How U.S. Sanctions Can Kill Your Deal

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International Supply Chain & Contract Risks

The United States (U.S.) had $2.21 trillion Dollars in exports in 2016 according to the U.S. Department of Commerce (D.O.C)[i], and an estimated 10.7 million U.S. jobs supported by exports[ii]. Yet U.S. unilateral sanctions are being applied more vigorously than ever to perceived foreign foes, negatively affecting trade balances.

One of the most important and sensitive supply chain risks for private and public organizations is how to manage U.S. unilateral sanctions. The U.S. Treasury Department Office of Foreign Assets Control (OFAC) is responsible for administering U.S. sanctions. OFAC does not, however, keep a country sanctions list per se. Instead it has a variety of lists that must be consulted since sanctions can be either broadly applied to a country, or narrowly tailored to individuals or entities for specific periods. Potentially affected businesses and individuals therefore, must regularly consult the Department of Treasury's online resources, or engage lawyers with OFAC compliance experience, to ensure they are not exposing themselves to significant penalties (or jail time) from U.S. authorities. For international or multi-lateral organizations, unilateral sanctions risks are particularly tricky because both the U.S. and the sanctioned country may be among their member countries. This article will focus on **U.S. unilateral sanctions risks affecting contracts with International Organizations.**

Nearly all international organizations have clauses prohibiting contracts, transfers of goods, or even technical cooperation engagements with vendors or countries subject to sanctions imposed by the United Nations Security Council. However, these organizations are not required by international law to adhere to unilateral sanctions of any one member country against another, due to the privileges and immunities conveyed upon them by international conventions.[iii] In theory this means that if the U.S. imposes sanctions on Iran for example (both member countries of the U.N. since 1945), but the United Nations itself does not impose sanctions on Iran, then U.N. agencies and similarly, non-U.N. multi-lateral organizations, could continue doing business with Iran and not have to abide by the U.S.'s unilateral action. In practice however, multi-lateral agencies may find it difficult not take note of the U.S.'s persuasive sanctions arguments, despite the detriment unilateral sanctions may cause another member. Why? The United States is a major actor on the world stage, and it has considerable influence. It can wield its tremendous political and economic clout as a powerful member of nearly every international organization in the world, to ensure its objectives are met, and that any transgressions are swiftly discouraged.

Why Are Unilateral Sanctions A Problem ?

The issue here is how to manage the inherent legal uncertainty of U.S. unilateral sanctions. Is there a duty of care on multi-lateral organizations to brief their suppliers and staff on eligibility requirements with regard to prohibitions related to broad U.S. imposed sanctions? Must they develop policies and procedures specific to unilateral sanctions? And, wouldn't this be discriminatory to the sanctioned party, also a member of the international organization (albeit, perhaps with less influence), and with an interest in being treated equitably by other members?

Given the pervasiveness of U.S. sanctions and their impact on international procurement, contracts, transfers, and technical cooperation with sanctioned countries, their reach should not be underestimated. The U.S. applies sanctions to entire countries (e.g., North Korea), sectors (e.g., petroleum or weapons), designated entities (e.g., banks, institutes, even hotels), or individuals (various nationals). Plus, there is the distinction between primary and secondary sanctions, with the former prohibiting U.S. persons from engaging with sanctioned entities, and the latter targeting non-U.S. persons, outside U.S. jurisdiction, engaged in activities with the sanctioned entity either directly or in an ancillary fashion.

Trying to ensure compliance in some cases, requires entire teams of lawyers and compliance professionals, to determine the type and extent of risk exposure. Without a keen awareness of the risks, a U.N. agency or other multi-lateral, for example, may inadvertently meet the short or long-term supply needs of a U.S. sanctioned country, and risk a strong (and often very public) reprimand from the U.S., or the withholding of U.S. contributions.[iv]

"Under no circumstances will we accept extra-territorial American sanctions on European companies"
-Sigmar Gabriel, German Diplomat-

What Are The Risks To Supply Chains?

Unilateral sanctions are a slippery slope and supply chain problems can sweep in quickly to negatively affect even the most well-intentioned procurement and contracts arrangements.

Supply interruption – U.S. unilateral sanctions can be applied overnight because the surprise element is very powerful in coercing the sanctioned party to comply with U.S. demands [v]. Because sanctions may be implemented quickly and unexpectedly, their enactment can trigger immediate supply interruption of goods (e.g., certain foods, raw materials, etc. that all of a sudden become banned commodities), and services (e.g., outsourced labor, travel restrictions, or certain banking risk exposures). All members of the supply chain can become subject to rigorous product or service inquiry to determine continued eligibility, and re-negotiation of terms is a real possibility. Suppliers may find themselves scrambling to ensure their contract doesn't involve activities or persons that expose them to secondary sanctions.

Payment restrictions – Cash flow can also become a problem, especially if suppliers negotiate special payment terms in certain currencies. If an international agency engages a supplier to provide goods or services, and that supplier is somehow involved with a sanctioned entity, directly or indirectly, payments or advance cash transfers may get tied up by banks who suspect the transfer may reach an entity subject to U.S. unilateral sanctions. This can lead suppliers to struggle to meet contract targets or cease delivery altogether. It can also make repatriation of payments back to a payer more difficult.

Reputational Impact – Although the U.N., other multi-laterals, and their staff enjoy immunity from legal process [vi], suppliers do not enjoy the same protections. Sanctions can bring additional costs they hadn't expected and they may attempt to secure compensation when things go awry. Even when the relevant law and jurisdiction for disputes is determined by the international agency, suppliers may still aggressively pursue disputes and the reputational risk for the agency if it does not comply or compensate for a presumed breach, is high. Diplomatic and political resources often prevail in settling such disputes away from the prying eyes of the press and public, however, coming to a satisfactory resolution involves time, money, and uncertainty. These factors must be carefully considered when contracting in the global marketplace.

What Mitigation Strategies Should be Used?

The answer is…. "It depends." First, it's important to understand that navigating unilateral sanctions of one member country against another can be a political minefield! Unlike private entities, there is no clear system that may be put in place to manage unilateral foreign policy objectives of one member state against another, within an international organization setting.

Second, although legal and procurement departments of international agencies monitor political developments of member countries, and no doubt try to avoid dealings that would disturb the delicate balance within these structures, it is not within their purview to implement one member country's unilateral sanctions against another, unless there is consensus among all members to do so. Staff involved in international dealings can request briefings and guidance, but that's usually about it. Third, supply chain risks are inherently unpredictable. Supplier audits and screenings only show a snapshot of current relationships, not entanglements with sub-contractors or other third party beneficiaries. Although parties can attempt strong due diligence and even stronger government compliance, knowing whose rules to follow when caught in the web of unilateral sanctions actions is challenging.

Instead, perhaps the best solutions are practical ones. They could include first notifying suppliers when a unilateral sanction is imposed by one member country against another, and requesting that they review their supply chain risk exposure. Second, periodically offering training on managing supply interruption risks generally, so that there is a better understanding of what to do when they inevitably occur. Third, sensitizing international organization staff to communicate high impact procurement decisions related to sanctions, through their management, to either country delegations, or the internal public affairs office. This could help counter any negative perceptions or misinformation about why the procurement is necessary and the scope of the resulting agreement.

Conclusion

Supply chain risk events associated with unilateral sanctions are disruptive. Given the U.S.'s increasing use of unilateral sanctions in its foreign policy, it's important to note that although such sanctions do not apply de jure to international organization deals, they often do apply de facto to vendors/suppliers along the supply chain. No one expects international organizations to have their actions dictated by one member state against another member, however, suppliers and staff need to be prepared to manage the risks, and have the support of their management in determining appropriate actions to respect the rights and obligations of the sovereign states involved.

End Notes

U.S. International Trade Administration, Department of Commerce 2016 Exports Fact Sheet, https://ibc-static.broad.msu.edu/sites/DEC/images/resources/1159b5b1-8a59-47a1-b988-4bb1836c9904us-exports-factsheet.pdf

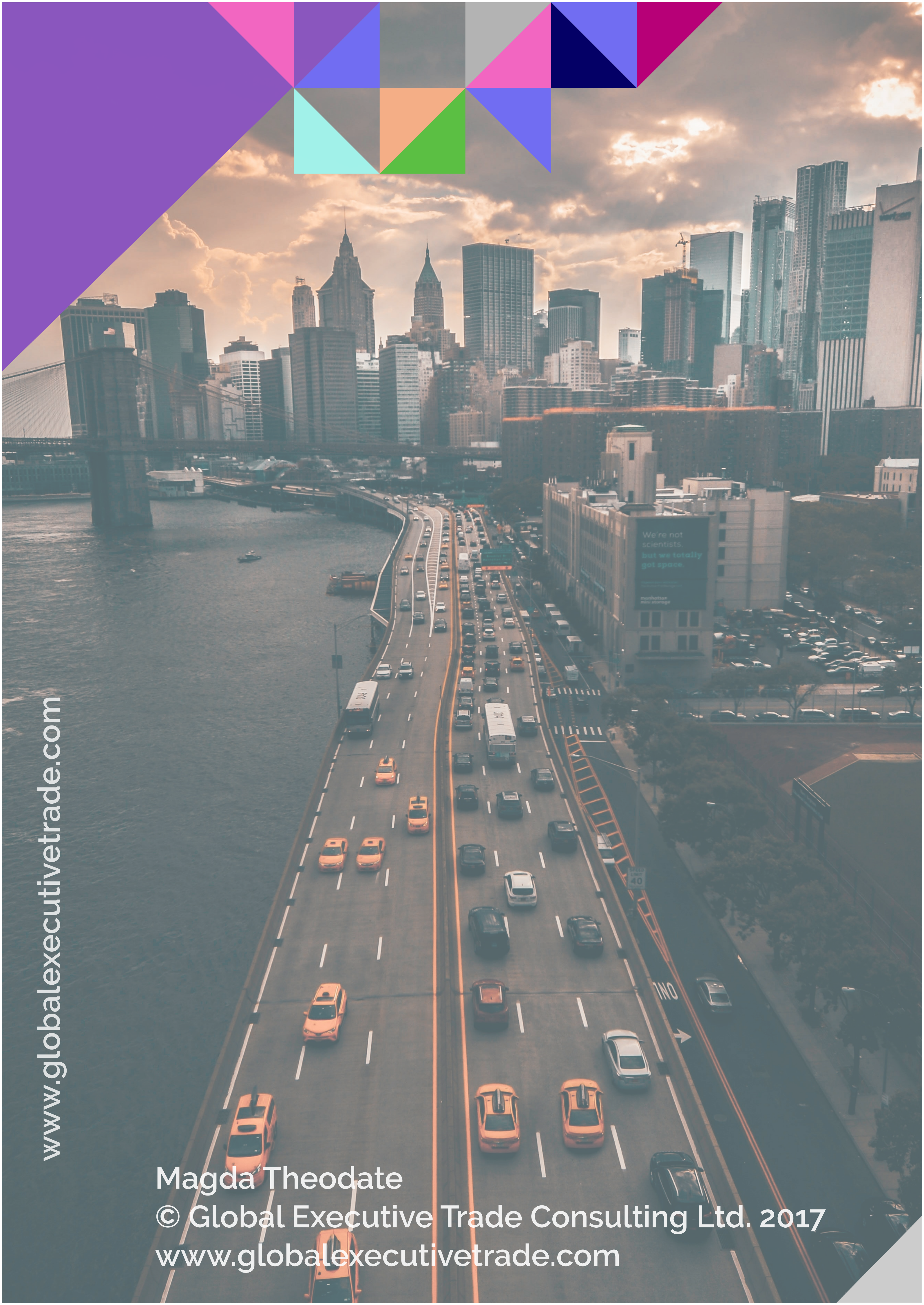
U.S. Office of Trade and Economic Analysis, Department of Commerce Jobs Supported by Exports 2016 https://www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_005543.pdf

Convention on the Privileges and Immunities of the United Nations (the "Convention"), adopted by the General Assembly of the United Nations February 13, 1946, and which set out specific privileges and immunities for the UN and its staff subject to waiver only by the Secretary General in certain situations.

The Hill, Graham Threatens to Withhold U.N. Funding, March 20, 2015, http://thehill.com/blogs/blog-briefing-room/236395-graham-threatens-to-withhold-un-funding

U.S. implemented changes to Cuba sanctions rules announced officially November 8, 2017 and taking effect on November 9, 2017, see U.S. Treasury Press Release https://www.treasury.gov/press-center/press-releases/Pages/sm0209.aspx

See Supra note 3.



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