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# Update: U.S. Sanctions

## INTRODUCTION

In an effort to foster voluntary compliance with U.S. sanctions, and to remove some of the opacity that surrounds them, U.S. Treasury's Office of Foreign Assets Control ("OFAC") recently hosted a day-long seminar for the international trade community in Washington D.C. During the conference, OFAC employees explained how the sanctions work, how OFAC enforces penalties, and how businesses and individuals can protect themselves from violating U.S. sanctions, among other topics. We set forth below some of the conference's more salient points for businesses and individuals involved in international shipping.

Before doing so, however, there are several points to keep in mind. First, the conference was meant to address all U.S. sanctions regimes, not just sanctions against Iran and, to a lesser degree, Syria. However, given the current political situation between Washington and Tehran, Iran sanctions dominated the discussion. Second, we note that although OFAC stated during the conference that its jurisdiction is limited to the U.S. and U.S. persons (which includes permanent residents), OFAC will likely still play a role in enforcing sanctions against non-U.S. persons who engage in sanctioned business. For example, Executive Order 13590, which President Obama issued on November 21, 2011, directs the State Department and Treasury to work together to implement financial sanctions against persons who facilitate the production of Iranian petrochemicals and petroleum. Though the State Department would presumably take the diplomatic lead with respect to implementing sanctions against non-U.S. companies, OFAC would likely be tasked with enforcing them, especially if the penalty entails blacklisting non-U.S. companies from the U.S. financial system.

Set forth below are some of the general themes and specific lessons gleaned from the OFAC conference in Washington D.C., which we hope you will find informative and useful.

## GENERAL THEMES

### Voluntary Compliance

OFAC places a very high premium on businesses and individuals self-policing themselves to comply with U.S. sanctions. The seminar itself was an effort to foster and maintain voluntary compliance, which OFAC recognizes as central to the sanctions' efficacy.

### Sanctions Are Effective

OFAC strongly believes that sanctions are an effective foreign policy tool. Case in point – Libya. U.S. sanctions against Libya resulted in the freezing of \$30 billion owned by the Gaddafi regime, thereby simultaneously depriving the regime funds to fight the opposition while holding the funds in trust for the future Libyan government. Post Libya, OFAC officials are bullish on sanctions, and they aim to replicate their success in Libya with respect to Iran and Syria.

### Emphasis on multilateral sanctions

Multilateral sanctions are more effective than unilateral sanctions. Sanctions against Syria and Iran (as with Libya) will be more effective if they function in concert with United Nations, United Kingdom, European Union, and/or Arab League sanctions. OFAC is thus keen on working with other countries to implement and expand multilateral sanctions against Syria and Iran.





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## Iran

Iran presents U.S. officials with a complicated challenge and thus the Iranian sanctions program will likely continue to expand. OFAC highlighted the recent sanctioning of Bank Tejarat, Iran's third-largest commercial bank, as evidence of the sanctions' expanding scope. OFAC officials have been traveling abroad to explain to governments, banks and firms how and why the U.S. government is severing Iran's access to the global financial system, and to lobby non-U.S. banks and firms to take necessary steps to support this effort.

## Shipping

OFAC recognizes the relationship between effective sanctions and international shipping, particularly with respect to Iran. The sanctioning of Iranian port operator Tidewater was highlighted as an example of targeting Iran's dependence on international shipping. Also highlighted by OFAC was the fact that IRISL's loss of insurance cover under E.U. sanctions resulted in the arrest of its vessels by a European mortgage bank.



## SANCTIONS ENFORCEMENT AND MITIGATION

A considerable percentage of sanctions enforcement results from voluntary disclosure, when persons (individuals and businesses) who inadvertently violate the sanctions self-report their violations to OFAC. Voluntary disclosure is also a key factor in financial penalty mitigation (see below). Thus, many persons who report their violations do so to lessen their financial penalty, especially as violators are strictly liable for their breach of the sanctions.

Regarding those who do not voluntarily disclose sanctions violations, OFAC may learn of the violations via a number of different sources. For instance, when a U.S. bank blocks or rejects a wire transfer because it suspects the transaction bears a connection to a sanctioned entity, the bank is required to report the blocking or rejection to OFAC within ten days. These reports often result in OFAC commencing its own investigation into the parties involved in the wire transfer, which leads to additional investigations into additional persons, and so forth. Also, a fair number of OFAC investigations result from referrals, whereby businesses inform OFAC that their competitors are unfairly making a profit from engaging in sanctioned trade.

The typical enforcement action begins with the service of an administrative subpoena on a person suspected of violating the sanctions. Failure to comply with the administrative subpoena can result in a severe increase in civil penalties and, if the underlying violation is serious enough, a referral to the Department of Justice for criminal investigation.

There is clearly a preference for settling, rather than litigating, enforcement actions, and there are a number of methods via which sanctioned persons can settle and greatly mitigate a financial penalty (the typical mitigation is between 33 and 37 percent of the penalty, with 50 percent mitigation not unheard of). As mentioned above, voluntary disclosure is a major mitigating factor. So too is whether the violation was a first time and/or incidental offense. The existence of a robust compliance program (see below) already in place when the violation occurred is also a major mitigating factor. A key *aggravating* factor is the harm that the sanctioned trade has inflicted on the sanctions program.

## COMPLIANCE PROGRAM AND INTERNAL CONTROLS

The existence and implementation of a robust compliance program is a major mitigating factor in calculating financial liability for sanctions violations. OFAC discussed a number of criteria and protocols to assist persons with developing an adequate compliance program, and is keen on companies taking the following steps to ensure compliance with the sanctions regimes:

- Assess risk via the following methods:
  - Know your customer base
  - Know your customer profile
  - Know the products and services that you offer and that your customers offer
  - Know the size and locations of the companies with whom you do business
  - Know whether the companies with whom you conduct business also conduct business in sanctioned countries
  - Be wary of conducting business in countries where there are lax export controls, specifically with respect to transshipments and re-exports to sanctioned countries
  - Know the brokers and intermediaries involved in any trade
- Implement internal controls
- Test and audit the success or failure of the internal controls
  - At the minimum, audits should be annual, independent, and comprehensive with respect to a company's risk profile
- Provide employee training and designate responsible individuals to internally enforce the sanctions
- Ensure the whole organization takes compliance seriously

OFAC further wants businesses and individuals to consider the following:

- are customers and business partners properly screened
- how are they screened
- what is being screened
- are compliance programs being updated
- is reporting adequate, ie., are company higher-ups listening to employees tasked with OFAC compliance
- is there adequate recordkeeping regarding customer account information, end-user statements, individual identification of business partners, export licenses (if applicable), and shipping and freight-forwarding information
- is the compliance program being properly tested and assessed

According to OFAC, transportation documents are an especially effective means for ensuring compliance with U.S. sanctions. Bills of lading and/or airway bills must be reviewed for the following:

- names of shipping companies, consignees, notification parties, and forwarding agents
- ports of loading, transshipment and discharge
- final destinations
- the names of vessels

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## ADDITIONAL MATTERS

### Branch Office v. Subsidiary

Common inquiries we receive are:

- (1) whether U.S. branches and/or subsidiaries of foreign corporate parents are culpable under the sanctions for the actions of the foreign parent, and
- (2) whether the foreign parent is itself violating U.S. sanctions if it maintains a branch and/or subsidiary in the U.S. and continues to conduct sanctioned business from its foreign office.

We posed these questions directly to OFAC officials, who advised as follows. The sanctionable activities of a foreign parent are directly imputed to its U.S. branch, and vice versa. Thus, the foreign parent may face liability under the sanctions for trading with Iran if it maintains a branch office in the U.S. However, if the U.S. entity is a separately-incorporated subsidiary, then the acts of its foreign parent are not attributable to the U.S. subsidiary, and the foreign parent is not subject to OFAC jurisdiction for the purposes of sanctions enforcement, so long as the U.S. subsidiary does not participate in the sanctionable activity. It should be noted, however, that this advice was informally provided during a roundtable session and could not be relied upon in the face of an enforcement action.

What determines CISADA thresholds?

The Comprehensive Iran Sanctions, Accountability and Divestment Act ("CISADA") contains monetary thresholds for the triggering of sanctions. Of importance to shipowners is the fact that CISADA sanctions shipping refined petroleum products (RFP) to Iran. In order for shipping RFP to trigger the sanctions, the transportation service must have a fair market value of \$1 million (or \$5 million during a 12-month period). However, providing Iran with \$1 million of RFP (or \$5 million during a 12-month period) is also a sanctionable offense. The key concern for shipowners is: what triggers the sanctions? Is it \$1 million in freight or charter hire for shipping the RFP to Iran? Or does shipping also constitute "providing" Iran with RFP, in which case the \$1 million threshold is determined by the value of the cargo and not the value of the service? The State Department has informally advised in the past that the value of the cargo may control. OFAC advised during the conference that the value of the shipping service controls. The answer, therefore, is not entirely clear, and shipowners are urged to take note of this continued opacity and exercise extreme caution with respect to the above.

## Conclusion

**The sanctions landscape is changing fast, specifically with respect to Iran. Case in point – fresh U.S. sanctions targeting non-U.S. third-country banks that conduct legitimate, non-sanctioned business with that country. The U.S. government is now requiring those banks to make a choice: either stop conducting business with Iranian banks or lose access to the U.S.-dollar based international financial system. The sanctions regime is clearly expanding, and we will endeavor to keep you advised of any future developments that may impact international shipping.**

## Disclaimer:

This update provides only a general summary and is not intended to be comprehensive. Specific legal advice should be taken with respect to any individual inquiry. Please feel free to contact William Juska (juska@freehill.com), Gina Venezia (venezia@freehill.com), or Edward Carlson (carlson@freehill.com) at +01 212 425 1900 regarding U.S. sanctions. This report was written by Edward Carlson.