Maritime Fraud and International Maritime Law

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Maritime fraud - insufficient international regulations

1. The most common types of maritime fraud

Maritime fraud, present since ancient times, is recorded for the first time in cuneiform texts of Mesopotamia. In Roman times, Livy, the historian, (while writing one of his 35 books out of 142 of which 107 are lost), recorded facts which took place in the year 215 B.C., during the Punic Wars. He mentions: false reports about ship’s grounding which never happened; old and rotten ships carrying small quantities of worthless cargoes, being sunk, while the crew, saved by boats prepared in advance, was telling lies about a great quantity of cargo lost. It sounds very modern and supports the thesis that a little, almost nothing, has changed since then.

In our present times, we can define maritime fraud as follows: “Maritime fraud occurs when one of the parties of an international trade transaction - buyer, seller, shipowner, charterers, ship’s master or crew, insurer, broker, banker or agent, succeed, unjustly and illegally, in obtaining money or goods from another to party to whom, on the face of it, he has undertaken specific trade, transport and financial obligations. In some cases, several of the parties act in collusion to defraud another.” (ICC Publ.370, p.3)

Maritime fraud can be divided into the following categories:

- it would be difficult, it not outright impossible, to change the system or some parts of it, without world wide negative repercussions.

Thus became clear that due diligence is an indispensable element required in the process of discharging professional and commercial duties and that it cannot be replaced by promoting new international acts.

The prevention of maritime fraud essentially requires a free flow of information available to everybody concerned and an international cooperation of the police forces and of the judiciary, ones which are also very much needed. Such developments would be helpful to the injured parties and to the newcomers in the business preventing them to become fraud victims.

Some of the recent international acts are expected to have, although indirectly, a positive impact on the overall frequency of maritime fraud. And this is what the paper is aiming at.
Deviation fraud, documentary fraud, charter party fraud, marine insurance fraud and other combined categories. Here is a short and simplified review of the above mentioned categories:

- **Deviation fraud** are fraudulent acts committed by shipowners against shippers, charterers or insurers. Deviation fraud can be bona fide or mala fide. The first group includes those which are perpetrated by a potentially honest shipowner. During the voyage of his ship, such a shipowner is faced suddenly with unsolvable financial difficulties, caused usually by the “disappearance” of the charterer, who has, after loading his cargo on board, paid (according to the C/P) only the first due installment of freight. Signed clean “Freight prepaid” bills of lading, combined often with lengthy unpaid laydays, leave the shipowner with little or no options. The shipowner who becomes thus himself a victim of fraud and faces bankruptcy, is being tempted to recuperate his losses, fraudulently from a third party. He deviates his vessel to another port where international controls are lax and where the climate is right for unlawful deals. In the second group, the shipowner is fraudulently deviating his ship in order to steal and sell the cargo loaded on his ship. After the sale of cargo, which takes place in a convenient port, (usually a country in a war zone or a country with an international embargo in force), the ship is sunk. The shipowner now claims not only the loss of his ship, but that of the cargo as well. Sometimes the ship changes her flag and continues to operate with a new flag and a new name.

- **Documentary fraud** is a fraud committed by forging documents or by illegally altering the existing documents. Most commonly forged papers are bills of lading and also those documents which normally accompany the bills of lading in any commercial transaction, such as an invoice for the selling price, a marine insurance policy for the transport, as well as certificates of origin and inspection. Some characteristic scenarios of this type of maritime fraud are:
  - non-existent cargo on a non-existent ship, or a non-existent cargo on an existing ship, located either at the loading port or anywhere else worldwide.

- **Charter party fraud** - has mainly 2 variations:
  - either it is a fraud committed by the charterers against a shipowner, through non-payment of hire, or by a sub-charterer defrauding the time charterer, shipowner and cargo interests,
  - or it is a fraud committed by the shipowner against the charterers or cargo interests by charging extortionate additional freight.

An example for each category is presented below:

In the **first category**, the charterers hire a vessel by signing with the shipowner a voyage time charter. The charterer’s obligations, according to the C/P are: paying regularly the freight rates (apportions) during stipulated time intervals and within the agreed period of time. Here is a “classical” example of an often successfully perpetrated fraud.

The charterers sign a time charter with the shipowner. After having paid the first or sometimes even the second freight installment, the charterers open a liner service. Alternatively charterers sub-charter the vessel to a sub-charterer. In both cases, very competitive freight rates are offered, and cargo is canvassed also from third parties. After the completion of the loading, the Charterer issues bills of lading, collects the freight and stops paying additional freight rates to the shipowner. After having done so, the Charterer “disappears” or announces bankruptcy. The owner now finds himself in a very difficult position. If the bills of lading have been signed by or on behalf of the master, without any qualifications or reference to a charter party, the ship is obliged to deliver the cargo to its destination. Additional troubles to the shipowner are caused by unpaid bills to other participants in the trade, to whom the possibility of arresting the ship’s bunkers, delivered by the now absent time charterers, remain open.

Even cautious shipowners are often defrauded. They rightfully insist and succeed in inserting a clause in the charter party: that the bills of lading will only be issued on “Freight collect” terms, in order to have the possibility of a lien on the cargo for unpaid freight. After the vessel sailed off to her destination, the fraudulent charterers now substitute, without the shipowners’ knowledge, these bills of lading with a new set, marked “Freight prepaid”, do collect the freight and “disappear”. The master discovers the fraud only when the ship reaches the port of destination.

In the **second category**, the fraudulent party is the shipowner. After signing a voyage charter party and the cargo being loaded on board, the ship sails towards her port of discharge. At some point during the voyage, the ship unexpectedly puts into a convenient way port, in order to “carry out emergency engine repairs”. (This could be for example a port in the Greek archipelago on her way from North Europe, via the Suez Canal, to the Far East). In this port, a creditor suddenly appears and arrests the ship for various past “unpaid bills”. The vessel is thereafter sold by a court order, and since the purchaser, now the new shipowner, takes the vessel free of all encumbrances, including the C/P signed by the previous owner, even as to the cargo on board, he thus demands additional freight from cargo interests (shippers or consignees). The conspirators in this case are the creditor himself and the old and new shipowner.

**Marine insurance fraud**, this type of fraud can involve both hull and cargo insurance. Fraudulent mis-representation or the non-disclosure to the insurer of material facts concerning the value of the insured object, or its very existence, are the basis for many marine insurance frauds.

**Scuttling**, the oldest of all marine insurance frauds which is understood as the “intentional sinking of own vessel”. Here are some examples:

- an over-insured vessel which benefits the shipowner in his claim for the loss from the hull insurer, for more than the ves-
sel is worth,
- the scuttling of a vessel with over-insured or non-existent cargo which, in addition to the hull claim, enables the cargo owner to claim similarly from the cargo insurer for the excess over the real value, or for the whole cargo in case of “non-existent” cargo.

Here are some variations of this type of fraud:
- the shipowner scuttles his ship in order to hide the theft of cargo, which he has sold before the sinking, or,
- the shipowner just claims that his ship has sunk with all cargo on board, which in fact has never been loaded.

In both cases the shipowner gains from the over-evaluation of the hull and enables the cargo owner to claim from the insurer the excess over the real value, or for the whole cargo (if non-existent).

**Arson** is an additional variation of the marine insurance fraud. It is rather rare because of the perils to the crew, although it would be convenient to defrauders because of the burden of proof.

As the sinking of a ship and fire on board are insured perils, it remains to the insurers to prove that the vessel has been intentionally sunk or put on fire. It is a rather difficult and costly task and many times not worthwhile to be undertaken.

**Agency frauds**, these are frauds perpetrated by shipping agents, whether acting as ship’s agents, charterer’s agents, receiver’s agents, ship’s brokers, freight brokers, etc.

In their role as intermediaries between various parties, the shipowners, charterers, cargo owners, etc., the agents could fail, by neglect or even by purpose, to undertake proper investigations or even deliberately hiding the proper names of known perpetrators of fraud.

The agent’s role in a fraud can thus be a willful act or a consequence of his neglect (the absence of due diligence). He could therefore be acting indirectly or in a direct way, by a tacit partnership with defrauders.

We shall stop here with reviewing various maritime fraud manifestations, because of their marginal importance to this paper.

2. **Insufficiency of available remedial measures**

Maritime fraud is by its character an international undertaking. Prosecuting international defrauders is therefore an arduous juridical task. The problems of jurisdiction and extradition are regulated by bilateral agreements between states, based mostly on reciprocity. There is not even in sight an international agreement. States are jealously guarding their own legislative independence (sovereignty) and do not give it up easily.

The process of extradition, therefore, even if available, would be taking too long a time to be of any practical use as a remedy, in cases of maritime fraud. To understand this problem it is necessary to understand the international environment in which maritime fraud is thriving. Here is an often cited real case: "A vessel is owned by a company in country “A” and is registered in country “B”. The vessel is “bareboat chartered” to a company in country “C”, who “spot charters” her to a company in country “D”, to carry a cargo to be loaded in country “E” and delivered to country “F”. The officers and crew are from countries “G” and “H”, supplied by an agency in country “I”. The cargo insurance is placed by brokers in country “J” with a company in country “K”. The vessel, on sailing from “E”, deviates and sells cargo in country “L”, and is scuttled."

In addition to setting in motion a pretty long process of eventual extradition, provided that the perpetrator(s) is identified and has not, as usually, “disappeared”, the victim of fraud would be facing expensive civil actions and many legal complexities, such as major difficulties of proof, the ability to enforce the judgement against the defrauders and most importantly, the fact that financial proceeds of the fraud will have been by then already successfully “laundered”. The defrauders’ degree of success of “laundering” and/or disguising their assets and the legal and other difficulties facing a fraud victim, in most of the cases dissuades him to take further steps to recuperate his losses.

It may be also added that fraud generates negative publicity and loss of confidence to the victim. Many fraud victims remain therefore silent.

Due to the unwillingness of most countries to give up some of their jurisdictional and extraterritorial rights, and also because of different national policies and of incompatibility of administrative and police force systems, a new convention, which would comprehensively regulate the above problems, failed to realize within the U.N. Maritime fraud has not been perceived as a treat to humanity nor as a world problem, as for instance air piracy has been.

The following three international acts are just marginally touching the yet unsolved set of problems regarding maritime fraud, its prevention and remedies. These acts however can be of help to the problems of maritime fraud only in an indirect way: by improving the business ethics of the international trade system and that of its participants.

**UNCTAD Minimum Standards for Shipping Agents**

Technical advancements in maritime transport, the massive introduction of container traffic and multimodal transport in the seventies, caused the agents and the shippers to bus themselves with additional and alternative activities. Instead of keeping to their traditional role as cargo brokers, ship’s brokers, ship’s sale and purchase brokers - agents and forwarders, started taking the role of multimodal transport operators. In view of such developments, the need of regulating the activities of agents has been voiced at international conferences. The question of regulating agents has been also raised within the UNCTAD, mostly by the developing countries, because they felt being even further backstaged, thus economically damaged, by the newly introduced technology of transport operations. There are present also some objective reasons causing such a situation, e.g. the fact that developing countries themselves are in most cases victims of fraud and that the taking over of the whole transport operation by agents, now called operators, shall undoubtedly increase considerably the number of agencies related to fraud cases.
Agents and forwarders of high international esteem, members of the international organizations, (FONASBA, Multiport Agencies, The Institute of Chartered Shipbrokers, FIATA, etc.), were, in principle not against an international standardization attempt, but they preferred self-regulation, as a better option.

In February 1984, the UNCTAD "ad hoc intergovernmental group to consider means of combating all aspects of maritime fraud", requested the UNCTAD secretariat to prepare, inter alia, in-depth studies on:
- "to what extent any minimum standards for professional qualifications of shipping agents may contribute to combating maritime fraud and whether such standards could be used as non-mandatory guidelines for the qualifications required";
- "the possible implications for maritime fraud of failure of shipping agents to provide sufficient financial standards based on specific cases where such implications have occurred".

A year later, namely in 1985, UNCTAD published the "Maritime fraud-preliminary report on shipping agents". This report was made possible by an international poll and with answers received by 39 government and 23 professional organizations. It has been evident that only one third of the states do have any rules regulating the activities of shipping agents, one fifth of the states do have professional associations of shipping agents, 47% of the states request some form of control and only 23% of the states require the shipping agents to register their activities to the authorities or need licenses or working permits.

The general conclusion was: states have only a limited interest in regulating shipping agents. On the other hand, shipping agents tend to regulate their own activities.

As a compromise, like so often used in international relations between countries wishing to regulate too much and those disliking any form of government interference, the UNCTAD Committee on Shipping at its 13th session, in March 1988, endorsed the "UNCTAD minimum Standards for Shipping Agents" and recommended their use as appropriate, non-mandatory in nature, to serve as guidelines for national authorities and professional associations in establishing their own standards.

The Minimum standards are inter alia prescribing professional and financial qualifications for agents and corporations, a code of professional conduct and measures of enforcement. Professional qualifications imply having necessary experience, to be of good standing and to be able to demonstrate good reputation and competence. Professional examinations, as required by national authorities or by professional associations, are also recommended.

Financial qualifications prescribe having adequate financial resources as well as adequate liability insurance. Enforcement is listed as a step of disciplinary measures taken by relevant national authorities or associations against a proved case of non-compliance, ranging from a warning to the cancellation of the authorization to operate as a shipping agent.

Such a set of non-mandatory guidelines to governments and to professional associations, instead of trying to regulate the problem by an international act, reflects the measure of self-regulation already achieved by top level shipping agents in the Western World.

These guidelines are expected to reduce agency related maritime frauds. United Nations Convention on Condition for Registration of Ships

By definition FOC (flag of convenience) ships are those who are registered in a country whose tax on the profits obtained by merchant ships is low, or whose requirements for manning or maintenance are not stringent. (Brodie P. Dictionary of Shipping Terms. 1997, p. 76).

The original purpose of introducing FOC ships, during the twenties, was the need for neutral ships in wartime as well as because of the prohibition in the U.S.A. After the second World War, the U.S.A. remained with a great merchant marine, but due to high taxes and an expensive, union organized crew, this great fleet of modern ships started soon to decline. The problem was partly solved by introducing open ship registers.

This was only the beginning and has, since then, become a world wide trend. These FOC fleets, primarily owned mainly by the U.S.A., were flying the flags the flags of Liberia, Honduras and Panama. In the 1970's, when the number of FOC ships reached 30% of the whole world merchant marine fleet, it became a political problem and the question of its existence was raised within the UNCTAD.

Many governments, especially those of the developing countries, as well as trade unions and a number of international organizations thought that FOC ships were harming the development of the merchant marine throughout the world.

They were thus pressing upon UNCTAD politically and lobbying in various ways - urging this organization to take appropriate steps against FOC ships or even banning them entirely from out of the sea, since the development of the merchant marine has been a part of its programme.

The main argument was based on the fact that registration of ships that flags of convenience was not in conformity with the 1958 Geneva Convention on the High Seas. This Convention required that a state must effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag based on the principle of the "genuine link" between the ship and the flag state and the duties of flag states established in that Convention and reaffirmed in the 1982 Convention on the same subject.

In 1978, an UNCTAD ad hoc working group was formed and its Secretariat produced in 1979 two reports related to open registries: "Repercussions of phasing out open registries" and "Legal mechanisms for regulating the operations of open registry fleets".

"Phasing out" meant indeed a total elimination of FOC ships by the year 2000. The opposing groups considered very forcefully their arguments, as to whether the open registry
system would be eliminated, or just phased out and, if survived, on what conditions, or it would be gradually transformed in normal registers.

Nine years of confrontation between supporters and enemies of FOC fleets, in which many western countries changed sides, produced at the time of the OPEC-induced oil crisis in the early 1970s, a consensus: that no one was advocating unsafe ships and that there is a need for an effective maritime administration, a proper ship registration machinery, an appropriate maritime legislation in the flag state and effective means for identification and accountability on the part of those responsible for the operation of the vessel.

The sticking points were the nationality of the crew, the nature of the management of ships and whether the ship must be partly owned by the flag state citizens.

The positive outcome of almost a decade of discussion was the signing, of the United Nations Convention on Conditions for Registration of Ships, effected at the diplomatic conference in Geneva on February 7th, 1986.

The most important articles of this Conference are the following ones:

**Article 5** prescribes that:
- the flag state shall have a competent and adequate national maritime administration, which shall be subject to its jurisdiction and control,
- the flag state shall implement applicable international rules and standards concerning, in particular, the safety of ships and persons on board and the prevention of pollution of the marine environment.

Moreover it prescribes that the maritime administration of the flag state shall ensure that the ships shall comply with its laws and regulations concerning registration of ships and with applicable rules and standards concerning, in particular, the safety of ships and persons on board and the prevention of pollution.

The ships must be periodically surveyed in order to ensure compliance with international rules and standards and that ships shall carry on board documents evidencing the right to fly its flag and other documents required by international conventions.

**Article 6** prescribes that the flag state shall take such measures as are necessary to ensure that shipowners and operators shall be held accountable for the management and operations and that ships flying its flag can be easily identified. Registers of ship should be available to those with legitimate interests and ship log books should be retained for a reasonable period notwithstanding any change of the ship's name.

This article is a very important contribution to in to combat maritime fraud.

**Articles 8 & 9** contain the most important provisions regarding the establishment of a genuine link between the ship and the flag state. Article 8 regulates the participation of flag state nationals in the ownership of vessels and Article 9 regulates the manning of ships by flag state nationals.

The flexibility of these articles, which reflects the political compromises, is made possible by **Article 7**, which practical-ly allows choosing any one of the two.

**Article 10** prescribes that the State of registration, before entering a ship in its register of ships, shall ensure that the ship owning company has its principal place of business within its territory, in accordance with its laws and regulations. If so, it requires the presence of only one representative or management person, being a national of the flag state or being domiciled therein. Such representative should be available for any legal process in order to meet the shipowners' responsibilities.

The flag states are required to legislate such questions and also to enforce such laws in order that ships flying their flags are in a position to provide, at all times, documents evidencing that an adequate guarantee, such as an appropriate insurance, has been arranged.

Furthermore, the State of registration should ensure that appropriate mechanism, such as maritime lien, mutual fund, wage insurance, social security scheme exist to cover the wages of seafarers in case of default of payment by their employers.

What has been achieved with the signing of this Convention?

The key Articles 8, 9 and 10 appear to be too mild, too optional and therefore easily circumvented.

The newly introduced standards, concerning accountability, can be easily overcome by parceling a ship-owning company into numerous fictive parts: one ship - one company.

The introduction of the "genuine link" concept, although being a novelty in international legislation, is not perceived as an achievement of great significance.

The Convention is the result of a compromise, in which the developing countries are giving up their demands for a gradual phasing out of open registers and Western countries are allowing UNCTAD to interfere into an area previously unmolested by the general public. And finally, the Convention tries to make some order in an unregulated domain.

The Convention has not yet been ratified by the needed number of 40 states.

**International Convention on Maritime Liens and Mortgages, 1983**

This is the third International Convention dealing with this matter:

the first one being: the International Convention for the Unification of Certain Rules relating to Maritime Liens and Mortgages, 1926;


The first Convention was ratified by the needed number of States taken effect in 1931, but the leading maritime countries abstained signing it.

The second Convention was never ratified and did not take effect.
The third Convention, the “International Convention on Maritime Liens and Mortgages”, Geneva 1993 was a joint endeavor of UNCTAD, IMO and CMI. The goal of this Convention has been to give a greater security to mortgagee on account of the beneficiary of a Preferred Maritime Lien. The developing countries thus got better conditions for financing the development of their national merchant fleets. The Convention can be considered as a contribution to the harmonization of various aspects of liens and mortgages. Our interest is to determine what effect can its application have on maritime fraud. Important are Articles 3, 11, 12 & 16. **Article 3** “Change of ownership and registration” is meant to protect the rights of the holders of mortgages, hypothecues or charges. This Article contributes, indirectly, to a more difficult de-registering of a vessel, and, consequently, to an easy way of changing its flag. **Article 11 “Notice of forced sale” and Article 12 “Effects of forced sale” and Article 16 “Temporary change of flag”** can have a similar positive effect. This specific section of the international seaborne trade was, up to this moment, lacking in any regulations. All these articles are thus a novelty in international maritime law. Their impact in combating maritime fraud is therefore expected to be meaningful.

**Conclusion**

Maritime fraud is an ever present threat to seaborne trade. The victims are most often the developing countries. Eastern countries are also an easy target, because of their past closed societies, and decades long engagement in the production at the expense of marketing and international trade. Maritime fraud is generally perceived as a threat against trade, but not a threat against humanity, as for example Air piracy (regulated by international law) is. No new international conventions regarding maritime fraud are to be expected in the near future. Many difficulties and legal obstacles in combating and prosecuting maritime fraud are expected to remain there in the future too. The Western approach of “due diligence”, seems to have won the argument over those trying to prevent maritime fraud by promoting international regulations. These three international acts, dealing with the related problems are contributing to making the whole milieu somewhat safer. Safer environment shall not eliminate fraud, it will be undoubtedly taking more sophisticated forms. And finally, due diligence combined with sophistication are the prerequisites that the participants in the modern international seaborne trade have the need of.

**LITERATURE**


