

**MARINE**  
M O N E Y

ACADEMY

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# **Regulatory Considerations: Jones Act & Citizenship Restrictions**

Gerald Morrissey, Partner, Holland & Knight

# Intended Commercial Operations Can Impact Financing

## **Financing Type / Structure:**

- As discussed previously, the choice of flag state can affect available or preferred financing structures and security elements, e.g., local law differences in lease finance legislation, bareboat security interests; types of mortgages ...
- Operating in certain U.S. trades involves certain highly regulated areas, such as coastwise trade and other U.S. coastal activities regulated by cabotage statutes such as the Jones Act, some of which can directly impact financing structures

## **Diligence:**

- Regulated operational areas also affect financing transaction diligence
- For companies or vessels intended to be used in U.S. coastwise trades, in certain U.S. Outer Continental Shelf (OCS) activities (mainly oil and gas and offshore wind), and in government contracting, for example, there are heightened diligence considerations

# What is the Jones Act?

- The “Jones Act” refers to a U.S. statute that regulates the carriage of merchandise by water in the U.S. “coastwise trade”
  - The term is also commonly used to refer collectively to a number of other U.S. “cabotage” statutes covering carriage of passengers, towing, dredging, salvage, and fisheries
- The Jones Act prohibits transportation of merchandise between two points in the U.S. unless carried on coastwise-qualified U.S. vessels
- The related Passenger Vessel Services Act prohibits non-coastwise vessel transport of “passengers” (generally meaning persons who are not part of vessel crew or working on board) between two points in the U.S. The PVSA precluded moving offshore structure crews and service personnel by non-coastwise vessels.
- The U.S. Coast Guard, the U.S. Maritime Administration (“Marad”), and U.S. Customs and Border Protection (“CBP”) have Jones Act oversight functions

# Jones Act Requirements

- **Jones Act-qualifying vessels must be:**
  - Hull and superstructure must be constructed in the U.S. (however, substantial foreign content including engines and equipment is permissible in U.S. construction, as is some foreign reconstruction)
  - Registered/flagged in the U.S. (with a “coastwise” endorsement)
  - Master and majority crewed by U.S. citizens
  - Owned by a U.S. citizen or Jones Act-qualifying U.S. citizen entity
  - Operated and overall control by a Jones Act-qualifying entity
- **Penalties are severe and can include:**
  - Permanent disqualification of vessel from coastwise trade
  - Forfeiture of vessel; forfeiture of cargo
  - Civil and criminal penalties

# Jones Act Ownership

Corporate U.S. citizen ownership requirements have three main elements

## (1) Place of organization

- Must be organized under the laws of the United States or a state

## (2) Control:

- If managed by a Board of Directors, not more than a minority of the number of directors necessary to constitute a quorum are non-citizens
- Have a CEO (by whatever title), Chairman of Board of Directors, and those with authority to act in such capacities who are U.S. citizens
- No private agreements by which non-U.S. citizens obtain control

## (3) Equity:

- Be at least 75% beneficially and of record owned by U.S. citizens
- In a corporate chain, all of these criteria, including the 75% U.S. ownership test, must be satisfied at each corporate level, up to and including the ultimate parent holding company and its individual shareholders
- Each class of equity at each corporate level must comply with the 75% ownership requirement and there is no distinction between voting and non-voting equity (i.e., all equity interests are counted toward the requirements)

Application of these principles differ to some degree based on the type of entity in question:

- Limited partnership ownership must have a general partner that is itself a Jones Act-qualifying citizen and at least 75% of interests in partnership as a whole held by U.S. Jones Act-qualifying citizens
- LLC ownership (1), if member-managed, must have all U.S. citizen members (2), if operated similar to a limited partnership, with a managing member making management decisions, the entity would be evaluated similar to a limited partnership, and (3) *if operated similar to a corporation, with a Board or the like making management decisions (essentially, “manager-managed”), the entity would be evaluated similar to a corporation*
- There are no simple work-arounds for U.S. citizen ownership and control: No private agreements by which non-U.S. citizens obtain economic benefits of ownership or control

# Compliance Mechanics

- Vessel owner self-certifies citizenship status for a coastwise endorsement in its application to the Coast Guard for documentation for a vessel – creates a rebuttable presumption as to citizenship status
- Coast Guard occasionally requests additional evidence at the time of documentation, e.g. involving documentation errors or unusual circumstances
- Coast Guard and Marad do not typically monitor ownership status on a regular basis
- Presumption can be rebutted with evidence of possible non-qualification
- Competitors may bring, and have brought, private compliance challenges with Coast Guard and Marad leading to detailed investigations of ownership and control arrangements (as well as operational arrangements)
- If presumption is rebutted, burden of proof shifts to vessel owner to establish compliance
- There is no single safe-harbor method acceptable to regulators to prove ownership compliance in all situations
- **Agency advance approval/determinations -- “Determination Letters” -- are the most effective means to obtain advance comfort with proposed compliance structures**

# Lending and Lease Finance

- Mortgage holding on coastwise vessels was previously restricted to U.S. citizen mortgagees, which effectively prohibited direct non-citizen lending
  - That restriction was removed in 1996
  - “Westhampton Trust” structures that were previously used for non-citizen lending are no longer necessary
  - However, a non-citizen lender remains ineligible to operate a coastwise vessel, which is at least conceptually a constraint on available options in the event of default
  - Non-citizen lending is common

# Lending and Lease Finance

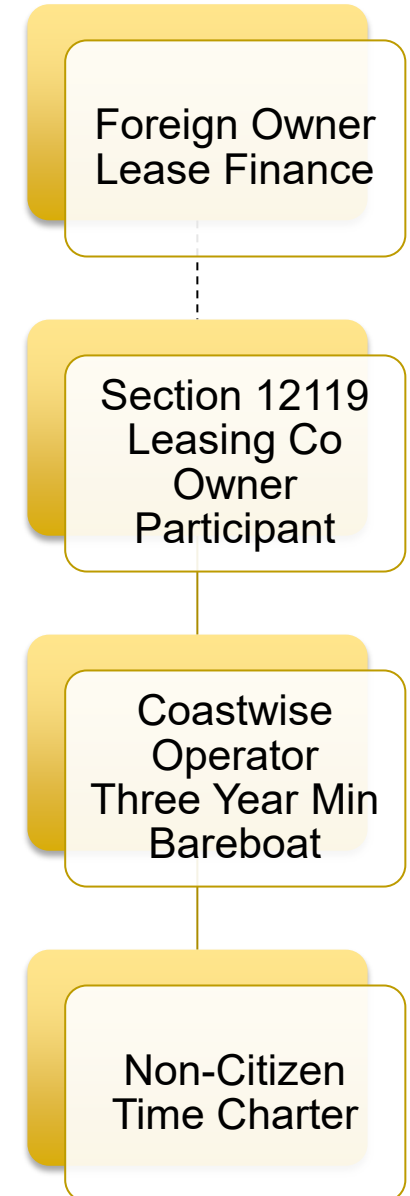
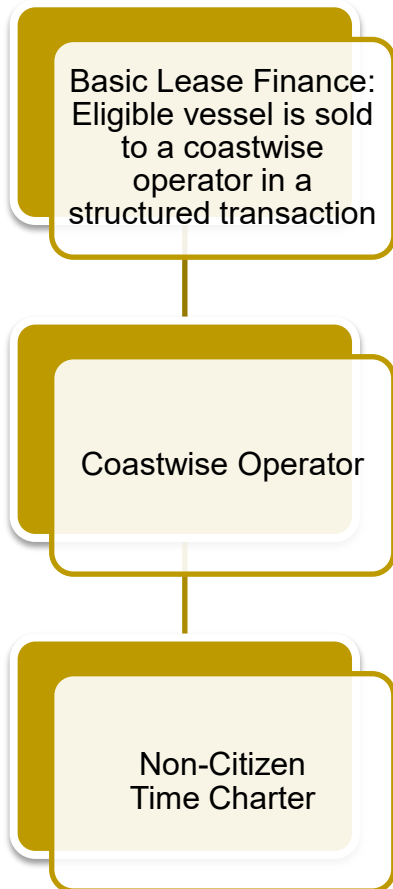
- Another somewhat modern-era legislative change permits “foreign owner” lease financing
  - Holding title to a coastwise vessel was previously restricted to only qualified coastwise U.S. citizens, excluding foreign banks and U.S. leasing subsidiaries from lease financing
  - The “foreign owner lease finance” statute removed some of the prior restrictions, permitting a U.S. “documentation citizen” entity to hold title to a coastwise qualified vessel, so long the vessel is operated under a *bona fide* bareboat charter with a qualifying Jones Act operator for a minimum 3-year term.
  - The lease finance exception in 46 U.S.C. § 12119 requires that:
    - (i) the Lessor is a leasing company, bank, or financial institution;
    - (ii) the Lessor owns, or holds the beneficial interest in, the Vessel solely as a passive investment;
    - (iii) the Lessor does not operate any vessel for hire and is not an affiliate of any person who operates any vessel for hire; and
    - (iv) The Company is independent from, and not an affiliate of, any charterer of the Vessel or any other person who has the right, directly or indirectly, to control or direct the movement or use of the Vessel.
  - In addition, the qualifying Jones Act operator can time charter the vessel in compliance with the section 12119 restriction and existing guidance permitting non-citizen time charters



# Lease Finance and Foreign Owner Lease Finance

Lease financing involving U.S. coastwise vessels:

- Can be used by U.S. citizen finance owners to finance vessels in otherwise permissible time charter arrangements to non-citizen users (left)
- Can be used by foreign banks/leasing companies, via U.S. subsidiary “documentation citizen” entities, to hold title to coastwise vessels in a compliant bareboat structure
- Can also be used in otherwise permissible time charter arrangements to non-citizen users (right)



# Financing Issues: Non-U.S. Participation – Equity

## **(1) Equity Structures**

- Minority investments
- Joint ventures
- Warrants

## **(2) Debt Structures**

- ABL
- Corporate credit
- Convertible debt
- Securitization

## **(3) Contractual (non-equity) structures**

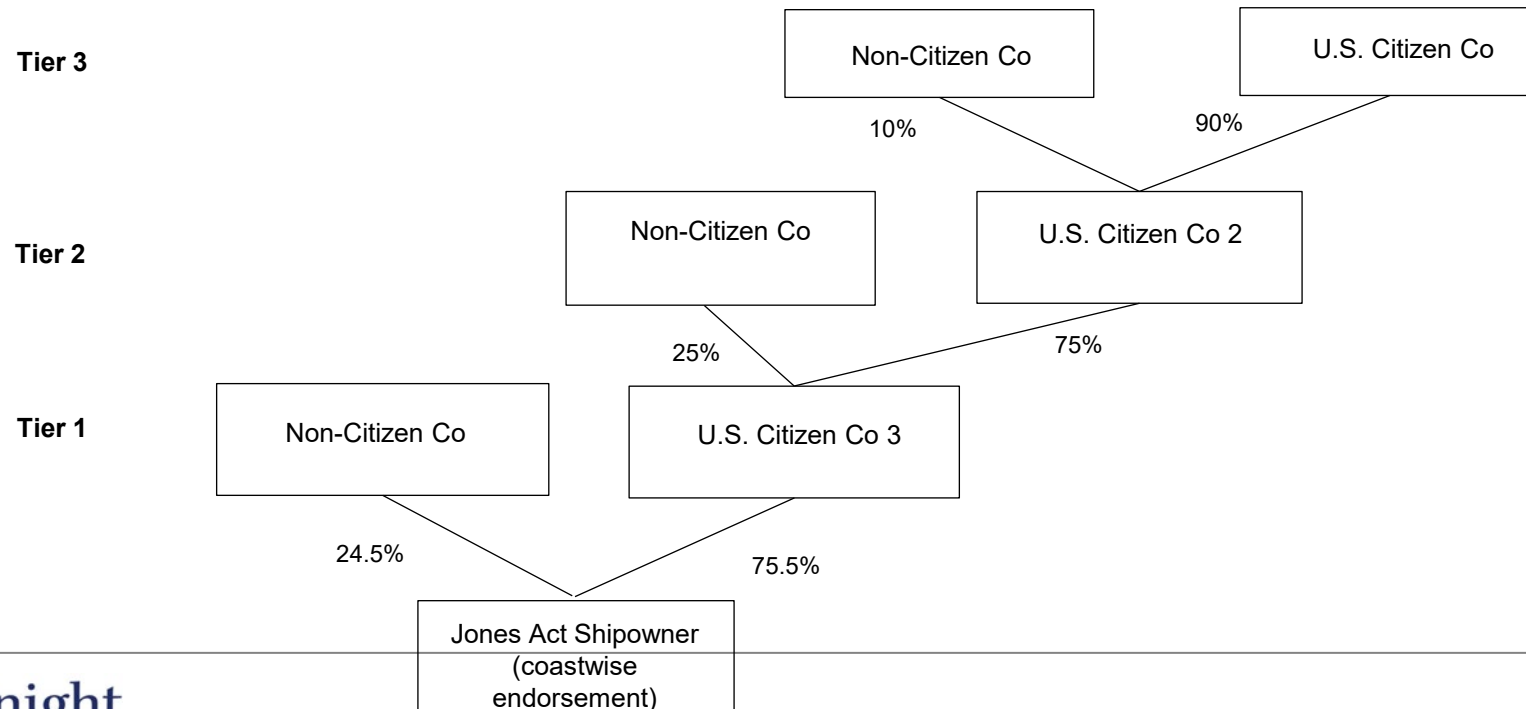
- Lease Finance Structures

## **(4) Hybrid equity and contractual structures**

- Different features are often combined to achieve project specific objectives

# Equity Structures

- The generally-applicable 75% U.S. citizen equity requirement permits up to 25% non-citizen equity
- In addition, a multi-tiered corporate structure can be utilized in compliance with the control and 75% threshold at each tier, but with an aggregate effective foreign equity of the vessel-owning entity of up to (but not exceeding) 50% (not applicable in fisheries)
- Other means are available to further increase effective economic participation, without impermissible control of vessel operations (such as warrants and/or convertible debt, in each case also providing economic protections, including for end of project or dissolution protection)



# Equity Structures - Control

- Tiered equity permits an increase in effective economic rights, but does not enhance control rights
- However, Marad and Coast Guard have permitted certain negative control rights and/or unanimous consent/super majority rights in the nature of minority investor and/or lender protective rights that can protect non-U.S. participants, as long as the foreign party does not control day-to-day operations
- The permissibility of negative controls is determined on a case-by-case basis in consideration of the totality of the structure

# Equity Structures – Totality of Circumstances

- Marad and Coast Guard review of proposed structures includes the proposed structure, the facts and circumstances, and also the commercial context
- For example, foreign equity rights permitted in the context of bankruptcy workouts may be evaluated differently in new commercial ventures/foreign investments. Some of the key issue areas include:
  - Use of existing/established Jones Act operator partners vs. newly established “U.S. citizen” entities
  - Overall capitalization structure of the Jones Act entity
  - Overall project economics and profit/equity potential of the Jones Act entity
  - Overall commercial risk undertaken by the Jones Act entity
  - Identity/independence of the directors

# Operational Sectors

- U.S. cabotage laws affect different parts of the maritime industry differently
  - The different statutes target different vessels and operations—e.g., passengers, towing, cargo, and dredging
  - Different industry operations are in turn affected by differences in vessel needs, how vessels are used, and geographic operations
- For the purposes of considering Jones Act financing structures and diligence, the different ways that cabotage laws impact different maritime operations can be important considerations
- Example operational areas with current new-build and financing interest:
  - Traditional oil and gas operations in the U.S. Gulf of Mexico/OCS
  - U.S. OCS Offshore Wind

# Jones Act – Oil and Gas

- Vessel related oil and gas operational activities have long been subject to significant cabotage laws and regulations, including the scope of activities that are permissible or not permissible by non-U.S. vessels, and important implications for crew, manning, and taxation of permissible operations by non-U.S. vessels
- Non-coastwise qualified vessels can permissibly engage in many activities, in general, so long as (1) one point of either the lading or unlading of cargo (broadly defined) is not conducted at a “coastwise point” and (2) the subsequent lading or unlading is not at a second “coastwise point”
- Permissible non-coastwise vessels engaged in certain “OCS activities” are also subject to U.S. manning requirements and have U.S. taxation implications unless qualifying for certain legislative exceptions

# Jones Act – Offshore Wind

- Any activity to move passengers or merchandise between two coastwise points is coastwise trade
- All points within U.S. territorial waters (generally 3 nautical miles) are considered coastwise points (“territorial waters” is distinct from the 12 NM “Territorial Sea”)
- On the Outer Continental Shelf (OCS), the OCS seabed, subsoil and artificial islands, installations or other devices permanently or temporarily attached to the seabed “which may be erected thereon for the purpose of exploring for, developing, or producing resources, *including non-mineral energy resources*” are considered coastwise points
- The highlighted phrase was recently amended to clarify a long-standing ambiguity about whether federal law, such as the Jones Act, would apply to renewable energy installations
- CBP has commenced issuing ruling request letters pertaining to OCS offshore Jones Act wind projects
- The USCG has not yet resolved an issue with respect to the applicability of its “OCS activities” regulations in connection to U.S. OCS offshore wind



# CONCLUSION

QUESTIONS?

Gerald Morrissey, Partner, Holland & Knight, +1 202 469 5497 [Gerald.Morrissey@hklaw](mailto:Gerald.Morrissey@hklaw)