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FLAGS OF CONVENIENCE: MARITIME AND AVIATION

ALLAN I. MENDELSON

I. INTRODUCTION

MR. ALLAN I. MENDELSON, a former Deputy Assistant Secretary of State (Transportation Affairs) of the U.S. State Department, a long-standing member of this Journal's Advisory Board, an Adjunct Professor at Georgetown University Law Center, and currently Of Counsel in the Washington, D.C. offices of Cozen O'Connor, presented the following remarks as one of several speakers at the American University Aviation Law Conference on March 26, 2014.¹

I want to say at the very outset that I am very pleased to have been invited to speak at this Conference and especially on this Panel that is focusing its attention on the hugely controversial and extremely important question of whether the Norwegian-owned airline, known as Norwegian Air International—or, as I shall call it for short, NAI—is in fact what is today known in international law as a “flag of convenience.” What do we mean by “flag of convenience” and why are we focusing on this issue at all?

Let me start out with the basics of the definition. “Flag of convenience” is an expression that first appeared in maritime law in the mid-1950s to describe oceangoing cargo ships that were owned totally and exclusively by U.S. owners and operated while flying the U.S. flag, but that, for reasons I shall describe next, engaged in the pernicious practice of what came to be known as “flagging out”—or in more kindly terms, trading in their U.S. flag and U.S. registration for the flag and registration of some foreign country. At that time, more than a half-century ago, the

¹ The speech has been edited for publication and only for purposes of readability. It has not been checked for accuracy. Subsequent footnotes have been added by the author alone.

foreign countries that engaged in this recipient practice were a small group primarily made up of only three foreign governments: Panama, Liberia, and Honduras—or as we knew them then, the “PanLibHon” governments and their fleets.

II. REASONS FOR FLAGS OF CONVENIENCE

Now, why did the U.S. owners of these vessels decide to trade in their U.S. flags? There were three main reasons at the time. First, U.S. vessel owners could avoid paying U.S. taxes and instead pay only the far more modest taxes—if any were imposed or required at all—of their adopted foreign flags and governments. Second, the owners could avoid hiring U.S. citizen seamen crews, which were invariably represented by either the National Maritime Union (NMU) or the Seafarers International Union (SIU). In their place, they were able to hire far cheaper, and usually non-unionized, foreign seamen crews from countries like the Philippines, Hong Kong, or other less developed countries in Latin America and Asia. Lastly, U.S. vessels could avoid the much higher and more regularly enforced safety standards imposed on U.S.-flagged vessels under U.S. law, which were, at the time, not imposed by most other countries on their own flagged vessels.

III. THE U.S. MERCHANT MARINE: POST WORLD WAR II TO TODAY

I have given you this background not just because it is interesting from the international law point of view, but mainly because I do not want to see what happened in the field of international maritime beginning in the late 1950s to happen again in the field of international aviation. What most of you may not know or recall is that, for at least one decade after World War II, the United States maintained by far and away the world's largest privately owned merchant marine fleet—with all of the vessels owned by American citizens and flying the U.S. flag. That U.S.-flagged fleet very successfully governed at least the United States maritime trades—if not also the international maritime trades—while paying U.S. taxes, employing American seamen and crews, and setting a welcome example of oceangoing fleets enforcing the highest safety standards of their day.

That was the early and mid-1950s. Coming back to today, it is fair to say that, as a direct consequence of what later became the highly popular and deregulated “flag-out” movement, the world,

and especially our own country, witnessed what can only be called a determined and successful race to the bottom. In fact, the United States has reached the almost totally deplorable situation today where there are almost *no* oceangoing cargo vessels owned by Americans that fly the U.S. flag. A few U.S.-owned and -flagged vessels ply the U.S. coastal or so-called cabotage routes, but only because of the requirements of the 1920 Jones Act (that, incidentally, the U.S. industry would very much like to see repealed). There are still a few other U.S.-flagged vessels involved in the ocean trades. However, they are mostly owned by the Danish company Maersk Lines, and they are flagged U.S.-only in order to retain at least a few, even if subsidized, trained U.S. crews, and to carry U.S. Agency for International Development (AID) and other government-related preference cargo shipments. That should prove to all of you just how successfully depressing a race to the bottom can be—at least in the world of maritime transportation.²

IV. NORWEGIAN AIR INTERNATIONAL

With this introduction, it should now come to none of you as a surprise that I am very opposed to the possibility that the U.S. Department of Transportation (DOT) may grant permission or operating authority to NAI. Nor, for that matter, do I approve of granting such authority to any other foreign-flagged airline that chooses, like NAI, to obtain operating authority from another country, such as Ireland, that maintains laws and regulations favorable to significant income tax avoidance and in support of less-than-adequate employment conditions. What I believe few of us have focused on so far in this controversy is Ireland's tax and employment policies. Whether what so many seemingly unbiased observers have repeatedly told me about Irish aviation policies is true or not, I must leave verification to further research by all of us, especially those pushing the DOT for approval of NAI's application.

But what I have been told by several individuals not involved in this controversy, and who would seem to be in a position to know the facts, is that Ireland's corporate taxes (12.5%) are very favorable, much more favorable than Norway's (about 27%). Indeed, these rates are just about the most favorable of any country in the European Union (EU) (for example, Germany—

² Similarly, almost every cruise vessel operating to and from U.S. ports is foreign flagged (though some U.S. ownership exists).

about 30%; France—about 33%) to businesses such as NAI. Perhaps they are not quite as favorable as those given by the “Pan-LibHon” nations to flagged-out vessels in the 1950s and ‘60s, but they are favorable enough such that it may be quite understandable why NAI would prefer to incorporate and obtain its license in Ireland rather than Norway. On this basis, it is thus fair to say that at least one of the three reasons for the maritime race to the bottom clearly seems to be present in the context of the current aviation controversy.³

Second, I have also been told, again by individuals with no relation to or interest in this controversy, that, so far as Ireland’s labor policies are concerned, pilots and crews flying with Ryanair (an Irish airline) seem to be all too quick to complain regularly and consistently about the airline’s labor policies. Despite their complaints, they have been unable to take effective steps to correct those policies so as to better their wages and employment conditions. This is due primarily, so it is said, to the fact that Ryanair wants to maintain its reputation for being among the lowest fare airlines. Ryanair can only continue to do so with the substandard labor conditions that it enforces—all in accordance with, or not outlawed under, Irish labor law.⁴ So we now appear to have two of the three reasons for the maritime race to the bottom that are also present in the aviation context.

I am not going to make any comparisons with respect to the safety aspects, first, because most of the maritime advantages that were originally available on these aspects have since been corrected by way of newly enforced international treaties; and, second, because the ICAO and the EU, much to their credit, do such an excellent job at maintaining the highest safety standards throughout international aviation that there would appear to be no advantages available in this area among possible flagging or registration states.

³ See Martin Sullivan, *If Ireland Is Not A Tax Haven, What Is It?*, FORBES (Nov. 6, 2013, 9:57 AM), <http://www.forbes.com/sites/taxanalysts/2013/11/06/if-ireland-is-not-a-tax-haven-what-is-it/>.

⁴ For a representative sampling of articles relating to Ryanair and its troublesome labor relations, see Oliver Wright, *You Thought Ryanair’s Attendants Had It Bad? Wait ‘til You Hear About Their Pilots*, INDEPENDENT (May 17, 2013), <http://www.independent.co.uk/news/uk/home-news/you-thought-ryanairs-attendants-had-it-bad-wait-til-you-hear-about-their-pilots-8621681.html>; Oliver Smith, *Ryanair Accused of ‘Exploiting’ Staff*, TELEGRAPH (May 17, 2013, 11:43 AM), <http://www.telegraph.co.uk/travel/travelnews/10063697/Ryanair-accused-of-exploiting-staff.html>; I HATE RYANAIR—THE WORLD’S MOST HATED AIRLINE, <http://www.ihateryanair.org> (last updated Apr. 11, 2014).

V. MIDDLE EAST AVIATION

It may be useful at this point to say a few words about the carriers from the Middle East who, thanks to all of our Open Skies Agreements, are enthusiastically expanding their fleets and operating hugely expanded routes throughout the world—certainly far more expansive than anyone involved in international aviation less than a decade ago would have ever thought possible.⁵

There is no doubt that, like flags of convenience in maritime, the Middle East carriers are hiring most of their employees (pilots and flight attendants) from third world countries—if for no other reason than that there are simply not enough trained personnel in the individual Middle East countries to meet the escalating needs of their ever-growing airlines. While there do not appear to be any serious published reports about the pay and working conditions of the pilots and crews operating these airlines, occasional newspaper articles suggest that Middle East airlines are paying pilot wages similar to those paid by U.S. and other western airlines—if for no other reason, we are also told, than that there is a general shortage of experienced pilots in today's international aviation, and if an airline wishes to operate long-distance aircraft, it must pay western equivalent wages to its pilots.

On the other hand, when it comes to flight attendants, the facts here may not be the same. As many of you know, I teach International Aviation and Maritime Law at Georgetown University Law Center. This is how and why, after a discussion this past semester on open skies and the Middle East carriers, I received an article from one of my students that tells an extraordinary story about the treatment of flight attendants on one of the Middle East carriers.⁶ I am not sure if the same story is true on other Middle East carriers, but there are two observations that I be-

⁵ On March 30, 2014, *Gulf Business* reported that Dubai's Emirates Airlines just added its 46th and 47th A-380s to its fleet. Other reports indicate that the airline very recently placed an order for fifty additional A-380s. On March 4, 2014, *Aviation Daily* reported that Abu Dhabi's Etihad Airline's fleet currently includes ten A-380s and has an additional seventy-one 787-9s on "firm" order. On March 19, 2014, *Aviation Daily* reported that the three largest Middle East carriers—Emirates, Qatar, and Etihad—accounted for 1.4% of the total Boeing/Airbus orders in 2000 and 5.3% of the orders in 2013, but will account for 8.9% in 2023.

⁶ Johanna Karlson, *The Truth About the Luxury of Qatar Airways*, EXPRESSEN.SE (Feb. 3, 2014, 11:22 AM), <http://www.expressen.se/nyheter/the-truth-about-the-luxury-of-qatar-airways/>.

lieve must be made: (1) employment conditions on carriers from countries that do not have an established history of maintaining first-rate conditions of employment should be a subject deserving of serious and continuing public examination; and (2) at least in the case of a carrier like NAI flagging in Ireland, there seems to be no reason why these carriers could not engage in much the same treatment of their foreign-hired flight attendants as is described in this article. Whether we wish to see such a recurring development is another question incident to that of flags of convenience.⁷

VI. MY REASONS FOR TAKING ON THIS CONTROVERSY

And now, I would like to give an answer to all of you who are understandably wondering why someone like me, who has no client, and hence no vested interest, in this controversy or its outcome, should be so concerned, and if you will, so definitive in his views opposing the NAI application. So I would like to give you my answer, which I hope will be as interesting and as persuasive to all of you as were, I also hope, my reasons for opposing the NAI application.

Well over fifty years ago, I was discharged from the U.S. Army, and because I then wanted to become a labor lawyer, I went to work for the National Labor Relations Board here in Washington, D.C. For reasons I will never know, I ended up working in the Appellate Enforcement Office where I enjoyed the unique and unparalleled opportunity of briefing and arguing cases before the U.S. courts of appeals throughout the country. For reasons I will also never know, my superiors really liked me (I always liked them too), and they assigned me to work as the briefing attorney on several of their most interesting cases pending at the time. And so it was then in late 1960 or so that I was

⁷ Even more unsettling are the very recent comments of Amer Hadidi, President and CEO of Royal Jordanian Airlines (RJ). As reported in *Aviation Daily* on April 28, 2014, President Hadidi railed at the “reality” that RJ must face because of the “strong government subsidy policy of the UAE and Qatar for their airlines—Emirates, Etihad, and Qatar Airlines—for fuel, airport charges, and capital investments.” Hadidi added that “there is nothing we can do about it. We have to face it.” But when, as here, the President of a fellow Middle East airline so publicly complains about subsidies provided by other Middle East governments to their airlines, it becomes a subject that requires very careful investigation by western governments. It is also a subject that is fraught with the same kind of very serious international problems as the EU’s apparent willingness to tolerate airline flags of convenience registered in the EU.

assigned to work on what was at the time the very important, but not yet fully appreciated, maritime flag of convenience case.

That case, ultimately destined for the U.S. Supreme Court, involved an effort by U.S. maritime unions to organize the foreign employees of a cargo vessel that once flew the U.S. flag. The U.S. owner of the cargo vessel, United Fruit Company, although continuing its regular U.S.-Latin American trading routes, had registered and flagged out several of its vessels to Panama and terminated the employment of its U.S. crews. By so flagging out, United Fruit became entitled to hire exclusively foreign seamen (who were much lower paid) and to largely avoid the payment of U.S. taxes—thus very substantially enhancing their own profits. The Labor Board won the case in the district court in New York,⁸ but after an emergency appeal, that decision was reversed by the Second Circuit Court of Appeals.⁹ In early 1963, the Supreme Court affirmed the Second Circuit, referring to the “well-established rule of international law that the law of the flag state ordinarily governs the internal affairs of a ship.” The Court further held that U.S. unions could not try to organize foreign seamen working on foreign-flagged vessels despite the vessels’ U.S. ownership and the fact that they plied U.S. trade routes almost exclusively.¹⁰

As I mentioned earlier, the three flag of convenience countries then were Panama, Liberia and Honduras. In the ensuing fifty or so years, more than thirty other countries (including such major countries as the Marshall Islands, Vanuatu, Tuvalu, etc.) have offered their registry and flags to any willing ship owner. In that same period of time, those of us involved in the litigation were to witness consequences that even we, despite our opposition at the time to the development, had never thought to be possible. Although the ship owners and their amici curiae in the cases had assured us and the courts that the vessels involved in the litigation were among the few to be offered up for registry transfer, today the top ten flag of convenience countries register 55% of the world’s deadweight tonnage. More importantly, and as I also mentioned earlier, the once all-powerful and dominant post-World War II U.S.-owned and U.S.-flagged

⁸ *Empresa Hondurena de Vapores, S.A. v. McLeod*, 200 F. Supp. 484, 1961, 488 (S.D.N.Y. 1961), *rev'd*, 300 F.2d 222 (2d Cir. 1962).

⁹ *Empresa Hondurena de Vapores, S.A. v. McLeod*, 300 F.2d 222, 237 (2d Cir. 1962), *vacated on other grounds sub nom. McCulloch v. Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10 (1963).

¹⁰ *See McCulloch*, 372 U.S. at 18–22.

merchant fleet has disappeared to the point where today, with the exception of only the U.S. coastal and Puerto Rican trades, there are hardly any U.S.-owned and -flagged vessels plying the "blue water" deep sea international maritime trades. And all of this, back in the 1960s as well as today, was publicly and widely justified on the basis that flag transfer was only to make ocean transport of cargos more competitively priced so that Americans could pay less for their ocean-borne produce and other goods.

VII. CONFIDENTIALITY

An even more pernicious aspect of the maritime movement to flags of convenience is the steadily emerging new trend that allows the beneficial owners of these vessels to hide or keep confidential their real identities. A most fascinating example of this occurred just very recently when, I think most of you will recall, the Israeli Navy intercepted and seized a freighter that had reportedly been secretly loaded with rockets and other sophisticated weaponry in Iran for shipment to Sudan and, from there, overland to Hamas in the Gaza Strip. The newspaper reports of the seizure identified the vessel with the name "Klos C" and as flying the Panamanian flag. The Iranian authorities quickly disclaimed any relationship or connection to the vessel and denounced the stories as lies manufactured by Israel in time for the annual American Israel Public Affairs Committee meeting.

Of course, the first thing one does at this point is research the Panamanian ship registry to learn who owned or chartered the vessel. Doing so, however, results only in the disclosure that the vessel is owned by a company called Whitesea Shipping and Trading Co., which is incorporated in the Marshall Islands. Going then to the Marshall Islands Registry (conveniently located in Reston, Virginia), one can learn only that Whitesea Shipping and Trading Co. is nothing more than a one-vessel corporation with absolutely no ownership of any nature identified or available. Moreover, while I myself am only a single individual making an inquiry, there is no doubt that agencies and departments of the United States and other governments made similar inquiries—if only because of the extreme importance in these circumstances of identifying the owner or charterer of the vessel. Unfortunately, because that identity has not yet been disclosed in any public media, it seems clear that the Marshall Islands Registry either itself does not know or, alternatively, is abiding by its pledge of confidentiality.

VIII. CONCLUSION

I hope that from my remarks about this incident and about the almost total disappearance of the U.S.-owned and -flagged fleet that you will agree with me that the consequences of the maritime movement towards flags of convenience were, and continue to be, truly deplorable. Why the U.S. government has allowed all of this to occur and remain largely unknown to most of the American public is a question to which I have no answer.

But apart from the sad state of the U.S. merchant marine and international maritime law, I also hope you will agree with me that if allowing NAI to obtain U.S. operating authority represents even the most modest first step towards flags of convenience in international aviation, we must urge the DOT to promptly and decisively reject NAI's application. NAI may follow the example set by United Fruit back in the 1960s and appeal the DOT's decision to the courts. But this time, unlike fifty years ago, we have the knowledge and experience of just how dreadful the consequences can be of taking even a modest step in the direction towards flags of convenience in international aviation.¹¹

¹¹ The problem of U.S. and foreign corporations abandoning their U.S. and foreign state citizenship status in order to register in tax haven states like Ireland, the Cayman Islands, and others is growing increasingly common nowadays. Indeed, it is even beginning to attract press and U.S. government attention. The easiest and best way to counter such tax haven relocations is for the United States and other developed countries to spearhead an international effort. This effort could work out the terms and negotiation of a multilateral treaty that would adopt a uniform 25% corporate tax rate for all adhering nations—and likewise fashion sanctions and penalties for nations that do not adhere or corporations that register in those non-adhering nations.



Case Notes

