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COMPLIANCE PROGRAMS

Export Controls and Economic Sanctions Enforcement Update Q317

BY MARIO MANCUSO, JOANNA RITCEY-DONOHUE, AND SANJAY MULLICK

Following is a summary of key national security enforcement actions and settlement agreements concerning export controls and economic sanctions occurring in the period July 1 to Sept. 30.

Kirkland & Ellis partner Mario Mancuso leads the firm's International Trade & National Security practice. Mario is a former U.S. Under Secretary of Commerce for Industry and Security and senior Defense Department official. Mario's new book, ''A Dealmaker's Guide to CFIUS,'' was released in November.

Joanna Ritcey-Donohue, also a partner in the Washington office, has experience that spans a broad range of international trade law and global compliance risk matters. She advises and represents clients with respect to economic sanctions, anti-corruption, anti-money laundering and export and import controls.

Sanjay Mullick, another partner in Kirkland's Washington office, regularly represent clients on investigative, regulatory and transactional matters related to economic sanctions, export and import controls, money laundering, and international corruption.

Recent actions by the U.S. Department of Commerce Bureau of Industry and Security (''BIS'') affirm the importance of being mindful that meaningful penalties extend beyond just fines and indicate that BIS increasingly may use settlements as a forcing function to get companies to implement export compliance programs. Recent actions by the U.S. Department of the Treasury Office of Foreign Assets Control (''OFAC'') affirm its broad assertion of jurisdiction and indicate that parties must undertake appropriate risk-based diligence, particularly if they will deal with the inherent regulatory risk related to U.S. origin items or utilizing the U.S. financial system.

Export Controls

Non-Financial Penalties

Narender Sharma and his company Hydel Engineering Products, both of India, agreed to pay $100,000 to settle charges they conspired to export a U.S. origin waterway barrier debris system to Iran via transshipment through third countries. Narender Sharma and Hydel Engineering Products, Docket No. 17-BIS-0005 (U.S. Dept. of Commerce Bureau of Industry and Security Aug. 10, 2017), https://efoia.bis.doc.gov/index.php/documents/export-violations/export-violations-2015/1131-e2516/file. Sharma was involved in omitting references to Iran in the transaction documentation, including when his U.S. supplier notified him to ''[p]lease

remember that there can be no paperwork from our end that has any mention of Iran.'' *Id.* at 14.

BIS suspended $70,000 of the fine and agreed to ultimately waive it, but did so on the condition that Sharma and Hydel not commit another violation of the Export Administration Regulations (''EAR'') for five years. Otherwise, in addition to collecting the remainder of the fine, BIS would issue a denial order against Sharma and Hydel under § 764.3(a)(2) of the EAR, by which they ''may not, directly or indirectly, participate in any way in any transaction involving any commodity, software or technology. . . exported or to be exported from the United States that is subject to the [Export Administration] Regulations.'' *Id.* at 18. This would include, *e.g.*, (i) applying for, obtaining or using any export licenses; (ii) ordering, receiving or using any item exported from the U.S. that is subject to the EAR; or (iii) benefiting from any transaction involving any item exported from the U.S. that is subject to the EAR.

It is often asked whether and how BIS will fine individuals and entities located outside the U.S. for violations of the EAR. However, being denied access to U.S. technology for several years can have an even greater adverse impact than having to pay a one-time fine.

Export Controls Audits

U.S. company Cryofab, Inc. agreed to pay $35,000 to settle charges it made two unauthorized exports to India. Though the items were valued at only $21,570 and were designated EAR99 and thus not sensitive for export control purposes, they were exported to a party on the Entity List. Cryofab, Inc. (U.S. Dept. of Commerce Bureau of Industry and Security Aug. 18, 2017), https://efoia.bis.doc.gov/index.php/documents/export-violations/export-violations-2015/1128-e2515/file. BIS stated that Cryofab did not screen the Entity List; had not obtained an export license; and otherwise had incorrectly instructed its freight forwarder that an export license was not required.

BIS also required Cryofab to engage an unaffiliated third-party consultant at its own expense to ''complete an external audit of its export controls compliance program'' covering a one-year period and to provide the results to BIS, which could lead to additional violations and further potential penalties. *Id.* at 7. BIS indicated that the audit ''shall be in substantial compliance with the Export Management and Compliance Program (''EMCP'') sample audit module.'' *Id.* at 8. The EMCP is a BIS audit module which consists of eight elements and covers topics such as management's commitment, risk assessment, export authorization, recordkeeping, training, audits, and handling export violations and taking corrective actions. U.S. Dept. of Commerce Bureau of Industry and Security, Compliance Guidelines: How to Develop an Effective Export Management and Compliance Program and Manual (2013), https://www.bis.doc.gov/index.php/forms-documents/compliance-training/export-management-compliance/1256-emcp-guidelines-november-2013/file.

Export Reports

Harold Rinko, doing business as Pennsylvania entity Global Parts Supply, agreed to pay $100,000 to settle charges it procured items from U.S. suppliers and exported them to Syria through third countries without a license. Harold Rinko, d/b/a Global Parts Supply a/k/a Global Parts Supply and Equip Repair (U.S. Dept. of Commerce Bureau of Industry and Security Jul. 26, 2017), https://efoia.bis.doc.gov/index.php/documents/export-violations/export-violations-2015/1120-e2507/file. BIS indicated that ''Rinko/Global Parts Supply concealed from the U.S. suppliers the items' ultimate destination and prepared invoices that listed false purchasers and end users in third countries,'' including in at least one instance informing a co-conspirator ''[h]e must make all of . . . [his] orders seem as they are only going to London and not further.'' *Id.* at 11 and 13.

As the condition of suspending the $100,000 fine and a ten-year denial of export privileges, BIS required Rinko to submit to BIS quarterly reports of all its export and re-export transactions involving items subject to the EAR for a period of ten years. BIS stated:

> Each report shall include, at a minimum, the following information for each item involved in each such export or re-export transaction during the applicable quarter: item description; classification under the Regulations for export control classification purposes, including any applicable Export Control Classification Number (''ECCN''); ultimate destination and ultimate consignee; any intermediate destination and intermediate consignee; end use; U.S. dollar value; and the identity of any freight forwarder, consolidator, or broker involved in the transaction.

Id. at 15. Previously, BIS regularly would suspend penalties so long as a company did not commit another violation for a certain period of time. However, recent indications are that now more routinely BIS will condition suspensions on companies taking active steps to safeguard against export violations and that BIS will impose requirements which will enable it to directly verify that has occurred.

Economic Sanctions

Restricted Party Screening

Richemont North America, Inc., d/b/a Cartier, agreed to pay $334,000 for four shipments of jewelry to a Specially Designated National (''SDN''). Richemont North America, Inc., d.b.a. Cartier (''Richemont''), Settles Potential Civil Liability for Apparent Violations of the Foreign Narcotics Kingpin Sanctions Regulations (U.S. Dept. of Treasury Office of Foreign Assets Control Sept. 26, 2017), https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170926_richemont.pdf. OFAC indicated that on four occasions an individual purchased jewelry from one of Richemont's Cartier boutiques and provided the SDN's name and address as the ship-to party, yet Richemont ''did not identify any sanctions-related issues with the transaction prior to shipping the goods.'' *Id.* at 1.

OFAC indicated that companies are encouraged to ''develop, implement, and maintain a risk-based approach to sanctions compliance, and to implement processes and procedures to identify and mitigate areas of risks.'' *Ibid.* OFAC explained that factors to consider in developing a compliance program include ''an assessment of its products and services, frequency and volume of international transactions and shipments, client base, and size and geographic locations.'' *Id.* at 2. In this case, OFAC stated that the risks included conducting retail operations that engaged in international transactions in an industry at high risk of money laundering.

One of the practical issues OFAC did not expressly address but which is central to sanctions compliance, is

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whether it is expected that companies will conduct restricted party screening instantly. In a retail operation it can be a challenge to screen against SDNs in real-time. In this case, however, though the customer may have purchased the jewelry at point-of-sale transactions, because Richemont still maintained possession of the jewelry and then had to ship it overseas, it seems there would have been reasonably sufficient time for it to screen the recipient. In any case, it is clear that OFAC expects screening of multiple counterparties to a transaction, not only the direct customer.

Freight Forwarders

California company American Export Lines (''AEL'') agreed to pay $518,063 to settle charges it committed 140 violations of the Iranian Transactions and Sanctions Regulations (''ITSR''). American Export Lines Settles Potential Civil Liability for Apparent Violations of the Iranian Transactions and Sanctions Regulations (U.S. Dept. of Treasury Office of Foreign Assets Control Aug. 17, 2017), https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170817_ael.pdf. OFAC considered it an aggravating factor that AEL ''provided an economic benefit to Iran,'' even though the products at issue were described as ''used and junked cars and parts'' and they were being transshipped via Iran ultimately to be used in their final destination Afghanistan. *Id.* at 1.

The case seems to highlight that U.S. government agencies including OFAC will continue to hold freight forwarders responsible for compliance given their key role in the supply chain of international commerce even though they are not a party to the underlying transaction. OFAC emphasized as an aggravating factor that ''AEL is a sophisticated international full-service freight forwarder with experience with U.S. export laws and OFAC regulations, particularly the ITSR.'' *Ibid.*

Facilitation

IPSA International Services, Inc. (''IPSA'') of Arizona agreed to pay $259,200 for 72 apparent violations of the ITSR. IPSA International Services, Inc. Settles Potential Civil Liability for Apparent Violations of the Iranian Transactions and Sanctions Regulations (U.S. Dept. of Treasury Office of Foreign Assets Control Aug. 10, 2017), https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170810_ipsa.pdf. OFAC determined that IPSA, which it described as a ''global business investigative and regulatory risk mitigation firm,'' apparently imported Iranian-origin services into the U.S. given that due diligence conducted in Iran by contractors and third parties hired by IPSA's subsidiaries in Canada and the United Arab Emirates, was done on its behalf and for its benefit. *Id.* at 1.

A key focus was the interplay between IPSA and its foreign subsidiaries, which OFAC considered prohibited ''facilitation,'' *i.e.*, engaging in actions U.S. persons were prohibited from undertaking. With respect to one contract, OFAC stated that IPSA ''reviewed, approved, and initiated the foreign subsidiaries' payments to providers of the Iranian-origin services.'' *Ibid.* OFAC indicated that one of IPSA's senior management knew or had reason to know of the importations and of the transactions otherwise. OFAC pointed out that, even under General License H, U.S. persons are authorized to engage only in limited activities with regard to U.S.-owned or controlled foreign entities and that ''the general prohibition of facilitation remains in place.'' *Id.* at 2.

This case serves as an important reminder that, even though non-U.S. subsidiaries may engage in certain business with Iran, risks to the U.S. parent remain. It points out some of the day-to-day challenges that can arise, *e.g.*, with respect to management knowledge and decision making, as well as with approval processes such as those for payments. Before proceeding, it is important to consider whether foreign subsidiaries actually do or can operate independently from their U.S. parent.

U.S. Origin Items

COSL Singapore Ltd. (''COSL'') agreed to pay $415,350 to settle its liability for 55 apparent violations of the ITSR. COSL Singapore Ltd Settles Potential Civil Liability for Apparent Violations of the Iranian Transactions and Sanctions Regulations (U.S. Dept. of Treasury Office of Foreign Assets Control Aug. 24, 2017), https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170824_cosl.pdf. COSL's procurement specialists located in Singapore purchased oil rig supplies from vendors located in the U.S. and then sent those items on to COSL's oil rigs operating in Iranian territorial waters. OFAC indicated that some of the purchase order quotes that COSL's procurement specialists received ''included specific language warning that any such goods could not be shipped or re-exported to countries subject to U.S. economic sanctions, specifically including Iran.''

Even though COSL is not a U.S. person and it did not engage in activities in the U.S., OFAC charged it with apparent violations of § 560.204 of the ITSR, which covers ''exportation . . . from the United States, or by a United States person.'' 31 C.F.R § 560.204. Instead, § 560.205, which specifically covers ''reexportation . . . by persons other than United States persons,'' would seem applicable given that COSL re-exported the supplies from Singapore to Iran. 31 C.F.R § 560.205. OFAC may have done so if some of the items were designated for export control purposes as EAR99, as that could make them permissible to re-export under § 560.205 but not to export under § 560.204.

Perhaps more likely was that OFAC was focused on COSL's conduct, given that it also charged the company with an apparent violation of § 560.203, which concerns evasion of sanctions. 31 C.F.R § 560.203. That provision specifically includes a prohibition on ''[a]ny transaction . . . that . . . causes a violation.'' *Ibid.* There is no express indication that COSL affirmatively misrepresented the ultimate destination of the items. Nonetheless, OFAC may have taken the view that, by agreeing to but then disregarding the terms in purchase orders which warned against the goods going to Iran, COSL caused the vendors to export them from the U.S. in violation of Iran sanctions.

Compliance Programs

Singaporean companies CSE Global Limited and CSE Trans Tel Pte. Ltd. (''Trans Tel'') agreed to pay $12,027,066 for allegedly ''causing'' six financial institutions to engage in the unauthorized exportation or re-exportation of financial services from the U.S. to Iran. CSE Global Limited and CSE TransTel Pte. Ltd. Settle Potential Civil Liability for Apparent Violations of the International Emergency Economic Powers Act and the

Iranian Transactions and Sanctions Regulations (U.S. Dept. of Treasury Office of Foreign Assets Control Jul. 27, 2017), https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170727_transtel.pdf. Trans Tel entered into contracts with, and received purchase orders from, Iranian companies to deliver and install telecommunications equipment for energy projects in Iran, and it engaged Iranian third-party vendors to provide goods and services on its behalf. Trans Tel paid those vendors by initiating wire transfers from its U.S. dollar account at a non-U.S. bank located in Singapore, which processed the funds transfers through the U.S.

OFAC pointed out that Trans Tel's then-managing director had executed a letter with the Singaporean bank stating that it would "hereby undertake not to route any transactions related to Iran through [the Bank], whether in Singapore or elsewhere." *Id.* at 2. However, Trans Tel proceeded to originate U.S. dollar funds transfers from its account for its Iran business. None of the transactions contained references to Iran, the Iranian projects, or any Iranian parties, which OFAC considered to be "systematically obfuscating" its prohibited conduct. *Ibid.* OFAC cited § 1705 (a) of the International Emergency Economic Powers Act, which makes it "unlawful for a person to violate . . . or cause a violation." 50 U.S.C. § 1705 (a). In doing so, OFAC emphasized:

> This enforcement action highlights the sanctions compliance obligations of all individuals and entities that conduct business in OFAC-sanctioned jurisdictions or with OFAC-sanctioned parties and that also process transactions directly or indirectly through the United States . . .

See CSE Global Limited, at 2 and 3. OFAC did not address the compliance obligations of the bank involved, particularly whether it was getting sufficient information about the transactions to be able to vet them and whether not doing so should have raised red flags. This seems noteworthy because OFAC indicated the bank requested Trans Tel sign the undertaking in order to "continue" to be able to do business with the bank, raising the question of whether the bank may already have been suspicious of the company's conduct. Nonetheless, OFAC was able to leverage Trans Tel's use of the U.S. financial system to impose a substantial fine on the company for violations of U.S. sanctions, a party over which it otherwise would not have had jurisdiction.

Key Takeaways

■ A BIS denial order can cut a company off from U.S. technology and have lasting adverse impacts beyond having to pay a monetary fine.

■ Companies should be prepared to verify compliance with BIS by conducting comprehensive export controls audits and submitting detailed records of their export transactions.

■ U.S. companies need to carefully assess whether their foreign subsidiaries can operate independently with respect to sanctioned country business and must continuously monitor their own involvement, lest they violate prohibitions against facilitation.

■ Non-U.S. companies remain within the scope of OFAC jurisdiction particularly if they deal in U.S. origin items or utilize the U.S. financial system.

■ OFAC will take seriously representations companies make about their transactions and will make it an enforcement priority to penalize those who do not fulfill those commitments.

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