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CLIENT MEMORANDUM

In a First-of-its-Kind Decision, a Federal Trial Court Upholds $4 Million OFAC Penalty for Re-Exports to Iran

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On March 7, 2016, the United States District Court for the District of Columbia issued an unprecedented decision on the scope of the prohibition on re-exports of U.S. goods and technology to Iran, granting the U.S. Government's motion for summary judgment and upholding the $4 million penalty imposed on a U.S. company for sales to a distributor in the UAE that was actively selling products in Iran.

The court's opinion in *Epsilon Electronics, Inc. v. United States Department of the Treasury, Office of Foreign Assets Control* upheld a civil penalty imposed by the Office of Foreign Assets Control ("OFAC") against Epsilon Electronics, Inc. ("Epsilon") under the Iranian Transactions and Sanctions Regulations ("ITSR"), which prohibit the export, re-export or supply directly or indirectly from the United States, or by a U.S. person, wherever located, of any goods, services or technology to a person in a third country *with knowledge or reason to know* that such goods are specifically intended for Iran (31 C.F.R. § 560.201).

The decision provides helpful guidance on the due diligence necessary to ensure a company does not *know or have reason to know* that U.S.-origin goods or technologies are intended specifically for supply, transshipment or re-exportation to Iran or other sanctioned countries or persons. In particular, the decision makes clear that an exporter's access to information readily available on the Internet about the probable destination of the goods is sufficient to support a penalty, even if the exporter never considers this information.

Background

In 2014, OFAC imposed a $4,073,000 civil penalty on Epsilon, a California-based corporation, for having indirectly exported car audio and video equipment to Iran, in violation of the ITSR. According to OFAC, Epsilon had exported $3.4 million of such equipment between 2008 and 2012 to Asra International Corporation, LLC ("Asra International"), a UAE-based corporation, despite *having reason to know* that these goods were intended to be re-exported to Iran through Asra International's affiliated entity in Iran, Asra Electronic Trading Co. Some of the violations were considered egregious as Epsilon continued doing business with Asra International, despite having received a cautionary letter from OFAC on January 26, 2012.

The court's assessment of the "inventory exception"

Epsilon contended that its shipments to Asra International, which subsequently re-exported most, if not all, of the equipment to Iran, should have been covered by the "*inventory exception*" found in OFAC's *Guidance on Transshipments to Iran* published in 2002. The inventory exception allows the re-export of goods that are not controlled under the Commerce Control List of the U.S. Export Administration Regulations to Iran when the items have been sold to a third-country party for its general inventory and are not specifically intended for re-export to Iran. The inventory exception is not available where the third-country party's sales are predominantly made in Iran.

OFAC's 2002 guidance states that:

> [P]rohibited sales to Iran through a non-U.S. person in a third country are not limited to those situations where the seller has explicit knowledge that the goods were specifically intended for Iran, but includes those situations where the seller had reason to know that the goods were specifically intended for Iran, including when the third party deals exclusively or predominantly with Iran or the Government of Iran. "Reason to know" that the seller's goods are intended for Iran can be established through a variety of circumstantial evidence, such as: course of dealing, general knowledge of the industry or customer preferences, working relationships between the parties, or other criteria […] A violation involving indirect sales to Iran may be based upon the actual knowledge of the U.S. supplier at the time of its sale, or upon determination that the U.S. supplier had reason to know at the time of sale that the goods were specifically intended for Iran […].

The court determined Epsilon "knew or should have known" the equipment was destined for Iran

The court determined there was ample evidence to support OFAC's conclusion that Epsilon had reason to know the car audio and video equipment was specifically intended for Iran when it was exported from the United States to Asra International in the UAE. Among relevant factors, the court found that Asra International's website (1) listed addresses in Dubai and in Tehran; (2) mentioned the company's success in the Iranian car audio and video market; (3) displayed photographs of what appeared to be car shows in various Iranian cities; and (4) showed that Asra International was doing business exclusively or predominantly in Iran during the relevant time frame. This determination was not contradicted by

the fact that Asra International had some limited distribution in other countries, as Iran apparently remained its primary market throughout the relevant time frame.

Lessons learned

While the inventory exception remains valid, the *Epsilon* decision demonstrates its limits. Based on *Epsilon*, it appears that U.S. courts will defer to OFAC's determination that the exporter had reason to know its goods would be exported to a prohibited destination if an exporter has access to "red flags" regarding a customer's sales, even if the exporter does not actually see them. A company is expected to be aware of publicly available information regarding its customers' markets. Consequently, exporters of U.S. goods and technology must ensure they are conducting risk-based due diligence on their overseas customers and distributors and where those customers do business.

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