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COMPLIANCE PROGRAMS

Economic Sanctions and Export Controls Enforcement Update Q4 2017

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Following is a summary of key national security enforcement actions and settlement agreements concerning economic sanctions and export controls occurring in the period October 1 to December 31, 2017.

Recent actions by the U.S. Department of the Treasury Office of Foreign Assets Control (''OFAC'') indicate that U.S. companies with foreign subsidiaries need to ensure compliance programs flow down through the entirety of the corporate enterprise and be mindful of maintaining independence between U.S. and non-U.S. entities as it relates to sanctioned country activities. They also emphasize the importance both of engaging in thorough due diligence with respect to proposed mergers and acquisitions, and of availing of the voluntary self-disclosure process, as a way to mitigate against successor liability.

Recent actions by the U.S. Department of Commerce Bureau of Industry and Security (''BIS'') affirm the importance of avoiding continued conduct once an export violation is known, and they serve as a reminder that non-U.S. companies can suffer significant non-financial penalties if denied access to U.S. technology. They also demonstrate that BIS regularly gathers intelligence to gain its own understanding of a party's export activities.

Economic Sanctions

Compliance Programs

American Express Company (''American Express'') agreed to pay $204,277 to settle potential civil liability for 1,818 apparent violations of the Cuban Assets Control Regulations (''CACR'') (U.S. Dept. of the Treasury Office of Foreign Assets Control, Nov. 17, 2017), https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20171117_BCCC.pdf. OFAC indicated that between 2009 and 2014, credit cards that American Express's Belgian indirect subsidiary BCC Corporate SA (''BCCC'') had issued to its corporate customers were used to make credit card purchases in or otherwise involving Cuba.

BCCC had been acquired in March 2009 by Belgian company Alpha Card Group (''Alpha Card''), itself a direct 50 percent-owned subsidiary of American Express. OFAC explained that Alpha Card and BCCC had policies and procedures in place to screen transactions against OFAC's List of Specially Designated Nationals and Blocked Persons, but that they ''nevertheless failed to implement controls to prevent BCCC-issued credit cards from being used in Cuba.'' Id. at 1. Prior to acquiring BCCC, Alpha Group dealt exclusively with American Express products such that it apparently had visibility into all the parties involved in any transactions. However, after the acquisition it got involved with prod-

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ucts issued by other credit card providers. OFAC stated that the companies did not appear to appreciate the ''possibility or risk'' that such credit cards could be used in Cuba. *Ibid*.

Under the CACR, non-U.S. companies ''owned or controlled'' by a U.S. company are still considered subject to U.S. jurisdiction. 31 C.F.R § 515.329. As such, it is important that U.S. corporate parents implement and maintain policies and procedures that flow down to all such entities, as they will be held responsible for compliance with OFAC sanctions. In this case, OFAC stated that the companies ''should have taken steps to assess the level of sanctions risk, and related controls, for BCCC-issued credit cards.'' *Ibid*. Not doing so created liability for the U.S. parent, in the form of a six-figure fine.

Foreign Subsidiaries

White Birch USA, a Connecticut company, agreed to pay $372,465 to settle its potential civil liability for three apparent violations of the Sudanese Sanctions Regulations (''SSR'') (U.S. Dept. of the Treasury Office of Foreign Assets Control, Oct. 5, 2017), https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20171005_white_birch_investment.pdf. OFAC indicated that between April and December 2013, the company was impermissibly involved with its subsidiary, White Birch Canada, in the sale and shipment to Sudan of over 500 metric tons of paper.

Though the paper was not U.S.-origin and the export was made from Canada, OFAC focused on how personnel within both White Birch USA and White Birch Canada ''were actively involved in discussing, arranging, and executing the export transactions to Sudan.'' For example, it stated that multiple White Birch USA personnel, including supervisors and managers, ''had actual knowledge of and were actively involved in, or had reason to know of, the conduct that led to the apparent violations.'' *Id*. at 1. OFAC was concerned that White Birch Canada personnel apparently ''attempted to conceal the ultimate destination of the goods'' from its U.S. bank. However, OFAC placed the ultimate responsibility on White Birch USA (i) for exhibiting ''reckless disregard for U.S. sanctions requirements by failing to exercise a minimal degree of caution or care'' and (ii) for a compliance program that ''was either nonexistent or inadequate.'' *Ibid*.

Though the SSR itself has now been revoked as of October 2017, under OFAC sanctions programs generally it remains important not to engage in prohibited ''facilitation.'' This means that, even when it it is the non-U.S. subsidiary of a U.S. company that is the entity that engages in a transaction involving a sanctioned country, the U.S. company still may not, e.g., ''approve, finance, facilitate, or guarantee'' that transaction. See 31 C.F.R. § 560.208. For example, supervisors and managers of the U.S. company generally may not be involved in decision making concerning sanctioned country business, in supporting or assisting it, or in otherwise enabling it to occur. As OFAC stated:

> Unless authorized by OFAC or otherwise exempt by statute, foreign subsidiaries of U.S. parent corporations must act independently from their parent corporations and any other U.S. person with respect to all transactions and activities that would be prohibited if the transactions were engaged in by a U.S. person or in the United States.

Id. at 2.

Due Diligence

Dentsply Sirona, Inc. (''DSI'') agreed to pay $1,224,400 to settle its potential civil liability for 37 apparent violations of the Iranian Transactions and Sanctions Regulations (''ITSR''), (U.S. Dept. of the Treasury Office of Foreign Assets Control, Dec. 6, 2017), https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20171206_Dentsply.pdf. OFAC indicated that between 2009 and 2012 one U.S. and one non-U.S. subsidiary of the U.S. company Dentsply International, Inc. (''DII''), exported 37 shipments of dental equipment and supplies from the United States to distributors in third countries, which were ultimately destined for Iran. Id. at 1. In February 2016, DII and Sirona Dental Systems, Inc. (''Sirona'') had merged to form DSI, the successor in interest to DII.

OFAC emphasized that DII's subsidiaries, UK International (''UKI'') and DS Healthcare (''Sultan''), acted willfully by exporting U.S.-origin dental products to third-country distributors with knowledge or reason to know that the exports were ultimately destined for Iran in apparent violation of the ITSR. Personnel from these entities concealed that the goods were destined for Iran, and in multiple cases continued to conduct business with these distributors after receiving confirmation that the distributors had re-exported DII products to Iran. OFAC also indicated that several supervisory and managerial personnel within UKI and Sultan had actual knowledge of and actively participated in the conduct that led to the apparent violations. *Id*. at 1 and 2.

OFAC considered it an aggravating factor that DSI ''is a large and commercially sophisticated company with knowledge of U.S. sanctions and export control requirements.'' *Id*. at 2. However, OFAC also stated that UKI and Sultan personnel ''appear to have deliberately concealed their awareness from DII,'' such that DSI apparently may not have known about the transactions. *Ibid*. Similarly, it is possible Sirona specifically may not have known about the transactions, as they occurred before its merger with DII. That OFAC emphasized DSI's collective responsibility in light of these facts indicates it has an expectation companies will undertake thorough acquisition and merger due diligence and be held to a standard of what they should have known. This is important because there is successor liability for economic sanctions violations, which are subject to a five-year look-back period.

OFAC also pointed out that the apparent violations were not voluntarily disclosed; OFAC issued a subpoena. *Ibid*. Upon finding apparent violations during diligence, a company that remains interested in pursuing the acquisition may require as a condition of closing that the counterparty file a voluntary self-disclosure. OFAC's Economic Sanctions Enforcement Guidelines generally provide that if there is a voluntary disclosure, any penalties will be discounted by 50%. Appendix A to Part 501, 31 C.F.R § 501. In the event the diligence process does not uncover such issues, post-transaction it would be important to immediately undertake a review of the company's distributors and their sales and customers, as this is regularly an area of sanctions exposure risk. A voluntary self-disclosure filed promptly thereafter still potentially could result in fines being meaningfully reduced, helping mitigate successor liability.

Export Controls

Knowing Violations

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Caspian Industrial Machinery Supply ("Caspian") and Saeid Yahya Charkhian ("Charkhian"), both located in the United Arab Emirates, agreed to a denial order preventing them from accessing any item subject to the Export Administration Regulations ("EAR") for a period of 12 years. Saeid Yahya Charkhian and Caspian Industrial Machinery Supply, LLC, Docket No. 17-BIS-0002 Settlement Agreement (U.S. Dept. of Commerce Bureau of Industry and Security, Dec. 14, 2017), https://efoia.bis.doc.gov/index.php/documents/export-violations/export-violations-2015/1161-e2541/file. The agreement was settle charges that on three occasions between 2012 and 2013 they obtained items valued at $190,000 that were subject to the EAR designated EAR99 and transferred them to end users in Iran.

Caspian and Charkhian received product orders from a customer in Iran, which they then placed on a reseller in the Netherlands that they knew was procuring the items from the United States. Once the items arrived in the UAE, Caspian and Charkhian transferred them to Iran in violation of U.S. sanctions and export controls. In doing so, BIS focused on the fact that Caspian and Charkhian "acted with knowledge of a violation" of the EAR. *Id*. at 2. For example, BIS pointed out that Charkhian, an Iranian national who was an owner and director of Caspian, "completed an end-user agreement" with a European subsidiary of a U.S. company that included statements related to the need for compliance with the EAR. *Id*. at 3. Inadvertent export violations can occur even if compliance efforts are made. However, when a party acts with knowledge that a violation "has occurred, is about to occur, or is intended to occur in connection with the item," BIS considers that an aggravating factor and is more apt to impose penalties, even if for export control purposes the items themselves are not sensitive. 15 C.F.R. § 764.2 (e).

Non-financial Penalties

Though neither Caspian nor Charkhian were U.S. persons, U.S. export controls continue to apply extraterritorially such that it remained a violation to transfer items subject to the EAR to Iran, particularly when misrepresenting their true destination when procuring the items. BIS issued a denial order against Caspian and Charkhian under 15 C.F.R. § 764.3 (a)(2), providing that 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 7. This would include, e.g., (i) applying for, obtaining or using any export licenses; (ii) ordering, receiving or using any item exported from the United States that is subject to the EAR; or (iii) benefiting from any transaction involving any item exported from the United States that is subject to the EAR. Though in this case BIS did not seek to impose fines against entities and individuals residing outside the United States, issuing the denial order still amounted to a significant penalty.

Intelligence Gathering

BIS gathered information in the course of administering U.S. export controls, which it used in the investigation. For example, BIS pointed out the U.S. supplier "filed an Automated Export System ("AES") record" indicating that the ultimate destination of the items was the Netherlands. *Id*. at 4. It relied on this filing as evidence that Caspian and Charkhian had misrepresented the ultimate destination of the items they were procuring and concealed that it was actually Iran. BIS also noted that Charkhian represented to BIS that he had not conducted business with Iran since 2001 and had not purchased any items from the United States since that time. This false statement was made during a December 2014 interview as part of a post-shipment verification BIS conducted with Charkhian, which it indicated was unrelated to the transactions at issue. *Id*. at 6. Parties should keep in mind that BIS has access to export documentation being submitted to all agencies of the U.S. government throughout the entirety of the supply chain and that it visits individuals and entities located outside the United States to inquire about transactions they conduct with items subject to the EAR. BIS can use access to U.S. technology as leverage to obtain cooperation with its requests and it continuously gathers intelligence about parties' export activities.

Key Takeaways

- U.S. companies should ensure sanctions compliance policies and procedures flow down to their foreign subsidiaries, as OFAC can impose liability for their actions.
- U.S. companies need to ensure their foreign subsidiaries act independently with respect to sanctioned country business, as involvement by the U.S. parent can be a violation.
- Thorough sanctions due diligence should be undertaken with respect to mergers and acquisitions targets because there is successor liability.
- Filing a voluntary self-disclosure can help meaningfully reduce any applicable penalties.
- Though export control violations can occur inadvertently, it is particularly important not to continue conduct once a violation is known, as that accentuates penalty risk.
- For non-U.S. companies, a denial order can be a significant penalty, as it cuts off access to U.S. technology.
- BIS has various tools at its disposal to gather intelligence about a company's export profile.

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