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Open registries as an enabler of maritime sanctions evasion

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Abstract

Vessels engaged in the evasion of maritime sanctions are predominantly flagged by open registries: registries that impose little to no nationality requirements on vessel owners and operators. This paper investigates the causes of this phenomenon, arguing that open registries generally lack adequate measures for detecting sanctions evasion in their fleets and that they are targeted for flagging services by sanctions evaders. At the root of this vulnerability to flagging sanctions evaders is the for-profit nature of the open registry system which encourages registries to jettison regulation and oversight to increase their marketability in the competitive industry of international flagging.

Key words

Sanctions evasion, open registries, flags of convenience, due diligence.

1. Introduction

All merchant vessels that sail on the high seas are required to do so under a national flag, which represents the legal jurisdiction under which the vessel operates while in international waters. Flags were traditionally assigned on the basis of the nationality of the vessel owners and operators. However, from the mid-20th Century vessels increasingly sailed under the flags of 'open registries', which impose little to no nationality requirements. Approximately thirty states worldwide currently operate an open registry (see Table 1), principally as an income generation tool, and they compete with one another for international clients through reduced regulatory burdens, lowered registration costs, and expedited certification. These services make open registries an essential enabler of cheap and fast maritime shipping, with upwards of 70% of global deadweight tonnage (DWT) sailing under such flags. However, the lax regulatory frameworks of open registries have been associated with poor records on environmental safety;¹ vessel safety;² seafarer safety;³ and illegal, unreported and unregulated

¹ P. S. Dempsey and L. L. Helling, "Oil Pollution by Ocean Vessels - an Environmental Tragedy: The Legal Regime of Flags of Convenience, Multilateral Conventions, and Coastal States," *Denver Journal of International Law & Policy* 10, no. 1; Dana D. Miller, Ngaiio Hotte, and U. Rashid Sumaila, "Mandating Responsible Flagging Practices as a Strategy for Reducing the Risk of Coastal Oil Spills," *Marine Pollution Bulletin* 81, no. 1 (2014).

² Jan Hoffmann, Ricardo J. Sanchez, and Wayne K. Talley, "Determinants of Vessel Flag," *Research in Transportation Economics* 12, no. 1 (2004); Kevin X. Li, Jingbo Yin, and Lixian Fan, "Ship Safety Index," *Transportation Research Part A: Policy and Practice* 66 (2014); K. X. Li and J. Wonham, "Who Is Safe and Who Is at Risk: A Study of 20-Year-Record on Accident Total Loss in Different Flags," *Maritime Policy & Management* 26, no. 2 (1999).

³ H. Edwin Anderson, "The Nationality of Ships and Flags of Convenience: Economics, Politics, and Alternatives," *Tulane Maritime Law Journal* 21 (1996); Stephen Roberts and Tim Carter, "Causes and Circumstances of Maritime Casualties and Crew Fatalities in British Merchant Shipping since 1925,"

(IUU) fishing⁴ – leading to criticism of the open registry system and the pejorative label of ‘flags of convenience’.⁵

[Table 1 here]

Despite this scrutiny, one implication of the open registry system yet to be fully determined is that of sanctions evasion. Sanctions are economic instruments deployed by various national and international authorities that bar certain entities (ranging from individuals to firms to entire countries) from trading in certain prohibited goods. United Nations (UN) Security Council resolution 2397, for example, bars all UN member states from importing wood, seafood, machinery, agricultural products, or electrical equipment from North Korea or its nationals. Entities that wish to skirt these sanctions through maritime trade are required to adopt various deceptive practices to prevent authorities from identifying that sanctions are being broken, for example by concealing or mislabelling cargo contents, forging bills of lading, obscuring port calls to sanctioned jurisdictions, or exchanging goods on the high seas (ship-to-ship transfers) to avoid customs scrutiny.

Indications suggest that open registries have a facilitative role in such maritime sanctions evasion. Open registries have been implicated in the violation of numerous sanctions regimes, including those against Iraq,⁶ South Africa,⁷ Syria,⁸ Iran,⁹ and North Korea;¹⁰ recent reports of UN Panels of Experts (monitors for UN sanctions regimes) have repeatedly pointed to the use of ‘flags of convenience’ by vessels engaged in sanctions evasion;¹¹ and 88% of the US Office of Foreign Assets Control- (OFAC) designated ships were sailing under a flag listed in Table 1 when sanctioned – well above their market share.¹² Despite such strong indications, the causal

International Maritime Health 69 (2018); Tony Alderton and Nik Winchester, “Globalisation and De-Regulation in the Maritime Industry,” *Marine Policy* 26, no. 1 (2002).

⁴ Dana D. Miller and U. Rashid Sumaila, “Flag Use Behavior and IUU Activity within the International Fishing Fleet: Refining Definitions and Identifying Areas of Concern,” *Marine Policy* 44 (2014); Environmental Justice Foundation, *Lowering the Flag – Ending the use of Flags of Convenience by Pirate Fishing Vessels* (London, UK: Environmental Justice Foundation, 2009); M. Gianni, W. Simpson, *The Changing Nature of High Seas Fishing: how flags of convenience provide cover for illegal, unreported and unregulated fishing* (Canberra, Australia: Australian Department of Agriculture, Fisheries and Forestry, 2005).

⁵ The concept of a ‘flag of convenience’ and the extent to which it can be considered synonymous with open registries is a point of contention in the literature, though for the most part they are used interchangeably. For a typological discussion of flag states see John Mansell, *Flag State Responsibility: Historical Development and Contemporary Issues* (Berlin: Springer, 2009), 100-110.

⁶ Robert Neff, “Flags That Hide the Dirty Truth,” *Global Policy Forum*, April 19, 2007, <https://www.globalpolicy.org/component/content/article/172/29942.html>.

⁷ Richard Knight, *Testimony, Hearings on the Oil Embargo Against South Africa, April 12–13, 1989* (New York: United Nations, 1989); Nabeela al-Mulla et al., *Report of the Intergovernmental Group to Monitor the Supply and Shipping of Oil and Petroleum Products to South Africa*, Supplement No.44 (A/44/44), (New York: United Nations, 1990), 20-21.

⁸ “Flag of Convenience Tanker Stormed by UK Troops Amid Accusations of Sanction Breaking,” *Handy Shipping Guide*, July 4, 2019, https://www.handyshippingguide.com/shipping-news/flag-of-convenience-tanker-stormed-by-uk-troops-amid-accusations-of-sanction-breaking_12071.

⁹ Michelle Wiese Bockmann, “Gabon deflags Iranian tanker,” *Lloyd’s List Maritime Intelligence*, February 11, 2020, <https://lloydlist.maritimeintelligence.informa.com/LL1130992/Gabon-deflags-Iranian-tanker>.

¹⁰ Leo Byrne, “Nearly 50 North Korea-linked ships reflag as Tanzanian,” *NK News*, October 7, 2016, <https://www.nknews.org/pro/nearly-50-north-korea-linked-ships-reflag-as-tanzanian/>.

¹¹ See, for example, UN reports S/2019/171, pp. 7, 108; S/2017/742, p. 20; S/2017/150, pp. 30-32; S/2015/131, pp. 45-46. See also Hugh Griffiths and Michael Jenks, *Maritime Transport and Destabilizing Commodity Flows*, SIPRI Policy Paper 32 (Solna, Sweden: Stockholm International Peace Research Institute, 2012), 11-18.

¹² Including those 17 states listed in the table notes. Using the Specially Designated Nationals And Blocked Persons List (SDN) from 10 September 2019. Sanctioned vessels were excluded from the calculation if: (a) the

relationship between open registries and sanctions evasion is understudied. The academic literature on open registries predominantly focuses on its implications for issues other than sanctions evasion (e.g. environmental safety),¹³ or offers legal analysis of the open registry system in terms of maritime law rather than international sanctions law.¹⁴ This gap can be attributed to the unavailability of data regarding maritime sanctions evasion, due largely to the efforts of sanctions evaders to maintain secrecy of operations and tradecraft, as well as sensitivities in publicly reporting instances of sanctions evasion due to legal and political liabilities.¹⁵ However, by leveraging recent efforts to document North Korea's elaborate maritime sanctions evasion network and by drawing insights from analogous illicit maritime activities such as IUU fishing, it is becoming possible to develop evidence-based arguments that explain the facilitative role that the open registry system plays in maritime sanctions evasion. It is to this task that this paper commits itself. Specifically, this paper argues that open registries generally exhibit two qualities that make them more susceptible to flagging sanctions-evading vessels than closed registries, leading to the observed overrepresentation of open registry flags in cases of maritime sanctions evasion: (1) inadequate measures for detecting sanctions evasion in their fleets; and (2) being specifically targeted for flagging services by sanctions evaders.

In making this argument this paper offers two primary contributions to the literature. First, it extends the literature on the implications of the open registry system by demonstrating its facilitative role in sanctions evasion. While the existing literature has focused on open registries' adverse effects on maritime issues such as vessel and seafarer safety, this paper shows that they also pose challenges to issues of international governance that extend beyond the maritime domain. Sanctions are, for example, central to international efforts to stifle nuclear proliferation, human rights abuses, and military aggression. Second, this paper provides a basis for policy interventions to improve sanctions enforcement in open registries. Appreciating, for example, that the use of private entities to run open registries on behalf of some flag states creates barriers to information sharing between the state and registry that compromise the latter's ability to detect sanctions evasion in their fleets (as argued below) might encourage these flag states to build information sharing arrangements into future private registry contracts.

2. Detecting sanctions evasion

The effective implementation of maritime sanctions requires the cooperation of various national and sub-national entities including importers and exporters, trade associations, customs and port authorities, and financial service providers. For example, customs authorities inspect cargo for sanctioned goods, importers ensure that the cargo is not coming from a

flag of the sanctioned vessel was unknown; (b) the status of the flag as an open registry as per Table 1 was not known; or (c) the vessel was flagged by Iran, as all Iranian vessels are subject to automatic US designation.

¹³ See note 1.

¹⁴ See, for example I. M. Sinan, "UNCTAD and Flags of Convenience," *Journal of World Trade* 18, no. 2 (1984), 95-109; Moira L. McConnell, "Darkening Confusion Mounted upon Darkening Confusion: The Search for the Elusive Genuine Link," *Journal of Maritime Law and Commerce* 16, no. 3 (1985), 365-396; Brian Baker, "Flags of Convenience and the Gulf Oil Spill: Problems and Proposed Solutions," *Houston Journal of International Law* 34, no. 3 (2012), 687-716; Carlos Felipe Llinás Negret, "Pretending to Be Liberian and Panamanian; Flags of Convenience and the Weakening of the Nation State on the High Seas," *Journal of Maritime Law and Commerce* 47, no. 1 (2016), 1-28.

¹⁵ Alleging sanctions evasion (typically a criminal offence) by a foreign state or national risks a lawsuit or diplomatic demarche.

sanctioned source, and financial service providers refuse insurance or foreign exchange services to sanctioned entities. Increasingly, flag registries are also being called upon to play a role in sanctions implementation. Under UN Security Council Resolutions 2321 and 2397, for example, the flag registries of all UN member states are required to block any North Korean entity from registering a vessel; de-register vessels owned, controlled or operated by North Korean individuals; de-register vessels suspected of engaging in sanctioned activities with North Korea; and generally prevent sanctioned goods from being shipped under their flag.

A central process performed by flag registries to ensure compliance with such obligations is ‘know-your-customer’ checks which, broadly speaking, determines whether vessels entering the fleet have links to sanctioned entities. As part of this process registries might, for example, review the flagging history of the vessel; determine whether a current or former vessel owner, manager, charterer, or lessee appears on a sanctions list; review the vessel’s history of port calls; or check if the vessel has been mentioned in a UN Panel of Experts’ report. Once registered, vessels are also subject to ongoing monitoring by their flag registries to ensure continuous adherence to sanctions regimes. Flag registries might, for example, monitor port calls to sanctioned jurisdictions, the switching-off of AIS transponders, or changes in vessel speed and draft that suggest an undeclared transfer of cargo. These checks form the core of flag registries’ due diligence activities in sanctions enforcement.¹⁶

The extent to which a flag registry performs such due diligence activities is decided by the flag registry itself based on its own interpretations of applicable sanctions instruments and its capacity to allocate resources to these functions.¹⁷ Accordingly, there is significant variation in the quality and comprehensiveness of such checks across flag registries. Open registries have been singled out as underperformers in this regard. The March 2019 report of the UN Panel of Experts on North Korea, for example, notes the “extremely poor reporting, oversight, monitoring and control over the vessels exercised by the flag-of-convenience States under whose jurisdiction they apparently sail.”¹⁸ Indeed, the record is littered with striking examples of due diligence failures by open registries. For example, in May 2017 the open Panamanian registry flagged the *Hua Fu* despite obvious indications observable through open-source maritime databases that this was a North Korean vessel and therefore ineligible for foreign flagging under UN Security Council Resolution 2321, for example having previously sailed under a North Korean flag and having a registered owner/ship manager/ISM manager based in the North Korean capital Pyongyang. In another example, in 2016 the open Tanzanian registry flagged nearly 50 vessels linked to North Korea, including those identified in UN Panel of Experts reports, those sanctioned by the US Treasury, and those de-registered by other flag states¹⁹ – even the most cursory of due diligence checks would have indicated that these were sanctioned vessels and therefore barred from registration. There are several explanations for such poor due diligence practices generally exhibited by open registries, three of which are discussed below.

¹⁶ See *Sanctions Advisory for the Maritime Industry, Energy and Metals Sectors, and Related Communities* (Washington D.C.: U.S. Treasury, 2020), pp. 11-12.

¹⁷ See Yoshinobu Takei, “Assessing Flag State Performance in Legal Terms: Clarifications of the Margin of Discretion,” *International Journal of Marine and Coastal Law* 28, no. 1 (2013), 124-129.

¹⁸ Hugh Griffiths et al., *Report to the Panel of Experts established pursuant to Resolution 1874, S/2019/171* (New York: United Nations, 2019), Paragraph 4.

¹⁹ Byrne, “Nearly 50 North Korea-linked ships reflag as Tanzanian.”

2.1 The costs of due diligence

Open registries are, for the most part, those of small states with small economies which use their power to flag vessels as a quick and easy source of revenue. With a limited economic base and a commercial interest in cost-savings, open registries tend to avoid the burdensome operating costs of effective due diligence, which include additional staff, specialised training, and subscriptions to various compliance tools such as AIS trackers and beneficial ownership screening that can run into the tens or hundreds of thousands of dollars. It was revealed in the abovementioned Panel of Experts report, for example, that “none of the flag-of-convenience States that replied to the Panel’s letters” use AIS-tracking tools²⁰ – AIS being critical in tracking the whereabouts and pathing of vessels to ensure that they do not enter sanctioned jurisdictions. Demonstrating this aversion to compliance costs, a 2003 survey revealed that some open registries were outright refusing to flag fishing vessels as meeting international obligations around the prevention of IUU fishing would require investments in due diligence capabilities that “outweigh the financial benefits that accrue from the registration of these vessels”.²¹

2.2 Anonymous vessel registration

It is this ultimate pursuit of profit that has led to a widespread practice among open registries of accepting anonymous vessel registration. The beneficial owners of entities engaged in maritime transit, including those engaged in licit trade, often seek to maintain their anonymity during the flagging process, for example to minimise liability or avoid taxes. Open registries court this business by allowing corporations to register as vessel owners, and then lowering the reporting and accountability requirements of those corporations, for example by allowing bearer shares, nominee shareholders, and intermediaries to act on the owner’s behalf.²² In this system it’s possible for true beneficial owners to obscure their identities behind layers of proxy corporate entities.²³ Some open registries do not even require that the vessel submit information on beneficial ownership during registration.²⁴ While this increases the marketability of their flagging services, it also deprives these registries of critical information required to conduct effective due diligence. For example, a Chinese shipping company currently designated by the UN for violating sanctions against North Korea allegedly continues to field a fleet of vessels through a network of proxy firms in China, Taiwan and the United Kingdom, some of which continue to be flagged by open registries, and some of which are alleged to be involved in ongoing sanctions evasion.²⁵ Full information on the beneficial ownership of these vessels

²⁰ Griffiths et al., *Report to the Panel of Experts established pursuant to Resolution 1874*, Paragraph 43.

²¹ No author, *Expert Consultation on Fishing Vessels Operating Under Open Registries and Their Impact on Illegal, Unreported and Unregulated Fishing*, FAO Fisheries Report No. 722 (Rome: Food and Agriculture Organization of the United Nations, 2004), 8, 87.

²² Michael Galley, *Shipbreaking: Hazards and Liabilities* (Cham, Switzerland: Springer, 2014), 104-107; OECD Maritime Transport Committee, *Ownership and Control of Ships: Options to Improve Transparency* (Paris, France: OECD, 2003), 17-18, passim.

²³ OECD Maritime Transport Committee, *Ownership and Control of Ships*, 2, 17.

²⁴ See, for example *Vessel Operations Under Flags of Convenience and Their Implications on National Security: Hearing Before the Special Oversight Panel on the Merchant Marine of the Committee on Armed Services*, US House of Representatives, 107th Congress, 2nd Session, Hearing Held June 13, 2002, Volume 63, 125-128; Tommy Piemonte and Stefanie Schreiber, *SOS on the high seas: Responsibility of financial institutions in the ship financing business* (Hannover: Imug, 2016), 41.

²⁵ James Byrne, Joe Byrne, Hamish Macdonald and Gary Somerville, *Down and Out in Pyongyang and London: North Korea’s Coal Smuggling Networks Using UK Companies* (London: Royal United Services Institute, 2019), esp. 15-22.

would've revealed that ultimate ownership rests with a sanctioned entity and thus likely precluded their flagging.

2.3 Privately run registries

In some cases states will want to profit from the use of their flag (i.e. by running an open registry) but lack the resources and expertise for flag administration, leading them to retain private entities for this purpose. Though governance arrangements vary, privately run registries will generally execute the bulk, if not all of that state's flag administration responsibilities, including vessel registration and de-registration, and pay royalties to the national government as an effective licensing fee for the use of its national flag. Historically the registries of Mongolia, Cambodia, Belize, Dominica, Vanuatu, Georgia, and Cyprus, among others, have so operated.²⁶

This non-state governance of open flag registries creates unique challenges for effective due diligence. In the first instance, the delegation of flag registration to private entities often headquartered in foreign jurisdictions creates distance – both geographical and organisational – between governments and their flags. For example, a 2017 analysis of six contracts between private registry providers and their government clients revealed that only two had specific provisions detailing data sharing arrangements between the registry and government; only one entitled the government to have a representative situated in the registry head office; and none contained “clauses that expressly place a duty upon the private flag company to forward reliable information upon request or in a timely fashion to the flag state administration about the identity or location of the vessels on the ship registry or their ownership interests.”²⁷ Demonstrating this disconnect, in 2002 a Greek-owned, Cambodian-flagged vessel was found to be trafficking narcotics, and for more than three days Phnom Penh was unaware that the reported vessel was theirs “as the Singaporean company that ran the Cambodian ship registry had failed to supply it with a complete list of vessels.”²⁸

This organisational separation means that, in fulfilling their due diligence requirements, private registries cannot draw on the complementary capabilities of their client governments, for example intelligence, law enforcement, and diplomatic engagement with international sanctions authorities. The staffing of these registries by foreign nationals also opens them up to infiltration by international agents of sanctions evasion. For example, the privately run Sierra Leone flag registry had at one point employed two Chinese nationals to register foreign vessels from offices in Dalian and Shanghai. It was later discovered that these individuals had extensive ties to North Korea's sanctions-evading shipping activities and were using their offices to register North Korean vessels with the Sierra Leone flag.²⁹ Similar infiltrations have been reported in the privately run registries of Mongolia, Kiribati, Tuvalu, and Niue.³⁰

²⁶ Galley, *Shipbreaking*, 103.

²⁷ North Atlantic Fisheries Intelligence Group and INTERPOL, *Chasing Red Herrings: Flags of Convenience and the Impact on Fisheries Crime Law Enforcement* (Oslo, North Atlantic Fisheries Intelligence Group), 40-41.

²⁸ Environmental Justice Foundation, *Lowering the Flag*, note 68.

²⁹ Leo Byrne, “Red flags: The African registry employing North Korea's arms smugglers,” NK News, May 15, 2017, <https://www.nknews.org/2017/05/red-flags-the-african-registry-helping-n-koreas-smugglers-a-void-sanctions/>.

³⁰ James Byrne, *The Sailors of Panama* (London: Royal United Services Institute, 2019); Andrea Berger, “North Korea's Friends in Singapore Running Flags of Convenience,” 38 North, June 22, 2015, <https://www.38north.org/2015/06/aberger062215>.

3. Strategic flagging by sanctions evaders

As argued in Section 2, open registries exhibit several qualities that compromise their ability to detect sanctions evasion in their fleets, presenting a credible causal model for the overrepresentation of sanctions-violating vessels on open flags. A second explanation is advanced here: that not only are open registries deficient in detecting and de-registering vessels engaged in sanctions evasion; but that sanctions evaders actively pursue flagging with open registries, leading to a higher number of vessels that ultimately slip through the cracks of poor due diligence.

Whether chartering a vessel or transporting illicit cargo on an unsuspecting vessel,³¹ sanctions evaders, as with all merchants, have a choice of flag: they can transport goods on vessels flagged to either open registries or their respective closed registries. Limited data are available for directly observing the preferences of sanctions evaders in making this decision. However, it is possible to identify reasons that open registries would make a preferable flagging choice for sanctions evaders, logically leading to the observed overrepresentation of open flags in cases of maritime sanctions evasion.

3.1 Lower detection rates

Firstly, and as demonstrated in Section 2, open registries generally underperform in the conduct of due diligence for sanctions enforcement. Given that the modus operandi of sanctions evasion is to avoid detection, sanctions evaders benefit from targeting open registries which are less likely to identify this illicit activity. This type of ‘strategic flagging’ behaviour has been observed with other illicit maritime activities. IUU fishing vessels, for example, have been observed targeting flag registries that “do not comply with their obligations regarding jurisdiction and control according to international law in respect of fishing”.³² And vessels engaged in environmentally dangerous voyages have similarly been observed targeting flag states with lower regulatory thresholds for environmental safety.³³

As sanctions evaders so engage in strategic flagging they are likely to look to the flag state’s performance in port state control lists. Port state authorities are responsible for inspecting ships and cargo that arrive in their ports to ensure compliance with the various IMO instruments around issues such as environmental and seafarer safety – essentially replicating and authenticating the regulatory responsibilities of flag registries. Though not assigned any formal sanctions enforcement responsibilities, port state authorities’ inspections, in particular cargo inspections, allow for the identification of the red flags of sanctioned behaviour which are likely to be reported up the chain of command, for example mislabelled or concealed cargo. Indeed, some port state authorities have specifically used port state inspections as a detection tool for illicit maritime trade. Japan, for example, from 2003 has used port state inspections to investigate “illegal shipments or any sort of illegality” on North Korean vessels stopping at Japanese ports.³⁴

³¹ Griffiths and Jenks have developed an ordinal scale of vessel culpability in illicit maritime trade: Griffiths and Jenks, *Maritime Transport and Destabilizing Commodity Flows*, 7-9.

³² Miller and Sumaila, “Flag Use Behavior and IUU Activity within the International Fishing Fleet,” 205; See also Henrik Österblom et al., “Adapting to Regional Enforcement: Fishing Down the Governance Index,” *PLOS One* 5, no. 9 (2010).

³³ Dana D. Miller, Kathryn Tooley and U. Rashid Sumaila, “Large-scale oil spills and flag-use within the global tanker fleet,” *Environmental Conservation* 42, no. 2 (2015).

³⁴ Griffiths and Jenks, *Maritime Transport and Destabilizing Commodity Flows*, 33.

Due to resource limitations, only a small portion of such traffic can be inspected, with port states generally prioritising vessels more likely to be in violation of these conventions for inspection. This risk of vessel violation is typically calculated at the level of the flag state: as more vessels flying the flag of a particular state are found in violation of conventions, that flag will score lower on port state control lists and therefore be subject to more inspections. The Tokyo MoU control list, for example, which is subscribed to by 20 port states in the Asia Pacific, has on its 'black list' (highest risk vessels requiring most frequent inspections) 12 flag states with an average inspection-to-detention rate of 15%. This compares with an average detention rate of 2% for the 40 'white list' flag states (lowest risk vessels requiring fewest inspections).³⁵ Sanctions evaders, who are trying to avoid detection, are therefore likely to flag with those open registries that score highly on port state control lists and are therefore less likely to be inspected when entering various port state jurisdictions. Though open registries do generally perform worse on port state control lists,³⁶ there is significant variation in the performances of individual open registries. Fiji, Tanzania and Togo, for example, are all on the Tokyo MoU black list with an average detention rate of 23%; whereas Malta, Tuvalu and the Bahamas are on the Tokyo MoU white list with an average detention rate of less than 3%.³⁷ The challenge, then, for sanctions evaders is to find a flag registry that is: (a) ineffective enough in its own inspections and due diligence that it is unlikely to detect sanctions evasion amongst its own fleet; but also (b) well-respected enough at target port state authorities that the risk of inspection will be minimal.

3.2 Cost savings

A second reason that sanctions evaders target open registries is to reduce operating expenses. As the vast majority of maritime transit is commercial in nature, there is an obvious pressure for vessel owners and operators to reduce costs, including with respect to flagging. Accordingly, lower flagging costs have repeatedly been found to be a dominant factor in a vessel's choice of flag.³⁸ Open registries, who are in competition for international customers with both closed registries and one another, court this business by offering various cost savings, for example allowing the employ of foreign crews that work for lower wages; enforcing lower standards of vessel safety to reduce maintenance and upkeep costs; and minimising registration fees and local tax liabilities. These cost savings reduce net operating expenditures. A 2010 survey, for example, showed that US vessels sailing under a flag of convenience were paying only 37% of the daily operating costs of an equivalent vessel sailing under the closed US flag.³⁹

³⁵ "Black-Grey-White lists," Tokyo MoU, no date, viewed 19 March 2020, <http://www.tokyo-mou.org/doc/Flag%20performance%20list%202018.pdf>.

³⁶ In the Tokyo MoU control list, for example, the average excess factor for the top 10 open registries (as per Table 1) was -1.13 compared with -1.31 for the top 10 closed registries (10 largest states by DWT not appearing in Table 1). The top 10 closed registries were: China, Denmark, Greece, India, Italy, Japan, Norway, South Korea, Spain (no Tokyo MoU excess factor thus excluded from calculation), and the United Kingdom. Source: "Maritime Profiles," United Nations Conference on Trade and Development.

³⁷ "Black-Grey-White lists," Tokyo MoU.

³⁸ Hoffmann, Sanchez, and Talley, "Determinants of Vessel Flag"; Angela Bergantino and Peter Marlow, "Factors influencing the choice of flag: empirical evidence," *Maritime Policy & Management* 25, no. 2 (1998); Peter Marlow and Kyriaki Mitroussi, "Shipping taxation: perspectives and impact on flag choice," *International Journal of Shipping and Transport Logistics* 3, no. 4 (2011); Meifeng Luo, Lixian Fan, and K. X. Li, "Flag choice behaviour in the world merchant fleet," *Transportmetrica A: Transport Science* 9, no. 5 (2013).

³⁹ "Flags of Convenience: Why do Shipowners Prefer Them and what is Charterer's Position?" Open Sea Pro, no date, accessed 17 September 2019, <https://opensea.pro/blog/flags-of-convenience>.

Accordingly, empirical studies have consistently associated sailing under the flag of an open registry with reductions in freight costs.⁴⁰

The cost-effectiveness of sailing under the flag of an open registry offers unique benefits for sanctions evaders. Sanctioned entities generally trade on international markets at lower margins to offset the risk that buyers/sellers take on in trading illicitly – arrest, seizure of cargo, designation by sanctions authorities etc. By way of example, in 2018 North Korean exporters were reportedly marketing sanctioned coal to Chinese traders for as little as one quarter of the market price.⁴¹ Where trading in such distorted markets might otherwise be financially unviable for the sanctioned entity, reductions in operating costs offered by open registries become an essential enabler of trade. This is especially the case for vessels that practice ‘flag hopping’: continuous reflagging to avoid scrutiny by sanctions monitors. The *Joint Pacific*, for example, a Chinese-built container ship recently implicated in sanctioned trade with North Korea,⁴² has reflagged seven times to six different open registries since being commissioned in 2009.⁴³ Where a vessel is so engaging in rapid reflagging, waivers in registration fees have a compounding ameliorative effect.

4. Discussion

Ultimately, the root cause of the susceptibility of open registries to flagging sanctions-evading vessels is not the unique attributes of particular open registry states or authorities, but rather the open registry system itself: the ability of flags to compete with one another for international clients promotes a ‘race to the bottom’ in which registries jettison regulation and oversight to increase their marketability in the competitive industry of international flagging. Defeating this underlying pathology would require eliminating the open registry system, however this is impractical for several reasons. First, open registries are an essential enabler of the cheap and fast transit of the majority of the world’s goods; removing them altogether would severely compromise international markets. Second, there is no guarantee that doing so would completely eliminate maritime sanctions evasion. Even though open registries are uniquely susceptible to flagging sanctions evaders, sanctions evaders can (and have)⁴⁴ operated within the domain of closed registries using the same practices of deception. And third, the sovereign right of states to flag vessels according to their own standards is a heavily codified norm enshrined in the United Nations Convention on the Law of the Sea and decades of precedent.

⁴⁰ Gordon Wilmsmeier and Inmaculada Martínez-Zarzoso, “Determinants of maritime transport costs – a panel data analysis for Latin American trade,” *Transportation Planning and Technology* 33, no. 1 (2010); Gordon Wilmsmeier, *International Maritime Transport Costs: Market Structures and Network Configurations* (London: Routledge, 2014), 65-66, 100-101; S. R. Tolofari, *Open Registry Shipping – a comparative study of costs and freight rates* (New York: Gordon and Breach Science Publishers, 1989), 320-346. See also Mansell, *Flag State Responsibility*, 109-110.

⁴¹ Sue-Lin Wong “North Korean traders offering cheap coal on hopes sanctions will ease: Chinese traders,” Reuters, May 11, 2018, <https://uk.reuters.com/article/uk-china-northkorea-coal-exclusive/exclusive-north-korean-traders-offering-cheap-coal-on-hopes-sanctions-will-ease-chinese-traders-idUKKBN1ICOM0>. North Korean coal exports are barred under UN Security Councils resolutions 2270, 2371 and 2321.

⁴² James Byrne and Tom Plant, *The Jie Shun Incident: Chinese State-Owned Enterprise Connections to the North Korean Arms Trade* (London: Royal United Services Institute, 2019), 7.

⁴³ Source: Equasis, IMO 9155286.

⁴⁴ See, for example: “Treasury Targets Russian Shipping Companies for Violations of North Korea -related United Nations Security Council Resolutions,” U.S. Department of the Treasury, August 21, 2018, <https://home.treasury.gov/news/press-releases/sm463>; Lucas Kuo and Lauren Sung, “Against The Grain: Sand Dredging in North Korea,” C4ADS, no date, viewed 2 March 2020, <https://c4ads.org/blogposts/against-the-grain>.

To revoke the capability of states to flag vessels in their own best interests would require major changes in international law and would challenge the cardinal right of state sovereignty.

Therefore, improving maritime sanctions enforcement will require working within the dual open/closed registry system. As a first step, port authorities should codify sanctions compliance checks into routine port state inspections, utilising their front-line status and boarding privileges to apply an additional layer of scrutiny for vessels. In addition to mislabelled or concealed cargo, port authorities could, for example, inspect for forged documentation, crews from sanctioned jurisdictions, or vessel modifications designed to obscure the vessel's identity. This would raise the possibility of port state inspections detecting incidents of sanctions evasion and also encourage open registries to clamp down on sanctions evasion in their fleets as they pursue higher scores on port state control lists.

Change should also occur at the level of open registries. Currently the biggest barrier to sanctions enforcement in open registries is a lack of due diligence capabilities, with open registries struggling to improve standards due to the financial investment required, for example in recruiting and training specialised staff and subscriptions to compliance tools such as AIS trackers. Currently open registries invest in, and develop these capabilities in isolation, leading to duplications in effort as registries independently attempt to keep pace with the changing regulatory environment and increasingly sophisticated tradecraft employed by sanctions evaders. Were open registries to pool these resources it would be possible to achieve economies of scale that see these limited investments go further. For example, open registries could invest in a joint advisory body that draws from a common bureaucratic and technical base in evaluating sanctions compliance in all ships coming onto the registers of member registries. Alternatively, a less ambitious proposal would be to have formal arrangements for information sharing between registries regarding suspect and de-registered vessels, such as the registry information sharing compact recently signed by Panama, the Marshall Islands and Liberia.⁴⁵

Of course, the viability of these recommendations is contingent upon the willingness of port authorities and open registries to improve sanctions enforcement practice. This will not always be the case as these entities seek to lower operating costs, maintain competitive advantage amongst one-another, and maximise their client base. However, recent U.S. support for secondary sanctions against maritime entities that fail to prevent sanctions evasion is likely to force the issue. The 2017 Countering America's Adversaries Through Sanctions Act, for example, legislates mandatory designations for any entity that provides bunkering or registration services to a UN- or U.S.-designated vessel (section 311), as well as enhanced scrutiny of port authorities that fail to inspect vessels for sanctions compliance or facilitate transshipment of sanctioned cargo (section 314). In another example, in May 2020 the U.S. Treasury released technical guidance for port authorities and flag registries to "address illicit shipping and sanctions evasion practices" in order to minimise their exposure to U.S. secondary sanctions.⁴⁶ Promulgating this risk amounts to a warning by the U.S. that it now considers these entities as fair game for the imposition of secondary sanctions. Within a risk management framework, the threat of being sanctioned by the world's largest economic power should push

⁴⁵ Stephen Osborne, "The Registry Information Sharing Compact is a major step forward in sanctions enforcement, Hellenic Shipping News," February 22, 2020, <https://www.hellenicshippingnews.com/the-registry-information-sharing-compact-is-a-major-step-forward-in-sanctions-enforcement/>.

⁴⁶ U.S. Treasury, *Sanctions Advisory for the Maritime Industry, Energy and Metals Sectors, and Related Communities*, pp. 11-13.

these entities toward robust sanctions enforcement, increasingly justifying the abovementioned measures.

5. Conclusions

Sanctions are a common instrument of economic pressure that have been deployed to stifle numerous international ills including nuclear proliferation, human rights abuses, and military aggression. The efficacy of sanctions as a coercive instrument is constantly under threat from those that evade their application, and nowhere is this practice more common than in maritime trade which has seen a variety of deceptive sanctions evasion practices including forged bills of lading, the obfuscation of port calls to sanctioned jurisdictions, and ship-to-ship transfers. This paper asked why vessels flagged to open registries are over-represented in cases of sanctions evasion and two arguments were advanced in response. The first is that the for-profit nature of open registries creates financial pressures to lower regulatory burdens and due diligence activities for incoming vessels, creating blind spots – for example with respect to beneficial ownership and at-sea monitoring – that allow sanctions evaders to carry on their activities undetected. The second is that sanctions evaders actively target open registries for flagging services, both because of the lower probability of detection, and because the lower costs of flagging with open registries make sanctioned trade economically viable where it might not otherwise be in a closed system. Recommendations for improving maritime sanctions enforcement were advanced advocating for an expanded role of port authorities and information sharing arrangements between open registries.