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The Facilitation Prohibition

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Contents

Overview of Facilitation

General Principles

- The U.S. Department of Treasury, Office of Foreign Assets Control ("OFAC") generally prohibits "*facilitation*" by U.S. Persons of transactions by non-U.S. Persons with a sanctioned country, individual or entity ("Sanctions Target"). "Facilitation" can include:
  - advising, assisting, approving, authorizing, supporting, referring, brokering, financing, or making decisions for a transaction by a foreign person that in any way involves a Sanctions Target other than activities of a purely clerical or reporting nature
  - altering operating policies or procedures, or those of a foreign subsidiary or affiliate, to permit the foreign subsidiary to engage in transactions with Sanctions Targets that previously required U.S. Person approval
  - referring to a foreign person purchase orders, requests for bids, or similar business opportunities involving a Sanctions Target
- Parent company facilitation can arise in many ways, e.g. providing various types of financial or legal assistance or mandatory approval for certain contracts
- Risks arise with foreign subsidiaries that are not sufficiently independent or if there is a divergence of operational structure from legal structure
- Facilitation risks exists with other relationships such as joint development, joint ventures, clients and customers

General Principles Cont'd

- OFAC takes the position that the prohibition applies to all comprehensive sanctions programs even if no express facilitation provision exists in the specific sanctions program
  - For example, the evasion prohibition in the Cuban Asset Control Regulations that prohibits "[a]ny transaction for the purpose or which has the effect of evading or avoiding" the Cuba sanctions has been interpreted to prohibit facilitation
- U.S. Persons are defined to include any business or entity organized under U.S. law as well as any U.S. citizen, permanent resident, or national and anyone physically present in the United States regardless of nationality
  - Includes any U.S. persons working for a foreign entity overseas
  - The definition also includes foreign branches of U.S. businesses, U.S. branches of foreign businesses and foreign nationals working for U.S. based companies
- Applies to even minor and indirect assistance related to transactions in sanctioned countries
- Additional provisions prohibit any actions designed to evade or avoid U.S. sanctions

General Principles Cont'd

- Easier to avoid direct contacts with sanctioned countries than violations arising from indirect contacts
- U.S. companies can do some business with companies that themselves do business in sanctioned countries
  - Basic variables are: how much business does the third-country entity do in sanctioned countries and what business is the U.S. company doing with the third-country entity?
- Due diligence, compliance programs and training are essential

Definitions of Facilitation (Iran)

- Approving, financing, facilitating, or guaranteeing any transaction by a foreign person where the transaction would be prohibited if performed by a U.S. Person or within the United States (31 C.F.R. § 560.208)
- Further defined to include (31 C.F.R. § 560.417)
  - **Altering 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 if performed directly by a United States person or from the United States
  - **Referring 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
  - **Changing 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

Definitions of Facilitation (Sudan)

- Any unlicensed action by a U.S. person that assists or supports trading activity with Sudan by any person (31 C.F.R. § 538.407)
- Further defined to include:
  - business and legal planning; decision making; designing, ordering or transporting goods; and financial, insurance, and other risk
  - financing or insuring trade or warranting the quality of goods sold by a subsidiary to the Government of Sudan
  - changing policies or operating procedures, or those of a foreign affiliate or subsidiary, in order to enable a foreign entity owned or controlled by U.S. persons to enter into a transaction that could not be entered into directly by a U.S. person or from the United States
  - referring to a foreign person purchase orders, requests for bids, or similar business opportunities involving Sudan or the Government of Sudan to which the United States person could not directly respond
- Excludes activity of a purely clerical or reporting nature that does not further trade or financial transactions with Sudan or the Government of Sudan

Definitions of Facilitation (Syria)

- Any approval, financing, facilitation, or guarantee by a United States person, wherever located, of a transaction by a foreign person where the transaction by that foreign person would be prohibited by this [order] if performed by a United States person or within the United States (Executive Order 13582)

Definitions of Facilitation (Burma)

- Approving, financing, facilitating, or guaranteeing a transaction by a person who is a foreign person where the transaction would be prohibited if performed by a U.S. person or within the United States (31 C.F.R. 537.205)
- General licenses (16-19) have now removed most prohibitions in the Burmese Sanctions Regulations

Definitions of Facilitation – Where Are We Now?

- OFAC has taken the position that all of the various facilitation definitions should be read together to apply across all sanctions programs
- OFAC reads the prohibition very broadly to include all instances where a U.S. person “assists” or supports” a non-U.S. person in transactions directly or indirectly involving sanctioned countries or parties
- Prohibitions apply even if authorized by a foreign government

Facilitation – Examples of What is Prohibited

- Business, legal planning or other support or assistance (other than compliance advice)
- Decision making
- Designing, ordering, or transporting goods
- Providing financial or insurance assistance
- Approving, reviewing, drafting or commenting on the terms of a transaction or deal documents
- Providing technical support or other assistance
- Assisting in negotiating the terms of a transaction
- Certain forms of IT support/access
- Strategizing sanctioned country business
- Routing a transaction in order to evade sanctions
- Enabling U.S. persons to perform functions that would be prohibited
- Altering polices or procedures to enable a foreign affiliate to perform prohibited transactions
- Referring sanctioned country business to foreign persons
- Otherwise assisting the foreign entity or individual in planning for or moving a transaction with a sanctioned country or entity forward

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Facilitation – Examples of What is Prohibited Cont'd

- Examples of facilitation can include:
  - A U.S. citizen employee of the Singapore office engages in business planning in support of Iranian investments by a Swiss client
  - A French employee of the Singapore office prepares and emails comments on a Swiss client's Syrian investments while attending a conference in Hawaii
  - A British national employed by an entity in the US receives an inquiry from a customer in Europe about trade advisory services needed in Iran and forwards that inquiry to the firm's Singapore office with a recommendation and tips on how best to pursue this new business opportunity
  - An employee of an entity in Singapore calls the firm's commodities expert in the US for commercial advice in connection with structuring a Sudanese transaction
  - A trader for an entity in Singapore asks an executive in the U.S. to authorize the export of non-US origin rice to Iran without the benefit of a license covering that consultation.
- OFAC also prohibits "*evasion*" of sanctions by concealing information or other means to enable the completion of a transaction through the United States that could not occur on a transparent basis

Facilitation – Examples of What is Allowed

- U.S. persons may engage in activities of a "purely clerical or reporting nature that do not further trade or financial transactions" with the sanctioned country
  - Includes the receipt of information from foreign entities relating to business in sanctioned countries
  - Use of information from foreign entities to prepare consolidated financial statements
- Compliance advice regarding U.S. sanctions regulations
- Certain other specified legal services that are not designed to facilitate trade with sanctioned countries
  - May still require authorization to receive payment for the services
- Facilitation is only prohibited if the underlying transaction is unauthorized
  - If not prohibited by the applicable sanctions regulations or otherwise authorized by general or specific license, then there can be no prohibited facilitation

Common Facilitation Risks

- Facilitation risks arise in a broad variety of contexts but are particularly prevalent where there the foreign entity lacks independence from U.S. based entities or individuals
  - U.S. Person management (director, CEO etc…) at the foreign entity
  - Overlapping employees and/or bank accounts
  - Business, legal advice or other support or assistance
    - Often the people with the requisite expertise are U.S. persons or are based in the United States (e.g. HR, help desks, corporate or legal departments)
  - Brokering, insuring, warranting or guaranteeing a transaction
  - Providing technical services, support or assistance
    - Technicians or help desks are often based in the United States
  - Assistance with the movement of goods
  - Financial assistance
  - Required products or technical data stored in the United States
  - Other back-office support from the United States (HR, Marketing, etc…)

Common Facilitation Risks Cont'd

- Centralized systems for management functions such as order processing, marketing, logistics or IT, located or performed in the United States
  - Prohibited from providing those services to a non-U.S. subsidiary or affiliate in connection with a sanctioned country or person
  - Prohibited from outsourcing the functions to a non-U.S. jurisdiction for the purpose of allowing the transaction to proceed
- Policies or Procedures Requiring U.S. Person Approval or Involvement
  - For example, a common pitfall is having mandatory monetary thresholds where U.S. person approval is required

Common Facilitation Risks – Mergers & Acquisitions

- Facilitation risks are also often present where a foreign subsidiary of a U.S. company has, or is entering into, a formal business relationship with a third party that has sanctioned country business
  - Joint ventures
  - Mergers and acquisitions
  - Technical or manufacturing agreements
- The level of risk depends to a large extent on the amount of sanctioned country business the entity is conducting
- Risks exist with unrelated third parties as well

Common Facilitation Risks – Mergers & Acquisitions

- No clear standard but any significant revenue from a sanctioned country can be problematic
- Asset vs stock acquisition
  - Asset acquisition of sanctioned country assets likely requires OFAC authorization
  - Stock acquisitions pose questions of independence following the acquisition
- Risk is generally based on:
  - the extent of sanctioned country business
  - the nature of the sanctioned country activities
  - the ownership interest in the foreign entity
  - the degree of control or participation in the governance of the entity
- Proper policies and procedures must be implemented and should be audited periodically
- Consider winding down the sanctioned country business prior to closing

Mergers and Acquisitions – Mergers & Acquisitions

- U.S. Persons likely prohibited from taking a controlling or majority position in any foreign entity that engages in business with prohibited sanctioned country transactions
- U.S. Persons may also be prohibited from making a minority investment in a foreign entity whose primary activities involve sanctioned country transactions
- If sanctioned country business is going to continue, consider:
  - Excluding U.S. persons from management or oversight positions
  - Establishing policies and procedures to exclude U.S. persons from sanctioned country business
  - Ensuring the foreign entity can operate independently from the United States
  - Requiring contractual representations and conducting reasonable due diligence to ensure that any funds invested are not used, directly or indirectly, to support sanctioned country business

Facilitation Penalties

- Iran, Sudan, Syria, and Burma (IEEPA)
  - Maximum civil penalty of $250,000 per violation or twice the transaction value
  - Maximum criminal penalty of $1 million per violation and 20 years in prison
- Cuba (TWEA)
  - Maximum civil penalty of $65,000 per violation
  - Maximum criminal penalty of $1 million per violation and 10 years in prison

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How to Mitigate Risk

How to Mitigate Risk

- OFAC counsels that, in transactions involving sanctioned countries or parties, foreign entities or individuals should ensure that they provide their goods or services independently of U.S. persons
- Problems arise with affiliated entities that are not sufficiently independent
  - Overlapping officers, directors or employees
  - Lack of separate corporate formalities
  - Oversight of foreign entity's business
  - Reliance on U.S. persons for legal and/or corporate transactions and decisions
- Red Flags require additional due diligence
  - Customers who are reluctant to offer information about the end-user or intended use of a product
  - Products that are incompatible with the technical level of the declared end-user
  - Customers who are willing to pay cash for shipping, plan vague delivery dates and abnormal routes or request delivery to out-of-the way or common diversion destinations

How to Mitigate Risk Cont'd

- The key to risk mitigation for foreign entities is understanding how U.S. persons typically support foreign transactions and developing policies and procedures to address those risk areas
  - Perform due diligence on all employees to determine if they are U.S. Persons and, if so, what their responsibilities are
  - Develop compliance policies and procedures
  - Train employees and raise general awareness
- Polices and Procedures
  - Establish independence of the foreign entity from any U.S. entity or U.S. persons
  - U.S. person recusal from sanctioned country transactions including:
    - Meetings or telephone calls where sanctioned country or entity transactions will be discussed
    - Receiving, initiating or forwarding any correspondence, documents or other materials related to sanctioned country or entity transactions
  - Proper screening of transactions
  - The designation of a person or group responsible for compliance
  - Specify how red flags should be addressed
  - Extra due diligence for transactions involving common diversion points
  - Records retention policy

How to Mitigate Risks Cont'd

- Training
  - All relevant employees should receive training on how to properly respond to inquiries related to sanctioned country or entity transactions. Non U.S.-persons should understand they cannot:
    - Provide or forward any correspondence, documents or other materials related to business with a sanctioned country or entity to a U.S. Person
    - Refer any matters or opportunities related to a sanctioned country or entity to a U.S. Person
    - Discuss any matters or opportunities with a U.S. person relating to a sanctioned country or entity including in meetings, telephone calls or private conversations
    - Request any assistance for sanctioned country or entity transactions from a U.S. Person
- Contractual Compliance Language
  - Require OFAC compliance in all third party contracts and include language allowing for periodic and trigger based compliance reviews and audits
  - Consider requiring sanctions compliance certifications
- Establish an Anonymous Compliance Hotline
- Periodically Audit Compliance

Additional Facilitation Prohibitions on Foreign Entities

Additional Facilitation Prohibition on Foreign Entities

- Executive Order 13608 (May 1, 2012)
  - Subjects foreign individuals or entities to potential sanctions to the extent they have:
    - violated, attempted to violate, conspired to violate or a caused a violation of U.S. sanctions against Iran or Syria
    - facilitated "deceptive transactions" for on or behalf of persons subject to U.S. sanctions against Iran or Syria
  - Deceptive transaction is defined to include any transaction "where the identity of any person subject to U.S. sanctions concerning Iran or Syria is withheld or obscured from other participants in the transaction or any relevant regulatory authorities."
    - Designed to address foreign financial institutions that "strip" reference to sanctioned countries from wire transfers although also applies to non-financial institutions
  - Penalties include:
    - Denial of access to the U.S. financial and commercial systems (not blocking)
    - Denial of entry into the United States
    - Prohibition on U.S. persons from providing to, or procuring from, the sanctioned party (or entities owned or controlled by or acting on behalf of) any funds, goods, services or technology

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Additional Facilitation Prohibitions on Foreign Entities – Financial Institutions

- E.O. 13622 (July 2012)
  - Potential sanctions on foreign financial institutions that are determined to have knowingly conducted <u>or facilitated</u> any "significant" financial transaction:
    - With the National Iranian Oil Company ("NIOC") or Naftiran Intertrade Company ("NICO")
    - Related to the purchase or acquisition of petroleum or petrochemical products from Iran
  - Whether a transaction(s) is(are) deemed significant depends on a number of factors including, for example: (i) size; (ii) number; (iii) frequency; (iv) type; (v) complexity; (vi) purpose; (vii) benefit to Iran; and (viii) whether the transaction illustrates a pattern or practice or involved the use of deceptive practices

Additional Facilitation Prohibitions on Foreign Entities – Financial Institutions Cont'd

- Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA)
  - Expanded CISADA to prohibit or impose strict conditions on the opening or maintaining of correspondent and payable-through accounts in the United States by foreign financial institutions found to have:
    - knowingly engaged in, <u>or facilitated</u>, certain proscribed activities, including the facilitation of efforts by the Government of Iran to acquire or develop weapons of mass destruction or provide support for international terrorism and the facilitation of a significant transaction or provision of significant financial services for Iran's Revolutionary Guard Corps ("IRGC") or other persons and entities whose property is blocked

Additional Facilitation Prohibitions on Foreign Entities – Financial Institutions Cont'd

- Iran Freedom & Counter-Proliferation Act of 2012 ("IFCA")
  - Provides for potential sanctions on foreign financial institutions that knowingly conduct <u>or facilitate</u> certain transactions related to Iran's energy, shipping or shipbuilding sectors or that involve certain specified precious metals, raw materials or blocked parties.
- Executive Order 13645 (June 2013)
  - Provides for potential sanctions on foreign financial institutions that have been determined to have:
    - Knowingly conducted <u>or facilitated</u> any significant transaction related to the purchase or sale of Iranian rials or a derivative, swap, future, forward, or other similar contract whose value is based on the exchange rate of the rial or maintained significant funds or accounts outside of Iran denominated in the Iranian rial

Additional Facilitation Prohibition on Foreign Entities – Pending Legislation

- The Nuclear Iran Prevention Act (H.R. 850)
  - Passed the U.S. House of Representatives in July, 2013. May be presented to the Senate this month
  - Significantly expands U.S. efforts to impose sanctions on Iran by granting the president specific authorization to bar companies from doing business in the United States if they carry out, or facilitate, virtually any significant commercial trade with Iran
  - Specifics still to be determined

Examples of Enforcement Cases

Examples of Enforcement Cases

- World Fuel Services (September 2013)
- ATP Tour, Inc. (June 2013)
- HSBC (December 2012)
- Great Western Malting Co. (July 2012)
- Genesis Asset Managers LLP (May 2012)
- ASF, Inc. (November 2011)
- JP Morgan Chase (August 2011)

World Fuel Services (Sept. 2013)

- OFAC alleged that World Fuel Services violated the Cuban, Iranian and Sudanese sanctions regulations by, *inter alia*, facilitating the sale by one of its non-U.S. affiliates of fuel for a vessel at port in Bandar Abbas, Iran
- World Fuel also allegedly facilitated services and fuel purchases for an aircraft that stopped in Khartoum, Sudan and provided coordination services for 30 unlicensed flights to Cuba
- Settled with OFAC for $39,501

ATP Tours (June 2013)

- ATP Tours allegedly approved, facilitated and made 18 salary payments to a tennis official ordinarily resident in Iran for services rendered and expenses incurred in connection with ATP tournaments the individual officiated
- Settled with OFAC for $48,600

HSBC (December 2012)

- The U.S. Department of Justice alleged that HSBC had engaged in multiple violations of economic sanctions and money laundering laws by, *inter alia,* stripping references to sanctioned countries and entities from transfers thereby facilitating payments to those countries by third parties
- Settled with DOJ for $1.2 billion

Great Western Malting Co. (July 2012)

- OFAC alleged that GWM violated the facilitation prohibitions in the Cuban Assets Control Regulations by performing “various back-office functions for the sales by a foreign affiliate of non-U.S. origin barley malt to Cuba”
- Settled with OFAC for $1.35 million

Genesis Asset Managers LLP (May 2012)

- U.S. investment manager for a Chanel Islands fund allegedly violated the Iran sanctions when its British subsidiary, acting as its agent, made a $3 million investment in a Caribbean based fund that invested exclusively in Iranian securities
- OFAC alleged that GAM US improperly facilitated the transactions by its foreign subsidiaries by altering its policies and procedures to permit one of its funds to make the investment without U.S. involvement
- Settled with OFAC for $112,500

ASF, Inc. (November 2011)

- ASF allegedly facilitated the exportation of goods by a foreign party from a third country to Iran in 2006
  - OFAC did not disclose the type or value of the goods.
- Settled with OFAC for $5,400

JP Morgan Chase (August 2011)

- OFAC alleged that JP Morgan had violated the Cuban, Iranian and Sudanese sanctions regulations by processing payments to those countries
- Included allegations that JP Morgan violated the facilitation prohibition in the Iranian sanctions regulations by processing an electronic fund transfer related to an Iranian entity
- Settled with OFAC for $88.3 million

Real World Hypotheticals

Hypothetical #1

- Asian subsidiary of a U.S. company sells equipment to a foreign third party in a transaction relating to a sanctioned country
- The necessary expertise and equipment for installing the equipment and monitoring its performance is located at the company's headquarters in the United States
  - Troubleshooting requests are also rooted through a U.S. based call center

Hypothetical #2

- A foreign entity employs a U.S. person salesman who, through his personal relationships, identifies a potential transaction in a sanctioned country
- The company wants to go forward with the transaction but requires the U.S. person's connections to do so

Hypothetical #3

- A foreign entity identifies an acquisition it would like to make of a foreign company whose business is predominately in a sanctioned country
- The foreign entity lacks the necessary acquisition expertise to conduct the transaction so seeks assistance in creating the required deal documents and legal assistance from its parent company in the United States

Hypothetical #4

- A foreign subsidiary of a U.S. company identifies a lucrative sales opportunity relating to a transaction involving a sanctioned country
- The proposed transaction is of a value that exceeds the approval authority of the foreign subsidiary and of an amount that typically requires approval of its U.S. parent

Hypothetical #5

- A foreign entity owned or controlled by a U.S. parent company is servicing equipment provided to a foreign third party when it learns that the third party intends to move the equipment to a sanctioned destination

Questions?

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