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Know the Ropes When Flagging Your Vessel: A COMPARISON OF THREE OF THE WORLD'S DU JOUR VESSEL REGISTRIES



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I. Introduction: Choosing a Flag – More Than a Matter of Convenience

Advising a client of the appropriate flag state for his or her vessel is a challenging retainer, requiring consideration of almost every commercial issue from vessel ownership, labor and manning issues, and even the reputation of the flag state. The only certainty is that a vessel must sail under a flag: United Nations Convention on the Law of the Sea (UNCLOS) Article 91 provides:

Ships have the nationality of the State whose flag they are entitled to fly. ... [Moreover] ships shall sail under the flag of one State only and ... shall be subject to its exclusive jurisdiction on the high seas.

When considering which flag state to choose, one encounters several different registration regimes: traditional, open, and a hybrid of the two. While traditional registries usually require the vessel's owner or operator and a certain percentage of the crew to be citizens of the registration state, open registries typically impose more lenient registration requirements

by not requiring the vessel owners, operators, and crew to have the same nationality as the country where the ship is registered or the disclosure of ownership information.¹

Today, "flag of convenience" refers to vessel registration in a country with an "open registry" for predominantly economic reasons, including: little to no local taxes on vessel income, acceptance of foreign owners and crew, increases in vessel market value, easy currency conversion, allowing vessel repairs abroad, lower operating costs due to lower wages (due to the ability of hiring non-union employees), and more lenient labor and safety standards, obtaining vessel tonnage more easily, and avoiding Coast Guard regulations.²

With the increased popularity in open registries for vessel registry, it is important to understand the advantages and disadvantages of the different available registries and the factors to consider when selecting a particular registry. Choosing where a vessel should be "flagged" is a complex process that requires consideration of a multitude of factors. This article considers some of the key factors in the context of the three of the most popular flag states: the Republic of Marshall Islands (RMI), Mongolia and Panama.

A. Taking the Right Tack – Flying the Marshall Islands Flag

The RMI Registry, governed by the RMI Maritime Act of 1990 ("RMI Maritime Act"), is the third largest

vessel registry in the world, reaching 100 million gross tons in February 2014.³ Headquartered in Reston, Va., the International Registries, Inc. and its affiliates ("IRI"), is the world's oldest and one of the most experienced privately administered Maritime and Corporate Registry provider; it operates 26 full-service offices in major shipping and financial centers around the world, and provides worldwide, around-the-clock duty officer system and real time support to vessels flying its flag.⁴

1. International Treatment

The RMI maintains a permanent representative and active delegation at the IMO.⁵ It is included on the White Lists of both the Paris and Tokyo Memorandums of Understanding ("MoUs"), and has also maintained Qualship 21 status with the U.S. Coast Guard for an unprecedented 10 consecutive years.⁶ Qualship 21 is an initiative that was implemented by the Coast Guard to identify high-quality ships, and provide incentives to encourage quality operations.⁷ Only approximately 10 percent of the foreign-flagged vessels that call in the U.S. qualify for this initiative and certification, which focuses predominantly on the vessel's Port State Control ("PSC") records and history⁸ ensuring the vessel

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is manned and operated in compliance with applicable international law.⁹

2. Qualifications for Registry

Business entity formation within the RMI is straightforward and efficient, and there are tax incentives associated with vessel registration with the RMI Registry. The RMI does not restrict the nationality of seafarers serving on RMI flagged vessels, and offers competitive registration fees and tonnage taxes.¹⁰ Additionally, RMI's legislation permits vessels to register with the RMI Registry although the vessel is still subject to a recorded mortgage in its present country of registry.¹¹ The foreign mortgage lien accompanies the vessel into the RMI Registry.¹²

Seagoing vessels of any tonnage engaged in foreign trade and those under construction are eligible for registration in the RMI.¹³ At the time of registration, vessels should not be more than 20 years of age, however, vessels that are older than 20 years may be granted a waiver for registration depending on their condition and classification.¹⁴ An owner may check availability of vessel names and reserve that name for six months for an existing vessel and two years for a newly constructed vessel.¹⁵

Ownership of vessels registered with the RMI must be through an RMI corporation, limited liability company, limited or general partnership, and associations of individuals or a qualified FME.¹⁶ The RMI has mandatory classification and statutory survey and certification requirements. The country provides a list of approved societies for an owner's convenience.¹⁷

3. Registration Fees

Registration fees as well as first year's RMI tonnage taxes and annual fees are payable upon registration.¹⁸ There are two fee option schedules available. Schedule A where the standard fees are payable for the registration in the RMI or Schedule B providing a sliding scale for various tonnage categories and a fleet discount structure.¹⁹ Discounts are

available for certain registrations, *e.g.*, a fleet or newly constructed vessels.²⁰

4. Mortgaging Vessels & Maritime Liens

The RMI Maritime Act incorporates provisions for recordation of security-related instruments and documents of title.²¹ Recordation provides notice to creditors, purchasers, suppliers and other parties with interest, and furnishes an internationally enforceable structure for the protection of legal rights recorded.²² The RMI does not require a particular form of vessel mortgage. However, for a mortgage to be recorded with the Administrator, the mortgage must be duly executed and acknowledged as required by the RMI Maritime Regulations (MI-108) Section 3.30, or with proof of due execution as required in RMI Maritime Regulation 1.04.2a.²³

All documents recorded under the Maritime Act (MI-107) must be in the English language, except notices of foreign language ship mortgages or financing charters recorded under the bareboat registry provisions of the Maritime Act, Section 264, which only have to have their cover and execution pages translated into English.²⁴ Preferred status gives priority to a lender's mortgage lien over those with certain other claimants.²⁵ An RMI ship mortgage must contain the: (1) vessel name; (2) hull number for a vessel under construction; (3) names and identifies of the parties to the mortgage; (3) interest in the vessel affected; and (4) amount(s) of the direct or contingent obligations that are or may become secured under its terms.²⁶

A preferred mortgage may secure sale and lease transactions, contingent and future obligations, advances and repayments, and guarantees. Owners also have an option to "tack on" a previously recorded mortgage.²⁷ Owners may submit the recorded foreign mortgage and a simple signed mortgage instrument that is recorded when a vessel is registered with the RMI.²⁸ Marshall

Island laws will govern the mortgage instrument.²⁹ In addition to the RMI legal system, international legal and financial professionals recognize the RMI mortgage recordation procedures and administrative controls.³⁰

5. Manning & Safety Requirements

There are no nationality restrictions for vessel crewmembers.³¹ However, RMI officers are required to hold a CoC/Certificate of Endorsement (CoE) issued by the Administrator, and all persons serving aboard RMI flagged commercial vessels are required to hold an RMI Seafarer's Identity and Record Book, which serves as a record of sea service and contains the Special Qualification Certificates (SQCs), specifying the rating in which the holder is qualified to serve and any special qualification(s) held by the seafarer.³²

6. Taxation

Pursuant to RMI Business Corporations Act Section 12, RMI business entities and foreign maritime entities ("FME" or "FMEs") are exempt from annual filings and corporate tax, net income tax, withholding tax on entity revenues, asset tax, tax reporting requirement on entity revenues, stamp duty, exchange controls or other fees or taxes, provided that they do not engage in business within the RMI.³³

7. Labor and Operating Costs

On September 25, 2007, the RMI ratified the Maritime Labour Convention of 2006 ("MLC 2006"), which provides: the minimum requirements for seafarers to work on board ships, conditions of employment, including pay, rest hours, leaves of absence, training and manning of ships, accommodation, health protection and care and compliance and enforcement mechanisms and measures. The government also adheres to certain minimum standards of social security, under the Social Security (Minimum Standards) Convention of 1952 ("SSC 1952"), concerning: medical

care, sickness benefits, unemployment benefits, employment injury benefits and survivors' benefits.³⁴

B. Full Steam Ahead: Flying the Mongolian Flag

1. International Treatment

Port State Control authorities, under the Memorandum of Understanding on Port State Control in the Asia-Pacific Region (Tokyo MOU), detained 26.76 percent of all Mongolian-flagged ships in 2013; the second highest detention percentage.³⁵ (Ships are detained when the condition of the ship or its crew does not correspond substantially with the applicable conventions.)³⁶ Based on the number of inspections and detentions from 2011-2013, Mongolia sits at the 6th position on the Tokyo MOU, 2013 "black list." A "black list" categorization is one of several factors considered when assigning a ship risk profile which can have the effect of increasing or decreasing the number of Port State Control inspections a particular vessel is subjected to.³⁷

2. Qualifications for Registry

To register a vessel under Mongolia's ship registry, a registrant submits a Bill of Sale, existing registry and statutory certificates, as well as a certificate of competency for all officers on board the vessel.³⁸ There are no restrictions on the ownership of the vessel, meaning that the owner's nationality, or registration as a corporate body or entity, are not taken into consideration for registration as long as the applicant is capable of owning a vessel under the law of its national country.³⁹ Moreover, the Mongolia ship registry offers to complete the entire registration process online in as little as 24 hours.

3. Registration Fees

When applying to register a vessel, financial considerations hold considerable weight. Mongolia's ship registry boasts as having "low initial registration and annual tonnage taxes" as well as no cost to the ship owner(s) for setting up an "owning company".⁴⁰

4. Mortgaging Vessels & Maritime Liens

The *Regulations for Registration of Ships in the Ship Registry of Mongolia* allows for a Mongolian vessel to be used as security for "a loan or other valuable consideration."⁴¹ However, a mortgagee or creditor is prevented from acting on its security interests by detaining a vessel's Certificate of Registry.⁴²

5. Manning & Safety Requirements

All seafarers are required to have a valid Mongolian certificate of endorsement ("COE") to work on board a Mongolian vessel.⁴³ Annex 2 to the *Regulations for Registration of Ships in the Ship Registry of Mongolia* provides that a duly licensed Master needs to be on board every registered Mongolian vessel.⁴⁴ Moreover, vessels with a propeller thrust of 300KW or more need to have a licensed Chief Engineer on board.⁴⁵ Pursuant to the International Convention on Standards of Training, Certification and Watchkeeping for Seafarers 1978 ("STCW Code") manning standards, every officer and crewman on a Mongolian vessel must have the requisite training and certification to perform their job duties.⁴⁶

With respect to safety requirements, a registered Mongolian vessel must be manned by the appropriate number of officers and crewmen necessary for the vessel's safe navigation and operation.⁴⁷ In the case of a registered Mongolian passenger vessel, a certified survival craft crewman must be assigned to each survival craft (i.e. lifeboat) on board the vessel.⁴⁸

6. Taxation

There is little taxation information provided to potential registry applicants. However, the Mongolian Ship Registry does entice applicants by purporting to have low initial registration and annual tonnage taxes as well as no taxes on profits or capital gains.⁴⁹

7. Labor and Operating Costs

At present, Mongolia has not ratified the MLC 2006, although a draft bill was submitted to Parliament last year in support of Mongolia's ratification of the MLC 2006.⁵⁰ Ratifying the MLC 2006 would mean that Mongolia has accepted the responsibility of ensuring the safety and wellbeing of seafarers, namely meeting requirements for minimum age, hours of work, wage payments and medical care.⁵¹ Nor has Mongolia ratified the SSC 1952.

Remaining as a non-ratifying flag state means that Mongolian flagged ships calling at ports of ratifying states will be subject to Port State Control inspections, the purpose of which is to enforce the Labour Conventions' minimum standards for work and living conditions upon vessels.⁵²

C. Plain Sailing under the Panamanian Flag

Panama's registry is the world's largest vessel registry.⁵³ Indeed, the Panama flag is flown by over 6,000 vessels currently trading in the world's oceans, most of which are not owned by Panamanians.⁵⁴ Panama is one of the oldest and most widely chosen jurisdictions for ship registration because of the ease of registration, low registration fees, low-tax offshore jurisdiction and regulatory protections.⁵⁵ Panama's Maritime Court is available 24 hours a day, 365 days a year.⁵⁶ Currently, Panama, which trades in U.S. dollars, has over 1,000 inspectors in over 300 ports ensuring compliance, worldwide.⁵⁷

1. International Treatment

Panama is a signatory of the four "pillars" of international maritime law - the STCW Convention, SOLAS, MARPOL and the MLC 2006. Panama was notably listed in the first edition of the IMO's "White List," released on December 6, 2000, defining the flag states assessed to be properly implementing the revised STCW 95 Convention.⁵⁸

2. Qualifications for Registry

Panamanian law provides that “[a]ny individual or corporate entity, irrespective of nationality or country of incorporation, may register a vessel under Panamanian flag.”⁵⁹ Accordingly, corporations are not required to have a place of business or business agent in Panama and incorporations, and officers and directors are not required to be residents of Panama to register vessels in Panama.⁶⁰ Further, vessel crewmembers need not be Panamanian nationals.⁶¹ There is no minimum tonnage requirement, and almost any category of ships can be registered, from passenger ships to dredges and floating docks.⁶² Although there are no age restrictions, vessels that are 20 years old require a special inspection.⁶³

Panama provides a provisional patent for a six-month period.⁶⁴ After the preliminary information about the vessel and vessel owner is provided by way of the registry application,⁶⁵ the vessel owner must notarize and file a number of required documents with the Consulate at the time of registration.⁶⁶

Another benefit of registering in Panama is the ability for dual registry. A foreign vessel bareboat chartered (where a vessel owner leases a ship, without its crew or provisions, to the charterer, which becomes responsible for the vessel’s operation), already registered in one state may be registered in Panama for the same period, up to two years (dual registration is renewable).⁶⁷ This allows a charterer, leasing a ship registered in a country without an open registry, to take advantage of the Panamanian registry benefits. A vessel owner can also maintain the vessel’s original registration, which is suspended during the dual registration and regains its effectiveness upon termination of the charter.⁶⁸ A certificate of consent from the country where the vessel is originally registered is required and dual registry can only apply if the vessels home country allows it.⁶⁹

3. Registration Fees

The cost to register a ship under Panama’s registry is lower than many of the other registries.⁷⁰ The initial registration fee is approximately \$0.25 per registered ton plus an additional \$0.10 per net ton in annual tonnage tax.⁷¹ Owners can receive fee and tonnage tax discounts when registering a fleet of vessels.⁷²

4. Mortgaging Vessels & Maritime Liens

Preliminary registration of a title or mortgage is accepted by the United States, Far Eastern, European, and worldwide banks as providing satisfactory security.⁷³ A vessel mortgage may be executed in Panama or any other country, but must be registered at the Public Registry of Panama.⁷⁴ The mortgage will not become effective against third parties until it is registered.⁷⁵ It may be written or executed in any language or form, but must include name, address of mortgagor and mortgagee, fixed or maximum mortgaged principal, schedules for payment of principal and interest, interest rate or manner for determining it, name of mortgaged vessel, patent number, tonnage and dimensions.⁷⁶ Fleet mortgages require paperwork of each vessel.⁷⁷ Additionally, special naval mortgage provisions are required for ships under construction.⁷⁸

5. Manning & Safety Requirements

To be registered with the Panama Registry, all vessels must pass an annual inspection to ensure that they meet international safety regulations, carry up to date certificates and are properly manned and equipped for their intended trade.⁷⁹ To prevent the enrollment of potentially hazardous ships, vessels built over 20 years ago are required to be inspected before a permanent patent can be issued. All vessels are subject to surveys by an approved classification society that will issue tonnage and other technical certificates.⁸⁰

6. Taxation

Corporations can be created in Panama to register vessels providing protection for owner’s assets.⁸¹ Panama does not collect income tax on profits resulting from the business made from merchant shipping outside of Panama, and, so long as services are not provided while the vessel is on coastal trade or performing work in the navigable waters of Panama, shipping companies are not required to withhold income taxes from employees’ salaries.⁸²

7. Labor and Operating Costs

On February 6, 2009, Panama ratified the Maritime Labour Convention of 2006. The government has also ratified the SSC 1952, accepting obligations under the Convention concerning the following branches of social security: old-age benefit, invalidity benefit and survivors’ benefits.⁸³

II. When the Ship Comes In: Final Thoughts and Conclusion

It is clear that while the only certainty for a commercial vessel is that it must be flagged, every other issue will be affected by the needs and requirements of one’s client. This paper canvasses the key considerations for each client, in order to provide insight into the differences and similarities amongst the three most popular flag states. For example, the convenience of quick registration under the flag of Mongolia can be balanced against the cost and labor requirements of the flags of Panama or the Marshall Islands. These in turn may be balanced against the ease of mortgage and lien registrations. In each case, the international reputation of the flag state, any port conveniences offered to a vessel flying certain flags, the labor requirements (or lack thereof), are balanced by the nationality of the purchaser (or not), and, perhaps, the age of the vessel. 

Endnotes

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22. *Id.*
23. *Id.*
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29. *Id.*
30. Richard Coles and Edward Watt, *SHIP REGISTRATION: LAW AND PRACTICE*, 20.18 at p. 238.
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62. *Id.*
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64. *Id.*
65. *Id.* (application may be obtained at: http://www.nyconsul.com/new_page_6.htm).
66.
 - 1) title of ownership (two copies), comprised of the bill of sale or a builder's certificate for a new vessel;
 - 2) power of attorney in favor of the persons registering the vessel and acting on behalf of the vessel before the Panamanian authorities (a practicing Panamanian lawyer must be appointed as legal representative of the vessel);
 - 3) a deletion or cancellation certificate, issued by the authority of the former country of registration and demonstrating that the vessel is no longer registered under the previous registry and that it is free from mortgages or encumbrances (not required for new vessels); 4) corporate resolution – if a corporation submits the registration application, its representative's authority must be established; 5) acceptance of sale – the buyer must state his approval of the sale transaction; 6) international tonnage certificate or certificate of admeasurement certified by the surveying company (does not need to be notarized); and 7) acceptance of sale – the buyer must state his approval of the sale transaction.
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