship identification burden to those persons—DTC participants—who are in direct contact with the ultimate beneficial owners.<sup>305</sup> MARAD and the Coast Guard should look at ways to improve Seg 100 so that it can provide even more accurate citizenship information than it provides today.

The Coast Guard criticized Seg 100 in the Trico Memorandum because it involved a delegation of “Jones Act compliance responsibilities to DTC” and because DTC did not stand behind Seg 100 information.<sup>306</sup> Others have made similar observations.<sup>307</sup>

The delegation criticism does not take into account that some delegation by a company issuing to the public is unavoidable and has been common for decades. Stock-issuing companies almost universally rely on stock transfer agents and registrars and intermediaries such as securities depositories, banks, and brokerage houses, which in turn rely

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302. Seg 100 has been cited in at least several instances to the SEC by issuers seeking regulatory approvals as the appropriate method for monitoring the citizenship of shares held in “street name.” See Letter from Skadden, Arps, Slate, Meagher & Flom LLP, *supra* note 209, at 14; Letter from Kirkland & Ellis LLP, *supra* note 209, at 2-3; Letter from Cravath, Swaine & Moore LLP, *supra* note 209, at 10-11. The FCC has also endorsed Seg 100. See *Pandora Radio LLC*, *supra* note 296, at 9.

303. See *Notice B# 4335-88*, *supra* note 206; Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by Depository Trust Company, 53 Fed. Reg. 30,893 (Aug. 16, 1988); see also *supra* Part IV.C.

304. Trico Memorandum, *supra* note 153, at 18-19.

305. See *American Petroleum Institute Comment*, *supra* note 254, at 7 (“In API’s view, however, the Seg-100 program is the only mechanism within the DTC trading system that potentially could be used to enforce compliance with U.S. citizen ownership requirements.”).

306. Trico Memorandum, *supra* note 153, at 18-19. The Coast Guard implied in its November 2012 guidance that Seg 100 is an acceptable due diligence measure. See *Mechanisms of Compliance*, 77 Fed. Reg. 70,452, 70,453 (Nov. 26, 2012) (“Companies that employ, and diligently administer and adhere to, measures *such as those identified above . . .*” (emphasis added)).

307. See, e.g., *American Petroleum Institute Comment*, *supra* note 254, at 7; *Baldwin, Haspel, Burke & Mayer LLC Comment*, REGULATIONS.GOV 8 (Mar. 30, 2012), <http://www.regulations.gov/#:documentDetail;D=USCG-2011-0619-0009> (follow “PDF Attachment” link).

on agents such as Broadridge for certain functions.<sup>308</sup> In order to avoid having to rely on any agents, a company would only be able to issue shares to persons it knows and registers on its own books, and it would have to supervise directly all trades and settlements. That is contrary to customary U.S. corporate practice and not practically achievable in today's public securities markets. In other words, a prohibition against reliance on third parties is the same as prohibiting public companies from qualifying as Jones Act citizens.

It also has been argued that Seg 100 puts "brokers and banks in the impossible position of judging the citizenship" of their customers.<sup>309</sup> It is certainly true that the Jones Act does not readily apply in the current investment markets. Clarifications from the U.S. Congress and the Coast Guard could assist in making citizenship judgments.<sup>310</sup> However, in the meantime, public companies must comply with the citizenship law as it exists today. That law can only be applied by the persons who have the most direct contact with the ultimate beneficial shareholders under the current DTC system, and those persons are DTC participants, whether such application is difficult or not.

The Coast Guard also does not appear to have understood that the contractual arrangements involved in Seg 100 are serious and substantial.<sup>311</sup> Each DTC participant is bound to the DTC Seg 100 guidance by the DTC organizational documents if they want to participate in the trading of a restricted security.<sup>312</sup> DTC has also indicated that any participant that fails to comply with the measures "will result in notification by DTC to the Participant's Regulator, and may also result in DTC imposing certain disciplinary sanctions, including fines, and/or operational limitations."<sup>313</sup>

Finally, Seg 100 has been criticized because it works to provide information and a remedy after the fact in that trades might occur that

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308. See *Report on Industry Efforts to Improve the U.S. Proxy Voting System*, SEC. TRANSFER ASS'N 3-4 (Sept. 23, 2014), <http://www.stai.org/pdfs/sta-report-on-us-proxy-voting-system-9-23-2014.pdf>.

309. See Daniel Michaeli, *Foreign Investment Restrictions in Coastwise Shipping: A Maritime Mess*, 89 N.Y.U.L. REV. 1047, 1070 (2014).

310. The Coast Guard resisted providing more definitive guidance both when it promulgated its current regulations in 1993 and in the Trico process in response to Trico's questions. See *American Petroleum Institute Comment*, *supra* note 254, at 5.

311. See *Overseas Shipholding Group, Inc., Comment*, *supra* note 263, at 3 ("If a DTC participant does not comply with DTC's notice of reversal, DTC may impose specified disciplinary sanctions including fines and/or operational limitations.").

312. *About Deposits*, *supra* note 213. DTC participants are bound by such guidance. See *Rules, By-Laws and Organization Certificate of the Depository Trust Company*, *supra* note 212, r. 27.

313. *Notice B# 3487-08*, *supra* note 215.

have to be reversed.<sup>314</sup> This impact can be significantly ameliorated by setting a permitted percentage for noncitizen ownership with a cushion, as some public Jones Act companies have done.<sup>315</sup> When the noncitizen ownership percentage is set below 25%, the reversal of trades can occur without noncitizens owning more than 25% at any point in time. Moreover, the Coast Guard did not show any inclination in the Trico investigation to impose a continuous beneficial ownership requirement. Instead, the Coast Guard focused on quarterly “snap shot” assessments of citizenship.<sup>316</sup>

The essential drawback that caused the Coast Guard discomfort, namely reliance by the issuer on third parties, is unavoidable for an issuer wanting to participate fully in today’s public securities markets. However, that does not mean that Seg 100 cannot be improved to increase confidence in DTC participants’ citizenship judgments and to give participants better guidance than they have now.<sup>317</sup> DTC’s organizational documents may point the way.

DTC already imposes a “compliance with laws” obligation on the part of DTC participants.<sup>318</sup> In particular, it imposes a special requirement with regard to compliance with economic sanctions administered by the U.S. Department of Treasury, Office of Foreign Assets Control (OFAC). DTC participants “are required to periodically confirm that the Participant . . . has implemented a risk-based program reasonably designed to comply with applicable OFAC sanctions regulations.”<sup>319</sup> That program must indicate how the DTC participant screens customers to ensure that such parties are not on any OFAC proscribed list and is premised on the fact that the DTC participant “has the primary relationship with the customers for whom it is conducting activity through DTC.”<sup>320</sup>

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314. See Michaeli, *supra* note 309, at 1069-70.

315. See, e.g., Cert. of Incorporation of Hercules Offshore, Inc., Div. B(h)(viii) (Dec. 26, 2006) (defined as 5% less than the percentage required to maintain citizenship). The criticism can also be muted by the issuer obtaining daily Seg 100 reports, as at least one issuer has done. *Overseas Shipholding Group, Inc., Comment, supra* note 263, at 2.

316. Trico Memorandum, *supra* note 153, at 4. Moreover, the Coast Guard has discretion not to impose penalties for technical violations as discussed *infra* Part VI.C.

317. There are no offerings in the Trico Docket for improving Seg 100.

318. *Rules, By-Laws and Organization Certificate of the Depository Trust Company, supra* note 212, r. 2, § 8.

319. *Id.*

320. *Important Notice to All Participants Regarding Confirmation of an OFAC Program Using the Self-Service Customer Confirmation Portal*, DEPOSITORY TR. & CLEARING CORP. (June 24, 2013), <http://www.dtcc.com/~media/Files/pdf/2013/6/24/1056-13.pdf>.

An analogous approach can be taken with citizenship compliance. DTC could require DTC participants to certify regularly and directly to the relevant issuer that they have a program, risk-based or otherwise, that is “reasonably designed to” identify persons who do not qualify as Jones Act citizens. DTC could require that such certification be subject to the issuer’s approval.

To assist in this regard, MARAD and the Coast Guard should consider a joint effort with DTC to establish a model program with practical steps for differentiating Jones Act citizens from noncitizens that DTC might endorse and DTC participants could adopt. DTC rules are subject to SEC approval and public comment pursuant to section 19(b) of the Securities Exchange Act of 1934.<sup>321</sup> A draft model program could be made the subject of an open process to ensure that the affected public has an opportunity to comment. Questionnaires tailored to differentiate citizens from noncitizens, which Jones Act companies have already utilized in the context of the issuance of shares upon the conclusion of a bankruptcy, could serve as the starting point for such a program.<sup>322</sup>

By all appearances, DTC developed Seg 100 without input from the Coast Guard or the maritime community.<sup>323</sup> Nor, apparently, did anyone advise MARAD or the Coast Guard about Seg 100 in the early 1990s when each agency rewrote their citizenship related regulations.<sup>324</sup> Thus, Seg 100, and the maritime citizenship agencies’ views of it, were developed without coordination. Each agency now has the opportunity

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321. See 15 U.S.C. § 78s(b)(1) (2012); 17 C.F.R. § 240.19b-4 (2013).

322. See, e.g., Horizon Lines, Inc., *U.S. Citizenship Questionnaire*, SEC, [http://media.corporate-ir.net/media\\_files/IROL/18/188937/Horizon%20Lines%20US%20Citizenship%20Questionnaire.pdf](http://media.corporate-ir.net/media_files/IROL/18/188937/Horizon%20Lines%20US%20Citizenship%20Questionnaire.pdf) (last visited Apr. 15, 2015). Such questionnaires usually provide an issuer contact point for questions. A similar mechanism could also provide a connection between DTC participants and the issuer.

323. No public comments were submitted to the SEC Seg 100 notices issued between 1988 and 1991. See Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by Depository Trust Company, 53 Fed. Reg. 30,893 (Aug. 16, 1989); Self-Regulatory Organizations; The Depository Trust Company; Notice of a Proposed Rule Change Relating to Expanded Use of the Seg-100 Account, Exchange Act Release No. 34-29296, 49 SEC Docket 28 (June 19, 1991); Self-Regulatory Organizations; The Depository Trust Company; Order Approving a Proposed Rule Change Relating to Expanded Use of the Seg 100 Account, Exchange Act Release No. 34-29481, 49 SEC Docket 652 (July 24, 1991). The lack of communication is evident in the notices DTC provides to participants regarding new listings of restricted maritime securities, which reference MARAD citizenship regulations but not Coast Guard citizenship regulations. See, e.g., *Important Notice to All Participants Regarding GulfMark Offshore, Inc.*, DEPOSITORY TR. & CLEARING CORP. (Feb. 25, 2010), <http://www.dtcc.com/~media/Files/pdf/2010/2/25/6259-10.pdf> 1822.

324. Seg 100 is not referenced in either agency’s regulatory explanations even though public company citizenship was mentioned. See, e.g., *Documentation of Vessels; Controlling Interest*, 55 Fed. Reg. 51,244, 51,245 (Dec. 12, 1990).

to fill that vacuum and take action to improve Seg 100 and provide public Jones Act companies an even more useful compliance tool than they have today.

*C. Approve Citizenship Compliance Programs*

In its November 2012 guidance, the Coast Guard took positive steps by acknowledging practical compliance measures adopted by public Jones Act companies, stating that it would be “realistic about acceptable measures in the current trading environment.”<sup>325</sup> The Coast Guard also indicated that companies that “employ . . . and diligently administer and adhere to” existing compliance measures would have sufficient basis to execute an application to document a vessel, which is subject to the False Statements Act.<sup>326</sup> Finally, the Coast Guard indicated that in investigations of potential citizenship violations that it would “give positive consideration to a company’s diligent and good faith efforts” to comply with the law.<sup>327</sup>

Although these steps were positive, more can be done. The Coast Guard could expressly approve individual company compliance programs and provide express benefits from having such a program, including reduced or eliminated potential penalties and providing a compliance grace period to persons with approved plans.

In its November 2012 release, the Coast Guard has all but defined a menu of available public-company-citizenship-compliance measures reviewed above: regularly review Williams Act, NOBO, and registered shareholder lists; participate in Seg 100; adopt formation document protective measures; and use a dual stock registry.<sup>328</sup> Commenters also suggested other potential measures, such as shareholder sampling and reliance on shareholder addresses.

The Coast Guard should establish a process whereby public companies could voluntarily present to the Coast Guard their particular citizenship compliance programs for review and approval. Once approved, a plan would provide the company certain protections in the event that it was discovered that a noncitizen had acquired more than 25% of the company’s stock. Such a plan submission and approval process could be similar to the MARAD process of requiring and reviewing annual citizenship affidavits for participation in its citizenship-

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325. 77 Fed. Reg. 70,452, 70,453 (Nov. 26, 2012).

326. *Id.*

327. *Id.*

328. *Id.* The Federal Communications Commission endorsed a very similar list of compliance measures on May 4, 2015. *Pandora Radio LLC*, *supra* note 296, at 9.

restricted programs.<sup>329</sup> The difference would be that the Coast Guard would be reviewing and approving compliance plans, not plan-generated citizenship facts that are arrayed in a citizenship affidavit.

In such a process, the Coast Guard could proceed on an ad hoc basis. As the Coast Guard recognized in its November 2012 release, each company is different, and it should not mandate “a one-size-fits-all structure or mechanism to ensure compliance.”<sup>330</sup> And, as pointed out in the Trico Docket comments, companies’ circumstances vary significantly.<sup>331</sup> For example, a company with a very large capitalization and millions of shareholders may have a different citizenship risk profile than a small public company with several hundred shareholders.

The Coast Guard could also preserve the ability of companies to adopt their own unique compliance plan but still develop a model compliance plan for companies to use as a guide. Model compliance plans have been used in other contexts to assist industry segments and provide regularity and uniformity among affected companies.<sup>332</sup> There is, for example, considerable variation in company formation documents as to appropriate Jones Act citizenship protective measures. Consolidation and streamlining of those measures could also potentially minimize investor confusion by making the measures more straightforward and less duplicative than they currently tend to be. A model compliance program should also give public companies confidence that their measures are appropriate.<sup>333</sup>

Compliance programs in other regulatory contexts provide the distinct benefit to the company of being heavily taken into account if a violation is alleged.<sup>334</sup> The federal organizational Sentencing Guidelines, for example, provide that an effective compliance program in the criminal context should weigh against prosecution and in favor of a reduced sentence.<sup>335</sup> A Coast Guard public company citizenship compliance program should have similar benefits.

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329. See 46 C.F.R. pt. 355 (2013).

330. 77 Fed. Reg. at 70,453.

331. See *Chamber of Shipping of America Comment*, *supra* note 258, at 3.

332. See, e.g., Health Insurance Reform: Standards for Electric Transactions; Announcement of Availability of a Model Compliance Plan, 67 Fed. Reg. 18,216 (Apr. 15, 2002) (adopting a model compliance plan relating to electronic health care transactions).

333. See *supra* Part IV.B.

334. See, e.g., Dan K. Webb & Steven F. Molo, *Some Practical Considerations in Developing Effective Compliance Programs: A Framework for Meeting the Requirements of the Sentencing Guidelines*, 71 WASH. U. L. Q. 375, 377-79 (1993).

335. See *2013 USSC Guidelines Manual*, U.S. SENTENCING COMM’N ch. 8 (2013), <http://www.ussc.gov/training/organizational-guidelines/2013-ussc-guidelines-manual>.

The Coast Guard has the authority to adopt a policy that sets forth what it will do in certain violation situations under its broad Jones Act penalty authority. In its November 2012 Trico-related guidance, the Coast Guard indicated that it was issuing notice as to “how the Coast Guard plans to exercise its discretion in enforcing the referenced U.S. citizen ownership requirement.”<sup>336</sup> That discretion extends to individual situations as indicated in the Trico investigation itself, where the penalties assessed, although severe, were not as great as the law permitted and did not include withdrawing the vessels’ coastwise trading privileges.<sup>337</sup>

The Coast Guard could publish a policy whereby a company acting in conformity with an approved compliance plan would either not be penalized or penalized to a minimum extent. It would remain up to the public company to comply with its approved program, and the Coast Guard could reserve its rights to take action if there was not good faith compliance. This is what occurs in other federal regulatory compliance program contexts.<sup>338</sup>

Moreover, such a policy should grant a public company a grace period in which to come back into compliance if it is discovered that noncitizens have acquired more than 25% of the stock of the company. A public company compliance program, although adopted in good faith and approved by the Coast Guard, might not discover that a noncitizen has acquired more than a 25% interest until after the fact. Companies with approved compliance plans should be accorded an express grace period in which to come back into compliance without affecting the trading privileges of affected vessels.

The Coast Guard has authority to provide such a grace period. Although the Jones Act does not have a *de minimis* exception or an express mechanism for overlooking temporary violations while the vessels continue in the U.S. coastwise trade, the Coast Guard has

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336. 77 Fed. Reg. 70,452, 70,452 (Nov. 26, 2012).

337. The Trico Memorandum recommended that the Trico vessels’ certificates of documentation be cancelled and that criminal proceedings be considered—neither recommendation was adopted. Memorandum from Kevin S. Cook to National Vessel Documentation Center, *supra* note 227. The Trico Memorandum also recommended that a civil penalty of \$1,000 per day be assessed even though the statute permitted \$10,000 per day—and that it be assessed on a per-vessel rather than per-owner basis, which was also a matter of Coast Guard discretion. Trico Memorandum, *supra* note 153, at 21-22.

338. For example, the U.S. Coast Guard reserves its rights if there are recurring violations or imminent harm in its Maritime Law Enforcement Manual. *U.S. Coast Guard Maritime Law Enforcement Manual: Appendix V: Environmental Crimes: Voluntary Disclosure Policy*, U.S. COAST GUARD, <http://www.uscg.mil/foia/docs/CH-4%20Appendix%20V.pdf> (last visited Apr. 16, 2015).

authority not to penalize such temporary violations.<sup>339</sup> The Coast Guard implicitly acknowledged this discretion in the Trico decision by requiring citizenship proof on a quarterly rather than continuous basis and by not withdrawing the trading privileges of the vessels despite the violations.<sup>340</sup>

Analogous support is also available in the way other federal agencies deal with similar issues. U.S. Customs and Border Protection, for example, has penalty mitigation guidelines where certain Jones Act violations are not penalized at all.<sup>341</sup> The U.S. Department of Transportation works with airlines, which may find that they have too much foreign citizen ownership without grounding their planes, “as long as the airline is making a good faith effort to bring its management and financial structure into conformity with the law.”<sup>342</sup>

The Coast Guard’s last guidance has all but provided a road map for public companies to follow to maintain good faith compliance with Jones Act citizenship requirements. With a few additional steps, the Coast Guard can further improve the situation and provide public companies with the guidance and comfort that they deserve.

## VII. CONCLUSION

Public company participation in the Jones Act is essential. Since Jones Act citizenship standards are stringent and appear to be inviolate, and public securities markets make compliance by Jones Act companies difficult, the only path that permits public company participation in the Jones Act is to adopt practical measures that help public companies comply with Jones Act citizenship requirements. Although the Coast Guard has taken positive steps following the Trico Memorandum to assist public companies with citizenship compliance, more can be done in terms of adopting a shareholder address rule, improving the DTC Segregation Account 100 System, and in expressly approving public company citizenship compliance plans.

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339. See *Mitigation Guidelines: Fines, Penalties, Forfeitures and Liquidated Damages*, U.S. CUSTOMS & BORDER PROTECTION 184 (Feb. 2004), [http://www.cbp.gov/sites/default/files/documents/icp069\\_3.pdf](http://www.cbp.gov/sites/default/files/documents/icp069_3.pdf) (interpreting the Jones Act penalty provision as providing for a “penalty up to the domestic value of the merchandise”).

340. Trico Memorandum, *supra* note 153, at 4.

341. See *Mitigation Guidelines: Fines, Penalties, Forfeitures and Liquidated Damages*, *supra* note 339, at 184 (assessing the penalty but mitigating it in full if the violation occurred “due to some humanitarian concern, e.g. disembarkation of a crew member because of a life threatening injury or illness”).

342. See *Airline Competition: Impact of Changing Foreign Investment and Control Limits on U.S. Airlines*, U.S. GEN. ACCOUNTABILITY OFF. 22 (Dec. 1992), <http://www.gao.gov/assets/160/152884.pdf>.