JAMES P. WALSH*
JOSEPH D. WEINSTEIN**

Foreign Investment in the U.S. Fishery Industry After the Anti-Reflagging Act of 1987

On January 11, 1988, the President signed into law the Commercial Fishing Industry Vessel Anti-Reflagging Act of 1987 (the Act).[1] The Act changes the way non-U.S. citizens may participate in the ownership and construction of vessels engaged in the U.S. fishing industry.

The Act is a continuation of the "Americanization" of the U.S. fishing industry started by the Magnuson Fishery Conservation and Management Act (Magnuson Act).[2] The Magnuson Act created a preference for U.S. fishing and fish processing vessels operating in the U.S. exclusive economic zone (the 200-mile zone from the coast of the United States containing some of the richest fishery resources in the world). A three-tier annual allocation system was adopted, with first priority to the fishery resources going to U.S. harvesters and U.S. processors. Second priority is given to U.S. harvesters participating in joint venture operations with foreign-owned processors. The final allocation, assuming the United States determined that sufficient fishery resources existed for such an allocation, would go to foreign harvesters and processors.

The Magnuson Act has been a significant inducement to the development of the U.S. fishing industry. As a result of the preference allocation system, harvesting of U.S. fishery resources is now done almost exclu-

*Davis Wright & Jones, Washington, D.C.
**Davis Wright & Jones, Seattle, Washington.

1. Pub. L. No. 100-239, 1987-2 U.S. CODE CONG. & ADMIN. NEWS (101 Stat. 1778).

2. Pub. L. No. 94-265, 90 Stat. 331 (codified as amended at 16 U.S.C.A. §§ 1811–27 (1982 & Supp. 1986)).

sively by U.S. fishing vessels. Foreign joint venture operations have also been greatly reduced as U.S.-owned harvester/processor vessels have taken a larger percentage of the resource. Foreign interests that wish to participate in harvesting or processing (as opposed to merely buying the finished product) have therefore sought to become U.S. harvesters and processors by making direct investments in U.S. fishing vessels and fishing companies. Japanese and, to a lesser extent, Korean and Canadian companies have made or are planning large investments, especially in the acquisition of floating processing facilities.

Under prior law, direct foreign participation was permitted in both harvesting and processing. As discussed below, a corporation that was 100 percent foreign-owned could own a U.S. flag fishing vessel. Flexibility was even greater in the case of ownership of processing vessels, where even foreign-built vessels were eligible for the U.S. flag. The 1987 Act, however, has made foreign participation much more difficult by expanding the requirements for a vessel fishery license, restricting the ownership of such vessels, and modifying the rules on reflagging and rebuilding.

I. Requirements for a Fishery License

The Act maintains the basic structure for the documentation of U.S. flag vessels.[3] For a vessel to operate as a fish harvester or processor (and thus be entitled to the priorities of the Magnuson Act), the vessel must be documented under the U.S. flag. The principal change effected by the Act is the expanded scope of a fishery license.

Licensing refers to the types of activities in which a particular vessel is authorized to engage. Eligibility for one of the four available licenses (registry, fisheries, coast-wise and Great Lakes) is a function of the type of activity of the vessel, its ownership (that is, the percentage of permissible foreign ownership), and where the vessel was built. Registry (operation in the U.S. import/export trade) is the most general license and the easiest to obtain. One hundred percent foreign ownership (through a wholly owned U.S. subsidiary corporation) and foreign construction is possible.[4] The requirements for a fishery license, on the other hand, are much more limited in terms of foreign participation.

Under prior law, a fishery license was only required for vessels engaging in the actual harvesting of fishery resources. Vessels involved in pro-

3. The Act, for the most part, consists of amendments to the Vessel Documentation Act, Pub. L. No. 98-89, 97 Stat. 585 (codified as amended at 46 U.S.C.A. §§ 12101–12122 (West 1988)).

4. § 12105.

cessing or in the transportation of fish could operate under a registry license and, thus, such activity was relatively open to foreign ownership and participation. The Act, however, expanded the definition of "fishery" to include the processing, storing, and transporting of fishery resources (except in foreign commerce).[5] As such, a fish processing vessel or fish tender vessel now requires a fishery license. With the expanded scope of a fishery license come additional restrictions on foreign ownership and foreign construction of vessels.

II. Foreign Ownership of a Fishery Vessel

The Act represents the first limitation on equity investments by non-U.S. citizens in a corporation owning vessels engaging in the fishery industry. As under prior law, for a vessel to be eligible for documentation under the U.S. flag (and, thus, eligible for any license), the vessel must be owned by a U.S. citizen.[6] One hundred percent foreign ownership was permissible, however, through the establishment of a U.S. subsidiary corporation as long as the President or CEO of the corporation was a U.S. citizen and no more of the corporation's directors were noncitizens than a minority of the number necessary to constitute a quorum.[7] Restrictions on foreign ownership had been rejected by Congress in the past because of the perceived need for foreign investment and for foreign business relationships that provided markets to U.S. harvesters and processors.

Congress has apparently decided that foreign investment capital in the U.S. fishing industry is no longer as necessary. The Act, therefore, adds a "controlling interest" requirement for vessels seeking a fishery license (which now includes harvesters, processors, and tender vessels).[8] To be eligible for a fishery license, the shareholders owning the controlling interest in a corporation, as measured by ownership of the majority of voting shares in the corporation, must be U.S. citizens. The controlling interest test will not be satisfied under a number of circumstances: if title to a majority of the stock of the corporation is not vested in citizens free from any trust or fiduciary obligation in favor of noncitizens; if the majority of the voting power in the corporation is not vested in U.S. citizens; if through any contract or understanding it is arranged that the majority of the voting power may be exercised, directly or indirectly, by noncitizens;

5. § 12101(a)(1).
6. § 12102.
7. § 12102(a)(4).
8. § 12102(b)(1).

or if by any other means whatsoever control of the corporation is conferred upon or permitted to be exercised by noncitizens. In addition, the Act provides that if the shares of a corporation are owned by other U.S. corporations, then the controlling interest in those other corporations, in the aggregate, must be owned by U.S. citizens.[9] As a practical matter, foreign investment through corporate form is limited to a 49 percent ownership interest of the voting shares.[10]

III. Reflagging and Reconstruction

Another perceived loophole closed by the Act is in the area of foreign construction and reconstruction of fishery vessels. In the past, for a vessel to be eligible for a fishery license, the vessel was required to have been "built in the United States."[11] No such building requirement applied, however, in the case of vessels licensed under registry. Because a registry license previously permitted vessels to operate as fish processors or tender vessels, foreign-constructed vessels, which often could be more cheaply produced than in the United States, were increasingly used in the U.S. fisheries.

In the case of fishery vessels, substantial foreign reconstruction was possible. Under prior U.S. Coast Guard regulations, a vessel would be deemed built in the United States if all major components of the hull and superstructure were fabricated in the United States and the vessel was assembled entirely within the United States.[12] The regulations were wholly

9. The "controlling interest" test for fishery vessels is the same test as has been applied to vessels licensed for coastwise trade. *See* 46 U.S.C.A. § 12102(b)(2); 46 U.S.C.A. § 802(b)(1982), app. § 802(b) (Supp. III 1985).

10. Marginally higher foreign ownership (50 percent) is permissible through partnership form. Under 46 U.S.C.A. § 12102(a)(3), a partnership will be deemed a U.S. citizen if the general partners are citizens of the United States and the controlling interest in the partnership is owned by United States citizens.

Effective June 16, 1988, the U.S. Coast Guard adopted formal rules for the controlling interest test in partnerships. *See* Documentation of Vessels, 53 Fed. Reg. 17,467 at 17,469-70 (May 17, 1988) (to be codified at 46 C.F.R. § 67.03-5). Under the rules, all general partners must be U.S. citizens. The controlling interest in a partnership will not be deemed to be owned by U.S. citizens if:

(a) Control of the partnership is conferred upon or permitted to be exercised by a partner who, if applying for a certificate of documentation as an owner of a vessel, would not qualify as a citizen; or

(b) If more than 50 percent of the equity in the partnership is owned by a partner who is not a citizen. Control includes an absolute right to direct partnership business, to limit the actions of or replace any general partner, to direct the transfer or operations of any vessel owned by the partnership or otherwise to exercise authority over the business of the partnership.

11. 46 U.S.C.A. § 12108(a)(2)(A).

12. 46 C.F.R. § 67.09-3 (1987). A vessel would be deemed a new vessel if its hull and superstructure are constructed entirely of new materials, or if it is constructed using

silent, however, regarding rebuilding and reconstruction. As long as reconstruction work did not result in the vessel being deemed a "new" vessel (which generally required substantial reconstruction of the hull and superstructure), the U.S.-built status of the vessel would remain. Based on this omission of reference to rebuilding, a number of factory catcher-processors were "reconstructed" in foreign shipyards where, in essence, an entirely new upper portion of the vessel was added, leaving little semblance to the old "U.S.-built" vessel.

The Act has drastically limited this practice. First, vessels engaging in processing and transportation of fishery resources now require a fishery license and, therefore, require that they be built in the United States. Second, the Act adds a rebuilding requirement under which the entire rebuilding, including the construction of any major components of the hull or superstructure, must be done in the United States.[13]

IV. Savings Clauses and Traps

Although the Act became law on January 11, 1988, it is effective as of July 28, 1987. The retroactive effective date would have negated a number of fishery vessel projects already substantially underway. The Act, therefore, contains several savings provisions that ameliorate the harshness of the retroactive date for those who relied on prior law.

The most significant savings clause deals with the prohibition against rebuilding vessels outside of the United States. The Act contains four exceptions whereby a vessel rebuilt outside of the United States will nonetheless be eligible for a fishery license. First, a license may be issued if, before July 28, 1987, the vessel was documented under the U.S. flag and operated as a fish processing or fish tender vessel in the navigable waters of the United States or the exclusive economic zone. Second, a license may issue if the vessel was purchased by a U.S. citizen for use as a fish tender or processing vessel under a contract entered into before July 28, 1987 (the contract to be demonstrated by reliable evidence). Third, if before July 28, 1987, the vessel was documented as a U.S. flag vessel and was either rebuilt in a foreign country before July 28, 1987, or was subsequently rebuilt in the United States, a license may issue. Fourth, the license may be granted for a vessel built in the United States that is subsequently rebuilt in a foreign country, provided rebuilding is done under a contract entered into before January 11, 1989, *and* either the

structural parts of an existing vessel which parts have been torn down so that they are no longer advanced to a degree which would commit them to use in the building of a vessel. 46 C.F.R. § 67.27-1 (1987).

13. 46 U.S.C.A. § 12108(a)(3).

vessel was purchased by a U.S. citizen for use as a fishing or fish tender vessel under purchase contract entered into before July 28, 1987, or, if the vessel was purchased for use as a fish processing vessel, the purchase contract was entered into before January 11, 1988. The fourth exception contains a final requirement that the vessel being rebuilt be redelivered before July 28, 1990, although this redelivery requirement can be waived by the Secretary of Transportation.

Similarly, the "controlling interest" restriction on foreign ownership of vessels operating under a fishery license does not apply if before July 8, 1987, the vessel was documented under the U.S. flag and operated as a fishing, fish processing, or fish tender vessel in the navigable waters of the United States or the exclusive economic zone, or was contracted for purchase for use as such (the contract to be demonstrated by reliable evidence).

The savings provisions raise a number of issues that have not been resolved. The most sensitive concern subsequent transfers of the "grandfathered" vessels or changes in the ownership structure of the legal entity owning the vessel so grandfathered. For example, although a vessel may be eligible for the "rebuilding" savings clause, should such vessel be subsequently transferred, it is unclear whether the savings provision would apply. Additionally, the legislative history to the Act suggests that the foreign ownership restriction savings clause is inapplicable if the ownership or operational control of the vessel so "saved" subsequently changes in whole or in part. Considering the enormous adverse consequences of an otherwise-exempted transaction becoming subsequently ineligible for a fishery license, persons acting in this area should closely consult with the U.S. Coast Guard prior to taking any steps that could jeopardize the "saved" status of a vessel.[14]

V. Opportunities for Foreign Participation in U.S. Fisheries

The Act, for the most part, has ended the days of complete foreign ownership (through use of a U.S. subsidiary) of U.S. harvesting, processing, and tender vessels. Foreign parties are now required to combine their investments with involvement by U.S. citizens, in a partnership of sorts. The foreign partner may not be satisfied with the 49 percent equity

14. In several letter rulings, the Coast Guard has taken the position that the vessel is "grandfathered" and that subsequent ownership changes (assuming the other requirements of the Vessel Documentation Act are met) would not jeopardize the vessel's eligibility for a fishery license. The Coast Guard's interpretation, however, is not law, and is not necessarily binding on a particular court.

position that the Act seems to offer. Within the terms of the Act, opportunities for significant foreign participation remain, however.

In the short term, the easiest method for minimizing the foreign ownership restrictions of the Act will be through purchase of existing fishing companies. If the particular fishing companies have U.S. documented vessels that have engaged in the U.S. fisheries prior to July 28, 1987, the purchase by a noncitizen of the corporation's stock probably will not jeopardize the eligibility of those fishing vessels for operations in the U.S. fisheries as long as the other requirements of the Vessel Documentation Act are met. The corporation, however, would not be permitted to construct new vessels to operate in the fisheries as the corporation would not meet the Act's citizenship requirements.

In the case of new vessels the simplest method for increasing permissible foreign involvement is through the use of nonvoting stock. The ownership restrictions apply only to corporate control and, thus, would not limit 100 percent foreign ownership of nonvoting stock of a U.S. corporation (which could be coupled with 49 percent foreign ownership of the voting stock). Alternatively, the foreign partner might structure part of the investment as a loan, secured by a preferred ship mortgage on the vessel, in accordance with the Ship Mortgage Act.[15] Considering the additional security the foreign partner would obtain with a preferred mortgage, debt-based participation has substantial advantages over equity investments that lack corporate control.

Another method of avoiding the equity-ownership restrictions of the Act is through operation of shore-side processing facilities. The prohibitions of the Act apply to vessels and would, therefore, not prevent even 100 percent foreign ownership of on-shore processing plants. Shore-side facilities are, of course, unsuitable for harvesting operations, but the majority of foreign investment in the last few years has been on the processing side. A possible variation on the use of shore-side processing facilities would be the conversion of current processing vessels into shore-side processors by removing the vessel propulsion system and permanently affixing the vessel to land. Theoretically, this practice would even permit the conversion of foreign-constructed vessels. We recommend careful consultation with the U.S. Coast Guard before taking this second variation, however, as this process has yet to receive official approval.

Ultimately, the greatest opportunities for foreign involvement may be contractual. A foreign party may enter into a long-term lease (or charter) of a U.S.-owned flag vessel already having a fishery license (or subse-

15. Ch. 250, § 30, 41 Stat. 1000 (codified as amended at 46 U.S.C.A. §§ 911–984 (1982), app. §§ 911–984 (Supp. III 1985)).

quently obtaining one) and by that contract have the right to operate the vessel. Similarly, backed by a long-term charter, a vessel eligible for a fishery license (owned by a U.S. citizen) could be constructed or rebuilt. Any lease or charter of a U.S. flag vessel by a noncitizen will require the approval of the U.S. Maritime Administration (MARAD).[16] Assuming such approval could be obtained, however, the foreign party might, through its contractual charter, achieve substantial operational control over the vessel. MARAD has previously given its approval to long-term bareboat charter agreements that vest substantial control in foreign parties over the life of the contract.[17] The Act will also place greater emphasis on the use of long-term supply contracts. Regardless of the ownership of the vessel, a long-term supply contract could assure the foreign party of an adequate supply of fishery resources at an affordable price, which is usually the foreign party's principal concern. Controls on the operation of the fishing business might be added as contractual requirements to the supply contract. Again, care should be had to avoid provisions that can be characterized as actual "control" of the enterprise.

The options above are neither exhaustive nor mutually exclusive. For example, direct foreign investment at the permissible 49 percent level, coupled with a loan secured by a preferred mortgage plus either a bareboat charter or long-term supply contract, could satisfy most of a foreign party's interests in operating in the U.S. fisheries. A variety of combinations may be possible.

VI. Conclusion

Prior to the 1987 Act, a foreign investor who wished to participate in the U.S. fishing industry could meet its entire operational needs through the establishment of wholly owned U.S. subsidiary companies. These companies could own and operate U.S. fishing vessels. The 1987 Act, however, has ended operations of this kind.

Accommodating the interests of foreign parties after the Act requires a combination of creativity and cooperation. It is now essential that foreign persons work with U.S. citizens in their fishing operations, with the ma-

16. 46 U.S.C.A. app. § 802.

17. Cases have most often arisen with respect to applications for bareboat charters for vessels operating under a coastwise trade license. As in the case of fishery vessels under the Act, a vessel engaging in coastwise trade must be owned and controlled by U.S. citizens, built in the United States and rebuilt in the United States. 46 U.S.C.A. § 12106. MARAD nonetheless has granted its approval to long-term bareboat charters of such vessels. *See* Alaska Excursion Cruises v. United States, 608 F. Supp. 1084 (D.D.C. 1985). In recent conversations with MARAD officials, however, they have indicated that consent to long-term bareboat charters or even time charters in favor of foreign parties may be difficult to obtain.

jority of the voting stock owned by U.S. citizens. Creativity will be required, on the one hand, to satisfy the foreign party's needs, and, on the other hand, to avoid the "control" issues that can jeopardize the entire investment. Part of the task will be in assisting potential foreign investors to identify more clearly their actual needs in the investment (which clarity was not necessary in the case of 100 percent foreign ownership). To this end the transaction will usually need to be structured so as to assure a source of fishery resources (such as through the use of long-term supply contracts) and yet to avoid provisions that put operational control in foreign hands.