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Don't Lose the Trees for the Forest: Drafting Sanctions Clauses for a Multipolar World

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Sanctions clauses might no longer be sufficient and could be difficult to enforce in non-U.S. jurisdictions. But financial institutions and companies can bolster—or at least maximize their ability to retain and defend—such clauses' effectiveness with contractual clauses requiring the disclosure of beneficial ownership information.

October 24, 2023 – Multinational companies and financial institutions subject to U.S. sanctions are often doing business in countries that do not fully endorse—or reject outright—certain U.S. sanctions regimes. It is common for such companies and institutions to rely upon contractual sanctions clauses by which counterparties agree not to violate U.S. sanctions. Although there is no "contractual clause" defense to sanctions evasion, as OFAC may impose civil penalties for sanctions violations based on a strict liability legal standard,[1] such clauses are expected by U.S. authorities to be included in commercial agreements to mitigate the risk of U.S. sanctions evasion. They are accordingly commonplace, even recognizing that parties already willing to evade U.S. sanctions are unlikely to be deterred by the inclusion of sanctions compliance clauses in contracts—and are likely quite willing to sign contacts containing such clauses to obtain the goods or services that otherwise would be unavailable to them.

A recent decision by a Singaporean court, however, underscores that such clauses while necessary may, in some jurisdictions, not be sufficient. While the decision received heightened attention given the U.S.'s significant reliance on economic sanctions today to pursue foreign policy objectives, the decision's reasoning tracks generally applicable principals of contract interpretation—including in the U.S.—suggesting that other similar sanctions clauses could be at risk, not only before Singapore courts. Yet sanctions clauses should not be abandoned: instead, they can be buttressed by other commitments to protect against similar limiting interpretations.

The U.S. Syria Sanctions Program

The relevant dispute arose out of an effort to mitigate the risk of evading U.S. sanctions against Syria. The U.S. included Syria on its first-ever list of state sponsors of terrorism in December 1979. Subsequently, the U.S. government established the Syria sanctions program in 2004 when it issued Executive Order 13338 in response to the Government of Syria's policies supporting terrorism, continuing its occupation of Lebanon, pursuing weapons of mass destruction

and missile programs, and undermining U.S. and international efforts to stabilize Iraq. After the start of the Syrian civil war in March 2011, the U.S. government issued subsequent Executive Orders imposing additional sanctions on Syria in response to the ongoing violence and human rights abuses taking place in Syria. The Syria sanctions program is one of the most comprehensive sanctions programs currently implemented by the U.S. government. Currently, U.S. persons are generally prohibited from, among other things, providing "any services" to Syria.

Commercial Context for the Dispute

JPMorgan Chase NA's Singapore branch agreed to act as the advising bank for two letters of credit for a Dubai-based buyer of Indonesian coal. As such, the U.S. bank would be obligated to release payment to the Singaporean trader, who had advanced funds to the Indonesian seller, if the presentation of documents and conditions of the letters of credit were fulfilled. The letters of credit included the following sanctions clause:

[JPMorgan Chase] must comply with all sanctions, embargo and other laws and regulations of the U.S. and other applicable jurisdictions to the extent they do not conflict with such U.S. laws and regulations ("applicable restrictions"). Should documents be presented involving any country, entity, vessel or individual listed in or otherwise subject to any applicable restriction, we shall not be liable for any delay or failure to pay, process or return such documents or for any related disclosure of information.

In December 2019, the bank, when presented with a request by the trader to release payment under the letters of credit, submitted the request to its sanctions compliance team for review. No named entity or vessel in the supporting documentation was obviously Syrian, nor were any of them on the U.S. list of specially designated entities. But risk-based due diligence by the bank's sanctions compliance team spotted several heightened concerns, including:

1. The vessel had a prior name under which it was linked to a Syrian shipping company, and in February 2019 the vessel had changed its name;
2. With the name change, the registered owner was listed as "unknown owners" rather than the previously identified Syrian owner;
3. Additional research suggested that the actual owner was a limited liability entity incorporated in Barbados with a Cypriot director;
4. The ship's technical manager was a management company registered in the U.A.E. and whose beneficial owners were "unknown"; and
5. Further due diligence suggested that the ship continued to have ties to Syria.

Prior January 2015 guidance from the United Nations identified facts such as these as indicating a risk of sanctions evasion.[2] Subsequently, the U.S. government published guidance identifying such facts as telltale sanctions evasion risks.[3] The bank refused to release the payment on the grounds that it could not do so without incurring the risk of violating U.S. sanctions and, accordingly, the sanctions clause had been violated. The trader sued the bank in Singapore over the refusal.

The Litigation

On October 31, 2022, the High Court of the Republic of Singapore dismissed the trader's lawsuit.[4] The High Court liberally construed the sanctions clause to allow reference to U.S. authorities' guidance, thereby confirming the bank's right to refuse payment in the presence of such heightened risks of evasion even when the bank's due diligence could not conclusively establish the new vessel ownership. The U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") provided evidence, writing (in response to a request from the bank), "[r]esearch by [the bank] and its Singapore branch indicated that the vessel is owned by [a Syrian commercial entity]. Had [the bank] and its Singapore branch not rejected the trade documents for a non-U.S. person's sale of cargo shipped via a Syrian vessel, it would have resulted in an apparent violation of OFAC regulations."

On September 28, 2023, however, the Court of Appeal of the Republic of Singapore reversed the High Court's decision and awarded damages to the Singaporean trader. The Court of Appeal looked narrowly to the contractual language and held that the High Court's reliance on third-party evidence such as U.S. government guidance was improper. The Court of Appeal was not persuaded that the indicia of sanctions evasion risk identified by the bank, including the opaque circumstances of the vessel's name change and re-registration, were sufficient to establish that the vessel "was subject to any applicable restriction," noting that "[i]t bears mention that the inquiry is directed at the ownership of the [vessel], i.e., whether it remained Syrian-owned at all material times, which is quintessentially an issue capable of objective determination." [5]

Drafting Contracts to Allow for an "Objective Determination" of Beneficial Ownership

At first glance, given the significant efforts undertaken by the bank's sanctions compliance team to try to confirm—without success—the vessel's new owners and OFAC's written letter cautioning that release of the payment would have resulted in an "apparent violation" of U.S. sanctions, the Court of Appeal's observation seems to place U.S. companies and financial institutions in an impossible situation. This is particularly so given U.S. authorities' recent emphasis that sanctions enforcement is a national security priority and that sanctions are the "new FCPA," [6] coupled with the potential sophistication of sanctions-evasion schemes (or the simple fact that some jurisdictions do not release or confirm beneficial ownership information). Day to day, sanctions compliance teams are often forced to make subjective, risk-based judgments to protect their companies based on incomplete or false information. Even well-resourced and experienced sanctions compliance teams are sometimes not able to conclusively determine beneficial ownership information on their own.

Does the Court of Appeal's decision mean that companies must immediately redraft their standard sanctions clauses? No. Whether other jurisdictions adopt a similar reticence to allowing one contracting party to declare breach of a sanctions clause based on its own assessment of evasion risk, and for such a party to incorporate then-current U.S. government guidance on sanctions evasion risk into such a determination, is still an open question. But it is advisable given the speed of changes to sanctions regimes and the increased focus on sanctions enforcement by U.S. authorities for companies to re-assess periodically their standard sanctions clauses, to ensure that the clauses will have the intended effect.

One potential change that companies could consider going forward would be to include in their contracts, in addition to the sanctions clause itself, a commitment to provide the data necessary to make objective sanctions determinations. For example, the Court of Appeal's decision leaves open the ability of U.S. persons to seek to buttress general sanctions compliance clauses with an additional clause requiring the disclosure of the ultimate beneficial owners of any entity or vessel related to the transaction. Such a requirement would have obligated the trader to obtain and provide the beneficial ownership information needed for the bank to determine objectively whether in fact the vessel was owned by Syrian persons, to whom the bank (a U.S. person) could not provide financial (or any other) services. In this sense, to flip the idiom, by focusing on the "trees" in its contractual provisions (i.e., requiring the underlying data necessary to determine the application of sanctions), the bank might have been able to see the "forest" (whether the vessel was actually subject to U.S. sanctions) for itself.

Counterparties could be expected to raise objections to this approach. They might claim that the jurisdiction in which the vessel or entity is registered does not make the information public. But even where true, nothing prevents the private counterparties themselves from sharing the information or imposing a similar obligation on their own freight forwarders and transport providers. They might also claim—as the trader did in this litigation—that under certain International Commercial Terms ("Incoterms"), they did not pay the transport company at all (e.g., if the goods were "Free-on-Board"). But there is no "Incoterms" defense to sanctions evasion, and the applicable sanctions regime in this circumstance prohibited U.S. persons from providing "any services" to Syria—regardless of the payment terms or flows. U.S.-person companies and financial institutions should, accordingly, stand firm if they choose to adopt this approach.

By contractually requiring the information necessary to make informed, objective sanctions evasion risk determinations, U.S. persons are more likely to do business with compliant companies and protect themselves from the consequences of foreign judicial determinations that refuse to look outside of the contract to third-party U.S. guidance, even in the face of what U.S. regulators might consider to be sufficient evidence of sanctions evasion.

References

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1 A strict liability standard means that a U.S. person may be held civilly liable for sanctions violations even without having knowledge or reason to know it was engaging in such a violation.

2 UNSC Sanctions Compliance for the Maritime Sector, January 2015.

3 See, e.g., the U.S. Department of the Treasury, the U.S. Department of State, and the U.S. Coast Guard, Guidance to Address Illicit Shipping and Sanctions Evasion Practices (May 14, 2020); Departments of Commerce, the Treasury, and Justice, Tri-Seal Compliance Note: Cracking Down on Third-Party Intermediaries Used to Evade Russia-Related Sanctions and Export Controls (Mar. 2, 2023)

4 Kuvera Resources Pte Ltd v. JPMorgan Chase Bank, NA, [2022] SGHC 213 (Oct. 31, 2022).

5 Kuvera Resources Pte Ltd v. JPMorgan Chase Bank, NA, [2023] SGCA 28, at ¶ 43 (Sept. 28, 2023).

6 See, e.g., U.S. DOJ, Principal Associate Deputy Attorney General Marshall Miller Delivers Remarks at the Global Investigations Review Annual Meeting (Sept. 21, 2023).

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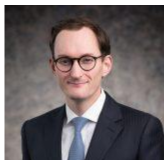

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