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Sanctions Considerations for Maritime Arbitrators

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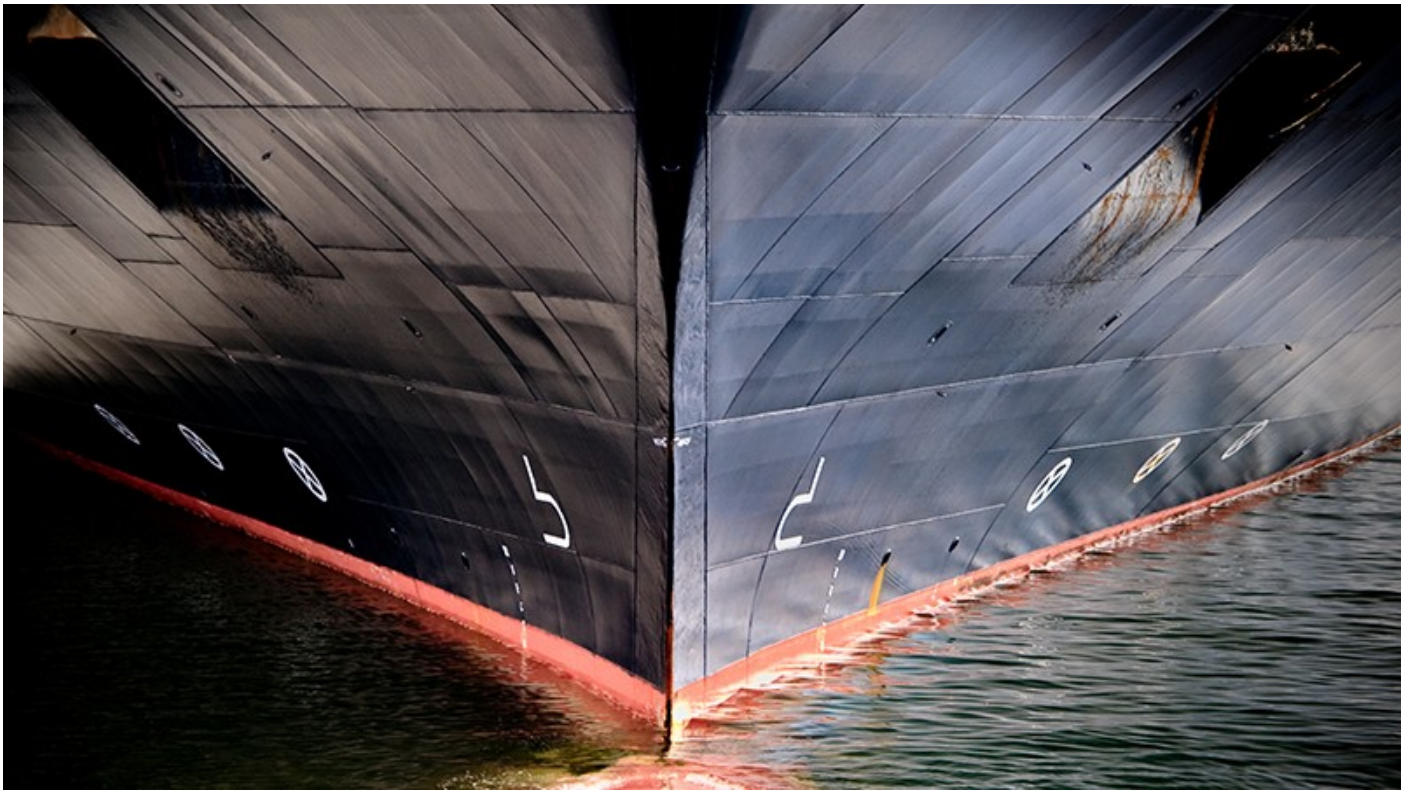

The United States has generally imposed economic sanctions against countries and groups to discourage malign or terrorist activities, ranging from continuing human rights violations to the pursuit of nuclear armament.[1] In recent months, the U.S. has increased the force and scope of its sanctions regimes, and has targeted the shipping sector in particular, directing a "maximum pressure" campaign on enforcement of Iran and Venezuela sanctions. As foreign policy and sanctions focus more closely on the maritime and shipping supply chains, maritime arbitrators in New York, generally considered "U.S. Persons" within the meaning of U.S. sanctions law, face a growing risk that U.S. sanctions could apply in disputes to which they are appointed - - and could even expose the arbitrator to sanctions.[2]

Such exposure imposes the burden on those arbitrators to recognize the risk and to consider the due diligence and other requirements necessary to comply with the relevant sanctions. This Note seeks to raise awareness of that issue by summarizing some potential pitfalls and by offering helpful considerations.[3]

The sanctions regimes thus pose traps for the unwary, including the substantial risks that banks may not

process arbitrators' fee payments or awards or that the provision of an arbitral service could confer a significant value or material benefit in violation of sanctions. Sanctions considerations may also arise in maritime disputes where the arbitrators are invited to interpret a sanctions exclusion clause in a charterparty, or where sanctions call into question or prohibit the conduct of the arbitration by contractually appointed New York arbitrators.

I. Intersection of Sanctions and Maritime Arbitration

Although the U.S. government aims that sanctions impact those who are targeted or in the targeted country, the collateral impact of sanctions stretches far wider - - both to persons and entities associated indirectly with the targets and to geographic areas outside the sanctioned regions. This sweeping reach of U.S. sanctions mandates that all persons who engage in transactions or similar activities that touch designated or blocked parties must be mindful of the sanctions risks and avoid running afoul of them. Maritime arbitrators often address disputes flavored with an international scope of diverse businesses and principals in the shipping sector, often with layered, obscure and complex structures. Given this playing field, maritime arbitrators in New York would be prudent to become familiar with the impact that U.S., as well as EU and UN, sanctions programs have on their work.

The U.S. Department of State imposes and implements sanctions under various legal authorities, and the Office of Foreign Assets Control ("OFAC") of the U.S. Department of the Treasury administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals.[4] In recent months, U.S. sanctions officials have publicly stressed that they are targeting the maritime sector, including marine insurers, flag registries, ship owners, managers and charterers. Sanctions compliance or enforcement can often disrupt vessel or cargo operations, resulting in delays for vessels and in other chartering issues. Moreover, U.S. sanctions programs can include secondary sanctions, which apply to non-U.S. persons, including third parties engaging with targeted entities. Further, the burden of complying with sanctions rests with the individual parties, as the prohibitions apply regardless of whether the party knowingly violates sanctions.[5] Managing such sanctions risk, therefore, requires that arbitrators gain and maintain awareness of the potential scope and application of such sanctions.[6]

Arbitrators must consider the risk of potentially violating sanctions. An arbitrator may be subject to OFAC enforcement action where the arbitrator is considered a U.S. person, or be subject to designation or secondary sanctions if considered a non-U.S. person. Arbitrators provide a service, value and a benefit to the parties involved. Where arbitrators render that service to a party subject to U.S. sanctions, they risk contravening the sanctions, which generally prohibit directly or indirectly providing services or benefits to sanctioned persons. The sanctions often allow the provision of specified legal services to, or on behalf of, persons blocked by a sanctions program, "provided that receipt of payment of professional fees and reimbursement of incurred expenses *must be specifically licensed*." (emphasis added).[7] The limitation on such "legal services" includes matters related to arbitration.[8] For example, the Venezuela sanctions include the following as such limited "legal services":

1. Provision of legal advice and counseling on the requirements of and compliance with the laws of the United States or any jurisdiction within the United States, provided that such advice and counseling are not provided to facilitate transactions in violation of this part;
2. Representation of persons named as defendants in or otherwise made parties to legal, ***arbitration*** or administrative proceedings before any U.S. federal, state, or local court or agency;
3. Initiation and conduct of legal, ***arbitration***, or administrative proceedings before any U.S. federal, state, or local court or agency; . . . .[9]

Additionally, some sanctions specifically prohibit the enforcement of arbitral awards.[10]

Sanctions risk can arise in maritime arbitration in the following respects, among others:

1. one of the entities or persons in the dispute is listed as a Specially Designated National ("SDN") under a sanctions regime, including a shipowner, charterer, manager, cargo shipper, intermediate cargo owner or cargo consignee or end-receiver;
2. one of the parties is connected to a sanctioned person, such as: (i) a sanctioned person owning, controlling or having an interest in a party; (ii) the party owning, controlling or having an interest in a sanctioned entity; or (iii) the party affiliated with or covering a sanctioned entity or person, or a relevant insurer, reinsurer or insured;
3. the subject matter of the dispute falls within the scope of a sanctions sectoral regime, including the use of the U.S. financial system for payments;
4. one of the parties is a citizen of a country subject to a sanctions regime; and/or
5. an arbitrator, mediator, expert or neutral party is a citizen of a country subject to a sanctions regime.

If an arbitrator recognizes a red flag in such a scenario, suggesting that sanctions risk exists in a dispute before that arbitrator, prudence would counsel that the arbitrator or the arbitration panel exercise due diligence to explore the sanctions status of the parties. Where the arbitrator(s) believe there is a risk of sanctions, the arbitrator(s) should consider - - and may direct the parties to address - - whether OFAC would issue a specific license to permit the arbitration and the parties to proceed without the risk of sanctions, or whether they should seek guidance from OFAC on whether the sanctions apply. Applications for OFAC licenses or guidance can take some time and may add costs to the proceeding. However, a failure to recognize such potential hazards at the outset of an arbitration can cause significant disruption to enforcement of an award, payment of the award or payment of arbitration fees.[11] Although OFAC reviews certain license applications with a presumption of denial, some sanctions programs provide an exception to the presumption for the provision of legal services.[12]

II. Potential Trouble Spots

Where an arbitration commences with sanctioned parties, practical and legal obstacles could undermine or delay the proceedings, or risk sanctions exposure to the arbitrators. If the dispute arises from a place subject to broad country-based sanctions, for example, the parties could find they are unable to obtain documentary evidence or witness testimony without running afoul of sanctions, or at least without incurring a significant additional cost.

As a threshold matter, the arbitrators(s) must consider whether holding proceedings and rendering arbitral services alone would constitute a violation of sanctions. Further, where an award would require a party to pay a sanctioned entity, questions arise whether:

1. the award, or the arbitrators' activity in hearing the evidence and issuing the award, would contravene the sanctions;
2. the sanctions prevent payment or enforcement by, for example, any U.S. person; and
3. a license by OFAC might be required to allow such payment. Even if the paying party is not a U.S. person, an award denominated in U.S. dollars arguably could cause a sufficient nexus with U.S. jurisdiction to raise a sanctions risk for the arbitrator and paying party. Such transactions would pass through the U.S. financial system and thereby expose the financial institution to sanctions risk. A sanctions risk could arise where the relevant sanctions prohibit causing a U.S. person, such as a

> U.S. financial institution or insurer, to violate sanctions.

In cases where the sanctioned party loses in arbitration, enforcing the award prove impractical if no property or accounts are subject to attachment or execution within the jurisdiction of U.S. courts.[13]

Finally, the sanctions may prevent or delay an arbitrator's recovery of fees from a matter involving a sanctioned party. OFAC may determine that arrangements to exclude direct payment to the arbitrator from the sanctioned party were made with the purpose of evading sanctions or that the arbitrator has provided a benefit to the sanctioned party.

A recent arbitration and its subsequent litigation highlight these issues. In *United Media Holdings, NV v. Forbes Media, LLC,* No. 16 CIV. 5926 (PKC), 2017 WL 9473164, at *1 (S.D.N.Y. Aug. 9, 2017), the U.S. District Court for the Southern District of New York observed the difficulty that the parties had in conducting the arbitration due to the involvement of a sanctioned party. Although an OFAC license was sought prior to the start of the arbitration, OFAC did not grant a license in time, and the arbitration was repeatedly interrupted by sanctions concerns: initially, by the repeated withdrawal of the sanctioned party's representation, and later by the suspension of the arbitration by the American Arbitration Association until a license was granted. *Id*. at *2-*4. After the parties were granted a license and the arbitration concluded, the sanctioned party requested the court to vacate the arbitral award on several grounds, including that it was illegal and against public policy for the arbitrator and counterparty to participate in the arbitration due to their sanctions status. *Id*. at *11. The court found that "the existence of OFAC licenses covering the arbitration proceedings, the issuance of the Award [and] enforcement of the Award" authorized the parties to participate in the arbitration. *Id.*

III. Who, me? - - Specific Concerns for Maritime Arbitrators

The recent uptick in enforcement actions by the State Department and OFAC targeting maritime operators shines new light on the risk of sanctions to consider by maritime arbitrators who are U.S. citizens or are otherwise subject to U.S. jurisdiction.[14]

On January 27, 2020, highlighting its campaign of vigorous enforcement of sanctions in the shipping sector, OFAC announced a settlement with Eagle Shipping International (USA) LLC ("Eagle Shipping"), a Marshall Islands company with its headquarters in Stamford, Connecticut; Eagle Shipping agreed to pay $1,125,000 to settle its potential civil liability for 36 apparent violations of the Burmese Sanctions between 2011-2014.[15] OFAC's announcement pointed out that the potential fine could have exceeded $9 million.[16] The subsidiary of U.S.-based vessel owner Eagle Bulk Shipping reported apparent violations of sanctions by carrying sand to Singapore for known SDNs in Myanmar during 2011-14. OFAC noted the egregiousness of the apparent violations, given that Eagle Shipping continued transporting the sand even after OFAC had denied their license application to do so.

Likewise, on September 25, 2019, the Secretary of State determined that COSCO Shipping Tanker (Dalian) Co., Ltd. ("COSCO Shipping") met the criteria for imposition of sanctions under Executive Order ("EO") 13846 and listed that company and another COSCO entity as designated entities whose assets are blocked.[17] The blocking of such a major tanker operator caused disruption across the industry, and exposed some of the challenges faced by the shipping sector. Many of the challenges arose from the lack of clarity in the scope of the listing, due to the opaque structure of the COSCO Shipping group of companies. In this respect, COSCO Shipping does not differ from many maritime operators. The ultimate beneficial ownership of and interest in vessels, shippers, receivers, and cargo are rarely disclosed and often difficult to ascertain.

This shadow area presents a challenge for arbitrators at the initial stages of an arbitration, where an inability to discern and identify the involvement of a sanctioned entity can cause many of the challenges

described above.[18]

Twenty-five years ago, the federal district court in New York upheld an arbitration agreement in a charterparty, despite finding the charterparty invalid from inception for violating U.S. sanctions. *Belship Navigation, Inc. v. Sealift, Inc.,* No. 95 CIV. 2748 (RPP), 1995 WL 447656, 1996 A.M.C. 209 (S.D.N.Y. July 28, 1995). In *Belship Navigation*, a U.S. company had chartered a Cuban-owned vessel and, upon making the first hire payment, was alerted that their bank blocked the payment due to the sanctioned status of the vessel owner. Both parties agreed the charter was void ab initio under the Cuban sanctions. The charterer declared the charterparty void, and the arbitration agreement in the charterparty thus void as well. However, the disponent owner succeeded in enforcing the arbitration agreement in the charterparty to resolve the matter, despite the sanctions application.[19] The court rejected the contention that enforcement of the arbitration agreement would conflict with the New York Arbitration Convention,[20] and found enforcement was not contrary to public policy.

The court reasoned that the Convention permitted nations to refuse enforcement of an arbitration award, but not the arbitration agreement, and observed:

Although "national policy" prohibits dealing with Cuba, the "public policy" exception in the [New York Arbitration] Convention "was not meant to enshrine the vagaries of international politics under the rubric of 'public policy.'" Instead, 'public policy' is best served by promoting the "supra-national" goal of the Convention, promoting the enforcement of international arbitration agreements. A "parochial refusal" to enforce an arbitration agreement would frustrate this purpose, therefore, a court should compel arbitration even if the arbitrator could make a ruling that an American court could not. "Public policy" should be invoked to bar enforcement only when enforcement "would violate the forum state's most basic notions of morality and justice."

Id. (internal citations omitted).

Although the court enforced the arbitration clause, the court's ruling raises more questions beyond the procedural issue resolved in that case: Would a court enforce any arbitration award issued in the case? If such issues arose today, would an arbitrator or a party consider whether OFAC would seek to enforce sanctions penalties against any of the parties (or the arbitrators) for violating Cuban sanctions by proceeding with the arbitration, or by seeking to enforce an award?

As maritime arbitrators and practitioners alike recognize, maritime disputes pose unique challenges to arbitrators considering sanctions risks; a dispute may involve numerous interested parties, such as a dispute arising from a chartered vessel carrying goods which could involve ultimate beneficial owners, registered owners, ship mortgage interests, bareboat charterers, time and voyage charterers, sub-charterers, NVOCCs, shippers, receivers, consignees, insurers and reinsurers. If any one of these parties, the vessel(s) or the cargo is subject to sanctions, the arbitrator(s) face a risk of sanctions, and would be well-advised to consider the red flags, due diligence requirements and compliance factors.

In short, the prudent maritime arbitrator should consider the need to perform adequate due diligence and to identify all the parties involved at the outset of an arbitration. By doing so, the arbitrator may gauge the sanctions risks which may arise ahead and may chart the course of proceedings to take measures managing such risks. The echo of OFAC's recent admonition in the *Eagle Shipping* settlement rings with equal force to maritime arbitrators:

This case demonstrates the importance for companies operating in high-risk industries (e.g., international shipping and trading) to implement risk-based compliance measures, especially when engaging in transactions involving exposure to jurisdictions or persons implicated by U.S. sanctions. ***It is essential that***

companies engaging in international transactions consider and respond to sanctions-related warning signs, such as information that goods originated from or were supplied by a person or entity subject to U.S. economic and trade sanctions.[21]

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[1] Gary Hufbauer & Barbara Oegg, CIAO Case Study: A Short Survey of Economic Sanctions, INST. INT'L ECON., (Aug. 2001), https://www.files.ethz.ch/isn/6866/doc_6868_290_en.pdf.

[2] Indeed, the risk may arise for maritime arbitrators outside the U.S., say in London or Singapore, to the extent secondary sanctions would apply to non-U.S. persons. A consideration of such risks in detail, however, is beyond the scope of this Note. The risk exists, and thus warrants care by maritime arbitrators in the major venues of maritime arbitration across the world.

[3] The Note is not intended to offer a comprehensive analysis or authoritative legal advice.

[4] Detailed information on current sanctions programs is provided by OFAC. See Office of Foreign Assets Control - Sanctions Programs and Information, DEP'T OF THE TREASURY, https://www.treasury.gov/resource-center/sanctions/Pages/default.aspx.

[5] *See* Anna Yukhananov & Warren Strobel, *U.S. sanctions net snares the innocent, burdens business,* REUTERS (June 21, 2014), https://www.reuters.com/article/us-usa-sanctions-list/u-s-sanctions-net-snares-the-innocent-burdens-business-idUSKBN0EW10A20140622.

[6] To aid such education, OFAC has published a guidance on due diligence and compliance, available at https://www.treasury.gov/resource-center/sanctions/Documents/framework_ofac_cc.pdf.

[7] *See, e.g.,* 31 CFR § 591.506 *"Provision of certain legal services authorized"* (The cited regulation applies to the Venezuela sanctions program, but most sanctions programs include similar provisions).

[8] Providing any unauthorized legal services would require a specific licence:

> "(b) The provision of any other legal services to persons whose property and interests in property are blocked pursuant to [Venezuela sanctions], not otherwise authorized in this part, requires the issuance of a specific license.
>
> (c) Entry into a settlement agreement or the enforcement of any lien, judgment, ***arbitral award***, decree, or other order through execution, garnishment, or other judicial process purporting to transfer or otherwise alter or affect property or interests in property blocked pursuant to [Venezuela sanctions], is prohibited unless licensed pursuant to this part." *Id*. (emphasis added)."

[9] *Id.* (emphasis added).

[10] *See, e.g.,* 34 CFR § 591.407 *"Settlement agreements and enforcement of certain orders through judicial process"* (prohibiting "the entry into a settlement agreement or the enforcement of any lien, judgment, arbitral award, decree, or other order through execution, garnishment, or other judicial process purporting to transfer or otherwise alter or affect" property blocked pursuant to the Venezuela sanctions) (emphasis added).

[11] *See, infra,* Sec. 2 discussion of *United Media Holdings, NV v. Forbes Media, LLC,* highlighting the challenges faced in arbitration.

[12] *See, e.g.,* OFAC FAQs: Venezuela Sanctions, no. 554, U.S. DEP'T OF THE TREASURY (Feb. 12, 2018).

[13] *See, e.g., Commodities & Minerals Enter. Ltd. v. CVG Ferrominera Orinoco, C.A.,* No. 1:16-CV-00861 (ALC), 2019 WL 4464391, at *2 (S.D.N.Y. Sept. 18, 2019) (court upheld attachment, and rejected contention that sanctions applied to the Venezuelan party).

[14] OFAC FAQs: Basic Information on OFAC and Sanctions, no. 11, U.S. DEP'T OF THE TREASURY (Jan. 15, 2015).

[15] Enforcement Information for January 27, 2020, OFAC, https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20200127_eagle.pdf.

[16] OFAC observed in its "Analysis and Conclusions": "The statutory maximum civil monetary penalty amount in this matter was ***$9,000,000***. OFAC determined, however, that Eagle Shipping voluntarily self-disclosed the Apparent Violations, and that the Apparent Violations constitute an egregious case. Accordingly, under OFAC's Economic Sanctions Enforcement Guidelines ("Enforcement Guidelines"), the base civil monetary penalty amount applicable in this matter was $4,500,000 . . . . The settlement amount of $1,125,000 reflects OFAC's consideration of the General Factors under the Enforcement Guidelines." (emphasis added).

[17] Press Statement from Michael Pompeo, Sec'y of State, The United States Imposes Sanctions on Chinese Companies for Transporting Iranian Oil (Sept. 25, 2019) (https://www.state.gov/the-united-states-imposes-sanctions-on-chinese-companies-for-transporting-iranian-oil/); Exec. Order No. 13846, 83 Fed. Reg. 38939 (Aug. 8, 2018).

[18] On January 31, 2020, OFAC de-listed COSCO Shipping from the SDN and blocked entity lists.

[19] The court further observed: "Any award that [the disponent owner] might recover through arbitration would be placed in a 'blocked' interest bearing account until relations with Cuba improve to the point where the funds may be released to [the disponent owner]. Allowing arbitration to proceed will hardly violate the United States' 'most basic notions of morality and justice.'" Id. at *6. The court did not address how an "award," if not funds, would be "placed" in such an account.

[20] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38.

[21] Eagle Shipping Enforcement, *supra* note 16 (emphasis added).

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