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Sanctions Provisions in Ship Loan Documentation

Why and to what extent should European Lenders request the incorporation of sanctions provisions in ship loan agreements – A case study.

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Chapter 1. Introduction

1.1 Presentation of the topic

Compliance with sanctions[1] has become a growing concern for European Lenders[2] as sanctions laws and regulations are constantly evolving. Furthermore, the severe consequences following a potential breach of sanctions have motivated European Lenders to adopt more comprehensive internal policies so as to ensure compliance with sanctions in their transactions to a greater extent.

Ship loan agreements could entail increased sanctions-related risks for European Lenders. The international character of a ship loan transaction where several jurisdictions may be involved, the plethora and the inherent complexity of the international shipping transactions and, inter alia, the close affiliation of shipping with the energy sector - which has been targeted with various sanctions[3] - seem to have turned compliance with sanctions into a quite challenging task for both European Lenders and borrowers which, ultimately, seems to impair European Lenders' position as financiers.

As the duty for compliance with sanctions laws is developing and enforcement is becoming more vigorous, European Lenders have sought to protect themselves from potential liability they may incur in the event of a breach of sanctions. Moreover, in the framework of a ship loan agreement, European Lenders seem to be concerned of the borrowers' compliance with sanctions as, a breach of an applicable sanction by the borrower or by any person or entity involved in the transaction (the guarantor, the shipowner, the charterer etc.), could by extension expose European Lenders to liability for directly or indirectly facilitating or financing the breach.

The incorporation of sanctions provisions in ship loan agreements seems to constitute a measure aiming to protect European Lenders against sanctions-related risks in an effort, inter alia, to ensure that they have an effective mechanism in the documentation to exit a transaction if any of these concerns result in sanctions exposure.

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[1] In the thesis, the term "sanctions" refers to the economic sanctions, i.e. financial and trade restrictions such as, asset freezes, import and export bans, the prohibition on investment, payments and capital movements etc.

[2] In the thesis, the term "European lenders" refers to the financial institutions active in shipping finance, which are under the jurisdiction (territory) of the European Union, including their branches in third countries and the branches of foreign financial institutions located or transacting within the EU.

[3] Norton Rose Fullbright, *Shipping Sanctions clauses*: *navigating stormy waters*, 2015.

This thesis deals with sanctions provisions that seem to be frequently used by European Lenders in ship loan agreements as part of the lenders' policies for compliance with sanctions laws. In particular, the thesis aims to point out why and to what extent the incorporation of sanctions provisions in ship loan agreements should be requested from European Lenders, in light of their and the borrowers' obligations under sanctions regulations. Moreover, the thesis aims to assess European Lenders' position under the new risk of sanctions laws and underline their potential liability due to the borrower's non-compliance with sanctions laws.

It should be noted that it is beyond the scope of this thesis to provide a thorough analysis of the current sanctions legislation applicable to European Lenders. As we will discuss below, European Lenders would be subject to different and numerous financial sanctions each imposing different financial restrictions, depending on each loan transaction. However, specific sanctions regulations will be mentioned as examples.

1.2 Structure of the thesis

The main body of the thesis is divided in three chapters: Chapter two addresses the reasons that seem to have prompted the incorporation of sanctions provisions in ship loan agreements. To this effect, the applicable sanctions regimes are introduced in brief and focus is made on the European Lenders' obligations under targeted financial sanctions as the most serious type of sanctions relevant to the thesis topic. Reference is also made to the consequences and the potential liability European Lenders may incur in the event of a breach of sanctions.

Chapter three examines the context of sanctions provisions frequently incorporated in ship loan agreements by European Lenders. In the absence of widely-used standard sanctions provisions, the areas European lenders tend to address in a ship loan agreement are presented; the general context of sanctions provisions and the rationale behind their drafting is also analyzed from the lender's perspective mainly, while the negotiation process is also examined.

Chapter four could be considered a case study; the sanctions template of Nordea is examined as an example of sanctions provisions established and used by a European lender in ship loan agreements. As there are no standard sanctions provisions in the European market that could be examined, the presentation of a sanctions template adopted by a European financial

institution, internationally active in shipping finance, will assist readers on comprehending how sanctions provisions operate in practice.

1.3 Legal sources and method

The thesis has been based on various sources. The analysis in chapter two is mainly based on primary legal sources. With regard to the EU sanctions regime, certain documents issued by the instruments of the European Union that have shaped the European Union's sanctions policy and have provided guidelines for their implementation and enforcement by the member states[4] while various EU regulations have been perused. The analysis on the US sanctions regime has been based on US primary legislation and guidelines published by the competent authority i.e. OFAC[5]. It should be noted that the European legal framework for compliance with sanctions laws is quite vague as the ultimate implementation and enforcement of EU sanctions rests with the member-states. However, the implementation of EU sanctions in national level is not examined in the thesis.

As the bibliography and references for the thesis topic are very limited, alternative sources had to be used. The lack of standard provisions, widely-used by European lenders in market practice as well as the fact that sanctions provisions constitute contractual terms subject to negotiations and drafted on a case by case basis, were serious impediments to the analysis. In addition, it was not possible to find extended analyses for this topic as the incorporation of sanctions provisions in ship loan agreements has relatively recently become a controversial issue. Therefore, the information on sanctions provisions is mainly based on newsletters published by reputable law firms that have dealt with sanctions provisions in practice and legal articles. Moreover, information regarding the drafting of Nordea's sanctions template, the lender's internal policies, the negotiation process, the sanctions provisions and further general information on the market practice, were based on an interview with my Supervisor, Ylva Cornelia Axelsen[6].

Consequently, in chapter two it is attempted to examine the European Lender's framework of compliance with sanctions, while chapter three aims to record and discuss the market practice that has been formed in the European market according to the information collected. Finally,

[4] European Commission, *EU Restrictive Measures*, 2008.
[5] Office of Foreign Assets Control of the United States of America Department of the Treasury.
[6] Ylva Cornelia Axelsen is First Vice President and Head of Transaction Management for Syndicated Loans at Nordea.

chapter four consists an original effort to present and analyze the sanctions template of Nordea, a financial services group, internationally active in shipping finance and proceed to the necessary correlations.

Chapter 2. What prompted the incorporation of sanctions provisions in ship loan agreements - Background Law.

2.1 Introduction

In this chapter we will introduce and examine the reasons that seem to have led European lenders to request from the borrowers the incorporation of sanctions provisions in ship loan agreements. To this end, we will look into the legal framework of financial sanctions and point out the issues that seem to have made an impact on European Lenders' position.

In general, financial sanctions may target third countries, legal entities or individuals and they may impose various financial and trade restrictions. Financial sanctions are adopted and imposed by the United Nations, the European Union and by individual states, against different targets, creating thus a matrix of several different and often overlapping sanctions regimes.

The term "financial and trade restrictions" may include a variety of restrictions such as import and export bans, asset freezes, prohibitions on investments, payments and capital movements etc.[7] In this thesis, we will refer to the financial and trade restrictions of the most serious sanctions regimes currently in force i.e. the European Union Restrictive Measures and OFAC sanctions regulations, in which European Lenders' concerns seem to have been largely concentrated. Notably, we will deal with the targeted (or so called "smart") financial sanctions which are designed to target specific persons, groups and entities[8], as it will be discussed further below.

As a starting point, we will make reference to the background law in respect of the abovementioned sanctions regimes. We will examine the European Lenders' obligations imposed by financial sanctions legislation and the potential liability they may incur in the event of a breach of the financial restrictions. Finally, on the basis of the background law of financial sanctions, we will discuss the sanctions-related risks for European Lenders which

[7] European Commission, *EU Restrictive Measures*, par. 2.2. and as follows from the various sanction laws.

[8] Ibid.

seem to influence the incorporation of sanctions provisions in ship loan agreements to a large extent.

2.2 The applicable sanctions regimes

In principle, European Lenders, being subject to EU jurisdiction, are subject to two different, although sometimes overlapping, sanctions regimes: the UN sanctions resolutions and the European Union Restrictive Measures. In the event European Lenders fall under the jurisdiction of a member-state that has further adopted its own sanctions legislation, the member-state's national legislation would also be applicable.

However, in a ship loan agreement, where various jurisdictional factors[9] would frequently be involved due to the international character of a ship loan transaction, other sanctions regimes would be further applicable. For instance, in a ship loan agreement between a European Lender and a U.S. person as borrower, the US sanctions regime would be also applicable to the transaction as the borrower would be subject to the US jurisdiction. Whereas, if the ship loan agreement wouldn't involve any factor concerning U.S. jurisdiction, the U.S. sanctions regime would not be applicable in principle. To put it more precise, the sanctions regimes applicable to a ship loan agreement, will be determined on a case-by-case basis.

2.2.1 The United Nations (UN) sanctions regime

UN sanctions operate as a tool to promote the ultimate objectives of the international community, i.e. international peace and security and their legal basis derives from Article 41, Chapter VII of the UN Charter[10]. They are the sole economic sanctions regime with global effect, i.e. all states have to comply with.

UN sanctions are less complicated due to their global effect as well as the lack of enforcement measures by the organization itself; insofar as member states adopt UN sanctions resolutions, may enforcement be effectively implemented[11]. The EU as well as the US adopt the UN resolutions in relation to economic sanctions invariably, incorporating them into their own legal system as mandatory legislation.

[9] Factors such as the place of incorporation of the transacting parties, the nationality of the physical persons involved in the transaction, the ownership structure of the ship, the flag state, the currency etc.
[10] Special Research Report - UN Sanctions, p.2.
[11] Ibid. p. 12-14.

2.2.2 The EU Restrictive Measures

Besides UN resolutions, the European Union has adopted its own sanctions policy known as "EU Restrictive Measures". The EU may reinforce UN sanctions by applying stricter and additional measures while it may also impose autonomous sanctions where it is deemed necessary[12].

The EU applies restrictive measures in pursuit of the specific objectives of the Common Foreign and Security Policy (CFSP) as set out in the TEU[13]. In brief, they may be imposed through regulations, which are directly applicable in all EU Member States and binding in their entirety or through Council Decisions or Common Positions[14]. In particular, in par. 6 of the Text completed by European Commission with regard the EU Restrictive Measures, in spring 2008, where the legal basis for the restrictive measures is analysed, it is stated that "*the legal basis for sanctions will depend on the exact nature of the restrictive measures and the areas or targets covered by them*". Under new restrictive measures, sanctions may also be renewed, amended or lifted.

The current EU restrictive measures, comprised by numerous regulations, decisions and their continuous amendments, can be found in the list of "Restrictive Measures in force" published by the Service for Foreign Policy Instrument of the European Commission, which is frequently updated[15]. They constitute mandatory EU legislation and all Member-States are responsible for their incorporation to their national legislation and their implementation.

The EU sanctions policy has been formed in a series of key documents published by the European Council[16]. These documents underline the basic principles on the use of the restrictive measures and their implementation by the member-states while they also provide guidelines on compliance with the EU restrictive measures and on the interpretation of certain terms included in the EU sanctions legislation. Thus, although the implementation and enforcement of the EU restrictive measures rests with the Member-States having a certain

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[12] European Commission, *EU Restrictive Measures*, par.1.
[13] Ibid.
[14] Ibid, par.6.
[15]http://eeas.europa.eu/archives/docs/cfsp/sanctions/docs/measures_en.pdf (as updated on 07.07.2016).
[16] Ibid. par.5.

grade of discretion to implement stricter restrictive measures into their national laws, a certain grade of uniformity as to the member states' national legislation seems to be ensured.

According to the EU Regulations adopting restrictive measures[17] and to the key document titled "Guidelines on the implementation and Evaluation of restrictive measures"[18] EU restrictive measures apply to any physical or legal person, entity or body within the EU jurisdiction. To put it more precise, they apply within the EU territory as well as on board any aircraft or vessel under the jurisdiction of a member state. Compliance with EU Restrictive Measures is required by all EU nationals, legal persons and any kind of entities incorporated under the law of a member state, whether or not they are located in the EU. This also includes branches of EU companies located outside the EU. Furthermore, non-EU legal persons or entities doing business in whole or in part within the EU are also required to comply with EU restrictive measures[19].

2.2.3 The US Sanctions Regime

The US sanctions regime is considered the most severe and robust regime currently in force. The Office of Foreign Assets Control of the US Treasury Department (OFAC)[20] is the main body responsible for administering and enforcing US economic sanctions pursuant to Presidential and other statutory authorities[21]. It has the authority to impose various transaction prohibitions and asset-freezes in its discretion depending on the purpose and the target of sanctions. In addition, OFAC publishes lists of specially designated persons, issues licenses for an otherwise prohibited transaction and provides guidance on sanctions programs as well as general information on sanctions-related issues. With regard to the financial institutions, OFAC has published a brochure[22] in order to inform the financial community on the sanctions programs and the sanctioned activities, the consequent penalties the reporting procedures etc.

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[17] See e.g. Article 35, Council Regulation No. 36/2012/EC, Article 13, Council Regulation 833/2014/EC etc.
[18] Council Doc. No.15114/05.
[19] According to guidance notes published by the Swedish P&I Club, in the latter case "*the restrictions would be limited to that particular business and would not extend to exclusively non-EU business carried out by those legal persons or entities*". This conclusion seems correct as non-EU legal persons carrying out non-EU business fall outside the scope of EU restrictive measures. (See for instance guidance note on Syria Sanctions published on 16.12.2014 at: https://www.swedishclub.com/upload/Loss_Prev_Docs/Sanctions/Syria_Sanctions_-_European_Union_20141216.pdf)
[20] The information in relation to OFAC is collected from the official page of OFAC (https://www.treasury.gov /resource-center/sanctions/ Pages/ default.aspx)
[21] E.g, the International Emergency Economic Powers Act (IEEPA).
[22] *OFAC Regulations for the financial community,* 2012.

Finally, a serious part of its multitask role is to monitor compliance and impose penalties to violators in the event of breach of US economic sanctions.

According to OFAC guidelines in conjunction to US sanctions regulations, US economic sanctions apply to "US persons" which includes "*all U.S. citizens and permanent resident aliens regardless of where they are located, all persons and entities within the United States and all U.S. incorporated entities and their foreign branches*"[23]. However, it is clarified that each sanctions program provides its own definition. Foreign subsidiaries owned or controlled by U.S. persons[24] and foreign persons in possession of U.S.-origin goods[25] would, in cases, be required to comply with OFAC regulations.

Furthermore, according to certain US sanctions, a US person cannot "facilitate" or "approve" an activity of a non-US person which would be prohibited if undertaken directly by a US person or from the US[26]. For instance, according to the Iranian Transactions Regulations[27], of OFAC "*no United States person, wherever located, may approve, finance, facilitate, or guarantee any transaction by a foreign person where the transaction by that foreign person would be prohibited by this part if performed by a United States person or within the United States"*. Although the term "facilitation" may be defined in every sanctions regulation variably, its definition seems to be interpreted in the most comprehensive way[28]. With regard to the Iran sanctions program, it could be considered as facilitation when a US person "*alters its operating policies or procedures, or those of a foreign affiliate, to permit a foreign affiliate to accept or perform a specific contract, engagement or transaction involving Iran or the Government of Iran without the approval of the United States person, where such transaction previously required approval by the United States person and such transaction by the foreign affiliate would be prohibited by this part if performed directly by a United States person or from the United States; (b) Refers to a foreign person purchase orders, requests for bids, or similar business opportunities involving Iran or the Government of Iran to which the United States person could not directly respond as a result of the prohibitions contained in this part;*

[23] OFAC Frequently Asked Questions No. 11 available at: https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#basic
[24] Such definition is included in the Trading With the Enemy Act (TWEA).
[25] Willkie Farr & Gallagher LL.P, *Financial and Trade Sanctions Briefing III*, 2013, par. 17.
[26] Ibid, par. 10.
[27] 31 CFR 560.208.
[28] Willkie Farr & Gallagher, *Financial and Trade Sanctions Briefing III*, par. 12.

or (c) Changes the operating policies and procedures of a particular affiliate with the specific purpose of facilitating transactions that would be prohibited by this part if performed by a United States person or from the United States[29]".

Moreover, certain US sanctions have been provided with an extra-territorial effect, enforcing compliance with sanctions even towards non-US persons. For instance, according to the IEEPA[30] "*it shall be unlawful for a person to violate, attempt to violate, conspire to violate, or cause a violation of any license, order, regulation, or prohibition issued under this chapter*'' while the term "*person*" includes not only US persons but also non-US, foreign persons[31].

In view of the above, it follows that if a non-US person causes a US person to violate sanctions, it could also be held liable for breaching US sanctions, although same is not subject to US jurisdiction, due to direct or indirect facilitation of a breach of sanctions by a US person.

- Conflict of laws

The extraterritorial reach of US sanction has been heavily criticised and condemned by the European Union on many occasions[32]. Since 1996, the European Union has adopted the Blocking Regulation[33] in order to prohibit compliance with extraterritorial legislation of a third country which could be detrimental to EU interests.

Under the Blocking Regulation, an entity subject to EU jurisdiction, may not comply with US sanctions unless non-compliance would seriously damage its interests[34]. The consequences in the event of a breach of the said provision would depend on the implementation and enforcement of the said Regulation by the member-states[35].

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[29] 31 CFR 560.417

[30] US. Code Title 50 Chapter 35 section 1705.

[31] US. Code Title 50 Chapter 53 section 4302 - Definitions: "the word "person," as used herein, shall be deemed to mean an individual, partnership, association, company, or other unincorporated body of individuals, or corporation or body politic.

[32] Council Doc.15114/05, par. 47.

[33] Council Regulation 2271/1996/EC.

[34] Willkie Farr & Gallagher, *Financial and Trade Sanctions Briefing III*, par. 27.

[35] Ibid, par. 27.

Consequently, it seems that compliance with US sanctions could be in conflict with European Legislation, under certain circumstances and could thus create uncertainty to European Lenders in relation to compliance with sanctions. Despite the potential illegality, most internationally active European banks seem to favor compliance with OFAC regulations due to the severe consequences of non-compliance imposed by OFAC. However, the applicable national law should always be taken into consideration by European Lenders, as in jurisdictions such as the UK[36] and Germany[37], where the Blocking Regulation prohibitions have been seriously implemented, conflicts of sanctions are likely to arise.

2.3 The European Lenders' obligations under EU financial sanctions.

Prior to analyzing the European lenders' obligations under EU financial sanctions, i.e. restrictive measures, it should be made clear that each sanctions regime and regulation imposes different prohibitions. In the following paragraphs we will attempt to categorize the most serious obligations arising from the sanctions regulations that are relevant to the thesis.

Both the EU and the US sanctions regimes have adopted various financial sanctions the most important for European Lenders being the targeted (or "smart") financial sanctions. Unlike the comprehensive sanctions targeting states, smart sanctions are designed to target specific persons, groups and entities that are suspected or found to be involved in certain prohibited activities such as terrorism[38]. The identity of such designated persons and entities are included in publicly available lists which are continuously updated[39].

In the context of targeted financial sanctions, European Lenders are prohibited from making funds and economic resources available to any designated person or entity, or to third persons the listed persons and entities would indirectly benefit from[40].Instead, European lenders are obliged to freeze any funds and economic resources belonging to, owned, held or controlled by such designated person or entity.

[36] Ibid, par. 28

[37] Watson, Farley & Williams, *Dealing with sanctions and anti-boycott measures under German and EU Law in financing transactions.*

[38] Council Doc. 15114/05.

[39]The Consolidated list of persons, groups and entities subject to EU financial sanctions. Under US regime OFAC publishes the SDN lists (Specially Designated Nationals). However, there are other lists of designated persons and entities.

[40] Bonelli Erede Pappalardo, Bredin Prat, De Brauw Blackstone, Westbroek, Hengeler Mueller, Slaughter and May, Uria Menendez, *Loan documentation in Europe: Recent trends and current issues,* 2014, *p.* 21-22.

The explanation of the above prohibition for European Lenders was provided in the last review of the key document titled "Update of the EU Best Practices for the effective implementation of restrictive measures"[41].

Under the EU restrictive measures, it is considered that a person or entity holds or controls the funds or economic resources in all situations where, "without having a title of ownership, he/it is able lawfully to dispose of or transfer funds or economic resources he/it does not own, without any need for prior approval by the legal owner"[42]. A similar definition is provided under US sanctions.

Furthermore, "the criterion to be taken into account when assessing whether a person or entity is owned by another person or entity is the possession of more than 50%[43] of the proprietary rights of an entity or having majority interest in it[44]".

However, it is a more difficult issue to determine who controls the person or entity. The same document provides guidance for the assessment by indicating certain criteria for consideration. Thus, if the person or entity in question has the right or exercises the power to appoint or remove the majority of the members of the administrative, management or supervisory body of the entity; or if it controls alone, pursuant to an agreement with other shareholders or members of a legal person or entity, a majority of shareholders' or members' voting rights in that legal person or entity; or even if it has the right to exercise a dominant influence over a legal person or entity, it is considered that the person or entity in question is controlled by another person or entity[45].

Furthermore, European Lenders are restricted from providing certain services[46] and transactions related to specific sectors and goods as listed in the applicable sanctions legislation, with listed persons and entities. The prohibition applies to indirect transactions as well. This means that transacting with and making payments to a non-listed person, whose actual beneficiary is a listed person, are also prohibited. In view of the above, European

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[41] Council Doc. 10254/15.
[42] Ibid,. par.34
[43] Under US sanctions it would be 50% or more.
[44] Ibid, par. 62.
[45] Ibid. par. 63-64.
[46] See e.g. Council Decision 2013/255/CFSP, Chapter II, where restrictions on financing of certain enterprises are imposed.

Lenders are obliged to reject any payment or transfer of funds to listed persons and entities and decline the provision of any prohibited service that purport to violate or circumvent the above prohibitions, unless an authorization or an exemption is granted by the competent authorities.

In addition, under EU restrictive measures, European Lenders have a duty to report any sanctions-related activity[47]. In the context of EU sanctions policy and as stipulated in EU regulations, European lenders have a reporting duty towards sanctions authorities, underlining that it is exercised "without prejudice to the applicable rules concerning reporting, confidentiality and professional secrecy". However the extent of this duty seems quite unclear.

2.4 Consequences in the event of breach of sanctions by European Lenders

Should European lenders be liable for breaching sanctions laws either directly or indirectly, they could confront serious penalties by the competent sanctions authorities, the most severe being OFAC in the event of breach of US secondary sanctions.

Under EU restrictive measures, there is no uniformity as to the consequences of a breach of restrictive measures. Member states have discretion to decide the type of the penalties which will be enforced by their national competent authorities. The EU general guidelines stipulate that penalties must be "effective, proportionate and dissuasive" while they must not be punitive.

Under the US sanctions regime, penalties imposed by OFAC would range from the issuance of a "cautionary letter" to large civil monetary penalties, forfeiture of funds, etc. whereas, in serious violations, criminal prosecution is imposed, and the violator may confront a sentence of imprisonment and a fine[48].

However, European Lenders would be mainly concerned of their exclusion from the US market as a penalty imposed for indirect facilitation of a breach of US secondary sanctions. The suspension of dollar clearing[49] through US banks is deemed a very serious penalty for

[47] Council Doc. 10254/15, par. 41-42.
[48] Clyde & Co, *Sanctions Update*, 2012.
[49] Interview with Mrs. Axelsen.

European lenders as, for a dollar transaction to be effected, it is necessary to pass through the US banking system. Such penalty would seriously hinder their business.

There have been certain instances where European Lenders were fined as a result of the extraterritorial reach of US sanctions. Two instances concern Credit Suisse and Lloyds TSB[50]. Credit Suisse agreed to pay a heavy fine on the basis that it systematically hid the identity of its Iranian clients when moving millions of dollars on their behalf while Lloyds TSB agreed to pay an enormous fine for processing prohibited payment transactions made by its clients through non-affiliated U.S. correspondent banks. According to the factual statements in the settlement agreement, Lloyds had a policy, inter alia, of intentionally manipulating and deleting information in wire transfer instructions[51].

It should be noted that, as it seems from all similar instances, the European Banks' sanctioning conduct was not considered inadvertent; the established policies and the repeating conduct could evidence that they were acting intentionally.

Finally, a very interesting issue, which is relevant to the thesis purposes, albeit quite unclear, seems to be the European Lender's potential liability that could potentially arise indirectly, due to a breach of sanctions by the borrower. To put it more precise, European Lenders could be held liable under sanctions laws not only for their own breaching conduct but also for facilitating of or financing the breach of sanctions by the borrower. In this case, the liability incurred would be secondary, as borrowers are primarily responsible to comply. In other words, should the borrower not comply with the applicable sanctions laws, the lender could potentially also be liable towards sanctions authorities.

The circumstances under which European Lenders could incur such liability seem quite unclear. Likewise primary liability, sanctions authorities would seek to investigate whether the lender's intention or knowledge can be assumed or whether it is a justifiable inadvertent breach.

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[50] Peter Burrell, Rita Mitchell, and David Savell, *Financial and trade sanctions: What banks need to know*, 129 BLJ, 511 (2012).

[51] Ibid.

The level of knowledge is not the same under all sanctions regimes. In principle, the US regime adopts strict liability[52] while the level of knowledge or other factorS would be estimated for the mitigation of the penalty[53]. Often, although not always, the lender will need to prove that it did not know nor it had reasonable cause to know about the breach[54]. The type of the penalty and its severity would typically be affected by several factors such as the exercise of due diligence, the type of the breach and level of the lender's awareness i.e. whether the breach was caused by a willful conduct, negligence or whether there was no knowledge whatsoever.

Furthermore, the assessment of the penalty would be made on a case by case basis being a matter of proof. For instance, it would be impossible for a bank, that is systematically stripping of payment information related to Iranian nationals when the transactions are to be processed through US banks, to proof that its conduct was inadvertent rather than intentional.

In view of the above and in the absence of adequate and official guidelines by the EU or OFAC, it could not be always clear whether a transaction is prohibited and under what circumstances European lenders could incur liability. Concomitantly, the risk of breaching sanctions is extremely high. To provide an illustrative example, several inquiries have been addressed to OFAC in relation to US dollar clearing through US banks by non-US persons[55]. After the Implementation Day[56], where certain Iran sanctions were lifted, the issues arising from dollar-clearing operations became even more unclear while the responses from OFAC seemed quite ambiguous as to what conduct may be sanctionable. According to OFAC guidelines, non-US banks can engage in certain dollar-clearing operations involving Iran, so long as they do not involve, directly or indirectly, the United States financial system or any

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[52] Willkie Farr & Gallagher, *Financial and Trade Sanctions Briefing III*, par.23.

[53] Ibid.

[54] In the EU, the member-states will determine the required level of awareness for imposing a penalty to the lender. On the other hand, OFAC, to evaluate the level of the lender's awareness of the conduct, will consider actual knowledge and whether it had "reason to know" about the conduct. According to OFAC, to assess whether the lender had reason to know the following must be examined: If the lender did not have actual knowledge that the conduct took place, did it have reason to know, or should it reasonably have known, based on all readily available information and with the exercise of reasonable due diligence, that the conduct would or might take place?

[55] Frequently Asked Questions Relating to the Lifting of Certain U.S. Sanctions Under the Joint Comprehensive Plan of Action (JCPOA) on Implementation Day, as updated on October 2016. (https://www.treasury.gov/resource-center/sanctions/Programs/Documents/jcpoa_faqs.pdf .

[56] Under the JCPOA (Joint Comprehensive Plan of Action), the 16th January 2016 was set as the Implementation Day, where certain restrictions in regard with Iran were lifted. Certain Us secondary sanctions were also lifted.

United States person and do not involve any person on the SDN List or any sanctioning conduct which is sanctionable for US persons[57].

Finally, as a general remark, it should be noted that OFAC guidelines are not binding while its broad discretion in enforcing sanctions and imposing penalties could create furhter uncertainty.

[57]http://sanctionlaw.com/unresolved-questions-on-offshore-dollar-clearing/ . OFAC also stressed that "… foreign financial institutions, need to continue to ensure they do not process U.S. dollar-denominated transactions involving Iran through the U.S. financial system or otherwise involve U.S. financial institutions (including their foreign branches), given that U.S. persons continue to be prohibited from exporting goods, services (including financial services), or technology directly or indirectly to Iran, with the exception of transactions that are exempt or authorized…".

Chapter 3. The incorporation of sanctions provisions in ship loan agreements.

3.1 Introduction

The incorporation of sanctions provisions in ship loan agreements seems to have become an established market practice for most European Lenders. Sanctions provisions, as contractual terms, incorporated into a ship loan agreement on the lender's request, would be negotiated between the parties, i.e. between the lender and the borrower. In this chapter, we will first make extended reference to the stage of negotiations and then we will analyze the context of sanctions provisions European Lenders would frequently request to incorporate in a ship loan agreement. It should be noted that the analysis hereunder will be principally from the lender's perspective.

This chapter aims to provide an overview of sanctions provisions frequently used by European Lenders according to our research and it could not constitute an exhaustive list. The number and the extent of sanctions provisions included in a ship loan agreement will be determined by various factors such as the lending bank's sanctions policy, the relevant market practice and the negotiations between the parties. In the absence of an established template or standard provisions widely used in the ship loan market, to the extent that it could be held to be customary market practice for ship loan agreements, European Lenders seem to have introduced their own sanctions wording in their ship loan agreements.

3.2 A glance into the ship loan agreement

In ship finance loans, freedom of contracts and the prominent principle of "pacta sunt servanda" prevail. In principle, the lender and the borrower would negotiate and agree the terms to be included in the loan agreement insofar as they do not deviate from mandatory legislation. The loan agreement would enclose the terms and conditions under which the loan would be advanced, while the structure of the loan agreement would already be orientated on

the term sheet[58] agreed between the parties beforehand. The term sheet would be the legal basis for the loan agreement which would constitute the framework for the legal transaction[59].

There is no standard rule on the form of the loan agreement as each bank and law firm has its own way of drafting documents. In practice though, most European Lenders, would likely approach the Loan Market Association (LMA)[60] recommended forms, where after careful and long negotiations between the parties a tailor-made loan agreement would be concluded. It should be noted that the choice of governing law would also be an important element of the loan agreement[61].

In the European market[62], the Loan Market Association (LMA) provides recommended forms for loan agreements which are widely used in ship finance. However, none of these recommended forms includes a special clause or wording for compliance with sanctions laws; unlike compliance with anti-corruption legislation, where a respective special clause was introduced in LMA recommended forms[63], there has been no such recommended clause or template for compliance with sanctions legislation so far. On the other hand, it is worth mentioning that, in the African loan market, the respective LMA recommended forms[64] have included sanctions wording in the form of special representations and undertakings for compliance with sanctions laws[65].

In the absence of a special provision for compliance with sanctions laws, a breach of sanctions laws would be dealt through the general customary clauses included in all ship loan agreements. To put it more precise, in the event of a breach of sanctions laws by the borrower,

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[58] Schinas, Johns, Grau, *HSBA Handbook on ship finance,* 2015, *p. 58-59.*
[59] Ibid, p.59.
[60] Ibid, p. 59.
The Loan Market Association (LMA) is the authoritative voice of the syndicated loan market in Europe Middle East and Africa and has introduced various recommended forms and standard clauses to be used in loan transactions. LMA has established widely-accepted market practice on this field. http://www.lma.eu.com/ .
[61] According to the interview with Mrs. Axelsen, as regards Nordea, English law, New York law or even Norwegian Law would frequently be accepted as governing law in ship loan agreements.
[62] Bonelli Erede Pappalardo et al., *Loan documentation in Europe: Recent trends and current issues, p.30:* In the US market, the LSTA (Loan Syndications and Trading Association) published a short guidance regarding sanction provisions in loan documentation with regard US sanctions.
[63] LMA recommended form for «Senior Multicurrency term and Revolving Facilities Agreement for Leveraged Acquisition Finance Transactions», clause 27.5.
[64] i.e. the recommended forms of facility agreements governed by the laws of South Africa (South Africa Agreements) and the facility agreement governed by the laws of Kenya, Nigeria,Tanzania, Uganda and Zambia (KNTUZ Agreement).
[65] Slaughter and May, *LMA loan documentation in Africa*, 2016.

European Lenders could rely on the general undertaking for compliance with laws and, thus, the said breach would probably constitute an event of default[66]. Whereas, if it would become illegal for the Lender to perform the loan agreement under sanction laws, the latter could invoke the illegality clause[67]. Provided that the conditions of the above clauses are met, European Lenders would be entitled to exit the transaction through the particular provisions of the loan agreement i,e event of default, prepayment and/or cancellation of the loan.

Despite the aforementioned customary clauses, which would typically be included in a ship loan agreement, European Lenders seem to consider that, in the context of compliance with sanctions laws, these clauses could not suffice[68] and that the incorporation of sanctions provisions in the ship loan agreement would be necessary[69].

3.3 Prior to the ship loan agreement: The negotiation process.

The ship loan agreement creates an important link between the lending bank and the borrower, not only due to the risk (financial, credit etc.) involved in the transaction but also because it evidences a long - term legal relationship between the lending bank and the borrower[70]. It may not always be easy to reach to an agreement; the parties would probably have opposite interests while, concomitantly, a range of different factors would need to be taken into consideration.

In the absence of a standard sanctions wording recommended by a recognized authority, the lending bank's standard sanctions provisions seem to consist the basis for the negotiations[71]. This means that sanctions provisions would be specifically negotiated in each loan transaction between the lender and the borrower and would be included in each loan agreement.

As a starting point, the strength of the borrower's bargaining position as well as the lender's credit policy seem to play a primary role during the negotiation process[72]. The borrower's

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[66] Senior Multicurrency term and Revolving Facilities Agreement for Leveraged Acquisition Finance Transactions, LMA recommended form,clause 27.2.
[67]Ibid, clause 11.1.
[68]Bonelli Erede Pappalardo, et al., *Loan documentation in Europe: Recent trends and current issues,* p.22-23, 26-27.
[69] Simonsen Vogtwiig, *Sanctions in loan facility documentation,* 2014.
[70] According to Mrs. Axelsen, the typical tenor of a shipping or offshore financing would be 5-7 years.
[71] Simonsen Vogtwiig, *Sanctions in loan facility documentation,* 2014.
[72] Ibid.

business profile would be of great relevance but not determinative, as, according to the current tendency, sanctions provisions seem to be incorporated in every ship loan agreement irrespective of whether the borrower's business profile presents particular sanctions-related risks[73]. Also, it is possible that during the loan facility, which is meant to be performed for a few years, sanctions laws or the borrower's business could likely change. Therefore, lenders would seek to address this particular risk even in transactions where sanctions are not currently relevant, but could become relevant in the future. It is also worth mentioning that the sanctions provisions that have already been agreed in other loan agreements within the borrower's group would also be relevant, as the borrower may want to ensure that the compliance obligations are consistent across the group's financings[74].

Moreover, the extent of sanctions provisions seems to depend on the sanctions regimes which would be applicable to the transaction[75]. In other words, the lender, in cooperation with the borrower, would determine all the sanctions regimes and the corresponding restrictions and prohibitions the transaction would be subject to. By including all applicable sanctions regimes, European Lenders seem to consider that borrowers' awareness towards compliance with sanctions would be increased[76].

More specifically, during the stage on negotiations, European Lenders seem to examine the following issues in order to draft proper sanctions provisions suitable for each ship loan agreement[77]:

a) The relevant jurisdictions[78]: in a ship finance loan agreement, several actors would be involved, which means that more than one jurisdiction would be relevant. The borrower, the guarantor, the lending bank as well as the other actors involved in the transaction, either directly or indirectly, such as the charterer, the sub-charterer the shipper, the ship's insurers and the ship itself, are most likely to be based in different jurisdictions. Consequently, several sanctions regimes would be applicable to the transaction, the most serious being the US

[73] Ibid.
[74] Ibid.
[75] Ibid.
[76] Ibid.
[77] Vedder Price, *Sanctions Regimes and Shipping Finance,* 2015.
[78] Ibid.

sanctions regime. Therefore, all relevant jurisdictions would need to be examined and taken into consideration in order to set the complete framework of sanctions prohibitions.

b) The identity of the relevant persons (borrower, guarantor, beneficial owners, charterers etc.): The lender would request detailed information on the identity of the borrower, the guarantor, their subsidiaries and their beneficial owners in order to check that none of these persons/entities are prohibited or designated persons[79]. To that effect, the ownership structure of the vessel under finance would also be relevant.

c) The purpose of the loan[80]: The purpose of the loan seems to increase the sanctions-related risks for the lender. Should the loan be advanced for general corporate purposes instead of financing a specific ship, it would be more difficult for the lender to monitor the advance of the loan i.e. whether it will be used to facilitate or finance directly or indirectly a sanctioned activity or in any manner breach sanctions laws.

d) The currency of the loan[81]: On the basis that all payments in U.S. dollars, which are the most common in ship finance loans, have to pass through the U.S. financial system for clearing, European lenders are risking of being accused of direct or indirect facilitation of a prohibited transaction under US sanctions regime and consequently confront onerous penalties by OFAC due to the extraterritorial effect of US sanctions[82]. To put it clear, even though the US sanctions regime may not be applicable in principle, compliance with the US sanctions regime may be inevitably necessary due to the currency of the loan.

e) The type of the loan[83]: Whether the loan is a revolver or a term loan seems also to affect the negotiations as revolving loan facilities are considered to entail increased risks due to their nature. In such loans, the monitoring ability of the lender would be more challenging as the borrower has the flexibility to drawdown, repay and redraw funds advanced to itself.

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[79] According to Mrs. Axelsen the information in relation to the identity of the transacting parties is already collected through the banks' Know Your Customer policies but additional information could be required in relation to sanctions.
[80] Interview with Mrs. Axelsen.
[81] Vedder Price, *Sanctions Regimes and Shipping Finance,2015*
[82] See par. 2.3
[83] Interview with Mrs. Axelsen.

f) The type of the vessel and the voyage routes (if known)[84]: these two elements seem to be of great relevance since, as mentioned, specific sanctions prohibitions may be applicable depending on the type of the vessel as well as the routes it is going to perform during the loan facility. For instance, European cruise ships are prohibited from entering or calling at certain ports in Crimea and Sevastopol[85]. In the event a cruise ship under finance purports to visit Crimean ports, the borrower would be in breach of sanctions. In such case, the lender could also incur liability for breach of sanctions as, participating, knowingly and intentionally, directly or indirectly, in activities the effect of which is to circumvent the said prohibition, is also prohibited[86]. It should be noted that the conditions under which such liability occurs seem quite unclear; in any case, such liability would depend on the lender's knowledge and intention.

g) The cargo of the vessel and the cargo owner[87]: Likewise, as certain sanctions laws include restrictions as regards imports and exports of certain goods, the goods transported by the ship under finance would concern the lenders. For instance, if the the shipowner (i.e. the borrower) purports to use the ship under finance to transport a cargo considered prohibited under applicable sanctions, the lender could potentially be found to facilitate or finance, either directly or indirectly, a sanctioned activity. The same could potentially be the case if the cargo owner is a designated person or a person acting on behalf of a designated person.

h) The charterparty (if known)[88]: lenders would be interested in knowing the charterparty provisions which may indicate the charterer's entity, the routes to be performed, the cargo and any sub-chartering agreements for the reasons stated above. In addition, it may be relevant for the loan agreement if the charter party includes specific covenants that could alleviate some of the lender's concerns, i.e. contractual obligations for compliance with sanctions laws by the charterer, similar to the borrower's obligations under the loan agreement.

[84] Vedder Price, *Sanctions Regimes and Shipping Finance.*
[85] Article 2d, Council Regulation 692/2014/EC, as amended by Council Regulation 1351/2014/EC.
[86] Article 4 Council Regulation 692/2014/EC, as amended by Council Regulation 1351/2014/EC.
[87] Interview with Mrs. Axelsen.
[88] Vedder Price, *Sanctions Regimes and Shipping Finance.*

3.4 The context of sanctions provisions in ship loan documentation from the lender's perspective.

Through sanctions provisions, European Lenders seem to address two main issues in relation to sanctions legislation: a) ensure the borrowers' compliance with sanctions laws throughout the loan facility, and b) ensure the right to exit the transaction if the performance of the loan agreement becomes illegal for the lender[89].

In the following paragraphs, we will present and discuss the typical areas where additional representations and undertakings seem to be requested from the borrower with regard to compliance with sanctions and we will examine their context. Furthermore, we will also discuss the the relevant provisions addressing the consequences for the loan facility in the event of a breach of sanctions. However, as already stated, this is an overview of the most frequently used sanctions provisions and it does not constitute an exhaustive list.

3.4.1 Policies and procedures[90].

The lender would often request from the borrower's group to establish adequate policies and procedures for maintaining compliance with applicable sanctions throughout the loan facility[91]. The policies and procedures usually would comprise of monitoring systems adopted by the borrower. This request could be included in the loan agreement in the sense of a continuous undertaking throughout the duration of the loan or, it could be implied, as an indirect practical consequence of the undertakings for compliance with sanctions laws.

While the borrower is obliged to comply with the applicable sanctions laws, the lender as a financial institution is assigned with the responsibility to apply sanctions laws during its transactions and report to the pertinent authorities any sanctioned activity[92]. Consequently, in the event of a sanctioned activity by the borrower, not reported by the lender, the latter could be held liable probably on the basis of facilitating a breach of sanctions. The question that arises at this point, is to what extent could the lender's duty be effected.

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[89] Ibid.

[90] Bonelli Erede Pappalardo et al., *Loan documentation in Europe: Recent trends and current issues,* p.23

[91] Ibid, p. 23-24.

[92] "The EU assigns particular responsibility to credit and financial institutions in regard with applying sanctions as they are involved in the bulk of financial transfers and transactions affected by the relevant Regulations". https://eeas.europa.eu/topics/sanctions-policy/8442/consolidated-list-of-sanctions_en.

To answer the question, it may be of assistance to compare the lender's monitoring ability to the borrower's. While the borrower may obtain internal policies to monitor its own activities effectively, the lender's monitoring ability cannot be as effective. This is quite reasonable considering that the borrower possesses the necessary means and information to monitor its own activities whereas the lender's capability depends on the information provided by the borrower during the due diligence checks and the KYC[93] policy, being thus limited.

The lenders' duty could meet further hurdles due to the complexity of sanctions regulations, the constant amendments and the lack of guidelines on behalf of the pertinent authorities. The terms of sanctions regulations could create uncertainty as to what is prohibited or permitted due to their vague and unclear wording[94], while the complex corporate structures and transactions being customary in shipping, could hinder lenders' monitoring duty.

Additionally, only the borrower's internal policy could function as a precautionary measure against a sanctioned activity; on the other hand, the lender has only access to the information provided by the borrower while it is very likely to become aware of the sanctioned activity after the breach takes place. In the latter case, the lender would have a duty to report the breach.

In view of the above, lenders could request from borrowers to undertake software services in order to conduct automatically periodical or specific screening checks to their business in relation to compliance with sanctions regimes. These screening checks may comprise screening of vessels, checking sanctions lists etc.[95]. By incorporating screening technology requirements into the loan documentation, borrowers could acquire a considerable leverage in negotiations as their monitoring ability in relation to compliance with sanctions would be enhanced. However, such services may be quite costly.

Raising the burden of the monitoring duty can be quite onerous for both sides. While lenders may not obtain the necessary information, borrowers may argue that the above may increase the burden and the cost of the compliance procedures within their business. In any case, the primary responsibility for the borrower's compliance with sanctions rests with the borrower

[93] The "Know Your Customer" policy.
[94] See par. 2.3 and 2.4
[95] Vedder Price, *Sanctions Regimes and Shipping Finance.*

who has to monitor its own activities. On the other hand lenders, being also subject to the additional burden of applying sanctions compliance and reporting, are also monitoring the borrowers' compliance on a secondary level.

3.4.2 Compliance with laws.

In addition to the customary compliance with laws clause included in all ship loan agreements, lenders seem to request further representations and undertakings explicitly providing for compliance with sanctions laws[96]. In particular, lenders seem to request from the borrowers to undertake explicitly that they and their groups are in compliance and will continue to be in compliance with sanctions laws during the tenor of the loan facility.

This provision could cover any void that might exist under the general compliance with laws clause[97] and concomitantly it could increase borrowers awareness in relation to compliance with sanctions[98]. Unlike the general undertaking, the respective undertaking for compliance with sanctions would have no reference to any materiality qualification indicating that lenders consider any breach of sanctions by the borrower as serious as a material adverse effect[99]. Thus, in the event of any breach of sanctions, lenders would be entitled to invoke an event of default[100] and thus exit the transaction irrespective of whether the said breach would constitute a material adverse effect.

Moreover, in the said sanctions provision the applicable jurisdictions would frequently be expanded, so as to include sanctions laws that may be indirectly applicable to the borrower due to the transitional nature and the extra-territorial effect of certain sanctions. While the general undertaking refers to all the laws that the borrower "may be subject to", the respective sanctions provision could be drafted so as to stipulate that the borrower is and will remain in compliance will all sanctions laws whatsoever[101].

Alternatively, it could be stipulated that the borrower is compliant and will continue to be compliant with more jurisdictions applicable only in relation to sanctions laws. To put it more precise, in practice, European Lenders, being conscious of the extraterritorial effect of

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[96] Bonelli Erede Pappalardo et al., *Loan documentation in Europe: Recent trends and current issues,* p. 23-24.
[97] See par. 3.2
[98] Bonelli Erede Pappalardo et al., *Loan documentation in Europe: Recent trends and current issues,* p. 23.
[99] Ibid.
[100] See par. 3.2
[101] Ibid, p. 22-25.

US sanctions and the heavy penalties imposed by OFAC, seem to consider it necessary to include US sanctions regime in every ship loan agreement irrespectively[102].

On the other hand, borrowers' attempts would focus on narrowing down the obligations deriving from this undertaking. Although borrowers may not object to provide lenders with specific representations and undertakings in regard with sanctions, in principle they would feel uncomfortable with very broad undertakings that could potentially constitute an obstacle to their business activities. This would be the case if the borrower becomes subject to more prohibitions under the loan agreement than under the applicable sanctions laws[103]. Likewise, borrowers may also feel uncomfortable to undertake that they will be compliant with overseas sanctions regimes completely unfamiliar to them and their businesses. This would be the case when lenders are subject to overseas regimes but with which the borrower's business has to connection[104].

3.4.3 Use of proceeds.

A very frequent sanctions provision that seems to be included in ship loan agreements refers to the use of proceeds. As European Lenders are prohibited from making any funds or economic resources available to or for the benefit of a designated person[105] or for a purpose prohibited under sanctions laws, they seem to request from the borrowers to undertake that the proceeds of the facility will not be used in breach of the sanctions regulations[106],in order to ensure their own compliance.

Under a ship loan agreement, funds could be made available to the borrower to finance the purchase of a specific ship, for general corporate purposes of the shipowing company or its group of companies in general. Therefore, the lending bank would seek to ensure that its funds under the loan agreement won't be used by the borrower to facilitate or finance any sanctioned activity, either directly or indirectly.

To that effect, lenders seem to request from the borrowers to undertake that the funds they advance will not be used to facilitate or finance any transaction in breach of applicable

[102] Ibid, p. 28.
[103] Ibid, p. 24-25.
[104] Ibid.
[105] See par. 2.3
[106] Ibid. p. 24

sanctions or in any other manner that might result in a violation of any sanctions provisions[107] by the borrower or the lender. Furthermore, the undertaking could be drafted even broader, providing that the funds shall not be used in a manner that might result in a violation of any sanctions provisions not only by the borrower and the lender but also by other persons, such as the borrower's directors, officers, employees, agents etc.The broader the circle of persons included in the undertaking, the more reluctantly borrowers would agree to it.

3.4.4 Repayment of the loan facility.

In a similar manner, lenders would seek to address the risks arising from the repayment of the of the loan facility. In particular, lenders seem to request from the borrowers to undertake that any funds used to repay or pay other amounts due under the facility shall not originate from any sanctioned person or entity or derive from any sanctioned activity/transaction[108].

By processing or accepting such payments, lenders could be directly or indirectly transacting with sanctioning parties or accepting funds deriving from sanctioned activities and consequently could be held liable for breach of sanctions laws. Insofar as the payment information is made available to the lender, the latter could become aware of the imminent breach and proceed to the necessary actions to report it to the pertinent authorities. The lender's liability could thus be avoided and the transaction would be blocked. But what would happens in the case of an inadvertent breach by the lender, where the transaction is processed and the lender becomes aware of the breach at a later stage?

The lender would need to protect itself against such inadvertent breaches so as to prove that there was neither knowledge nor intention to cause any breach[109]. Subsequently, this sanctions provision as well as the provision in relation to the use of proceeds could have a dual function: to increase the borrower's awareness in regard with certain financial restrictions and concomitantly, to be used as a defense, proving that the lender has not consented intentionally to any restricted transactions from the commencement of the facility.

3.4.5 Management and control of the borrower.

It would not be uncommon for the scope of sanctions-related representations and undertakings to be expanded so that they cover not only the borrower itself, but also its group and its

[107] Ibid.
[108] Ibid.
[109] However, US sanctions impose strict liability.

directors, officers, employees and other persons and entities related to the management and the control of the borrower's business. A common undertaking to this effect, could stipulate that none of the borrower's group nor any of their respective subsidiaries or directors, employees or officers, is a sanctioned party or is engaged in any activity in violation of sanctions laws[110].

As under a typical sanctions prohibition, European Lenders are prohibited from dealing with funds or economic resources that belong to, are held or controlled by a sanctioned party, lenders would need to ensure that no member of the borrower's business is owned or controlled by a person or entity subject to sanctions or engaged in a sanctioned activity[111]. Subsequently, the lender would need to be aware of all the beneficial owners and shareholders of the borrower's business at any time.[112].

In ship loan agreements, the undertaking could be drafted in a broader sense, including representatives, agents, subsidiaries, joint ventures, operators, charterers, managers etc. or it could be narrower depending on the negotiations and the lending bank's policy. It could also be formulated as a continuous undertaking; the borrower may undertake that none of the above persons and entities is or will become a sanctioned party nor will it be subject to sanctions in any other manner.

In a customary loan agreement, the borrower would not be responsible for so many persons and entities under any undertaking. It seems quite reasonable for borrowers to object to include in the loan agreement such broad undertaking[113]. A basic argument is that the mere designation of a director, officer or employee of a company does not necessarily implicate the company itself. However, under the US regime, the actions of employees could be properly attributable to their organizations, depending on the facts and circumstances of the particular case[114].

Furthermore, it should be noted that it could be very difficult or even impossible for the borrower to police such an undertaking in an effective way. A publicly listed borrower would

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[110] Ibid, p. 24.
[111] Ibid.
[112] See par. 2.3
[113] Ibid. p. 24-25.
[114] 31 CFR 501, 5e.

not be able to monitor day to day the changes in its share register and thus inspect if its shares have been purchased by or for the benefit of a sanctioned person[115]. Likewise, in case of bearer shares, the identity of the shareholders may not be easy to be controlled or found[116].

Provided that there are additional risk mitigants, European Lenders would negotiate such provision. For instance, borrowers could disengage with persons that are designated or seem to be linked to designated persons. Moreover, European Lenders could depend borrower's liability on the latter's knowledge and due diligence. Thus, should a director or a representative becomes a sanctioned person, the borrower would be liable to the extent that it knew or should reasonably have known of the breach[117].

As sanctions regulations do not have a standard requirement in regard with the above, the level of compliance for the borrower may vary under different sanctions laws. A borrower subject to US sanctions regime, being the strictest of all, would always be more careful with its transactions. On the other hand, internationally active lenders would have to consider all the sanctions regimes they are subject to, in addition to the borrower's.

3.4.6 Location of business/income.

The location of the borrower's business as well as the source of its income would often be a matter of concern for lenders due to the imposed comprehensive sanctions. Lenders could request a further undertaking providing that neither the borrower, nor any member of the borrower's group is located, resident or organized in a sanctioned state. Alternatively, the undertaking could be connected to the income earned from investments in sanctioned countries or transactions with sanctioned persons[118].

3.5 Breach of sanctions provisions.

A breach of sanctions provisions by the borrower could be considered by the lender as a mandatory prepayment event or an event of default, depending on the provisions of the loan agreement[119]. As a main rule, should the borrower not comply with the general undertakings included in the ship loan agreement or should it make misleading or incorrect information to the lender, an event of default could be triggered, whereupon the lender would be entitled to

[115] Ibid. p. 25.
[116] Ibid. p. 25.
[117] Ibid. p. 26.
[118] Ibid. p 24.
[119] Ibid. p 25.

cancel the ship loan agreement and accelerate the repayment of the loan. If an event of default is triggered though, the borrower's position will impair, as this could potentially cross-default other obligations[120]. However, the circumstances under which these two tools will be activated will be explicitly stipulated in each loan agreement constituting contractual terms[121].

Through sanctions provisions, European Lenders would seek to ensure that they would be entitled to exit the loan transaction in any case where continuing with its performance would become illegal for same (for instance, due to new sanctions imposed), or would result in their sanctions exposure. For instance, a European Lender may wish to exit the loan transaction although the performance of the loan facility has not become illegal for the lender despite the borrowers breach of sanctions[122]. This would be the case when the lender would seek to avoid potential reputational exposure. As the illegality clause may not always provide sufficient protection to that effect[123], lenders could include, in an explicit manner, that non-compliance with sanctions would in any case constitute an event of default[124].

It is worth mentioning that the ship loan agreement would often include a provision where a relatively short grace period could be granted to the borrower in order to remedy the breach of sanctions provided that the breach is considered remediable, - in principle- within the grace period[125]. For instance, the borrower could obtain a license by the competent authorities permitting the sanctioned activity which triggered the event of default and, thus restore the breach. However, it would probably be at the Lender's discretion to accept the borrower's remedial action instead of triggering the event of default. In such case, the Lender would typically request enhanced information[126], i.e. frequent reporting by the borrower and legal advice by external legal advisors so as to ensure compliance with sanctions in this respect.

Finally, lenders would also include indemnity clauses as an additional consequence of the borrower's breach.

3.6 Risk assessment concerns - Conclusion.

[120] Ibid.p 25.
[121] See par. 3.2
[122] Ibid. page 26.
[123] See par. 3.2
[124] Ibid., page 26
[125] Interview with Mrs. Axelsen.
[126] Interview with Mrs. Axelsen.

In light of the above, it seems that sanctions provisions would often be heavily negotiated in most current loan transactions. While lenders would seek to protect themselves from the increasing risks that sanctions laws entail and eliminate the possibility of being heavily penalized by the competent authorities, borrowers would try to avoid further cumbersome provisions and obligations related to circumstances that might be beyond their control, under the loan agreement.

In a ship loan agreement, the first step for the parties to address in relation to sanctions laws would be whether to include sanctions provisions in the loan agreement. Nowadays, for most internationally active banks in ship finance loans, this would not be negotiated. Only in clear cases, where there would be no risk for the lender in regard with sanctions would the bank accept not to include sanctions wording[127].

The next issue to be addressed by the parties would be the extent of sanctions wording in the ship loan agreement which, as examined in the previous paragraphs, could be quite challenging. It seems wise to address this issue at an early stage, during the negotiation of the term sheet[128]. The lender would likely seek for the highest protection which is translated to wide-ranging representations and undertakings, whereas for the borrower's interest the less and narrower wording the better. During the risk assessment by the Lender, which would be always made on a case by case basis, the extent of sanctions provisions in the ship loan agreement would be determined by a lot of factor, such as the relevant jurisdictions, the borrower's bargaining strength, the structure of the shipowner's Group and its business, the type of the vessel being financed and the voyage routes, among others. The internal policies the borrower maintains for monitoring its business would be also taken into consideration.

To comprehend the increased risk European Lenders could possibly incur in regard with sanctions laws, it would be important to refer to the parameters that seem to be taken into serious consideration. A parameter which seems quite important, is the severe penalties that could potentially be imposed on European Lenders in the event of a sanctioned activity due to the borrower's conduct. To put it more precise, it seems that, in certain cases, a European Lender could incur secondary liability for indirect facilitation of or financing a breach of

[127] Interview with Mrs. Axelsen.
[128] Simonsen Vogtwiig, *Sanctions in loan facility documentation*

sanctions, primarily performed by the borrower. Although this seems quite unclear as the sanction wording in this respect is quite broad, European Lenders seem to be concerned of the heavy fines and other measures that could potentially be imposed, mainly by OFAC.

Moreover, besides the pure legal risk, European Lenders seem to assess the potential reputational risk being publicly related a sanctioned activity. In the event the lending bank is penalized due to its potential inadvertent involvement in an sanctioned activity, the reputational cost it might confront could be as important as the financial one.

In addition, the uncertainty around sanctions laws seems to increase the risk as well. The unpredictability of sanctions laws and their change on short notice in conjunction with their complexity and lack of specific guidelines from the pertinent authorities, has rendered compliance with sanctions laws a real challenge for both lenders and borrowers.

Furthermore, lenders seem to consider that, by placing specific obligations on the borrower, the latter's grade of awareness may increase and thus the importance of this topic not only for the European Lender but also for the borrower itself may be emphasized. The lack of awareness as well as the limited guidelines by the competent authorities, in conjunction with the complexity of economic sanctions laws could lead sometimes to inadvertent breach from the borrower's side. Consequently, lenders seem to consider that, by incorporating sanctions provisions in ship loan agreements, borrowers could become more conscious of sanctions laws and thus, be more cautious about their transactions.

Concomitantly, lenders could use sanctions provisions as evidence of their compliance towards the competent sanctions authorities[129]. In particular, by incorporating sanctions provisions in ship loan agreements, lenders could evidence that they have exercised due diligence, i.e. they have acted properly and have taken measures to ensure compliance with sanctions laws not only on their own part, but also on the part of their customers, i.e. the borrowers. Thus, in the event of a breach of sanctions laws by the borrower, where the lender could consequently be accused of alleged indirect facilitation or financing of the breach, the latter could invoke the sanctions provisions to defend itself.

[129] Interview with Mrs. Axelsen.

Considering the above, the incorporation of sanctions provisions in ship loan agreements seems to be a valuable tool to European Lenders not only for the pure legal-technical reasons, i.e., to the extent the customary provisions are considered insufficient for their protection against sanctions-related risks, but also for reasons concerning their internal compliance policy.

Chapter 4. The Sanctions Template of Nordea.

4.1 Introduction.

Nordea[130] is a key lender to the shipping and offshore industry with global presence, being a leading bank in syndicated loans and export credit financings for the maritime industries. Nordea, as well as other financial institutions operating in the same field, has established its own sanctions template to strengthen its internal policy for compliance with sanctions. In this chapter, the sanctions template of Nordea will be presented in order to provide a better understanding of sanctions provisions in practice. This template, constitutes one valid example of the incorporation of sanctions provisions in ship loan agreements by a European Lender.

Nordea's sanctions template[131] for ship loan agreements was first established in 2013, subject to minor amendments ever since[132]. Before that, there was no sanctions wording in the loan documentation. As a general remark, the template is based on the classic anglo-contractual structure, i.e. it consists of representations and undertakings a breach of which constitutes an event of default. The negotiated template with the tailor-made sanctions provisions, is added to each loan agreement on a case to case basis. According to the interview with Mrs. Axelsen, the final purpose is to draft sanctions provisions that mirror the borrower's obligations under the applicable sanctions laws.

It shall be noted that the template will be examined from the lending bank's perspective so as to comprehend the basic concept of the incorporation of sanctions provisions. Beforehand, it is necessary to make a reservation as to the form and content of the template as it is subject to

[130] https://www.nordea.com/en/

[131] In the Norwegian market, the two leading banks in the shipping sector, Nordea and DNB have agreed on a common set of sanctions provisions. However, each bank adapted the template to its own documentation and wording making the necessary adjustments.

[132] Interview with Mrs. Axelsen.

continuous legal review and update in light of the current sanctions laws and market trends and in accordance with Nordea's internal policies and drafting guidelines[133].

4.2 The scope of the template.

As a starting point, we will examine the scope of sanctions provisions under the ship loan agreement, i.e. which sanctions regimes and laws apply and to whom. To that effect, the template introduces new terms in the loan agreement such as "Restricted Party", "Sanctions Laws", "Sanctions Authority" and "Sanctions List". These terms are defined in the template and determine the scope of the provisions. The definitions are broadly drafted and they are subject to negotiations so as to reflect the applicable sanctions regulations in each particular case.

4.2.1 To whom sanctions provisions apply.

Under the term "Restricted Party", the template includes all persons and entities the borrower is prohibited from dealing with. The term comprises persons and entities that are listed on sanctions lists[134] or are connected in any manner[135] to a territory which is subject to a sanctions regime as well as persons and entities that are directly or indirectly owned or controlled by such persons and entities[136].

The interpretation of the term "directly or indirectly controlled or owned" has raised borrowers[137]' concerns due to its unclear and vague context. The wording derives straight from EU and OFAC regulations and does not constitute a provision autonomously introduced by Nordea. As it is not uncommon for sanctions regulations to stipulate that it is prohibited to make not only directly but also indirectly available funds or economic resources to or for the benefit of designated persons and entities[138] the template seems to be aligned with the provisions of sanctions laws. Nordea, as a European bank, is primarily subject to the EU restrictive measures while OFAC regulations merely differentiate at this point. Consequently, the terms of the template would need to cover at least the respective context under the EU sanctions regulations. If the criterion of ownership or control is satisfied and the person or

[133] Nordea Sanctions Template
[134] The designation may be by name or by reason of being included in a class of persons.
[135] Either because they are located anyhow in a targeted country or because they are incorporated under the laws of that country.
[136] Nordea Sanctions Template - Definitions
[137] See par. 2.3
[138] See par. 2.3

entity in question is owned or controlled by a designated person or entity, it would fall under the term Restricted Party of the loan agreement[139].

In the event the borrower's ownership or control is established in accordance with the above criteria, the lending bank would be at risk of making indirectly available funds or economic resources to designated persons under the loan facility in breach of sanctions regulations. However, it shall be noted that the borrower may refute the the above criteria of ownership or control[140].

Moreover, the term also comprises persons and entities the Lender[141] is prohibited from dealing or otherwise engaging in a transaction with, by any sanctions laws. But isn't the Lender already prohibited from dealing with such persons or entities according to the above? What persons are covered in this category that are not already covered?

Although it might seem superfluous, the provision is of great importance. It seems that Nordea seeks to include cases where the applicable sanctions regimes for the borrower and the lender differ and subsequently, the applicable restrictions differ. In certain situations, the lender may be subject to more or different sanctions regimes than the borrower, due to its international activities. In such cases, the borrower may be required to comply with a sanctions regime that otherwise would not be applicable to its business. This is frequently the case with US sanctions regimes which may be applicable due to their extraterritorial effect. As already stated, in loans denominated in US dollar clearing, US sanctions may also be applicable. Moreover, in syndicated loans where there are many participating lenders, the borrower will be required to comply with multiple sanctions regimes applicable to each participating lender.

[139] Ibid.
[140] Council Doc.10254/15 par.65.
[141] In syndicated loans the term refers to any Lender participating in the syndicate.

4.2.2 A heavily negotiated issue.

"The Obligors shall (and shall ensure that each of their Subsidiaries [other member of the Group] [, as well as any manager and charterer]),:
(a) comply with all laws or regulations:
(i) applicable to its business; and
(ii) applicable to the Ship, its ownership, employment, operation, management and registration,including the ISM Code, the ISPS Code, all Environmental Laws, all Sanctions Laws and the laws of the Approved Flag;
(b) obtain, comply with and do all that is necessary to maintain in full force and effect any Environment Approvals; and without limiting paragraph (a) above, not employ the Ship nor allow its employment, operation or management in any manner contrary to any law or regulation including but not limited to the ISM Code, the ISPS Code, all Environmental Laws and all Sanctions Laws."[142]

A typical negotiating point concerns the scope of the undertakings and representations with regard to compliance with sanctions. As a starting point, Nordea would request to include a range of persons and entities that are related to the borrower, the borrower's business and the ship under finance. In addition to its own compliance, the borrower would be required to ensure that persons and entities such as the borrower's and the guarantor's group, including joint ventures, subsidiaries, directors, officers, employees as well as agents, representatives and other affiliates, are in compliance with sanctions laws; In other words, the borrower would be requested to ensure not only its own, but also third parties' compliance with sanctions laws throughout the loan facility.

Borrowers would be reluctant to undertake such broad undertakings as it may not always be feasible to inspect compliance with sanctions laws on a daily basis as, in some cases it would be beyond the borrower's monitoring ability. This could be the case with a publicly listed entity which is subject to day to day changes in its share register or with a representative that does not belong to the borrower's group[143].

However, the aim of ensuring the group's compliance and their affiliates', is to prevent any potential liability for indirect dealing with restricted persons as well as any indirect facilitation

[142] Nordea Sanctions Template, Undertaking regarding compliance with Laws.
[143] See par. 3.5.5

or financing of sanctioned activities[144] pursuant to the prohibitions of sanctions laws. Taking into consideration the extent and severity of OFAC regulations namely, this risk has to be allocated under the loan agreement. The template seeks to ensure that the lenders will not be held liable for the borrowers' counterparties[145]. The employees and the transacting parties of the borrower as well as their conduct is outside the lender's control.

To alleviate the borrowers' concerns in this respect, specific wording could be added in the template, qualifying the relevant provisions by reference to the borrower's knowledge or best effort[146]. Consequently, the borrower may become liable for the persons and entities in question only when the breach has been caused knowingly; the borrower may prove that it did not know about the breach nor it had reasonable cause to know. It is worth mentioning that the borrower is expected to be aware of its own employees[147] as they are under its direct control, whereas the level of knowledge for the representatives and agents is not as strict.

The template seeks to adopt the knowledge qualification in consent with the requirements of the applicable sanctions laws and in line with the lender's potential liability that may arise from indirect facilitation or financing of a breach of sanctions. Under the Eu sanctions regime should the borrower violate sanctions as a result of an employee's conduct, the lender could potentially be liable towards sanctions authorities for indirect facilitation of the breach, unless it did not know nor it had reasonable cause to know about the breach. By establishing the same level of awareness for the borrower, the lender seeks to avoid such potential indirect liability. For the assessment, i.e. whether the borrower knew or had reasonable cause to know about the breach, the criteria stated in the respective guidelines could be taken into consideration. Similarly, intentional breach cannot be exempted under the template[148].

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[144] Interview with Mrs. Axelsen.
[145] Ibid.
[146] Nordea Sanctions Template
[147] According to OFAC guidelines, the actions of employees may be properly attributable to their organizations depending on the facts and circumstances of the particular case. Among the factors that are taken into consideration are the nature of the conduct, how long it lasted, the existence and the nature of a compliance program intended to identify and stop such conduct.
[148] Interview with Mrs. Axelsen.

4.2.3 Which sanctions regimes and laws apply.

To determine the sanctions regimes and laws that apply in each ship loan agreement the terms "Sanctions Laws" and "Sanctions Authority"[149] of the template should be combined.

Under the first term, the template defines the type of sanctions applicable to the loan agreement. There are several types of sanctions issued by several authorities, but not all of them are relevant to the loan agreement. The sanctions template is dealing with namely financial and trade prohibitions which may be issued under different terminology depending on the jurisdictions. Thus, while in the US we refer to economic sanctions laws as OFAC regulations, the EU renames sanctions to "restrictive measures". To avoid any misunderstanding around the term, the template makes explicit reference to any type of economic or financial sanctions[150].

The second determinative element in order to identify the applicable sanctions laws, as stated above, is the pertinent authority for their issuance. According to the template, the term Sanctions Authority comprises the basic state authorities that are relevant to the transaction, i.e. the state the facility agent is located, the United Nations, the European Union, the member states of the European Union, the United States of America and any authority acting on behalf of any of them in connection with Sanctions Laws. Should another state relevant to the transaction, it will also be included.

An important issue in the case of ship loan agreements is the flag state. Traditionally, the jurisdiction of the flag state, as one of the applicable jurisdictions, is covered under the customary clauses of the loan agreement. Any special provision on the template would be thus redundant. However, it should be noted that Nordea has introduced certain restrictions in relation to the choice of flag for the ship under finance and the switch of flag as well[151].

The template has also introduced the term "Sanctions List". The definition given in the template aims to include any list of persons or entities published in connection with Sanctions Laws by or on behalf of any Sanctions Authority. The term "Sanctions List" as well as all the terms "Restricted Party", "Sanctions Laws" and "Sanctions Authorities" are dynamic

[149] Nordea Sanctions Template, Definitions
[150] For instance, trade embargoes, prohibitions, restrictive measures, decisions, Executive Orders or notices.
[151] Interview with Mrs. Axelsen.

terms[152], as their context may change throughout the loan facility, being subject to the constant updates and amendments of the underlying laws.

4.3 The representations and undertakings for compliance with sanctions laws.

The core of Nordea's sanctions template consists of wide-ranging representations and undertakings which explicitly require the borrower's compliance with sanctions laws and regulations in all respects[153]. While representations reflect the borrower's compliance in a snapshot, the respective undertakings provide for a continuous obligation for compliance with sanctions laws throughout the tenor of the loan[154].

In the template, the basic obligations for compliance with sanctions laws are highlighted while it is made clear to the borrower that any breach may be considered serious enough to put at risk the loan facility itself.

4.3.1 The context of the representations and undertakings.

To remedy the insufficiencies of the customary general compliance clause and in light of the potential liability for indirect facilitation of a breach of sanctions, Nordea has drafted the undertakings for sanctions compliance without any reference to a materiality qualification[155]. As a general remark, it should be mentioned that the template is drafted with quite flexible provisions; the representations and undertakings of the template are broadly-drafted to confront the unpredictability and ever-changing nature of sanctions laws and regulations[156]. The purpose is to mirror the applicable sanctions regimes at any given time. Finally, the provisions are quite strict for the borrower, but they are always subject to negotiations on a case to case basis[157].

The representations and undertakings address three main areas of sanctions compliance aiming to ensure that:

a) The borrower is not and will not become a Restricted Party.

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[152] Interview with Mrs. Axelsen.
[153] See Sanctions provision provided in 4.2.2
[154] Interview with Mrs. Axelsen.
[155] See par. 3.2 and 3.5.2
[156] Interview with Mrs. Axelsen.
[157] Ibid.

"Each[158] Obligor shall ensure that none of them, nor any of their Subsidiaries [their joint ventures] [other member of the Group], respective directors, officers, employees, [agents or representatives or any other persons acting on any of their behalf], is or will become a Restricted Party".

According to the template, the borrower is requested to undertake explicitly that they are not and will not become a Restricted Party. The undertaking is not limited to the borrower only; the persons and entities that will be eventually included in the prohibition, is a highly negotiated issue as discussed above.

The legal basis for the above is found in the sanctions legislation. Under sanctions prohibitions, Nordea will be obliged to freeze the borrower's accounts and terminate any further dealings should the borrower become a designated person, as it would be prohibited to transact with the latter and to make funds and economic resources available to the latter either directly or indirectly. Subsequently, Nordea cannot proceed to any advance of the loan to a designated borrower nor can it accept any payment from the latter[159]. As a result, the loan facility has to be terminated. Any performance of the obligations under the loan agreement by the lender following a breach of sanctions by the designated borrower may constitute a sanctioned activity, being severely penalized[160].

b) The proceeds of the loan facility will not be used in breach of sanctions laws.

"No[161] proceeds of any Advance of the Loan shall be made available, directly or indirectly, to or for the benefit of a Restricted Party nor shall they otherwise be applied in a manner or for a purpose prohibited by Sanctions Laws".

The template is also intended to increase the borrower's awareness in relation to the use of the proceeds. The borrower is requested to undertake that no proceeds of the advance of the loan will be made available to or for the benefit of a designated party nor will the borrower apply the proceeds of the advance of the loan in a manner or for a purpose prohibited by sanctions laws. This means that the borrower must be very careful when monitoring the transactions

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[158] Nordea Sanctions Template.

[159] Although there are certain exemptions in regard with interest crediting, fees etc.

[160] The liability in such cases would depend on the lender's knowledge of the breach which is a matter of proof towards the competent Sanctions Authorities.

[161] Nordea Sanctions Template.

with other parties and be aware of their real identity and the real purpose of the transaction. Any indirect financing of a designated person or a sanctioned activity by the borrower could hold the lender liable for indirect facilitation or financing a breach of sanctions laws.

Additionally, the undertaking aims to function as a defense against allegations of facilitating or funding the breach of sanctions by the borrower. The lending bank seeks to clarify beforehand that it does not and will not consent to such behavior by the borrower[162].

c) No proceedings have commenced by any sanctions authority against the borrower in relation to sanctions laws.

Although it is not itself illegal to be involved in an investigation by a sanctions authority or any kind of proceedings in relation to sanctions, Nordea has chosen to address this area to avoid, inter alia, reputational exposure[163]; dealing with borrowers that are already suspected to be involved in sanctioned activities, albeit not legally prohibited, is very likely to have a negative impact on the lender's business in general. Concomitantly, the undertaking has a preemptive purpose; commencing long-term relations, such as a loan facility with a borrower who is already carrying the burden of the suspect, puts in direct risk the future of the loan facility[164]. Should the borrower be reluctant to undertake such representations, Nordea could receive it as a reason to exercise further diligence[165].

4.3.2 Duty of disclosure.

"The[166] Obligor shall supply to the Agent:...
promptly upon becoming aware that it, any of its direct or indirect owners, Subsidiaries… has become or is likely to become a Restricted Party".

The template establishes a separate duty for the borrower to inform the lender on any sanctioned-related activity or behavior which is closely related to the obligation for compliance with sanctions. Should the borrower become aware of a breach of any of the above undertakings, it is obliged to inform the lender immediately. Notifying the lender of a sanctioned activity is considered, under the template, a serious duty[167]. Nordea recognizes and

[162] Interview with Mrs. Axelsen.
[163] Ibid.
[164] Ibid.
[165] Ibid.
[166] Nordea Sanctions Template
[167] Interview with Mrs. Axelsen.

accepts that compliance with sanctions may not be an easy task and that inadvertent breach or wrongful conduct could take place. Nevertheless, in the event of a breach the borrower still carries a serious obligation to inform the lender about the breach or any sanctions-related event[168].

As already stated, a similar duty is imposed on Nordea, as financial institution, from sanctions regulations. The financial institutions have to monitor their transactions and report any sanctioned activity to the pertinent authorities promptly upon becoming aware of it; a breach of such duty could have severe consequences for lending banks as it could further constitute facilitation under certain circumstances. The internal monitoring systems are of great relevance to that effect, as they may detect, probably in retrospect, sanctioned behavior which has not been duly disclosed by the borrower.

4.3.3 Special risks addressed in the template.

Being aware that shipping activities entail special risks, Nordea has addressed in the template certain risks that are very likely to occur during the borrower's shipping business in relation to sanctions.

a) Change of jurisdictions.

Unlike an on-shore business, the ship is a moving enterprise and may be connected to several jurisdictions. A ship under finance is very likely to fall under different jurisdictions, depending on the voyage routes, being thus exposed to multiple sanctions regimes. Subsequently, the sanctions regimes that apply to the ship may change during a single voyage. Moreover, as the typical corporate structure of a shipping business is quite complex, consisting of shipowning entities incorporated under the laws of jurisdictions such as Cyprus or Liberia and management companies located in other jurisdictions etc., several jurisdictions may be relevant to the borrower and the loan transaction.

Therefore, in the template, the borrower's obligation for compliance is not limited to the sanctions laws applicable to its business; it further extends to the laws and regulations that apply to the ship at any time[169]. In addition, the sanctions laws that apply to the ownership of

[168] Ibid.
[169] See 4.2.2 Nordea Sanctions Template, Undertaking for compliance with laws.

the ship, its employment, operation, management and registration i.e. all possible jurisdictions that may be connected to the ship, are also included in the template. The purpose is to highlight and ensure that borrowers should be extremely careful to adhere to sanctions laws anytime and in every relevant jurisdiction[170].

b) Chartering.

Chartering is another special risk that a diligent lender could not overlook. Chartering the ship under finance is a very frequent practice where the charterer takes partial control of the ship - especially in the case of time charter where the charterer takes over the commercial management of the ship-. However, the charterer is not bound by the borrower's contractual obligations towards the lender. How can the lender ensure the charterer's compliance with sanctions in that case?

Aa a general rule, lending banks, including Nordea, request information from the borrower regarding the charterparty and the charterer, as part of their due diligence[171]. The lending bank is also likely to reserve the right for prior approval of the charter party or prohibit any material changes to its main terms[172].

Moreover, in the template, sanctions provisions may apply to the charterer[173] as well. The lender may request from the borrower to ensure the charterer's compliance with sanctions laws. This is an additional monitoring duty imposed on borrowers, which it may not be always possible to perform. On the other hand, as already stated, borrowers are primarily responsible for their own counter-parties.

4.4 Consequences of breach of sanctions provisions.

As stated in 3.6., a breach of sanctions laws and consequently of the sanctions provisions included in the ship loan agreement, could be considered from the lender as a mandatory prepayment event or an event of default providing the latter with the right to exit the transaction. The sanctions template itself does not address this issue by specifying a separate

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[170] Interview with Mrs. Axelsen.
[171] Ibid.
[172] Ibid.
[173] The same applies in the case of the manager or the sub charterer of the ship under finance.

clause for the consequences in the event of breach of sanctions provisions[174]. However, it follows from the structure of the loan agreement that any breach of the undertakings and representations included in the template triggers an event of default in accordance with the customary provisions of the LMA recommended forms, despite that this may cross-default other obligations of the borrower[175]. The strict approach that Nordea has adopted points out that compliance with sanctions has become an issue of great importance for the lending bank[176].

However, the breach of sanctions laws may be accepted as a mandatory prepayment event by Nordea in certain circumstances and only upon the borrower's request. In particular the bank could grant a prepayment period of maximum thirty days so long as the prepayment is ensured[177]; However, any breach of the obligation for prepayment would be considered as an event of default. In any case, whether the breach of sanctions will be considered as an event of default or not, is very frequently a heavily negotiated issue[178].

Moreover, the template provides for a grace period of maximum thirty days to remedy the breach[179]. The basic condition upon which the grace period is granted is that the breach in question should be remediable within the period provided. In the event the breach is not remediable within thirty days and a longer period is required, Nordea could decide to extend the grace period upon the borrower's request[180]. The grace period would not be granted to the borrower, if the breach is not deemed remediable according to the lender's assessment[181]. For instance, if it is likely that the borrower will be granted with an exemption or obtain a license by the competent sanctions authorities, the lender could consider the breach remediable and thus will grant the grace period to the borrower. To that effect, the lender would often request from the borrower certain reliable evidence such as a legal statement assessing the situation in favor of the borrower obtaining the license[182].

[174] Nordea Sanctions Template
[175] Interview with Mrs. Axelsen.
[176] Ibid.
[177] Ibid.
[178] Ibid.
[179] Nordea Sanctions Template.
[180] Interview with Mrs. Axelsen.
[181] Ibid.
[182] Ibid.

In addition to the above, the template includes indemnity provisions in the event of breach of sanctions which would be included at the end of the indemnification clause of each ship loan agreement. The indemnity covers "*any*[183] *loss, costs or liability incurred by each indemnified Person in any jurisdiction*". As per the template, the borrower is obliged to indemnify the Lender and any Secured Party[184] against any loss or liability incurred by the lender as a result of the borrower's[185] sanctioning conduct.

4.5 Overall remarks on the template.

Overall, the provisions of the template are considered quite flexible; apparently the purpose of this flexibility is to capture both expansions of and revocations of sanctions laws and be the point of departure for the relevant negotiations. The negotiations will determine the extent of the borrower's obligations and create tailor-made provisions for each particular loan transaction. It seems that the performance of the ship loan agreement is contractually connected with the borrower's compliance with sanctions laws while the lender's obligation for compliance with sanctions seems to prevail. In principle, according to the template, the borrower is requested to undertake obligations same is already subject to, pursuant to the underlying sanctions laws and regulations. It should be noted that the borrower is primarily responsible for its own compliance with sanctions being directly liable for any sanctioned activity. On the contrary, the lender's liability as a financier, addressed in the template, is in principle, indirect and secondary.

A serious issue under the template that should be worth mentioning is that the borrower is requested to to ensure not only its own compliance but also third parties' compliance with sanctions. These parties consist persons and entities that may not be directly connected to the loan agreement but they are related to the borrower and the borrower's business. As these persons and entities are outside the lender's control, the risk is allocated to the borrower[186]. However, this could indicate that the lender's purpose would be to establish a back-to-back obligation for sanctions compliance rather that encumbering the borrower[187]. To put it more

[183] Nordea Sanctions Template.
[184] According to the definition of the term in the LMA Leveraged Agreement: "Secured Parties" means each Finance Party from time to time party to the loan agreement, any Receiver or Delegate and each agent arranger and lender from time to time party to the Mezzanine Facility Agreement.
[185] And any of the borrower's partners, directors, officers, employees etc.

[186] Interview with Mrs. Axelsen.
[187] Ibid.

precise, while the lender requests from the borrower to ensure third parties' compliance with sanctions laws under the loan agreement, the borrower may also request similar assurances from its transacting parties. As the borrower may be contractually connected with these parties, the obligation for compliance with sanctions and subsequently the respective liability in the event of sanctions could be transmitted contractually.

As a final remark on the template, it should be mentioned that there is no requirement for the borrower to obtain a specific monitoring system. Although there is no such provision, the need to implement and maintain an effective monitoring system derives indirectly from the representations and undertakings of the template[188]. In order to ensure day to day compliance with sanctions laws, the borrower has to maintain and operate an adequate system and procedure to monitor its business.

Moreover, requiring from the borrower to obtain a specific monitoring system could imply more obligations for the lender; as both the borrower and the lender have to monitor their transactions the lender could not impose monitoring duties on the borrower that the same cannot perform. In addition, such a provision would be impractical as the extent of the monitoring duty may depend on the borrower's corporate structure, the transactions it may perform and the risk involved in relation to sanctions[189]. Thus, an internationally active borrower whose transactions entail high risk in relation to sanctions will need to implement a more comprehensive monitoring system than a small-sized borrower with low-risked business.

Chapter 5 Conclusions – Final remarks

5.1 The necessity of incorporating sanctions provisions in ship loan agreements by European Lenders.

The thesis was initially based on the question why and to what extent should European lenders request the incorporation of sanctions provisions in ship loan agreements. Considering the discussion above and the outcomes of the case study, the thesis concludes that the incorporation of sanctions provisions seems necessary for European lenders especially in ship

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[188] Ibid.

[189] Interview with Mrs. Axelsen.

loan transactions. However, the answer as to the extent of sanctions provisions that should be included in a ship loan agreement, is quite complex.

First, in view of the analysis above, through sanctions provisions European Lenders may address in a contractual level certain issues that are likely to arise out of a ship loan agreement in relation to compliance with sanctions and thus, avoid complex legal analyses or disputes. Should the borrower proceed to a sanctioned activity or, should it become illegal for the lender to perform its obligations under the loan agreement, sanctions provisions will be used to clarify or even determine the future of the loan facility and the parties' liability thereunder.

Furthermore, European Lenders are concerned of being exposed to sanctions-related risks unless specific wording is included in the ship loan agreement n order to address two main issues: the borrower's compliance with sanctions laws and the Lender's right to exit the loan transaction in the event of illegality.

The serious liability European Lenders could incur, notably for an inadvertently made indirect facilitation or financing of a breach of sanctions laws by the borrower, renders the incorporation of sanctions provisions in ship loan documentation completely indispensable. By incorporating sanctions provisions in ship loan documentation, European lenders may evidence towards sanctions authorities that they have exercised enhanced due diligence in their transactions to prevent any sanctions-related conduct and thus, avoid liability; in other words, sanctions provisions constitute a serious defense for European lenders against potential allegations of facilitating or financing a breach of sanctions by the borrower.

Moreover, sanctions provisions are considered an effective tool for European lenders to address potential reputational exposure, as a result of a borrower or a transaction linked to sanctions-related risks. As discussed, European lenders may confront an uncomfortable situation in the event of a breach of sanctions by the borrower, where the performance of their contractual obligations under the ship loan agreement is likely to result in their reputational exposure in addition to their potential legal liability as financiers. Therefore, through sanctions provisions, European lenders could establish an effective mechanism to exit the transaction in such situations, favoring compliance with sanctions laws from the commencement of the loan transaction.

To determine the extent sanctions provisions should be incorporated in ship loan documentation, several parameters should be taken into consideration as analyzed. To this end, the negotiation process is of great relevance. Lenders and borrowers should take into consideration all the necessary factors affecting the loan agreement in order to determine all the sanctions prohibitions applicable to the particular transaction. The purpose of negotiations should be to conclude to an agreement that will balance the Lenders' concerns with the borrower's commercial interest, not to encumber the borrower with exaggerated obligations. In this respect, the extent and final context of sanctions provisions should be decided on a case by case basis.

Regarding the borrowers' position, it seems that although it is not the initial intention of European lenders to impair borrowers' business activities, same could be hindered due to the extended undertakings for compliance with sanctions laws. Although European Lenders may argue that, through sanctions provisions, they aim to increase borrowers' awareness as to obligations for compliance, already existent under the applicable sanctions laws, it seems that the contractual obligations finally incorporated, could supersede these existent obligations. In particular, the extended undertakings frequently required by European Lenders in relation to compliance with sanctions and the application of further sanctions regimes not initially applicable to the borrower, could potentially hinder the borrower's position by imposing further prohibitions to the borrower's activities.

Moreover, from the analysis of the relevant market practice and the case-study, it follows that sanctions provisions seem to be broadly drafted and be flexible enough so as to be subject to negotiations and thus be tailored for each loan agreement. In this respect, the operation and maintenance of efficient monitoring systems by the borrower seems to be very crucial; should borrowers monitor effectively and adequately their business, they may succeed narrower sanctions provisions, as lenders' concerns may be alleviated to a certain extent.

Finally, it is also noteworthy that European lenders seem to establish a back-to-back obligation for compliance with sanctions as concluded above. The case study was quite illustrative in this respect. Although the sanctions undertakings generally follow from the respective sanctions regulations, a question for how far down the chain these obligations and consequently the liability may be transmitted yet remains.

In view of the above, as a final remark, it could be concluded that, in principle, European lenders should incorporate sanctions provisions in ship loan documentation to the extent that they mirror the borrower's obligations under the underlying sanctions laws.

5.2 The European Lenders' position.

In light of the imposed obligations for compliance with sanctions, as introduced throughout the thesis, European lenders position has been affected to a great extent. The additional monitoring duties for compliance with sanctions laws and the potential liability they may incur, in conjunction with the severe penalties sanctions authorities may impose, seem to have impaired the performance of their business and their position as financiers. In addition to that, European lenders must deal with the uncertainty and vagueness in regard with the obligations for sanctions compliance and the sometimes unclear circumstances under which they may incur potential liability for direct or indirect facilitation or financing of a breach. Moreover, their duty for compliance becomes even more complex due to the unpredictability and the constant amendments of the numerous sanctions regimes, the extra-territoriality of US sanctions regimes and the potential conflict of laws and the limited reliable guidelines by the competent authorities.

5.3 Future concerns.

As compliance with sanctions seems to become broader and more important in the future, European lenders will seek to protect themselves from the increased risks by enhancing their due diligence and adopting more comprehensive policies to avoid potential liability. However, the borrower's position could be negatively affected and ship finance transactions could be hindered or slow down. A key aspect though, could be the cooperation between the lender and the borrower. As compliance with sanctions is an important part of risk management for both lenders and borrowers, by cooperating with lenders in compliance with sanctions, they may achieve to reduce their risk.

Another aspect that is very likely to be in the center of concern for the lenders, but was beyond the thesis scope, is their potential contractual liability that may arise during the enforcement of the contractual sanctions provisions against the borrower. Interesting case law has started to develop in this respect. In any case, as economic sanctions regimes are increasing, compliance with sanctions will remain in the spotlight for European Lenders.

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