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## NORTH KOREA: SHIPPING AND SUPPLY CHAIN RISKS AND RISK MITIGATION

*In 2018, the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") published two advisories, both related to North Korea's sanctions evasion tactics. The advisories identified risks for companies specifically related to shipping and supply chains, potential indicators of a North Korean nexus, and how to mitigate such risks. The authors discuss these advisories, their impact and implications for both U.S. and non-U.S. parties, and how OFAC expects companies to comply.*

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U.S. economic sanctions play an increasingly important role in serving as an instrument of U.S. foreign policy. The size of the U.S. market and the central role of the U.S. dollar in the global economy lend themselves to the U.S. being able to use economic sanctions as levers against those it believes spread nuclear weapons and WMD-related technology, do not comply with international norms, or violate basic human rights. Currently, the U.S. maintains over 30 different sanctions programs, including some that target specific industry sectors in countries like Russia or Venezuela, and others that target particular behavior, like terrorist financing. Within these programs, five countries are the target of such comprehensive U.S. sanctions that they effectively bar U.S. business: Cuba, Iran, Syria, the Crimea region of Ukraine, and North Korea.

The situation with respect to North Korea brings to bear all of the aforementioned issues. North Korea has

launched missiles and tested nuclear weapons, in defiance of international condemnation; has circumvented international sanctions, including United Nations Security Council resolutions; and has committed severe human rights abuses. In response, the U.S., especially during the Trump Administration, has expanded economic sanctions on North Korea that can even extend to non-U.S. persons. Understanding the reach of these sanctions is essential for those involved in financing, insuring, and otherwise engaging in international commerce.

### I. OVERVIEW OF U.S. SANCTIONS ON NORTH KOREA

The North Korea sanctions program is one of the oldest U.S. sanctions programs in force, originating in 1950 during the Korean War. In 2008, as a direct response to North Korea's development and expansion

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of its nuclear weapons program, the U.S. government began modernizing these long-standing U.S. sanctions on North Korea, with President Bush terminating<sup>1</sup> their historical authorization under the Trading with the Enemy Act<sup>2</sup> and instead issuing Executive Order 13466.<sup>3</sup> Executive Order 13466 authorized U.S. sanctions on North Korea under the International Emergency Economic Powers Act (“IEEPA”),<sup>4</sup> the statute that currently authorizes all other comprehensive U.S. economic sanctions programs except Cuba.

### **A. The Current Architecture**

The current scope of comprehensive U.S. economic sanctions on North Korea includes a trade embargo and widespread designations of individuals and entities on various restricted party lists. The comprehensive embargo generally prohibits all U.S. persons, wherever located, from directly or indirectly engaging in any transactions or having any dealings with any individual or entity that is located in, organized under the laws of, or otherwise a national of North Korea. This prohibition applies to exports to, imports from, investment in, and transactions involving North Korea and North Korean vessels. There are similar restrictions for U.S. dollar-denominated transactions involving North Korea and for exports or re-exports of U.S. origin goods, software, or technology.

The individual and entity-specific sanctions designations on various restricted party lists cover almost every aspect of the North Korean government and economy. These sanctions designations include agencies and departments of the Government of North Korea and the Workers’ Party of Korea (“WPK”); many high-ranking members of the Government of North Korea, WPK, and North Korean military; and numerous North Korea-flagged vessels and aircraft. The

designations mainly are on the OFAC Specially Designated Nationals List (the “SDN List”).

If any property (broadly defined) of a sanctioned person comes within the jurisdiction of the United States or the possession or control of a U.S. person, it is subject to “blocking.” Blocking requires the U.S. person who comes into possession of such property to alert OFAC to the transaction (including how the U.S. person came into receipt of such property) and to place the property into a separate “frozen” account from which no party can transfer or withdraw funds until OFAC provides further instruction.

### **B. Sanctions Violations**

IEEPA sets the penalties for civil and criminal violations of their prohibitions. For civil violations, the maximum penalty per violation is currently up to the greater of \$295,141 or twice the value of the transaction.<sup>5</sup> For criminal violations, the maximum penalty is up to \$1,000,000 and/or up to 20 years imprisonment.<sup>6</sup> OFAC generally assesses penalties based on whether the violations were voluntarily self-disclosed and whether they were “egregious,” a standard that OFAC determines by applying a series of factors.<sup>7</sup> Even voluntarily self-disclosed non-egregious cases in industries that may not naturally correlate to U.S. national security can still result in significant fines. Just recently in January 2019, e.l.f. Cosmetics, Inc. (“ELF”) agreed to settle with OFAC-apparent violations of the North Korea Sanctions Regulations by inadvertently importing false eyelash kits from North Korea for almost \$1 million.<sup>8</sup>

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<sup>1</sup> Proclamation 8271, June 27, 2008.

<sup>2</sup> Trading with the Enemy Act of 1917, 50a U.S.C. §§ 1-44 (1917).

<sup>3</sup> Exec. Order No. 13466, 31 C.F.R. § 510.507 (June 26, 2008).

<sup>4</sup> International Emergency Economic Powers Act, 50 U.S.C. 1701 *et seq.* (1977); North Korea Sanctions Regulations, 31 C.F.R. § 510 (2008).

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<sup>5</sup> North Korea Sanctions Regulations, 31 C.F.R. § 510.701(a)(1) (2008); Federal Civil Penalties Inflation Adjustment Act of 1990, 28 U.S.C. 2461 (1990); Inflation Adjustment of Civil Monetary Penalties, 83 Fed. Reg. 53, 11877 (Mar. 19, 2018).

<sup>6</sup> North Korea Sanctions Regulations, 31 C.F.R. § 510.701(a)(2) (2008).

<sup>7</sup> 31 C.F.R. § 501 Appendix A to Part 501.

<sup>8</sup> U.S. DEP’T OF THE TREASURY OFF. OF FOREIGN ASSETS CONTROL, Enforcement Information (Jan. 31, 2019), e.l.f. Cosmetics, Inc. Settles Potential Civil Liability for Apparent Violations of the North Korea Sanctions Regulations, [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20190131\\_elf.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20190131_elf.pdf).

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## II. SECONDARY SANCTIONS

While requirements to block and exposure to penalties are the traditional consequences for U.S. persons who deal with persons or property subject to U.S. sanctions, a new and increasingly implemented element of U.S. sanctions architecture — “secondary sanctions” — has an extraterritorial reach.<sup>9</sup> Secondary sanctions place non-U.S. persons at risk of losing their ability to transact with the U.S. or U.S. persons if they engage in specified activity. A more detailed discussion of the risks secondary sanctions impose on non-U.S. persons is in Section V below.

The most recent North Korean sanctions legislation, the Countering America’s Adversaries Through Sanctions Act (“CAATSA”), which entered into force in July 2017, expanded U.S. sanctions on North Korea, specifically through the Korean Interdiction and Modernization of Sanctions Act (“KIMSA”).<sup>10</sup> KIMSA prohibits U.S. persons from conducting direct or indirect dealings with or in North Korean cargo (including North Korean origin goods); North Korean shipping companies; and goods produced in whole or in part by North Korean prisoner or forced labor. In addition, KIMSA prohibits U.S. financial institutions from establishing or maintaining correspondent accounts used by foreign financial institutions to provide indirect financial services to North Korea. This prohibition effectively denies the foreign financial institution from ongoing access to U.S. dollars.

Most importantly though, KIMSA authorized secondary sanctions against non-U.S. persons who knowingly engage in transactions related to North Korean defense, transportation (both aviation and shipping), mineral, financial, petroleum and gas, fishing, and online commercial sectors, and non-U.S. persons who employ North Korean forced laborers or exploit workers that generate revenue for the North Korean Government or WPK. President Trump expanded the

scope of the secondary sanctions in September 2017 when he signed Executive Order 13810, which authorized the Secretary of the Treasury, in consultation with the Secretary of State, to impose secondary sanctions, if one of four types of activities occurred.<sup>11</sup> These activities are: (1) operating in construction, energy, financial services, fishing, information technology, manufacturing, medical, mining, textiles, or transportation industries in North Korea; (2) owning or operating a port in North Korea; (3) engaging in at least one significant export to or import from North Korea; or (4) materially assisting any person whom the U.S. has subjected to North Korea sanctions.

Notably, Executive Order 13810 singles out foreign financial institutions as a potential target of secondary sanctions. The Secretary of the Treasury, in consultation with the Secretary of State, can impose secondary sanctions if the foreign financial institution (1) knowingly conducted or facilitated any significant transaction of any person whose property is blocked under U.S. Executive Orders imposing sanctions on North Korea or (2) knowingly conducted any significant transaction in relation to North Korean trade.

## III. OFAC ADVISORY ON SHIPPING PRACTICES

In light of the U.S. government’s determination that North Korea is actively seeking to evade sanctions and the related decision to establish secondary sanctions for non-U.S. persons, including foreign financial institutions, in 2018 OFAC issued two advisories concerning North Korea’s practices, to educate industry and put it on notice of the need for compliance. The first advisory, entitled Sanctions Risks Related to North Korea’s Shipping Practices and published in February 2018, described North Korea’s deceptive shipping practices and risk mitigation measures to avoid such activity.<sup>12</sup> The OFAC North Korea Shipping Advisory established three broad categories of deceptive shipping practices: (1) altering information; (2) Ship-to-Ship (“STS”) transfers; and (3) disabling and manipulating a ship’s Automatic Identification System (“AIS”). These are described below.

### A. Altering Information

OFAC reported that North Korean ships engage in two common practices related to altering information:

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[hereinafter ELF North Korea OFAC Settlement]. For more information, *see* Section VI below.

<sup>9</sup> Secondary sanctions are currently part of the U.S. sanctions architecture for Russia and Iran. *See generally* Countering America’s Adversaries Through Sanctions Act, 22 U.S.C. 9401 (2017); Iranian Transactions and Sanctions Regulations, 31 C.F.R. § 560 (2012).

<sup>10</sup> *See generally* Countering America’s Adversaries through Sanctions Act, 22 U.S.C. 9401 (2017); Korean Interdiction and Modernization of Sanctions Act 22 U.S.C. 9201 (2016).

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<sup>11</sup> Exec. Order No. 13810, 31 C.F.R. § 510.201 (Sept. 25, 2017).

<sup>12</sup> U.S. Department of the Treasury, Office of Foreign Assets Control, North Korea Sanctions Advisory: Sanctions Risks Related to North Korea’s Shipping Practices (Feb. 23, 2018) [hereinafter OFAC North Korea Shipping Advisory].

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physically altering the vessel information and falsifying cargo and vessel documentation. According to international law and regulations, each vessel (and its cargo) is required to have and display specific information, notably an International Maritime Organization (“IMO”) identification number, with the number visible on the vessel’s side.<sup>13</sup> Even if the vessel were to change its name, flag-state, ownership, or port of call, the IMO number would remain the same.<sup>14</sup> To avoid identification or disguise their identity, North Korean ships regularly alter their identification information by painting over the IMO numbers or putting a fake name on the ship. Moreover, North Korean ships or parties may falsify vessel and cargo documents, such as packing lists and bills of lading, to obscure the cargo’s origin or destination.

One example of this practice involves the North Korean vessel the Kum Un San 3, a tanker vessel and restricted party on the SDN List.<sup>15</sup> The crew of the Kum Un San 3 painted on its side the IMO number of another cargo vessel, the Zhi Kun 6, as well as the fake name Kus Dalian. A second example involves the Chon Ma San vessel, which is also on the SDN List.<sup>16</sup> The vessel’s crew or owner painted over the IMO number by converting the threes to eights and making it appear to be the IMO number of a Chinese-flagged barge, the Shenyuan 2. They also painted on the vessel’s side the vessel name “Whale” and marked Sierra Leone as its flag-state, though currently there are no vessels named “Whale” that are Sierra Leone-flagged.<sup>17</sup>

To mitigate against information alteration, including identity alteration, parties engaging with vessels for chartering, docking, transferring of cargo, or any other activity, should verify the vessel name, IMO number, and flag-state prior to engaging in transactions. Any indication of manipulation by third parties should be

considered a red flag.<sup>18</sup> In addition, shipping documents should reflect details on the underlying voyage, including the relevant vessel, cargo, origin, and destination.

### **B. Ship-to-Ship Transfers**

Second, the OFAC North Korea Shipping Advisory also warns that North Korea engages in STS transfers to avoid detection at ports of call.<sup>19</sup> An STS transfer is the transfer of cargo from one ship to another while both are at sea. This type of behavior does occur in the ordinary course from time-to-time for legitimate reasons. However, OFAC indicated that North Korea engages in STS transfers to avoid U.S. sanctions, commonly transferring petroleum or other cargo between the Yellow Sea and the East China Sea. The purpose behind the transfers is to engage in North Korean exports by hiding the cargos’ origin, or to receive petroleum or other sanctioned materials for import into North Korea. As of 2018, there are 24 North Korean tankers capable of engaging in STS transfers, specifically for refined petroleum products and other banned goods, all of whom are restricted parties on the SDN List.

Mitigating risk against possible sanctions violations involving STS transfers requires other vessels engaging in STS transfers to be more aware of the facts surrounding those transfers or non-vessel parties to understand if an STS transfer even took place, since some vessels may conceal such activity. Operators should also seek to ensure that if there is an STS transfer, there is a legitimate business purpose for it and that it is not a method to avoid U.S. sanctions. Documents related to these transfers should demonstrate that the underlying goods were delivered to the port listed. Finally, any transfers that occur around the Korean Peninsula, especially on the western side near China, merit additional scrutiny.

OFAC’s emphasis on STS transfers as a source of potential sanctions evasion carries forward similar compliance priorities established in the Iran sanctions program; indeed, in 2017 OFAC brought an enforcement action for ship-to-ship transfer activity occurring in apparent violation of the Iranian Transactions and Sanctions Regulations (“ITSR”).<sup>20</sup> In 2013, the ship

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<sup>13</sup> International Convention for the Safety of Life at Sea, Ch. XI, Reg. 3, Nov. 1, 1974, 1184 U.N.T.S. 3.

<sup>14</sup> Amendments to the Annex to the International Convention for the Safety of Life at Sea, 1974, Ch. XI, Reg. 3, Dec. 12, 2002, SOLAS/CONF.5/32.

<sup>15</sup> OFAC North Korea Shipping Advisory, *supra* note 12.

<sup>16</sup> Press Release, U.S. Department of the Treasury, Treasury Announces Largest North Korean Sanctions Package Targeting 56 Shipping and Trading Companies and Vessels to Further Isolate Rogue Regime (Feb. 23, 2018).

<sup>17</sup> *North Korean Vessels*, RESOURCE CENTER, U.S. DEPARTMENT OF THE TREASURY (Feb. 23, 2018), [https://www.treasury.gov/resource-center/sanctions/Programs/Pages/dprk\\_vessels.aspx](https://www.treasury.gov/resource-center/sanctions/Programs/Pages/dprk_vessels.aspx).

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<sup>18</sup> Engagement with vessels can be through the chartering or hiring of the vessel, by having the vessel dock in an affiliated port or location, or engage in STS transfers with the vessel.

<sup>19</sup> *Id.*

<sup>20</sup> Iranian Transactions and Sanctions Regulations, 31 C.F.R. § 560 (2012).

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known as “B Whale” conducted an STS transfer with a vessel owned by an Iranian entity on the SDN List. The Company that owned B Whale (B Whale Corporation (“BWC”) based in Taiwan), would not normally be considered a U.S. person, thus removing most U.S. sanctions risks.<sup>21</sup> However, BWC had entered into bankruptcy proceedings in the U.S., which OFAC considered a sufficient connection to the U.S. to place BWC within the scope of the ITSR and subject it to an undisclosed fine.

### **C. Disabling and Manipulating Automatic Identification Systems**

The third and final focus of the OFAC North Korea Shipping Advisory is disabling and manipulating a ship’s AIS.<sup>22</sup> AIS is a collision avoidance system that transmits the vessel’s identification, navigational, and positional data (and sometimes other data) in very high frequency radio waves. Ships meeting certain tonnage thresholds in international voyages are required to carry and operate AIS. Other than outright disabling a vessel’s AIS to prevent tracking the location of the vessel, AIS data can be manipulated to change what is being transmitted, such as vessel names, IMO numbers, Maritime Mobile Service Identities, the next port of call, and other unique identification or voyage information.

In a recent article, *The Wall Street Journal* gave two clear examples of ships disabling or manipulating their AIS to avoid sanctions against North Korea.<sup>23</sup> In the first instance, a Panamanian vessel named the Hua Fu loitered off the Chinese coast near North Korea, but never actually went into port. This activity gave the false impression that the Hua Fu loaded coal from China. At this point, the vessel turned off its AIS for five days while it went to North Korea and loaded coal for export. Eventually, the Hua Fu enabled its AIS again, but much further south on the Chinese coast, making it look as if

the vessel never went to North Korea. Finally, the Hua Fu offloaded the coal in Vietnam, giving the impression that the coal was from China, not North Korea.

In the second example, the Sam Jong 1, a North Korean oil tanker, turned off its AIS for 80 days right after the U.S. named it a restricted party on the SDN List. When the Sam Jong 1 turned the AIS back on, it transmitted fake and unregistered identification numbers, while also indicating the vessel’s name was the Myongson and its flag-state was Panama. Then, the Sam Jong 1 switched to a second fake identification number, name (Luckystar), and destination (China). Lastly, the Sam Jong 1 turned off its tracker once more, right before it arrived in North Korea with petroleum acquired from STS transfers.

The OFAC North Korea Shipping Advisory notes that it is possible for third parties to recognize and react to AIS disabling and manipulation.<sup>24</sup> If another vessel or third party notices a vessel has disabled its AIS, or shows any sign of AIS manipulation while operating in the area around the Korean Peninsula, that vessel or third party should consider investigating the vessel of concern’s information through ship registries, insurers, charters, vessel owners, or port-state control entities.

### **D. General Risk Mitigation**

In addition to the mitigation measures discussed above, there are other measures vessels and third parties can undertake to try to mitigate against their own risks of sanctions violations. Fundamentally, those measures require the parties to be on heightened alert for any North Korea nexus. Parties contracting for shipping services or otherwise engaging in shipping activities should apply extra scrutiny if a ship name or number is on a restricted party list, North Korean-flagged, owned by a North Korean party, primarily operates near North Korea, or contains North Korean exports or imports.

Furthermore, there are resources available for other vessels and third parties to obtain the most accurate information. Certain U.S. agencies and international organizations, including OFAC, the U.S. Coast Guard, the UN, and the IMO, provide commercial shipping data, including ship locations, registry information, and flag-state information.<sup>25</sup> Other vessels and third parties

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<sup>21</sup> U.S. DEP’T OF THE TREASURY OFF. OF FOREIGN ASSETS CONTROL, Enforcement Information (Feb. 3, 2017), OFAC Issues a Finding of Violation to B Whale Corporation, a Member of the TMT Group of Shipping Companies, for a Violation of the Iranian Transactions and Sanctions Regulations, [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170203\\_bwc.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170203_bwc.pdf).

<sup>22</sup> *Id.*

<sup>23</sup> Niharika Mandhana, *Fake Signals and Illegal Flags: How North Korea Uses Clandestine Shipping to Fund Regime*, WALL ST. J., Nov. 28, 2018, <https://www.wsj.com/articles/fake-signals-and-illegal-flags-how-north-korea-uses-clandestine-shipping-to-fund-regime-1543402289>.

<sup>24</sup> OFAC North Korea Shipping Advisory, *supra* note 12.

<sup>25</sup> *Specially Designated Nationals and Blocked Persons List (SDN) Human Readable Lists*, U.S. DEP’T. OF THE TREASURY, <https://www.treasury.gov/resource-center/sanctions/sdn-list/pages/default.aspx>; *List of Prohibited Vessels*, U.S. COAST GUARD, [https://www.nvmc.uscg.gov/nvmc/\(S\(2qg50](https://www.nvmc.uscg.gov/nvmc/(S(2qg50)

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should incorporate this data into their due diligence process. In addition, other vessels and third parties should engage in clear communication about U.S. sanctions (and EU or UN sanctions) obligations and compliance, to help identify what issues are at risk and promote compliance between parties.

#### IV. OFAC ADVISORY ON SUPPLY CHAIN LINKS

OFAC published a second advisory in July 2018 entitled *Risks for Businesses with Supply Chain Links to North Korea* that described how supply chains can have North Korea connections, creating a potential U.S. sanctions risk, and a need for mitigation measures.<sup>26</sup> The Supply Chain Advisory focused on two principal topics: the risks for and potential indicators of a North Korea nexus in the supply chain, and North Korean overseas labor.

##### A. Potential Indicators of a North Korean Nexus

The OFAC North Korea Supply Chain Advisory identified a number of methods by which North Korean persons, particularly suppliers or manufacturers, can insert their products or labor into international supply chains without detection.<sup>27</sup> One such method occurs when third-country suppliers shift manufacturing or subcontracting work to North Korea, to reduce the cost of production, without informing the original customer or other relevant parties. Another common example is North Korean exporters disguising the origin of goods or services. North Korean parties may disguise their goods by affixing country-of-origin labels showing a third-country origin instead, such as “Made in China.” This labeling occurs frequently with North Korean seafood

that is then smuggled into a third country where it is processed, packaged, and sold as a product of the third country. Similarly, North Korean firms sell IT products and services abroad (*e.g.*, website and app development, security software), but disguise the North Korean nexus through front companies, other aliases, and third-country nationals.

A key concern for both U.S. and non-U.S. firms is that their counterparty is in a joint venture with a North Korean entity. OFAC has specifically noted that North Korea joint ventures usually occur with Chinese companies, while also pointing out that joint ventures exist in many industries ranging from food, energy, tobacco, and even animation. OFAC has provided a non-comprehensive list of such entities and industries. To mitigate risks of a potential North Korean nexus, companies should be looking for indicators, such as raw materials sold at artificially low prices. Due diligence on counterparties, such as Chinese joint ventures, can also reduce the risk of a North Korean nexus.

##### B. Potential Indicators of North Korean Overseas Labor

To raise funds for the government, OFAC has indicated that North Korea forcibly exports large numbers of laborers to other countries to fulfill contracts. This export of laborers, like joint ventures, occurs across multiple industries, including apparel, construction, hospitality, IT services, logging, medical, pharmaceuticals, restaurants, seafood processing, shipbuilding, and textiles.<sup>28</sup> Geographically, examples occur in countries across Asia, Africa, and the Middle East, and even a few countries in Europe and Latin America. However, China and Russia hold more North Korean forcibly exported labor than all the other countries combined. Activity within both countries, especially near the North Korean border, is at higher risk.

The OFAC North Korea Supply Chain Advisory provides three indicators of North Korean labor. First, wages, contracts, and housing for the laborers are abnormal. Employers will withhold wages, make unreasonable deductions, pay late, and make in-kind payments. In some instances, laborers receive their wages in cash and then have to pay a lump sum to the North Korean government upon their return home. Moreover, contracts for laborers, which are usually for two to five years, also require large up-front payments to the North Korean government, sometimes up to 30% of

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<sup>26</sup> U.S. Department of the Treasury, Office of Foreign Assets Control, Department of State, and Department of Homeland Security, Immigration and Customs Enforcement (ICE) and Customs and Border Protection (CBP), *North Korea Sanctions & Enforcement Actions Advisory: Risks for Businesses with Supply Chain Links to North Korea* (July 23, 2018) [hereinafter *OFAC North Korea Supply Chain Advisory*].

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*



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the contract. Employer-provided housing is an indicator as well, with unsafe and unsanitary housing conditions. It is frequently collective housing and isolated from laborers of other nationalities.

Second, the employers have an unusual amount of control over the laborers. For example, laborers have no access to or control over their bank accounts; are given little to no time off; and commonly are required to attend what are termed “self-criticism sessions.” Employers may retain their laborers’ passports, and confiscate or destroy other personal documents, such as visas. Ironically, official documentation, including government-issued passports, is usually a sign of sanctionable North Korean labor, as if North Korean individuals lack the proper government-issued paperwork, it is more likely that they are refugees. Hiring North Korean refugees is not a U.S. sanctions violation. Finally, there is a general lack of transparency. Employers hide contract details and handle financial transactions in a way that makes it difficult to determine the ultimate beneficiary. In addition, parties will be limited from conducting worksite inspections and cannot interview laborers without a “minder” present.

Companies can reduce the risk of indirectly transacting or contracting with North Korean-forcibly-exported labor by looking for the aforementioned indicators. It is especially important for companies to look for such indicators when engaging foreign labor pools in China and Russia, and in the industries that OFAC has identified.

## V. RISKS TO NON-U.S. PARTIES

Beyond primary sanctions, which clearly prohibit U.S. persons or those with a U.S. nexus from engaging with North Korea or those with a North Korean nexus, CAATSA and Executive Order 13810 have expanded the reach of U.S. sanctions on North Korea extraterritorially, essentially making non-U.S. persons have to choose between conducting business with North Korea or with the U.S.<sup>29</sup>

As previously discussed, Executive Order 13810 authorizes OFAC to impose secondary sanctions — including placement on the SDN List — on any non-U.S. person that engages in almost any North Korea

related activity, such as operating in the previously identified industries, conducting transactions with significant North Korean exports or imports, or even just assisting a person subject to U.S. North Korea sanctions. Foreign financial institutions must proceed with even greater caution. CAATSA already restricts U.S. financial institutions from establishing or maintaining correspondent accounts used by foreign financial institutions to provide indirect financial services to North Korea, and Executive Order 13810 identifies an additional secondary sanctions designation process unique to foreign financial institutions.

Designation on the SDN List would close off access to the U.S. financial system, prevent U.S. persons, wherever located, from conducting transactions with the designated third party, and require U.S. persons (including U.S. banks) to freeze all assets of the restricted party in their possession or control.

In short, this expansion of U.S. sanctions on North Korea now essentially forces any non-U.S. party that seeks to do business with North Korea to forgo conducting business in the U.S., with U.S. financial institutions, or with U.S. dollars. Given the central role of the dollar in global finance and international trade, the size of the American economy, and the geographic operations of most major financial institutions, non-U.S. parties do not have a meaningful choice. Removing a North Korean nexus from the shipping networks and supply chains becomes imperative.

## VI. CHALLENGES WORKING WITH NON-NORTH KOREAN PARTIES

North Korea’s efforts to avoid detection and evade U.S. and other sanctions programs create challenges for U.S. and non-U.S. companies working with certain non-North Korean parties, particularly Chinese parties. The OFAC advisories specifically identify China as a country with heightened North Korean risks.<sup>30</sup> China is North Korea’s largest trading partner with significant commercial ties between the two countries, and North Korea is highly reliant on the Chinese economy given its international diplomatic and economic isolation. The sizable number of joint ventures between China and North Korea reflect this relationship. In addition, most of North Korea’s northern border is with China, making it easy for North Korea to export its labor and conduct STS transfers near China. Adding to these complications, many North Korean companies or ships pose as Chinese to hide their identity. Due to lack of

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<sup>29</sup> Countering America’s Adversaries through Sanctions Act, 22 U.S.C. 9401 (2017); Korean Interdiction and Modernization of Sanctions Act 22 U.S.C. 9201 (2016); Exec. Order No. 13810, 31 C.F.R. § 510.201 (Sept. 25, 2017).

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<sup>30</sup> OFAC North Korea Supply Chain Advisory, *supra* note 26.

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transparency, standard due diligence may not always be enough to determine the true nature of a counterparty, and whether it may actually be North Korean or have a nexus with North Korea.

OFAC's recent near \$1 million settlement with ELF, a California cosmetics company, is instructive in this regard.<sup>31</sup> ELF collaborated with two Chinese companies to supply false eyelash kits, who then incorporated materials from North Korea. OFAC found that, though ELF is a large and sophisticated company frequently engaging in international trade, its OFAC compliance program was essentially non-existent. ELF's supply chain audits failed to discover the North Korea nexus until January 2017 because those audits did not include country-of-origin verification, something parties that engage with Chinese suppliers should undertake.

To avoid potential violations of North Korean sanctions, it is essential for companies to try to determine the ultimate beneficial owner(s) of counterparties with which they interact, such as customers and suppliers, as well as the source of the funds for any new financial services customers. If counterparties provide insufficient or opaque information, such as non-verifiable documents, multiple tax identification numbers, or if there is a general reluctance to share information about the business, these may be red flags. Having a heightened awareness of these factors may trigger the need for further due diligence and better enable companies to assess the potential risk of non-compliance with U.S. sanctions on North Korea.

## VII. CONCLUSION

OFAC expressly recognizes that the lengths to which North Korea will go to avoid sanctions create compliance complexities. As a result, OFAC has made extensive efforts to provide information about North Korea's evasion tactics with respect to shipping and supply chains. Yet, in doing so, OFAC is also putting all stakeholders on notice of these practices so that they are aware of them and implement risk mitigation measures accordingly. This notice is important because OFAC applies a strict liability standard, as dictated by the underlying sanctions laws, to findings of violations of U.S. economic sanctions.

At the same time, OFAC's formal enforcement guidelines,<sup>32</sup> off-the-record guidance, and enforcement actions themselves indicate that OFAC will consider whether the company undertook compliance measures when assessing the appropriate penalties for apparent sanctions violations. To try to safeguard against violations, companies should understand the risks and indicators discussed above and design a compliance program tailored to the company's particular risk profile. Finally, as U.S. sanctions serve as an instrument of U.S. foreign policy, they are constantly evolving and changing depending on current events, political shifts, and domestic and foreign priorities. Companies should constantly monitor U.S. sanctions programs to better ensure their continued compliance. ■

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<sup>31</sup> ELF North Korea OFAC Settlement, *supra* note 8.

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<sup>32</sup> 31 C.F.R. § 501 Appendix A to Part 501 (establishing existence or absence of a compliance programs as a factor in determining if a violation exists, and the associated penalty for said violation).