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The Flags-of-Convenience Problem

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NOTES

THE FLAGS-OF-CONVENIENCE PROBLEM

Although some scholars regard Hugo Grotius (1583-1645) as the father of international law, the better view, it would seem, is that Grotius supplied ". . . not a system of law, but a philosophy of inter-state relations. . . ."[1]

Grotius' philosophy evolved the traditional international legal principle of freedom of the seas for the maintenance of the public order at sea. In modern times, however, the philosophy of Grotius, with respect to the sea, maintains a concern more basic than and different from traditional sea law. The present problem at sea is within world maritime commerce and trade and consists of the international competition prevalent in the shipping industry. Because this problem is economic rather than legal, there is some question whether the traditional philosophy of Grotius should accord a solution.

The problem of international shipping competition manifests itself in the legal complications that arise from the national character attributed to merchant vessels operated by the industry. The crux is that certain nations foster the registration under their flags of foreign-owned ships. The flags of these nations, known as "flags of convenience," presently confront the philosophy of Grotius with one of its most acute twentieth century problems.

The most accessible flags of convenience are those of Panama, Liberia, and Honduras, who represent approximately thirty-six per cent of all privately owned American merchant ship tonnage. Such flag of convenience registration enables the American shipowner to reduce his operating costs by avoiding requirements that American-flag vessels employ American seamen, either be repaired in American shipyards or pay a penalty of fifty per cent of the value of the repairs made elsewhere, and undergo periodic Coast Guard inspections requiring high maintenance standards. By avoiding these costly requirements, the American flag of convenience operator—employing alien crews, decreasing maintenance standards, and repairing his vessel abroad—pays from one-third to one-fifth American wages and reduces maintenance and repair bills by about twenty-five per cent for a total operating cost reduction of about one-half.[2]

1. BISHOP, INTERNATIONAL LAW 18 (2d Ed. 1962).
2. Comment, *The Effect of U. S. Labor Legislation on the Flag-of-Convenience Fleet,* 69 YALE L. J. 498, 500 (1960).

Although the greatest concentration of foreign flag operations involve American-owned ships, flag of convenience shipping represents about fifteen per cent of the world's merchant tonnage. Thus, flags of convenience are an international economic problem. However, because there is no real connection between the countries that provide flags of convenience and the ships that use them, opponents of flags of convenience fleets construe the problem as an uncertainty that is unfavorable to the sea's public order. Allegedly, the connection is merely a matter of form. As stated by the Oslo Shipowners Association in 1958:

> Because the shipping registered under their flags does not pay tax, these countries are unable to make any reasonable contribution to the defense of western civilization and the freedom of the seas. In these uncertain times, when preparedness is essential, large merchant fleets sailing under the flags of countries outside the general control, constitute an element of uncertainty that must not be underestimated.[3]

As participants in the shipping industry's international competition, the Oslo Shipowners admitted their inability to remedy the flags of convenience situation and concluded that the problem is "soluble only at government level—national or international."[4]

The basic dilemma in the flags of convenience problem on the national level is the conflict between the "inclusive interests" of the maritime nation (such as free commercial navigation) and the "exclusive interests" which that nation seeks to protect. More specifically, the dilemma in the United States consists of the inclusive principles of comity embodied in international law in contradistinction to the exclusive interest in the welfare of American labor. American labor unions maintain that because of American-owned flags of convenience vessels, the employment of American seamen continues to decrease. The unions also claim that because of this decrease, pay scales and working conditions on board American-flag ships will deteriorate and that because of the relationship between a strong merchant mariners' force and the defense of a nation, the security of the United States may be diminished. However, thus far, the American labor movement has sought unsuccessfully the passage of remedial legislation by Congress.

3. Harolds, *Some Legal Problems Arising Out of Foreign Flag Operations,* 28 FORDHAM L. REV. 295, 313 (1959).
4. *Ibid.*

After gaining no assistance from the United States government, the unions turned directly on the flags of convenience fleets with an attempt to unionize and obtain American wage scales for seamen serving aboard these foreign-registered vessels. In this attempt to organize, the unions sought the aegis of the National Labor Relations Act. This statute grants the Labor Board power to resolve "questions of representation" when "commerce" is affected.[5] Commerce is defined to include that ". . . between any foreign country and any state, territory, or the District of Columbia."[6] Thus, arguably, only those ships that never enter United States ports are specifically excluded from coverage under the act. Such an interpretation of a national law would obviously be in opposition to international law doctrine. However, based on still another theory—that of "substantial contacts" with American interests—the Labor Board in the *United Fruit Co.*[7] decision, found that it had jurisdiction of a foreign corporation's maritime operations that encompassed transportation and trade between foreign countries and states of the United States, despite foreign registry of the vessels and the foreign-national status of the seamen employed. Thus, because of the underlying stock or other beneficial ownership resulting in ultimate control of a foreign corporation and its operations by domestic United States interests, the Labor Board found American-owned foreign-flag operations within the coverage of the NLRA and directed a representation election for seamen employed within such operations. On appeal, the Labor Board finding was reversed by the Supreme Court which held that assertion of United States jurisdiction by the Labor Board over flags of convenience ships employing alien seamen would require a clearly expressed affirmative intention of Congress. The Court found no such intention and therefore held that the Labor Board was without jurisdiction, in view of the well established rule of international law that the law of the flag state ordinarily governs the internal affairs of such a ship.[8]

As a result of this decision, the Labor Board is without jurisdiction to administer elections on flag of convenience ships, to qualify a union as the seamen's bargaining agent, or to prevent unfair employer labor practices. Thus, practically speaking,

5. NATIONAL LABOR RELATIONS ACT §§ 9(c)(1), 10(a), as amended, 61 STAT. 144, 146 (1947), 29 U.S.C. §§ 159, 160 (1958).
6. NATIONAL LABOR RELATIONS ACT § 2 (6), as amended, 61 STAT. 138, 29 U.S.C. § 152 (1958).
7. 49 L. R. R. M. 1138 (1961).
8. McCulloch v. Sociedad Nacional de Marineras, 52 L. R. R. M. 2425 (1963).

American labor unions are reduced to a position where they are unable to organize seamen on board flag of convenience ships. Therefore, until there is congressional modification of the NLRA, the restrictive policy of the courts toward the Labor Board, the unsupportable desires of American labor, and the unassailable position of the flags of convenience fleets will continue.

The Supreme Court's decision was entirely proper. For the Labor Board to extend United States jurisdiction to the internal affairs of American-owned flag of convenience vessels would be a breach of the international law principles, founded on comity of nations, that the Court has traditionally sought to protect. Admittedly, Congress has the constitutional power to apply United States jurisdiction to crews working foreign ships while in American waters. However, as long ago as *The Schooner Exchange v. M'Faddon*[9] the Court held that foreign ships are granted an implied consent by the United States to enjoy immunity from our jurisdiction. The principles of comity—primarily, freedom of access—that demanded the *Schooner Exchange* decision are equally applicable today. Such principles represent the inclusive interests of the whole American people, and it would seem that these inclusive interests prevail over the exclusive interests of America—the welfare of the American seamen, represented by the American labor movement.

We now consider flags of convenience from an international viewpoint. Whereas nationally, the labor movement is virtually the only adversary to foreign flag operations, internationally both the unions and foreign shipowners continue to exert pressure in opposition to PanLibHon "runaway" shipping. The unions and the shipowners contend that the flags of convenience countries maintain no effective jurisdiction over their ships, have not developed a mercantile legal system, have no rational method for recruiting their own seamen, no officer-training institutions, no effective ship control, and allow their ships to operate essentially tax-free. Because foreign flag operations are the manifestations of competition within the world shipping industry, and because national solutions have thus far failed to be forthcoming, the unions and foreign shipowners have sought a solution from international law and the law of the sea.

For many years, the law of nations has clearly indicated that a ship is regarded as belonging to the country that registered

9. 11 U.S. (7 Cranch) 114 (1812).

the ship.[10] Specifically, international law has traditionally left each individual nation to determine under what conditions it will register and thereby confer its nationality upon a ship. In 1958, the United States Supreme Court in *Lauritzen v. Larson*,[11] re-affirmed the United States' concurrence with the above international law principles. The Court held that each state under international law may determine for itself the conditions requisite for granting its nationality to a ship, as evidenced to the world by the ship's papers and national flag. The Court concluded that the United States has firmly and successfully maintained that the regularity and validity of registration can be questioned only by the registering state.[12] These principles have evolved over many years, the result of a multitude of sea crises. Paramount in their solution was the maintenance of the public order of the seas. Almost as significant as freedom of the sea *vis a vis* the public order thereof, has been the established right of nations to confer national character upon vessels, based on self-determined criteria.

Notwithstanding traditional international legal principles, the International Law Commission submitted a radically new concept of international law to the United Nations Conference on the Law of the Sea, held at Geneva in 1958. While adhering to the traditional principles that "Each state shall fix the conditions for the granting of its nationality to ships, for the registration of ships in its territory, and for the right to fly its flag,"[13] Article 5 of the Geneva Convention substantially confirms the new concept of the I.L.C.:

> . . . there must exist a genuine link between the State and the ship . . . the State must effectively exercise its jurisdiction and control in administrative, technical, and social matters over ships flying its flag.[14]

Supported by the traditionally maritime nations—Norway, Sweden, the Netherlands, Britain, and Italy—representing the non-American shipowners and the International Labor Organization, representing the unions, the "link" requirement was adopted by the Geneva Conference and became a new, yet unratified element of the international law of the sea. The United States

10. 5 HUDSON, INTERNATIONAL LEGISLATION 639 (1936).
11. 345 U.S. 571, 584 (1958).
12. Lauritzen v. Larson, 345 U.S. 571, 584 (1958).
13. Jessup, *U. N. Conference on the Law of the Sea,* 59 COLUM. L. REV. 234, 255 (1959).
14. Jessup, *supra* note 13, at 256.

ratified the Convention on March 21, 1961, but as of January 12, 1962, neither the "link" theory nor the Convention were effective for lack of required ratification by twenty-two nations.

As previously mentioned, the "link" innovation for the identification of the national character of ships was stimulated by the interested pressure groups—the unions and the interested foreign shipowners. However, this innovation owes its inspiration to the International Court of Justice, which, three years before the 1958 Geneva Conference, produced a novel and controversial decision. In 1955, the Court held in the *Nottebohm Case*[15] that Liechtenstein citizenship conferred on a former German national who had his business interests and residence in Guatemala for thirty-four years did not correspond with the factual situation because certain minimum factors necessary for citizenship were absent. Because of the lack of any "real and effective link" between the nation and its national, the Court denied Nottebohm the citizenship that Liechtenstein had granted him.

After *Nottebohm*, the International Law Commission, encouraged by union and shipowning interests, transplanted the "link" theory into a dissimilar environment—the law of the sea. Whether this new criterion will ultimately be ratified by the participating nations in the Geneva Conference is unforetold. Whether the International Court of Justice will utilize the "link" standard to determine the national character of ships is still another question.

However, Phillip Jessup predicted in 1959 that ". . . in light of the court's opinion in the *Nottebohm Case*, it is probable that if the issue were presented to it, that tribunal would sustain the link theory in its application to the nationality of ships."[16]

To date, the "link" theory has not been in issue before the International Court, although the *Inter-Governmental Maritime Consultive Organization Case*[17] in 1960 skirted the issue. IMCO was organized in 1959, and under the convention for the organization's establishment, certain committee seats were reserved for the "largest ship-owning nations." Two flags of convenience nations, Panama and Liberia, were not elected to committee membership; and IMCO's assembly asked the International Court for an advisory opinion as to whether Panama and Liberia were

15. Liechtenstein v. Guatemala [1955], I.C.J. Rep. 4.
16. Jessup, *supra* note 13, at 256.
17. Advisory Opinion on the Constitution of the Maritime Safety Committee of the Inter-Governmental Maritime Consultive Organization [1960], I.C.J. Rep. 150.

disenfranchised. In a carefully phrased question that evaded a test of the "link" theory, the Court held that both nations should have been chosen to membership on the committee as among the eight largest ship-owning nations. The Court reasoned this because both nations rank in the top eight in terms of registry and flag, although actual ownership of many of the vessels concerned was foreign.

At this point the "link" theory remains in suspension, unratified by the required number of Geneva Conference participants, circumvented by the International Court, but predicted of probable sustainment by one of the Court's present magistrates.

The writer feels that the "link" theory fostered by the International Law Commission at the behest of union and shipping interests spokesmen is an unjustified imposition thrust upon the philosophy of international law. It would seem that the law of nations is not appropriate for the solution of an economic problem within a particular industry—though world-wide it may be. Problems of labor are self-evidently different and hardly comparable to the traditional objectives of international law. Better working conditions, higher wages, increased job opportunities, and more comprehensive social security are problems whose solutions lie within national boundaries and which have a too distant relationship to the traditional law of the sea and its objective—the maintenance of the public order of the sea. Equally true is that the problems of the shipping interests, principally the maintenance of their competitive position in maritime commerce, are unfit for solution by the law of nations. These problems are dependent upon taxes, safety regulations, labor legislation, government subsidies, and a nation's international trade, each of which are national considerations. These factors are matters of economics and politics—matters for national solution and improper considerations for the law of nations. It would seem that when a philosophy of law such as the law of nations becomes focused on the problems of a particular industry, resulting in the upheaval of the traditional right of a state to grant unquestioned its nationality to ships, only uncertainty and danger can ensue. The establishment of the "link" principle would grant to each state the unilateral competence to question or even deny another state's ascription of nationality to a vessel. Ships without nationality are deemed stateless. Stateless ships are without protection; they are not allowed access to ports; they are considered suspect of piracy. These are overdrawn possibilities. However,

they are distinct probabilities if the "link" theory were adopted as a prevailing principle of international law. The preamble of the Geneva Convention stipulates that the articles are "generally" declaratory of international law. Were the Convention ratified by the required number of nations, the United States Supreme Court, might find sufficient foundation in the ratification by the United States to uphold the Labor Board's "substantial contacts" theory. Because the "link" standard would allow the United States to question another nation's ascription of nationality to a vessel, the Court could hold that American-owned flags of convenience vessels were essentially American nationality, and therefore the Labor Board could interfere in the internal affairs of such ships. Based on these possibilities, the solution to the flags of convenience problem could be foreseeable. However, we must remember that these possibilities would, in fact, interfere with the principles of comity, such as freedom of the seas and freedom of access, that are essential to world trade and commerce which all commercial nations seek to protect. More important, respect for comity principles are requisite for healthy relationships between independent and sovereign nations. Without mutual restraint and appreciation for the inclusive interests that all ocean trading nations share, the unimpeded flow of ocean commerce, indeed, the maintenance of the public order of the sea are likely to become far less satisfactory.

Presently the "flags of convenience" problem continues unsolved. The writer has concluded that a solution fraught with dangers and uncertainties through the law of nations philosophy is inappropriate. In addition, present United States statutory law has proved inapplicable. The supreme question beckons its resolution, but where? In the United States, the courts have deferred the problem to Congress. Here, by the national government, the writer feels the matter of foreign flag operations rightly should be resolved—both by the United States and other interested nations. This is because a national level solution is most conducive to each nation's objective—the maintenance of the public order of the sea.

In the United States, Congress has continually refused assistance to the unions, who are the prime American opponents of flags of convenience. However, whether this policy will continue is not predictable. Conceivably, Congress could amend the present NLRA to include all ships owned or ultimately controlled by United States interests. But, because of potential foreign

retaliation and possible international trade disruption resulting from this seeming over-extension of American labor legislation, such an amendment is doubtful. Another possible congressional solution that would virtually eliminate American-owned flags of convenience shipping would be the application of federal minimum wage laws to employees on vessels owned or controlled by American citizens though operating under a foreign flag. However, this solution would probably produce equal consternation as extension of the Labor Act to include American-owned foreign flag operations.

Perhaps the most reasonable solution by Congress to American-owned flags of convenience shipping is the elimination of subsidy proposals. For some years it has been unlawful for one receiving subsidies to operate any foreign flag vessel that competes with an American-flag service.[18] This law has proved ineffective against flags of convenience shipping because owners may operate through foreign corporations ultimately controlled by Americans. Much more stringent legislation, introduced in 1957, that would have effectively eliminated American-owned flags of convenience transfers, failed to be enacted by Congress. Specifically, the proposal would have required Federal government certification, of any vessel to be transferred, that the vessel would not during its useful life be necessary to the American merchant marine, and, if transferred, would not be operated in competition with American-flag ships or be placed in an operation that would release another foreign-flag vessel for such competition. In addition, this proposal would have denied a construction-differential subsidy to those persons that own or operate, or whose affiliate owns or operates any foreign-flag vessel that competes with an essential American-flag operator.[19] Although this comprehensive bill was unsuccessful, in 1959 the opponents of flags of convenience received favorable consideration in the House of Representatives for an extension of the present subsidy law. Although unsuccessful in the Senate, this extension would have prohibited granting of operating-differential subsidies to owners with considerable interests in foreign flag operations.[20] This proposal, though hardly a panacea to the flags of convenience problem, would eliminate some American shipping interests from holding both American-flag and Ameri-

18. 49 STAT. 2012 (1936), as amended, 46 U.S.C. § 1222 (1958).
19. Note, *PANLIBHON Registration of American-owned Merchant Ships*, 60 COLUM. L. REV. 711, 717 (1960).
20. *Ibid.*

can-controlled foreign-flag operations. A search of the *United States Code* indicates that the subsidy law extension has yet to be passed by Congress. Essentially, the two elimination-of-subsidy proposals would require that American shipping interests become either fully American or fully flag of convenience operations. This is a choice few who receive American benefits would cherish. Many would consider, but few would become fully flag of convenience operators.

Because the elimination of subsidies is a national solution that in no way would impair or render uncertain the maintenance of the public order of the sea, it is the writer's belief that the subsidies-elimination proposals are presently the most feasible remedy to the problem of flags of convenience.

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