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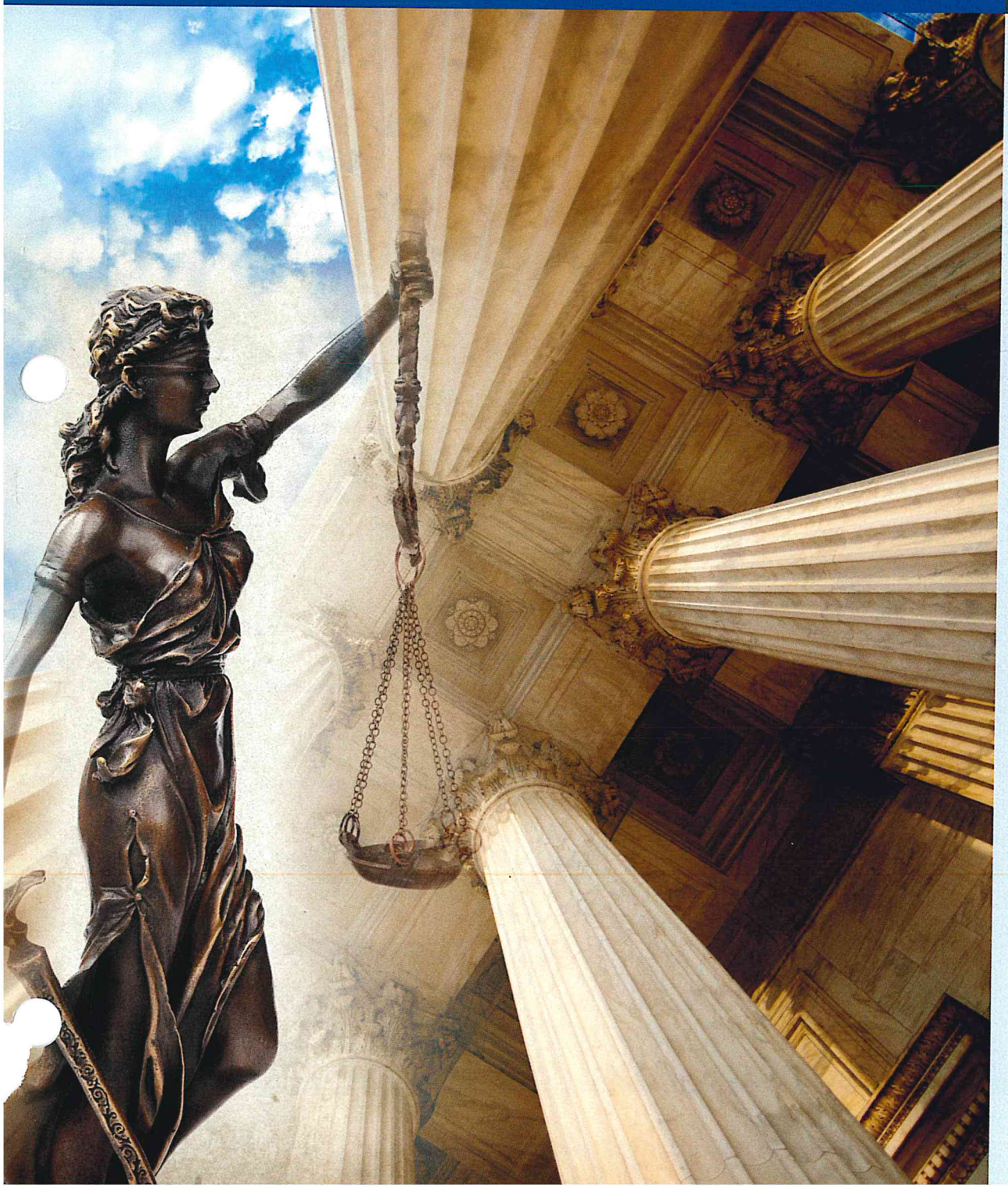

INSIDE

How Sanctions Get Made

ALSO INSIDE

Cooks in the Kitchen: How the Sanctions Get Made

By Sean Kane *

The increasing complexity of economic and trade sanctions is largely by design. As the U.S. government continues to search for non-military options to respond to national security threats, it has adapted a once blunt instrument to apply pressure more surgically.

In many cases, such as the sanctions imposed against terrorists, narcotics traffickers and transnational criminal organizations, that has meant the deployment of traditional blocking tools against discrete networks of bad actors. In other cases, such as the sanctions imposed against Iran and Russia, that has meant the development of new tools to leverage U.S. economic power, and the indispensability of the U.S. financial system, in support of diplomatic engagements.

In another sense, however, the increasing complexity of sanctions is an accident of circumstance. As sanctions have grown in profile and expanded in scope, a growing number of executive departments, federal agencies, state regulators and law enforcement bodies have played a role in developing, implementing and enforcing such laws and regulations.

The risk is that U.S. and overseas businesses and financial institutions, acting in good faith, may find themselves trying to interpret conflicting rules or guidance. That prospect is likely to feed a growing risk aversion within the private sector, ultimately undermining the effectiveness of sanctions as a foreign policy tool.

Policymaking

Sanctions are a tool of foreign policy, intended to incentivize a change in behavior rather than to impose retribution. They can be deployed by the president, via executive order, in response to an unusual and extraordinary threat to the national security, foreign policy or economy of the United States, and pursuant to the president's declaration of a "national emergency" to deal with such a threat.

Before the president issues such executive orders, the development of a new sanctions program commonly involves an interagency discussion among the State, Treasury, Defense and Commerce departments, among others. Those discussions are informed by assessments from the intelligence community regarding likely points of leverage, and guided by the National Security Council at the White House.

Sanctions can also be imposed by legislation. Congress has displayed newfound assertiveness in this space, recently passing high-profile sanctions bills to deal with threats posed by Iran, Russia, North Korea, Syria, Hezbollah, narcotics trafficking and human rights abusers, among others (see related story, page 19).

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Although legislation is frequently prompted by a sense that the president has not done enough to act, it is common for Congress to work with the administration to create workable tools that are broadly consistent with sanctions imposed by executive order. Similarly, the president often issues executive orders to implement sanctions passed by Congress.

Implementation

While the president and Congress create the tools and authorities, the implementation and administration of sanctions programs is left to executive branch departments and agencies. Treasury's Office of Foreign Assets Control (OFAC) is the primary agency charged with administering and enforcing U.S. economic and trade sanctions, although others – including the Bureau of Industry and Security (BIS) and State's Directorate of Defense Trade Controls (DDTC) – may also have jurisdiction over certain transactions with sanctioned countries, entities or individuals.

Here, it is important to distinguish between the traditional roles of economic and trade sanctions, which are imposed in order to change behavior, and other export controls that are imposed in order to restrict the proliferation of sensitive goods, dual-use technologies, and defense articles and services.

This distinction does have practical implications. Sanctions are intended to be dynamic and nimble, and the prospect of imposing – as well as lifting – sanctions must be credible in order for them to induce behavior change. Accordingly, sanctions regulations are frequently ratcheted up and down to accommodate foreign policy goals and respond to external stimuli.

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For example, OFAC made a number of changes to its Iran sanctions program in 2016 in order to fulfill commitments made as part of the multilateral agreement to curb the development of Iran's nuclear program. Similarly, BIS – which remains the lead implementing agency for sanctions governing the export and re-export of U.S.-origin goods and technology to Cuba – issued new regulations to implement President Obama's initiatives related to the island in 2015.

Despite this distinction, there remains substantial overlap between the respective roles of OFAC and BIS, in particular, when it comes to transactions with sanctioned countries, entities or individuals. For instance, under the Russia sanctions program administered by OFAC, U.S. persons are prohibited from providing goods, technology and services (except financial services) in support of certain frontier oil projects involving Russia.

At the same time, BIS prohibits the export, re-export or transfer of U.S. origin items in support of the same. What at first appears to be redundant is actually complementary – while many goods are subject to both OFAC and BIS jurisdiction, OFAC prohibitions extend further by covering U.S. persons exporting non-U.S. origin goods (e.g., from a third country) or services, while BIS prohibitions extend further by covering non-U.S. person re-exports of U.S.-origin goods and technology.

Regardless of which agency or agencies are delegated which authorities, the implementation of any sanctions regime will be effectuated by the issuance of regulations. These regulations define the specific prohibitions and provide, in some cases, exceptions to those rules. The implementing agencies will also commonly issue official guidance documents or frequently asked questions.

Finally – and most critically from the perspective of an exporter – the implementing agencies will have licensing authority over exports to a sanctioned jurisdiction, entity or individual. It is important to note that sanctions can implicate different components of the same transaction, and that different agencies may have jurisdiction over those distinct components.

For example, an exporter sending agricultural equipment to Syria may need to confirm that such exports are licensed or otherwise authorized by BIS, while the act of exporting such goods may involve a provision of services to Syria that would need to be licensed or otherwise authorized by OFAC. While BIS and OFAC have, in many cases, provided that exports licensed by one are thereby authorized by the other, there is an independent obligation to ensure compliance with all applicable regulations in every instance.

Enforcement

While the development of sanctions policy is a collaborative process, and establishing the rules is a relatively straightforward exercise in regulatory drafting, enforcing those rules is a more unwieldy affair that can obscure and sometimes confuse the applicable standards of compliance. It can also inadvertently upset certain policy goals, particularly because enforcement actions will ultimately dictate the private sector's risk tolerance.

The International Emergency Economic Powers Act (IEEPA) is the statute underlying most of the regulations that OFAC and BIS administer and enforce. For instance, both the Export Administration Regulations (EAR) administered by BIS and the Iranian Transactions and Sanctions Regulations (ITSR) administered by OFAC are authorized by IEEPA. Violations of IEEPA are currently subject to civil fines of up to the greater of $284,582 or twice the amount of the transactions at issue.

Because OFAC and BIS share jurisdiction over many exports to sanctioned countries, certain transactions can result in the simultaneous violation of OFAC and BIS (and, less commonly, DDTC) regulations. The agencies will commonly coordinate on civil enforcement investigations and actions.

For example, in 2016 OFAC and BIS agreed to concurrent settlements with Alcon Laboratories, Inc., Alcon Pharmaceuticals Ltd., and Alcon Management, SA, for apparent violations of the Sudanese Sanctions

Regulations, ITSR, and EAR, related to the sale and export of certain products to distributors in Sudan and Iran (see *The Export Practitioner,* August 2016, page 8).

In the case of willful violations of sanctions laws or regulations, IEEPA also allows the Department of Justice (DOJ) to enforce criminal penalties that can reach up to $1 million per violation and/or imprisonment for up to 20 years. Criminal cases brought by DOJ are commonly (though not always) initiated in conjunction with civil actions brought by OFAC, BIS and DDTC.

For instance, in 2017, China-based Zhongxing Telecommunications Equipment Corp. (ZTE) entered into settlement agreements with DOJ, OFAC and BIS to resolve criminal and civil actions related to the re-export of U.S. technology to Iran and North Korea (see *The Export Practitioner,* April 2017, page 12).

The ZTE case was also illustrative of another trend – the increased involvement of other federal agencies, including the FBI and the Department of Homeland Security (DHS), in sanctions investigations and enforcement actions. Such investigations can be difficult to negotiate and settle, not least because of the different institutional cultures and enforcement processes among the federal agencies involved. Nonetheless, coordinated action –even among several agencies – at least allows for consistent enforcement of the applicable laws and regulations.

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The more worrisome prospect, from the perspective of the private sector, is the involvement of state and local regulators in sanctions enforcement actions. In recent years, New York's State Department of Financial Services (NYDFS) has played an increasingly assertive role in bringing enforcement actions against banks and financial institutions subject to its jurisdiction.

In one 2012 case, NYDFS reached a $340 million settlement with the New York branch of Standard Chartered bank for violations of sanctions laws, reportedly without coordinating with federal authorities investigating the same alleged infractions.

State and local regulators like NYDFS have limited jurisdiction, and institutions that are subject to their oversight are generally familiar with the standards and expectations they require. It is not clear, however, that such regulators actively seek to harmonize and coordinate those standards and expectations with federal enforcement agencies.

The risk is that banks receive guidance from their regulator that is inconsistent with, or even conflicts with, guidance provided by OFAC or BIS. That lack of clarity, and the potential that any number of federal and state agencies can initiate enforcement action for alleged violations, may further contribute to the de-risking phenomenon – where U.S. and foreign banks indiscriminately refuse business that involves certain jurisdictions or types of transactions.

From the exporter's perspective, an inability to access financial services can be fatal to commercial relationships and the establishment of overseas markets. It can also undermine the effectiveness of sanctions, as businesses are reluctant (or unable) to engage in even authorized transactions that the U.S. government might wish to see take place.

Compliance

As a foreign policy tool, sanctions are only as effective as they are implementable, which is why government officials commonly state that the private sector is a partner – even if it may not feel like it from the standpoint of a U.S. bank or exporter. The government has an interest in ensuring that prohibitions are adhered to, and that authorized transactions are not impeded, in order to ensure the right amount of pressure is being applied (or the right amount of sanctions relief is provided).

For its part, the private sector has an obvious interest in adhering to the law and avoiding enforcement action that can seriously damage their reputation, if not their bottom line. This means there is a growing awareness within OFAC and BIS that outreach is critical.

However, the private sector has often been wary of such outreach efforts. While it may seem an obvious point, it's worth remembering that OFAC and BIS are enforcement, not trade promotion, agencies. Especially in the realm of explaining changes to relax sanctions – such as occurred with Burma, Cuba, Sudan and Iran in recent years – policy goals can conflict with OFAC's and BIS' institutional cultures, and official positions articulated by high-level officials at these agencies can sometimes be inconsistent with the approach taken by licensing and enforcement officers in their daily interactions with parties seeking guidance on specific transactions.

Given its role as the foreign policy arm of the U.S. government, the State Department has sometimes stepped into the breach – or, more commonly, coordinated

outreach efforts across departments. This, too, has caused some confusion within the private sector regarding whose voice is authoritative on issues of statutory or regulatory interpretation.

While various components of the State Department play a prominent role in the development of U.S. sanctions policy, and are similarly critical in articulating the strategic interests that underpin them, it is critical that U.S. businesses and exporters rely upon official guidance from the implementing agencies. If there is ever any question about whose perspective governs, it may be useful to determine who has licensing authority over any given transaction.

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Conclusion

Sanctions aren't easy, and there is little prospect that they'll get easier as the tool continues to evolve. That makes it all the more critical that all levels of government and the private sector continue to improve upon the lines of communication between them. For the policymakers and implementing agencies, it is critical that the private sector's perspectives feed into their decision-making processes in order to identify points of leverage.

For businesses in the U.S. and abroad, it is important to understand policymakers' thinking and intent, both so they can faithfully implement the laws and in order to avoid inadvertent violations. Building upon the channels that already exist, and actively seeking additional opportunities for policymakers, regulatory agencies and private sector to engage, will improve both the effectiveness of sanctions and compliance with those rules.

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