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Complying With List-Based Sanctions Programs

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Law360, New York (October 12, 2010) -- The majority of recent sanctions programs administered by the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) are so-called "list-based" programs, which are narrowly targeted and are not territorial in nature. They do not apply to the country as a whole and do not target its government.

Examples of these include, but are not limited to, programs such as the Balkans, Belarus, Cote d'Ivoire (Ivory Coast), Democratic Republic of the Congo, Somalia and Zimbabwe.

These sanctions prohibit "U.S. persons" from engaging in virtually all activities with, and require the blocking of property interests of, persons and entities who are Specially Designated Nationals and Blocked Persons (SDNs).

Because targeted parties are included on the SDN list, U.S. persons may conduct automated or manual screening of names against the OFAC's SDN list. Clients often ask: What are we missing? How much is enough?

Two key issues should be considered in developing screening procedures: 1) "Shadow" SDNs (also known as "phantom" SDNs); and 2) broad types of activities that could trigger a designation as an SDN under certain sanctions programs.

“Shadow” SDNs

“Shadow” SDNs are entities that are owned by an SDN but have not (yet) been included on OFAC’s SDN list. Prior guidance from OFAC, which has recently been incorporated in new sanctions regulations, states that an entity in which an SDN owns, directly or indirectly, a 50 percent or greater interest is also considered to be blocked. See e.g., 31 C.F.R. § 551.406 (75 Fed. Reg. 24394, May 5, 2010).

Hence, an entity owned by an SDN, even though not named on the SDN list, should be treated as an SDN because the same prohibitions apply to it.

If a U.S. person were to rely solely on screening against the SDN list, no “hit” would result because the entity is not included on the list. Yet if an SDN owns 50 percent of that entity, the U.S. person would be prohibited from engaging in virtually all activities with that entity, and would need to block (freeze) any property interests of such entity that are within the U.S. person’s possession or control.

Is OFAC saying that all U.S. persons must obtain ownership information from every entity with which they do business? Not exactly.

OFAC has consistently emphasized that U.S. persons may perform a risk-based analysis and implement compliance procedures commensurate with the level of risk posed by a particular transaction. That said, OFAC’s regulations do impose strict liability.

In performing a risk assessment, U.S. persons should be mindful that performing due diligence is a significant mitigating factor even though it may not always result in OFAC foregoing a fine.

Risk of Future Designation for Certain Activities Not Involving SDNs

The executive orders (EOs) implementing list-based sanctions programs specify not only the types of activities that are prohibited but also the types of activities that could serve as a basis for OFAC, in consultation with the U.S. Department of State (DOS), to designate additional persons and entities as SDNs.

In the case of certain EOs, the language is very broad. Activities that are not currently prohibited could possibly serve as a basis for future SDN designation.

While the U.S. government may appear unlikely to designate as SDNs persons and entities who are engaging in those activities, the language of EOs is broad enough to allow for such a possibility.

Accordingly, it is prudent to perform a risk-based analysis before engaging in such activities.

Somalia

President Obama issued EO 13536 on April 12, 2010, prohibiting U.S. persons from dealing in property interests of SDNs designated pursuant to that order. EO 13536 specifically named 11 individuals and one entity as SDNs targeted by these new sanctions as persons contributing to the conflict in Somalia.

It is clear from the EO that U.S. persons are prohibited from engaging in virtually any transactions with those SDNs. The Somalia Sanctions Regulations (SSR), 31 C.F.R. Part 551, implement this prohibition.

Section 1(a)(ii) of EO 13536 lists several types of activities that serve as the basis under which OFAC could designate persons as SDNs. For example, OFAC could designate a person who has:

- “engaged in acts that directly or indirectly threaten the peace, security, or stability of Somalia.”

- “provided financial, material, ... support for, or goods or services in support of” such acts.

The EO further states that “acts of piracy or armed robbery at sea off the coast of Somalia threaten the peace, security or stability of Somalia.” Section 1(b).

As a result, there is legal basis for OFAC to designate as an SDN anyone who provides financial support for, or goods/services in support of, acts of piracy.

What about those who make ransom payments to Somali pirates who are not SDNs?

The EO and the SSR do not specify whether a payment of a ransom constitutes the provision of financial support for acts of piracy, or even the provision of goods in support of piracy. The payment of a ransom by a U.S. person to a non-SDN would not be prohibited under the EO.

OFAC and the DOS confirmed that point in a written response to questions posed by industry stakeholders, as posted on the Lloyds Market Association (LMA)'s marine committee website.

Specifically, when asked whether it would be a breach of the EO if a ransom payment is made to a person who is subsequently designated as an SDN, OFAC stated that “[o]nly payments involving persons on the SDN list at the time of the transaction are prohibited.”

Even if not prohibited, could such payment expose the person making the payment to a possible future designation by OFAC as an SDN?

If OFAC were to consider ransom money as “support” of piracy, then such payment could trigger a future SDN designation of the payor because the language in the EO is broad enough.

Also, would it be consistent with U.S. foreign policy interests to target owners of vessels and cargo hijacked on the high seas who decide to make ransom payments to non-SDN pirates?

Another OFAC response to LMA offers some insight:

"The U.S. government will make no concessions to individuals or to groups holding U.S. citizens hostage. It is the U.S. government policy to deny hostage takers the benefit of ransom, prisoner releases, policy changes or other acts of concession. Treasury intends to target for piracy-related designation only those persons that freely seek to support acts of piracy or armed robbery at sea off the coast of Somalia, including through the supply of weapons, communication devices or small boats or equipment."

The OFAC response implies that future designations would focus only on those who directly support pirates by supplying weapons and other equipment.

But, the OFAC’s response also indicates that it is the U.S. government’s policy to deny pirates the benefit of ransom. So, how “safe” is it to make a ransom payment to a non-SDN pirate?

At this time, it does not appear likely that OFAC would target for future designations those who merely pay ransom to non-SDN pirates to secure the release of their vessel, crew and cargo.

But if increased willingness to pay ransom were to initiate a vicious cycle by fueling more hijackings that lead to activities that further destabilize the situation in Somalia, it is conceivable that OFAC may reassess its position.

The existing EO would appear to provide legal basis for OFAC to designate as SDNs even those making ransom payments.

For U.S. persons, the bigger challenge in making a ransom payment to a person in Somalia is to ensure that the payment is not being made to an SDN (or a person acting on behalf of, or at the direction/control of an SDN).

For both U.S. and non-U.S. persons, any payments to Somali pirates present significant compliance challenges that warrant enhanced due diligence, which is further complicated by the nature of piracy itself. But even if sufficient due diligence is done to conclude that a particular payment is permissible, a possibility of future SDN designation, albeit remote, continues to linger.

Zimbabwe

President George W. Bush issued three EOs that imposed sanctions against persons and entities found to be undermining democratic processes or institutions in Zimbabwe: EO 13288 of March 7, 2003; EO 13391 of Nov. 23, 2005; and EO 13469 of July 25, 2008.

In addition, OFAC issued the Zimbabwe Sanctions Regulations (ZSR) in July 2004, 31 C.F.R. Part 541, implementing the restrictions set forth in EO 13288 (the ZSR have not been amended upon issuance of the subsequent EOs in 2005 and 2008).

Under the EOs and ZSR, U.S. persons are prohibited from engaging in virtually any transaction with a person or entity designated as an SDN of Zimbabwe (as explained above, U.S. persons also cannot engage in activities with “shadow” SDNs).

The current sanctions do not apply to the country of Zimbabwe as a whole, nor do they target the government of Zimbabwe itself, including the current Zimbabwe unity government (unity government).

Specifically, U.S. persons were not, and still are not, prohibited from entering into transactions with the government of Zimbabwe. The EOs and ZSR only prohibit dealings with SDNs, including any entities owned or controlled by SDNs.

For example, President Robert Mugabe was designated an SDN of Zimbabwe but the entire government of Zimbabwe was not, and still is not, considered an SDN.

The sanctions target President Mugabe in his individual capacity as well as certain members of President Mugabe’s prior regime and others who participated in or supported undermining democratic processes or institutions in Zimbabwe.

However, EO 13469 was issued before the formation of the unity government and it contains a broad reference to the “government of Zimbabwe” when listing the types of activities that could serve as legal basis for a future SDN designation.

Specifically, section 1(a)(vii) states that OFAC, in consultation with the DOS, could designate as an SDN any person who “provided financial, material, logistical or technical support for, or goods or services in support of, the government of Zimbabwe ...”

The term “government of Zimbabwe” is defined in EO 13469 to mean the government of Zimbabwe, its agencies, instrumentalities and controlled entities. See Section 3(d).

At the time the EO was issued, that term referred to President Mugabe's regime, which was trying to stay in power and which refused to recognize election results. The scope of the EO was not modified after the formation of the unity government (i.e., when President Mugabe entered into a power-sharing arrangement with the former opposition leader who is the current prime minister).

As a result, a U.S. person who, for example, enters into a contract to provide technical consulting or financial advice to the current unity government would be engaging in the provision of "technical" or "financial" support to the government of Zimbabwe.

Although the provision of services to the government of Zimbabwe is not currently prohibited, such activity could theoretically serve as legal basis for a future designation of that U.S. person as an SDN.

There is no "carve out" in the broad language of the EO that acknowledges the fact that the unity government is currently in power.

Unlike the Somali ransom payments that may not be in the U.S. government's interest, support for the unity government is in the U.S. foreign policy interest.

Consequently, it is highly unlikely that OFAC would use the broad language of EO 13469 to target persons who are currently providing goods, support or assistance to the unity government.

It is worth noting that OFAC has not designated any SDNs of Zimbabwe since the unity government began functioning in February 2009 (in fact, the most recent SDN designations made by OFAC were on Nov. 25, 2008, while the international community was still applying pressure on President Mugabe to accept a power-sharing arrangement).

The actual designations under the EO reflect a more narrow interpretation by the OFAC of the relevant criteria (i.e., OFAC had designated persons and entities before President Mugabe agreed to share his power with Morgan Tsvangirai, with no designations since that time, indicating that support to the existing government is not currently viewed as a sufficient basis for SDN designation).

Neither the EOs nor the ZSR currently prohibit U.S. persons from entering into transactions with the government of Zimbabwe. For some, that alone may provide a sufficient level of comfort to proceed with a transaction.

For others, additional due diligence would be required prior to proceeding to ascertain the true nature of the transaction, who is involved (i.e., whether any SDN controls a particular agency or branch of the government of Zimbabwe and is he/she acting in official capacity with respect to the transaction at issue) and what is the likelihood that a U.S. policy toward Zimbabwe may change during the "life" of the transaction.

As with "shadow" SDNs, this broad language in Somalia and Zimbabwe EOs highlights the complexity of legal issues involved in analyzing OFAC sanctions compliance.

Although screening of names against the SDN list is an important compliance measure, these complex issues reinforce the need for risk assessment and legal guidance.

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