

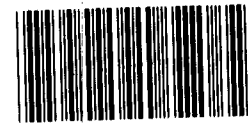
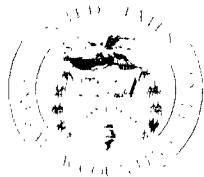
GAO

Report to the Honorable
Bob Packwood, U.S. Senate

October 1990

COAST GUARD

Anti-Reflagging Act Has Mixed Impact on U.S. Fishing and Ship Rebuilding



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**Resources, Community, and
Economic Development Division**

B-237971

October 25, 1990

The Honorable Bob Packwood
United States Senate

Dear Senator Packwood:

On June 13, 1989, you asked that we evaluate the effect of specific provisions of the Commercial Fishing Industry Vessel Anti-Reflagging Act of 1987. In general, this act, implemented by the Coast Guard, was enacted to help ensure control by Americans of the U.S. fishing industry in U.S. coastal waters. As requested, this report provides our evaluation of the impact of the act's provisions for

- ensuring American control of fishery operations by establishing more stringent U.S. vessel ownership requirements and
- prohibiting vessels rebuilt in foreign countries from participating in U.S. fisheries.

We have also gathered information regarding your specific interests in (1) the act's impact on the groundfish¹ industry off the coast of Alaska and (2) the Coast Guard's procedures for enforcing certain of the act's prohibitions. This information is contained in appendix I.

During our review, litigation was initiated against the Coast Guard challenging, in part, whether its interpretations used to implement the act's grandfather provisions are consistent with the intent of the Congress. These provisions, discussed in sections below, exempt vessels from meeting the act's ownership and vessel-rebuilding requirements, if certain conditions are met. In view of this litigation, we agreed with your office not to evaluate the issues that are before the court.

Results in Brief

The act's American control provisions have had little impact on ensuring increased American control of the U.S. fishing industry. This results from the Coast Guard's interpretation of the act's grandfather clauses, which exempt vessels from meeting the American control provisions if the vessels were licensed under U.S. law and operating in U.S. coastal waters before July 28, 1987—about 6 months before the act was passed. The Coast Guard has interpreted that the grandfather exemptions

¹Groundfish are fish that are caught on or near the sea floor. Some examples of groundfish stocks off the coast of Alaska are Pacific cod, sablefish, flounders, Alaska pollock, and various types of rockfish.

remain with the vessels even if the vessels are subsequently sold to foreign-owned companies. This interpretation gives foreign-owned companies continued access to U.S. fisheries.

By contrast, the act's prohibitions against foreign rebuilding of vessels used in U.S. fisheries are likely to have a significant impact. This is so because the grandfather exemptions that allowed foreign rebuilding are tied to specific deadlines, all of which have passed. Generally, vessels rebuilt in a foreign country were required to be delivered to the owners before July 28, 1990, in order to be eligible for U.S. fishery privileges. Because the deadlines have passed, owners who desire to rebuild their vessels and who wish to participate in U.S. fisheries will likely rebuild in U.S. shipyards.

Background

Unregulated fishing and concern for depletion of fish stocks relied upon by coastal fishermen across the nation resulted in attempts to ensure control of the U.S. fishing industry by Americans (i.e., Americanize the industry) as early as 1971. These Americanization efforts continued under the Magnuson Fishery Conservation and Management Act, which was passed in 1976. The Magnuson Act established exclusive U.S. management of fisheries out to 200 miles off our shores and gave priority to U.S. fishermen and vessels for receiving fish quotas within the 200-mile limit.

Although the Magnuson Act led to increasing American control of our fishing industry through U.S. fishery management, several concerns developed among fishermen, shipbuilders, and others over some remaining barriers to the Americanization process. One concern was that the existing American control requirements for licensing a corporate-owned vessel under U.S. flag were minimal. These requirements allowed, for example, a company's stock to be totally owned by foreigners. A second concern was that foreign owners could merely reflag² their foreign-built fish-processing vessels³ as "vessels of the United States" and operate within the U.S. fishery, thus gaining first priority to process fish caught by U.S. fishing vessels. Third, although

²To reflag, a vessel gives up its foreign registry and becomes licensed (documented) under U.S. laws to participate in trades, such as the fishery. (See app. I for details on the documentation process.)

³We discuss three basic types of fishing industry vessels in this report: fish-catching only; fish-processing vessels, which are at-sea factory ships that only process fish caught by other vessels; and factory trawlers, which catch fish using trawling nets and process them on board. Before the Anti-Reflagging Act, fish-processing vessels could be foreign built and still process fish within the U.S. fisheries.

before the act any vessels catching fish had to be built in the United States, these vessels retained their U.S.-built status and resulting fish-catching privileges even if they were later substantially rebuilt abroad so that they were essentially new vessels. Fishermen and others told us that many owners were rebuilding vessels abroad because doing so was less costly than rebuilding in the United States.

To address these concerns, the Anti-Reflagging Act was signed into law on January 11, 1988. Its provisions included the following:

- It established more stringent American control requirements for corporations licensing vessels under the U.S. flag by requiring that the controlling interest in the vessel, as measured by a majority of voting stock, be owned by U.S. citizens. In assessing if a vessel is in fact controlled by Americans, it also required that a variety of factors be considered from the Shipping Act of 1916⁴ that could lead to foreign control, such as the existence of foreign financing.
- It required fish-processing vessels entering the fisheries after the act was passed to be U.S. built. Foreign-built fish-processing vessels already operating in the fisheries must be licensed to process fish only and are not permitted to catch or harvest fish. This action eliminated the ability of new entrants to reflag foreign-built or foreign-owned fish-processing vessels so as to gain priority access to U.S. fishery resources.
- It prohibited owners from participating in the U.S. fishing industry with vessels rebuilt abroad.

The act also contained several grandfather clauses to protect the financial interests of owners who had become involved in U.S. fisheries under the previous conditions of law. For example, the grandfather clauses allowed an owner, if certain conditions were met, to operate fish-processing vessels used in the fisheries prior to the act without regard to where the vessels were built or to the new stock ownership requirement. Also, under certain conditions, an owner could continue with foreign-rebuilding plans without jeopardizing the vessel's right to participate in the fisheries. (The conditions of these grandfather clauses are explained in later sections of this letter.)

⁴The Anti-Reflagging Act requires that, in determining controlling interest in a partnership or corporation, the criteria in section 802(b) of the Shipping Act of 1916 (46 App. U.S.C. 802(b)) be applied. The Shipping Act conditions for vessel ownership by U.S. citizens include (1) clear title to a majority of the stock, (2) majority of the voting power, (3) no contract or understanding that would allow the voting power to be exercised in favor of a noncitizen, and (4) no other means by which control of the corporation is permitted to be in favor of a noncitizen.

The Coast Guard is responsible for enforcing the Anti-Reflagging Act. Its procedures for doing so, explained in more detail in appendix I, fall into three categories—licensing (called “documentation”), at-sea boarding of vessels, and investigations. If it finds violations, the Coast Guard can impose civil penalties. Actions triggering the imposition of criminal penalties or the seizure and forfeiture of vessels to the United States are referred to a U.S. Attorney.

The Act’s American Control Provisions Have Had Little Impact

The act’s American control provisions have had little effect on ensuring U.S.-citizen control of fishery operations. Under the Coast Guard’s interpretation of the act’s grandfather clauses, vessels that meet applicable conditions are permanently exempt from the act’s American control provisions. According to the Chief of Vessel Documentation, nearly all of the vessels licensed for the U.S. fishery at the time the act was passed could likely be grandfathered and, as a result, could be resold to foreign-owned companies that do not meet the new, more stringent conditions. The Coast Guard’s interpretation was challenged in court at the time of our review by several U.S. fishing and shipbuilding groups.⁵

Prior to the Anti-Reflagging Act, for a vessel to be documented to fish in American waters, corporate ownership had to meet several citizenship standards. For example, the chief executive officer and the chairman of the board of directors had to be U.S. citizens. Also, the number of non-citizens on the board of directors could be no larger than a minority of the number of directors necessary to constitute a quorum. Notwithstanding these requirements, however, the law allowed 100 percent of the corporation’s stock to be foreign owned.

The Anti-Reflagging Act made the American control requirements more stringent for fishery participation by requiring that the majority of voting stock be owned by U.S. citizens. As discussed above, it also added the American control conditions of the Shipping Act of 1916. But under the Anti-Reflagging Act’s grandfather clauses, vessels are exempt from these requirements if either of two conditions was met before July 28, 1987: (1) The vessel was licensed under U.S. law and operated as a fishing, fish-processor, or fish-tender vessel in the navigable waters of the United States or the 200-mile zone established by the Magnuson Act, or (2) the vessel was being purchased for such purposes. Thus, a foreign-owned company whose vessel was operating in U.S. waters prior

⁵*Southeast Shipyard Association v. United States of America*. Filed on May 16, 1990, in the U. S. District Court for the District of Columbia. (Civil Action No.90-1142.)

to July 1987, or that had a contract to buy a vessel to do so, could continue to operate or carry out its plans after passage of the act.

The Coast Guard believes that under the act's wording these grandfather exemptions apply to the vessel, not to the vessel owner. Under that interpretation, a vessel that meets the grandfather conditions has a permanent exemption from the new American control requirements. This means that the vessel can be bought and sold repeatedly without losing fishery privileges, regardless of whether the new owner is a corporation with totally foreign-owned voting stock or other arrangements that offer potential for foreign control.

This interpretation is significant for the U.S. fishing industry because of the large number and percentage of vessels that apparently meet the act's grandfather exemptions. According to the Chief of Vessel Documentation, a total of about 29,000 vessels were licensed for catching fish, and were therefore U.S. built, at the time the act was passed in 1987; and nearly all of them could likely be grandfathered for American control requirements under the act by virtue of the past fishing within the 200-mile limit. By contrast, he estimated 2,000 new vessels constructed and documented for the fisheries in the 2 years following passage of the act are subject to the new American control conditions.

This interpretation is also significant for the groundfish industry off the coast of Alaska. About 86 percent of the vessels we reviewed (see app. II for a description of vessels selected for review) would likely meet the American control grandfather exemptions. According to the Coast Guard's Chief of Vessel Documentation, the lives of these vessels could be extended almost indefinitely by periodic rebuilding in the United States.

In addition, the Chief estimated that about 800 of the 29,000 vessels in the United States, licensed for fish catching when the act was passed, meet the grandfather exemptions and are well suited for rebuilding or conversion into factory trawlers or other types of relatively large vessels that now dominate groundfish operations in Alaska.⁶ Thus, any number of these vessels could, at any time in the future, enter the Alaska groundfish fleet without needing to meet the new American control provisions.

⁶U.S.-built vessels can be converted for different fishery activities. For example, a fish-catching vessel could be converted into a factory trawler.

Several U.S. fishing and shipbuilding groups have filed a lawsuit to overturn the Coast Guard's interpretation. These groups contend, in part, that the grandfather clauses should apply to the vessel's owner, not to the vessel itself. Under this interpretation, vessels that were sold would continue to be eligible for participation in U.S. fisheries only if the new owners met the American control requirements.

The Act Is Likely to Eliminate the Foreign Rebuilding of U.S. Fishing Vessels

In contrast to the Anti-Reflagging Act's American control provisions, which may have little impact on U.S. control of the fishing industry, its prohibitions against foreign rebuilding are likely to have a significant effect. While much foreign rebuilding continued after the act under its grandfather clauses, the period for delivering rebuilt ships to the owners ended on July 28, 1990. Because future rebuilding in foreign shipyards will result in the vessels' ineligibility for U.S. fishery privileges, owners who desire to rebuild their vessels will likely choose to do so in U.S. shipyards.

The act prohibited the Coast Guard from licensing a foreign-rebuilt vessel for use in U.S. fisheries unless certain grandfather conditions were met. Coast Guard regulations provide that a vessel is rebuilt when any considerable part of its hull or superstructure is built upon or is substantially altered.⁷ Under the grandfather exemptions, a vessel could be rebuilt overseas without loss of fishing privileges if all of the following conditions were met: The vessel was (1) built originally in the United States and contracted for purchase before July 28, 1987, for use in the U.S. fisheries, (2) contracted to be rebuilt before July 12, 1988, and (3) delivered to the owner before July 28, 1990. If a vessel owner wants an exemption under the grandfather clauses, the Coast Guard requires that the owner request a decision in writing and provide the necessary documentation to show the vessel meets all three of these conditions.

We found that some of the vessels participating in the groundfish industry off the coast of Alaska were apparently rebuilt under the grandfather exemptions. For example, of the 52 factory trawlers that participated in the Alaska groundfish industry between January 1989 and February 1990, 15 vessels, or 29 percent, appear to have been

⁷The regulations are based on rebuilding requirements in the Merchant Marine Act of 1920, as amended in 1960 (46 U.S.C. App. 883). In 1988, the Anti-Reflagging Act (46 U.S.C. 12101(a)(2)) adopted the same rebuilt standard by referencing the Merchant Marine Act.

rebuilt in foreign countries since the act's passage and had received exemptions from the Coast Guard under the act's grandfather clauses.

No more foreign rebuilding of U.S. fishing vessels seems likely under the definition used for rebuilding. The act stipulated that rebuilt vessels must be delivered by July 28, 1990, to be eligible for grandfathering. While the act also allowed extensions past this time in the event of delays caused by circumstances beyond the control of the owner, the Chief of Vessel Documentation at Coast Guard headquarters told us that only one request for extension had been made as of August 1990 and the decision is pending. The Chief explained that this case involves a situation in which the shipyard closed for a period of time.

Matters for Consideration by the Congress

The Anti-Reflagging Act's American control provisions have had little impact on ensuring that U.S. fishery operations are controlled by U.S. citizens. This is a result of the Coast Guard's interpretation allowing the grandfather exemption to remain with a vessel even if the vessel is subsequently sold to a foreign-owned company. Consequently, should the Congress desire another result, it may wish to consider changes to the existing legislation.

Scope and Methodology

We conducted our audit work between November 1989 and August 1990. During that time, we interviewed Coast Guard headquarters and field office officials with responsibility for enforcing the Anti-Reflagging Act. We also met with members of the Alaska groundfish industry, and we developed data on that industry's factory trawlers and other processing vessels from Coast Guard documentation files and vessel listings provided by the National Marine Fisheries Service. Appendix II of this report discusses our objectives, scope, and methodology in further detail.

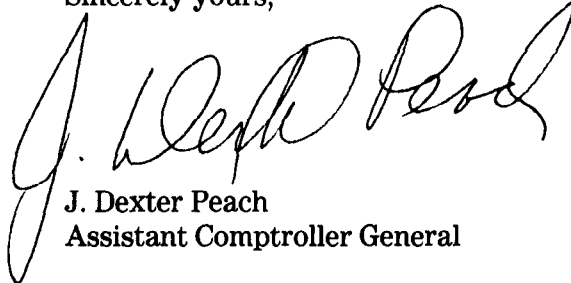
We discussed our findings and conclusions with Coast Guard officials who generally agreed with the facts contained in this report. As you requested, however, we did not obtain formal agency comments. We performed our work in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary

of Transportation, the Commandant of the Coast Guard, and other interested parties.

This work was performed under the direction of Kenneth M. Mead, Director, Transportation Issues, (202) 275-1000. Other major contributors to this report are listed in appendix III.

Sincerely yours,



J. Dexter Peach
Assistant Comptroller General

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Coast Guard Procedures for Enforcing the Act's Prohibitions

As requested, we obtained information on how the Coast Guard enforces certain of the Anti-Reflagging Act's prohibitions. We did not assess the adequacy of the Coast Guard's procedures.

The Coast Guard enforces the Anti-Reflagging Act's foreign-built, foreign-rebuilt, and foreign-control prohibitions through several activities carried out in support of other laws and maritime missions. In general, its procedures fall into three broad categories—documentation (licensing), at-sea vessel boarding, and investigations. In addition, when the Coast Guard finds violations, it can impose civil penalties or refer matters to a U.S. Attorney for criminal or forfeiture action. The Coast Guard has also started actions aimed at strengthening certain of its procedures.

Vessel Documentation

Through its vessel-documentation function, the Coast Guard licenses (documents) vessels to participate in U.S. fisheries. Vessel owners can apply for documentation at 15 Coast Guard documentation offices throughout the country. If an application to document a fishing vessel shows compliance with the Coast Guard regulations, the field office will issue a "certificate of documentation" with an endorsement authorizing the vessel's use in the fisheries. The certificate, which must be available for inspection at all times on the vessel, expires after 1 year; and it is routinely renewable if no changes have occurred. The Coast Guard otherwise requires owners to apply for new documentation under certain conditions, such as changes in the vessel's ownership or dimensions.

According to the Chief of Vessel Documentation, for vessels that fall under the Anti-Reflagging Act's foreign-built, foreign-rebuilt, and foreign-control prohibitions, the Coast Guard will not issue documentation for fishery privileges unless the vessel owners can show compliance with the act's grandfather clauses. To help ensure consistency in these determinations at the field office level, the Chief of Vessel Documentation at Coast Guard headquarters has ruled on whether specific cases involving foreign rebuilding or ownership meet applicable grandfather exemptions.

The Coast Guard relies on a variety of owner-supplied information in making decisions on grandfathering and documentation. For example, in applying for documentation, owners submit an application, which they certify as accurate, showing citizenship information. For corporate owners, this information includes the extent to which stock is owned by

U.S. citizens. Owners often are required to provide information in addition to what is contained on the application form in order to demonstrate compliance with other aspects of the act. To demonstrate that grandfather exemptions on rebuilding are met, for example, owners have provided shipyard contracts verifying that prior to the act's passage the owner had plans to rebuild a vessel in a foreign shipyard for use in the U.S. fishing industry. Similarly, to show that grandfather exemptions dealing with American control have been met, owners have provided certified statements from past owners or crew members that the vessel was used in the U.S. fisheries prior to the passage of the act. According to the Chief of Vessel Documentation, the Coast Guard does not verify the authenticity of the documents or statements prior to issuing documentation except for verifying that the vessel was documented at a specific time.

Because the documentation process relies on the owner to initiate the application and does not verify the accuracy of the information the owner submits, the process by itself cannot fully ensure that all vessels participating in the U.S. fisheries comply with the act, according to the Chief of Vessel Documentation. He stated, however, that some violations can be identified through vessel boarding and following up on tips from the public and that potentially severe penalties can be imposed on owners who do not document a vessel when required or who provide inaccurate information during the documentation process.

Vessel Boarding and Investigations of Potential Violations

The Coast Guard can identify and enforce violations of the Anti-Reflagging Act by boarding vessels at sea and carrying out investigations of potential problems identified from boardings, tips, or other means. Some limitations, however, are associated with these procedures.

The Coast Guard conducts at-sea boarding to detect violations of applicable maritime laws, not just the Anti-Reflagging Act. With regard to that act, Coast Guard officials said boardings are more suited to identifying some types of violations than others. For example, according to one Coast Guard law enforcement official, boardings were more suited to identifying vessels fishing in Alaska waters with documentation that restricted fishing but not to identifying vessels that violated American control prohibitions. The latter, he said, would involve examining documents—such as corporation records—not normally found on board the vessel.

To determine the merit of potential violations identified through tips or other means, the Coast Guard may conduct more detailed follow-up investigations. Coast Guard investigations and law enforcement officials said investigations can involve such steps as interviewing vessel owners and crew and reviewing financial or other records associated with the control or operation of the vessel. According to the Chief of Vessel Documentation, the lack of staff resources in the Coast Guard severely limits the extent that investigations can be done. Additionally, he said that some violations, such as those involving American control, as noted above, are difficult to detect and prove.

Penalties

If violations are identified, the Coast Guard may impose civil penalties up to \$500 for each day for each violation of documentation requirements. When a vessel is participating in a trade not covered by its documentation, seizure of the vessel for forfeiture to the United States is authorized and the matter is referred to a U.S. Attorney. Criminal penalties include (1) fines of up to \$10,000 and/or imprisonment of up to 5 years for providing false information and (2) seizure and forfeiture of a vessel and its equipment for knowingly concealing information or providing false information. Coast Guard operations and documentation officials told us that, to their knowledge, penalties have never been imposed for the foreign-built, foreign-rebuilt, and foreign-control prohibitions because violations have not been identified and proved.

Actions Proposed by the Coast Guard to Strengthen Procedures

As agreed with your office, we did not evaluate the adequacy of the Coast Guard's actions in implementing the act's grandfather clauses. However, in its efforts to strengthen its procedures, the Coast Guard advised us that it is addressing two main areas.

- First, the Coast Guard acknowledges that the application form for obtaining documentation needs to be updated to provide additional information for determining whether a vessel and its owners meet the act's requirements. For example, while the form does ask for information about U.S. ownership of all corporate-owned stock, it does not ask for information on "voting" stock, a majority of which the act requires be owned by U.S. citizens. Similarly, the form does not ask for any information on or certification of the four Shipping Act's American control requirements or information on the location of any vessel rebuilding.
- Second, Coast Guard officials do not view existing penalties as a sufficient deterrent to violations. Coast Guard officials at different branches and geographical locations said the easiest penalty to impose (a fine of

up to \$500) is too small to be a deterrent, and criminal penalties cannot be imposed without proving that the violation was done intentionally—a difficult effort requiring substantial resources.

The Coast Guard advised us that it has recently taken the following steps to address these issues.

- It is updating the application form to more fully obtain information needed to enforce the act's provisions. For example, the form will call for information on voting stock ownership, the American control conditions, and the location of rebuilding.
- It has asked the Congress for changes to strengthen its penalty process. For example, to better ensure that fines are paid, the Coast Guard is asking for authority to withhold or withdraw a vessel's documentation.

We did not address the extent to which the contemplated actions will fully resolve the concerns the Coast Guard has expressed.

Objectives, Scope, and Methodology

On June 13, 1989, Senator Bob Packwood requested that we evaluate the effect of specific provisions of the Commercial Fishing Industry Vessel Anti-Reflagging Act of 1987 (P.L. 100-239). In subsequent discussions, we were also asked to address the Senator's particular interest in the effect of this act on the Alaska groundfish industry and on the factory trawlers that are used to both catch and process Alaska groundfish.

Shortly after beginning our fieldwork in November 1989, we learned that several fishing and shipbuilding groups had filed a lawsuit against the Coast Guard over its implementation of the act's grandfather clauses. The plaintiffs argued, in part, that the Coast Guard's implementation of the act's American control provisions was inconsistent with the intent of the Congress. In view of this litigation, we agreed with Senator Packwood's office that we would not evaluate the issues that are before the court.

On March 29, 1990, we briefed Senator Packwood's office on the preliminary results of our fieldwork. We were subsequently advised that the Senator wanted a written report to address the following three areas included in our briefing:

- the Coast Guard's procedures for enforcing the act's prohibitions against foreign-built, foreign-rebuilt, and foreign-controlled vessels,
- the impact of the act's provisions for American control of fishery operations, and
- the impact of the act's provisions that prohibit vessels rebuilt in foreign countries from participating in U.S. fisheries.

To meet these objectives, we largely used information and data we had collected between November 1989 and the March 1990 briefing. Some additional data were collected and analysis made through August 1990 to prepare this report.

We reviewed the Anti-Reflagging Act and its legislative history. We also interviewed Coast Guard officials at headquarters and at the Seattle and Juneau field offices, which had responsibility for implementing key provisions of that act. We selected those two field offices because they had documented the great majority of the groundfish industry's factory trawlers. To obtain perspectives from industry on the act's implementation, we met with a variety of fishing associations and individuals that were involved in the Alaska groundfish industry.

To determine a universe of factory trawlers participating in the groundfish industry, we used a list of vessels reporting groundfish-processing information to the National Marine Fisheries Service, which is responsible for ensuring management of the U.S. fish stocks. Our universe consisted of 91 processing vessels that participated in the Alaska fishery sometime between January 1989 and February 1990, 52 of which were factory trawlers.

For each of these 91 vessels, we obtained a variety of documents from the Coast Guard that allowed us to develop a variety of data for the factory trawlers and other processing vessels dealing with the three prohibitions we were asked to address. For example, we developed information on the extent that the vessels (1) were foreign built, (2) were granted exemptions to build abroad after the act, and (3) were likely to meet grandfather exemptions under the act's American control provisions.

We reviewed the documentation we had obtained for the 91 vessels for apparent violations of the Anti-Reflagging Act. We reviewed the files to ensure that the vessels were documented for use in the fishery and that they met the applicable grandfather exemptions. Our ability to make judgments was often limited because the Coast Guard had not yet updated its application form or documentation process to collect all information needed to determine compliance with the Anti-Reflagging Act. For example, while the application form asked for information on the extent that a corporate vessel owner's stock was owned by U.S. citizens, the form did not ask for such information on "voting" stock—the class of stock required by the act to be owned mostly by U.S. citizens. Similarly, no information was being collected on the factors contained in the Shipping Act of 1916, which the act requires to be assessed to ensure American control of the vessel. In most cases, however, this lack of information was not critical for making judgments because of the large percentage of vessels that appeared to meet the Coast Guard's interpretation of the act's grandfather exemptions for American control.

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