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A Note from the Chair

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BY JOHN D. KIMBALL

As with the world economy, the shipping markets are currently experiencing a major bout of volatility. The wide range of matters we are handling in our maritime law practice certainly reflects the current swings the shipping industry is seeing. Just a few examples below help paint the full picture.

One leading story over the past few months has been the significant adjustment in our relationship with Cuba. In one of our recent client alerts, New Regulations Further Ease Maritime Transport and Travel Restrictions on Cuba, we highlighted the new regulations announced by the U.S. government on September 20, 2015, which will ease maritime transport and travel restrictions on Cuba. Cruise lines in particular have been immediate beneficiaries of these changes, and we expect the opening with Cuba to expand trade opportunities for shipping companies. This development is certainly a positive one for shipping.

But we also have seen shipping companies use our bankruptcy laws to address their financial distress. The recent Chapter 11 filing by GMI and the Chapter 15 filing by Daiichi Chuo are notable developments and reflect what has become a long stretch of compression in the charter markets. Our own practice has seen a notable uptick in maritime bankruptcy cases, which can truly benefit from specialized knowledge of the shipping industry.

Possible consolidations in the liner industry continue to make headlines, as does the increased role of the private equity markets in shipping finance. This latter development has been felt particularly in New York, which is by far the largest source of private equity capital in the world. Our Firm is particularly well positioned to assist clients in this area.

At Blank Rome, we remain dedicated to maintaining a top-tier maritime law practice that can provide excellent legal services to all segments of the shipping industry. We are continuing to grow our practice in this area, and greatly appreciate the support we have received from a broad range of clients.

Due Diligence Key to Successful Liner Mergers

BY MATTHEW J. THOMAS AND BRETT M. ESBER

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Like the change in seasons, every few months brings a new report of potential consolidation in the liner shipping sector. Container carriers continue to look for new ways to address overcapacity and reduce costs while maintaining the highest possible level of service to their shipper customers. Vessel sharing alliances have been part of the solution, as they can dramatically reduce capital costs. But they do not reduce overhead costs, as each carrier continues to maintain its own marketing and administrative operations. To achieve efficiencies and reduce overhead costs, many carriers are looking at potential mergers as a means to grow their networks while reducing capital cost and lowering overhead spending.

A merger of two liner shipping companies involves the combination of large organizations with multiple offices around the world and myriad contractual relationships, including (to name just a few) agreements with other carriers, customers, equipment providers, and terminals. Due diligence for liner combinations can prove a formidable task, as specialized maritime sector contracts, regulations, and legal regimes can lead even experienced merger & acquisition experts into perilous and unfamiliar waters. Similarly, post-merger integration efforts must take into account unique maritime law rules, rights, and remedies to keep the tie-up off the rocks.

When evaluating a major carrier as a merger target, there are a broad range of maritime contracts and other measures that must be reviewed carefully, both to identify any material risks and liabilities lurking below the surface, and also to plan for a speedy and painless integration process.

While the list below focuses on the issues from a U.S.-law perspective, some version of this exercise should be undertaken for every major market in which the combining carriers operate.

- **Regulatory compliance:** Is the target operating in compliance with the unique rules and regulations applicable to liner shipping, including the U.S. Shipping Act of 1984 and the regulations of the U.S. Federal Maritime Commission? Does the carrier have a clean bill of health on antitrust, trade sanctions, and anti-bribery issues?

- **Environmental compliance:** Does the carrier have appropriate environmental controls in place, or is it at risk for U.S. environmental prosecution for shipboard discharges? All of these regulatory matters pose particular challenges for shipowners and operators calling U.S. ports.

- **Contracts with vendors and operating partners:** Close attention must be paid to contracts with terminal operators, stevedores, inland truck and rail operators, agents, logistics and warehouse partners, equipment providers, technology partners, and other maritime companies to ensure the target is not exposed to unusual risks, and to assess the viability and strategy to consolidate these supplier relationships post-transaction. A similar approach should be taken for agreements with other carriers, including vessel sharing and alliance agreements, especially for mergers crossing alliance lines.

Due diligence for liner combinations can prove a formidable task, as specialized maritime sector contracts, regulations, and legal regimes can lead even experienced merger & acquisition experts into perilous and unfamiliar waters.

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Due Diligence Key to Successful Liner Mergers (continued from page 2)

- **Customer service contracts:** Careful attention must be paid to major accounts, to assess cargo and service commitments, liability terms, and possible damages.

- **Time and bareboat charter arrangements, and vessel finance agreements:** Ship finance and chartering experts must give close scrutiny to the terms under which the target's fleet is chartered or financed.

- **Taxation:** The United States and many other countries have unique tax provisions for international shipping, including revenue from intermodal operations. Ensuring that these rules and exemptions have been properly applied is an important part of assessing the target.

- **Shoreside labor union contracts and pension obligations:** A potentially overlooked but critical part of combining operations is understanding what rights unions or workers might have to block or penalize efforts to consolidate or eliminate services.

There are many other specialized contracts and maritime operations that merit scrutiny as well, such as technical management and crewing agreements, U.S. government contracts, marine insurance and workers compensation, and outstanding maritime claims and liens, to name a few. The key to managing these issues efficiently is having proper maritime legal expertise on hand to address these issues, allowing the core corporate team to focus on constructing a firm foundation for the combined enterprise. □

Maritime Cyber Attacks: Changing Tides and the Need for Cybersecurity Regulations

BY KATE B. BELMONT

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Front-page headlines revealing devastating cyber attacks on government agencies and the world's largest companies have become a regular occurrence. Recent cyber attacks reported by the mainstream media include the cyber attack against SONY, Anthem Health Insurance, the White House, the Office of Personnel Management ("OPM"), Ashley Madison, and even the Houston Astros. As the list of companies and agencies that suffer cyber attacks grows longer, it is clear and undeniable that no industry is safe, and any company that relies on information and communication technology ("ICT"), must take the appropriate steps to protect itself against cyber threats. Although the maritime community has not yet garnered front-page attention as a victim of a recent cyber attack, make no mistake, the maritime industry is one of the most heavily targeted industries in the world and also suffers cyber attacks regularly.

Targeting the Maritime Community

Like many government agencies, as well as the aerospace and defense industry, banking and health insurance industries, and even the entertainment industry, the maritime industry is a prime target of cyber attacks and has suffered, and continues to suffer, many significant cyber attacks. The maritime community has been able to avoid disastrous media coverage regarding cyber attacks not because it is immune from cyber threats, lack of opportunity, or that the industry employs cutting-edge cybersecurity programs and effective protocols to protect itself from cyber attacks, but mostly because of luck, timing, and our tight-lipped community.

For example, the BP oil spill was not caused by hackers or cyber criminals, but it could have been, and such an event is likely to occur in the future. Yes, oil rigs are hackable. There have been multiple reports of oil rigs having been hacked, including at least one case where hackers were able to tilt the rig. Although no oil spill resulted, this should serve as a warning to the maritime community.

Likewise, the grounding and partial-sinking of the *Costa Concordia* appears to be the fault of human error, not

because hackers manipulated the GPS, ECDIS, or AIS. But all vessels that rely on e-navigation and GPS, ECDIS, and AIS are susceptible to cyber attacks, and all such systems can be manipulated by hackers and cyber criminals. There have been recent accounts outlining how both airplanes and cars can be manipulated and controlled remotely by cyber hackers, due to reliance on ICT. Vessels are no exception. It is only a matter of time before the next headline of *The New York Times* alerts us to the recent grounding of a particular cruise ship, river-cruising vessel, ferry, or container ship due to the hacking of the vessel's e-navigation system.

Cyber threats are very real and the consequences of a hugely successful cyber attack in the maritime industry would be disastrous. However, cyber attacks have been happening in the maritime community for years, resulting in mostly financial losses, as opposed to loss of human life or severe damage to the environment, which is of particular concern to the maritime community. In addition to recent reports regarding the hacking of oil rigs and the manipulation of GPS, ECDIS, and AIS, the bunkering community and many shipping companies continue to suffer tremendous losses due to cyber attacks. For example, in December 2014, a major maritime company engaged in a deal to order a sea floor mining vessel in China on the back of a long-term charter. The maritime company reportedly pre-paid $10 million of the $18 million charterer's guarantee. Unfortunately, the company was a victim of a cyber attack as it unknowingly paid the deposit into a bank account that belonged to a cyber criminal. The matter was promptly referred to police authorities, who pursued an investigation. In an effort to better protect itself from future cyber attacks, the maritime company also engaged a cybersecurity firm to ensure the ongoing security of its networks and to investigate the source of the cyber attack. Similarly, as recently as this past August, hackers stole about $644,000 from a shipping company registered in Cyprus. The Limassol-based shipping company received an e-mail purportedly coming from their fuel supplier in Africa requesting that money owed be paid to a different bank account than usual. The shipping company complied, only to find out that they had been defrauded when they later received an e-mail from the fuel company asking for payment.

> Although the maritime community has not yet garnered front-page attention as a victim of a recent cyber attack, make no mistake, the maritime industry is one of the most heavily targeted industries in the world and also suffers cyber attacks regularly.

Cyber Regulations on the Horizon

Since the U.S. Government Accountability Office ("GAO") issued its 2014 report on maritime security outlining the maritime community's vulnerability to cyber attacks, the maritime community has slowly begun to recognize, acknowledge, and address the need for greater information sharing and the need to develop maritime cybersecurity regulations and guidelines. While the maritime industry does not currently have any cybersecurity regulations, change is on the horizon.

In 2015, the U.S. Coast Guard launched a year-long initiative to fully understand the cyber threats facing the industry, with the ultimate goal of developing cybersecurity guidelines. Midway through their initiative this past June, the Coast Guard issued a "Cyber Strategy," summarizing its vision for operating in the cyber domain. The Cyber Strategy discusses the Coast Guard's approach to defending cyberspace, including risk assessment and risk management and the strategic priority of protecting Maritime Critical Infrastructure, which includes ports, facilities, vessels, and related systems that facilitate trade within the United States. The Cyber Strategy offers a framework for the Coast Guard's plan to operate effectively and efficiently within the cyber domain.

In addition to the U.S. Coast Guard, the Round Table ("RT") group, comprising of BIMCO, ICS, Intercargo, and Intertanko, is also developing standards and guidelines to address cybersecurity issues in the industry. Acknowledging that all major systems onboard modern ships (main engine, steering, navigation systems, ballast water, and cargo handling equipment), are controlled and monitored by software and reliant on ICT, the RT group has committed to developing guidelines to assist the maritime industry to better protect itself from cyber attacks. It is reported that the RT group is in the final phase of developing a pattern for the maintenance and updating of electronic systems. Mr. Angus Frew, Secretary General of BIMCO, is noted as saying, "The standards under development are intended to enable equipment manufacturers, service personnel, yards, owners and operators, as well as crew, to ensure their shipboard

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computer-based systems are managed securely—and kept up-to date to protect against the ever-growing threat from exploitation by criminals."

Likewise, the IMO also has turned its attention to the very real threat of cyber attacks and the need for cybersecurity guidance and regulations. At the 95th session of the IMO Maritime Safety Committee ("MSC"), held this past June at the IMO headquarters in London, the MSC addressed the issue of cybersecurity extensively and agreed to work on guidelines on managing cyber-related risks onboard ships and in port facilities at MSC 96. Proposed amendments to the ISPS Code were discussed, but ultimately it was decided that more time would be needed to develop the appropriate guidelines—given the current ongoing work of the industry on cybersecurity—with the ultimate goal of submitting a draft proposal or set of guidelines to present and discuss at MSC 96.

Accepting the Reality of Cyber Crime

The maritime industry faces very real cyber threats and potentially devastating fall out from its failure to address and employ proper cybersecurity measures. While the industry has been somewhat hesitant to discuss these cyber threats, cyber attacks, and its subsequent losses, the reality of cyber attacks in the maritime industry can no longer be ignored or denied. Accordingly, the maritime industry is on the verge of great change.

The leaders of the maritime community around the world have acknowledged the threat of cyber attacks and have begun to develop cybersecurity guidelines and regulations. In the interim, cyber attacks will continue to inundate the maritime community. To avoid catastrophic losses and to avoid becoming another victim of cyber crime reported on the front page of *The New York Times,* it behooves all companies in the maritime industry to ensure they have the best cybersecurity protections available, and remain diligent in the fight against cyber crime. Cyber attacks are very real, and while regulations are on the horizon, cybersecurity protections are available to help guide us today. ◘

For more information on cybersecurity, please visit www.blankrome.com/cybersecurity and read our cybersecurity team's blog at http://cybersecuritylawwatch.com.

Reporting Marine Casualties: U.S. Coast Guard Guidance Helps Bring Some Clarity to the Debate

BY JEANNE M. GRASSO

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In July 2015, the U.S. Coast Guard released the Navigation and Vessel Inspection Circular 01-15 ("NVIC"), *Marine Casualty Reporting Procedures Guide with Associated Standard Interpretations.* The purpose of the NVIC is to assist vessel owners and operators in understanding the marine casualty reporting requirements, which many in the industry think are about as clear as mud. Confusion as to what constitutes a marine casualty and what incidents need to be reported has persisted in the marine industry for years. And, unfortunately, little official guidance had been published by Coast Guard Headquarters regarding its policy interpretation of the reporting requirements. This problem was historically exacerbated by differing interpretations within the various Coast Guard field commands and attendant inconsistent enforcement actions.

The NVIC was an attempt to resolve some of these issues—it clarifies terminology and phrases within the regulatory context, draws attention to helpful regulatory citations, and provides policy interpretations to assist vessel owners/operators with the casualty reporting process. But, there's still a long way to go to make the marine casualty reporting process efficient and meaningful, and those necessary fixes may require a regulatory project, so relief is still on the distant horizon.

Back to the Basics

To put things in context, a *marine casualty or accident* includes any casualty or accident involving vessels, with few exceptions, that: (1) occurs on the navigable waters of the United States, its territories, or possessions (generally out to 12 nautical miles from the coastline); (2) occurs on a tank vessel in the Exclusive Economic Zone ("EEZ") if there is material damage affecting the seaworthiness or efficiency of the vessel, or involves significant harm to the environment as a result of a discharge, or probable discharge, resulting from damage to the vessel or its equipment; or (3) occurs outside the navigable waters of the United States in a certain geographic area *and* involves a U.S. citizen on a vessel that (i) embarks/disembarks passengers in the United

States or (ii) transports passengers traveling under any form of an air and sea ticket package marketed in the United States. Not all marine casualties, however, are reportable. The reporting requirements, described below, are different based on whether the casualty or accident occurs inside or outside the navigable waters (*i.e.,* 12 nautical miles), whether it involves "significant hard to the environment," or whether it occurs on a tanker in the EEZ. For U.S.-flag operators, however, these reporting requirements apply anywhere in the world.

A *reportable marine casualty* means:

- an unintended grounding or an allision with a bridge;
- an intended grounding or strike of a bridge that creates a hazard to navigation, the environment, or the safety of a vessel;
- a loss of "main propulsion, primary steering, or any associated component or control system" that "reduces the maneuverability" of the vessel;
- an occurrence materially and adversely affecting the vessel's seaworthiness or fitness for service or route, including but not limited to fire, flooding, or failure of or damage to fixed firefighting systems, lifesaving equipment, auxiliary power generating equipment, or bilge pumping systems;
- loss of life;
- an "injury" that requires "professional medical treatment" (treatment beyond first aid) *and* if the person is engaged onboard a vessel in commercial service (*i.e.*, a crew member or contractor), that renders the individual unfit to perform his or her routine duties or stand their normal watch;
- an occurrence causing property damage in excess of $25,000 (including labor and material to restore the property to its pre-damaged condition, but not including the cost of salvage, cleaning, gas-freeing, dry-docking, or demurrage); and
- significant harm to the environment (including a discharge of oil, *i.e.,* a sheen, or other hazardous substance in a reportable quantity into navigable waters and the EEZ).

Importantly, a certain type of marine casualty, called a *serious marine incident,* also requires drug and alcohol testing for:

- any reportable marine casualty that results in one or more deaths;
- an injury to a crewmember, passenger, or other person that requires professional medical treatment beyond first aid *and,* if the injured party is a crewmember, renders the individual unfit to perform his or her routine vessel duties or stand their normal watch;
- damage to property in excess of $100,000 USD;
- actual or constructive total loss of any vessel subject to inspection;

- actual or constructive total loss of any self-propelled vessel, not subject to inspection, of 100 gross tons or more;
- a discharge of oil of 10,000 gallons or more into navigable waters whether or not resulting from a marine casualty; or
- a discharge of a reportable quantity of a hazardous substance into the navigable waters, or a release of a reportable quantity of a hazardous substance into the EEZ, whether or not resulting from a marine casualty.

At the time of occurrence of a marine casualty, a company must make a timely, good faith determination as to whether the incident is, or is likely to become, a serious marine incident. If so, each individual engaged or employed on board the vessel who is "directly involved" must be

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Reporting Marine Casualties: U.S. Coast Guard Guidance Helps Bring Some Clarity to the Debate **(continued from page 6)**

drug and alcohol tested. Alcohol testing must be completed within two hours and drug testing within 32 hours, unless precluded by safety concerns directly related to the incident. An individual "directly involved" means an individual whose order, action, or failure to act is determined to be, or cannot be ruled out as, a causative factor in the incident.

All reportable marine casualties must be immediately reported to the nearest U.S. Coast Guard Sector Office, Marine Inspection Office, or Coast Guard Group Office after addressing the resultant safety concerns, with one exception. If the marine casualty involves "significant harm to the environment," it must be reported to the National Response Center ("NRC"), not the Sector. A written report on a Form CG-2692 must follow within five days, along with drug and alcohol testing results, if required, on Form CG-2692B.

> Until there is wholesale reform of the marine casualty reporting system, however, the industry should become familiar with the guidance provided in the NVIC, which is in essence the Coast Guard's "playbook" for how it will respond to casualty reports or failures to report.

NVIC 01-15

In an effort to make compliance with the marine casualty reporting requirements more attainable and enforcement more consistent, in January 2014 the Coast Guard published a draft NVIC seeking industry feedback on how the marine casualty reporting requirements can be clarified. According to the Coast Guard, the majority of the comments received from multiple industry segments and organizations made it clear that more detail was needed for specific types of marine casualties that had led to uncertainty in the past in terms of what needed to be reported (or not). As a result, several new definitions, interpretations, and common casualty scenarios were included in the NVIC.

The Coast Guard clearly sets forth its guiding principle in the NVIC when Rear Admiral Paul Thomas states, "[i]f there is any doubt whether an occurrence is a reportable marine casualty, the Coast Guard strongly encourages responsible industry parties to contact the nearest Officer in Charge of Marine Inspection…to determine an appropriate response." The NVIC goes on to indicate that when a report is made, the Investigating Officer will make a determination if the incident is reportable or not. If not, it is recommended that you document such a determination in writing. If so, a Form CG-2692 is required within five days of the incident.

The Coast Guard also issued industry-specific interpretations for different types of commercial maritime operations. For example, the NVIC addresses incidents involving tankers at length. The Coast Guard also issues interpretations and policy statements related to reporting in the contexts of commercial diving, shipyards, and harbor workers. Further, the NVIC lists a variety of incident and occurrence scenarios and provides interpretations of regulations that have proven to be problematic for years. The NVIC also provides for interpretations of key terms that caused much consternation in the past, such as:

- a loss of main propulsion, primary steering, or any associated component or control system that reduces the maneuverability of the vessel;
- an occurrence materially and adversely affecting the vessel's seaworthiness or fitness for service or route; and
- an injury that requires professional medical treatment (treatment beyond first aid). Here, the Coast Guard adopts the Occupational Safety and Health Administration ("OSHA") definition, which is widely understood.

Bottom line, though, the marine casualty reporting regime still needs reform. As some commenters have noted, the Coast Guard should adopt a two-tier reporting system, similar to OSHA's, for reportables and recordables. This would allow minor incidents to be differentiated from major incidents, lessening the burden on both industry and the Coast Guard. As such, the Coast Guard would get an immediate oral report followed by a Form CG-2692 for major incidents where a response may be needed, but would not burden its limited resources with minor incidents, which could be reviewed on a log during inspections. In addition, enforcement should be streamlined and should more consistently take into consideration a company's efforts at compliance,

considering the size of the company's fleet, past history, and significance of the incident, rather than issuing what sometimes seem to be arbitrary penalties.

The DHS Office of Inspector General Report, *Marine Accident Reporting, Investigations, and Enforcement in the USCG,* dated May 23, 2013, noted:

> *The purpose of the investigations program in the Coast Guard (USCG) is to ensure the safety of mariners and vessel passengers by preventing marine accidents, protecting the environment from oil spills, minimizing the property loss and disruptions to commerce. The USCG is responsible for identifying, investigating, and enforcing reporting requirements related to marine accidents involving commercial vessels…*
>
> *The USCG does not have adequate processes to investigate, take corrective actions, and enforce Federal regulations related to the reporting of marine accidents. These conditions exist because the USCG has not developed and retained sufficient personnel, established a complete process with dedicated resources to address corrective actions, and provided adequate training to personnel on enforcement of marine accident reporting. As a result, the USCG may be delayed in identifying the causes of accidents; initiating corrective actions; and providing the findings and lessons learned to mariners, the public, and other government entities. These conditions may also delay the development of new standards, which could prevent future accidents.*

With its limited resources, the Coast Guard should focus on which incidents should be reportable and which warrant investigations. This way, the Coast Guard could direct its efforts at ascertaining trends to further marine safety and help companies reduce their risks, rather than collecting data that often is not timely evaluated for purposes of ascertaining lessons learned. All marine casualties are not equal and should not be treated that way.

Until there is wholesale reform of the marine casualty reporting system, however, the industry should become familiar with the guidance provided in the NVIC, which is in essence the Coast Guard's "playbook" for how it will respond to casualty reports or failures to report. Industry stakeholders should ensure that crew and shoreside personnel are familiar with the Coast Guard's guidance, and heed the recommendation to contact the Coast Guard whenever in doubt to avoid Coast Guard enforcement action for a failure to report a marine casualty, as penalties can range up to $35,000.

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Risk-Management Tool for Maritime Companies

Blank Rome Maritime has developed a flexible, fixed-fee Compliance Audit Program to help maritime companies mitigate the escalating risks in the maritime regulatory environment. The program provides concrete, practical guidance tailored to your operations to strengthen your regulatory compliance systems and minimize the risk of your company becoming an enforcement statistic.

To learn how the Compliance Audit Program can help your company, please visit www.blankrome.com/complianceauditprogram.

Europe, Migrants, and the Perils of the Sea

BY NOE S. HAMRA

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Increased international media coverage has brought to light the plight of thousands of Syrian migrants making the dangerous journey to Europe. Many of these migrants travel to Europe via the Mediterranean Sea and are often rescued by commercial ships transiting through the area. This article addresses the current international legal framework governing the duties and obligations of owners and operators who conduct search and rescue operations of migrants. A summary of the applicable cover afforded by P&I clubs in the International Group (IG clubs) to their members follows. The article concludes with a reflection on the issues that owners and operators should be aware of when conducting search and rescue operations.

Background

The wars in Iraq and Afghanistan, together with the civil war in Syria and the longstanding human rights abuses in certain African countries, have recently permeated Europe with an unprecedented influx of migrants and refugees. According to the International Organization for Migration ("IOM"), more than 350,000 migrants were detected at the European Union's border in 2015 alone. Although immigration and external border control has always been a major policy concern for the European Union, the recent migration patterns have spiraled out of control. Countries like Hungary, Serbia, Greece, and Italy are struggling to cope with large numbers of migrants that are arriving at their borders on a daily basis.

According to the United Nations Commission on Human Rights ("UNCHR"), the Mediterranean is currently experiencing the largest number of migrants travelling by sea. Generally, the journey is made on overcrowded boats and flimsy inflatable dinghies, making the crossing from North Africa to Europe extremely dangerous. Some of the worst tragedies in 2015 include the sinking of two boats on August 27 carrying 500 Libyan migrants; the shipwreck off Italy's Lampedusa Island on April 19 where approximately 800 migrants drowned; and the drowning of at least 300 Syrians while attempting to cross the Mediterranean early this February. All in all, the IOM estimates than more than 2,800 migrants have drowned in the Mediterranean this year.

Commercial ships operating in the Mediterranean are also impacted as a consequence of this migration pattern. The likelihood of encountering persons in distress or being called to assist in search and rescue operations has drastically increased, and international regulations addressing search and rescue operations have been on the rise as a result. In 2014, the Italian Rescue Coordination Center ("RCC") diverted more than 800 merchant ships due to migrants in the area, and many of these ships ended up taking migrants onboard.

Transporting migrants exposes the owners and operators of commercial ships to several different risks. These risks include: a shortage of stores, food, and medical supplies; a lack of proper accommodations for migrants; sanitation and hygiene issues; and a compromise of security onboard the ship. Also, the search and rescue of migrants raises several legal issues. There may be a question as to whether owners or charterers should cover the costs of the search and rescue operation. Also, who would be responsible for any damage to the cargo or the ship? Would the seaworthiness of the ship be affected by having large numbers of migrants onboard? Would the owner or operator be considered negligent if the crew was not properly trained and prepared, or the ship did not have proper plans and procedures in place?

As a result of this situation, IG clubs have issued multiple guidelines and loss prevention bulletins to their members reminding owners and operators of their obligations to assist persons in distress; to take all steps necessary to save lives and deliver all those rescued at sea safely to ports; and to maintain proper plans and procedures in place together with the exercise of regular drills and crew training.

Legal Framework

The United Nations Convention on the Law of the Sea ("UNCLOS") and the International Convention for the Safety of Life at Sea ("SOLAS") are the main international conventions dealing with rescuing distressed persons at sea. Article 98 of UNCLOS mandates that "[e]very State shall require the master of a ship flying its flag, in so far as he can do so without serious danger to the ship, the crew or the passengers: (a) to render assistance to any person found at sea in danger of being lost [and] (b) to proceed with all possible speed to the rescue of persons in distress, if informed of their need of assistance, in so far as such action may reasonably be expected of him." Equally, UNCLOS requires "[e]very coastal State [to] promote the establishment, operation and maintenance of an adequate and effective search and rescue service regarding safety on and over the sea and, where circumstances so require, by way of mutual regional

arrangements cooperate with neighbouring States for this purpose." SOLAS establishes similar obligations upon masters and governments in its Chapter V, Regulations 33(1) and 7, respectively.

In November 2012, SOLAS was amended to require ship-specific plans and procedures for the recovery of persons from the water (regulation III/17-1). The International Convention on Standards of Training, Certification and Watchkeeping for Seafarers ("STCW") also requires seafarers to be trained in relation to search and rescue operations. Additionally, drills should be carried out to ensure that the crew is familiar with the plans, procedures, and equipment adopted by owners and operators.

As stated by the International Chamber of Shipping ("ICS") in its report, *Large Scale Rescue Operations at Sea,* "[t]he underlying legal principle is that nation States and ships have an obligation to assist persons in distress at sea, regardless of their nationality, status or circumstances in which they are found. The practicalities of meeting the obligations under the international Conventions are described in…the procedures for responding to emergencies as required by the International Management System (ISM) Code and included in the company's Safety Management System (SMS)…and [t]he procedures included in the ship specific plans for recovery of persons from the water as required by SOLAS."

P&I Club Cover

IG clubs provide liability cover for approximately 90 percent of the world's ocean going tonnage. An examination of IG club rules is in order to determine what may be covered as a result of a search and rescue operation of migrants. Note that this examination is in general terms. Determining club cover pursuant to a search and rescue operations of migrants will depend on the specific facts of the case, will be subject to the applicable individual IG club rules, and the specific ships' terms of entry.

Based on an examination of all IG club rules, cover extends to the members' liability at law for loss of life, injury, or illness to anyone other than crew or passengers arising out of a negligent act onboard or in relation to the ship. As rescued persons would be considered third-parties onboard the members' ships, clubs will cover the members' legal liability that they may have towards an injured or ill migrant, to the extent that said illness or injury arose from the members' or the entered ship's negligence.

In addition to liability for loss of life, injury, or illness, the typical IG club rule for stowaways, refugees, and migrants covers "expenses…incurred by the Owner in discharging his obligations towards or making necessary arrangements for stowaways or refugees, but only if and to the extent that the owner is legally liable for the expenses or they are incurred with the approval and agreement of the Managers." Some clubs have addressed the issue of assisting persons in distress, with more specificity. For example, Rule 19 (8) of North of England P&I Association, entitled "Persons in Distress," states that cover extends to the "[a]dditional expenses incurred by the Member in respect of an Entered Ship in proceeding to the assistance of, or searching for, persons in distress and taking such steps as are reasonable in succoring and landing such persons to the extent that such expenses cannot be recovered from underwriters or other parties and represent the net loss to the Member (over and above such expenses as would otherwise have been incurred) in respect of fuel, insurance, seamen's wages, stores, provisions and port charges."

> Landing migrants can be challenging for the owner or operator at the next port as governments may refuse to allow rescued persons ashore on the basis that the migrants may lack proper immigration documentation, may pose a security threat, or the fact that they may be considered migrants as opposed to refugees.

Whether the wording of the rule addresses migrants, stowaways, and refugees generally or specifically, the cover is practically the same. Based on these rules, expenses incurred in the search and rescue of distressed people at sea would be a covered liability, as long as the owner/operator is legally liable for these expenses. To be cautious, it is advisable that owners and operators inform their club of any search and rescue operation as soon as practicable, and seek the approval of their club managers before expenses are incurred.

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Europe, Migrants, and the Perils of the Sea (continued from page 10)

In addition to the search, rescue, and landing expenses, IG clubs may also cover the net additional costs of diversion, as long as the diversion is solely for the purpose of landing migrants or refugees. As described by one IG club, "[t]he diversion is deemed to commence as soon as the ship changes course, in order to engage in the [search and rescue], and it is completed when the ship has reasonably returned back on course—to her original, intended, destination. The diversion costs which can be reimbursed [by the club] include: extra costs of fuel, insurance, wages, stores, provisions and port charges."

Landing migrants can be challenging for the owner or operator at the next port as governments may refuse to allow rescued persons ashore on the basis that the migrants may lack proper immigration documentation, may pose a security threat, or the fact that they may be considered migrants as opposed to refugees. Also, immigration authorities may impose fines upon owners and operators for breach of immigration laws (*e.g.,* arriving with migrants onboard without proper documentation). Note that these fines may be covered as of right or on a discretionary basis depending on the specific applicable IG club rules.

Another potential issue associated with rescuing migrants at sea is the risk that they may carry an infectious disease. If the ship is placed under quarantine due to this possibility, the expenses arising from this event will also be a covered liability as all IG clubs incorporate a rule in its books dealing with this specific situation.

Any cargo liabilities arising while the ship is conducting a search and rescue operation and/or proceeding to disembark migrants or refugees may be covered under the traditional cargo rule. Furthermore, if the Hague-Visby Rules are incorporated into the contract of carriage, then Article IV Rule 4 empowers the carrier to deviate to save life or property at sea by providing that "[a]ny deviation in saving or attempting to save life or property at sea or any reasonable deviation shall not be deemed an infringement or breach of these Rules or the contract of carriage, and the carrier shall not be liable for any loss or damage resulting therefrom." Therefore, cover will most likely not be prejudiced as any deviation for the sole purpose of saving life will be considered 'reasonable,' and thus will not fall within the deviation exclusion of the traditional cargo rule.

A final thought should be given to who is liable to bear the costs and expenses of search and rescue operations. As discussed, search and rescue operations have the potential to cause significant delays to the ship, force deviations, cause damage to the cargo and/or the ship, and cause injury, illness, or death to the crew and/or those rescued. All of these incidents may give rise to disputes between owners and charterers under the contract of carriage. A dispute may arise as to whether hire is payable during search and rescue operations, or whether owners or charterers are ultimately responsible to pay for the costs and expenses of the search and rescue operation. The answer to these questions will depend on the charterparty form used to fix the ship together with the agreed additional clauses, which as a whole form the terms and conditions for the contract of carriage between owners and charterers. It should be noted, however, that hire disputes are not covered by traditional P&I coverage.

Final Considerations

Owners and operators in the Mediterranean should be aware of the many issues that may arise from rescuing migrants at sea and properly prepare for a potential operation of high magnitude. At the very least, preparation should include: equipping ships with additional stores, food, water, and medical supplies; implementing and maintaining proper plans and procedures for safe search and rescue operations; and conducting drills in accordance to SOLAS and the ISM code.

Owners and operators must also be aware of the increased security risks posed by having a large numbers of migrants onboard. According to the ICS, "[a]ppropriate security measures in accordance with the [Ship Security Plan required by the IMO ISPS Code] should be implemented to limit any risk to the ship and crew." Owners and operators should be aware that there is a risk that rescue persons can become stowaways or could even attempt to hijack the ship and crew. The ICS has listed several security procedures that can be implemented if the ship becomes involved in a large scale rescue operation (see section 6.1 of the *Large Scale Rescue Operations at Sea* report issued by the ICS). A large rescue operation may also pose a risk to the health of the crew and call into question the seaworthiness of the ship. As for seaworthiness, this can arise from the presence of numerous additional persons onboard (breach of a ship's certificates) or from the lack of proper preparation, planning, and training by the ship and crew.

Finally, owners and charterers should address apportionment of expenses for search and rescue operations in charterparties to decrease potential disputes. ◘

Meet Blank Rome

Susan Witkin is a partner in Blank Rome's Private Client group and her practice focuses on estate, trust and tax planning, estate and trust administration, and related litigation. She represents domestic, foreign, and multi-national clients in these areas.

The Non-U.S. Investor: Unforeseen Exposure to U.S. Gift and Estate Taxation for Non-Resident Aliens

BY SUSAN PECKETT WITKIN

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An individual who is neither a resident nor a citizen of the United States (referred to here as a "non-resident alien" or "NRA") may be presented with an opportunity to invest in U.S. real estate, tangible property such as art or collectibles that will be located in this country, stock of a U.S. company, or as a partner in a limited partnership or member of a limited liability company ("LLC"). Typically, the savvy NRA investor knows what he must do to avoid being treated as a U.S. resident for income tax purposes. However, he may not be aware that these investments could attract one of the three federal transfer taxes, namely, the federal gift tax, estate tax, and generation-skipping transfer ("GST") tax.[1]

Gifts by NRAs will trigger current gift taxation if the subject of the gift is real property or tangible personal property that is situated in the United States or, as we sometimes say, has a U.S. situs for federal gift tax purposes. Basically, this means real estate and tangible property (like the furniture in a residence, jewelry, art, a car, a boat, or a plane) that is physically located in this country at the time of the gift. Thus, if the NRA who owns a Florida residence decides to transfer it by gift to his son, or if he decides to gift some of the home's contents to his daughter, the gift tax will be triggered. There is a modest annual exclusion from gift tax generally available for gifts to donees other than a spouse—in 2015, this amount is $14,000 per donee. The exclusion is increased to $147,000 if the gift is to a NRA spouse. (If the spouse is a U.S. citizen, an outright gift to the spouse, as well as certain transfers in trust, would fully qualify for the marital deduction and would be entirely gift tax-free regardless of amount.) In all cases where there is a current tax on the amount by which the gift exceeds the annual exclusion, the tax rate in effect is 40 percent. Thus, a NRA's gift of his $1,150,000 residence to his NRA spouse would attract approximately $400,000 of gift tax.

In contrast to this rule for real estate and tangibles, shares of stock in a corporation are considered to be intangible personal property and, regardless of situs, are not subject to gift taxation upon lifetime transfer by the NRA.[2]

Property that is taxable if given away during the NRA's life is subject to federal estate tax if owned by the NRA at the time of his death. In addition—and subject to any different rules set forth in a governing estate tax treaty between the United States and the NRA's country of domicile—intangible personal property with a U.S. situs (*i.e.,* intangible personal property situated or deemed situated in the United States at the NRA's death) is taxable under the federal estate tax laws, with only a $13,000 credit against the tax that is due. If the property passes to the NRA's spouse, it is subject to current estate taxation under the above rule unless it qualifies for the federal estate tax marital deduction. If the surviving spouse is a U.S. citizen, a full marital deduction will apply. If not, the marital deduction can be obtained by transferring the property into a special type of trust that is held for the lifetime benefit of the spouse. This trust is known as a "qualified domestic trust" or "QDOT."

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The Non-U.S. Investor: Unforeseen Exposure to U.S. Gift and Estate Taxation for Non-Resident Aliens **(continued from page 12)**

Even where such a trust is utilized, the estate tax is merely deferred: trust property will be estate taxable if distributed to the surviving spouse during her lifetime, and the property held in the trust at the surviving spouse's death will be taxable at that time.

As noted above, shares of stock issued by a corporation constitute intangible personal property. If the corporation is a U.S. corporation, then the stock has a U.S. situs, and if it is owned by the NRA at the time of his death, then it will be subject to federal estate taxation regardless of where the stock certificate or other physical evidence of ownership is located. A partnership interest and a membership interest in a LLC are also intangible personal property under U.S. laws, but the application of the federal estate tax is not as clear with a partnership or LLC treated as a partnership for U.S. tax purposes as it is in the case of a corporation. Generally speaking, if the partnership terminates upon the NRA's death or is not then a valid and continuing entity under the law that governs such an entity, a federal estate tax will be imposed if and to the extent any of the entity's underlying assets have a U.S. situs. However, if the partnership ***does not*** terminate and is a recognized legal entity that continues after the NRA's death, then the situs of its underlying assets at the NRA's death should not be relevant, although the government may seek to assert an estate tax based on either the place where the entity's business is conducted or the domicile of the NRA partner. The NRA investor should be cognizant of the uncertainties and potential estate tax exposure when investing in partnerships and LLCs.

Perhaps the most common trap for the unwary NRA is investment in U.S. real estate. It is preferable for the NRA to avoid direct ownership in U.S. real estate because a transfer during life will attract a gift tax, and ownership at death will subject the property to estate taxation.

Other examples of intangible personal property are interests in patents and trademarks, debt instruments, bank accounts, certificates of deposit, and cash on hand in a brokerage account. Accounts held in U.S. banks are deemed non-U.S. situs property so long as these are not effectively connected with the conduct of a U.S. trade or business; but a brokerage firm is not considered to be a bank, and funds on deposit in the NRA's name at the time of the NRA's death will be deemed U.S. situs property and subject to federal estate taxation. Debt instruments issued by U.S. persons will be deemed situated outside the United States and will not be subject to federal estate taxation if the interest derived from such instruments qualifies as portfolio interest for federal income tax purposes. Patents, trademarks, and certain copyright interests issued or licensed in the United States are generally property situated in the United States, but should be reviewed carefully. Life insurance, whether held in a trust or owned outright by the NRA, is not treated as situated in the United States even if the policy is issued by a U.S. insurance company. Life insurance is thus often utilized as a hedge against the federal estate tax. Life insurance can also be used as a wrapper to hold U.S. situs investments that would otherwise trip the estate tax at the NRA's death.

In addition to insurance products, NRAs often invest indirectly in U.S. situs property through foreign holding companies or other structures. These should be reviewed by counsel in the United States to make sure the structure is sound from the U.S. tax perspective, and by counsel in the home country as well, lest there be a tax cost to the structure there. Care must be taken to review trusts as well. A trust that is established by the NRA, or by a family member and benefiting the NRA, may be subject to U.S. estate taxation at the time of the NRA's death, depending on the interests in, or rights over, the trust property that the NRA held at death, when the transfer occurred, and, if created by the NRA, the type of property that was initially transferred to the trust.

Perhaps the most common trap for the unwary NRA is investment in U.S. real estate. It is preferable for the NRA to avoid direct ownership in U.S. real estate because a transfer during life will attract a gift tax, and ownership at death will subject the property to estate taxation.[3] Therefore, it is generally advisable to consult with counsel *before* an

investment in a U.S. residence is acquired. The laws of the NRA's domicile must be reviewed and evaluated, but it is generally advisable to have a foreign entity rather than the NRA himself make the purchase. Foreign ownership may not be permissible in all cases, the most notable being the cooperative apartment: a foreign corporation (or a domestic corporation, for that matter) will not be permitted to own a co-op. However, foreign entity ownership is generally allowed in the case of a condominium, house, or other interest in real property, including undeveloped land. A two-tier structure is frequently employed, in which a domestic corporation or LLC is the owner of the real property and a foreign holding company or trust holds the domestic entity.

If the real property is already owned by the NRA individually, it can be transferred to a foreign corporation, for example, and if corporate formalities are observed, this should be effective to block federal estate taxation. This will clearly be the case if the property is sold to the foreign corporation.[4] If instead the property is simply contributed to the corporation, and the corporation is wholly owned or controlled by the NRA, many believe the U.S. government may attack the transaction and assert that the estate tax applies to the underlying real estate if it is still owned by the entity at the time of the NRA's death, but the outcome of this attack is far from clear and the strategy of foreign corporate ownership is probably superior to the certain exposure to federal estate tax if the NRA continues to own the property himself. As noted above, life insurance can be obtained to cover the cost of the estate tax due at the NRA's death in this case. Provided it is economical to obtain, life insurance may be a viable alternative to a corporate structure; the combination of simplicity and certainty it provides may indeed make it the more appealing choice for many NRAs.

This is intended as an overview of general rules and not as advice to any particular person. Obviously, each situation's facts and circumstances must be reviewed for planning opportunities. ◘

This article is an update from Ms. Witkin's July 2010 *Mainbrace* article of the same title.

1. Since most of the transfers that NRAs contemplate tend to be to a spouse or child(ren), and not to grandchildren, and because the GST is more limited in its application to NRAs, we will not discuss its application here. However, one should be aware that if a transfer is gift or estate taxable, and is made to a grandchild or remote descendant of the NRA, or to a trust that could benefit such an individual, the GST tax may be implicated as well. Also note that various states impose local estate and/or inheritance taxes that apply in addition to the federal estate tax. While these generally follow the federal rules regarding what is taxable, due to the different approaches of the states, we discuss only federal taxes here. Finally, different tests are applied to determine whether one is resident in the United States for income tax purposes or for estate and gift tax purposes. The income tax rules are quite clear, while the estate and gift tax meaning of "resident" is actually one who has a "domicile" in the United States, a much more amorphous concept. We ignore those differences here as we assume that if someone is a non-resident for U.S. income tax purposes, then he or she does not consider the United States to be his or her domicile.
2. This rule applies to other types of intangible personal property as well. Note, too, that if the donee is a U.S. resident, the donee may have reporting obligations. See Form 3520. Further, if the NRA is a "covered expatriate," as defined in the Internal Revenue Code, different rules will apply following expatriation, and the U.S. recipient may be taxable upon receipt of gifts from the former U.S. resident. The topic of expatriation is beyond the scope of this article.
3. Note also that dispositions of interests in appreciated U.S. real property are subject to special income tax rules under FIRPTA (Foreign Investment in Real Property Tax Act) and generally trigger taxable capital gain, unlike dispositions of most capital assets held by NRAs. These rules are outside the scope of this article.
4. As noted, U.S. real estate owned by the NRA (and not used in a U.S. trade or business) that has appreciated will be subject to a capital gains tax upon sale to a corporation, subject to certain limited exceptions. However, if the appreciation is not substantial, it may be worthwhile to sell rather than contribute to capital to achieve certainty regarding non-application of the U.S. estate tax at the NRA's death.

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