The OFAC/Export Control Evasion and Facilitation Prohibitions — A Trap for Unwary In-house Counsel

Compliance and Ethics

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CHEAT SHEET

- ***Loose lips sink ships.*** Even seemingly innocuous legal advice can be detrimental to US national security interests if it facilitates a transaction with an actor in a sanctioned region.
- ***Serious BISness.*** The Bureau of Industry and Security (BIS) and the Office of Foreign Asset Controls have stepped up their enforcement of illegal trade in conflict zones.
- ***Some things never change.*** While a détente in US relations with Iran has opened the country to business, US firms will still be largely barred from investing there.
- ***Keep your red flags ready.*** To single out export diversions, it's worth flagging suspicious procurement behavior from potential clients.

There have been high costs arising from the United States and its allies' involvement in the Afghanistan and Iraqi conflicts, not to mention ever-growing concern stemming from the ISIS crisis in

Syria, Iraq and beyond. Given the current multiple major conflict zones where illegal trade can be highly detrimental to US interests, the enforcement of global sanctions and export controls by the Office of Foreign Asset Controls (OFAC [Department of the Treasury]) and the Bureau of Industry and Security (BIS [Department of Commerce]) is trending sharply upward.

For example, in June 2014, BNP Paribas SA agreed to pay OFAC $964 million (out of a total of almost $9 billion in civil penalties to US regulators for various offenses). Additionally, in June 2012, ING Bank N.V. settled OFAC violations for $619 million in civil penalties. In December 2012, HSBC Global Holdings plc settled OFAC violations for $375 million in civil penalties (out of a total $1.9 billion HSBC paid in penalties to US regulators for various offenses). Recently, it was announced on March 25, 2015, Schlumberger agreed to pay a $233 million OFAC criminal penalty, the largest OFAC criminal penalty to date.

The one area fraught with pitfalls for violations, even if merely inadvertently done, is with respect to the OFAC and BIS prohibitions against evasion and facilitation. Where in-house counsel have been accustomed to providing legal advice to navigate strategically through and perhaps even around legal requirements via perceived loopholes, this is an area where zealous advocacy can quickly amount to a serious violation of the law.

It does not help matters that this area of the law is a moving target. For example, the five permanent members of the UN Security Council (China, France, Russia, the United Kingdom and the United States) plus Germany reached an agreement with Iran on July 14, 2015, on nuclear containment. Once implemented, the agreement could result in Iran being removed from the list of embargoed countries with some of the toughest sanctions being lifted (a dramatic change in a restrictive policy that has been in place for over the past three decades).

Moreover, on April 14, 2015, US President Barack Obama recommended to Congress that Cuba be removed from the US government's list of state sponsors of terrorism. The president said the government of Cuba had not provided any support for international terrorism during the preceding six-month period, and had provided assurances that it will not support acts of international terrorism in the future. The immediate effect of this action led to the United States deciding to reopen its embassy in Havana (with Cuba reciprocating with plans to open its embassy in Washington, DC). With the ultimate possibility of US Congress lifting the Cuban sanctions in the future, the potential removal of the US embargo of Cuba would be the most significant major policy change in over half a century.

This article will address the OFAC and BIS prohibitions against evasion and facilitation, will provide examples of what can go wrong, and will conclude with best practices for preventing violations.

OFAC and BIS prohibitions against evasion and facilitation

To understand the scope of the OFAC and BIS prohibitions against evasion and facilitation, it is first necessary to set forth the definitions of which persons are subject to OFAC and BIS jurisdiction. OFAC's regulations provide a broader definition than BIS of who is subject to its jurisdiction.

OFAC definition of person

For the OFAC general definition of person, 31 CFR § 560.314 states as follows:

> "The term *United States person* means any United States citizen, permanent resident alien,

entity organized under the laws of the United States (including foreign branches), or any person in the United States."

In addition, 31 CFR § 560.305 defines person and entity as follows:

"(a) The term person means an individual or entity.

(b) The term entity means a partnership, association, trust, joint venture, corporation or other organization."

While the above general definition is similar to the BIS definition of "Person," OFAC has broadened the definition to include foreign subsidiaries under certain embargoes.

For example, in August 2012, President Obama signed into law the Iran Threat Reduction and Syria Human Rights Act (ITRA). Under ITRA, similar to the law already in effect regarding Cuba, a US person "owns or controls" a foreign entity if it: (1) holds more than 50 percent of the equity interest by vote or value in the entity; (2) holds a majority of seats on the board of directors of the entity; or (3) otherwise controls the actions, policies, or personnel decisions of the entity."

Section 218 of ITRA also makes the US person directly liable under the International Emergency Economic Powers Act penalty scheme for activities by the foreign entity to violate or "cause" a violation of the OFAC sanctions.

As another example, the Ukraine Related Sanctions Regulations block transactions with entities 50 percent or more owned by specially designated nationals (SDNs), including where two or more such nationals exercise such control in the aggregate.

In short, for certain sanctions programs, OFAC covers not only foreign branches, but US controlled foreign subsidiaries, or, for targeted sanctioned entities, OFAC blocks the property of SDNs even when two or more such SDNs control an entity 50 percent or more in the aggregate.

BIS definition of person

Meanwhile, BIS provides its own definitions regarding the scope of its coverage over US person activities, and it is similar to the OFAC general definition. The relevant sections are discussed below:

15 CFR § 744.6 (a) provides that "No US person shall . . . knowingly support an export, reexport, or transfer (in-country) that does not have a [required] license . . ." Part (c) of that same section defines US person as:

"Any individual who is a citizen of the United States, a permanent resident alien of the United States, or a protected individual . . . [one seeking political asylum];

Any juridical person organized under the laws of the United States or any jurisdiction with the United States, including foreign branches; and

Any person in the United States."

United States Person / US Person

	OFAC Definition	BIS Definition
Sources	31 CFR § 560.314 (Iranian Transactions and Sanctions Regulations)	15 CFR § 744.6(c) (Export Administration Regulations)
Statutory Language	“The term United States person or U.S. person means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States.”	“Definition of U.S. person. For purposes of this section, the term U.S. person includes: (1) Any individual who is a citizen of the United States, a permanent resident alien of the United States, or a protected individual . . . [one seeking political asylum]; (2) Any juridical person organized under the laws of the United States or any jurisdiction with the United States, including foreign branches; and (3) Any person in the United States.”

Extension to foreign persons?

Both OFAC and BIS prohibitions can be extended to foreign persons, arguably, through certain criminal statutes. First and foremost, 18 U.S.C. §2 provides:

> “(a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.
>
> (b) Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal.”

Moreover, 50 US Code §1705 (implementing Section 260 of the International Emergency Economic Powers Enhancement Act of 2007) states:

> “(a) Unlawful acts It shall be unlawful for a person to violate, attempt to violate, conspire to violate, or cause a violation of any license, order, regulation, or prohibition issued under this chapter.”

Foreign persons who therefore commit acts against the United States (i.e., an act counter to OFAC sanctions would be so considered) can expect to be the subject of a prosecution attempt under the

right circumstances (e.g., a high profile case along with entry into the United States).

OFAC Prohibitions on Evasion and Facilitation

OFAC prohibits evasion and facilitation through the different executive orders issued in imposing sanctions as well as through eventual codification as regulations.

For example, under the Iranian Transactions and Sanctions regulations, 31 CFR § 560.208 provides in the relevant part that

> “. . . no United States person, wherever located, may approve, finance, facilitate, or guarantee any transaction by a foreign person where the transaction by that foreign person would be prohibited by this part if performed by a United States person or within the United States.”
>
> [64 FR 20171, Apr. 26, 1999]

Likewise, § 560.417 states

> “. . . a prohibited facilitation or approval of a transaction by a foreign person occurs, among other instances, when a United States person:
>
> (a) Alters its operating policies or procedures, or those of a foreign affiliate, to permit a foreign affiliate to accept or perform a specific contract, engagement or transaction involving Iran or the Government of Iran without the approval of the United States person, where such transaction previously required approval by the United States person and such transaction by the foreign affiliate would be prohibited by this part if performed directly by a United States person or from the United States;
>
> (b) Refers to a foreign person purchase orders, requests for bids, or similar business opportunities involving Iran or the government of Iran to which the United States person could not directly respond as a result of the prohibitions contained in this part; or
>
> (c) Changes the operating policies and procedures of a particular affiliate with the specific purpose of facilitating transactions that would be prohibited by this part if performed by a United States person or from the United States.”
>
> [64 FR 20172, Apr. 26, 1999]

Moreover, Executive Order 13608 (May 1, 2012) targets “Foreign Sanctions Evaders” that undermine US sanctions targeting Iran and Syria. Specifically, Section 1(a)(ii) of Executive Order 13608 targets those who “facilitate deceptive transactions” where the identity of Iranian or Syrian parties are withheld or obscured from other parties or regulatory authorities.

Prohibited facilitation

Under EAR General Prohibition 10, you may not:

“. . . sell, transfer, export, re-export, finance, order, buy, remove, conceal, store, use, loan, dispose

of, transport, forward, or otherwise service, in whole or in part, any item subject to the EAR and exported or to be exported with knowledge that a violation of the Export Administration Regulations, the Export Administration Act or any order, license, License Exception, or other authorization issued thereunder has occurred, is about to occur, or is intended to occur in connection with the item. Nor may you rely upon any license or License Exception after notice to you of the suspension or revocation of that license or exception…"

Also, under Executive Order 13662 of September 12, 2014, covering the Ukraine Related Sanctions, it provides in the relevant part:

> ". . . the following are also prohibited: (1) any transaction that evades or avoids, has the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions contained in this Directive; and (2) any conspiracy formed to violate any of the prohibitions in this Directive."
>
> *ACC Docket*, December 2015

BIS prohibitions on evasion and facilitation

The chief BIS prohibition in this regard can be found in General Prohibition 10 codified under 15 CFR Part 734, which states as follows:

> "Proceeding with transactions with knowledge that a violation has occurred or is about to occur
> (Knowledge Violation to Occur). . . "

The prohibitions against evasion and facilitation are strict

Given the strict nature of these OFAC and BIS prohibitions, three points come into view:

- Overzealous advocacy in the spirit of attempting a "work-around" can easily lead to running afoul of the prohibitions;
- US persons cannot be involved in any transactions involving sanctioned nationals; and
- A number of foreign entities of late have found themselves caught with large OFAC penalties for a failure to take these prohibitions seriously as will be discussed in the next section.

Examples of what can go wrong

The two industries most targeted for OFAC and BIS sanctions have been the financial industry services and oil-field services industries. To illustrate what can go wrong, this article will review two of the leading financial services cases as well as two of the leading oil field services cases.

Two financial industry cases for lessons learned

PNB Paribas case

The largest OFAC fine to date involving the financial industry came in the summer of 2014 against PNB Paribas (PNPP) for $964 million. The settlement agreement details numerous instances of facilitation and concealment all of which BNPP's subsidiary in Geneva and branch in Paris overwhelmingly conducted in violation of US sanctions laws. Those instances of facilitation and concealment included omitting references to sanctioned parties; replacing the names of sanctioned parties with BNPP's name or a code word; and structuring payments in a manner that did not identify the involvement of sanctioned parties in payments sent to US financial institutions.

Given the numerous repetitive violations in this regard, it is readily apparent how BNPP managed to ratchet up the largest OFAC fine to date. Specifically, OFAC penalties are imposed as follows: Depending on the program, criminal penalties for each willful violation can include fines ranging up to $20 million and imprisonment of up to 30 years. Civil penalties for violations of the Trading With the Enemy Act can range up to $65,000 for each violation. Civil penalties for violations of the International Emergency Economic Powers Act can range up to $250,000 or twice the amount of the underlying transaction for each violation. Civil penalties for violations of the Foreign Narcotics Kingpin Designation Act can range up to $1,075,000 for each violation.

The chief lessons learned from the BNPP case include a failure to recognize that foreign office facilitation and evasive sanctions activities are illegal. The use of US intermediary banks in New York City to process US dollar wire transfers constitutes an OFAC violation. Because of BNPP's presence in the United States and continued desire to make use of the US dollar reserve currency in its international commercial operations, BNPP was subject to OFAC jurisdiction, and the bank was forced to pay heavy fines for its facilitation and evasion activities to retain its privilege to operate in the US financial market.

ING Bank case

The second largest OFAC fine was imposed against ING Bank N.V. (ING) in the summer of 2012 for $619 million. The violations involved ING's commercial banking offices in the Netherlands, Belgium, France, Curaçao and Cuba processing wire transfers, trade finance transactions, or travelers' checks involving the following sanctioned countries: Burma, Cuba, Iran, Libya and Sudan. In the settlement agreement, OFAC found these violations to be egregious under the following rationale: OFAC determined that ING's conduct was marked by willfulness and recklessness; several ING employees, including senior management, were found to be aware of the conduct that led to the violations; the violations resulted in significant harm to US sanctions programs objectives; and ING was determined to be a highly sophisticated global financial institution.

The chief lesson learned for a prominent and well known financial institution like ING Bank is that the government's expectation for compliance will be higher for those companies well-established in the global market place.

Two oilfield services company cases for lessons learned

Schlumberger case

The largest criminal sanctions fine levied against a company came against Schlumberger Oilfield Holdings Ltd. (Schlumberger) on March 25, 2015, in the amount of $232.7 million. The Department of Justice levied this fine, imposed a three-year probationary period and required Schlumberger to hire an independent consultant to review its sanctions compliance program all as a result of Schlumberger conspiring to violate the International Emergency Economic Powers Act (IEEPA) by

willfully facilitating illegal transactions and engaging in trade with Iran and Sudan.

The specific conduct that violated US sanctions law started on or about early 2004 and continued through June 2010. The Department of Justice (the DoJ) reported that Drilling & Measurements (D&M), a United States-based Schlumberger business segment, violated US sanctions against Iran and Sudan by:

- approving and disguising the company's capital expenditure requests from Iran and Sudan for the manufacture of new oilfield drilling tools and for the spending of money for certain company purchases (in particular, the DoJ reported that in Schlumberger email communications, D&M personnel outside the United States referred to Iran as "Northern Gulf" and Sudan as "Southern Egypt" or "South Egypt" in their email communications with D&M personnel in the United States);
- making and implementing business decisions specifically concerning Iran and Sudan (that is, D&M headquarters personnel made and implemented business decisions in the day-to-day operations of Iran and Sudan); and
- providing certain technical services and expertise in order to troubleshoot mechanical failures and to sustain expensive drilling tools and related equipment in Iran and Sudan (that is, at times, queries entered by, or on behalf of, D&M personnel in Iran and Sudan were addressed by D&M personnel located in the United States).

There is a chief lesson learned from the Schlumberger case. Schlumberger, though incorporated outside the United States, managed to violate US sanctions laws by involving persons (including non-US citizens or residents), affiliates, unaffiliated business partners or facilities located in the United States. In short, any involvement in sanctioned country activities by a person or entity (whether an affiliate or not) within the United States, or by US citizens or residents anywhere in the world, may trigger liability for a foreign company that itself has no direct presence in the United States but which benefits from those facilitated activities.

Best practices for preventing evasion

Aside from providing comprehensible policies and procedures, this area calls for targeted training for management, both the C-Suite (including in-house counsels[!]) and general managers leading regional teams. It also calls for empowering the international trade compliance team to issue a stop order on transactions where potential red flags are present. Undertaking proper due diligence to rule out red flag indicators will form a crucial part of a transaction defense file. Another critical part of an effective compliance program will involve monitoring and auditing. Big data analysis on certain search terms can provide real-time insight into any red flags or outright violations in progress. Moreover, a proper escalation process for handling uncovered violations, both for making potential voluntary self-disclosures and to undertake swift and appropriate remedial measures will be necessary. Where the parent company is incorporated outside the United States, the educational effort will have to be ramped up all the more to ensure inadvertent violations are not created through involving persons subject to US jurisdiction (or a jurisdiction where similar types of sanctions are likely to be deployed, such as the UK and the European Union).

The Weatherford case

The other oilfield service company case involved Weatherford International Ltd. (Weatherford). In November 2013, Weatherford agreed to settle potential civil liability for violations of the Cuban Assets Control Regulations (CACR), 31 C.F.R. part 515; the Iranian Transactions and Sanctions Regulations (ITSR), 31 C.F.R. part 560; and the Sudanese Sanctions Regulations (SSR), 31 C.F.R. part 538, for $91,026,450.

OFAC concluded the Weatherford violations were egregious and not voluntarily self-disclosed. OFAC determined that: (1) between 2005 and 2008, Weatherford conducted 441 transactions totaling $69,268,078, that provided oilfield equipment and services in which the government of Cuba and/or blocked Cuban nationals had an interest, including travel-related transactions by Weatherford employees to and from Cuba; (2) between 2003 and 2007, Weatherford conducted extensive oilfield services business in Iran, including 100 transactions totaling $23,001,770, which involved the direct or indirect exportation of goods, technology, and/or services to Iran, and/or the facilitation of those transactions by US persons; and (3) between 2005 and 2006, Weatherford conducted oilfield services business in Sudan, including 45 transactions totaling $295,846, which involved the direct or indirect exportation of goods, technology or services from the United States to Sudan.

Weatherford exhibited aggravating as well as mitigating factors in its conduct that impacted the final determination of its penalty. OFAC, for example, determined Weatherford’s conduct to be willful because various executives and senior management in Weatherford companies knew or had reason to know of the conduct that led to the apparent violations; the apparent violations constituted a long-term pattern of conduct; the apparent violations resulted in significant harm to US sanctions programs objectives; Weatherford is a large and sophisticated oilfield services company; and Weatherford’s compliance program at the time of the apparent violations was substantially deficient.

OFAC found mitigating factors to the extent Weatherford had not been the subject of prior OFAC penalties or of other administrative action; Weatherford undertook significant remedial steps to ensure future compliance; and Weatherford substantially cooperated with OFAC’s investigation of the apparent violations. Specifically, Weatherford retained outside counsel to conduct a comprehensive internal investigation and submitted extensive documentation and reports regarding potential sanctions violations. Finally, Weatherford agreed to toll the statute of limitations.

The chief lesson learned in the Weatherford case centers on the value of having an effective compliance program in the first instance. With an effective compliance program, Weatherford would have had an additional mitigating factor in its favor, and it may have even discovered the misconduct in time to make a voluntary self-disclosure rather than having the government first open an investigation to get at the bottom of the misconduct.

Practical steps to take to avoid violations

For known shipment diversion vulnerabilities, it might behoove one to create an operations playbook to alert personnel to be on the look-out for customers who might be at risk for operating in harsh sanctioned countries. There are certain countries known for a high incidence of improper transshipments, namely: Hong Kong, Singapore and the United Arab Emirates. For branch or subsidiary and sales agent offices in these countries, in-person training should occur annually.

In addition, personnel are now requiring customer certifications that any contemplated work in a harsh sanctioned country will require sufficient notice for return of any rented equipment as well as notice of the need to discontinue any managed services. This all underscores the importance of raising awareness through targeted training.

It goes without saying that any BIS noted red flags for potential diversion should be investigated. Those red flags are cited in the below sidebar box.

Suspicious minds

- The customer or purchasing agent is reluctant to offer information about the end-use of a product.
- The product's capabilities do not fit the buyer's line of business; for example, a small bakery places an order for several sophisticated lasers.
- The product ordered is incompatible with the technical level of the country to which the product is being shipped. For example, semiconductor manufacturing equipment would be of little use in a country without an electronics industry.
- The customer has little or no business background.
- The customer is willing to pay cash for a very expensive item when the terms of the sale call for financing.
- The customer is unfamiliar with the product's performance characteristics but still wants the product.
- Routine installation, training or maintenance services are declined by the customer.
- Delivery dates are vague, or deliveries are planned for out-of-the-way destinations.
- A freight forwarding firm is listed as the product's final destination.
- The shipping route is abnormal for the product and destination.
- Packaging is inconsistent with the stated method of shipment or destination.
- When questioned, the buyer is evasive or unclear about whether the purchased product is for domestic use, export or re-export.

The key best practices for preventing evasion and facilitating violations of US sanctions laws are spelled out in the below side-bar box. In the end, in-house counsel need to take a step back from overzealous advocacy in engaging in any kind of "workaround" in this instance. Indeed, the law prohibits conduct that either evades legal requirements or that may facilitate a third party to violate the law.

Further Reading

Department of the Treasury: Settlement Agreement with PNP Paribas, June 30, 2014.

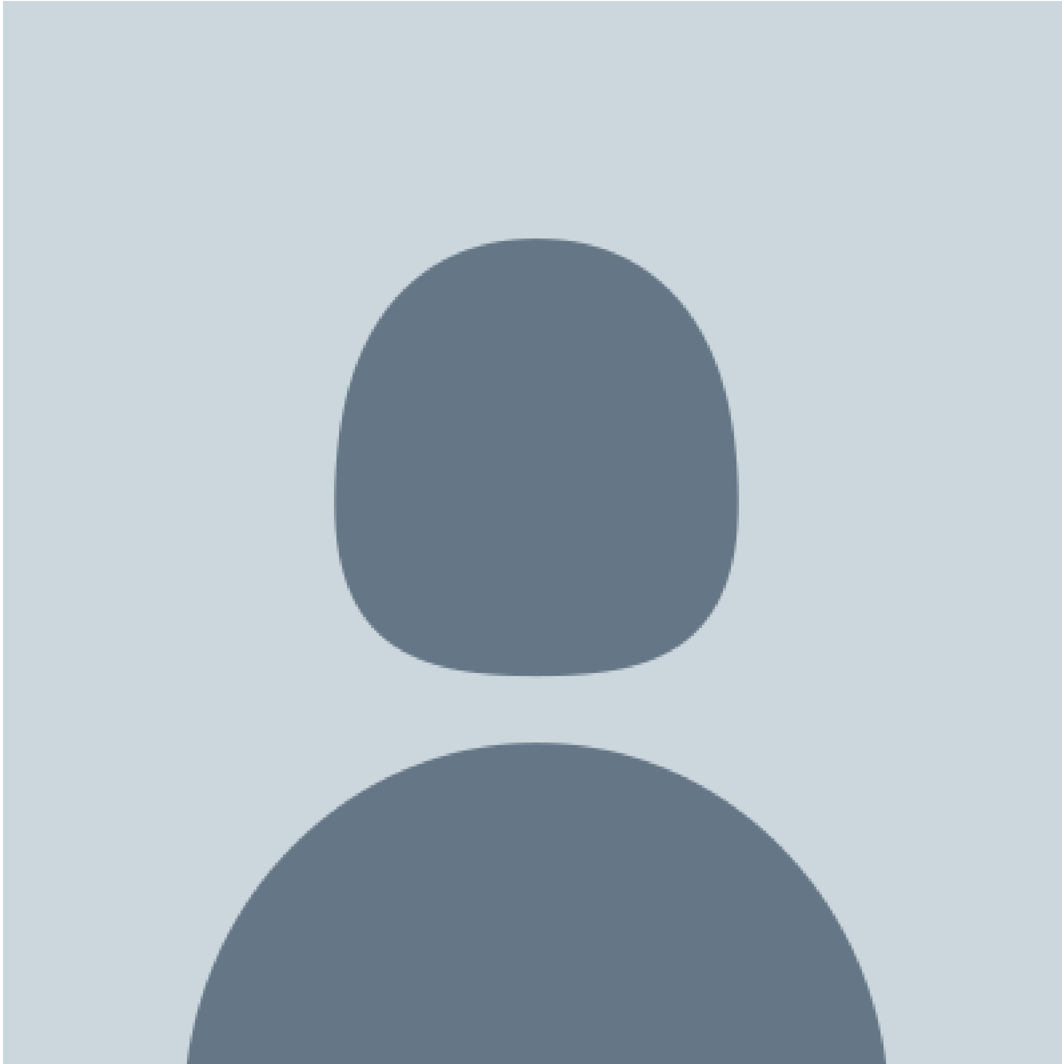
Department of the Treasury: Settlement Agreement with ING Bank N.V. June 12, 2012. MUL-565595.

Department of the Treasury: Settlement Agreement with HSBC Global Holdings plc. December 11, 2014. MUL-615225.

Please see 31 C.F.R. §589.406.

15 CFR Part 732, Supplement 3.

Robert J. Ward, Jr.



Lawyer in the global trade compliance group

Hewlett Packard, Inc

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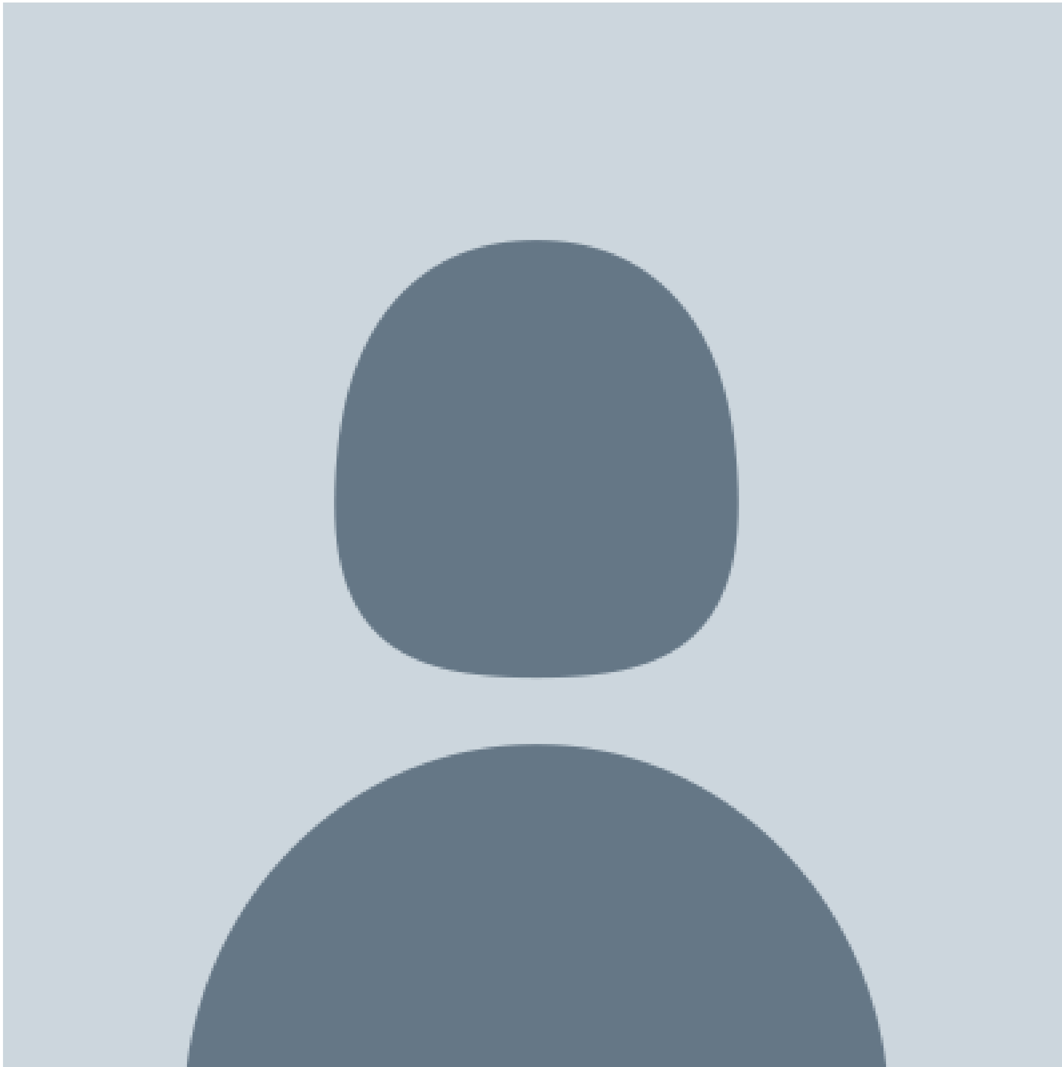
Jan Farley



Global Compliance Officer

Dresser-Rand Company

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