

## 2010: OFAC's Big Year

Law360, New York (March 14, 2011) -- 2010 saw increasing fines and increasing focus on export enforcement at the Office of Foreign Assets Control. It was perhaps not surprising, then, that OFAC got front page treatment in the New York Times on Dec. 24, 2010 in an article provocatively entitled "U.S. Has Approved Billions in Business With Blacklisted Nations." [1] And though it reflects the current social media age, it may have surprised some that Stuart Levey, then the undersecretary for terrorism and financial intelligence, chose to publicize his response to the Times article by using a blog post. [2]

This article discusses major OFAC-related items from 2010, followed by a practical discussion of prudent business practices appropriate to adapt to OFAC's increasingly prominent role.

### Major OFAC Enforcement Actions In 2010

The trend in the direction of larger settlements and larger penalties accelerated in 2010. Starting with the massive settlements with Lloyds Bank and Credit Suisse at the very end of 2009, OFAC settlements and penalties totaled nearly a billion dollars in a 13-month period.

Even factoring out the December 2009 settlements, OFAC's civil penalties were over \$200 million in 2010 alone. Since the comparative 2007 and 2008 annual numbers were about \$5 million, the data from 2009 and 2010 show an order of magnitude change in the level of financial risk involved. Summarized below are some of the noteworthy OFAC enforcement actions of 2010.

#### ***Agar Corporation Inc. (ACI)***

OFAC alleged that ACI exported equipment, with knowledge that it would be incorporated into items sent to Sudan, in violation of the Sudanese Sanctions Regulations. [3] The violation was not voluntarily disclosed. ACI settled by payment to OFAC of \$860,000, with a computed base penalty of \$1,967,098.

While OFAC considered the alleged violations to be egregious, based on a perceived intent to evade sanctions, the settlement reflected: 1) ACI's cooperation with the Bureau of Immigration and Customs Enforcement and OFAC; 2) a plea agreement with the U.S. Department of Justice, pursuant to which ACI pled guilty to one count of violating IEEPA. ACI further agreed to pay a total criminal penalty of \$1,140,000, accept four years' probation that include intensive sanctions compliance monitoring; and 3) entry into a tolling agreement with OFAC.

#### ***United Nations Federal Credit Union (UNFCU)***

OFAC alleged that UNFCU violated the Cuban Assets Control Regulations (CACR) by providing services for blocked Cuban nationals.[4] The violations were not voluntarily disclosed. UNFCU settled by payment of \$500,000, with a computed base penalty of \$5,237,100. Mitigation was enhanced by UNFCU's: 1) cooperation with OFAC; 2) agreements to conduct a compliance review, and to augment its compliance program; 3) the fact that a significant portion of the base penalty amount was attributable to many substantially similar alleged violations; and 4) the absence of prior OFAC violations.

#### ***Innospec Inc.***

OFAC alleged that Innospec violated the CACR through transactions in which the government of Cuba and/or Cuban nationals had an interest.[5] Specifically, a subsidiary ran afoul of the CACR by maintaining local sales offices in Cuba, incurring general operating expenses, and by holding accounts in Cuban financial institutions. The violations were voluntarily disclosed.

The matter was settled by payment of \$2.2 million, with a computed base penalty of \$4,447,878. Mitigating factors included: 1) cooperation with OFAC, which included entry into a tolling agreement; 2) remedial measures, including selling the affected subsidiary, and instituting compliance program enhancements; and 3) the fact that the OFAC settlement was part of a \$40 million comprehensive criminal and civil settlement between Innospec and OFAC, the DOJ, the U.S. Securities and Exchange Commission, and the U.K.'s Serious Fraud Office.

Among other provisions, the settlement included guilty pleas to wire fraud and Foreign Corrupt Practices Act violations for certain dealings with Iraqi and Indonesian officials.

#### ***Barclays Bank PLC***

OFAC alleged that Barclays circumvented U.S. bank sanctions detection filters in more than 1,000 funds transfers worth about \$113 million over a four-year period.[6] The transfers were alleged violations of Sudanese, Iranian, Cuban and Burmese sanctions. The violations were voluntarily disclosed.

The matter was settled by payment of \$176 million, with a calculated base penalty of \$218,971,000. The obligation was deemed satisfied by Barclays' payment of \$298 million to the DOJ and the Manhattan District Attorney's Office in a related criminal proceeding.

Aggravating circumstances included the alleged recklessness of the violations, management awareness and Barclays' sophistication. Mitigating factors included: 1) cooperation, entry into tolling agreements and other remedial efforts; 2) the absence of OFAC penalties in the five years preceding the conduct; and 3) the fact that a number of the Sudanese transactions involved the export of agricultural products.

***Balli Group PLC, and Balli Aviation Ltd. (Balli)***

OFAC alleged that Balli exported three commercial airliners to Iran, and further attempted to export three additional airliners, in violation of the Iran Transactions Regulations and the Export Administration Regulations.[7] The violations were not voluntarily disclosed.

Balli entered a settlement with OFAC and the U.S. Commerce Department's Bureau of Industry and Security (BIS). Provisions included: 1) payment of a \$15 million civil penalty (\$2 million of which would be suspended if there were no further export control violations); 2) agreement to externally provided annual compliance audits conduct annual external audits for five years; and 3) BIS's removal of Balli's export privileges for five years — BIS agreed to suspend export denial as long as Balli continued program compliance, and timely paid its penalty).

In a related criminal case, Balli Aviation pled guilty and paid a \$2 million fine, for illegally exporting commercial aircraft from the U.S. to Iran.

***Maersk Line Ltd., and its wholly owned U.S. subsidiaries, Farrell Lines Incorporated, and E-Ships, Inc. (collectively, MLL)***

OFAC alleged that MLL violated the Sudanese Sanctions Regulations and the ITR by providing unlicensed shipping services for cargo originating in, or bound for, Sudan and Iran.[8] The violations were not voluntarily disclosed. The matter was settled for \$3,088,400, with a computed base penalty of \$61,768,000.

Aggravating factors included MLL's sophistication, and the harm to sanctions program objectives by conferring economic benefits on Sudan and Iran. Mitigating factors included: 1) no violations of OFAC sanctions in the preceding five years; 2) cooperation with OFAC, including entry into two tolling agreements; 3) substantial remediation measures; and 4) freight charges for entire voyages were included in the base penalty calculation, although the apparent violations involved a portion of the voyage.

**OFAC Regulations Published in 2010**

## ***Introduction***

As with the passage of the Comprehensive Iran Sanctions Accountability and Divestment Act, regulatory activity in 2010 reflected continued focus on Iran. OFAC also seemed to act in 2010 to respond to criticism that OFAC was slow to act to support executive orders (EOs) with necessary regulations.

New regulations published in 2010 include the programs for Belarus (Part 548), Somalia (Part 551), Lebanon (Part 549), Iraq Stabilization and Insurgency Sanctions (Part 576), and North Korea (Part 510). The Iraqi Sanctions Regulations (Part 575) was canceled.

Not only did OFAC issue some regulations based on older EOs, but OFAC also acted fairly quickly to issue regulations for EOs issued in 2010. However, some regulations were issued in abbreviated form (Belarus and North Korea), and did not completely spell out prohibited activity, and other elements normally found in regulations. OFAC did issue full regulations for Lebanon, though they followed the associated EO by over three years.

## ***Iran-focused Regulations***

### *Expanded Definition of "Government of Iran"*

The ITR prohibits transactions with the government of Iran, and a June 2010 update substantially broadens the ITR's scope by giving OFAC the authority to define the meaning of "government of Iran."<sup>[9]</sup> Anyone, anywhere, can be "government of Iran" if OFAC determines that a party's actions support the government of Iran, or governmentally controlled enterprises. Subsequent action under this regulation included designation of German, Japanese, Belarusian, Luxembourgian and Italian entities as "government of Iran."<sup>[10]</sup>

### *Regulations Implementing CISADA*

OFAC issued two sets of regulatory updates to implement provisions in CISADA. The first occurred in August, with changes to the Iran Financial Sanctions Regulations, implementing Sections 104(c) and (d) of CISADA.<sup>[11]</sup> The regulations prohibit or impose strict conditions on U.S. correspondent or payable-through accounts for foreign financial institutions.

Subsequently, a September 2010 update to the ITR implemented Section 103 of CISADA. The ITR update removed the license to import carpets and foodstuffs from Iran. OFAC also invoked Subsection 103(d)(1) of CISADA to indicate that, with the exception of carpets and foodstuffs, the ITR's exemptions and general licenses remained in force.<sup>[12]</sup>

### *Non-Iranian Country Programs:*

As mentioned, OFAC acted in 2010 to issue regulations to cover several executive orders that had been previously issued. These included the Belarus Sanctions Regulations,[13] implementing EO 13,405 of June 16, 2006, and the Lebanon Sanctions Regulations,[14] implementing EO 13,441 of Aug. 1, 2007.

OFAC also made changes required to become current with Iraq policy. OFAC canceled the Iraqi Sanctions Regulations (Part 575), and published the Iraq Stabilization and Insurgency Sanctions (Part 576). Part 576 implements several EOs, including EO 13,303 of May 22, 2003, EO 13,315 of Aug. 28, 2003, EO 13,350 of July 29, 2004, EO 13,364 of November 29, 2004, and EO 13,438 of July 17, 2007. Though most Iraqi transactions are now unblocked, blocking remains for senior officials of the former Iraqi regime, those threatening peace and stability, or those undermining reconstruction efforts and political reform in Iraq.

OFAC issued new regulations for Somalia and North Korea shortly after the president issued EOs declaring national emergencies covering those nations. The Somalia regulations[15] implement EO 13,536 of April 12, 2010, which addressed the deterioration of security and persistence of violence, and acts of piracy and armed robbery at sea off the coast of Somalia.

The North Korea regulations implement[16] EO 13,466 of June 26, 2008, and EO 13,551 of Aug. 30, 2010. The first of the North Korea EOs maintained prior blocking provisions in effect, while the legislative authority for the North Korean sanctions program was shifted from the Trading With the Enemy Act[17] to the International Emergency Economic Powers Act (IEEPA).

The latter EO announced increased sanctions following the sinking of the South Korean ship Cheonan, and North Korean nuclear-missile testing and launch activity.

### ***Other Regulatory Developments***

#### *Increased Access to Communications*

March 2010 regulatory changes to the Cuban Assets Control Regulations, Sudanese Sanctions Regulations and Iranian Transactions Regulations [18] permit the exportation of services incident to the exchange of personal communications over the Internet.

Covered services include social networking, among others means of communications. Services must be publicly available at no cost to the user. For Sudan and Iran the regulations permit export of software not subject to Commerce Department export control. The exportation of software to Cuba is not authorized by this OFAC regulation, because all software for Cuba requires Commerce licensing.

### *Increased Access to Legal Services under Terrorism Sanctions Programs*

OFAC made changes in December 2010 to the Global Terrorism Sanctions Regulations (GTSR), the Terrorism Sanctions Regulations (TSR), and the Foreign Terrorist Organizations Sanctions Regulations (FTOSR) to widen access to legal review for designations made under those programs.[19]

Specifically, the regulations expanded the scope of authorized services under the GTSR and TSR for U.S. or state court proceedings. Additionally, OFAC added new general licenses to the GTSR, TSR and FTOSR authorizing U.S. persons to receive specified types of payment for certain authorized legal services. Payments can only be made from limited sources, and specific licenses are required for payment in all cases.

### *One Year Change to Agricultural Export Rules for Cuba:*

OFAC published this unusual change in March 2010,[20] to implement a one-fiscal-year change to the definition of “payment of cash in advance” for agricultural exports, as was directed by Section 619 of the Consolidated Appropriations Act of 2010.[21]

## **Executive Orders Issued in 2010**

The president issued executive orders in 2010 establishing or enhancing a number of sanctions programs. The most significant EOs focus on three foreign policy hot spots: namely Iran, North Korea and Somalia.

### ***Iran***

EO 13,553 (Sept. 28, 2010) implements and expands the scope of CISADA and prior EOs to address human rights abuses by the government of Iran.[22] The order targets persons responsible for “serious human rights abuses” in Iran following the Iranian presidential election in June 2009.

EO 13,553 reflects the Obama administration’s efforts to raise economic pressure on Tehran. It represents a significant expansion of scope by addressing human rights abuses in Iran, in addition to the more traditional foreign policy concerns of weapons proliferation, terrorism and energy.

Additionally, the EO shows U.S. government focus on enforcement across a spectrum from ranging from the global scale, down to small personal transactions.

The administration achieved an international success in December 2010, when the Reserve Bank of India (India’s central bank) terminated use of the Asian Clearing Union, a regional clearinghouse, to settle payments for Iranian oil and gas purchases.[23] At the other end of the spectrum, OFAC removed the general license for certain Iranian imports, including carpets and foodstuffs, the week before EO 13,553 was published.

## ***North Korea***

EO 13,551 (Aug. 30, 2010) blocks the property of designated parties involved in arms sales, money laundering, narcotics trafficking, the procurement of luxury goods and other “illicit economic activity” supporting the government of North Korea.[24]

The EO expands the scope of the prior presidential designation of a “national emergency” under IEEPA (EO 13,466 (June 26, 2008)) with respect to North Korea’s nuclear weapons program. The president issued EO 13,551 following a series of destabilizing actions by North Korea, including the sinking of the South Korean Navy ship Cheonan in March 2010.

One of the entities blocked by EO 13,551 was identified only as “Office 39.” Office 39 is apparently affiliated with the North Korean Workers’ Party and, according to news reports, engages in narcotics trafficking and counterfeiting to raise money for the purchase of luxury goods for the North Korean leadership.

Analogous to measures against Iran, the EO shows the use of sanctions to apply economic pressure, by targeting luxury goods like expensive yachts and automobiles. OFAC issued regulations implementing the EO on Nov. 4, 2010.[25]

## ***Somalia:***

EO 13,536 (Apr. 12, 2010) established a sanctions program that blocks the property of individuals and entities involved in the violent unrest in Somalia.[26] OFAC promptly issued a final rule in May 2010 implementing this EO (31 C.F.R. 551).[27]

## **OFAC 2010 Legislation: CISADA**

The major sanctions legislation enacted in 2010 was the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010.[28] CISADA imposed more restrictive sanctions to impede Iran’s nuclear ambitions, and responded to human rights abuses in the wake of the 2009 elections.

CISADA directs significantly increased restrictions on financial transactions, raising the likelihood that Iranian business counterparties will risk loss of U.S. business. CISADA imposes new sanctions against Iran; expands the Iran Sanctions Act; enhances OFAC’s Iranian Transactions Regulations; requires Treasury to issue certain regulations applicable to U.S. financial institutions and their foreign subsidiaries, and affecting foreign financial institutions; sets criteria for states to prohibit certain investment involving Iran; and establishes a requirement for the director of national intelligence to compile “Destinations of Diversion Concern.”[29]

## **(Immediate) Past as Prologue: Future Directions in OFAC Enforcement**

Predictions are necessarily imprecise, but several distinguishing features from OFAC's recent history are worthy of the attention of anyone doing business in the global marketplace. The scope and magnitude of enforcement actions are increasing in response to sanctions violations. Regardless of how large a business is, a fine denominated in the hundreds of millions of dollars is serious money. OFAC enforcements increasingly include criminal dimensions, raising the stakes even further.

Global corporate reach can result in more severe penalties, since sophisticated participants in the financial system are held to higher standards. Additionally, the willingness to use sanctions as a behavior-shaping tool in foreign policy has risen, as can be seen by use of sanctions to respond to human rights violations.

Taken together with President Barack Obama's focus on exports generally, including through the establishment of the Export Enforcement Coordination Center, the confluence of trends indicate that OFAC's portfolio will only grow.

Businesses must respond to the changing enforcement landscape by establishing effective internal controls. Deep scrutiny of every transaction would be wasteful, but a risk-based approach can identify potential concerns, with minimal impact on operations. Penalty magnitude is strongly influenced by aggravation and mitigation factors, and by whether disclosure of the behavior is voluntary. As a result, prudent internal controls, and swift reporting when potential violations are found, are critical factors in reducing risk. A general list of protective considerations are:

- a) Risk-based assessment of vulnerabilities associated with transactions, based on their magnitude, location and the history of prior dealing.
- b) Training for personnel involved with cross-border transactions, to sensitize them to the potential risks, and to provide guidance on what procedures should be followed in the event that possible inappropriate activity is discovered.
- c) Escalation provisions that allow senior compliance officials to evaluate unusual situations detected by employees. This allows problems to be avoided, or to be minimized and rapidly reported if they do occur.
- d) Routine monitoring of compliance procedures, to verify operation within established parameters.
- e) Pre-planned responses established by corporate leadership, to ensure that possible violations are correctly reported. Because promptness is a factor, leaders should have had discussions in advance about what will be done, and who will do it, when apparent violations are to be reported. A time-consuming internal investigation to gain greater fidelity about whether a violation actually occurred may not be the most prudent approach.

Well-crafted compliance programs might also consider integration of a wider constellation of risk, since OFAC issues frequently overlap with other U.S. laws that touch on cross-border transactions. FCPA compliance, along with monitoring for International Transactions in Arms Regulations and EAR issues, are examples of additional elements beyond OFAC that might be included in a thoughtfully constructed global transaction compliance program.

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[1] Jo Becker, U.S. Has Approved Billions in Business With Blacklisted Nations, N.Y. Times, Dec. 24, 2010, at A1, available at <http://www.nytimes.com/2010/12/24/world/24sanctions.html>.

[2] Erika Gudmundson, Fact Check: Under Secretary Levey Responds to the New York Times, Treasury Notes (Dec. 24, 2010), available at <http://www.treasury.gov/connect/blog/Pages/Under-Secretary-Levey-Responds-to-the-New-York-Times.aspx>.

[3] See Press Release, Dep't of Justice, Houston Company Pleads Guilty to Illegally Facilitating Exports to Sudan (June 22, 2010), available at <http://www.justice.gov/usao/txs/releases/June%202010/062210%20Agar%20Corporation%20Inc.htm>; Office of Foreign Assets Control, Enforcement Information for July 15, 2010 (July 15, 2010), available at <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/07152010.pdf>.

[4] See Office of Foreign Assets Control, Enforcement Information for July 15, 2010 (July 15, 2010), available at <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/07152010.pdf>.

[5] See Press Release, Dep't of Justice, Innospec Inc. Pleads Guilty to FCPA Charges and Defrauding the United Nations; Admits to Violating the U.S. Embargo Against Cuba (Mar. 18, 2010), available at <http://www.justice.gov/opa/pr/2010/March/10-crm-278.html>; Office of Foreign Assets Control, Enforcement Information for March 19, 2010 (Mar. 19, 2010), available at <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/03192010.pdf>.

[6] See Press Release, Dep't of Justice, Barclays Bank PLC Agrees to Forfeit \$298 Million in Connection with Violations of the International Emergency Economic Powers Act and the Trading with the Enemy Act (Aug. 18, 2010), available at <http://www.justice.gov/opa/pr/2010/August/10-crm-933.html>; Office of Foreign Assets Control, Barclays Bank PLC Settles Allegations of Violations of Multiple Sanctions Programs (Aug. 18, 2010), available at <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/barclays08182010.pdf>.

[7] See Press Release, Dep't of Justice, U.K. Firm Pleads Guilty to Illegally Exporting Boeing 747 Aircraft to Iran (Feb. 5, 2010), available at <http://www.justice.gov/opa/pr/2010/February/10-nsd-131.html>; Office of Foreign Assets Control, Enforcement Information for February 5, 2010 (Feb. 5, 2010), available at <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/02052010.pdf>.

[8] See Office of Foreign Assets Control, Enforcement Information for July 28, 2010 (July 28, 2010), available at <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/07292010.pdf>.

[9] 75 Fed. Reg. 34,630 (June 18, 2010).

[10] 75 Fed. Reg. 48,562 (Aug. 11, 2010).

[11] 75 Fed. Reg. 49,836 (Aug. 16, 2010).

[12] 75 Fed. Reg. 59,611, 59,612 (Sept. 28, 2010).

[13] 75 Fed. Reg. 5,502 (Feb. 3, 2010).

[14] 75 Fed. Reg. 44,907 (July 30, 2010).

[15] 75 Fed. Reg. 24,394 (May 5, 2010).

[16] 75 Fed. Reg. 67,912 (Nov. 4, 2010).

[17] 50 U.S.C. App. 1 et seq. ("TWEA").

[18] 75 Fed. Reg. 10,997 (Mar. 10, 2010).

[19] 75 Fed. Reg. 75,904 (Dec. 7, 2010).

[20] 75 Fed. Reg. 10,996 (Mar. 10, 2010).

[21] Pub. L. 111-117, 123 Stat. 3034.

[22] 75 Fed. Reg. 60,567 (Oct. 1, 2010).

[23] Lydia Polgreen and Heather Timmons, Move to Curb Transactions for Iranian Oil Leaves Indian Companies Scrambling, N.Y. Times, Dec. 31, 2010, at A4, available at <https://www.nytimes.com/2010/12/31/world/asia/31india.html>.

[24] 75 Fed. Reg. 53,837 (Sept. 1, 2010).

[25] 75 Fed. Reg. 67,912 (Nov. 4, 2010).

[26] 75 Fed. Reg. 19,869 (Apr. 15, 2010).

[27] 75 Fed. Reg. 24,394 (May 5, 2010).

[28] Pub. L. 111-195, 124 Stat. 1312. (CISADA).

[29] For a more complete discussion of CISADA, see Gibson, Dunn & Crutcher's "Iran Sanctions Legislation: New Controls and Penalties for U.S. Financial Institutions" <http://www.gibsondunn.com/Publications/Pages/IranSanctionsLegislation-NewControlsAndPenaltiesForFinancialInstitutions.aspx>, (last accessed March 6, 2011).

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