FLAGGING AND SHIP REGISTRATION
Background briefing note

Questions B.1.4.; B.2.3.; and B.2.4. of the State Aid Guidelines review questionnaire

A. Ships and the concept of nationality

Flagging is an embodiment of the legal principle that every ship, like every person or enterprise, should belong to a State. In order to be within the law, a ship must belong to a State. A ship that does not belong to any state is, like a stateless person, outside the law.

Procedures for the registration of ships existed in Ancient Rome, whereby the State kept a register of every ship, recording its owner and its tonnage. In the modern era, several countries that are now Member States of the EU have similarly kept registers of “their” ships since the 17th Century. The right to establish and maintain a register of its ships is today regarded as the sovereign prerogative of every State (and not just littoral States).

The act of registration is performed by entering the ship in the public records of the State, according to whatever procedure the State may specify. Such registration entitles the ship to fly the flag of the State concerned, as a symbol of belonging to it. By accepting a ship onto its register, the Flag State acquires sovereign rights over it and assumes various duties in relation to it. These are set out in Section B below.

Historically, a shipowner would register his ship in the State where he lived and carried out his business. This national connection was lost during the 20th Century, in a phenomenon usually traced back to the desire of American shipowners in the 1920s to avoid the prohibition on the sale of alcohol on board US-flag ships. Shipowners now have, in effect, a free choice about where they register their ships. The factors that typically influence that choice are set out in Section C below.

Ship registers are nonetheless still regarded in some quarters as emblems of national prestige, akin to the army or the car-making industry, with a large register (ie one with lots of ships on it) deemed to be more prestigious than a small one. Such sentiments rarely influence shipowners’ own considerations, or those of their customers on whom the success of their business depends.

In certain cases, ship registration fees represent a significant part of national income (e.g. Liberia, Vanuatu, Marshall Islands) and thus are supported for commercial as opposed to prestige reasons.

B. The practical consequences of ship registration

The registration of a ship brings it within the law. Specifically, it entitles the ship to navigate freely on the high seas and (provided that its navigation is innocent)
through territorial waters, and to enter ports. In practice, therefore, it enables the ship to trade.

Historically, registration of a ship in a particular country would often also confer rights to carry that country’s trade. The Navigation Acts of the 17th Century, for example, restricted the carriage of cargoes between England and its Colonies to English vessels only. The Acts were repealed in 1849 amid the emerging economic orthodoxy that free trade, rather than restrictive practices, was the key to creating wealth and that there was a clear public interest in the reductions in the price of imported commodities (in particular, food) that would result from liberalisation.

All developed countries now subscribe to that policy; indeed, restrictions on access to international trades are prohibited in law. In the EU, Council Regulation 4055/86 requires the international trades of EU Member States to be open to ships of any flag; and the OECD Shipping Agreement of 1987 commits OECD countries to the same policy. Flag-based restrictions on international trades are now confined to some countries in the Third World and to some countries with State-controlled economies. Registration under any flag therefore confers equal access to international cargo markets.

Domestic (“cabotage”) markets remain more restrictive. These are clearly outside the scope of international law, and some countries (such as the US and Japan) restrict access to their domestic trades to ships flying their flag. Ships registered in other countries are excluded. Within the EU, some Member States restrict access to their domestic trades and some do not, but Regulation 3577/1992 requires those trades to be open to ships flying the flag of any EU Member State though it has taken time to remove all the special cases/exemptions, particularly in the Mediterranean States.

For a State, the principal practical consequence of registering a ship is that it becomes responsible for ensuring that the ship complies with any standards that have been agreed at international organisations, such as the International Maritime Organization, of which the State is a member, and for security matters (e.g. counter-terrorism, piracy prevention). This duty is typically fulfilled by periodic inspection or survey of the ship by the State, or by agents acting on its behalf, and the issue of certificates on which other States (and commercial entities) can rely as evidence of compliance.

In response to the variable performance of Flag States in fulfilling this duty, a number of European countries in 1982 agreed upon a supplementary regime of Port State control (established in the “Paris Memorandum of Understanding”). In summary, ships registered under flags with a poor record of enforcing international standards are more likely than others to be inspected when visiting European ports. Other groups of countries elsewhere in the world have set up comparable arrangements.

As well as enforcing international safety standards, some States choose to apply their national laws to ships on their register. These may include social restrictions on smoking or the sale/consumption of alcohol on board, taxation of certain activities, or employment-related controls (on the nationality of persons employed on the ship, for example, or on wages). States may apply laws to ships on their register as they
think fit, and most do so according to the prevailing priorities of their national politics. The practical result is a wide variation in compliance costs between registers.

There has been a general legal/constitutional “fiction” that a vessel represents a floating part of the jurisdiction indicated by its flag.

C. Factors influencing shipowners’ choice of flag

Shipowners no longer register their ships unthinkingly in the country where they live and carry out their business. Nor do they generally need to be mindful of flag-based restrictions in international shipping markets. Instead, shipowners are largely free to select a flag for their ship on a purely commercial basis. The factors that typically may influence such a choice include:

- **Corporate custom.**
  A shipowner necessarily has close contact with the Flag State Administration that is responsible for the survey and certification of his ships. A good working relationship with the Administration corporately and with its surveyors personally will tend to influence the shipowner to stick with that Flag State.

- **Vessel type.**
  Certain flags have a strong reputation in specific shipping sectors (e.g. for cruise ships, the Bahamas) and have registry practices and rules tailored to these sectors.

- **Quality reputation.**
  Many shipowners trade on a reputation for quality. The registration of ships under a flag (such as those on the Paris MoU “white list”) that is recognised as upholding safety standards and being well run is an important element of a quality reputation.

- **Marketing.**
  As well conferring an assurance of quality, a particular flag may have specific marketing benefits in some sectors. Several cruise lines and ferry companies promote a holiday/travel experience that is rooted in a particular nationality.

- **Charterer specification.**
  The charter (especially if it is a bareboat charter) under which a ship is employed may stipulate the flag under which it must operate; a charterer is free, as a customer, to make any stipulation he chooses. Quality assurance is a typical reason for stipulating a particular flag. Occasionally this issue is handled by the practice of dual registration but the complexities of that practice are beyond the scope of this paper.

- **Bank specification.**
  The bank that finances the purchase of a ship may stipulate a group of acceptable flags under one of which it must be registered. Clearly, it will wish to ensure that the ship against which the mortgage is secured is operated and maintained to a high standard, and that the ship is registered in a jurisdiction.
where it is confident that a mortgage governed by the laws of that jurisdiction is good security and thus it can enforce payment.

- **Shipyard specification.**
  Shipyards similarly have well-established relationships with particular Flag State Administrations, building ships to the specifications of their surveyors. A standard contract may accordingly specify that the ship will be built to meet the requirements of a particular Flag State, with alternative flags available only at additional cost to cover the requirement for bespoke design or re-survey.

- **Cost of operation.**
  The cost of operating a ship under one flag may be greater than under another as a consequence of the application of domestic laws. The difference may be a matter of the direct cost of employing seafarers of prescribed nationalities or at prescribed rates of pay or other remuneration (e.g. pension entitlements), or of the indirect cost associated with the risk of legal proceedings (including vexatious ones) at employment tribunals. Equally, it may be a matter of opportunity cost: marriages cannot be performed on UK-flag ships, so all UK-flag ships are excluded from the lucrative wedding cruise market.

- **Access to flag-restricted cabotage trades.**
  A shipowner wishing to operate in the domestic trades of countries where flag-based access restrictions apply will need to register his ship appropriately.

- **Insurance.**
  Underwriters may require that a ship be flagged in one of a group of acceptable flags.

- **Liability to requisition.**
  Registration under certain flags renders the ship liable to requisition by the Flag State, and some States are more likely than others to undertake military operations that might necessitate the requisitioning of ships.

- **Naval protection.**
  Conversely, some States are in a position to offer naval protection to ships on their register; and such protection is valuable where the ship is at risk of attack (whether by pirates or by another State).

The matrix of factors will vary in every instance, and the shipowner’s choice of flag will reflect the balance of costs and benefits associated with the particular ship in the particular circumstances prevailing at the time.

D. **Considerations for the State Aid Guidelines**

The Commission’s Guidelines on State Aid to Maritime Transport include, as an objective, encouraging the flagging of ships onto Member States’ registers. The Guidelines do not make clear what this objective is intended to achieve in practice.
The sole assured practical effect of flagging ships in EU Member States is to make those States responsible for ensuring that those ships comply with international standards, although there may be other effects as well if the Member State chooses to apply national restrictions to ships under its flag. Whether such a move would enhance safety would depend on their owners’ commitment to high standards and where they might otherwise be flagged. If the ships were registered under other flags on the white list of the Paris MoU, for example, there are no reasons to suppose that standards would be different.

Indeed in some cases there are reasons to suppose that Flag State Administrations outside the EU are more experienced in safety regulation for certain types of vessels simply due to the number of vessels of those types registered with them (e.g. if a particular EU Member State has no LNG carriers on its flag, it would not be likely to enhance safety to force an owner in that jurisdiction to register his vessel there if the Flag State Administration did not have access to surveyors or technical advice appropriate to LNG carriers).

Similarly, it is not clear that registering ships under Member States’ flags confers any commercial advantage. It does not confer access to any international shipping markets, as they are already open to ships of all flags, and the value of those Member States’ cabotage trades from which they would otherwise be excluded is modest. Indeed, it may even represent a commercial disadvantage, as it brings additional employment costs and litigation risks that would not otherwise apply.

Nor, from a State’s perspective, does the registration of a ship under its flag bring it any significant direct economic benefit (in the context of the economies of EU States registration fees are unlikely to be significant with the possible exceptions of Malta and Cyprus), either in terms of taxation or of employment. Tax revenues and jobs, and their knock-on benefits, will be driven largely by the location where the ship is operated rather than by the flag that it flies.

Increasing the number of ships on a Member State’s register might be regarded as enhancing the Member State’s prestige, and it will give the State a stronger voice at the International Maritime Organization. It is not obvious that State Aid should be directed to such an end, however, and any such prestige and weight at IMO will be short-lived if ship is rendered uncompetitive by being saddled with additional costs.

Ultimately, it is not clear why flagging a ship in a Member State rather than on another quality register should be considered an over-riding objective in the Guidelines. The achievement of any positive objective will be dependent on the commercial success of the shipowner. For the Guidelines to be effective, therefore, their over-riding focus needs to be on generating business growth and jobs.

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