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Lawsuits, Claims, and Legislative Implications of the *Deepwater Horizon* Spill

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On April 20, 2010, a fire and explosion occurred onboard the *Deepwater Horizon,* a mobile offshore drilling unit owned by Transocean Ltd. and, at the time, operated for BP Exploration & Production, Inc. ("BP"). On April 22, 2010, the *Deepwater Horizon* sank, resulting in an uncontrolled flow of hydrocarbons from the wellhead into the Gulf of Mexico. As of the date of this article, BP is still trying to stem the flow of the oil and has reportedly spent over $3.1 billion responding to the ruptured oil well, including costs of the spill response, claims paid, and grants to the Gulf states. To date, BP has taken responsibility for responding to—and cleaning up—the spill and has established a process to manage claims from the incident, reportedly spending over $162 million in damage claims. As part of this process, BP is making advance payments based on estimates of business losses and has agreed to establish a $20 billion claims fund.

In addition, there have been numerous ongoing administrative and congressional investigations, various Congressional hearings have been held and legislative proposals introduced, and multiple law suits have been filed.

Following the *Deepwater Horizon* incident, many questions and concerns have arisen regarding the liability for damages and claim rights and procedures. If you have incurred losses, including economic losses, as a result of the oil spill, you may be entitled to compensation under the Oil Pollution Act of 1990 ("OPA 90"). In addition, Congress is holding a series of oversight hearings to look into the *Deepwater Horizon* incident and many Members of Congress have already responded by introducing bills to address perceived problems.

CONTENTS

	PAGE
Lawsuits, Claims, and Legislative Implications of the *Deepwater Horizon* Spill	1
Walking the Plank	4
Notes From The Editor: The Expansion of Admiralty Jurisdiction	7
Digital Signatures Revisited	9
MEET BLANK ROME— The Non-U.S. Investor: Unforeseen Exposure to U.S. Gift and Estate Taxation for Non-Resident Aliens	10
Emerging Environmental Requirements for Foreign Transfers of U.S.-Flag Vessels	13
***Erika* Process: French Appeal Court Pronounced Judgment**	16
Money For Nothing: Maritime Salvage For Fun and Profit	18
***Chambers 2010* Awards**	20

Background

In 1990, Congress enacted OPA 90 to increase pollution prevention, ensure better spill response capability, increase liability for spills, and facilitate prompt compensation for clean-up and pollution damage. OPA 90 created the Oil Spill Liability Trust Fund (the "Fund") to provide funds for oil spill clean-up, assessment and restoration of natural resources, and compensation to claimants for removal costs and damages. The Fund is managed by the U.S. Coast Guard's National Pollution Funds Center (the "NPFC"), which is charged with evaluating and determining whether to accept claims made

(continued on page 2)

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***Deepwater Horizon* (continued from page 1)**

against the Fund. At the start of the spill, there was approximately $1.6 billion available in the Fund and a $1 billion limit per incident, of which no more than $500 million may be paid for natural resource damages.

The Coast Guard has designated BP as the "Responsible Party" ("RP") ultimately responsible for payment of both the removal costs and damages due to the incident. The limits of liability for an offshore facility are $75 million in addition to all removal costs; however, the limits of liability can be broken under various scenarios.

Numerous lawsuits have been filed alleging both OPA 90 claims for removal costs and damages, as well as claims for removal costs and damages under general maritime law in a negligence action in a federal or state court. The problem with negligence claims under general maritime law is that it is not a strict liability regime, and generally a defendant is not liable under the general maritime law for purely economic losses in the absence of physical injury to the claimant's person or property, even though such losses may be deemed a foreseeable consequence. Experience has shown with OPA 90 that the claims process discussed below provides a viable and fairly efficient means for recovery without the attendant expenses and uncertainties for recovery associated with litigation.

Claims Procedures

Before filing a claim with the NPFC, the claimant must have submitted its claim to the RP for resolution—unless otherwise directed by the NPFC to file directly against the Fund—and must not be involved in a pending law suit. The RP is authorized to make interim payments, but if the RP denies the claim or fails to pay it within 90 days, the claim may be submitted to the NPFC. Claims associated with removal costs must be submitted within three years of the completion of all removal actions related to the incident. Claims for all damages must also be submitted within three years of the date of injury (from the time the injury was reasonably discoverable with the exercise of due care). Claims that are settled with the RP may not be submitted to the Fund for reimbursement of a greater amount. However, if partial settlements are received from the RP, *e.g.,* only a portion of the claim was resolved, subsequent claims may be submitted to the Fund for reimbursement. Such partial claims must be clearly documented as to what portion of the claim was paid and/or not paid by the RP.

Upon receipt of a claim, the NPFC reviews it for completeness and may request additional information from the claimant. Once the NPFC makes a determination with regard to the claim, the claimant must accept or reject the determination within 60 days. More details concerning claims procedures may be found under the NPFC's website at: www.uscg.mil/npfc/claims/.

On June 16, President Obama and BP announced that BP established a $20 billion claims fund for the incident. The fund will be available to satisfy legitimate claims, including natural resource damages and state and local response costs. Fines and penalties will be excluded from the fund and paid separately. Payments from the fund will be made as they are adjudicated by an Independent Claims Facility ("ICF") set up

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for this purpose. Standards for claim adjudication will be developed and published in the near future. Dissatisfied claimants maintain all current rights under law, including the right to go to court or to the Fund. Processing details for this mechanism are still being worked out.

Claims for Economic Damages

Among the compensable damages specified in OPA 90 are damages arising from economic loss. Specifically, RPs are liable for "[d]amages equal to the loss of profits or impairment of earning capacity due to the injury, destruction, or loss of real property, personal property, or natural resources. . . ." One of the major concerns arising out of this incident is whether parties will be able to seek compensation and reimbursement for such things as vessel delays, diverting from original plans, chartering alternative vessels, and other similar actions resulting in lost profits or earning capacity. Although the Coast Guard will not pay claims for demurrage or contractual charter party disputes per se, once the dispute has been settled between the subject parties, the party suffering an economic loss due to lost profits or earning capacity may have a viable claim under OPA 90.

Congressional Oversight and Legislation

In response to the *Deepwater Horizon* incident, numerous hearings have been held—and will continue to be held—with a focus on the economic and environmental effects of the spill, as well as the impact of the oil rig explosion on offshore oil and gas development policy. Members of Congress have already introduced over 100 bills to address various aspects of the spill. Various Congressional committees are now starting to take action to consolidate and consider various bills. For example, H.R. 5629, sponsored by Congressman Oberstar and under consideration by three committees, would among other things, repeal limits of liability, increase the minimum level of financial responsibility for an offshore facility to $1.5 billion, authorize recovery for non-pecuniary damages and human health injuries, require all vessels engaged in OCS activities to operate under the U.S. flag and be 75% U.S. owned (and a Mobile Offshore Drilling Unit ("MODU") would also have to be built in the United States), and substantially revise the oil spill response planning and safety regimes for vessels, facilities, and MODUs.

Notwithstanding the advance of H.R. 5629, conflicts have emerged over the question of who should be in charge of the oversight of the spill. Chairman Oberstar's committee understandably puts the Coast Guard in charge. Chairman Rahall of the House Natural Resources Committee questions whether that is correct and whether an official in the Department of the Interior should have that responsibility consistent with the responsibility for Outer Continental Shelf resources. There is also continuing concern by a number of Members of Congress over broader unintended consequences for liability having nothing to do with the oil spill such as for cruise lines and overflying aviation, approval and use of dispersants, trade secret protections for response techniques, and impacts on small business ability to participate in response and clean up activities, among other concerns. Finally, other committees such as the House Judiciary and Energy and Commerce Committee have yet to make their mark on this legislation.

Conclusion and Recommendations

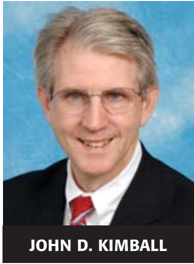
If you have suffered any of the aforementioned damages as a result of the *Deepwater Horizon* incident, you may be entitled to compensation. BP has established 25 claims centers and a 24-hour, toll-free claims hotline at (800) 440-0858, and the **Deepwater Horizon Unified Command** has established a website providing detailed information about the incident at www.deepwaterhorizonresponse.com and www.restorethegulf.com. Similarly, if you have a technology or assets that you think would be effective in the response and cleanup, BP and the Coast Guard has set up procedures for submittal of those ideas for evaluation and approval.

We recommend you continue to monitor the implementation of the new ICF funded by BP. We also recommend you contact your counsel with regard to claims to fully understand your rights.

With regard to legislation, although it is impossible to predict exactly what legislation will ultimately be enacted, it is a virtual certainty that a new pollution regime will emerge. In fact, there are indications that the House leadership will push for House approval of a *Deepwater Horizon* bill before the August 2010 recess and that the Senate will take up a bill in September 2010. Accordingly, any person or entity involved in offshore oil and gas exploration, development, production, or the movement of goods by sea will be affected by this new pollution regime and should at a minimum continue to monitor these developments or engage in the legislative development of the new regime as appropriate. Consequently, we recommend you monitor proposed legislation and consider possible action to protect your interests. It is highly likely that some legislation will be enacted before the end of the year. ■

Walking the Plank

BY JOHN D. KIMBALL[1]



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Editor's Note: This article was originally prepared as a speech given by Mr. Kimball at the Connecticut Maritime Association's ("CMA") Shipping 2010 Conference on March 24, 2010.

In the pirate tradition, walking the plank was a preferred method for disposing of unwanted prisoners when a ship was seized. Usually, the prisoner's descent to death was hastened by tying a heavy weight to his body. Some historians suggest that pirates of old thought eliminating prisoners by this means was not actually murder since no one laid a hand on them to cause their death. More realistically, it most likely was the quickest way of discarding seamen who were not useful to the pirates as hostages.

This small piece of pirate history may serve as a backdrop to the narrow question to be discussed in my short talk today of whether our government and the United Nations should prohibit the payment of ransom to pirates to secure the release of a vessel and her crew. Unlike pirates of old whose goal was to capture a ship and its cargo, the pirates of Somalia have worked on the basis that their greatest reward will come from holding the crew hostage and demanding a large ransom payment. This is a question which has been the subject of much discussion and has gained currency recently from a headline article on the front page of *Lloyd's List*.[2]

It is a point that warrants discussion. The scourge of piracy in the Gulf of Aden has claimed many victims in the last two years and, despite a significant and very costly military effort, the problem remains and certainly has not lessened. The pirates show no signs of giving up. While this CMA Shipping 2010 Conference has been proceeding, at least four ships have been captured by Somali pirates. There is historical precedent for banning ransom payments to pirates, and a compelling argument can be made in favor of the idea. My own conclusion, however, is that making ransom payments illegal is not likely to deter Somali pirates. Instead, it could take us back to the age old problem of pirates forcing their hostages to walk the plank, if necessary, to up the ante and increase the pressure on a ship owner to pay up. Except in the modern era, scenes of this happening would likely fill the internet.

The Pirate Problem

This audience needs no introduction to the pirate problem. I daresay some in the audience may have had direct experience with pirates prowling around the Gulf of Aden.

Piracy and ransom payments are not a new problem. Julius Caesar himself was seized by pirates in 75 B.C., and released after ransom was paid. Piracy on the high seas was a major preoccupation during the early years of the American republic; by 1800, the United States was paying about 20% of total federal revenues to the Barbary States as ransom and tribute.[3] This only ended when the U.S. navy built up a fleet of warships able to take on the pirates.

The International Maritime Bureau's Piracy Reporting Centre ("IMB PRC") has reported a total of 406 incidents of piracy and armed robbery in 2009, with attacks by Somali pirates accounting for 217 of the total.[4] In addition, in 2009, 49 vessels were hijacked, of which 47 were captured by Somali pirates. 120 vessels were fired upon, 1,052 crewmembers were taken hostage, and 76 crewmembers were either injured or killed. All of this took place despite the presence of the world's navies around the Gulf of Aden, which increased significantly beginning in the spring of 2009.

According to experts on the subject, "[i]n 2008, ransoms would have averaged between $500,000 to $1 million. In 2009, ransoms were between $1 million and $7 million and…a rough estimate [indicates] that the average is now $2 million."[5]

The largest reported ransom to date was paid in January 2010 to secure the release of the tanker *MARAN CENTAURUS,* which was laden with two million barrels of oil when it was hijacked by Somali pirates in November 2009 near the Seychelles in the Indian Ocean. The vessel was released only after an aircraft delivered a ransom payment believed to be between $5.5 million and $7 million.

There can be little doubt that the payment of ransom has contributed to the problem. For otherwise unemployed young men in Somalia, the prospect of getting a share of a multi-million dollar ransom payment far outweighs the comparatively low risk of being shot, caught, or otherwise confronted by the world's navies. Each ransom paid only encourages pirates to demand more, thus, further perpetuating the problem. This is a principal reason behind suggestions that ransom payments should be illegal.

In addition to paying increased insurance premiums to cover ransom payments, ship owners are also negatively impacted by rising operational costs due to higher wages paid to crews to transit the higher risk areas, and delays caused by longer transit times or diversions to avoid the area altogether.

According to *Lloyd's List,* vessels electing to transit around the Cape of Good Hope to avoid piracy in the Horn of Africa incur hundreds of thousands of dollars in increased fuel costs per trip and an additional seven to ten days of

transit time. When this occurs, "both the shipper and the consumer are ultimately impacted due to higher operating costs and the delays in the supply chain."[6]

As the piracy problem has escalated, so has the development of specialized insurance policies created to respond to this increased risk. It is reported that the cost of kidnap and ransom insurance in 2009 was 10 times more expensive than it was in October 2008 for ships transiting the Gulf of Aden.[7] These numbers may not be precisely up to the minute, but it has been reported that a ship owner can obtain up to $3 million of cover for the ship and the crew for a maximum of five or six days for a premium of $4,000 to $5,000.[8] The shipping and insurance industries have adapted very quickly to the reality of having to pay ransom, regrettably as a virtually normal cost of doing business. It is accepted that ransom may be treated as a general average expense and the cost will be spread among all parties to the venture.

The insurance industry's readiness to insure against ransom undoubtedly has contributed to the piracy problem and no doubt has led to a spike in ransom demands. In turn, this has led to an increase in attacks, since payments enable the pirates to recruit more pirates and buy more sophisticated weapons and equipment.[9]

By virtually all accounts, the Somali pirates appear to be motivated by money, not ideology, and the continued payment of ransom fuels this affront to maritime navigation. The question is, will the attacks end if governments make the payment of ransom to pirates illegal?

Ransom Payments

At a Security Council Debate on Piracy and Somalia held on November 18, 2009, Ambassador Rosemary A. DiCarlo, Alternate U.S. Representative for Special Political Affairs, remarked "[the United States is] concern[ed] that ransom payments have contributed to the recent increases in piracy and [the United States] encourage[s] all states to adopt a firm 'no concessions policy' when dealing with hostage-takers, including pirates."

While many countries, including the U.S., do not make or facilitate substantive concessions to hijackers—including the payment of ransoms to terrorists and pirates—very few countries, if any, actually have laws making it illegal for private parties, such as ship owners and insurance companies, to pay ransoms. It is legal in the U.S. and England to pay ransom to a pirate. Countries that do have laws prohibiting ransom payments, such as Italy and Colombia, have not had much success in deterring the attacks or the subsequent ransom payments.

Historical Precedent

There is historical precedent for establishing legal prohibitions against ransom payments. England, France, and other European countries formerly had laws that banned ransom. These laws, however, were repealed long ago.

The easiest solution for outlawing ransom payments to pirates would be to redefine "piracy" as an act of "terrorism." One vehicle for doing so would be to modify existing Security Council resolutions and U.S. laws that prohibit payments to terrorist groups. Making ransom payments illegal would be enormously difficult and, to be effective, require approval by the U.N. Security Council. By doing so, ransom payments to pirates will be deemed illegal under the prohibition against furthering terrorism. For instance, payment of ransom to pirates is not illegal as a matter of English law.[10] However, payments that are known, or reasonably suspected, to be used for "terrorist purposes" are illegal and punishable by fourteen years in prison. "Terrorism," under the United Kingdom's Terrorism Act of 2000, is defined as the use or threat of action designed to intimidate the government or the public for the purpose of advancing a political, religious, or ideological cause.[11]

As a matter of international law, however, piracy is not terrorism. Indeed, the two are quite distinct and the difference is important. Under Article 101 of the United Nations Convention on the Law of the Sea, piracy is defined as "illegal acts … committed for private ends …." The aim of pirates is simply to make money, whereas terrorists have the wholly different goal of destroying governments and the world economy. Therefore, laws aimed at those who make payments to terrorists, as currently defined, do not apply to ransom payments paid to Somali pirates. Governments should be reluctant to change their laws in order to redefine piracy as an act of terrorism unless—and until—evidence is provided that proves that pirate ransom payments are, in fact, funding terrorist organizations.

One key problem with making pirate ransom payments illegal is the need for international cooperation to make the measure effective. In the absence of wide international acceptance of a ban, the problem will continue to persist.

While it is more realistic to tackle the problem at a national level, governments may find that they do not have the support from shipowners and the insurance industry who are pragmatic and prefer paying ransoms to bloodshed. As the English Commercial Court held in a recent opinion dated February 18, 2010, "[n]o one favors the payment of ransom, but the alternative of leaving the vessel, its cargo, and

(continued on page 6)

Walking the Plank (continued from page 5)

especially its crew in the hands of pirates is significantly worse." Moreover, attempting to restrict ransom payments may be problematic for a number of reasons.

Reasons for Not Making Ransom Illegal

1. Enforcement would be very difficult.
2. It would criminalize what may be the only action available to ship owners and their insurers to free captured crew members.
3. It would escalate the problem by forcing pirates to take even more drastic action than we have seen to force their demands. Seeing even one seaman who is forced to walk the plank because of a refusal to pay ransom would be one too many.
4. It is not likely to solve the problem.
5. There are better solutions. Our governments have done a commendable job on many different fronts to prevent pirate attacks. These efforts should continue to be the main focal point for dealing with the problem.

   Our governments also should be making a concerted effort to prosecute pirates who are captured. The *Maersk Alabama* prosecution in the U.S. is notable. The U.S. government also has been working with Kenya and helping to fund its efforts to prosecute and convict pirates and this is likely to have a greater impact than trying to shut-off ransom payments. There was a positive development recently with the successful prosecution and conviction of 8 Somali pirates in Kenya, all of whom received 20 year prison sentences. According to *Lloyd's List,* this was only the first of 12 major piracy cases working their way through the Kenyan judicial system. These prosecutions should be helpful in deterring piracy.

For all of these reasons mentioned above, I urge government leaders to keep the focus on prevention and prosecution, and not on criminalizing the only means that may be available to a ship owner to secure the release of the vessel and crew if captured by pirates.[12] ■

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1. Partner, Blank Rome LLP. The author wishes to thank Lauren Wilgus and Marija Pecar for their assistance in the preparation of this presentation. The views stated in this paper are solely the opinion of the author and should not be considered the opinion of Blank Rome LLP or our clients.
2. "High Court clarifies legality of ransom payments—Move comes amid rumors that U.S. is planning to outlaw ransom payments to Somali pirates," *Lloyds List,* February 22, 2010. *See also* "UN should ban ransom payments," by Fred C. Ikle, *The Washington Post,* April 15, 2009; and "U.S. Condemns Ransom Payments to Pirates," *The Somaliland Times (Issue 408),* November 2009. As a result of the conflict with the Barbary pirates, Thomas Jefferson advocated an international treaty banning ransom, *see* "America and the Barbary Pirates: An International Battle Against an Unconventional Foe," by Gawalt, *The Thomas Jefferson Papers.*
3. Statement of Under Secretary of Defense, Michèle Flournoy, in her opening statement before the Senate Armed Services and Commerce Subcommittee on May 5, 2009.
4. *See* "2009 Worldwide piracy figures surpass 400" dated January 14, 2010 at http://www.icc-ccs.org/index.php?option=com_content&view=article&id=385:2009-worldwide-piracy-figures-surpass-400 &catid=60:news&Itemid=51.
5. As reported by Simon Goodley in an article entitled "Piracy A Growing Threat to Shipping Trade on the High Seas" published in *The London Evening Standard* on February 11, 2010.
6. Acting Deputy Administrator James Caponiti's February 4, 2009 statement before the U.S. Coast Guard Sub-Committee on Transportation and Infrastructure of the U.S. House of Representatives on International Piracy.
7. *See* "Piracy driving up kidnap and ransom rates: Aon" dated April 9, 2009 at http://www.businessinsurance.com/article/20090409/NEWS/200015933.
8. *Id.*
9. *See* http://www.marad.dot.gov/documents/Countering_Piracy_Off_The_Horn of_Africa_Partnership_Action_Plan.pdf
10. *See Masefield AG v. Amlin Corporate Member Ltd.,* [2010] EWHC 280 (Comm)(February 18, 2010)(the payment of ransom was formerly illegal in England under the (now repealed) Ransom Act of 1782).
11. *See* United Kingdom Terrorism Act 2000 at www.opsi.gov.uk.
12. Subsequent to the presentation of this paper at the CMA Shipping 2010 Conference on March 24, 2010, on April 13, 2010, President Obama issued an executive order imposing economic sanctions against persons contributing to the deteriorating situation in Somalia, including acts of piracy in the waters off of Somalia. The executive order freezes the assets of certain persons who are identified as "specially designated nationals" and prohibits U.S. persons from doing business with these individuals. Two persons on the list of specially designated nationals are known pirates. The executive order does not contain a general ban on the making of ransom payments to Somalia pirates. However, the order could affect ransom payments to the extent they involve the two identified pirates or their associates. *Please see Blank Rome's April 2010 Maritime Developments Advisory* "New U.S. Sanctions Against Somalia Terrorists and Piracy and Terrorism" at www.blankrome.com/index.cfm?contentID=37&itemID=2225.

Notes From The Editor: The Expansion of Admiralty Jurisdiction

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In recent years, we have seen a trend of expansion of the federal court's admiralty jurisdiction in a number of different areas. To a large degree, this has been an offshoot of two fairly recent decisions of the Supreme Court, which many have construed as representing a trend of widening the federal maritime jurisdiction.

In *Exxon Corp. v. Central Gulf Lines,* the Supreme Court reversed a nearly 150-year-old "bright line" rule that agency contracts were excluded from the admiralty jurisdiction, holding that such contracts should be considered maritime where "the services performed under the contract are maritime in nature." *Exxon* involved a claim by a bunker supplier that supplied bunkers domestically and arranged bunkers internationally as an agent through local suppliers. Under the "traditional" rule, claims under the former arrangement were maritime, whereas claims under the latter were not. The Supreme Court reversed this rule, finding that the nature and subject matter of the two arrangements were essentially identical and holding that both were maritime. This ruling has reopened the possibility that many other kinds of agency contracts traditionally outside the maritime context might now be considered maritime.

In *Norfolk Southern v. Kirby,* the court considered the question of whether bills of lading issued for a multi-modal transport involving both an ocean carriage and an over-land carriage should be construed under the federal maritime law or state law when the cargo is damaged during the over-land portion of the carriage. The Court held that the multimodal carriage was "essentially maritime" even though it also involved an over-land leg, and thus the entire carriage was governed by the federal maritime law.

One fascinating side-effect of the recent and now deceased Rule B EFT-attachment craze was to put the development of maritime law concerning admiralty jurisdiction into "fast forward" mode. Since one of the two key requirements of Rule B is that a claim must be "maritime," Rule B plaintiffs constantly strove to test the outer boundaries of the admiralty jurisdiction. Some of these attempts were, perhaps surprisingly, successful. Others were not but may well foreshadow future expansions by the Supreme Court.

Shipbuilding and Ship Constructions Contracts

People are often surprised to learn that contracts for the construction and for the sale of a vessel are not considered to be within the admiralty jurisdiction. Intuitively, it is difficult to see how either kind of contract is not "essentially maritime in nature" within the meaning of the *Exxon* and *Kirby* Supreme Court cases. But long standing precedent, from the Supreme Court in the case of shipbuilding contracts, and from the Circuit Courts of Appeal in the case of ship sale contracts, has held that these kinds of contracts are not maritime.

In *Kalafrana Shipping Co. v. Sea Gull Shipping Co. Ltd,* one brave district court judge concluded that *Kirby* and *Exxon*—as well as a recent Second Circuit decision that had applied their reasoning to construe a commercial general liability insurance policy as maritime based on the subject matter of what was being insured—gave her sufficient cover to announce a change in the rule insofar as ship sale contracts were concerned. Thus, she allowed a Rule B attachment in connection with a dispute under such a contract.

Numerous other district judges considering the identical question thereafter, however, declined to follow the decision in *Kalafrana*—not necessarily because they disagreed with its interpretation of *Kirby,* but on the grounds that they were constrained by prior precedent of the Second Circuit, which they concluded had not actually been overruled by *Kirby* and *Exxon*. This issue was on appeal to the Second Circuit in several cases at the time *Shipping Corp. of India v. Jaldhi* was announced and, as far as I understand, all of those appeals died an untimely death before this jurisdictional issue could be considered by the Second Circuit.

The Second Circuit did get the chance to consider the shipbuilding contract issue in *Primera Maritime Limited v. Jiangsu Eastern Heavy Industry Co. Ltd.* None of the district courts had been courageous enough to conclude that *Exxon* and *Kirby* had actually overruled the old Supreme Court precedent holding that a ship sale contract is not maritime, although the point was argued in several cases to the lower courts. On appeal, the Second Circuit observed that the plaintiff was "correct to point out that the conceptual approach taken in those cases suggests that modern principles disfavor *per se* admiralty rules based on the site of the contract's formation or performance." Ultimately, however, the Second Circuit was not prepared to conclude that the Supreme

(continued on page 8)

Notes From The Editor (continued from page 7)

Court's earlier precedent had been overruled, concluding in its "summary order" that "[u]ntil the Supreme Court declares that contracts for ship construction are maritime in nature, disputes arising from such contracts will not give rise to the federal courts' admiralty jurisdiction." So, perhaps this issue is just waiting for the right case to take all the way to the Supreme Court.

Forward Freight Agreements

Another area where Rule B drove the development of the law on maritime jurisdiction was in the context of Forward Freight Agreements, or FFAs. FFAs have been described as a contractual commitment to "pay the difference between a price agreed today and the future price of moving a product from one location to another, or for the future price of hiring a ship over a period of time." FFAs are financial instruments that were created to allow maritime parties to hedge market risks in the shipping freight market, though of course there is no requirement that a buyer or seller of FFAs be a maritime party, and the ultimate obligation is to pay or receive money under the agreement, and never to actually operate a ship or carry cargo. Numerous district court decisions have found FFAs to be maritime contracts.

The Second Circuit has not had the opportunity to weigh in on this issue yet, but I think there are some who might legitimately question the correctness of those decisions. While it is true that FFAs are linked to ocean freight values and are certainly used by parties in the shipping industry to hedge their freight positions, FFAs are in their essence financial derivatives, not pegged to any actual carriage of cargo or other actual maritime commerce except insofar as it may impact indexed freight rates. And certainly, there is nothing that limits FFAs to use by the maritime industry. In any event, I think it is an open question whether the appeals courts will ultimately agree with the district courts on this issue.

Commodity Sales Contracts

Another area where the district courts got a bit giddy was with commodity sales contract. There were quite a few cases dealing with these kinds of contracts, and in most cases the dispute involved a contract for the sale of a given commodity in which the buyer had some involvement in nominating a vessel or, for instance, in undertaking to be responsible for demurrage at the discharge port. Plaintiffs argued that when disputes arose under the "maritime" component of the contract—*e.g.,* over the buyer's obligation to pay demurrage —that part of the contract at least was a maritime contract thus giving the court admiralty jurisdiction.

This argument met with mixed results in the district courts. The early trend seemed to be away from seeing these kinds of contracts as maritime, but as matters progressed it seemed that the tide turned and the decisions began to more uniformly agree that claims under the "maritime" terms of a sales agreement do give rise to maritime jurisdiction.

As with FFAs, a number of pending appeals suffered early termination as a result of *Jaldhi.* The Second Circuit did address this issue in *Tradhol Int., S.A. v. Colony Sugar Mills Ltd.,* however, and found that the plaintiff in that case had failed to establish either how the "maritime" elements of the claim were severable or how the non-maritime elements were "incidental". Only time will tell whether this burden can ever be met.

Multi-Modal Transport Contracts

The latest word on the subject of maritime jurisdiction came as recently as June 21, 2010, when the Supreme Court decided *Kawasaki Kisen Kaisha Ltd. v. Regal-Beloit Corp.* ("K-Line"). That decision answered the question—closely related to the issue decided in *Kirby*—of whether COGSA should govern in respect of a claim relating to a multi-modal carriage involving ocean carriage, where the cargo is damaged on an inland rail leg that ordinarily would be covered by another federal statute, the Carmack Amendment.

In *K Line,* cargo was being shipped from China to Chicago under through bills of lading issued by the ocean carrier K Line. The carriage involved inland transport on a train operated by Union Pacific Railroad, arranged by K Line, and the UP train derailed in Oklahoma in April 2005 causing substantial damage. Suit was filed in California, and the district court found that the entire carriage was covered by COGSA and enforced a Tokyo forum selection clause in the bill of lading. The Ninth Circuit reversed, finding that by issuing a through bill of lading and contracting for a railroad to transport the goods from Long Beach to Chicago, K Line had "engaged in railroad transportation" governed by the Carmack Amendment. Thus, COGSA's package limitation was inapplicable and the Carmack's stricter forum selection regime invalidated the forum selection clause.

The Supreme Court reversed the Ninth Circuit's ruling, finding its earlier decision in *Kirby* to be closely analogous and ruling that the Carmack Amendment does not apply to inland segments of a multi-modal shipment from overseas under a through bill of lading. Rather, "Congress considered such international through bills and decided to permit parties to extend COGSA's terms to the inland domestic segment of the journey."

Quoting *Kirby,* the *K-Line* Court observed that "[t]he international transportation industry clearly has moved into a new era—the age of multi-modalism, door-to-door transport based on efficient use of all available modes of transportation by air, water, and land." Based on the decisions in *Kirby* and *K-Line,* it appears that this new era largely will be governed by maritime law. ■

Digital Signatures Revisited

BY GLEN T. OXTON

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It has been ten years since E-Sign—the federal law validating electronic signatures—was adopted, yet there has been little use of them in maritime and other transactions. Lack of familiarity, trust, and comfort in a new process that is fundamentally different from traditional signatures has delayed progress toward electronic contracts. As businesses shift to electronic recordkeeping, however, the need for digital signatures will become increasingly compelling. Deciding how to proceed requires consideration of practical, legal, and technological issues.

E-Sign validated "electronic signatures" are defined as an electronic sound, symbol, or process associated with a contract or other record by a person with the intent to sign the record. 15 U.S.C. § 7006. Digital signatures are a subset of electronic signatures and are more elaborate and secure than a simple symbol or typed name that might be used as an electronic signature. Under such a broad validation, the issue of validity of an electronic signature will rarely arise. The real issue is a question of evidence and proof—whether a particular electronic signature method will provide a party with the means to readily establish the genuine text of the document and the identity of the signatories in the event of a dispute. A simple method could be used for such things as internal documents, and a more elaborate one for important contracts.

The fundamental difference between paper and electronic documentation of a deal is that, in the electronic world, there are no original documents. In the paper world, each party would be given a signed original of the contract that would be stored in paper form. If a discrepancy in contract language later surfaced, each party would rely on its original document to establish the terms of the contract. If necessary, the paper contracts would be examined to detect alterations.

In the absence of a paper original, the parties could still establish the chain of custody and control of an electronic document, but in the absence of a digital signature, it is much more difficult to establish that an unauthorized change was made to the document.

The typical method of documenting a deal today is half electronic. The parties exchange electronic drafts and red-lined copies until an agreement is reached on the document. Then, either the entire document or the signature pages are printed and circulated physically to the parties for signature. At the time of signing, there is no efficient way to determine

(continued on page 12)

The Non-U.S. Investor: Unforeseen Exposure to U.S. Gift and Estate Taxation for Non-Resident Aliens

BY SUSAN PECKETT WITKIN

Editor's Note: *This article continues a series aimed at introducing some of our other practice groups at Blank Rome. In this article, contributed by our Private Client Group, we discuss gift and estate tax issues as they pertain to non-resident clients.*

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Often, an individual who is neither a resident nor a citizen of the U.S. (referred to here as a "non-resident alien" or "NRA") is presented with an opportunity to invest in U.S. real estate, tangible property such as art or collectibles that will be located in this country, stock of a U.S. company, or as a partner in a limited partnership or member of a limited liability company ("LLC"). Typically, the savvy NRA investor knows what he must do to avoid being treated as a U.S. resident for income tax purposes. But, he may not be aware that these investments could attract one of the three federal transfer taxes, namely, the federal gift tax, estate tax, and generation-skipping transfer ("GST") tax.

Although the federal estate and GST taxes are in a one-year sunset period and technically do not apply in 2010 to U.S. citizens, U.S. residents, or NRAs, the gift tax remains in effect. The estate and GST taxes will, even without passage of new federal legislation, apply again beginning in 2011, so for simplicity we may assume all three taxes to be in effect.[1]

Gifts by NRAs will trigger current gift taxation if the subject of the gift is real property or tangible personal property that is situated in the U.S. or, as we sometimes say, has a U.S. situs for federal gift tax purposes. Basically, this means real estate and tangible property (like the furniture in a residence, jewelry, art, a car, a boat, or a plane) that is physically located in this country at the time of the gift. Thus, if the NRA who owns a Florida residence decides to transfer it by gift to his son, or if he decides to gift some of the home's contents to his daughter, the gift tax will be triggered. There is a modest annual exclusion from gift tax generally available for gifts to donees other than a spouse—in 2010 this amount is $13,000 per donee. The exclusion is increased to $134,000 if the gift is to a NRA spouse. (If the spouse is a U.S. citizen, an outright gift to the spouse, as well as certain transfers in trust, would qualify for the marital deduction and would be gift tax-free.) In all cases, the fair market value of the gift in excess of the annual exclusion is taxable, and the maximum tax rate currently in effect is 35%.

In contrast to this rule for real estate and tangibles, shares of stock in a corporation are considered to be intangible personal property and, regardless of situs, are not subject to gift taxation upon lifetime transfer by the NRA (unless the NRA is a covered expatriate, in which case different rules will apply during the 10-year period following expatriation).

The same property that is taxable if given away during the NRA's life is subject to federal estate tax if owned by the NRA at the time of his death. In addition—and subject to any different rules set forth in a governing estate tax treaty between the U.S. and the NRA's country of domicile—intangible personal property with a U.S. situs (i.e., intangible personal property situated or deemed situated in the U.S. at the NRA's death) is taxable under the federal estate tax laws, with only a $13,000 credit against the tax that is due. If the property passes to the NRA's spouse (who presumably is also a NRA), it is subject to current estate taxation under the above rule unless the marital deduction is obtained by transferring the property into a trust that is held for the lifetime benefit of the spouse. Even in this case, the estate tax is merely deferred and the property held in trust will be estate taxable at the surviving spouse's death.

As noted above, shares of stock issued by a corporation constitute as intangible property. If the corporation is a U.S. corporation, then the stock has a U.S. situs, and if it is owned by the NRA at the time of his death, then it will be subject to federal estate taxation regardless of where the stock certificate or other physical evidence of ownership is located. A partnership interest and a membership interest in a LLC are also intangible personal property under U.S. laws, but the application of the federal estate tax is not as clear as in the case of a corporation. Generally speaking, however, if the partnership or LLC does not terminate upon the NRA's death, and is also a valid and continuing entity, then the situs of its underlying assets at the NRA's death would not be relevant, but the U.S. may seek to assert an estate tax based on either the place where the entity's business is conducted or the domicile of the NRA partner. Therefore, the NRA should be cognizant of the potential estate tax exposure when investing in partnerships and LLCs.

Other examples of intangible personal property are interests in patents and trademarks, debt instruments, bank accounts, certificates of deposit, and cash on hand in a brokerage account. Accounts held in U.S. banks are deemed non-U.S. situs property so long as these are not effectively connected with the conduct of a U.S. trade or business; but a brokerage firm that is not considered to be a bank, and funds on deposit in the NRA's name at the time of the NRA's death, will be deemed U.S.-situs property and subject to federal estate taxation. Debt instruments issued by U.S. persons—the interest on which qualifies as portfolio interest for federal income tax purposes—will be deemed situated outside the U.S. and will not be subject to federal estate taxation. Patents, trademarks, and certain copyright interests issued or licensed in the U.S. are generally property situated in the U.S., but should be reviewed carefully. Life insurance, whether held in a trust or owned outright by the NRA, is not treated as situated in the U.S. even if the policy is issued by a U.S. insurance company. Often, NRAs will invest indirectly through foreign holding companies or other structures. These should be reviewed by counsel in the U.S. to make sure the structure is sound from the U.S. tax perspective. Care must be taken to review trusts as well. A trust that is established by the NRA, or by a family member and benefiting the NRA, may be subject to U.S. estate taxation at the time of the NRA's death, depending on the interests in, or rights over, the trust property that the NRA held at death; when the transfer occurred; and the type of property that was transferred to the trust.

Perhaps the most common trap for the unwary NRA is investment in U.S. real estate.[2] It is preferable for the NRA to avoid direct ownership in U.S. real estate because a transfer during life will attract a gift tax, and ownership at death will subject the property to estate taxation. Therefore, it is generally advisable to consult with counsel before an investment in a U.S. residence is acquired.
The laws of the NRA's domicile must be reviewed and evaluated, but it is often advisable to have a foreign entity rather than the NRA himself make the purchase. Foreign ownership may not be permissible in all cases, the most notable being the cooperative apartment; typically a foreign corporation will not be permitted to be the purchaser of a co-op. However, foreign entity ownership is generally allowed in the case of a condominium, house, or other interest in real property, including undeveloped land. Once real property is owned by the NRA, it can be transferred to a foreign corporation, for example, and if corporate formalities are observed, this should be effective to block federal estate taxation. (Although there are arguments the IRS may assert at the time of the NRA's death to tax the property if it is still owned by the entity, this strategy is generally offers maximum protection against exposure to federal estate tax.)

This is intended as an overview of general rules. Obviously, each situation's facts and circumstance must be reviewed for planning opportunities.

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1. Since most of the transfers that NRAs contemplate tend to be to a spouse or child(ren), and not to grandchildren, and because the GST is more limited in its application to NRAs, we will not discuss its application here. But, one should be aware that if a transfer is gift or estate taxable, and is made to a grandchild or more remote descendant of the NRA, or to a trust that could benefit such an individual, the GST tax may be implicated as well. Also note that various states impose local estate and/or inheritance taxes that apply in addition to the federal estate tax. While these generally follow the federal rules regarding what is taxable, due to the different approaches of the states, we discuss only federal taxes here. Finally, different tests are applied to determine whether one is resident in the U.S. for income tax purposes or for estate and gift tax purposes. The income tax rules are quite clear, while the estate and gift tax meaning of "resident" is actually one who has a "domicile" in the U.S., a much more amorphous concept. We ignore those differences here as we assume that if someone is a nonresident for U.S. income tax purposes, then he or she does not consider the U.S. to be his or her domicile.

2. Note also that dispositions of interests in appreciated U.S. real property are subject to special income tax rules under FIRPTA (Foreign Investment in Real Property Tax Act) and generally trigger capital gain, unlike dispositions of most capital assets held by NRAs. These rules are outside the scope of this article.

Digital Signatures (continued from page 9)

if the document being signed is identical to the form of the agreed draft. Often, when the signed paper original is received, the parties will return it to electronic form by scanning it for filing and archiving. The scanned document is subject to inadvertent and deliberate alteration.

In contrast, a document that is to be signed digitally may be circulated for signature by e-mail, it can be readily compared to the previous draft, and its integrity will be maintained when archived. If the signed document is altered (other than by adding signatures), the signature software will indicate that the document is no longer identical to the one that was signed.

Digital signatures are generated by software that uses public key encryption systems. Each user has a public key, which is made available to others, and a private key, which is kept confidential. The keys, which consist of a long series of numbers, are unique. Anything encrypted by the private key can be decrypted only by the related public key. A document is signed by using the private key to do an encryption. If a public key will decrypt that encryption, then you know that it was encrypted using the related private key. The identity of the holder of that private key must be established separately as described below.

The encryption that is performed in signing a document is essentially a unique digital fingerprint of the document, known as the "hash." The hash is a mathematical expression of the distribution of the ones and zeroes in the digital form of the document. Signature software verifies the integrity of a signed document by calculating the hash value of the current document and then comparing it to the encrypted hash in the digital signature. If they match, the document has not been altered since the time of signing. Digital signatures do not prevent future alterations to the signed document. Instead, document integrity is established by having the software confirm that the file has not been altered since the time it was signed. The software can detect even the most minute changes to a signed document. Removal of one space from a document, for example, will cause the software to report that the document has been modified.

The most challenging aspect of digital signatures is establishing the identity of the signatory, the holder of the private key. The keys themselves do not provide this information. A separate digitally signed certificate must be obtained that states essentially that "John Smith is the holder of public key 175984236…9." This certificate is issued by a recognized certification authority such as Verisign or Truste. To confirm the identity of the signer, the certificate can be checked online with the issuer who will also verify the period during which the certificate is valid. If the certificate was valid at the time of signing, the identity of the signer is established.

Adobe has simplified the use and management of digital signatures by integrating some of the steps in signing and verifying signatures into its Acrobat software. In Acrobat, a digital signature can be applied to a pdf document. (Other software companies also provide electronic signature systems. Adobe is used as an example here because it developed the portable document format ("pdf") and it has had long experience with electronic signatures. In addition, all the courts that have instituted electronic filing require the use of documents in pdf.)

Adobe has collaborated with security companies such as Verisign, Truste, and GeoTrust enabling them to offer an "Adobe credential." The credential contains a private key and a certificate issued by the security company. Prior to issuing the credential, the security company verifies the identity of the applicant. If the applicant is signing on behalf of an entity, the certificate will reflect such capacity if the entity confirms the applicant's authority to the security company. A fee is charged for issuing credentials. Verisign, for example, charges $595.

The credential itself is contained in a USB token and access is protected by a password. To sign a document in Acrobat, the user would plug the USB token into the computer, invoke the signatures section of Acrobat, and enter a password. Acrobat will then affix a digital signature to the document together with a certificate of the security company.

The Acrobat software is programmed to recognize the certificates of the security companies that issue Adobe credentials. Thus, a recipient of the document can obtain confirmation of the document's integrity and the identity of the signer by using

Acrobat. If the computer is on-line, Acrobat will check the security company's list of expired certificates to ensure that the certificate was valid at the time the contract was signed.

Assuming that the security companies use adequate procedures to verify an applicant's identity and any representative capacity, the Adobe credential provides a secure and reliable digital signature system. Signing in this manner will not be commonplace, of course, until enough people obtain Adobe credentials.

Acrobat also contains a signature generating facility that produces what is known as a "self certificated signature." Such a signature is like a traditional holographic or "wet" signature in that it is not accompanied by any independent verification that it is the signature of the person purportedly signing the document. It does establish the integrity of the document. A graphic of one's wet signature can be attached to the digital signatures applied by Acrobat. If you are dealing with a person whose signature is known to you, a self certificated signature could be sufficient. For an important contract, or one for which the identity of the signatory may need to be confirmed when the signatory is no longer available, a self certificated signature would not be appropriate.

Adobe recently started testing a cloud-based service using its LifeCycle software, called Adobe eSignatures. (LifeCycle is enterprise software that manages workflow and digital signatures. eSignatures essentially permits smaller entities to use parts of the LifeCycle program that is running on Adobe's computers on the Internet, hence in the "cloud.") To use this system, a user registers with eSignatures on the web by providing their name, e-mail address, and a password. eSignatures then confirms the e-mail address by sending an e-mail to the user containing a return link. Once registered, the user can have a document signed by logging into eSignatures, uploading a pdf document to be signed, and listing the e-mail addresses of the other persons whose signatures are required. eSignatures then applies the signature of the first signer and notifies the other signatories that there is a document to be signed at the eSignatures site. The signatories will then either register (which will be followed by confirmation of their e-mail address) or login if they have previously registered. Once logged in, they will be presented with the text of the document and a request that they sign it by clicking a "Sign" button.

Presumably, eSignatures issues signature keys to each registrant, retains them, then applies them to documents each time eSignatures receives authorization on its website from that user to sign a document. From the user's perspective, the process is quick and easy and results in a digitally signed document whose integrity is certified by Adobe. Adobe does not, however, certify the identity of the signatories, which is entirely dependent upon the initiator's providing the correct e-mail addresses of the signatories.

In situations in which e-mail messages are frequently exchanged, sufficient trust can be established that it would not be unreasonable to assume that the person at an e-mail address is who he says he is, particularly if the address follows the usual name@companyname format. If the identity of the signatory is later disputed, it should be possible to obtain information from the company to establish the signatory's e-mail address, even if the signatory is no longer employed. Then the process used by eSignatures would have to be proved. With eSignatures, we progress from having to know a person's signature (as with the self certificated signatures) to needing to know only his e-mail address.

While the ease and convenience provided by eSignatures is attractive, there are some drawbacks. Many parties will be reluctant to upload their contracts to Adobe unless they are assured that unauthorized access is prevented. Because eSignatures presents signatories with a static image of the document, comparison of the document to be signed does not appear to be possible.

A great deal of time and expense could be saved by using digital signatures that would be beneficial for commerce. When delays are reduced, commerce usually increases. Adobe estimates that over $7 billion a year is spent shipping paper documents in order to obtain signatures, most of which could be eliminated by using digital signatures. ■

Emerging Environmental Requirements for Foreign Transfers of U.S.-Flag Vessels

BY JOAN M. BONDAREFF AND R. ANTHONY SALGADO

Background: MARAD's Foreign Transfer Regulations

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In general, the transfer of a U.S.-flag vessel to another registry and/or to a non-U.S. citizen owner requires the prior approval of the Maritime Administration ("MARAD") under 46 U.S.C. § 56101 (which is the current codification of Section 9 of the Shipping Act, 1916, as amended). Specifically, subject to certain exceptions, Section 56101 prohibits the sale, lease, charter, delivery, or other transfer (and any agreement to do so) to a non-U.S. citizen of any interest in, or control of, a U.S.-flag vessel owned by a U.S. citizen and the transfer of a

(continued on page 14)

Foreign Transfers of U.S.-Flag Vessels (continued from page 13)

U.S.-flag vessel to a foreign flag. In addition, the prohibitions of Section 56101 apply to vessels whose last documentation was the U.S. flag.

To address frequent approval requests, MARAD adopted regulations (46 C.F.R. Part 221) that grant general approvals under Section 56101 for certain transfers of U.S.-flag vessels and interests in such vessels to non-U.S. citizens. In general, those regulations permit the sale, lease, charter, delivery, or other transfer of an interest in, or control of, a U.S.-flag vessel to a non-U.S. citizen, provided that the vessel remains documented under the U.S. flag following the transaction and is not operated under authority of a foreign country. Exceptions to this general approval include bareboat or demise charters of U.S.-flag vessels for operation in the coastwise trade and sales for scrapping. In addition, foreign transfers of vessels less than 1,000 gross tons are subject to a general approval subject to certain conditions.

In the case of foreign transfer transactions that are not covered by a general approval, an application must be filed with MARAD, which evaluates them on a case-by-case basis. In evaluating applications, MARAD considers, among other things, the following:

- (i) the type, size, speed, general condition, and age of the vessel;
- (ii) the acceptability of the owner, proposed transferee, and the country of registry or the country under the authority of which the vessel is to be operated; and
- (iii) the need to retain the vessel under U.S. documentation, ownership, or control for purposes of national defense, maintenance of an adequate merchant marine, foreign policy considerations, or the national interest.

46 C.F.R. § 221.15(b)(1). MARAD's approval of an application is usually subject to certain standard conditions, which are set forth in its regulations, and MARAD may impose other conditions it deems appropriate. For vessels that are 3,000 gross tons or more, these conditions typically include continuing restrictions—in the form of a contract secured by a surety bond—on the transfer and operation of the vessel for the remainder of its economic life, which is deemed to be 20 years for tank vessels and 25 years for non-tank vessels subject to extension for rebuilt or modified vessels. These restrictions are generally aimed at prohibiting the vessel from being owned or operated by or in countries such as Cuba and North Korea.

During times of war or national emergency declared by the President, 46 U.S.C. § 56102 applies to foreign transfers, and it is more comprehensive and restrictive than Section 56101. For example, these foreign transfer restrictions also apply to the transfer of interests in vessels that are under construction in U.S. shipyards and to the shipyards themselves.

The penalties for violations of Sections 56101 and 56102 are somewhat severe. In the case of Section 56101, a person who knowingly commits a violation is subject to criminal fines and imprisonment for not more than five years. Civil penalties may also be assessed regardless of whether the violation was knowingly made. In addition, transfers made in violation of Section 56101 are void, and a U.S.-flag vessel may be seized and forfeited to the U.S. government for these violations. Similar penalties apply to violations of Section 56102.

MARAD Arrangement with EPA on Foreign Transfers—TSCA Restrictions

In recent years, MARAD has agreed, on an informal basis, to refer foreign transfers of U.S.-flag vessels requiring its approval to the Environmental Protection Agency ("EPA") for EPA's review of compliance with U.S. environmental laws, in particular the Toxic Substances Control Act ("TSCA"), which is codified at 15 U.S.C. §§ 2601-2629. According to MARAD officials, there is no formal Memorandum of Agreement with EPA on this subject, but one is being currently developed. Therefore, MARAD has undertaken this process as a matter of policy and has not issued any amendments to its foreign transfer regulations formally notifying interested parties that this review will take place. In light of the MARAD regulatory criteria for evaluating foreign transfer applications (quoted above), there does not appear to be a clear basis under the Administrative Procedure Act for the current informal arrangement. Each shipowner seeking to transfer a vessel out of the U.S. flag has been left to their own devices to navigate what has become a cumbersome and unregulated process.

TSCA prohibited the manufacture, processing, or distribution in commerce of polychlorinated biphenyls ("PCBs") one year after the law's enactment in 1977. Under EPA's regulations, the distribution in commerce, including for export, of PCBs at concentrations of 50 ppm or greater is prohibited, unless a waiver is granted. 40 C.F.R. §§ 761.20 and 761.97. Vessels manufactured before 1977 did contain PCBs in transformers, capacitors, and cables, among other places. However, presumably vessels built in the United States after 1978 do not include PCBs and, hence, are not affected by this prohibition.

Several federal court decisions have held that the sale of a vessel containing PCBs is the equivalent of distributing PCBs in commerce and is prohibited under TSCA's restrictions. For example, in the case of the *United States v. M/V Sanctuary,* 540 F. 3d 295 (4th Cir. 2008), involving a former U.S. Navy

hospital ship that the owners wanted to bring to Greece for "refurbishing", the U.S. Court of Appeals for the Fourth Circuit held that EPA has the authority to issue an administrative warrant to inspect the ship at its dock in Baltimore before the ship could leave the country. EPA suspected that the ship contained PCBs.

As a practical matter, EPA's review of a foreign transfer request can take weeks or months, which adds significant time to the MARAD review process. It is up to the shipowner to decide to what extent to comply with any EPA orders for inspection of a vessel. If EPA were to issue such an order, most shipowners would have to retain environmental experts to determine whether their vessels contain PCBs or any other hazardous materials, such as asbestos, over which EPA has jurisdiction. If a shipowner is able to convince EPA that its vessel does not contain any of these materials, the process will be easier.

In the past, EPA admitted that it had no authority over U.S. vessels once they left U.S. territory. In other words, it admitted that there is no extraterritorial effect of TSCA or other environmental laws, unless Congress were to explicitly determine otherwise. Many vessels that are the subject of foreign transfer applications to MARAD are being sold for the purpose of scrapping. However, through MARAD's unofficial arrangement with EPA granting EPA review of a foreign transfer application before MARAD will issue its approval under Section 56101, MARAD has granted EPA new jurisdiction over U.S.-flag vessels, even those that have left U.S. shores.

We have not yet encountered a case where EPA has instructed a shipowner to return a vessel suspected of containing hazardous materials to the United States for scrapping, but this day may yet come. We will then have a test case of the extent of EPA's authority overseas.

What Will the Future Bring for Vessel Scrapping and Sales of U.S. Vessels to Foreign Owners?

In the coming green world, vessels will not be built with any hazardous materials—they will carry certificates that document what is on the vessel that may be hazardous, and a plethora of green shipyards will exist to conduct safe vessel scrapping both here and overseas. This is the future envisioned by the new Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships, negotiated under the auspices of the International Maritime Organization and completed in Hong Kong in 2009.[1] However, this world does not yet exist, so shipowners have to struggle with current conditions.

The Hong Kong Convention, which has only been signed by one party, France, is not yet in force, and will not enter into force until at least 15 nations have signed it. These 15 signatories must represent a combined merchant fleet of no less than 40% of the world's gross tonnage of merchant shipping, and the combined annual ship recycling volume of these nations during the preceding 10 years must constitute no less than three percent of the gross tonnage of the combined merchant shipping of these nations. In other words, we can expect a long wait until the Hong Kong Convention enters into force, unless the major shipping nations make a commitment to its earlier implementation.

In brief, the Hong Kong Convention requires each vessel to carry a certificate that accompanies the vessel throughout its life and identifies any hazardous materials that may be contained in the vessel. PCBs and asbestos are prohibited under Annex I to the Convention; installations containing hydrochlorofluorocarbons ("HFCs") are permitted only until January 1, 2020. The Convention also requires that each member state ensure that ship recycling facilities within its borders conduct ship scrapping in an environmentally sound and safe manner. Removal of hazardous materials must be

(continued on page 16)

Emerging Environmental Requirements for Foreign Transfers **(continued from page 15)**

conducted by properly trained and equipped workers. Flag states are required to ensure that their vessels comply with the Convention's requirements. (For further details of the Hong Kong Convention, see the July 2009 issue of *Mainbrace* at http://www.blankrome.com/index.cfm?contentID=37&itemID=2021.

Until the Convention enters into force and all countries have certified that their shipyards are in compliance with the Convention, shipowners have to decide where to scrap their older vessels. The two options for U.S. shipowners are in the U.S. and overseas. We know that overseas shipyards, particularly in Asia, have been under scrutiny for some of their scrapping practices.[2] On the other hand, there is a scarcity of U.S. shipyards that have been willing to undertake ship scrapping (with the exception of some smaller yards). This leaves U.S. shipowners on the horns of a dilemma.

Conclusions and Next Steps

If EPA continues to step up its enforcement actions against U.S. shipowners under TSCA, Section 56101 and other statutes, shipowners will have no choice but to clean up their vessels before they are sold for scrap overseas. From a legal perspective, MARAD must amend its foreign transfer regulations to make clear to interested parties that it has adopted this new practice. At a recent maritime forum, a MARAD attorney announced that the agency planned to do so. Until the agency amends its regulations and establishes a new procedure, MARAD will have to document the legal authority under which it is imposing the new requirements. The EPA has also issued an Advance Notice of Proposed Rulemaking requesting comments on its reassessment of use authorizations for PCBs.[3] Specifically for the maritime industry, EPA is seeking comments on nine questions about the use of PCBs on vessels.[4]

Eventually, Congress will have to review the new MARAD and EPA requirements to determine if they make sense for the maritime industry and if new legislation addressing the subject is needed. ■

1. The Convention exempts from its coverage warships, vessels of less than 500 GT, and vessels operating throughout their life only in internal waters. Article 3, Hong Kong Convention.

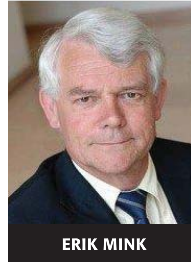
2. http://articles.baltimoresun.com/keyword/alang.

3. 75 Fed. Reg. 17,645-17,667 (April 7, 2010). The comment period closes on July 6, 2010. *See also* "EPA Reviewing PCB Rules and MARAD Foreign Transfer Approvals," *Maritime Developments Advisory,* June 2010, No. 4.

4. 75 Fed. Reg. at 17,665.

Erika Process: French Appeal Court Pronounced Judgment

BY ERIK MINK



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The French Cour d'Appel ("the Court") in Paris was charged with reviewing the judgment of the Paris Tribunal in 2008 concerning the damage resulting from the sinking of the tanker *Erika* off the coast of Brittany, France in 1999. This catastrophe resulted in heavy losses of crude oil and considerable damage along a 400km stretch of the French coast, as well as consequential damage for the local economies. The court case had been initiated by the affected regions as well as by a number of other civil parties.

The Court published the arrest on March 30, 2010. It basically upheld the lower court judgment; but while doing so, it revisited all the fundamental considerations. It should be emphasized that this is a process under criminal law, notably under the French law of July 1983, which establishes that harmful environmental damage caused willingly, or by acts of omission or negligence, is a criminal offence.

The earlier judgement, as confirmed by the Court, breaks new ground:

- this is one of the few cases where the consequences of the collapse and sinking of a vessel were judged under criminal law;
- among the accused parties is the classification society RINA; and
- the boundaries between French law, International Conventions, and European law had to be revisited.

The parties accused of wrongdoings were: the owner of the vessel, Mr. Savarese, acting as director of the company, Tevere Shipping; Mr. Pollara, the executive of Panship Management, in the capacity of operator of the ship; the classification society RINA; and the oil company TOTAL, which was identified as the "real shipper".

The Court established that there is no conflict between the French law on environmental pollution and the MARPOL Convention. According to the Court, the definition of oil pollution under MARPOL is so wide that the sinking of a tanker due to earlier negligence or omissions can be seen as wrongdoing.

The Court also established that the 1992 Civil Liability Convention for Oil Pollution ("CLC") provides coverage for civil liability; but after examining the position of the accused parties, it concluded that:

- while the owner may benefit from civil compensation under CLC, it is not protected for its role under criminal law;
- the operator is not covered by the terms of the CLC and cannot benefit from "channeling";
- the classification society has an equally independent role and cannot be brought under the cover of the CLC; and
- TOTAL, the shipper, was guilty of certain wrongdoings (see below), but can benefit from the "channeling" protection under the CLC.

In an earlier related court case involving *Erika,* the Court also asked advice from the European Court of Justice ("ECJ") concerning the definition of "waste" under European waste legislation. The ECJ determined that the leaking and dispersion of persistent oil at sea, be it in small or large quantities, but with the properties to harmfully damage the environment, is illegal in EU territorial waters if it is clear that such an incident could have been avoided. (This implies that a substance or product when lost during transport could become "waste".) The ECJ pointed out that, according to European law, the "owner" of the "waste" is responsible for "discarding'" the waste in an acceptable manner. If this is not done correctly, the "polluter pays" principle would be applicable.

The Court has not insisted on following ECJ's route, but it determined that French law is not incompatible with European law.

This is not the place to concisely summarize 400-plus pages of the Arrest; but suffice it to state the essence of the judgment below:

- All four parties have been found guilty of "environmental crime", but for different reasons and with different responsibilities.

- The owner knew that the vessel was heavily attacked by corrosion, but he nevertheless requested and obtained the International Oil Pollution Compensation Funds ("IOPC") certificate in order to continue to lease the vessel for further commercial operation.
- The operator had been informed by class of the need for important repairs; some repairs were done, but not enough by far. The Court suggests that the cost of repairs were minimized for commercial reasons, thus inviting disaster.
- The inspector of RINA was familiar with the poor condition of the vessel and the worrying degree of corrosion. Even in the port of departure, Dunkirk, the inspector had indicated that the certificate of compliance may be withheld. The vessel nevertheless was allowed to leave port and the inspection report was faxed later. RINA had, on a number of occasions, issued certificates of compliance without prior inspection. It had also warned the operator and the owner that the safety management system was inadequate, but they failed to take corrective action.
- TOTAL was recognized as the "real shipper." It had established a charter party agreement with the operator. Although it checked vessel compliance under the usual vetting procedure, this internal acceptance had expired and the Court concluded that TOTAL violated its own rules concerning the allowable age of a chartered tanker and its technical condition. It should have been more careful in accepting the vessel for a further transport to Italy. Moreover, the weather conditions were awful, but TOTAL insisted on departure.

On the basis of defining the guilt of each of the accused parties, the Court assessed the fines. The total amounted to 200 million euros, slightly up from the previous judgment. However, the Court also held that TOTAL was exempt from civil liability under the terms of the CLC, while considering that it had already paid compensations on a voluntary basis for a total amount of 170 million euros.

After studying the arrest, all four accused parties decided independently to appeal the judgment further, but several of the civil parties expressed dissatisfaction as well.

Unfortunately, after more than ten years of legal wrangling, one can therefore only conclude with "to be continued". ■

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Money For Nothing: Maritime Salvage for Fun and Profit

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So you are sailing along in your ship, minding your owner's business, when suddenly you come upon a vessel in distress. Under the SOLAS Agreement, you are obliged to assist in saving the lives of those onboard the vessel; but in doing so, you also manage to save the vessel itself from imminent total loss.

This article examines what you should do next to receive your just desserts—and where you should do it.

The British Experience

Under the English common law, as well as in many other British Commonwealth countries, the right to claim for maritime salvage forms part of the admiralty jurisdiction of the High Court. A lengthy and exhausting explanation of the origins and scope of this jurisdiction may be found in the High Court and Court of Appeal decisions leading up to the House of Lords decision in the "GORING" [1988] 1 *Lloyd's Law Reports 397*.

In essence, a person who renders services to a vessel in danger, at sea, or within tidal waters is entitled to be remunerated for having rendered such assistance. The remedy is exercised by way of an admiralty action *in rem* against the owners of the vessel, her bunkers, stores, cargo, and freight at risk, if any. The *in rem* writ of summons that commences the action is served upon the vessel to which the services were rendered, or upon another vessel in the same ownership, while the vessel is physically within the jurisdiction where the writ was issued.

If that jurisdiction is one of those which have incorporated the 1989 International Convention on Salvage into its laws, then once the entitlement to a salvage award is established, the court will proceed to assess the amount of its salvage award using the criteria set out in Article 13 of that convention, namely:

(a) the salved value of the vessel and other property;
(b) the skill and efforts of the salvors in preventing or minimizing damage to the environment;
(c) the measure of success obtained by the salvor;
(d) the nature and degree of the danger;
(e) the skill and efforts of the salvors in salving the vessel, other property, and life;
(f) the time used, and expenses and losses incurred, by the salvors;
(g) the risk of liability and other risks run by the salvors or their equipment;
(h) the promptness of the services rendered;
(i) the availability and use of vessels or other equipment intended for salvage operations; and
(j) the state of readiness and efficiency of the salvor's equipment and the value thereof.

Alternatively, the parties to the salvage claim may opt to have salvage remuneration assessed by way of a private arbitration. By far, the most popular form of contractual salvage assessment is that offered under Lloyd's Open Form of Salvage Agreement "No Cure—No Pay" ("LOF").

This form of salvage contract may be entered into by the parties at any time before, during, or after the services have been performed and, as its name implies, requires success for payment to be due to the salvor. One exception to this principle that "success" is required is where the Special Compensation Protection & Indemnity Clause ("SCOPIC") is incorporated into the LOF2000 form. If SCOPIC is invoked, and should the salvor fail to save the vessel or her cargo, he may still be compensated for his out-of-pocket expenses reasonably incurred in his attempt, plus an uplift of 25% thereon. The rationale behind this is to encourage salvors to continue their efforts to prevent or minimize marine pollution in circumstances where their award under Article 13 of the Convention (which is also applicable to LOF) would not warrant continuing with the services.

The Position in the United States

In the main, U.S. law closely tracks the English law of salvage. Three elements must be proven to be entitled to a salvage award: (1) that the salvage service was voluntarily rendered, (2) that the vessel or other maritime property at issue was in marine peril, and (3) that the salvage was at least partially successful. The law of salvage applies in respect of "navigable" waters that are within the federal court's admiralty jurisdiction. One might think it perverse that there is no entitlement for an award for the "mere" salvage of human life; however, one who acts to save human life, while others simultaneously act to save the damaged vessel, is entitled to share in the salvage award in respect of the vessel.

As one might expect, each of the above "elements" of salvage has been subject to extensive judicial gloss. Thus, for instance, fire fighting services rendered in a harbor by a town fire department are not "voluntary" because the fire crew was

under a pre-existing duty to the town to aid in fighting fires. Additionally, a vessel that is "softly aground" in mud or silt, with no imminent danger from weather and the ability to refloat herself on the next tide, is not necessarily in marine peril. Further, success can mean something less than saving the vessel from total loss where, for instance, some portion of her cargo is rescued before she sinks.

The factors to be considered in determining what level of salvage award should be granted are essentially in keeping with the English system, which follows the basic principle that salvages of valuable property in serious peril and at extreme risk to the salvors should be more handsomely rewarded than simple and routine acts of assistance. Importantly, the award is not intended to be a simple *quantum meruit* reimbursement—*i.e.,* to cover the salvor's expenses. Rather, it is intended to be a reward that is large enough to affirmatively encourage those at sea to attempt to rescue property in marine peril.

Notably, U.S. courts and arbitrators, recognizing the valuable aid that commercial salvors render to the shipping community at large—and acknowledging the large overhead expenditures those companies need to make in order to have assets at the ready at all times—frequently award commercial salvors a commercial "uplift" for a successful salvage.

A claim for salvage can be enforced either against the salved vessel *in rem* by commencing a maritime arrest action, or against the owner by commencing a lawsuit against him personally, pursuant to the admiralty jurisdiction of the federal courts. Federal courts have exclusive jurisdiction over salvage claims, and state courts are not competent to make maritime salvage awards.

As is the case under English law, the parties can, and often do, agree to arbitrate salvage claims. This is often preferred on both sides of the table because of the significant potential cost savings and the ability to have the dispute decided by arbitrators who are experienced in this somewhat esoteric field. The Society of Maritime Arbitrators, Inc. in New York has published a form salvage agreement (MARSALV Form) and salvage arbitration rules that are finding more widespread use recently—particularly in the area of pleasure-boat salvage.

Conclusion

Finally, the best thing a person who has rendered assistance at sea can do next is to contact a lawyer. There are many pitfalls for the inexperienced, and a lawyer with good salvage experience can help his client negotiate a path through them and get the salvor paid for the valuable services he has rendered.

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