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A NOTE FROM THE EDITOR

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It's hard to believe another summer has come and gone. The kids are back in school, the commuter trains are a bit more crowded, and everyone is back from their holidays, hopefully refreshed and ready to get back down to business. We know we are.

In this issue of *Mainbrace,* we discuss some of the hot and developing issues in our practice these days. First and foremost is offshore wind development. It is no secret that the United States has been well behind our friends in Europe in developing and installing this technology, but there are clear signs that the United States is finally getting serious about this important source of energy. Deepwater Wind, a five-turbine project off Block Island in Long Island Sound is nearing completion; the State of Massachusetts (home of the ill-fated but not deceased Cape Wind project) recently enacted legislation requiring the state to take a significant portion of its energy from offshore wind going forward; and other projects are starting to get off the ground up and down the East Coast. Jonathan Waldron and Joan Bondareff, two members of our offshore wind practice team, discuss recent developments in greater detail in their article (see page 2).

Unfortunately, bankruptcy has been another hot story in the maritime space for the past few years, and this shows no signs of abating any time soon. Our maritime group has worked very closely with our bankruptcy group to develop a focused maritime bankruptcy practice experienced in advising clients, be they in the position of debtors or secured or unsecured creditors. In his article (see page 13), Mike Schaedle discusses recent developments in Chapter 15 practice, which involves recognizing foreign bankruptcy proceedings in the United States.

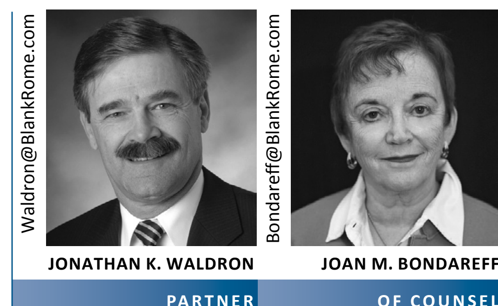
Meantime, technology races on, in shipping as in every other aspect of our lives. New technology brings increased productivity, but it also brings disruption and uncertainty. Nowhere is that more apparent than in the area of cybersecurity, where increased integration of systems means heightened risk. The shipping industry has been struggling to make up lost ground in responding to these risks. And meanwhile, the development of drones brings great promise of new and innovative uses in the maritime industries, from inspecting tanks and platforms to delivering consumables to vessels offshore. But it also raises important questions about safety and regulation. Kate Belmont addresses the former in her article (see page 7), and Sean Pribyl the latter (see page 4).

We also cover recent developments in the South China Sea (see Joan Bondareff and Sean Pribyl's article on page 16), new opportunities in government contracting (see David Nadler and Justin Chiarodo's article on page 11), and age-old questions about the continued relevancy of the Shipowner's Limitation of Liability Act (see Jeffrey Moller's article on page 9).

Hopefully, there is something for everyone in this issue of *Mainbrace,* and we hope you enjoy the read.

First Offshore Wind Project in United States to Launch This Fall

BY JONATHAN K. WALDRON AND JOAN M. BONDAREFF



Although skeptics said it couldn't happen, the first offshore wind project in the United States is scheduled to begin operation by the end of this year, bringing wind power to shore from waters off Block Island, Rhode Island. Bragging rights can go to Jeffrey Grybowski and his team at Deepwater Wind. The project may be relatively small—five turbines producing only 30 megawatts ("MW") of wind and providing power to about 17,000 homes—but it is a giant step forward in the world of offshore wind in the United States.

Credit can also go to Rhode Island for creating a State Ocean Management Plan identifying potential sites for offshore wind farms, and to the residents of Block Island, Rhode Island, who in large numbers supported the project, which will connect Block Island to the mainland and the grid for the first time. Power from the five turbines will be brought ashore by a large submarine cable, and purchased by National Grid. The price of the power is expected to be somewhat higher than the average price of electricity in the United States overall. However—and most notably—the power will be clean and renewable compared to the diesel fuel that Block Islanders have previously relied on, and it will reduce island electric rates by an estimated 40 percent as well as diversify Rhode Island's power supply.

Serious investors like D.E. Shaw also helped finance the estimated $300 million project, and it is subsidized by investment tax credits for offshore wind that Congress extended last year with a schedule for phasing out the subsidies over the next few years.

Impact of the Jones Act on Deepwater Wind

Developers such as Deepwater Wind had to run the gamut of state and federal laws and regulations, including the Jones Act. They were able to comply with the Jones Act by bringing the giant turbine nacelles from Europe on a jack-up installation vessel called the *Brave Tern* owned by Fred. Olsen Windcarrier. Smaller vessels transported other supplies to the wind platforms, and these were U.S.-owned, built, and crewed.

The Future of OSW Leasing Looks Positive

The future bodes well for U.S. shipyards, marine suppliers, and labor for future offshore wind projects. While Deepwater Wind is the first of its kind, many other projects are in the works along the Eastern Seaboard. Ten years from the "Smart from

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First Offshore Wind Project in United States to Launch This Fall
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the Start Program" created under a 2005 amendment to the Outer Continental Shelf Lands Act, the Obama Administration's Department of the Interior ("DOI") has awarded 11 commercial leases in federal waters along the Atlantic Seaboard, and is in the process of issuing leases in waters adjacent to other states. A lease sale is pending for the waters off North Carolina, and one off the end of Long island, New York, is possible by the end of the year. The DOI is also investigating the feasibility of floating wind farms off the coasts of Oregon and California as well as Hawaii; leases have already been awarded on the continental shelves of Massachusetts, Rhode Island, Delaware, Maryland, and Virginia.

New State Support for OSW Development

Support from neighboring states is critical to the development of these larger offshore wind farms. While the DOI has leasing authority on the Outer Continental Shelf, the power must be fed ashore by gigantic cables to power stations on land and eventually into the power grid. Earlier this year, New York State Governor Andrew Cuomo announced his commitment to renewable energy by establishing a goal of acquiring 50 percent of the state's energy from renewable sources by 2030. The New York State Energy and Research Development Authority ("NYSERDA"), and its partner the Long Island Power Authority ("LIPA"), may also be interested in acquiring offshore wind from leases expected to be awarded later this year off the end of Long Island. (In July, NYSERDA requested that LIPA postpone consideration of offshore wind proposals until a statewide wind blueprint and clean energy standard were released.) Most of the energy to meet the state's ambitious renewable energy goal is expected to come from offshore wind.

A similar welcoming sign for offshore wind was established last month in Massachusetts when Governor Charlie Barker signed into law legislation that required utilities and other power purchasers to acquire 1600 MW of wind energy by 2027. Procurement requests for this energy are expected to be issued in 2017. Companies that have lease sales in the region are the potential bidders for these contracts.

Europeans Arrive to Help U.S. Companies

Another factor that has promoted the offshore wind industry in the United States is the entry of European companies experienced in the already well-developed industry in Europe. For example, DONG Energy, the largest developer of major wind farms in Europe, has acquired two leased areas, one off Massachusetts and one off the coast of New Jersey. U.S. Wind, a subsidiary of Italian energy firm Renexia, has purchased the lease off the coast of Maryland. Maryland has also supported offshore wind by enacting legislation establishing a system of ocean renewable energy credits ("ORECs")—modelled on New Jersey legislation—while capping the price Maryland residents and businesses would have to pay. Copenhagen Infrastructure, another Danish company, just acquired a 100 percent interest from Offshore MW LLC in a leased area just south of Massachusetts. Both DONG Energy and Copenhagen Infrastructure are poised to participate in the upcoming Massachusetts utility tenders for offshore wind.

► The future bodes well for U.S. shipyards, marine suppliers, and labor for future offshore wind projects. While Deepwater Wind is the first of its kind, many other projects are in the works along the Eastern Seaboard.

Deepwater Wind is a success because of the persistence of its leadership team, the experience of its partners, and its supporters in the state. In summary, the success of this project amounts to a welcoming beacon for wind farms all along the Atlantic Seaboard, bringing clean, renewable energy to the grid and consumers. ◻ — ©2016 BLANK ROME LLP

Is the Maritime Industry Ready to Embrace Drones?

BY SEAN T. PRIBYL

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Unmanned aerial systems ("UAS"), or "drones" in common parlance, have not been a part of the historical maritime vocabulary. At least, not yet. While UAS may conjure images from science fiction, the reality is that companies are designing commercial UAS for the private sector. In fact, UAS are gradually permeating our daily lives, and over the next five years, the commercial UAS industry is predicted to surpass that of the defense industry.

But, while UAS technology continues to rapidly evolve, regulators have been struggling to keep pace. Consequently, the legal issues that surround the use of UAS remain complex and unsettled. There are benefits and risks with UAS as with any innovation, and this article suggests practical areas in which UAS may afford the maritime industry a novel approach to cost and time savings. Clients should be poised to harness the potential advantages and technological progresses that UAS now offer in the maritime, energy, shipping, offshore, and ship construction markets, and this article provides recommendations on how to best do so as they navigate largely uncharted waters.

The Cookie Test and What Follows Next

The following is a summary of key developments in particular segments of the maritime industry.

VESSELS

Currently, in order to send urgent supplies to a vessel underway or at anchor, owners and operators must rely on boats, barges, or mooring the vessel while paying for crews and fuel. However, these options are time-consuming and expensive. But, those limitations are dissipating. To illustrate, in January, A.P. Moller Maersk A/S completed a UAS delivery over a distance of 247 meters of a 1.3kg package of cookies to an underway tanker. Accordingly, the industry should be optimistic that as technology advances and UAS integrate into the maritime supply chain, companies may save thousands of dollars each year on deliveries. With further testing, UAS could foreseeably inspect vessel tanks or lashing aboard cargo ships, and assist in surveillance of ice navigation or piracy.

OFFSHORE ENERGY

Companies are increasingly utilizing UAS in the energy sector. Ongoing testing in challenging offshore environments indicates that UAS could be used in oil and gas surveys as well as inspections of rigs or vessels for leaks, damages to piping, structural defects, or other irregularities in dangerous locations, such as risers or flare stacks. For example, a UAS reportedly conducted a two-day inspection aboard a drillship in the Gulf of Mexico of the derrick, heli-deck, and four cranes, saving two weeks of work. UAS could also assist in class survey work, including hull tank inspections, and potentially could be used to detect and quantify discharges or spills to mitigate environmental impact in times of disaster. Furthermore, Protection and Indemnity ("P&I") Clubs could use this same technology in lieu of Coast Guard overflights for oil spills, resulting in significant cost reductions in response costs.

> ► By 2018, the International Civil Aviation Organization hopes to deliver an unmanned aircraft international regulatory framework, and the International Maritime Organization may have a role in recommendations on UAS use by vessels at-sea for search and rescue, migrant monitoring, or ice navigation.

Besides oil and gas exploration, UAS are being tested in inspections of offshore wind turbines in an effort to both decrease the economic losses caused during turbine downtimes and enhance safety for repair technicians required to climb on the blades. As with other UAS markets, the global revenue for UAS sales and inspection services for wind turbines is also expected to grow significantly over the next decade.

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Is the Maritime Industry Ready to Embrace Drones?
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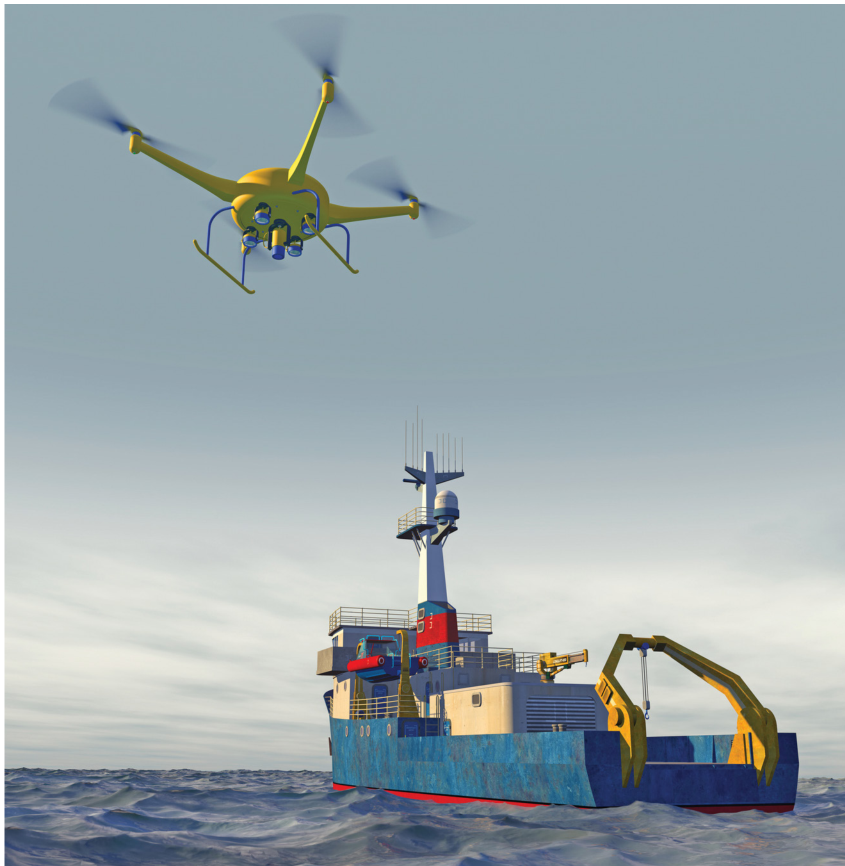
SHIPYARDS, SURVEYS, AND PORTS

Overseas shipbuilders are employing UAS technology to increase efficiency during construction and inspection stages. Poland's Remontowa Shiprepair Yard used a UAS to inspect internal spaces of chemical and product tankers, accessing the cargo tanks for an assessment of the condition of the hull and bulkheads. Remontowa may expand inspections to other areas of the vessel, such as the masts or deck crane jibs. Also, Japanese shipbuilder Tsuneishi Holdings Corporation and Turkish Besiktas Shipyard have been using UAS at their respective shipyards to assist in vessels undergoing repairs.



More recently, Knut Ørbeck-Nilssen, CEO of DNV GL–Maritime, reported that DNV GL had tested the use of UAS to conduct surveys inside chemical tanker tanks. DNV GL was the first classification society to utilize UAS to assist surveyors in completing production surveys, an accomplishment garnering attention in the industry.

Cargo ports and terminals are also taking steps to monitor the yard and vessel operations, and may consider UAS to enhance the management of a terminal or augment security plans. Most recently, Abu Dhabi Ports Company began testing the use of UAS to increase the surveillance at ports. And, the Maritime and Port Authority of Singapore intends to use UAS to monitor marine incidents.

Government Contracts and Grants

Federal agencies such as the U.S. Coast Guard are actively conducting UAS market research to support missions related to law enforcement, immigration, fisheries, counter-drug, smuggling, and ice navigation, and have entered into cooperative agreements with companies to evaluate the potential use of small UAS. Besides the Coast Guard, the National Oceanic and Atmospheric Administration is using UAS to collect data on living marine resources and environmental conditions.

And, the U.S. Navy continues to integrate unmanned aircraft following successful testing of an unmanned aircraft from an aircraft carrier, recently awarding a significant defense contract for unmanned aircraft while establishing two new offices dedicated to unmanned systems. Also, some federal and state agencies offer grant funding related to developing UAS technologies. Overall, procurement, acquisition, and grants related to UAS look to be a growth market over the next decade.

Regulatory and Legal Regimes

So, what does it take to operate a UAS in the maritime industry? Basically, it depends. The location and purpose of the UAS may call into play overlapping jurisdictional and legal concerns. Currently, the FAA has exclusive sovereignty over U.S. airspace and regulates UAS as aircraft. The FAA previously authorized commercial UAS purposes through Section 333 Exemptions of the FAA Modernization and Reform Act. Now, the FAA has released a Final Rule on small UAS, effective as of August 29, 2016, which streamlines commercial small UAS under certain flight prohibitions, such as those related to nighttime flights, over people, altitudes above 400 feet, and beyond the operator's line of sight. Additionally, commercial use operators must be cognizant of state or local government regulations, such as trespass, privacy, or nuisance laws, as well as potential flight restrictions for national security reasons. Consequently, the enforcement landscape in many cases lacks conformity, requiring constant vigilance of developing legal regimes. Careful consideration should be given in each case as to what requirements must be met before operating.

Outside U.S. airspace, operators must be cognizant of UAS laws, which may vary from country to country. To illustrate, the European Aviation Safety Agency is currently developing UAS rules as civil operators currently rely on basic national safety rules. Additionally, international organizations may have a role in international airspace issues. By 2018, the International Civil Aviation Organization hopes to deliver an unmanned aircraft international regulatory framework, and the International Maritime Organization may have a role in recommendations on UAS use by vessels at-sea for search and rescue, migrant monitoring, or ice navigation.

Essentially, innovators outpaced the regulators, and agencies such as the FAA were relatively unprepared for UAS integration. Consequently, the maritime sector is currently left with a shifting legal landscape in both domestic and international regulatory schemes that may lack clear comity or consistency. More importantly, UAS operators failing to comply with legal requirements risk license revocation, seizure, and fines, among other civil and criminal penalties. But, if the maritime industry cautiously navigates these legal regimes, the benefits could outweigh the risks.

Liability

Admittedly, assimilation of UAS into the maritime industry has hurdles to overcome. Currently, the full range of data is still being developed on which to measure all the risks that UAS pose in the maritime sector. In order to meet a wide range of liabilities, including cybersecurity, UAS operators should consider whether they have sufficient levels of insurance, such as hull, casualty, loss, and product liability. Overall, while it is clear that UAS have a number of attendant risks, their wide-ranging uses also have the potential to significantly benefit the maritime industry. Prudence would dictate seeking legal assistance to conduct a due diligence review of risks in advance of any UAS flights.

► Ongoing testing in challenging offshore environments indicates that UAS could be used in oil and gas surveys as well as inspections of rigs or vessels for leaks, damages to piping, structural defects, or other irregularities in dangerous locations, such as risers or flare stacks.

Conclusions and Recommendations

In sum, UAS offer flexibility for a broad number of business opportunities that may reduce cost and time, while integrating into existing maritime safety practices and operations. In view of these developments, industry stakeholders should—depending on their business challenges—focus on UAS now, and consider whether it is time to enter this market to get ahead of the competitive curve. Given the complex legal and regulatory landscape in which UAS operate, clients should consult with counsel as part of their UAS review to assist in evaluating regulatory, technical, legal, and public policy issues in order to prudently mitigate risk while assisting with business solutions. ◻ — ©2016 BLANK ROME LLP

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IMO Interim Guidelines: Recent Developments in Maritime Cyber Risk Management

BY KATE B. BELMONT

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Cyber risk management continues to be one of the most significant challenges currently facing the maritime industry. With an overreliance on information technology ("IT") and operational technology ("OT"), the shipping industry is vulnerable to cyber risks, cyber threats, and cyber attacks that could result in significant damages and loss, including loss of business and damage to reputation and property. While the maritime industry has yet to be regulated, various stakeholders have recognized the need for the industry to address cyber risk. As the United States Coast Guard continues to assess and evaluate cyber risk throughout the marine transportation system, the International Maritime Organization ("IMO") and various industry organizations have issued guidelines on cyber risk management this past year. Most notably, on May 20, 2016, the IMO approved Interim Guidelines on Maritime Cyber Risk Management ("IMO Interim Guidelines").

► Vulnerable systems include bridge systems, cargo handling and management systems, passenger servicing and management systems, access control systems, and communications systems.

The Significance of the IMO Interim Guidelines

The IMO Interim Guidelines are high-level recommendations for maritime cyber risk management, and are intended for all organizations in the shipping industry. This is a significant development as "The Guidelines on Cyber Safety and Security Onboard Ships" ("Industry Guidelines for Onboard Ships"), which was produced by BIMCO, CLIA, ICS, INTERCARGO, and INTERANKO and released in January of this year, is limited in its recommendations to cyber risk management for onboard ship operations. In contrast, the IMO Interim Guidelines provide recommendations for safety and secure management practices for all stakeholders in the shipping industry. How does the release of these guidelines affect the maritime industry? While no regulations have been established yet, both sets of guidelines have created a greater level of care and can now be considered best practices for owners and operators, and should be carefully considered and incorporated into current safety and security risk management processes.

Addressing Cyber Risk Management

In addressing cyber risk management, the IMO Interim Guidelines outline various systems used throughout the marine environment that are susceptible to cyber risk. Vulnerable systems include bridge systems, cargo handling and management systems, passenger servicing and management systems, access control systems, and communications systems. Accessing or interconnecting these systems leads to cyber risk, and as cyber technologies have become essential to the maritime industry, these systems must be protected. Significantly, the IMO Interim Guidelines make the distinction between IT and OT systems, which is critical in the greater understanding of cyber risk. IT systems focus on the use of data as information and are commonly identified as transaction systems, including business systems and information systems. OT systems focus more on the use of data to control or monitor physical processes or equipment. As the maritime industry is reliant on both IT and OT systems, it is important to understand that cyber risk extends to all systems that are reliant on information communication technology—for example, systems operated by finance and administrative departments and those operated by engineers, technicians, and crew.

The IMO Interim Guidelines state that vulnerabilities in these systems can be exploited intentionally or unintentionally. The threats facing these systems range from intentional, malicious actions, including hacking or introduction of malware, to unintentional consequences of poor cyber risk management, including outdated software, ineffective firewalls, the absence of network segregation, and procedural lapses. While the IMO Interim Guidelines do not address every possible cyber threat and vulnerability, these guidelines make clear that effective cyber risk management should consider all kinds of threats. The IMO also correctly notes that these technologies and threats

are constantly changing, therefore effective cyber risk management must be holistic and flexible and evolve as a natural extension of existing safety and security management practices.

The IMO Interim Guidelines address the elements of effective cyber risk management, which is defined as "the process of identifying, analyzing, assessing, and communication cyber-related risk and accepting, avoiding, transferring, or mitigating it to an acceptable level considering costs and benefits of actions taken to stakeholders." Both the IMO Interim Guidelines and the Industry Guidelines for Onboard Ships state that effective risk management should start at the senior management level. To best achieve effective cyber risk management, a culture of cyber risk awareness must be incorporated into all levels of an organization. Cyber risk policies and procedures can be unique to each organization and must be constantly evaluated and evolving.

► The IMO Interim Guidelines state that vulnerabilities in these systems can be exploited intentionally or unintentionally. The threats facing these systems range from intentional, malicious actions, including hacking or introduction of malware, to unintentional consequences of poor cyber risk management, including outdated software, ineffective firewalls, the absence of network segregation, and procedural lapses.

A Call to Action for the Maritime Industry

Owners and operators must take heed of the Interim Guidelines on Maritime Cyber Risk Management. Although "recommendatory," along with the Guidelines on Cyber Safety and Security Onboard Ships, a new standard of care and best practices have been established in the maritime industry. Owners and operators will be held to a higher standard when dealing with loss and damages resulting from a cyber attack or breach. Cyber threats, vulnerabilities, and loss have plagued the maritime industry for years, but effective cyber risk management has only recently become a priority. That said, owners and operators can no longer claim ignorance to dangers posed by cyber threats and must take the appropriate steps to mitigate cyber risk and avoid potential liability for any loss or damages resulting from a cyber breach or attack.

Ports continue to be targets for cyber attacks from malicious actors, mainland IT systems at major shipping companies continue to be besieged with malware and spear-phishing campaigns, and onboard ship systems continue to be vulnerable to intentional and unintentional cyber threats. With its overreliance on IT and OT systems, its reliance on outdated software, and its failure to develop current and effective cybersecurity practices, the maritime industry is faced with the unique challenge of mitigating cyber risk on many different levels. While the IMO Interim Guidelines are not mandatory, they serve as a baseline for better understanding and mitigating cyber risk, and should be referenced in developing sound cyber risk management policies and procedures. Failure to actively engage in cyber risk management will result in increased liability for owners and operators.

For additional guidance on the implementation of cyber risk management procedures and practices, the IMO also recommends referring to the Guidelines on Cyber Safety and Security Onboard Ships; ISO/IEC 27001 standard on Information technology – Security techniques – Information security management systems– Requirements; and the United States National Institute of Standards and Technology's Framework for Improving Critical Infrastructure Security (the NIST Framework). ◻ —©2016 BLANK ROME LLP

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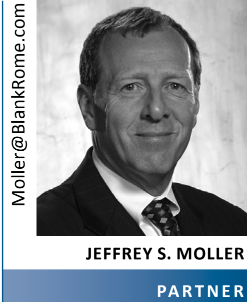
What the Heck Is "Privity"? Is the Limitation of Liability Act Still Relevant?

BY JEFFREY S. MOLLER



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In the aftermath of a major shipping disaster, a vessel owner may be expected to exercise its right to file a petition to limit its liability in accordance with the U.S. Shipowner's Limitation of Liability Act, 46 USC §30501, *et seq.* This may evoke negative press and social media reaction with a now-familiar refrain: Why should a shipowner escape full liability for a disaster by hiding behind a 19th-century (*i.e.,* outdated, antique, and ancient) statute? One might well ask whether the Limitation Act has outlived its usefulness, but this author's belief is that the statute need not be repealed. Modern safety management systems, communication systems, and vessel tracking systems have served to make it far more difficult for owners to limit their liability, and the procedural benefits of the statute are helpful to all concerned. It may, however, be time for the United States to become signatory to the existing up-to-date international treaty on a limitation of liability.

► It may therefore be said that a shipowner's right to limit liability has been so severely circumscribed by recent technological events, that the U.S. statute need not be repealed.

What Is the U.S. Limitation of Liability Act?

The U.S. Limitation of Liability Act was passed in 1851, modeled upon an English statute existing since 1734, a time before corporations had come into routine and legally respected use. The modern corporation is now a very common form of limitation of liability. Although under certain circumstances one can "pierce the corporate veil" and impose liability directly upon the shareholders of a corporation, for the most part the corporate form of business organization is well-established and unquestioned today as a means by which investments can be made without imperiling other assets. Essentially, the Limitation of Liability Act provides the same type of protection as does the corporate form. It can serve to protect assets other than the amount of capital invested into a particular ship. It provides a means of "breaking" limitation that is arguably less difficult than piercing the corporate veil, allowing for limitation only if the cause of the disaster was without the "privity and knowledge" (*i.e.*, the direct involvement) of the owner's shoreside management.

The U.S. Limitation of Liability Act is thought to be onerous primarily because, in its basic form, the statute can limit the vessel owners' liability to the value of the vessel after the incident. There have been infamous cases where after a vessel sinking the only thing recovered is a life raft. Considering the fact that hull insurance proceeds are not a part of the limitation fund and that protection and indemnity ("P&I") insurance exists universally, allowing the shipowner (and its insurers) to escape scot-free can appear to be grossly inequitable. The U.S. statute was amended after a notable 20th-century passenger vessel disaster to assure some minimal recovery to victimized passengers even in a total loss situation, but has not otherwise been substantially changed since its passage.

Why Was the Act Passed in the First Place?

According to the legislative history, the statute was enacted in order to encourage capital investment in U.S.-flag shipping at a time when, not unlike the present, the amount of capital required to purchase and equip a ship was relatively large and the profit margins relatively thin. As indicated above, it was modeled upon an English statute. U.S. owners had complained that the laws in other countries provided limitation protection for their shipowners, which created a non-level playing field. Encouraging private investment in the shipping industry also had a defense-related purpose that is arguably as important now as ever. In times of war, the movement of men and material to and from theater is most often performed by commercial vessels that are chartered to (or commandeered by) the U.S. government. Unless a sizeable commercial U.S.-flag fleet exists in peacetime, there could be significant problems coping with an outbreak of hostilities.

Most other modern seafaring nations have replaced their domestic statutes and become signatories to an international treaty (or convention) (first formed in 1957 and most recently amended in 1996) that limits shipowners' liability. Clearly, there remains a global consensus that allowing shipowners to

limit their liability in certain circumstances can serve worthwhile purposes. Of course, the amount of the limitation fund under that international convention, as recently amended with effect in 2015, is substantially greater than that under U.S. law. The international convention does not allow the owner to limit its liability to the post-casualty value of the vessel, but instead requires a minimum fund based upon the vessel's tonnage. The owner of a 50,000 GRT vessel could, under the current convention, be required to pay an amount in excess of $42 million, even if it succeeds in proving an absence of causative privity/knowledge. On the other hand, as discussed more fully below, it is generally considered much more difficult to "break" limitation under the Convention than under the U.S. Limitation Act.

One key procedural benefit of the U.S. Limitation Act is the so-called "concursus" of claims. In order to exercise its right to limit liability, the vessel owner must file a petition and create a fund within six months of the receipt of notice of a claim. The court then issues an injunction order staying any and all other existing litigation and requiring all potential claimants to file their claims in one forum. This "concursus" is a sort of reverse class action that can avoid the expense of multiple litigations and the risk of inconsistent verdicts. It also assures that the limitation fund will be distributed in an equitable way among all claimants.

Privity and Modern Technology

The antiquated language referring to "privity and knowledge" has been roughly translated for modern purposes as "participation and control." The time-tested legal axiom is that "control is the *sine qua non* of liability." In other words, it is only appropriate to blame someone for an outcome if they had substantial control over the precipative events. In the days when the limitation of liability statutes were initially passed, it was understood that an owner had a duty to make its vessel seaworthy, but lacked effective control over the vessel once at sea. It was therefore thought that the owner ought not to be liable beyond the value of its investment in the ship for the independent negligence of the captain and crew. (A similar principle is embedded in the U.S. Carriage of Goods by Sea Act.) In days when communication with a ship at sea was impossible and knowledge of the ship's whereabouts sketchy, the shipowner very often lacked privity or knowledge with respect to the occurrence of an accident.

Today's shipping world is much different, of course. AIS tracking devices and transponders accessible by a cellphone "app" make it possible to know a vessel's whereabouts, course, or speed at any time anywhere in the world. Modern voyage planning tools, including weather routing systems, make it difficult to claim that bad weather is unforeseeable from shore. And modern communication devices, including e-mail, cellphones, and satellites, make it difficult for an owner to claim that it had no effective means by which to direct the ship's master in real time, though, of course, the master remains initially responsible for the navigation of the vessel.

It may therefore be said that a shipowner's right to limit liability has been so severely circumscribed by recent technological events, that the U.S. statute need not be repealed. The potential for an "inequitable" result is severely limited and the statute's procedural/judicial benefits are of continuing value. And the owner who can truly prove that it was without any control over the cause of an accident should still be afforded limitation.

There may be good arguments that, given the existence of hull and P&I insurance, it is time for the United States to join with the other leading seafaring nations in signing the existing international convention in order to assure a certain minimum recovery to victims in total loss situations involving onboard negligence. Given our beloved country's propensity to go its own way with respect to such treaties, however, the author is not inclined to hold his breath. ◻ —©2016 BLANK ROME LLP

Government Contracts

SBA Rule Expands Mentor-Protégé Program, Creates New Opportunities for the Maritime Industry

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After a long wait and much anticipation, the Small Business Administration ("SBA") issued its final rule expanding the mentor-protégé program to all small businesses on July 25, 2016. The new rule broadly expands upon the existing 8(a) mentor-protégé program, and is projected to result in two billion dollars in federal contracts to program participants. The final rule makes some key changes to the February 2015 proposed rule, including changes regarding size certification and reporting. As the new rule is now final, contractors in the maritime industry, both large and small, should prepare now to take advantage of what the newly expanded program has to offer.

Background

The SBA mentor-protégé program has long-allowed large businesses to provide technical, management, and financial assistance to small businesses, and for the mentor and protégé to compete together for contracts. The program was designed to help protégé businesses by leveraging the experience and expertise of the larger mentor contractors. Originally limited to 8(a) concerns, the program was extremely successful. Large businesses were attracted to the program because it allowed them to pursue small business set-aside contracts as a joint venture with a protégé and foster small business relationships, and small businesses benefited from the resources and expertise of their mentors.

In 2010 and 2013, Congress authorized the expansion of the mentor-protégé program. In February 2015, SBA issued its proposed rule expanding the program to include all small businesses, although the 8(a) program will also remain independent of the new program. The proposed rule indicated that the SBA was contemplating a number of changes to the 8(a) model, including size certification approval requirements from the SBA and additional reporting and compliance requirements, particularly with regard to the structure of the joint venture. Many of these new requirements remain in the final rule, but there are some significant changes that government contractors in the maritime industry should be aware of.

Key Provisions of the Final Rule

The key changes and provisions of the final rule are discussed below.

1. **Size Status Determination:** The proposed rule contained a requirement for formal SBA verification of the size status of the protégé. This requirement was removed from the final rule. The SBA will continue to allow protégés to self-certify, and will rely on the size protest mechanism to ensure that businesses are accurately certifying their size.

2. **NAICS Code Standard:** Under the final rule, businesses that do not qualify as small under their primary NAICS code can still participate under a secondary NAICS code if the protégé can show that it would benefit from the progression into a secondary industry to enhance its current capabilities.

3. **Financial Condition of the Mentor:** Under the proposed rule, a mentor was required to demonstrate to the SBA that it was in "good financial condition." This requirement was removed from the final rule. The SBA acknowledged that as long as the mentor can meet all obligations under its mentor-protégé agreement, then the "good financial condition" requirement was unnecessary and created too much confusion, since the term was undefined.

4. **Duration of the Agreement:** The proposed rule limited the mentor-protégé agreement to three years. It also only allowed for a protégé to engage in one three-year agreement with one entity and one with a separate entity, or two three-year agreements with the same entity. Commentors did not believe that three years was long enough. SBA's final rule allows for two three-year agreements with different mentors, but also allows for each agreement to be extended for an additional three years as long as the protégé continues to receive the agreed-upon business development assistance.

5. **Joint Venture Entity:** The SBA clarified in the final rule that a joint venture need not be, but could be, a separate legal entity. The SBA sought to clarify that formal or informal joint ventures were permissible. Also, consistent with the proposed rule, the SBA clarified that a joint venture may not be populated with employees who are performing the contract, as this would defeat the purpose of the protégé learning from the mentor. A mentor may, however, own up to 40 percent of their small business protégé under the final rule. If ownership continues after the mentor-protégé agreement expires, the SBA indicated that its affiliation rules would apply.

6. **Compliance and Reporting:** In order to ensure the program serves its purpose and is not abused, the SBA has enacted rigid reporting requirements under the final rule. The SBA requires both the mentor and protégé to certify the joint venture's compliance with the regulations, the terms of the joint venture agreement, and the performance requirements of the particular contract. The protégé is also required to engage in annual reporting on compliance. Penalties for non-compliance can include suspension and debarment.

► Contractors should be aware that nearly all future small business set-aside contracts will draw bids from mentor-protégé joint ventures. Given this expansion to all small businesses, mentors will now have a wider selection of protégés to choose from. The new rule is expected to result in thousands of additional applications for the program.

Impacts on Government Contractors

Contractors should be aware that nearly all future small business set-aside contracts will draw bids from mentor-protégé joint ventures. Given this expansion to all small businesses, mentors will now have a wider selection of protégés to choose from. The new rule is expected to result in thousands of additional applications for the program. Indeed, the SBA has created an entirely new division within the Office of Business Development to process and review applications, and has left open the possibility of imposing open and closed enrollment periods for the program. Companies that are interested in participating in the program should make sure they obtain appropriate guidance on the final rule to ensure that all application, performance, and reporting requirements can be met. ◻ —©2016 BLANK ROME LLP

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Creative Finance: U.S. Bankruptcy Courts Will Not Tolerate Manipulation of COMI and Bad Faith Uses of Chapter 15

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In chapter 15 practice, recognition of a foreign proceeding (whether a main or nonmain proceeding) focuses on specific statutory bona fides. To prosecute a chapter 15 in the United States, a properly authorized representative of a foreign debtor has to provide a U.S. Bankruptcy Court with straightforward evidence of the raising of a proceeding under foreign insolvency laws, which are designed to create a collective remedy, in a jurisdiction where a foreign debtor either has an "establishment" or a "center of main interests." 11 U.S.C. §1517(a) (statute mandates recognition where requirements of (a)(1-3) are met). Courts have noted that chapter 15 does not contain a provision for dismissal for cause and that the intentions of the foreign representative in seeking relief generally are not germane to the findings required of an American bankruptcy court under sections 1515 and 1517 of Title 11 of the United States Code, 11 U.S.C. §101, *et seq.* (the "Bankruptcy Code").[1]

Further, the United States Court of Appeals for the Second Circuit in *Morning Mist Holdings Ltd. v. Krys (In the Matter of Fairfield Sentry Ltd.),* 714 F.3d 127 (2d Cir. 2013) has held that a foreign debtor's "center of main interests" ("COMI") is to be determined as of the commencement of the chapter 15 case. This has permitted foreign debtors in liquidation in so-called "letterbox" jurisdictions—places where a liquidating or liquidated debtor did not operate, but where the debtor is registered as a business organization—to obtain recognition of foreign liquidation proceedings pending in the "letterbox" jurisdictions. There is nothing generally improper about this, as a liquidation in bankruptcy can serve a collective purpose and can be very complex.

Public Policy and Abstention Limits on Recognition Obtained in Extraordinary Circumstances

Chapter 15 does restrain improper uses of ancillary proceedings by refusing recognition and other actions that are "manifestly contrary to the public policy of the United States." 11 U.S.C. §1506.[2] And Bankruptcy Code section 305 expressly states that a bankruptcy court can either suspend or dismiss a recognized chapter 15 case if the purposes of chapter 15 would be fulfilled by such dismissal or suspension or if such abstention is sought by the foreign representative. 11 U.S.C. §305(a)(2), (b). But these constraints on recognition are extraordinary. Courts do not lightly find that international law contravenes the fundamental policy of the United States, and abstention requires a court to find that the pendency of a chapter 15 case actually frustrates the purposes of chapter 15 itself—an extraordinary finding.

"Bad faith" bankruptcy filings on the other hand, while not exactly commonplace in plenary bankruptcy practice in the United States, are not extraordinary. Generally, "bad faith" exists where the use of bankruptcy itself is futile, and thus, the debtor cannot or will not create a fair, collective remedy. A "bad faith" filing constitutes "cause" under the Bankruptcy Code, *see, e.g.,* 11 U.S.C. §1112, to dismiss a case. "Bad faith" actions in using bankruptcy are also cause for the appointment of an independent fiduciary in American bankruptcy, a trustee. In chapter 11 practice, for example, if "bad faith" use of bankruptcy is at issue, creditors and other stakeholders will often litigate with debtors, seeking to force dismissal or the appointment of a trustee.[3]

Quintessential "bad faith" is the use of bankruptcy to ratify or obscure a prior fraudulent act. And Judge Gerber, the author of the *Millard* decision cited in fn 1, confronted this quintessence in *In re Creative Finance Ltd.* (In Liquidation), 543 B.R. 498 (Bankr. S.D.N.Y. 2016), a chapter 15 case.

Insider Strips Creative Finance and Cosmorex of All Assets on the Eve of *Marex* Judgment

The *Creative Finance* case arose from litigation in the United Kingdom. Marex brought suit against Creative Finance and Cosmorex (foreign exchange traders) in the English High Court of Justice and succeeded in obtaining a USD$5.6 million judgment against the companies. On the eve of the final entry of judgment, and weeks after the High Court had circulated a draft of its judgment to the parties, the Creative Finance/Cosmorex principal, Carlos Sevillja, transferred all of the companies' cash (USD$9.5 million) out of the United Kingdom, where Creative Finance/Cosmorex had operated, to accounts in Dubai and Gibraltar. Marex was the two companies' only non-insider creditor. Primary remaining company assets were significant and valuable claims in the chapter 11 cases of *In re Refco, Inc.,* Bankr. Case No. 05-60006 (Bankr. S.D.N.Y.) and the proceeds of those claims. Interim distributions on the Refco claims appear to have been diverted by Sevillja away from Creative Finance/Cosmorex.

A BVI Liquidation Proceeding Commences, and Chapter 15 Relief Is Sought and Contested in New York

Marex domesticated its U.K. judgment in the New York Supreme Court and immediately began process to capture future Refco distributions.

Sevillja then caused Creative Finance/Cosmorex to file a voluntary liquidation proceeding in the British Virgin Islands (where each of Creative Finance and Cosmorex were organized). In the BVI proceeding, a liquidator was appointed and the liquidator was funded by Sevillja. The liquidator did the statutory minimum in respect of the Creative Finance/Cosmorex debtors (limited notices to creditors, formal establishment of BVI bank accounts, and basic establishing process before the BVI court and reporting, etc.). He never obtained the debtors' books and records and the liquidator never investigated the Sevillja-controlled transfer of debtor cash or Refco distribution proceeds.

In order to restrain Marex process against Refco distributions, the liquidator filed a voluntary petition under chapter 15 in the New York Bankruptcy Court, seeking provisional and permanent relief staying Marex in the United States from enforcing its judgment and entrusting the liquidation estate with the Refco distributions. Provisional relief was resolved by an agreement by and among the liquidator, Marex, and the Refco liquidating fiduciary to deposit Refco distributions in the New York Bankruptcy Court registry (a form of interpleader).

The Recognition Battle

The liquidator then pressed his petition for recognition, which was opposed by Marex. The liquidator focused on chapter 15 basics. BVI liquidation laws are intended to benefit a creditor collective. The debtors' registered offices are in the BVI. Formal process had been raised under the BVI liquidation laws and the status of the liquidation case was evidenced by certified orders of the BVI court. Likewise, after the commencement of the BVI liquidation, the liquidator was now the sole person authorized to act for the debtors. And per *Fairfield Sentry,* as of the chapter 15 commencement date, the debtors had no operations or business activity anywhere but the BVI.

The purpose of the chapter 15 was to capture and ratably share the Refco distributions with multiple creditors, including Marex. In the liquidator's view, all 1517 requirements were met and recognition was required. The liquidator argued that chapter 15 does not contemplate "bad faith" dismissal as a form of relief and that such relief exists to be had only in plenary American bankruptcy proceedings.

Marex argued that the BVI liquidation should not be recognized because the act of recognition would violate fundamental U.S. public policy given Sevillja's actually fraudulent conduct, apparent influence over the liquidator, and the liquidator's complete failure to investigate Sevillja and his bad acts. Marex also sought dismissal of the chapter 15 case as a "bad faith" filing and under Bankruptcy Code section 305 for the same reason.

Finally, Marex contested whether the liquidator could establish that the BVI liquidation was either a foreign main or nonmain proceeding since BVI could not be considered a "center of main interests" for either debtor, nor did either debtor have an "establishment" in BVI. In so doing, Marex drew the New York Bankruptcy Court's attention to its ability to consider pre-commencement facts that demonstrated COMI or the establishment of a facility was manipulated by a foreign debtor to frustrate the goals of a collective remedy under *Fairfield Sentry.*[4]

Judge Gerber and the Bankruptcy Court's Ruling

"This Chapter 15 Case was Brought as … the Most Blatant Effort to Hinder, Delay and Defraud a Creditor this Court has ever Seen."

—Judge Robert E. Gerber

Judge Gerber, who just retired, is one of the most distinguished bankruptcy judges in the United States, having sat in one of the preeminent U.S. jurisdictions for complex bankruptcies, the Southern District of New York. He has encountered every species of fraudulent conduct that commercial legal practice can produce. For the judge to characterize the *Creative Finance* chapter 15 as part of "the most blatant effort to hinder, delay and defraud a creditor" that he and the New York Bankruptcy Court had ever seen is notable (this is, after all, the same court that administered the *Enron, Adelphia,* and *WorldCom* chapter 11 cases, which all dealt with various kinds of fraud on a grand, systemic scale).

The court found that Sevillja defrauded Marex by stripping the debtors of all of their assets. In doing so, Sevillja defied the orders and judgments of the High Court in the U.K. *and* the New York Supreme Court, while violating all applicable laws relating to the Marex claims and judgments. Per the court, he then traduced the international insolvency system, using BVI insolvency laws to stop Marex enforcement, while controlling the liquidator and asserting that the claims of companies he controlled against the debtors should dilute Marex recoveries.

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Creative Finance: U.S. Bankruptcy Courts Will Not Tolerate Manipulation of COMI and Bad Faith Uses of Chapter 15 **(continued from page 14)**

Acknowledging the important case law favoring efficient recognition of foreign liquidations and the need for swift ancillary relief to support international restructuring and liquidation process, Judge Gerber, however, was clear that the New York Bankruptcy Court does not and will not tolerate schemes that use chapter 15 to implement actual fraud. He, however, refused to conflate a finding that the *Creative Finance* chapter 15 was part of such a scheme as evidence that BVI insolvency law is unfair and "manifestly contrary to the public policy of the United States." He did this because the invidious aims and schemes of Carlos Sevillja and the administrative failures of the liquidator do not impugn the essential fairness of the BVI law.

If a company has a COMI in the BVI or in any foreign state, subject to the other requirements of Bankruptcy Code section 1517, then the company's foreign proceeding can be recognized as a foreign main proceeding. To prove that COMI exists in a foreign state, the foreign representative ultimately has to demonstrate that the foreign debtor's known center of financial, legal, and business decision-making is located in that state. If a company has an "establishment" in the BVI or in any foreign state, subject to the other requirements of Bankruptcy Code section 1517, then the company's foreign proceeding can be recognized as a foreign nonmain proceeding. To prove that an establishment is located in a foreign state, the foreign representative has to show that the foreign debtor conducts non-transitory, local business in the state.

In *Creative Finance,* although the court reflected that a liquidation in a "letterbox" jurisdiction can and often is properly recognized, here the liquidator had done so little work, so little administration of assets, so little investigation into debtor assets and liabilities and Sevillja, that the debtors could not be said to have COMI or an establishment in the BVI. Accordingly, recognition as either a foreign main or foreign nonmain proceeding was denied. Upon denial of recognition, Marex was relieved of its duties under the order for provisional relief and authorized to seek recovery of Refco interim distributions to satisfy its judgment.

The court also did not explore the U.S. bankruptcy law on abstention or how it might enforce a rule of essential good faith as a prerequisite to recognition. In important dicta, the court noted that the abstention/dismissal/good faith question remained open for another day, and that even if there is no "bad faith" dismissal right *per se* in a chapter 15 case, the court can always limit the effect of the stay upon recognition and limit a foreign debtor's access to the protections of U.S. bankruptcy laws or courts if chapter 15 is being used in bad faith. In his decision, the judge focused on a narrower and more limited question under the Bankruptcy Code: whether the liquidator had failed to demonstrate that the debtors properly raised a foreign main or nonmain proceeding in BVI.

In *Creative Finance,* Judge Gerber acted vigorously to protect the integrity of judicial processes in the United Kingdom, the British Virgin Islands, and in the United States from fraud, including bankruptcy fraud, but he did so in a conservative manner that preserves the 1517 mandate to order recognition by reference to a straightforward evidentiary standard, focusing his ruling on the definition of COMI. ◘

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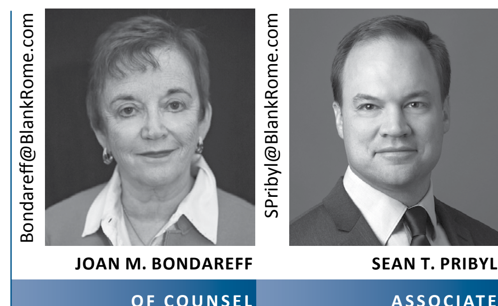
1. *See, e.g., In re Millard,* 501 B.R. 644, 653-54 (Bankr. S.D.N.Y. 2013) (Gerber, J.) (bad faith alone cannot result in denial of recognition).
2. *See, e.g., In re Toft,* 453 B.R. 186 (Bankr. S.D.N.Y. 2011) (denying recognition to German administrator where administrator sought enforcement of German court order permitting interception of debtor email).
3. *See, e.g., In re Northshore Mainland Services, Inc., et al.,* 537 B.R. 192, 202 (Bankr. D. Del. 2015).
4. *Fairfield Sentry,* 714 F.3d at 137.

Foul Weather and Heavy Seas May Follow South China Sea Ruling

BY JOAN M. BONDAREFF AND SEAN T. PRIBYL



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The South China Sea is a major shipping route between China, Japan, South Korea, Europe, and the Middle East, with approximately $5.3 trillion in shipping trade passing through the region every year. The South China Sea is also a vital area for environmental resources, including fisheries and marine species. Freedom of navigation and adherence to the rule of law is of paramount importance to the international shipping community. According to Esben Poulsson, President of the Singapore Shipping Association, any actions that restricted the right of innocent passage and freedom of safe navigation for merchant shipping "would potentially drive up shipping costs, resulting in a detrimental impact on maritime trade." Consequently, regional conflict that impinges on current shipping lanes and causes expensive routing diversions or delays could have far-reaching economic consequences to global trade.

The recent development is that on July 12, 2016, the Permanent Court of Arbitration ("PCA") in The Hague, Netherlands, issued a landmark arbitral ruling with direct impact on international maritime issues in the region. The binding decision essentially extinguished Chinese historical claims to maritime entitlements over about 90 percent of the waters of the South China Sea—an area as big as Mexico—commonly reflected by China as a "Nine-Dash-Line" on its maps of the area. (See map.) In its monumental decision, the PCA unanimously awarded against China's claims and in favor of the Philippines, presumably quelling any question as to the legal basis of China's expansive claims to sovereignty over the waters and its construction of artificial islands. However, China refused to both participate in the proceedings and accept the decision.

Background

Annex VII to the United Nations Convention on the Law of the Sea ("UNCLOS") requires parties to arbitrate disputes before five-member arbitral tribunals. Since the Philippines and China are parties to the Convention, the Philippines called for the arbitration in 2013 to dispute China's claims, unilaterally making 15 submissions to the proceedings requesting, for example, the PCA find that:

- China interfered with traditional Philippine fishing activities at Scarborough Shoal, an island in the South China Sea;
- China had no "historic rights" with respect to the maritime areas of the South China Sea;
- China violated its duties under the Convention to protect and preserve the marine environment;
- China breached its obligations under the Convention by operating its law enforcement vessels in a dangerous manner, causing serious risk of collision to Philippine vessels navigating in the vicinity; and,
- China claimed reefs that were low-tide elevations, which do not generate any entitlement to a territorial sea, Exclusive Economic Zone ("EEZ"), or continental shelf.

The hearings proceeded before the PCA over a two-year period, and China never participated in the proceedings. In fact, China has consistently argued that the PCA lacked jurisdiction over the matter under the proposition that the issue is one of sovereignty over land, and as such the PCA cannot address this issue. China made their position clear in a Position Paper in December 2014.

At the conclusion of the hearings, the tribunal ruled for the Philippines on virtually all aspects of their submissions. Notably, the ruling is the first time a tribunal has ruled on disputed claims of parties to the waters of the South China Sea. The ruling also represents an authoritative interpretation of the duties and international obligations of parties to the Convention to abide by its established maritime zones and rules protecting the marine environment, which extinguish any earlier claims parties may have to extended maritime areas.

The Award

The arbitral award addressed a number of significant legal issues. As a threshold matter, the PCA first had to determine whether it had jurisdiction over the dispute. The PCA denied that the dispute was one over territorial sovereignty; rather, it held it was a dispute under the Convention with respect to claims that certain islands or rocks in the South China Sea created their own EEZs.

The PCA next turned to the merits of the case and found that China's claim of historic rights to the resources of the South China Sea was incompatible with the allocation of rights and

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maritime zones in the Convention, and if China had any historic rights to resources in the waters of the South China Sea, such rights were nullified by the entry into force of the Convention to the extent they were incompatible with the Convention's system of maritime zones.

To determine whether any of the features claimed by China had the right to either a 12-mile territorial sea or a 200-mile EEZ, the PCA found that certain reefs were above water at high tide, therefore they could have a 12-mile territorial sea. However, the Tribunal concluded that they were not entitled to an EEZ under Article 121 of the Convention because "rocks which cannot sustain human habitation or economic life of their own shall have no exclusive economic zone or continental shelf." Although fishermen had used the Spratly Islands, temporary use of the features by fishermen did not amount to inhabitation by a stable community; therefore, all of the high-tide features in the Spratly Islands are legally "rocks" that do not generate an EEZ or continental shelf.

Finally, the Tribunal concluded that China had violated its duty to respect the traditional fishing rights of Philippine fishermen by halting their access to Scarborough Shoal after May 2012, and that China's large-scale land reclamation and construction of artificial islands at seven features in the Spratly Islands had caused severe harm to the coral reef environment, thus violating its obligations under UNCLOS to preserve and protect the marine environment.

Moreover, China had breached its obligations under UNCLOS by repeatedly having its law enforcement vessels approaching the Philippine vessels at high speed and crossing ahead of them at close distances.

Subsequent Actions

The Tribunal has no authority to enforce its ruling, but noted that UNCLOS provides that the "award…shall be complied with by the parties to the dispute." However, China has been adamant: they neither adhered to nor participated in the arbitral proceedings. And, following the decision, China has continued to flex its muscles in the South China Sea by operating patrols there, sending its aircraft to the Spratly Islands, and using Chinese coast guard ships to block access by Filipino fishing boats from access to the Scarborough Shoal.

The United States, Japan, and Australia issued a joint statement on July 25, 2016, expressing their "serious concerns over maritime disputes in the South China Sea" and "strong support for the rule of law," calling on both China and the Philippines to abide by the PCA's award. Senators John McCain (R-AZ) and Senator Dan Sullivan (R-AK) were also quick to release a joint statement welcoming the decision and calling on China to be guided by international law principles. But, while the United States recognizes the maritime principles of UNCLOS as customary international law, the United States has not ratified UNCLOS. Since the PCA relied on UNCLOS in guiding their decision, such comments from the United States may lack the complete conviction and clout they otherwise would have in the international community.

Regardless, the U.S. Navy relies on interpretation of customary international law and has continued to patrol the waters of the South China Sea by sending Navy destroyers close to Scarborough Shoal and in the Spratly Islands, according to defense officials.

Conclusions and Implications for Commercial Shipping

Other countries also have claims to areas of the South China Sea, including Vietnam, Malaysia, Brunei, and Taiwan. Taiwan has been silent on the ruling, not wanting to offend its trading partner China. So far, Chinese ships have not harassed any U.S. commercial ships transiting the area. Many experts expect that China is unlikely to take steps to interrupt commercial shipping lanes, as it would be detrimental to Chinese business interests. The world is watching closely to see if China will escalate its claims to the islands of the South China Sea and disregard the binding yet unenforceable award, or whether it will decide to abide by the rule of law, and perhaps enter into talks with the Philippines to resolve these disputes. Overall, much remains at stake for the global shipping community, and the continued tension in the region warrants continued monitoring of events. In conclusion, our take is: do not expect China to back down. ◻ — ©2016 BLANK ROME LLP

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