

CLIENT ALERT

Expansion of Limited Sanctions Imposing More Complex Compliance Obligations on U.S. and International Companies

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AUTHORS

David Mortlock | **Priya R. Aiyar** | **Michael J. Gottlieb** | **William J. Stellmach**
Peter Bogard | **Noman A. Goheer** | **Nikki M. Cronin**

Recent actions by the U.S. Department of Treasury's Office of Foreign Assets Control ("OFAC"), including the creation of the Correspondent Account or Payable-Through Account Sanctions List (the "CAPTA List"), suggest an increased use of partial restrictions on sanctions targets, creating more nuanced restrictions on companies and requiring the development of more sophisticated compliance programs.

The Obama and Trump Administrations increasingly have used iterative sanctions, including prohibitions on dealing in debt and correspondent accounts and broad general licenses, in lieu of general prohibitions on doing business with entities placed on the List of Specially Designated Nationals and Blocked Persons ("SDN List"). The use of these iterative sanctions allows the government to carve out more nuanced restrictions and calibrate the economic impact, as well as target major international companies that were previously thought beyond the threat of sanctions because of the unintended consequences of adding such a large economic player to the SDN List. While this practice gives the government flexibility to increasingly impose sanctions on large commercial targets, this trend is likely to complicate compliance programs.

If a company's compliance screening indicates that a sanctions target is subject to these more limited sanctions or an SDN is subject to a general license, the screening process will require a more in-depth examination of both the specific restrictions on that entity and the details of the underlying transaction before a company can determine its obligations with

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respect to the transaction. As a result, financial institutions and other companies are increasingly reliant on manual review of screening results, increasing the risk of potential violations without an increasingly sophisticated understanding of the restrictions. Some financial institutions have even rejected permissible transactions that rely on general licenses or are broadly subject to these more limited sanctions in a continuing trend to “de-risk” their businesses.

I. March 2019 Creation of the CAPTA List

OFAC’s recent actions suggest it will increasingly rely on these iterative restrictions. Most recently, on March 14, 2019, OFAC announced that it is creating the List of Foreign Institutions Subject to the CAPTA List. The CAPTA List contains identifying information of foreign financial institutions for which the opening or maintaining of a correspondent account or a payable-through account in the United States is prohibited or is subject to one or more strict conditions. Unlike entities on the SDN List, for which U.S. persons are generally prohibited from engaging in any transaction in which an SDN has an interest, entities on the CAPTA List will be subject only to these limited restrictions on correspondent and payable-through accounts and other commercial transactions with these entities will not be prohibited.

The CAPTA List will replace the List of Foreign Financial Institutions Subject to 31 C.F.R. Part 561 (the “Part 561 List”), which prohibited U.S. persons from providing payable-through or correspondent accounts to entities subject to the Iranian Financial Sanctions Regulations. Additionally, OFAC issued an amendment to the Hizballah Financial Sanctions Regulations (“HFSR”)¹ to replace references to the HFSR List in those regulations with references to the CAPTA List. Both regulatory amendments took effect immediately on March 14. Several other authorities allow OFAC to add entities to the CAPTA List, including the Ukraine Freedom Support Act of 2014,² as amended by the Countering America’s Adversaries Through Sanctions Act,³ and the North Korea Sanctions Regulations.⁴

By consolidating the Part 561 List into the CAPTA List, OFAC is placing the correspondent account sanctions into a single list. The more streamlined approach to listing sanctioned entities benefits those who are required to screen transactions for such parties, as there are fewer sources to review. However, it does indicate that OFAC expects an increased use of such sanctions. Instead of simply accepting or rejecting a transaction based on a review of the CAPTA List, parties will need to engage in a more robust assessment of the specific restrictions applicable to entities on the CAPTA List. This recent action by OFAC resembles other actions in recent years to impose more nuanced restrictions on sanctions targets.

¹ 31 C.F.R. part 566.

² 22 U.S.C. § 8924.

³ H.R. 3364, Pub. L. 115–44.

⁴ 31 C.F.R. part 510.

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II. Sectoral Sanctions in Russia and Venezuela

Sectoral sanctions are a relatively new form of sanctions that focus on specific goods or services of a nation's economy. Unlike traditional sanctions, sectoral sanctions do not create blanket prohibitions for the entities included in them. Only specific types of transactions, e.g., those dealing in debt of a listed entity, are prohibited under sectoral sanctions.

These types of sanctions were first introduced in March 2014 against Russian entities in response to Russia's actions in Ukraine. The initial sanctions on Russia in response to its attempted annexation of Crimea placed Ukrainian separatists, Russian officials, and Putin's inner circle on the SDN List. However, the sanctions were further expanded due to Russia's continued involvement and support of the separatists in the ongoing conflict in Eastern Ukraine.

As part of the expansion, the Department of the Treasury issued several directives that prohibited U.S. persons from dealing in new debt with a maturity longer than 30 days or 90 days, depending on the entity list and/or equity of listed entities.⁵ In addition, dealings in new debt with all major Russian financial, energy, or technical firms are prohibited.⁶ The time limit on the debt maturity varies between 14 and 90 days, depending on the entity and the date the debt was issued.⁷ The directives also prohibit U.S. persons from providing assistance to Russian non-conventional oil projects involving listed Russian energy companies.⁸ This includes providing, exporting, or re-exporting goods, services (except for financial services), or technology in support of exploration or production for deep-water, Arctic offshore, or shale products in Russia or its territory involving a listed Russian entity.⁹

More recently, the United States again utilized sectoral sanctions against the government of Venezuela. In an effort to cripple the regime of Nicolás Maduro, the current president of Venezuela, the United States prohibited U.S. persons from dealing in new debt of Petróleos de Venezuela, S.A. ("PDVSA") with a maturity over 90 days, and in new debt with a maturity greater than 30 days or new equity with the government of Venezuela other than PDVSA, as well as in bonds issued by the government of Venezuela prior to August 25, 2017, and dividend payments or distribution of profits to the government of Venezuela from an entity owned or controlled by the government of Venezuela.¹⁰ Even given the limited nature of these sanctions, OFAC simultaneously issued general licenses to allow the wind-down of contracts that would

⁵ See Directive 1 (as amended) Under Executive Order 13662 (September 29, 2017).

⁶ See Directive 2 (as amended) Under Executive Order 13662 (September 29, 2017); see also Directive 3 Under Executive Order 13662 (September 12, 2014).

⁷ *Id.*

⁸ See Directive 4 (as amended) Under Executive Order 13662 (October 31, 2017).

⁹ *Id.*

¹⁰ Executive Order 13808 (August 24, 2017).

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otherwise violate Executive Order (“E.O.”) 13808,¹¹ certain transactions involving CITGO Holding, Inc. (the parent company of CITGO Petroleum Corporation),¹² trading in certain listed bonds,¹³ and transactions relating to agriculture, medicine, medical devices, and replacement parts.¹⁴ General License 2, in particular, exempts CITGO Holding from restrictions on new debt and equity, and the purchase of debt and equity securities from the government of Venezuela when the only government of Venezuela entities involved are CITGO Holding and its subsidiaries.¹⁵ This carve-out is for the express purpose of maintaining CITGO Petroleum’s solvency and assets that are mostly located in the United States.

III. Expansive General Licenses

In addition to less severe restrictions on sanctioned entities, OFAC also has increased its use of broad general licenses to create more limited and nuanced restrictions. In introducing recent SDN sanctions for Russian and Venezuelan entities, for example, OFAC simultaneously issued several general licenses that authorized certain transactions and activities, subject to conditions and for a specified amount of time. These general licenses act as exemptions or exceptions to allow parties to proceed with transactions and activities that would otherwise be prohibited. OFAC provides these general licenses in order to target the specific actions which are the goal of the sanctions and to minimize immediate disruptions to U.S. persons, partners, and allies.

For example, on April 6, 2018, OFAC designated seven Russian “oligarchs” and the 12 companies they owned or controlled pursuant to E.O. 13661 and E.O. 13662, authorities codified by the Countering America’s Adversaries Through Sanctions Act, as well as E.O. 13582, and added them to the SDN List. Along with these designations, OFAC issued General Licenses 12 and 13. General License 12 authorized until June 5, 2018, all transactions and activities that are ordinarily incident and necessary to the maintenance or the wind-down of operations, and contracts involving several named Russian entities that were in effect prior to April 6, 2018. General License 13 authorized until May 7, 2018, all transactions and activities ordinarily incident and necessary to divest or transfer debt, equity, or other holdings in EN+ Group PLC, GAZ Group, and United Company RUSAL PLC.¹⁶ By issuing these general licenses, OFAC provided a

¹¹ See General License 1 - Authorizing Certain Transactions Involving CITGO Holding, Inc. (August 25, 2017).

¹² See General License 2 - Authorizing Certain Activities Necessary to Wind Down Existing Contracts (August 25, 2017).

¹³ See General License 3E - Authorizing Transactions Related to, Provision of Financing for, and Other Dealings in Certain Bonds (April 17, 2019).

¹⁴ See General License 4B - Authorizing New Debt Transactions and Transactions Involving Certain Banks Related to the Exportation or Reexportation of Agricultural Commodities, Medicine, Medical Devices, or Replacement Parts and Components (April 17, 2019).

¹⁵ See General License 2.

¹⁶ OFAC has removed EN+ Group, JSC Eruosibenergo, and RUSAL PLC from the SDN List on January 27, 2019. See Ukraine-/Russia-related Designations Removals, available at <https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20190127.aspx> (last visited April 26, 2019).

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window for U.S. persons to untangle themselves from any business relationships involving the specific entities and minimize the subsequent financial harm.

On January 28, 2019, OFAC designated PDVSA, Venezuela's state-owned oil company and added it to the SDN List, while simultaneously issuing eight new general licenses. Four of these licenses specifically carve out exemptions concerning CITGO Petroleum and other American oil companies. General License 7 authorizes transactions and activities involving only PDV Holding, Inc. ("PDVH"), CITGO Holding, and their subsidiaries, as well as purchase and import petroleum and petroleum products from PDVSA.¹⁷ General License 8 permits Chevron Corporation, Halliburton Company, Schlumberger Limited, Baker Hughes, a GE company, and Weatherford International to support certain operations in Venezuela involving PDVSA.¹⁸ General License 9 authorizes dealings in debt of PDVSA or its subsidiaries issued prior to August 24, 2017 and dealings in bonds of PDVH, CITGO Holding, and Nynas AB issued prior to August 25, 2017.¹⁹ General License 12 authorizes the purchase and importation into the United States of petroleum and petroleum products from PDVSA or a PDVSA-owned entity and the wind-down of operations and contracts involving PDVSA or a PDVSA-owned entity that were in effect prior to January 28, 2019.²⁰ These carve-outs specifically allow CITGO Petroleum and other U.S. oil companies to continue operating under the sanctions. The other general licenses authorize individuals in Venezuela to purchase PDVSA-produced petroleum, wind-down operations with PDVSA, and transactions and activities involving certain U.S. government actors on official business.

These general licenses (1) helped minimize the financial harm against U.S. entities; (2) provided a transition period before the sanctions took effect on U.S. entity holdings; and (3) helped preserve CITGO Petroleum's assets and operations for the hopeful and eventual takeover by the Guaidó government.

IV. Implementing "Risk-Based" Compliance

Addressing these more nuanced sanctions creates both opportunities and burdens for companies. These sanctions, which are accompanied by strict liability civil penalties, create significant potential liability for companies that have direct or indirect exposure to sanctions targets. Even non-U.S. companies face potential liability for exporting goods or services from the United States to a sanctioned jurisdiction or "causing" a violation of the sanctions by a U.S. person. At the same time, these more nuanced sanctions provide companies with the opportunity to do business with sanctions targets,

¹⁷ General License 7A.- Authorizing Certain Activities Involving PDV Holding, Inc. and CITGO Holding, Inc. (March 14, 2019).

¹⁸ General License 8 - Authorizing Transactions Involving Petroleos de Venezuela, S.A. (PdVSA). Prohibited by Executive Order 13850 for Certain Entities Operating in Venezuela (January 28, 2019).

¹⁹ General License 9D - Authorizing Transactions Related to Dealings in Certain Securities (April 17, 2019).

²⁰ General License 12 - Authorizing Certain Activities Necessary to Wind Down of Operations or Existing Contracts with Petróleos de Venezuela, S.A. (PdVSA) (January 28, 2019).

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including companies with significant international operations, without having to declare *force majeure* or otherwise abandon the business relationship completely.

Recognizing the complexities of balancing these opportunities and burdens, OFAC recently published thorough guidelines on the compliance practices the agency recommends. [*A Framework for OFAC Compliance Commitments*](#) is designed to provide at-risk organizations with OFAC's perspective on the essentials of a competent compliance program. OFAC's intent is to assist persons in navigating sanctions programs, such as CAPTA List and sectoral sanctions, and prevent violations before they occur, which in turn inhibits the targets of sanctions from circumventing them. The guide outlines how OFAC incorporates these practices into its evaluation of apparent violations and investigations of settlements, and provides analysis of common root causes of violations.

In accordance with the new guidelines, companies may wish to review or update internal compliance procedures and in anticipation of the escalation in more limited sanctions. Companies should examine their compliance programs in light of the nature of their business, their customer base, and the geography of their operations, and ensure that they have an appropriate risk-based screening mechanism in place that incorporates both (1) tailored automated screening, potentially using a subscription software database, and (2) expert manual compliance review with specialized legal oversight to identify the particular restrictions applicable to a specific individual or entity, and to apply OFAC's guidance to avoid prohibited transactions and move forward with permissible transactions.

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If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

David Mortlock

202 303 1136

dmortlock@willkie.com

Priya R. Aiyar

202 303 1189

paiyar@willkie.com

Michael J. Gottlieb

202 303 1442

mgottlieb@willkie.com

William J. Stellmach

202 303 1130

wstellmach@willkie.com

Peter Bogard

202 303 1441

pbogard@willkie.com

Noman A. Goheer

202 303 1295

ngoheer@willkie.com

Nikki M. Cronin

202 303 1203

ncronin@willkie.com

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