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# U.S. Coastwise Trade Citizenship Requirements

## Example

**Covenant.** The Borrower shall remain a citizen of the United States within the meaning of Title 46, U.S.C., Chapter 505, Section 50501, as amended, eligible to own and operate vessels in the coastwise trade of the United States.

Loan Agreements that include such a covenant will also include an equivalent representation.

## What is it and what does it do?

This covenant (and the corresponding representation) in a loan agreement is a confirmation from a borrower to the Lender that it is eligible to own and operate vessels in the coastwise trade of the United States, and will continue to remain eligible for such trade. The eligibility for the coastwise trade within the United States entails stringent requirements, and the loss of such eligibility can have severe consequences (see below). Any breach of this covenant (or representation) will be an event of default under the loan agreement.


## Why is it there?

The United States, like many other nations whose citizens engage in maritime commerce, looks to promote its citizens' interests over others. One way that it does this is by reserving the right to transport goods from one port in the United States, such as New York, to another port in the United States, such as New Orleans to Coastwise Citizens (also known as Jones Act Citizens) only. Such persons or entities must own and operate vessels built in the United States, crewed by United States citizens, and flagged under the United States flag. Except for very rare exceptions granted in times of emergency, no other vessel (including those owned by foreign interests or flying the flag of another nation) is permitted to carry goods in the United States coastwise trade.

## Why is it important (or not so important) to Lender?

An important component of a Lender's credit decision is how a borrower operates its business and the trades in which it is involved. A Lender which has made a loan to a borrower which operates in the coastwise trade of the United States will generally require that it continues in such trade.

The barriers of entry to the United States coastwise trade are high because building a vessel in the United States is more expensive than in most other jurisdictions and the crewing expenses for a United States flagged vessel are generally higher than those of a vessel flagged in other jurisdictions. However, the expectation would be that a borrower involved in the coastwide trade would receive an equivalent benefit, such as being involved in a trade with fewer competitors able to meet the Coastwise Citizenship requirements or fewer vessels that are eligible to operate in the coastwise trade.

If a borrower defaults on its Coastwise Citizenship covenant (or representation), a Lender may decide to exercise its remedies and foreclose on its preferred mortgage lien covering the vessel. Because of the Coastwise Citizenship requirements, the number of eligible buyers in foreclosure may be limited if it is the expectation that such vessel will continue to operate in the coastwise trade. Alternatively, the Lender may offer the vessel to buyers who are not Coastwise Citizens but are eligible to operate the United States flagged vessel in the foreign trade only (there are still citizenship requirements for such buyers but they are not as stringent as the Coastwise Citizenship requirements) or perhaps even flag the vessel foreign (with the permission from the United States Maritime Administrator), i.e., transfer the vessel to the registry of another nation, but the Lender should expect in such situations that the price the vessel will receive at auction will be reduced.

## How does it affect a Borrower in practical terms?

Compliance with Coastwise Citizenship requirements are strict.

In order for a corporation to be a Coastwise Citizen it must be organized under the laws of a state, (such as Delaware), its CEO (or equivalent) and chairman of its Board of Directors must be citizens of the United States, and no more than a minority of the directors necessary to constitute a quorum may be non-citizens. The corporation must be at least 75% owned by United States citizens at each level in the corporate chain including by its ultimate beneficial owners and (iii) it must satisfy the "control test."


In order to satisfy the control test, the corporation must be able to demonstrate that (i) title to at least 75% of the stock is vested in citizens of the United States free from any trust or fiduciary obligations in favor of any non-citizen, (ii) at least 75% of the voting power is vested in citizens of the United States, (iii) there is no contract or understanding by which more than 25% of the voting power may be exercised, directly or indirectly, on behalf of non-citizens, and (iv) there are no other means by which control of more than 25% of any interest is given to or permitted to be exercised by a non-citizen.

Compliance can become even more complicated for Coastwise Citizens involved in the coastwise trade who, at some level in their corporate structure, have a beneficial owner with stock being freely traded on a public exchange. There are many different approaches that such a Coastwise Citizen can take to help ensure compliance which will be the subject of a separate "Simply Speaking" edition.

## How is it relevant to shipping?

Even a minor violation (e.g., foreign interests owning 26% of the stock in a Coastwise Citizen at any tier in the corporate chain at any time), can result in penalties such as forfeiture of the merchandise being transported, temporary suspension of coastwise trading privileges and fines. More serious violations may result in more severe penalties such as imprisonment, the complete loss of coastwise trading privileges or even the forfeiture of the vessel.

## How is it negotiated?

The requirements that the vessel owner is eligible (and will remain eligible) for the coastwise trade of the United States can appear in different forms throughout the loan agreement (including as a covenant, representation and event of default). The concept is rarely resisted by the borrower engaged in such trade, especially if the Lender's underwriting decision was based upon the borrower's eligibility. Generally, if there is any negotiation on these concepts in a loan agreement (or an ancillary document, such as a mortgage granted over a coastwise trading vessel), it is to ensure that they are consistent in application.

## Questions?

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