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SANCTIONS LAWYERS: AT THE NEXUS OF FOREIGN POLICY AND THE LAW

Economic sanctions have played a starring role in the execution of U.S. foreign policy throughout history. *WorldECR* examines the politicians' tool of choice and the impact it can have on the law.

U.S. embargo/sanctions law leaves an indelible trail through foreign policy for which historians present and future will be forever indebted. In 1807, Thomas Jefferson imposed an embargo on trade with Britain in an attempt to gain independence while averting war. Half a century later, America in effect embargoed itself when the forces of the Union blockaded Confederate ports during the Civil War.

More contemporary statutes reveal the Export Control Act of 1940 limiting the sale of war-critical products to Japan; Harry Truman's Battle Act of 1951 banning U.S. help to European countries doing business with the Soviet Union; the 1956 oil embargo against Britain and France during the Suez crisis; sanctions against Vietnam, Cuba, South Africa, Sudan, Iraq and, of course, Iran.

Sanctions are the tool by which the United States government exercises foreign policy short of military action. It is of course, in Washington, DC that these laws and schemes are formulated, debated, amended, promulgated and announced.

Thus the making and unmaking of sanctions policy has form in DC. The terminology is familiar and the arguments – about ethics, effectiveness and impact on domestic interests – are well rehearsed and incarnated through each generation's national security concerns. As one lawyer joked, 'Trade practitioners can be carbon-dated by reference to how far back their embargo experience extends: The Oil-for-Food program? 1963 Cuba regulations? Jackson-Vanik Amendment? The Anaconda Plan?' (The latter refers to the 1861 blockade upon the

Southern states – a 'giant snake' choking off exports of cotton and other commodities.)

Since Barack Obama took presidential office, the White House has very actively invoked sanctions to respond to a slew of evolving international challenges. Iran has dominated the international pages up until and beyond the negotiation of the Joint Plan of Action ('JPOA'), the first six months of the implementation of which is soon to expire. But the Arab Spring, civil war in Syria and conflict in South Sudan have also generated legislative responses – as has, of course, the current crisis in Ukraine.

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Jeremy Zucker, Dechert

At the same time as developing its own policies, the United States has worked hard to galvanise allies to take measures that are broadly aligned, with the corresponding effect that 21st Century businesses now face an unprecedented volume of complex legislation and compliance regimes. And while it was always the case that certain cliques of business knew that the nature and location of their activities were likely to be impacted by sanctions, now they make a bigger splash throughout the ecosystem of business – banking, insurance, private equity, service providers, and ICT companies

'There's definitely a sense of more robust enforcement by the agencies involved in this area, and of stronger assertion of jurisdiction generally,' says Jeremy Zucker, co-chair of the International Trade and Government Regulation practice at the DC office of Dechert.

Zucker says that it was the ramping up of the sanctions against Iran in particular (with the passing of legislation including CISADA (Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010) and ITRSHRA (Iran Threat Reduction and Syria Human Rights Act of 2012) that has heightened sensitivities very significantly.

With the JPOA still under negotiation between Iran and P5+1, Iran-related legislation still holds sway over the much of the day-to-day work of lawyers, and this despite the fact that U.S. trade with Iran is at an all-time low. 'That really reflects the extra-territorial element of the sanctions. Many U.S. businesses long ago wrote off doing Iran business. But non-U.S. entities, especially financial institutions, are feeling potentially very exposed,' says Zucker.

The reason for that, he says, lies in the rapid expansion of the sanctions and their extra-territorial impact. That not only draws in non-U.S. clients seeking advice on their potential exposures, but also increases the exposure of U.S. companies to 'suspect' business partners.

'The consequences for non-U.S. entities of being hit by the extra-territorial effects of U.S. sanctions include loss of access to U.S. markets and finance,' points out Zucker. That each of those would be accompanied by the kind of reputational fall-out attendant on recent big settlements goes without saying.

Latham & Watkins' Les Carnegie describes the sanctions landscape as being 'very active at the moment. The challenge is that the rules are complex, far-reaching, and in some cases counterintuitive – so clients are always looking for extra clarity. And there's high sensitivity, especially amongst the banks, about the possibility of becoming subject to an enforcement action or engaging in activities that present reputational risks.' In particular, with the new Russia-related sanctions announced through three executive orders in March 2014, client interest in understanding sanctions' impacts is incredibly high.

'The sanctions have such a chilling effect that companies are walking away from deals that are perfectly lawful and some banks aren't taking any chances with sales of medicines to Iran – the juice just isn't worth the squeeze.'

Les Carnegie, Latham & Watkins

One of the oft-mentioned corollaries of sanctions legislation has been that many institutions, particularly in the financial sector, have become risk averse to the extent that legitimate activity with sanctioned countries becomes very difficult. For instance, Carnegie described that a client could not persuade a bank that contemplated activities in Burma were lawful because of the targeted nature of the Burma sanctions or that sales to Iran of most U.S.-regulated medicines no longer require an OFAC specific licence: 'The sanctions have such a chilling effect that companies are walking away from deals that are perfectly lawful and some banks aren't taking any chances with sales of medicines to Iran – the juice just isn't worth the squeeze.'

As at time of writing, the U.S. and its Security Council partners (plus Germany) are quietly negotiating with Iran an agreement which would, if successful, relax sanctions in return for assurances and safeguards relating to Iran's nuclear programme. Under the terms of the JPOA, Iran is already afforded some limited sanctions relief, creating some opportunities for EU businesses but few for their U.S. counterparts. In February, U.S. vice-president Joe Biden criticised a delegation of French businesspeople visiting Tehran for sending the wrong signals. Nonetheless, Iran is a big market. Covington & Burling partner Kim Strosnider says that the first steps toward a relaxation of Iran sanctions – as called for by the JPOA – has garnered some interest already.

'No-one is jumping the gun,' says Strosnider. 'The U.S. government has issued many cautions on taking premature steps. Nonetheless, people are looking closely, watching the slight easing.' Covington is, she says, also keeping a weather-eye on the changing

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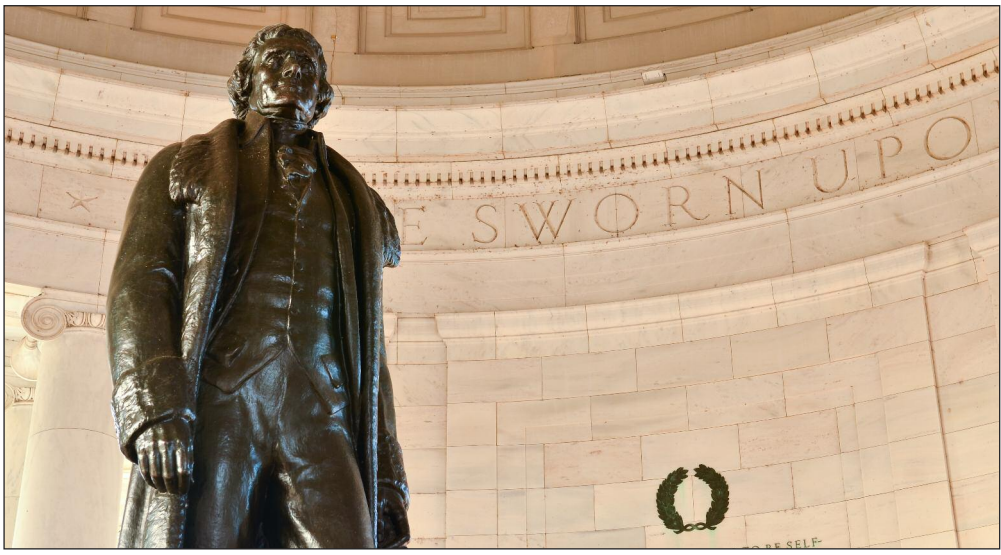
relationship because, as she points out, the art of giving accurate sanctions-related advice requires political awareness and astuteness as much as legal accuracy.

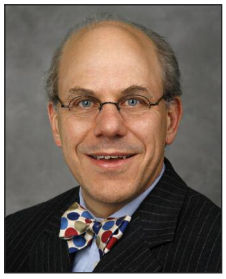
If one diplomatic door appears to be, however tentatively, looking less resolutely shut than it once did, another is drawing closed, with Russia/U.S. relations at a post-Cold War all-time low in the wake of the violence inflicted against demonstrators in Kiev during the dying embers of the Yanukovych regime, and with the abrupt annexation of the Crimean peninsula by Russia. '[The Ukraine-related] sanctions are very much *de jour* right now,' says Arent Fox partner Kay Georgi.



Orhan Cam

Though narrowly targeted, designating a very restricted number of individuals and few entities, the handful of executive orders that have constituted the U.S. response to those events have, in concert with actions taken by the European Union, Canada and Australia, precipitated a seemingly disproportionate volume of client enquiries.

Georgi suggests that the reason for this is that while her clients might not be involved with the SDNs directly, 'Under OFAC rules U.S. persons are prohibited from doing business with entities that are 50% (or more) owned by designated persons. In tandem with the lack of transparency typically attendant on Russian corporate ownership structures, it really makes sense to look closely at your business operations.'



'There's an obvious difference between the Russia-related sanctions and the Iran embargo – which is that Russia is a major trading partner with the United States.'

Robert Shapiro, Thompson Coburn

'Perhaps the single most frustrating compliance challenge that clients are encountering in the sanctions arena,' says Barbara D. Linney of Miller & Chevalier, 'is the lack of clear guidance on the standard of care expected of companies when attempting to determine whether a party is owned or controlled by a blocked person or SDN (under the U.S. rules) or a designated person under asset freezing programmes of other countries. Is a rumour or an unsubstantiated (or even denied) allegation enough to create an unacceptable risk of violation? Published guidance – OFAC's so-called "50% rule" and HM Treasury's deference to section 1162 of the Companies Act 2006, for example – does little more than establish the applicable thresholds of ownership. Far more challenging is assembling the facts necessary to determine whether the threshold has been met in a given case, and while HMT invites consultation in cases of doubt, OFAC is as reluctant as ever to share intelligence. This leaves companies with limited sources of verifiable information regarding the ownership of private entities with whom they may wish to deal.'

Berliner, Corcoran & Rowe partner Ben Flowe gives a flavour of the sense of urgency created by the Ukraine/Russia sanctions: 'It got pretty confusing when we saw three executive orders and one law passed in the space of a few weeks – there's guidance on the OFAC website, but that's not the whole story. It doesn't answer all the questions. The sanctions looked limited but they still affect all kinds of transactions. All of a sudden our clients were asking all sorts of questions: "Can I sell my goods to Russian Railways if the CEO is a designated individual? What happens where a designated person divests of a business? Can I buy those assets?"'

Whether the designations of Russian and Ukrainian individuals and entities put the brakes on business between the Cold War's erstwhile sparring partners has yet to be seen. Thompson Coburn partner Robert Shapiro says that 'There's an obvious difference between the Russia-related sanctions and the Iran embargo – which is that Russia is a major trading partner with the United States. And in the broader ambit of trade, they play on so many dimensions.'

As at time of writing, the mood around the situation in Ukraine is ominous, and as NATO countries talk about bolstering the presence of troops in Eastern Europe, and Moscow makes a show of force close to the Ukraine border, something greater than the self-determination of a Russian-speaking population appears to be at stake.

Russia is neither immune from the impact of sanctions, but nor does it have the energy card to play with respect to relations with the United States. Already amongst those designated by the State Department are included Kremlin insider Igor Sechin, chairman of Rosneft, the world's largest publicly-traded petroleum company. The designation does not preclude U.S. companies from doing business with Rosneft, but it will send tremors, says Shapiro, who adds that it is within this industry that the impact of sanctions may be felt.

'From a geopolitical perspective, this means that the United States is going to have to focus on Europe's supplies of energy. Surely there's going

to be greater pressure to increase exports of U.S. crude and natural gas. These are tough issues that are going to have to be faced,' says Shapiro, adding that, looked at through an energy security prism, the Russia sanctions 'may also have some influence on the dynamics of the Iranian sanctions'.

Fried Frank partner Mario Mancuso brings his policy experience as a former member of the President's national security and economic leadership teams to bear on his client engagements. In recent days, he has been called upon extensively to provide practical counsel – not merely legal advice – in relation to the new Russia sanctions. 'It's certainly true that the real world reach of the sanctions is greater than their actual legal reach,' he says. That can be partly attributed to the difficulties outlined above but also, says Mancuso, to the probable 'incremental trajectory' of further and more restrictive measures.

As we go to press, pro-Russian rebels have held referendums in Eastern Ukraine, the result of which purports to show overwhelming support for 'self-rule' or absorption into Russia. These have been widely criticised as flawed by observers, and decried as 'farcical' and lacking in legal basis by the authorities in Kiev. The world is now watching the Kremlin's response, which could in turn bring more far-reaching, sector-based, sanctions from Washington.

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Amit Mehta, Zuckerman Spaeder

As ever in the world of sanctions, who makes the next move and how is contingent on a bigger picture. In the case of Iran, the United States has succeeded in convincing the EU that it should align its policy, in effect, with Washington, a strategy that appears to have succeeded in advancing the current diplomatic efforts.

Vis a vis Russia, it's yet to be proven that the same choreographed response can be sustained. There are, of course- both plus and minus factors, as Mario Mancuso points out: 'European countries are more economically exposed than U.S. companies [to a slowdown in commercial relations with Russia]. On the other hand, Europe has a greater security interest in preventing Eastern Europe from becoming a contested, strategic frontier between the West and Russia'

'It's certainly true that the real world reach of the sanctions is greater than their actual legal reach.'

Mario Mancuso, Fried Frank

No certainty but change

Counselling on these kinds of political trajectories, uncertainties and nuances is all part of the remit for DC trade security lawyers. Indeed, the only certainty is that while there are constants, sanctions practice, following as it does the contours of both foreign affairs and enforcement trends, is seldom repetitive.

Broadly speaking, practice tends to fall into one of two categories. The 'preventive' work involved in advising on ongoing compliance measures, and secondly, the more aggressive investigatory work and advocacy demanded when a company strays off course.

Within some firms' teams the two elements are parts of the same spectrum, with the emphasis shifting to respond to demand. Latham & Watkins' les Carnegie says that firms have responded to an increase in enforcement activity and thus 'There's more demand for investigative skills than there was a few years ago.' As a result, he says, he and his team have been taken up with a slew of investigations-related work, but also see many more clients placing a premium on pre-emptive compliance strategies.

Amit Mehta of Zuckerman Spaeder LLP sees things very much from the sharp end. Prior to joining his current firm, Mehta (whose clients have included Dominique Strauss-Kahn, former President of the World Bank, who was cleared of criminal allegations of sexual assault in 2011) worked at the Public Defender Service for the District of Columbia. He says there is a palpable sense of 'greater commitment by criminal prosecutors to come after those who violate export control regulations, and it's not just financial penalties they are seeking – the U.S. Department of Justice has secured significant jail sentences in many of these cases.'

Mehta also observes that one of the ironies of the export control world is that, typically, despite or because of the fact that larger companies are taking compliance very seriously, 'with some high-profile exceptions, the big companies are not getting caught up in these prosecutions. It's the small companies that tend to take the bigger risks and that get caught.'

One sometimes vexed question is whether/when clients should undertake a voluntary disclosure (for OFAC, in the case of potential sanctions violations, or the departments of Commerce or State if EAR- or ITAR-related). Jacobson Burton's Michael Burton outlines some of the horns of the dilemma:

'What's the best thing to do if you discover a violation? It depends on the circumstances, on the harm done, on whether a mistake was made through ignorance or negligence versus more egregious conduct. We're seeing an increased understanding or clemency on the part of the three main agencies enforcing export controls and economic sanctions laws – if the exporter has been responsible overall, the violation did not involve knowing

or willful conduct, and a voluntary disclosure has been made. Having a strong compliance programme is a critical part of that.'

Is disclosure always the best way forward where a client uncovers 'red flags'? Burton says, 'A company that undertakes a voluntary disclosure is less likely to face a penalty, and any penalty that might be imposed is significantly mitigated. That being said, whether, when, and how to disclose turns on the facts of a given case. We always lay out the pros and cons of making a disclosure, including the costs both in legal fees and implementing remedial measures, but it is ultimately the client's decision. On the other hand, in certain situations – such as a breach of the ITAR involving a s.126.1 country (arms-embargoed countries), or where a company finds it has received blocked property belonging to an SDN, there's no choice. You have to disclose.'

'Companies tend to react to what they perceive the agencies to have been focusing in on in the previous year.'

Cari Stinebower, Crowell & Moring

Just as world events are subject to their own, particular rhythms, so also are enforcement trends, says Crowell & Moring partner Cari Stinebower: 'Companies tend to react to what they perceive the agencies to have been focusing in on in the previous year.'

What's interesting, she adds, is that they don't only base their understanding on completed investigations, which can take up to three years to conclude. '[Compliance professionals within industry] "hear the chatter" ie. get wind of the direction of interest by the agencies before an investigation is completed – so they're responding to the trend even before the outcome of the investigation has been published. This information sharing and trend spotting is an essential component to securing the financial sector against new money laundering and sanctions busting trends.'

Stinebower says that heightened sanctions compliance, in conjunction with an increase in corporate activity, means that she and team colleagues are working closely with M&A lawyers: 'For example, we're currently working for a client that's making a few acquisitions a month and we find that the due diligence is really focused on anti-money laundering, FCPA, customs/imports, sanctions, and export controls.'

Mostly, she says, the general trend she is seeing is acquirers are U.S. companies buying U.S. companies with overseas sales facilities or subsidiaries. As a result, often the team is having to work 'fast and furious' with the process of management interviews and data room access so they are paced to tight deal deadlines: 'We haven't seen this volume of activity until recently. But there was an uptick that began around 2006 when we saw some hard-hitting successor liability issues coming up. Now it's more common to deal with these issues in the pre-closing due diligence – the banks are expecting this.'

What is also apparent is that the nexus to foreign trade need only be slim before sanctions-related due diligence becomes an issue – indeed, Corey Norton of Trade Pacific PLLC says that clients are sometimes surprised to see sanctions-related compliance checks emerging.

'This stuff isn't always intuitive,' says Norton. 'What's interesting to my mind is that sanctions issues are coming up in contexts which have absolutely no obvious foreign component or dimension whatsoever. You're actually seeing sanctions-oriented contract clauses in purely domestic, U.S. activity, such as real estate contracts that contain provisions to ensure that one or other party has no connection with anybody on an SDN list.'

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There are other arenas, such as employment, where businesses sometimes need reminding of potential exposures: 'If you're buying a company in Latin America, have you checked to see, for example, whether that business hires Cuban nationals – and is that a problem?' Norton asks.

'Our team of sanctions/export controls lawyers is increasingly working with lawyers in other practice areas,' says Steve Pelak of Holland & Hart, 'partly due to a growing recognition by both our colleagues and our clients that export controls/trade sanctions issues permeate these transactions. We routinely help business attorneys with drafting contracts for services that require export control, trade sanctions or anti corruption provisions. Our intellectual property colleagues increasingly seek assistance from us with licensing for transactions in sanctioned countries to protect clients' IP rights. And, in the M&A arena, successor liability concerns have helped to make trade sanctions issues a more common component of transactional due diligence. For example, we are currently helping a U.S.-based mining company to implement a trade sanctions and anti corruption compliance programme to satisfy the requirements of the foreign bank that financed our client's acquisition of assets from a foreign company.'

That sanctions-related issues can arise in circumstances that are, if not surprising, at least counter-intuitive, reflects the extent to which the legislation has permeated through multiple layers of the business 'ecosystem', but also the fact that in an age where technology eschews boundaries the distinction between 'domestic' and 'foreign' is easily blurred. Web-based applications for example can by default be accessed by users anywhere in the world, regardless of whom the intended users might be – as Goodwin Procter partner Richard Matheny, whose clients

include (among others) a portfolio of early and growth stage technology companies around Boston and Silicon Valley: 'Often we're representing these companies as acquisition targets, and they are using or producing controlled software, services or hardware – due diligence concerns arise, as they do where technology can be accessed by SDNs or from designated countries. Often I'm involved in interpretative disputes as to whether licences are required or are eligible for a first amendment or social media exception.'

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Rich Matheny, Goodwin Procter

Many of Matheny's clients, he says, would not naturally conceive of their products as presenting a potential threat of sanctions violations; sometimes the topic isn't on the agenda until there's a scaling up of their ambitions: 'We do a lot of work for the underwriters in IPOs – some of the banks can be very skittish about underwriting because they've seen how hard financial institutions have been hit.'

Matheny adds that private equity firms financing technology companies are also extremely interested in understanding the potential liabilities of companies within their portfolios and targets.

'A sudden change in the law can create a tremendous amount of work,' says Matheny. 'The October 2012 Executive Order [Authorizing the Implementation of Certain Sanctions Set Forth in the Iran Threat Reduction and Human Rights Act] which was intended to close off loopholes relating to the activities of foreign subsidiaries unleashed a degree of chaos!'

It is the kinetic nature – and the multi-dimensionality – of the sanctions and trade security arena that attracts practitioners. Sanctions regimes can bed in with a kind of semi-permanent chilling effect on trade with a given country pending a tectonic change in relations with the United States.

Increasingly they are more targeted and exhibit more dynamic, but often no less or indeed more, confusing characteristics as policy makers strive to avoid the negative impacts that so often attended the blanket embargoes of the past.

A good practitioner in this area takes on board these nuances – and also understands that key to giving sound advice is having a grasp of the policy rationale driving the legislation or regulation. As Fried Frank's Mario Mancuso puts it: 'Regulation is an instrument, it is the vessel of policy. Regulation is the bottle; policy is the wine. That is why technical expertise is necessary but not sufficient to providing clients with judicious, actionable advice. Understanding how the U.S. government is reading and assessing a particular scenario is what enables you to help your clients comply with the law and look around the corner. That is strategically valuable advice'