

BENEFICIAL OWNER

The Supreme Court of India in the matter of *m.v. Sea Success I* has stated that "...we do not intend to delve deep into the questions as to whether the two ships named hereinabove are the sister ships of the respondent No. 1 Vessel or whether the requirement of law as regard ownership of a ship in the Respondent No. 1 as beneficial owner has been fulfilled or not. Such issues must be considered at an appropriate stage".

Beneficial owner means, one recognized in equity as the owner of something because use and title belong to that person, even though legal title may belong to someone else; esp., one for whom property is held in trust.- also termed equitable owner. Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement. The defining characteristic of the beneficial owner of an asset is that he holds a degree of control over the asset that allows him to benefit from it. Whether he is the legal owner (that is, holds legal title to it) is irrelevant. The essence of beneficial ownership is precisely not ownership in the ordinary sense of the word—but rather control. Control and legal title often will lie in the same hands.

Beneficial ownership is a concept that is relatively straightforward in theory but difficult to apply in practice. The essence is to identify the person who ultimately controls a corporate vehicle. This identification always will be a highly context-dependent, beneficial ownership cannot be reduced to a legal definition.

The Bombay High Court division bench hearing appeal, in the matter of Lufeng Shipping Company Ltd -vs- m.v. Rainbow Ace & Anr has handed down a decision that lifting of corporate veil will arise if there is fraud and evidence thereof. A ship can be arrested under beneficial ownership for a maritime claim under the 1999 arrest convention supported with evidence of the beneficial ownership of the ship sought to be arrested is the same as the one who is responsible and liable for the claim, and not merely on suspicion.

Cloaking of Beneficial Owner, Ownership and Control of Ships

It is very easy, and comparatively cheap, to establish a complex web of corporate entities to provide very effective cover to the identities of beneficial owners who do not want to be known. While some ship registers actively facilitate and promote anonymity for reluctant owners, the principal mechanisms are not the registers themselves, but the corporate mechanisms that are available to owners to cloak their identity. These corporate mechanisms are freely available in many jurisdictions, they are quite legal, and will provide a properly incorporated International Business Corporation that can transact business almost everywhere in the world but generally not in the country of incorporation. From the perspective of the ship registering process, the most important single feature that facilitates anonymity of individuals is the ability (quite sensible from a commercial perspective) of corporations to be registered as owners of vessels. The most common and effective mechanisms that can provide anonymity for beneficial owners include bearer shares, nominee shareholders, nominee Directors, the use of Intermediaries to act on owners' behalf and the failure of jurisdictions to provide for effective reporting requirements. The most common institutional devices used to create corporations are Private Limited Companies, and International Business Corporations (IBCs). Other devices such as Trusts, Foundations and Partnerships may also be used.

Open registers, which by definition do not have any nationality requirements, are the easiest jurisdictions in which to register vessels that are covered by complex legal and corporate arrangements. The arrangements will almost certainly cover a number of international jurisdictions which would be much more difficult to untangle. While open registers would be (by choice) the most obvious targets for beneficial owners wishing to avoid revealing their identities, traditional registers, may not be immune to being used by anonymous beneficial owners. The additional complexity and risk of registering vessels in traditional registers would be made up by the status and perhaps lesser attention directed towards vessels registered in these traditional registers. Some institutional arrangements involving dependencies, overseas territories and jurisdictions with special constitutional and/or administrative arrangements, (as exist, for example in the UK, France, the Netherlands and Australia), as well as some free trade arrangements (such as the EU) may also provide opportunities, albeit complex and perhaps risky ones, for beneficial owners seeking anonymity to achieve their objectives.

Beneficial (or ultimate) ownership and control of vessels can be cloaked by owners who for one reason or another wish to remain anonymous. Anonymity can be sought by owners for a variety of reasons. Some may be perfectly legitimate and even innocuous. Others may wish to remain anonymous to minimise legal and fiscal exposure (which may or may not be legal), or for reasons that are absolutely illegal, such as criminal activities or money laundering.

Secretive owners use corporate vehicles and vessel registrations procedures to ensure their anonymity, as well as the features of corporate and shipping register requirements that permit, or even facilitate, the cloaking of the true identities of the ultimate owners of vessels; that is those who exercise true control of what those vessels do, and the purposes to which the revenue they generate can be put to.

It is beneficial ship owners that decide how their vessels will be used, or at least remain responsible for the uses to which their vessels are put, even if this is done without their knowledge or consent. Owners are also the ultimate beneficiaries of the revenue generated by vessels they own, and can put these revenues to any use they wish, including activities that may be inimical to security interests. Of course, owners can delegate many of their responsibilities to ship managers, who may (with or without the beneficial owner's knowledge and/or consent) themselves undertake illegal or undesirable activities. It is therefore also important to know the details of the managers of the day-to-day operations of those vessels.

The following questions were relevant. Who appoints the crew? Who fixes the use of the ship? Who signs the charterparty on behalf of the owner?

In order to operate internationally vessels must be registered in a recognised ship register, which will then permit the vessel to fly its flag. In effect the state of registration will then become the ship's "Flag State". The Flag State's obligations and responsibilities towards ships carrying its flag are contained in the UN Law of the Sea Convention, the relevant parts of which are reproduced in Appendix A to this convention. While those provisions are relatively comprehensive in respect of technical, crewing and legal requirements that must be met by vessels before they can operate, apart from noting that there "must exist a genuine link between the State and the ship" (Article 91), the Law of the Sea Convention is silent on ownership requirements, which is a crucial factor from this paper's perspective. The genuine link concept has been used a number of times in respect of linking the nationality of a ship to the state in which it is registered. This very loose interpretation has enabled the existence and rapid growth of "Open Registers" where the nationality of the owner/s has no relevance. From an operational or commercial point of view this lack of a direct link is probably unimportant, as long as the Flag State exercises adequate oversight and control over the shipowner and his vessel. However, this lack of a link also

facilitates the opportunities available to shipowners to hide their identities. This also extends to corporate ownership of ships, where the country of registration of the corporate entity is also of no relevance and this in turn enhances the opportunities for anonymity.

All ship registers require some information on ownership to be provided when application is made for the registration of a ship. As a general observation, most registers examined in the course of preparing this paper at least superficially attempt to establish the ownership of vessels on their register. At the very least they require some ownership details to be provided, even if their ability to unequivocally confirm the information provided may for a variety of reasons be inadequate. The principal difference between registers is that while some clearly make some effort to establish the true ownership (but may be thwarted by other mechanisms), others advertise anonymity as a desirable attribute of that register. For example an advertisement for the Anguillan ship register (but there are many others) notes that two key features of the register are the non disclosure of beneficial owners and the availability of bearer shares which greatly assist owners to ensure anonymity.

The means by which shipowners can ensure anonymity can be found not so much in the shipping registers themselves (although some seem very happy to facilitate this happening), but in international corporate arrangements that exist for reasons quite unrelated to shipping.

Anonymity can be achieved in two ways. First, through the use of various mechanisms that enable the identity of beneficial owners to remain cloaked, or at least known to very few people. The second is through institutional devices that govern the creation of corporate entities and which are also geared to minimising the exposure of beneficial owners when these seek anonymity. On most occasions beneficial owners who seek to remain hidden will use a combination of methods to achieve their intent.

Mechanisms to Achieve Anonymity

Bearer Shares

Bearer shares are perhaps the single most important (and perhaps the most widely used) mechanism to ensure total anonymity for beneficial owners. Bearer shares are negotiable instruments that accord ownership of corporations to the person (or persons) who physically possess the bearer share certificates. That is, mere possession accords ownership, so that they can be passed from person to person without money necessarily changing hands, nor having to meet any registration or transfer requirements. Unlike normal registered shares (such as those traded through a stock exchange) which are transferred by written or electronic means (thus creating a traceable trail) bearer shares are transferred by simple delivery of the share certificate to another person. Bearer shares do not contain the name of the shareholder, and with the possible exception of their serial numbers they are not registered. Because of their very nature bearer shares provide a high level of anonymity and are easily transferable in the event of an investigation. This is especially the case when these bearer shares are issued by private limited companies. While some jurisdiction are acting to reduce the potential misuse of bearer share (for example by registering them and requiring notification of transfer), many others are actively promoting them as ways of ensuring the anonymity of participants.

Nominee Shareholders

It is implicit that private companies must have at least one share, and at least one shareholder. Generally such companies are created with a structure that contains more than one share, but compared to public companies there are far fewer shares in private companies (counted in single digits rather than millions) so it is far easier for such private companies to be controlled by a small number of people, or perhaps only one person. Every registered private company that is structured around ordinary shares (that is, shares other than

bearer shares) needs to provide some details of shareholders at the time of registration. In these cases, where beneficial owners wish to hide their identity they are able to appoint “nominee shareholders”, that is shareholders nominated by the true owner of the shares to represent their interests in the company, including making decisions and issuing directions on their behalf.

Not all jurisdictions can compel nominee shareholders to reveal the identity of the actual beneficial owner(s), so this provides a legally robust means of owners avoiding their identities being known.

Nominee Directors

All corporate bodies require the appointment of at least one Director, who is nominally responsible for the operation of the company. In normal private companies such Director(s) will generally come from the owners themselves. However, many jurisdictions allow the appointment of Nominee Directors, whose names will appear on all company documents and official registrations, and may even exercise some functions within the company. While they will pass on all official duties (and ultimate decision making) to the beneficial owner(s), by acting as their legal intermediary they would shield their identities. Like nominee shareholders only some jurisdictions can legally compel Nominee Directors to disclose the true identity of the true owners.

Some jurisdictions further allow corporations to be nominee directors, thus creating a further level of complexity in the company structure.

Intermediaries

This category include company formation agents, trust companies, lawyers, trustees and other professionals that offer their services to those who wish to create and operate private companies in particular jurisdictions. Intermediaries are very prominent in offshore locations, and specifically design their services to ensure anonymity for those who desire it. Many of the intermediaries are

globalised off-shore activities themselves, and while they maintain branch offices in some jurisdictions they can frequently represent their clients' interests without the necessity of a local presence in the jurisdiction chosen by those clients. The basic purpose of these intermediaries is to make it as simple as possible for individuals to establish and operate off-shore companies. Their services (obtained on simple payment of a fee) can include the provision of a local address (brass plaque), act as local agents (but with little or no actual functions) and provide nominee shareholders and directors for the company (again, with no real function except to provide a front and meet minimum legal requirements). In many cases the express purpose of these intermediary functions is to keep beneficial owners' names from official records.

In some jurisdictions that specialise in ensuring anonymity, official institutions may not undertake due diligence checks if an intermediary vouches for an anonymous client. This is despite the fact that the intermediary may not have carried out due diligence checks on the facts that are purporting to be true.

In the case of trustees, these can hide identities by not disclosing the person for whom he is holding shares as trustee. In other words, to all but more serious checks the nominee appears to be the true owner of the shares. Lawyers and notaries can claim professional confidentiality to protect the identities of their clients. Some jurisdictions extend this privilege to management companies.

Institutional Devices to Cloak Identity

Private Limited Companies (and Public Limited Companies whose shares are not traded on a stock exchange).

Because these companies are not listed on public stock exchanges they generally operate in less stringent regulatory and supervisory regimes. Their private nature means that their operations can be more secretive, not subject to any public scrutiny (e.g. by securities commissions or shareholder

meetings), nor do they have to publish annual reports or financial accounts. Such companies are easily converted to “shell” companies, where the company has no assets, undertakes no activities, but remains as an active corporate body with legal standing that can be sold and utilised by a third party for any purpose consistent with its articles of association. These “shell companies” can be found virtually anywhere, but are particularly prevalent, and available off-the-shelf for very little cost, in jurisdictions where such entities can also use nominee shareholders and corporations as directors and officers of the company. This enables these companies to be put into operation cheaply (probably less than \$US 1000), and with minimal involvement by the beneficial owner of the company. Limited liability Companies (LLCs) are also available in some jurisdictions. In these there is no requirement to publicly disclose the identities of members. Each of these types of companies can enhance the shield over the identities of beneficial owners by issuing bearer shares which, as noted earlier allow transfer of the ownership of the shares (and hence the proportion of the company that they represent) by simply handing them over to another person.

International Business Corporations (IBCs) and Exempt Companies

IBCs are the primary vehicles used in international business and finance to facilitate international transaction. These can be established virtually instantly (many on-line) and at relatively low cost, and are available in many jurisdictions that specialise in off-shore activities. A key feature of IBCs is that they are barred from doing business in the country of incorporation. This means that these companies are rarely required to lodge annual report to the authorities, nor do they pay any taxes. Consequently, as there is little incentive for rigorous monitoring they are rarely supervised. In almost all cases such companies can employ all of the mechanisms available to disguise ownership and control, such as bearer shares and nominee shareholders and directors. Some jurisdictions provide for different regimes for resident and non-resident

corporation, thereby further isolating those that are non-resident (and further enhancing their anonymity).

Trusts

These are common law bodies that have many legitimate and useful purposes, but some of their features also provide considerable anonymity. Essentially trusts are vehicles intended to separate legal ownership and beneficial ownership, and enjoy a greater degree of privacy and anonymity than other corporate vehicles. Trusts represent a contract between private persons, and as such many jurisdictions choose not to regulate them. The disclosure of the identities of either the beneficiary or the trust creator (the “settlor”) is rarely required. Amongst other things, trusts can be used to conceal the beneficial ownership of assets, and can provide an ideal vehicle for those who wish to control how assets are used (e.g. a vessel), while remaining out of the limelight and unidentified. Some jurisdictions (e.g. Cook Is, Nevis and Niue) allow names of the settlor and beneficiaries to be left out of trust deeds and other usual requirements can be avoided.

Foundations

Foundations are separate legal entities. They have no owners or shareholders, and are managed by a Board of Directors. They are the nearest civil law equivalent to trusts (which have their basis in common law). While they are essentially intended to fulfil private purposes in many jurisdictions these can also be created to engage in commercial activities. Because of their nature Foundations are usually highly regulated, but in some jurisdictions there are few requirements for disclosure, and they are inadequately supervised. Frequently founders can exert significant control over their activities, even though they are not on the Board of Directors. For example, in Panama government approval is not required for the establishment of Foundations, or for the amendment of their memoranda, and there is no government agency to supervise them. Also, the identity of beneficiaries (which can include the

founder) are not required to be publicly filed, and foundations do not have to submit annual reports or accounts. Foundations can also be formed by nominees, thus ensuring that identities are further protected. While trusts and foundations are comparatively clumsy vehicles to run shipping operations, they nevertheless offer a new layer of complexity and anonymity to potential terrorists, especially when their intention is not so much to use the vessels for direct terrorist act, but rather to use them to generate revenue and profits that can then be used to fund terrorist activities.

Partnerships

Because of their status of unlimited liability these vehicles are less regulated than corporations, even though in some cases corporations, as well as individuals are permitted to serve as partners. In some jurisdictions limited liability partnerships are required to only register general partners, while those who are limited need not be registered publicly. These limited liability (and frequently anonymous) partners can still act as officers of the partnership, and can influence management. While partnerships can be used effectively to hide activities or individuals (because of their relatively unregulated nature) their lack of corporate status means that they are not well suited to the ownership of vessels, where the partnership itself could not be the owner of a vessel, thus requiring the partners to reveal their identities in order to register the ship.