## Note

# Ownership and Control: A Red Herring in the Decline of the Merchant Marine

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ABSTRACT

The United States Maritime Strategy, promulgated by Congress, states that the American Merchant Marine must be sufficient to carry our foreign commerce, and capable of serving as a naval auxiliary. It further states that the government should foster its development and encourage its maintenance for those purposes. Nevertheless, this strategy has not been supported by policy for decades, and the American merchant fleet has dwindled to the point that the executive branch has called it "the greatest threat to the country's strategic well-being."[1]

Extensive literature has debated the role of foreign ownership and control over American shipping and aviation assets, and whether changes to the governing laws could improve the economy without damaging national security. This article argues, however, that any such discussion in the maritime domain is premature so long as there remains such a profound discrepancy between the purported strategy for the merchant

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1. Prepared Remarks of Paul "Chip" Jaenichen, Acting Mar. Adm'r, Nat'l Mar. Strategy Symposium (Jan. 14, 2014), https://www.marad.dot.gov/wp-content/uploads/pdf/NMSS_011414_Jaenichen_NMS_Symposium_Opening_FINAL.pdf.



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marine and its actual capabilities. Regulation of foreign ownership and control must be consistent with a coherent, articulated, and observed strategy for the merchant marine.

The history of the merchant marine suggests that Congress's vision for it perhaps more ambitious than necessary. That history demonstrates a common cycle: expensive American regulation drives up costs and leads to the flight of U.S. shipping, military and political leaders decry the state of the merchant marine, the U.S. suffers from inadequate merchant shipping at the outbreak of a conflict, the U.S. buys up foreign shipping and ramps up production sufficient to prevail in the conflict, the shipping is demobilized following the conflict, and the cycle repeats.

A comparison of ownership and control requirements in the aviation and maritime contexts demonstrates the lack of consistent vision in the purposes of these requirements. The Department of Transportation regulates proposed foreign investments, even where the airlines involved serve no formal national security function. The DOT rigorously enforces domestic ownership requirements, often barring investments where explicit requirements are met but the deal raises the possibility of a modicum of foreign influence. By contrast, the domestic U.S. ownership requirements of the domestic maritime fleet are largely self-policed, and the international U.S. maritime fleet – which is directly subsidized for national defense – has been allowed to become almost entirely foreign-owned.

In order to craft the most effective approach to foreign ownership and control, Congress must determine whether to pursue policies sufficient to return the American merchant marine to world leadership, or develop a new maritime strategy consistent with the present reality. This article argues for the latter, proposing specifically that national policy should be (1) to ensure a minimum baseline of fully-controlled sealift access, (2) to promote indirect access to vessels for surge, (3) to cultivate expertise that can be scaled, and (4) to promote an international system that is conducive to American competitiveness.

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## I. Introduction

The United States Maritime Objectives and Policy dictates that the American merchant marine must be sufficient to carry our foreign commerce, and capable of serving as a naval auxiliary, and that the government should foster its development and encourage its maintenance for those purposes.[2] The United States, however, has utterly failed to do so. As of 2016, as the result of what one scholar calls an "abandon ship" policy,[3] the number of U.S.-flagged ships engaged in international trade has slipped to 78,[4] carrying less than 2% of seaborne trade.[5] The 78 ships active in international trade are a decline from 106 five years ago, largely as a result of the cutback in foreign aid and war cargoes after the drawdown in the Middle East.[6] The nation's Maritime Administrator has called the state of the merchant marine "the greatest threat to our country's strategic well-being."[7] That is because, as the revered naval strategist Alfred T. Mahan recognized, a strong merchant fleet permits a nation to carry out commerce at all times, and project power broadly.[8] In that vein, the commander of U.S. Transportation Command (TRANSCOM) has stressed the need for U.S. ships with U.S. mariners to support American military operations when needed,[9] while congressional leaders have emphasized the need to control the oceans in light of the large and grow-

2. 46 U.S.C. § 50101 (2017).

3. Patrick Bratton & Carl Schuster, "Sea Strangulation": How the United States Has Become Vulnerable to Chinese Maritime Coercion (2015).

4. Sashi Kumar, *U.S. Merchant Marine & World Maritime Review*, 142 (5) Proceedings Mag. 1359 (2016); *Logistics and Sealift Force Requirements: Hearing Before the H. Comm. on Armed Serv.*, 114th Cong. 3 (2016) (statement of Paul N. Jaenichen, Maritime Administrator, U.S. Dep't Transp.).

5. Bratton & Schuster, *supra* note 3.

6. Kumar, *supra* note 4.

7. Jaenichen, *supra* note 1.

8. *See generally* Alfred T. Mahan, The Influence of Seapower Upon History: 1660-1783 (Little, Brown & Co., 12th ed. 1890).

9. *Seagoing Maritime Labor Testifies on How Federal Programs and Policies Can Strengthen U.S.-Flag Merchant Marine*, West Coast Sailors (Apr. 22, 2013), http://www.sailors.org/sites/default/files/newsletter/pdf/wcs_april_2016.pdf.

ing fleets of rising maritime powers such as China.[10]

In discussions about the legal framework in which the merchant marine operates, one question that has been much debated is that of foreign ownership and control.[11] That is, whether foreign investors should be permitted to own and exercise control over American merchant vessels, the extent of that ownership and control if so, and, once those issues are decided, how American authorities should evaluate compliance. However, that discussion is premature in the absence of a coherent strategy for the merchant marine. This comment will begin to elaborate that by reviewing the history of the merchant marine and its present state. I will then review the ownership and control requirement by comparing its application in the aviation, domestic maritime, and international maritime contexts. I will also consider the impact of other relevant law such as that of requisition, neutrality and expropriation. I will then suggest options to modernize merchant marine policy. Finally, I will conclude by arguing that ownership and control is ultimately a peripheral matter, which cannot be effectively addressed without a more decisive maritime strategy.

## II. A History of the Merchant Marine

### A. Evolution of the Merchant Marine

The government has made efforts to support the American merchant marine since the inception of our republic. In 1789, one of the first acts of Congress was to effect a 10% reduction in tariffs for U.S. flag vessels in international trade.[12] As a result, U.S. flagged shipping expanded rapidly, from 23% of American imports and exports in 1789 to nearly 90% by 1800.[13] Cabotage was enacted in 1817.[14] The American merchant marine was expansive until the Civil War, when ship-owners fled southern raiders and, consequently, the U.S. flag in pursuit of the protection of a neutral flag.[15] After the Civil War, anger at this "whitewashing" led the country to forbid these owners to reflag in the United States, leaving a

10. Duncan Hunter, Congressman, Nat'l Mar. Strategy Symposium (Jan. 14, 2014) (transcript available at https://www.marad.dot.gov/search/Nationalāritime‡ay/page/3/).

11. *See, e.g.*, Daniel Michaeli, *Foreign Investment Restrictions in Coastwise Shipping: A Maritime Mess*, 89 N.Y.U. L. Rev. 1047 (2014); Katherine Wiarda, *The Problem's in the Proof: How Public Companies Can Prove Compliance with the Jones Act Vessel Citizenship Requirements for Eligibility in U.S. Coastwise Trade*, 39 Tul. Mar. L.J. 337 (2014); Constantine G. Papavizas, *Public Company Jones Act Citizenship*, 39 Tul. Mar. L.J. 383 (2015).

12. Christopher J. McMahon, *The U.S. Merch. Marine: Back to the Future?*, Naval War C. Rev., Winter 2016, at 88.

13. *Id.*

14. *Id.*

15. *See* Andrew Gibson & Arthur Donovan, The Abandoned Ocean: A History of United States Maritime Policy 73 (rev. ed. 2001).

paltry fleet.[16] An 1882 article in *Proceedings* magazine, a publication of the U.S. Naval Institute, lamented: "That our merchant marine had declined is notorious."[17] Congress attempted to support the remaining American fleet through subsidized international mail routes, but a pattern of low bids followed by cost escalation once the carriers had secured their routes became rampant.[18]

It was also around the late 19th century that a primitive form of flags of convenience began to emerge.[19] American companies began to incorporate in foreign nations and then flagged their ships in the new country to evade U.S. requirements that U.S.-flagged ships be built domestically.[20] By 1901 there were nearly 700,000 tons of such vessels, greatly exceeding American-flagged capacity.[21]

In no small part because of this dynamic, the American merchant fleet was largely neglected until the first World War, despite a series of military, diplomatic and economic disasters that highlighted the consequences of this weakness. For example, as the Navy engaged the Spanish in the Philippines during the Spanish-American War, it quickly ran out of sealift capacity, and was ultimately forced to charter dozens of foreign vessels at a cost of $10 million.[22] Shortly thereafter, the Boer War led many foreign-flagged merchant vessels to withdraw from the American market to support the war effort, causing shipping rates on those vessels still serving the United States to soar.[23] These episodes did not motivate the U.S. to develop a more capable merchant marine, and in 1907 America's "great white fleet" set sail around the world to display American sea power, only for the government to find that it needed to charter a wide variety of foreign vessels to supply that fleet with food, fuel, and other supplies, embarrassingly undermining what was supposed to be a show of American strength.[24]

On the eve of the first World War, the U.S. flag merchant marine was carrying less than 8% of the nation's commerce.[25] Exports fell precip-

16. Rowan Wainwright, *Our Merchant Marine: The Causes of Its Decline and the Means to Be Taken for Its Revival*, 8 PROCEEDINGS MAG. 1, 19 (1882).

17. Wainwright, *supra* note 16, at 19.

18. GIBSON & DONOVAN, *supra* note 15, at 82.

19. *Id.* at 80.

20. *Id.*

21. *Id.*

22. Christopher G. Janus, *VISA: What Should be in America's Sealift Wallet?*, NAVAL WAR C. (May 3, 2010) (referencing that the Bureau of Labor Statistics' inflation data begins in 1913, and adjusted for inflation from 1913 to 2016, the current cost would be roughly $244 million); *see also* U.S. Bureau of Labor Statistics, CPI Inflation Calculator (Jul. 1, 2017), https://data.bls.gov/cgi-bin/cpicalc.pl.

23. GIBSON & DONOVAN, *supra* note 15, at 92-93.

24. McMahon, *supra* note 12, at 92.

25. *Id.* at 90.

itously as transportation costs through war zones rose as much as 700%.[26] However, this time it was the Americans who were neutral, and the president this time encouraged re-flagging *to* the United States, with Congress even permitting foreign-built vessels to reflag and ply the coastwise trade for the duration of the war.[27] At its postwar zenith, the American merchant marine was the largest in the world.[28]

Between the wars, Congress passed a variety of measures to protect American shipping. First came cabotage. The Merchant Marine Act of 1920 – known as the "Jones Act" – reserved the U.S. domestic trade for ships built, registered, and flagged in the U.S., crewed and owned by Americans.[29] By law, a Jones Act ship owning corporation must be incorporated in the U.S., its CEO and chairman must be citizens, less than a quorum minority of its directors may be noncitizens, and a minimum of 75% of the interest in the company must be held by Americans.[30] The attendant regulations clarified that the maximum of 25% foreign ownership applied to nonvoting as well as voting shares, and that foreign interests cannot exert control by any means.[31] Penalties for violation ranged from daily fines to possible seizure by the government.[32]

In the 1930's, Congress would begin to address international shipping. Public Resolution 17, passed in 1934, required cargoes generated by the Export-Import bank to be carried by U.S. flagged vessels.[33] The Merchant Marine Act of 1936 ("Merchant Marine Act"), meanwhile, authorized the Maritime Commission[34] to grant subsidies meant to make up, at least partially, the differential between the cost of constructing and operating an American vessel versus those costs abroad.[35] A 1939 amendment to the Merchant Marine Act also authorized the American government to requisition U.S.-owned, but foreign-flagged, vessels, in times of national emergency.[36]

Against this policy background, the interwar period also experienced the beginning of the modern form of flags of convenience. Following the passage of prohibition, some cruise vessels began to reflag in Panama to

26. GIBSON & DONOVAN, *supra* note 15, at 104.
27. *Id.* at 105-06.
28. McMahon, *supra* note 12, at 95.
29. Merchant Maritime Act of 1920, Pub. L. No. 66-261, 41 Stat. 988 (1920).
30. *Id.* at 1008.
31. *Id.*; 46 C.F.R. § 67.31(a) (2013).
32. 46 U.S.C. § 55102(c) (2006); 46 U.S.C.A. § 12151(a) (LEXIS through 2017 legislation).
33. *See generally* LAWRENCE J. WHITE, INTERNATIONAL TRADE IN OCEAN SHIPPING SERVICES: THE UNITED STATES AND THE WORLD (Am. Enterprise Inst. on Trade in Servs. Series, Ballinger Pub. Co., 1988).
34. Which would later become the Maritime Administration.
35. McMahon, *supra* note 12, at 94.
36. HENRY S. MARCUS ET AL., INCREASING THE SIZE OF THE EFFECTIVE UNITED STATES CONTROL FLEET 7 (Mass. Inst. of Tech. 2002).

avoid American restrictions on alcohol.[37] Other types of vessels eventually followed suit to take advantage of lower taxes, cheaper labor, and a looser regulatory environment.[38]

In fact, at the outset of World War II, the U.S. encouraged ships to reflag in Panama or Honduras to escape the restrictions imposed by the domestic Neutrality Act on trade with the belligerent powers.[39] When the U.S. entered the war, the extant American merchant marine was quickly decimated, as the Navy was woefully unprepared to defend it.[40] At first, the relative lack of shipping capacity created significant strategic problems. For instance, U.S. military commanders could not exercise complete control over sealift, as the British insisted on priority being given to delivering their vital supplies.[41] Similarly, joint plans for a multi-front strategy were scuttled when the limited supply of sealift was exhausted by the first theater to be invaded.[42] Nonetheless, the Allied governments soon controlled most of the world's available shipping, either chartering foreign vessels or purchasing them outright.[43] At the same time, the U.S. began to build merchant ships faster than they could be sunk by the enemy – production increased from one million tons in 1941 to seventeen million by 1943.[44] An initial shortage of crews was also resolved by 1943 due to a combination of training centers and the appeal of high union wages and promotion opportunities in the merchant marine.[45] By D-Day, the merchant marine was able to join and supply the 2,700-ship allied armada that supported the invasion of Europe.[46]

After the war, the U.S. again had the largest fleet in the world, carrying 65% of the country's international seaborne commerce.[47] This fleet was somewhat aided by the Cargo Preference Act, which favored U.S. flag vessels in shipping government cargoes overseas.[48] However, much of the fleet was transferred to foreign countries rebuilding after the war.[49] As post-war aid to Europe declined, so too did the remaining merchant marine. The U.S. maintained a fleet of over 2,000 inactive vessels in the

37. Maria J. Wing, *Rethinking the Easy Way Out: Flags of Convenience in the Post-September 11th Era*, 28 TUL. MAR. L.J. 173, 175 (2003).

38. *Id.*

39. *Id.*

40. GIBSON & DONOVAN, *supra* note 15, at 159-61.

41. *Id.* at 164.

42. GIBSON & DONOVAN, *supra* note 15, at 164.

43. *Id.* at 162.

44. *Id.* at 155, 167.

45. *Id.* at 167-68.

46. *Id.* at 167.

47. Victor G. Hanson & John V. Berry, *The Diminution of The Merchant Marine: A National Security Risk*, 74 U. DET. MERCY L. REV. 465, 472 (1997).

48. *See generally* WHITE, *supra* note 33.

49. Hanson & Berry, *supra* note 47, at 472.

National Defense Reserve Fleet (NDRF), established in 1950.[50] However, by the dawn of the 1970's, the merchant fleet had fallen to fourth in the world, slightly ahead of the Soviet Union by capacity, but with fewer and older ships, carrying only 5.6% of foreign waterborne commerce.[51] The Naval War College Review bemoaned: "It's pathetic. This nation, once first, has become a fifth-rate maritime power."[52]

In Vietnam, 172 ships were activated from the NDRF[53] and 96% of war material was sent by ship to the theater during the course of conflict.[54] At the height of the war more than 500 ships supported operations, roughly 40% of American commercial sealift capacity.[55] Nonetheless, on several occasions the crews of chartered foreign-flagged ships refused to deliver military cargoes to Vietnam.[56] The U.S. also faced near peer-level sealift from its adversary,[57] and was unable to achieve victory.

To improve American sealift capacity, in 1977, Congress created the Ready Reserve Force (RRF).[58] These ships – six at the program's inception and 46 at present – are administered by the Maritime Administration (MARAD) and maintained with a reduced crew able to bring them into active service on short notice.[59] The government-owned RRF and NDRF, in combination with the Navy's Military Sealift Command, began to form the heart of America's strategic sealift capability. During the first gulf war, nearly 80% of seaborne cargo to the Middle East was carried on U.S.-flag vessels, with foreign-flagged ships able to provide the rest.[60] However, at least one foreign vessel refused to enter the Persian Gulf.[61]

With the operational subsides from the Merchant Marine Act set to expire in 1998, Congress passed the Maritime Security Act of 1996.[62]

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50. U.S. Dep't of Transp. Mar. Admin., *National Defense Reserve Fleet*, https://www.marad.dot.gov/ships-and-shipping/strategic-sealift/office-of-ship-operations/national-defense-reserve-fleet-ndrf/ (last visited Oct. 22, 2017).
51. Richard G. Colbert, *Challenge!*, NAVAL WAR C. REV., Apr. 1969, at 2.
52. Ralph E. Casey, *Political and Economic Significance of the World's Merchant Marines Into the 1980's*, NAVAL WAR C. REV., Apr. 1969, at 6.
53. U.S. Dep't of Transp. Mar. Admin., *supra* note 50.
54. Colbert, *supra* note 51, at 1.
55. GIBSON & DONOVAN, *supra* note 15, at 246.
56. Colbert, *supra* note 51, at 1.
57. *Id.* In 1964, 47 Soviet ships supplied North Vietnam, which rose to 433 by 1967.
58. U.S. Dep't of Transp. Mar. Admin., *The Maritime Administration's Ready Reserve Force,* https://www.marad.dot.gov/ships-and-shipping/strategic-sealift/office-of-ship-operations/ready-reserve-force-rrf/ (last visited Oct. 22, 2017).
59. *Id.*
60. Janus, *supra* note 22, at 9.
61. Hanson & Berry, *supra* note 47, at 484.
62. Kirsten Bohmann, *The Ownership and Control Requirement in U.S. and European Union Air Law and U.S. Maritime Law-Policy; Consideration; Comparison*, 66 J. AIR L. & COM. 689, 736 (2001).

Signing the bill, President Clinton said, "[The Act] will ensure that the United States will continue to have American Flag ships crewed by loyal American citizen merchant mariners to meet our Nation's economic and sealift defense requirements."[63] The act created the Maritime Security Program (MSP), which subsidized 36 U.S. ships for use in international trade.[64] The Program has since increased to 60 ships, crewed by American mariners, which must dedicate their services to the Defense Department upon request during periods of war or national emergency.[65]

Interestingly, the act provided for "documentation" citizenship ownership – that is, the owners need not be American citizens, so long as the entity that owns the vessel is incorporated in the U.S. under U.S. law, its CEO and chairman are American, and no more non-citizens serve on the board than would constitute a minority quorum.[66]

This direct subsidy program was followed by the Voluntary Intermodal Sealift Agreement (VISA), a MARAD program approved by the Department of Defense (DOD) in 1997.[67] VISA offers priority preference in transporting DOD cargoes in peacetime, in exchange for a promise to devote a certain percentage of cargo capacity to DOD use when the program is activated.[68] All MSP ships must be enrolled in VISA, and indeed, 75% of VISA is the MSP fleet.[69] The program is open only to U.S.-flag, American-owned vessels, and permits foreign-flag vessels to enter the program immediately if reflagged.[70]

### B. Current State of the Merchant Marine

In the event of a military need, the merchant marine must be able to provide two elements: surge and sustainment.[71] Surge capacity is the abil-

63. The White House, Off. Of Comm., President on Signing the Maritime Security Act (1996), Westlaw 576962, at *1.

64. *Id.*

65. U.S. Dep't of Transp. Mar. Admin., *Maritime Security Program*, https://www.marad.dot.gov/ships-and-shipping/strategic-sealift/maritime-security-program-msp/ (last visited Dec. 10, 2017).

66. Bimal Patel, *A Flight Plan Towards Financial Stability-the History and Future of Foreign Ownership Restrictions in the United States Aviation Industry*, 73 J. Air L. & Com. 487, 518 (2008).

67. U.S. Dep't of Transp. Mar. Admin., *Voluntary Intermodal Sealift Agreement (VISA)*, https://www.marad.dot.gov/ships-and-shipping/strategic-sealift/voluntary-intermodal-sealift-agreement-visa/ (last visited Oct. 22, 2017).

68. *Id.*

69. U.S. Dep't of Transp. Mar. Admin., *Voluntary Intermodal Sealift Agreement*, https://www.marad.dot.gov/wp-content/uploads/pdf/VISA-BROCHURE.pdf (last visited Oct. 22, 2017).

70. *Id.*

71. S. REP. No. 104-167, at 3 (1995).

ity to rapidly deploy maritime sealift within 30 days.[72] Sustainment is the ability to ship cargo to supply and resupply forces beyond that window.[73] Today's U.S. merchant marine amounts to a small sealift capacity supported through three mechanisms: (1) the protection of a domestic fleet through cabotage rules, (2) the support of a small oceangoing fleet through subsidy, and (3) direct ownership and operation of active and reserve sealift vessels. The Jones Act fleet of oceangoing[74] cabotage vessels consists of less than 100 ships,[75] while the oceangoing U.S.-flagged fleet engaged in international trade has fallen to 78 vessels.[76] The NDRF fleet has shrunk to 100 vessels, 46 of which constitute the RRF.[77] That is less than 300 U.S.-flag vessels available in the event of an emergency requiring significant sealift needs – barely enough to meet surge needs and "grossly inadequate" for sustained operations.[78]

As a result, the United States merchant marine is at a historic disadvantage with its global rivals. For example, the Chinese-flagged commercial, oceangoing merchant fleet alone totals roughly 3,600 ships.[79] The disparity in merchant mariners is 500,000 to 11,000.[80] And China leads the world in shipbuilding.[81] In 2017, Chinese shipbuilders delivered 35 million gross tons of new ships – nearly four times as much as the entire privately-owned U.S.-flagged merchant fleet.[82] These Chinese-flagged vessels carry over 90% of Chinese seaborne trade; American vessels carry less than 2% of theirs.[83] Chinese interests also control over 500 vessels flying the Panamanian flag, and control terminals on both ends of the

72. S. REP. NO. 104-167, at 3 (1995).

73. *Id.*

74. The oceangoing Jones Act fleet serves U.S. states and territories such as Alaska, Hawaii, and Puerto Rico, Transp. Inst., *The Jones Act*, https://transportationinstitute.org/jones-act/ (last visited Oct. 22, 2017).

75. *See* U.S. Dep't of Transp. Mar. Admin, *U.S. Flag Privately-Owned Fleet*, https://www.marad.dot.gov/wp-content/. . ./us-flag_fleet_10000_dwt_and_above.xls (last visited Oct. 22, 2017).

76. *See* Kumar, *supra* note 4, at 4.

77. U.S. Dep't of Transp. Mar. Admin., *National Defense Reserve Fleet*, https://www.marad.dot.gov/ships-and-shipping/strategic-sealift/office-of-ship-operations/national-defense-reserve-fleet-ndrf/ (last visited Oct. 22, 2017).

78. *See* BRATTON & SCHUSTER, *supra* note 3, at 5.

79. CIA, *World Factbook: Merchant Marine*, https://www.cia.gov/library/publications/the-world-factbook/fields/2108.html (last visited Oct. 22, 2017). This number counts vessels registered both in China and Hong Kong.

80. *Id.*

81. Soy Transp. Coalition, *Major Shipbuilding Countries and Companies*, http://www.soytransportation.org/Stats/Ocean_MajorShipbuilding.pdf (last visited Oct. 22, 2017).

82. U.S. Dep't of Transp. Mar. Admin., *National Defense Reserve Fleet*, https://www.marad.dot.gov/ships-and-shipping/strategic-sealift/office-of-ship-operations/national-defense-reserve-fleet-ndrf/ (last visited Oct. 22, 2017).

83. BRATTON & SCHUSTER, *supra* note 3, at 5.

Panama Canal.[84] As a result, China has the ability to manipulate U.S. foreign trade by manipulating shipping rates or service,[85] to restrict American access to much of the international oceangoing fleet, and provide sealift to support its own military operations or those of a proxy. The situation is less dire with respect to other geopolitical rivals, however Russia has over 1,000 vessels of its own, and even Iran and North Korea have over 200 between them.[86]

## III. The Ownership and Control Requirement

Considering the importance of civilian augmentation of military forces during conflict, it is little surprise that much attention has been paid to the question of who may own and exercise control over assets such as ships or aircraft. In both the aviation and maritime contexts, countless pages of scholarship have been devoted to the question of ownership and control: whether foreigners should be allowed to invest in U.S. transportation companies, what the extent of that ownership and control should be, and how to ensure compliance with the rules that are adopted. Although the notion has been disputed,[87] it is broadly accepted that restrictions on foreign investment or ownership are necessary to limit foreign influence and thus in the best security interests of the United States.[88]

The issue of ownership and control in the maritime sector has been relatively settled. The Jones Act strictly limits foreign interest in U.S. cabotage shipping, and the U.S. Coast Guard's (USCG) National Vessel Documentation Center lists only one case in which an investigation needed to be made as to foreign interests in Jones Act shipping.[89] MARAD, meanwhile, has effectively ceded the international U.S.-flag fleet to unlimited foreign investment. The aviation sector is instructive, as it shares many similarities in restrictions to the Jones Act trade, and demonstrates one viable way to regulate such investments.

84. *See* McMahon, *supra* note 12, at 104.

85. Bratton & Schuster, *supra* note 3, at 5.

86. CIA, *supra* note 79.

87. *See, e.g.*, Allan I. Mendelsohn, *Myths of International Aviation*, 68 J. Air L. & Com. 519, 525-26 (2003).

88. *See, e.g.*, Victor G. Hanson & John V. Berry, *The Diminution of the Merchant Marine: A National Security Risk*, 74 U. Det. Mercy L. Rev. 465, 481 (1997); Bohmann, *supra* note 62, at 690, 695, 697.

89. National Vessel Documentation Center, *Investigation Reports*, U.S. Coast Guard, http://www.dco.uscg.mil/Our-Organization/Assistant-Commandant-for-Prevention-Policy-CG-5P/Inspections-Compliance-CG-5PC-/National-Vessel-Documentation-Center/National-Vessel-Documentation-Center-Investigation-Reports/ (last visited Oct. 22, 2017).

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### A. Jones Act Restrictions, the Trico Marine Decision, and Coast Guard Notice

The Jones Act requires that vessels involved in the coastwise trade be American-owned, with U.S. citizens as CEO and chairman, and noncitizens as less than a non-quorum minority.[90] By regulation, foreign equity cannot exceed 25%, even if that does not represent voting interest, and foreign entities cannot exercise control by any means.[91] This requirement is largely self-policed – the submission of a properly-completed registration form to the USCG creates a rebuttable presumption that the owner is a U.S. citizen.[92]

In 2011, the Coast Guard investigated Trico Marine for suspected violations of these restrictions, the only such investigation currently published.[93] The USCG received a credible allegation that, in addition to the interest from several foreign entities acknowledged by Trico, several additional entities of indeterminate citizenship held interests as well.[94] This rebutted the presumption that Trico met the citizenship requirement.[95] The Coast Guard examined seven quarters of ownership information, finding that the combination of foreign and undetermined interests ranged from 31.19% on March 31, 2010, to 62.4% on December 31, 2008.[96]

To rebut the inference that the indeterminate shares were foreign-owned, Trico pointed to the shareholders' U.S. incorporation, and the fact that in some cases a U.S. citizen had exercised voting rights on their behalf.[97] The shareholders in question were Objecting Beneficial Owners (OBO's), and as such they were permitted under SEC rules to prevent their identities from being disclosed to anyone except their broker.[98] The securities in question, like 90% of all U.S. securities,[99] were ultimately deposited with the Depository Trust Company (DTC).[100] In order to allow securities to satisfy foreign ownership restrictions, the DTC offers the

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90. 46 U.S.C. §50501 (2017).

91. *See* Michaeli, *supra* note 11, at 1054.

92. National Vessel Documentation Center, *Trico Report of Investigation*, U.S. Coast Guard (Jan. 12, 2011), http://www.dco.uscg.mil/Portals/9/DCO%20Documents/NVDC/Trico_Report_of_Investigation.pdf?ver=2017-05-08-104715-490.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Trico Report of Investigation*, *supra* note 92.

98. *Id.*

99. *See* Depository Trust & Clearing Corporation, *An Introduction to DTCC's Issuer Services*, http://dtcc.com/~/media/Files/Downloads/Settlement-Asset-Services/Issuer%20Services/Issuer_Serv_Brochure.ashx (last visited Oct. 22, 2017).

100. *Id.*

"Seg-100" program, allowing foreign-owned shares to be deposited with DTC in a special segregated account for companies operating under foreign-ownership restrictions.[101] Any such company could then theoretically be aware of the level of foreign investment based on the amount of shares labelled Seg-100. Trico thus attempted to rely on this program to satisfy the foreign ownership requirements, apparently because the suspect shares were not labelled Seg-100, and thus were presumably not foreign. Moreover, the brokers working for the DTC obtained a U.S. citizenship declaration form from the suspect owners.[102]

The USCG flatly rejected this argument.[103] In its investigative report, the USCG noted that the coastwise trade is a "restrictive trade," and that ship-owners must proactively comply.[104] Companies unwilling to do so can choose not to operate in the coastwise trade, and those concerned with ambiguity about the ownership of publicly trades shares can restrict sale of their stock to U.S. citizens, or use a transfer agent to issue a dual certificate system.[105] Because of those options, once the presumption of citizenship is challenged, the burden shifts to the vessel owner to affirmatively establish its eligibility for the coastwise trade.[106] Each of the shareholders comprising the 75% U.S.-citizen requirement must *themselves* be Jones Act eligible in shareholder citizenship, management and board citizenship, and foreign control.[107] Trico produced no evidence beyond the states of incorporation, and thus was ultimately fined nearly $6 million for the violation.[108]

Following this decision, the Coast Guard published a notice in the Federal Register seeking comment on how publicly traded companies comply with citizenship requirements.[109] In November 2012, the Coast Guard posted a follow-up notice in the Federal Register to elucidate its policy going forward.[110] It ultimately left the choice of compliance mechanisms to the individual companies, although it highlighted a variety of measures that could be taken to ensure compliance: (a) use of the Seg-100 system, (b) monitoring SEC filings and requesting follow-up information, (c) use of protective provisions in organizational documents to

101. *See* Michaeli, *supra* note 11, at 1050-51.
102. *Trico Report of Investigation*, *supra* note 92.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.*
107. *Trico Report of Investigation*, *supra* note 92.
108. *Id.*
109. Mechanisms of Compliance with United States Citizenship Requirements for the Ownership of Vessels Eligible to Engage in Restricted Trades by Publicly Traded Companies, 77 Fed. Reg. 70452-01 (Nov. 26, 2012).
110. *Id.*

guard against excess shares, (d) communication with non-objecting beneficial owners, (e) analysis of registered stockholders, and (f) use of dual stock certificates.[111] The Coast Guard insisted that it would give "positive consideration" to "diligent and good faith efforts" to monitor stock ownership and take prompt action where necessary.[112] This vague standard remains the law today, however it appears no investigations have been launched since its publication.

### B. The Maritime Security Program, VISA, and International Maritime Shipping

The standard applied to U.S. flagged vessels in international trade is similar, with one key difference – the ownership of stock is not considered.[113] Even vessels participating in the MSP or VISA programs may be owned either by American citizens (persons, partnerships, etc.), or by "documentation citizens."[114] Requirements for documentation citizenship are (1) incorporation in the United States, (2) no more non-citizens than would constitute a minority of a board quorum, and (3) citizenship of the Chairman and CEO.[115]

The decision to permit foreign companies to operate U.S.-flag vessels in the MSP was discussed in Congressional hearings,[116] but the then-commander of U.S. TRANSCOM testified that military needs were met by documentation citizens.[117] It appears that no documentation citizen vessel has had its citizenship challenged to date, nor do there appear to be any incidents of foreign-owned vessels failing to fulfill their MSP or VISA obligations.[118]

### C. American Aviation

American ownership and control of airlines first came about in the Air Commerce Act of 1926, which mandated that a majority of ownership interest and two thirds of the corporate board be in the hands of U.S. citizens.[119] The Federal Aviation Act extended the U.S. citizenship requirement to 75% of the voting interest in the company.[120] The Civil

111. Mechanisms of Compliance, *supra* note 109.
112. *Id.*
113. Patel, *supra* note 66, at 518.
114. *Id.*
115. *Id.*
116. *See, e.g., Reauthorization of the Maritime Security Program: Hearing Before the Special Oversight Panel on the Merchant Marine,* 107th Cong. 107-47 (2002).
117. *Id.*
118. As noted earlier, these obligations are a commitment of a portion (VISA) or all (MSP) of their capacity to DOD use during war or national emergency.
119. *See* Bohmann, *supra* note 62, at 695-96.
120. 49 U.S.C. § 40102 (2017).

Aeronautics Board (CAB, predecessor to the Department of Transportation (DOT)), in turn, interpreted the statute to preclude "actual control" by foreign entities as well.[121] The DOT later clarified that the influence need not be sinister in nature, nor limited to investment from any particular foreign nation.[122] The control need not even be formalized – personal relationships could constitute control.[123]

In rejecting a 1989 initial application for investment from a KLM (the Dutch national airline) subsidiary in Northwest Airlines, the DOT explained that evaluation of the "actual control" standard would be done on a case by case basis, looking to see if *de facto* control existed.[124] KLM's subsidiary initially sought to invest $400 million in Northwest.[125] While this would not have resulted in greater than 25% foreign ownership of voting stock, KLM would have been able to, inter alia, block amendments to the certificate of incorporation and name a three-person committee to advise Northwest's management.[126]

To make the deal more palatable to regulators, KLM agreed to limit its share to no more than 25% of total *equity*.[127] Thus not only was its voting power limited, but also its financial interest and, presumably, clout. KLM would also eliminate the advisory committee, recuse its representative in certain circumstances, and regularly update DOT about Northwest's ownership structure.[128] At last, the DOT approved. In fact, two years later the KLM subsidiary would request a modification to the arrangement.[129] The DOT ultimately allowed foreign *equity* investment of up to 49%, allowing KLM to appoint three members of the holding company's board, recently increased in size from twelve to fifteen.[130] In DOT's view, this situation was permissible so long as U.S. citizens actually controlled the American carrier.[131]

In the mid-2000's, DOT examined the proposal by a British company, Virgin Group, to establish a U.S.-based airline, Virgin America

121. Willye Peter Daetwyler d/b/a Interamerican Airfreight Co., Docket No. 71-10-114, Final Agency Decision (Oct. 28, 1971), http://dotlibrary.specialcollection.net/Document?db=DOT-ORDERS&query=(select%2031017).

122. Intera Arctic Services, Inc., D.O.T. Order No. 87-8-43, 58 C.A.B. 120 (1987).

123. In re Compliance with U.S. Citizenship Requirements of DHL Airways, Inc., Third Party Complaint and Request to Commence Enforcement Proceedings, Dkt. No. OST-2001-8736 (Jan. 19, 2001) (citing Willye Peter Daetwyler d/b/a Interamerican Airfreight Co., Foreign Permit, 58 C.A.B. 120 (1971)).

124. *See* Bohmann, *supra* note 62, at 698.

125. *See id.* at 700.

126. *Id.*

127. *Id.* at 701.

128. *Id.*

129. *Id.*

130. *See* Bohmann, *supra* note 62, at 701.

131. *Id.* at 698.

(VAI).[132] Similar to the situation in the Trico case, the prospective Virgin America was established with an American corporation holding 75% of the voting stock.[133] However, whereas the burden was on Trico to prove its shareholders' citizenship bona fides in the absence of clear ownership, in Virgin America's case the issue was the evident foreign influence, including Virgin Group's influence over Virgin America's management, Virgin Group's role in creating Virgin America, the funding provided by the Virgin Group, the trademark agreement between the two companies, and the veto power of the Virgin Group over certain Virgin America decisions.[134] Nonetheless, after changes were made to Virgin America's control structure, DOT approved the new airline.[135]

Interestingly, in 2007 DOT also faced a case of a publicly-traded airline contending with the ownership and control requirement.[136] MAXjet, now defunct, proposed to limit foreign investment to 25% of voting shares, and 50% of equity.[137] MAXjet would review the citizenship of any investor in its voting stock, and remove the voting rights of any share of stock that would bring the amount of voting control above 25%.[138] Investors that would bring MAXjet over the limit would be forced to sell their shares within 90 days, with the company making the sale itself if the investor failed to do so.[139] While the DOT required notification of any changes to this structure, and reserved the right to reject such changes, it ultimately approved this arrangement.[140]

A year later, in 2008 the DOT approved an investment by the German airline Lufthansa in JetBlue.[141] Lufthansa gained 19% of JetBlue equity, and one seat on JetBlue's board.[142] The arrangement also included the possibility of another seat on the board the following year.[143] In approving the deal, DOT reserved the right to change its determination as to JetBlue's ownership in the event of changes to its corporate ownership.[144]

132. Ryan Patanaphan, *Navigating the Complex Skies: A Caveat on Liberalizing Foreign Ownership Restrictions in U.S. Airlines*, 72 Ohio St. L.J. 191, 197-98 (2011).

133. *Id.* at 198.

134. *Id.* at 198-99.

135. *Id.*

136. *Id.* at 200.

137. *Id.*

138. Patanaphan, *supra* note 132, at 200.

139. *Id.*

140. *Id.*

141. *Id.* at 199.

142. *Id.* at 199-200.

143. *Id.* at 200.

144. *Id.*

### D. Review

Domestic maritime, international maritime, and airline ownership restrictions present a variety of different ways to approach the issue of foreign investment. In international maritime shipping, all efforts to restrict foreign ownership have been more or less abandoned. This is striking given that, of these three elements of the transportation network, the international maritime shipping industry is the one that is directly subsidized for the sake of supporting national defense.[145] By contrast, many American airlines participate in the Civil Reserve Air Fleet program,[146] which offers peacetime DOD bidding preferences in exchange for availability for emergency use by the DOD. Yet even those few U.S.-based airlines that choose not to participate are bound by the foreign ownership restrictions imposed by the Federal Aviation Act and the DOT. And the domestic maritime fleet has foreign ownership limitations without any formal involvement in a national security program at all.

Also striking is the distinction between the hands-off approach of regulators in maritime and the vetting required for approval in the aviation domain. The Coast Guard simply grants a presumption of citizenship, and will investigate potential non-citizenship only if that presumption is rebutted. Applied after the fact, the USCG post-hoc determination is formalistic. Ship-owners must meet the precise requirements set down in U.S. law. To be counted as an American interest that can constitute part of the 75% American ownership requirement, any investor must also meet these precise requirements. Yet, there is also flexibility in this approach – ship owners need not particularly identify every single investor in their publicly-traded company, so long as they diligently seek to maintain their required minimum American ownership interest.

Aviation authorities, by contrast, make this determination before the investment is permitted to proceed. As the MAXjet case shows, for publicly traded companies, DOT must first approve the company's foreign investment strategy, and that strategy itself must proactively *prevent* foreign ownership. Investments by foreign airlines in existing American airlines likewise require a prospective review by the DOT. This review applies a much more realistic standard than that applied by the Coast Guard, as the DOT looks beyond the numbers for evidence of any exertion of foreign control over the American airline.

145. Of course, only MSP vessels are directly subsidized for this purpose. Non-MSP vessels merely get cargo bid preference, and, to the extent there are any such vessels, U.S.-flag oceangoing ships participating in neither program receive no direct benefits from the government and provide no direct support to national defense.

146. Air Mobility Command, *Civil Reserve Air Fleet*, U.S. Air Force (July 28, 2014), http://www.af.mil/AboutUs/FactSheets/Display/tabid/224/Article/104583/civil-reserve-air-fleet.aspx (noting that "[a]s of June 2014, 24 carriers and 553 aircraft are enrolled in CRAF.").

This divergence of approaches has led to much disagreement as to the proper role of foreign ownership restrictions. The Jones Act is a particular target, the target of newspaper articles,[147] academic writing,[148] think tank pieces,[149] speeches in Congress,[150] and even repeal legislation.[151] However, the Jones Act also has many defenders, arguing that any economic gains from repeal are overstated, and that the national security consequences could be devastating.[152]

The similar debate in the aviation context is informative. For years, many have argued for liberalizing ownership and control requirements.[153] The primary argument for such liberalization is the purported economic benefit of such policies, which is beyond the scope of this comment. Assuming there are such benefits, the question of the effect of liberalization on national security remains. Some point to the lack of such requirements for U.S.-flag vessels engaged in international trade as evidence that the national security implications are overblown.[154] Nonetheless, many also propose solutions to mitigate any such risk. Participation in CRAF could be made a condition for investment, and failure to fulfill those obligations could cost an airline its operating privileges.[155] Another scholar has suggested looking both at the investor and its country of origin, requiring a reciprocal right for the U.S. to invest in the foreign country in question, a defense treaty between the two countries, and a national security review by the Committee for Foreign Investment in the United States.[156] Such proposals indeed seem like reasonable ways to apply a liberalization scheme to the U.S. maritime industry. However, the DOD has traditionally opposed such measures.[157]

At any rate, it is not clear what these restrictions have bought in

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147. *See, e.g.*, Paula Stern, *Protection Harms US Security*, JOC.COM (Sept. 09, 1987, 8:00 PM), https://www.joc.com/protection-harms-us-security_19870909.html.

148. *E.g.*, Michaeli, *supra* note 11.

149. *See* The Heritage Foundation, *The Jones Act's Costly Impact* (Dec. 4, 2014), http://thf_media.s3.amazonaws.com/2014/pdf/FS_154.pdf.

150. 114 Cong. Rec. S378-82 (daily ed. Jan. 22, 2015) (statement of Sen. John McCain).

151. S. 1813, 104th Cong. (1996).

152. *E.g.*, Samuel A. Giberga & John H. T. Thompson, *We and Mr. Jones: How the Misunderstood Jones Act Enhances Our Security and Economy*, 46 J. MAR. L. & COM. 493, 502-03 (2015); Constantine G. Papavizas & Bryant E. Gardner, *Is the Jones Act Redundant?*, 21 U.S.F. MAR. L.J. 95, 115 (2009).

153. *See generally*, Jeffrey D. Brown, *Foreign Investment in U.S. Airlines: What Limits Should Be Placed on Foreign Ownership of U.S. Carriers?*, 41 SYRACUSE L. REV. 1269 (1990); *also see*, John T. Stewart, Jr., *United States Citizenship Requirements of the Federal Aviation Act-A Misty Moor of Legalisms or the Rampart of Protectionism?*, 55 J. AIR L. & COM. 685 (1990).

154. Mendelsohn, *supra* note 87, at 532-33.

155. *Id.* at 532-35.

156. *See generally* Josh Cavinato, *Turbulence in the Airline Industry: Rethinking America's Foreign Ownership Restrictions*, 81 S. CAL. L. REV. 311 (2008).

157. Letter from JayEtta Z. Hecker, Director, the United States General Accounting Office,

terms of loyalty. Foreign crews of foreign-flagged ships have refused to deliver cargoes during Vietnam and Desert Shield/Desert Storm,[158] but the foreign-owned "documentation citizens" in the MSP and VISA have not failed to fulfill their obligations. Conversely, although CRAF participants have delivered when called upon, some airlines – whose American ownership and control, as noted earlier, is most rigorously enforced – have in the past raised questions about their commitment. For instance, following an activation to support Desert Storm in which pilots needed to be given chemical protective suits in case of attack or contamination, several CRAF airlines reduced their participation in the program.[159]

## IV. Beyond Ownership and Control: Collateral Matters

In evaluating the way forward, there are three legal concepts that bear on the effective evaluation of ownership and control from a national security standpoint: requisition, expropriation, and neutrality.

The U.S. flagged fleet is not the entire story when considering merchant marine readiness for a large-scale conflict with a near-peer adversary. In response to the decline of the flag fleet, the Joint Chiefs of Staff formulated a concept of Effectively U.S. Controlled (EUSC) shipping.[160] This concept takes advantage of the Secretary of Transportation's authority under 46 U.S.C. § 56301 to requisition U.S.-owned vessels.[161] If the President has declared an emergency or proclaimed that it is essential to the national defense, the Secretary of Transportation may requisition, charter, or purchase vessels owned by U.S. citizens, regardless of where they are registered.[162] Currently, U.S. interests own roughly 800 ships flying under a foreign flag.[163] This provides an important source of supplemental merchant shipping capacity in the event of a large-scale conflict.

An important caveat to the power of the U.S. to requisition or otherwise obtain vessels when needed is the international law of expropriation. The law of expropriation holds that where a state takes the property of a foreign national it is obliged to provide just compensation.[164] This has significant consequences for foreign-owned U.S.-flag vessels and Ameri-

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to Trent Lott, Chairman, Subcommittee on Aviation Committee on Commerce, Science, and Transportation, at 29 (Oct. 30, 2003).

158. *See supra* Section II.

159. Steven J. Zamparelli, *Contractors on the Battlefield: What Have We Signed Up For?*, A. War C., at 22 (March 1999).

160. Marcus et al., *supra* note 36, at 14.

161. 46 U.S.C. § 56301 (2006). This is subject to the Fifth Amendment takings clause requirement of just compensation.

162. *Id.*

163. CIA, *supra* note 79.

164. Restatement (Third) of Foreign Relations Law § 712 cmt. b (1987).

can-owned foreign-flagged vessels with foreign co-owners. In either case, any seizure will require compensation. Of course, should a vessel need to be seized, rather than chartered, the same would hold true for American owners under the Takings Clause.[165]

A further consideration in evaluating U.S. access to sealift capacity during a conflict is the law of neutrality. International law permits the sale, gift, or charter of merchant vessels by a neutral nation to belligerents.[166] However, ships flying a neutral flag are not subject to seizure absent some violation of neutrality.[167] Further, neutral countries may choose to restrict the export or transportation of merchant vessels to a belligerent, although it must apply such restrictions impartially to all belligerents.[168] Thus, requisition is limited in its usefulness to cases where the flag nation does not place restrictions on exports to belligerents, and the U.S. has an advantage over its adversary in the amount of sealift it can extract from the neutral state. For example, Americans own over 300 ships in the Marshall Islands and the Bahamas, whereas Chinese and Russian interests control less than 20 combined.[169] The 90 American-owned Panamanian-flagged vessels pale, however, compared to the 534 such vessels owned by the Chinese.

## V. Improving Merchant Marine Policy

The national merchant marine is undoubtedly important, and our national maritime strategy still posits that it must be sufficient to carry on foreign commerce and serve as a naval auxiliary. The most recent joint Maritime Strategy promulgated by the sea services,[170] meanwhile, insists that the ability to project American power depends on sealift support.[171] The current state of the merchant marine seems inadequate for that purpose, and as such has been the subject of much consternation among maritime leaders.[172] However, current policy provides only a patchwork solution that offers no hope of achieving the putative strategy's lofty ambitions. Accordingly, the national strategy should either be adjusted to align with the present reality, or policy should be changed to effect the national strategy. Either choice will affect the approach to ownership and control, but it must be made to determine the best way to proceed.

165. U.S. Const. amend. V.

166. Hague Convention (V) Respecting the Rights and Duties of Neutral Powers and Persons During War on Land, art. 7, Oct. 18, 1907, U.S.T.S. 540, 2 A.J.I.L. Supp. 117.

167. Annotated Supplement to the Commander's Handbook on the Law of Naval Operations, 396-97 (A.R.Thomas & James C. Duncan eds., 1999).

168. Hague Convention (V), *supra* note 166, art. 7, 9.

169. CIA, *supra* note 79.

170. The U.S. Navy, Marine Corps, and Coast Guard.

171. A Cooperative Strategy for 21st Century Seapower 24 (2015).

172. *See supra* Section I.

## A. Status Quo Approach

A foundational premise of the national strategy and the widespread concern over the state of the merchant marine is the notion that a strong merchant marine is indispensable to U.S. security interests. However, this premise is far from proved. The United States has survived and thrived often despite a substandard merchant marine, rather than because of an excellent one, and embracing that history could allow a more coherent approach to maritime strategy.

One can search the records of virtually any era and find an American leader bemoaning the state of the merchant marine.[173] Perhaps the only conflict that the United States has entered with a first-rate merchant marine was the Civil War. As noted above,[174] that conflict led American-flag shipping to flee to other flags, and as such victory is hardly attributable to that strength. The U.S. entered both World Wars with just a fraction of global shipping flying the American flag,[175] yet in both cases achieved a resounding victory.

Although it is far from certain that the U.S. could replicate this success against a modern near-peer adversary, history suggests that a weak merchant marine at the outbreak of a major conflict can be overcome. Recent, smaller conflicts have demonstrated that the American skeleton merchant marine can also support modern military operations overseas. Although the Vietnam operation was unsuccessful, the failure was not due to the merchant marine, which at any rate did not benefit from the buildup that spurred its success in the prior conflicts. The Persian Gulf conflicts, meanwhile, were fought successfully despite the need to supplement the U.S.-flag fleet with foreign shipping.

Given this track record, one might say that economic concerns should be paramount in merchant marine policy. U.S.-flag shipping in the international trade is two to three times more expensive than its foreign equivalent in operational costs alone.[176] Although the question of whether reducing or eliminating ownership restrictions in the Jones Act trade would reduce costs is hotly contested,[177] at the very least permitting greater foreign investment could provide additional sources of capital for coastwise shipping interests. Thus, a viable maritime strategy may be to embrace the cost savings and economic benefits that come with reliance

173. *See, e.g.*, Wainwright, *supra* note 16; Colbert, *supra* note 51.

174. *See supra* Section II.

175. The American merchant marine comprised 15% of global tonnage just prior to World War II, and just 6% prior to World War I. *See* Gibson & Donovan, *supra* note 15, at 165.

176. *See* U.S. Dep't of Transp. Mar. Admin, *Comparison of U.S. and Foreign-Flag Operating Costs* (Sept. 2011), https://www.marad.dot.gov/wpcontent/uploads/pdf/Comparison_of_US_and_Foreign_Flag_Operating_Costs.pdf.

177. *See, e.g.*, Giberga & Thompson, *supra* note 152, at 505-09.

on foreign flagged vessels and foreign investment, given the relatively minimal need to rely on foreign shipping in smaller-scale conflicts, the enormous expense necessary to develop a merchant fleet sufficient to support a large-scale conflict (of the variety that has not occurred in over 70 years) from its outset, and the ability of American industry to respond in the event of such a need.

### B. Restoration Approach

On the other hand, there are compelling reasons to believe the U.S. should live up to its ambitions and return the merchant marine to a state capable of independently fulfilling American international commerce and defense needs. As noted earlier, the American merchant fleet is currently unable to compete with geopolitical rivals. Although foreign-flag shipping is currently significantly cheaper in terms of operating costs and taxes,[178] the overall impact on the economy of stronger policies to support the merchant marine may not be so dramatic. Moreover, in an era where government leaders are embracing protectionist philosophies[179] the merchant marine may be a suitable place to apply them.

As noted in Section II, the United States merchant marine is at a historic disadvantage with its global rivals. In the event of a large-scale conflict the U.S. would struggle to match Chinese or even Russian sealift capacity, and even without armed conflict the strength of the Chinese merchant marine affords it the power to manipulate foreign trade rates and access. Although the U.S. has successfully fought wars in the Persian Gulf with the support of foreign-flag shipping, that support has not always been reliable, and might not be available in the event of a shock elsewhere in the world.[180]

Taking steps to ensure that there is an American merchant fleet adequate to meet these demands would seem to entail very high costs, given the cost differential between U.S. and foreign flagged shipping noted above. However, that is difficult to calculate directly. Many have rejected the notion that repeal of the protectionist Jones Act, thus allowing ostensibly cheaper foreign shipping to compete in the coastwise market, would lower costs, even in places like Puerto Rico.[181] A GAO study con-

178. *See Comparison of U.S. and Foreign-Flag Operating Costs*, *supra* note 176, at 4.

179. *See* Reid J. Epstein & Colleen M. Nelson, *Donald Trump Lays Out Protectionist Views in Trade Speech*, Wall St. J. (June 28, 2016, 5:33 PM), http://www.wsj.com/articles/donald-trump-lays-out-protectionist-views-in-trade-speech-1467145538.

180. For example, as noted in Section II, many foreign-flag vessels trading with the U.S. withdrew at the advent of the Boer War. A modern external shock might similarly cause foreign shipping to withdraw from their support of an American military expedition.

181. *See* Sarah Beason et al., *Myth and Conjecture? The "Cost" of the Jones Act*, 46 J. Mar. L. & Com. 23, 33 (2015).

curred that it could not be reliably determined that the Jones Act raises costs.[182] There are also economic benefits to relying on U.S.-flag international shipping. Studies have suggested that the subsidies under the Merchant Marine Act of 1936 returned more in taxes than was spent on the subsidies.[183] Another study showed that the subsidy program produced over 30,000 jobs, over 1.5 billion dollars in household earnings, and almost a quarter million dollars of tax revenue.[184] Thus, the economic impact of transitioning to U.S.-flag shipping would be mitigated by gains elsewhere in the economy.

Subsidies are one option to promote the merchant marine. The federal government often subsidizes industries that are vital to the national interest, such as agriculture, energy, and infrastructure. However, subsidies have a variety of drawbacks. They are visible and usually appropriated annually, and therefore frequently vulnerable to cuts.[185] The subsidy program from the Merchant Marine Act of 1936 shows the danger of relying on subsidies. It ultimately collapsed under rigid controls that hampered effective management and constant administrative proceedings that consumed time and legal fees.[186] The Maritime Security Program shows that subsidies can work for a limited purpose, however it is difficult to imagine the U.S. restoring its merchant marine to world leadership through direct subsidy.

If the U.S. wished to engage in more explicit protectionism of the merchant marine, there are certainly options to do so. Foreign-flagged vessels often enjoy significant tax advantages over American registry,[187] which can be addressed through tax incentives. Foreign ownership could be strictly policed, as in aviation, or banned altogether. Tariffs could also be introduced, and would be the most direct route to make American shipping competitive. The U.S. could also require compliance with American labor laws, including wage requirements and acceptance of American jurisdiction a condition of port entry. Stronger still, the U.S. could restrict exports partially or completely to American-flagged vessels. Of course, the more strongly protectionist the policy, the more likely it is to provoke a conflict with foreign nations, particularly China. Given that the need to strengthen the merchant marine is based on American inability to compete with China in sealift and maritime trade, aggressive protectionist policies are probably not prudent.

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182. *Id.*

183. Hanson & Berry, *supra* note 47, at 485.

184. *Id.* at 486.

185. *See* Gibson & Donovan, *supra* note 15, at 85.

186. René De La Pedraja Toman, A Historical Dictionary of the U.S. Merchant Marine and Shipping Industry: Since the Introduction of Steam 394-95 (1994).

187. *See Comparison of U.S. and Foreign-Flag Operating Costs*, *supra* note 178, at 4.

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### C. Recommendation

It is difficult to imagine a political climate in which the U.S. could reinvigorate its flag merchant fleet through either subsidy or protection. Accordingly, the U.S. merchant marine strategy should be revised to reflect current reality. The merchant marine simply cannot carry American commerce on its own, let alone provide sealift in support of a major global conflict. Instead, the national strategy should reflect several more plausible goals: (1) ensure a minimum baseline of fully-controlled sealift access, (2) promote indirect access to vessels for surge, (3) cultivate expertise that can be scaled, and (4) promote an international system that is conducive to American competitiveness.

#### *1) Baseline of Assured Access*

Although the U.S. may not be able to maintain a significant oceangoing merchant fleet, it is important to retain a small fleet of vessels that are or can be fully and immediately controlled by the U.S. in the event of an emergency, and the fleet that is sufficiently large to support contingency operations overseas such as the conflicts in the Persian Gulf. The NDRF, RRF, MSP, and VISA[188] currently fill this role. The exact number of ships may vary based on the U.S. strategic posture, and feedback from civilian and military officials, but the permanent availability of sufficient shipping to support a full-scale operation such as Iraqi Freedom with minimal use of foreign charters should be a starting point.

#### *2) Promote Indirect Access*

Knowing that there will be few vessels that the government can directly control, it will be important to develop sound legal strategies to procure the use of both U.S.-flag (Jones Act[189]) and foreign-flag shipping when needed. For the cabotage fleet, ensuring domestic ownership would create a higher likelihood that a shipowner would voluntarily use a vessel to support national objectives and offer a simpler legal framework (eminent domain/takings) for the government to seize and use the vessel if necessary. If foreign interests are permitted in the Jones Act fleet, that raises issues of expropriation and neutrality. However, so long as the U.S. flag remains required by the Jones Act fleet, the U.S. would be gain access to vessels in an emergency even if foreign-owned.

For foreign-flag oceangoing shipping, the U.S. must take steps to promote American ownership of oceangoing vessels, and the flagging of such vessels in EUSC registries such as the Marshall Islands. The Mar-

188. At full activation, VISA ships need only contribute 50% of their capacity to Defense Department cargoes, and as such they do not strictly fit this category.

189. Virtually every U.S.-flag ship that does not fall into category 1 is a Jones Act ship.

shall Islands is a former Trust Territory of the U.S. that continues to maintain a close military relationship.[190] In theory, this allows U.S. shipowners to operate with the financial benefits of a flag of convenience, while the U.S. benefits from American-owned vessels subject to repatriation from a closely-allied nation. However, changes to the tax code in the 1980's that caused these shipowners to be taxed in the U.S. led to a decline in the number of EUSC vessels as shipowners exited a market where they earned only 66 cents on the dollar compared to their non-U.S. competitors.[191] These policies must be reversed to maximize American investment in merchant shipping.

*3) Cultivate Scalable Expertise*

Should the U.S. become engaged in a conflict with a near-peer adversary as in World Wars I and II, it will be vital that the nation be able to quickly ramp up production of vessels and mariners. Thus, the nation should pursue policies that develop and maintain expertise in shipbuilding and seafaring. For instance, the Coast Guard could offer tours for naval architects to work in shipyards, former enlisted military sailors could be enrolled in a reserve mariner program, the Defense Department could sponsor engineering student internships with Japanese or Korean shipbuilders, and so on. The expertise developed could then contribute to the rapid expansion of infrastructure necessary to quickly produce ships and mariners in times of crisis.

*4) Promote an American-Friendly World Order*

Finally, the U.S. should continue to push for ever-improving international law and regulations to narrow the competitiveness gap. Through treaties and international organizations such as the International Maritime Organization, the seas have become more and more regulated on issues such as crew safety and environmental impact.[192] High American standards allow shipowners to cut costs by flying the flags of nations that require only the international minimum. The U.S. should make every effort to raise that minimum, and thus edge closer to international competitiveness in shipping.

## VI. Conclusion

The choice between the pursuit of a first-rate merchant fleet or preferring peacetime economic advantages while making contingency plans is the central issue in the debate over the merchant marine. That choice

190. Compact of Free Association, U.S.-Marshall Islands, Apr. 30, 2003, T.I.A.S. No. 04-501.
191. *See* Marcus et al., *supra* note 36, at 53.
192. *See* Wing, *supra* note 37, at 180-81.

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will naturally frame how regulators approach the question of foreign ownership and control of maritime assets. A liberalization approach would naturally lead regulators to choose the most economically efficient option, permitting maximum investment to spur growth, so long as the U.S. can exercise indirect control over the vessels. A protectionist framework, by contrast, would suggest prioritizing American ownership above all, to ensure that the merchant fleet is nurtured. The approaches currently taken in the coastwise maritime, international maritime, and aviation domains illustrate that many policies are viable, and ample scholarship suggests avenues for reform and improvement. Reform of ownership and control requirements, however, will do little to correct the fundamental indecisiveness of the current strategy for the merchant marine. Instead, resolving that indecisiveness is crucial to effectively shaping a legal and regulatory framework for foreign investment.

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