Responding to an OFAC Violation

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Given the complexity of U.S. sanctions laws, even a sophisticated company employing an effective compliance program is bound to misstep from time to time. The company's response to a violation, however, can have significant consequences for both its corporate reputation and its pocketbook.

Upon discovering a potential sanctions violation, a company faces a host of decisions. Is the conduct ongoing, and if so, how can it be immediately halted or reversed? How broad of an investigation should be performed? How can similar violations be prevented in the future? Should the violation be disclosed to the government?

This practice note considers these and other issues when responding to a violation of U.S. sanctions laws. Although each decision involves unique considerations, a decision about a later step (e.g., whether to self-disclose) may inform the decision about an earlier step (e.g., whether to discipline any employee involved in the violation). It is therefore useful to think carefully, at the outset, about the proper approach to any potential or actual violation.

For more information on U.S. sanctions laws in general, see *Understanding and Complying with OFAC Regulations*.

Step 1 – Implement Immediate Remedial Actions

The first, and arguably most important, step in responding to a suspected sanctions violation is to halt whatever conduct caused the violation.

In many cases, problematic conduct may have occurred simply because an employee was unaware that his or her conduct violated U.S. sanctions. In this type of situation, the proper remedial action could consist of educating the employee and taking action to halt any ongoing prohibited business.

This second action can be particularly challenging, however. There are, of course, the commercial considerations of halting a trading relationship mid-transaction. But there are also legal challenges, since U.S. sanctions themselves often prohibit the activities needed to unwind a transaction. For example, U.S. sanctions on Iran would prohibit a U.S. company from engaging in the business activities—meetings, negotiations, arbitration, and the like—with Iranian transaction partners to conclude a transaction. Accordingly, before taking any action beyond simply ceasing the prohibited business activities (e.g., before modifying or renegotiating a contract involving a prohibited country or individual), a company should carefully consider whether such action would require a license from OFAC. See *Understanding and Complying with OFAC Regulations — How Do Parties Apply for Sanctions Licenses?*

In other cases, a violation will have occurred because a company's systems and processes failed to anticipate the particular situation that led to the violation. This is an especially salient issue in the economic sanctions context, since the laws are subject to frequent and sometimes unexpected changes. In such a case, a company's immediate response should include modifying applicable procedures and approval mechanisms to prevent against similar violations in the future.

Finally, it is possible that a violation could be the result of intentional action by an individual who is aware that his or her conduct violates U.S. law, and likely company policy, and proceeds anyway. In this case, the proper immediate remedial measures may consist of disciplinary action up to and including termination of the employees involved. However, it is also important to consider whether the employee's cooperation will be valuable to the internal review, as termination may decrease the likelihood of cooperation. Taking remedial action is particularly important if the company is considering self-disclosing the violation to the U.S. government, as the government expects that any company committed to compliance will take decisive disciplinary action against employees who fail to adhere to the company's policies and procedures.

Regardless of the underlying reason for the violation, or the company's decisions about subsequent steps, it is imperative that any company facing a potential sanctions violation does not simply ignore the issue and hope it will go away. The remedial actions a company takes in the early stages of responding to a violation can come back to help or haunt a company, both in terms of later prospective penalty discussions and in terms of preventing future violations of the same sort. Responding promptly to a suspected

violation sends the message to personnel (and the public) that the company is committed to compliance and that violations of U.S. sanctions laws will not be tolerated. It is the delivery and reiteration of that message, perhaps more than any other action a company takes, that can help to prevent future violations.

Step 2 – Decide Whether to Self-Disclose

As the company stops the proverbial bleeding, it must also decide whether to disclose a discovered sanctions violation to the U.S. government. While self-disclosure is not required by law, a company can receive mitigation credit (and a corresponding reduction in penalties), so long as the disclosure is self-initiated, authorized by senior management, and made prior to or at the same time that the government discovers the apparent violation or another substantially similar apparent violation.

Myriad factors underlie the decision of whether or not to self-disclose, but one important consideration is the likelihood that the government will discover the violation through other means. Sanctions enforcement is somewhat unique at OFAC, as the agency is small: it reportedly employees approximately 200 personnel who are responsible for everything from issuing new regulations, to providing compliance guidance, to reviewing and responding to license applications, to investigating suspected violations. As a result, in many cases, OFAC simply does not have the bandwidth to single-handedly seek out and punish suspected wrongdoers.

Instead, many violations are brought to OFAC's attention through alternative means. Sometimes, the agency learns about suspected violations from routine reporting by financial institutions. At other times, a company already under investigation may offer information about other companies (particularly, competitors) that it suspects to be engaged in similar prohibited activities. In other cases still, OFAC may learn of a sanctions violation from its international counterparts investigating suspected violations of their nations' laws. In each of these situations, the likelihood that OFAC will independently learn of a violation turns, at least in part, on the breadth of wrongdoing. For example, the agency is far less likely to independently discover a single instance of a company providing a prohibited service than it is to discover a company that has been engaged in consistent and extensive business within a prohibited country.

Accordingly, a company deciding whether or not to self-disclose must consider both the industry in which it operates and the particular activities involved in the suspected violation. OFAC is more likely to learn of violations that occur in certain industries, such as banking and financial services, which are subject to extensive regulatory oversight, but even companies operating largely outside of regulatory control can be brought to OFAC's attention by either other companies or other U.S. or foreign government agencies. Accordingly, if other similarly-situated entities have come under OFAC scrutiny, or if a company itself has been subject to any other government inquiry, those factors could certainly tip the scales toward self-disclosure.

Separately, a company must evaluate the degree to which the activities that underlie a sanctions violation could expose the company to government scrutiny. Where, for example, the problematic activities consist of exporting U.S. origin goods to a prohibited destination, there is the chance that U.S. export control authorities (which often have the benefit of significant enforcement capabilities) could become aware of the export violations and thereafter notify OFAC of the corresponding potential sanctions violations.

Separately, just as the scope of wrongdoing can impact the likelihood that OFAC will independently discover a violation, it also factors into the analysis of the potential penalty that could be imposed. Needless to say, a single circumscribed violation will generally yield a significantly smaller potential penalty than will widespread prohibited conduct that occurs over a significant period of time. In the face of significant prospective penalties, a company may be disinclined to report widespread violations. However, because pervasive conduct is more likely to be independently discovered by OFAC, in many cases, such a company still would be best-served by remedying and reporting the conduct.

In addition to the ultimate penalty that could be imposed, a company should consider the practical impact of self-disclosure on the company's operations. OFAC will expect that a company that has disclosed a potential or actual sanctions violation has or will complete a robust internal investigation to identify and respond to related violations. Such investigations tend to be time-consuming and expensive, often diverting company resources from other functions and requiring the assistance of outside legal counsel and other consultants. On the other hand, by self-disclosing, a company may maintain some control over the scope of the ensuing investigation—whereas a company responding to an independent OFAC inquiry will be at the agency's whim in terms of the expected scope and duration of the ensuing internal investigation.

Finally, a company must consider—as with all business activities—the impact of a self-disclosure on its corporate reputation. On the one hand, the publication of a sanctions violation that might not otherwise come to light could have a detrimental impact on public perception of a company. On the other hand, a company's willingness to disclose a discovered violation suggests that the company is dedicated to compliance—a fact that could solidify its reputation as a responsible corporate citizen in the court of public opinion.

Step 3 – Scope the Internal Investigation

Just as a company should take steps to halt the underlying conduct (regardless of its decision about self-disclosure), so too should it take steps to fully investigate the circumstances that led to the apparent violation. A properly scoped investigation will review transactions related in time and subject matter to the discovered violation. Depending on the particular violation at issue, and the size of the company involved, this approach could mean, for example, reviewing only transactions performed by the same business

unit, within the same geographic region, or involving the same agent or third party.

In most cases, a company will want to review similar transactions that have occurred in the preceding five years, as this is the typical statute of limitations applying to U.S. sanctions violations. An exception to this general rule is when the violation involves a conspiracy to violate U.S. law, in which case the statute of limitations can reach back to the date the conspiracy began.

Likewise, the steps involved in the investigation itself will vary depending on the size of the company and the scope of wrongdoing. At minimum, an appropriate investigation will involve interviews with personnel involved or suspected to possess relevant information and a review of relevant documents (e.g. e-mails, contracts, shipping documents, related invoices, and the like). In many cases, it will be appropriate to secure outside counsel to perform the investigation to ensure the independence of the review and to benefit from the protection of the attorney-client privilege. Also important is the potential impact the presence of outside counsel can have on company personnel, particularly in situations involving unintentional violations. Should outside counsel be employed, careful consideration should be given to counsel's investigative approach and capacity to gather necessary information so as to avoid alarming company personnel.

To be clear, the integrity of the investigation is paramount. However, to the extent that steps can be taken to minimize the disruption that the enterprise experiences—for instance, by limiting the language of preservation notices, or asking personnel to self-collect documents as opposed to requiring them to turn over hard drives—such steps should be considered.

Upon completion of an investigation, a thorough report should be drafted to document the investigative steps and outcome. Among other elements, the report should identify the root cause of any discovered violations and propose targeted corrective actions to prevent similar violations in the future. Finally, the report should commit to a timeline for, identify the personnel responsible for, and provide a mechanism to audit the completion of, each corrective action.

Step 4 – Take Corrective Action

An internal investigation can be exhausting, and a company may be inclined to take a breather following its completion. It is essential, however, to capitalize on an investigation's momentum to implement efficient and effective corrective actions that respond directly to the root cause of the identified violations. If, for example, an employee was properly trained but acted outside of company policy, the appropriate corrective action could consist of disciplinary action against that employee, rather than large-scale retraining efforts or redeployment of company policies or procedures. If, on the other hand, an investigation revealed broad gaps in the company's compliance program, more systemic changes may be needed. At a minimum, any company that has discovered a sanctions violation should ensure that its policies and procedures address U.S. sanctions requirements and prohibitions and that all personnel involved in international business transactions are provided periodic training on applicable U.S. laws and company policies.

Finally, regardless of the scope of a discovered violation or violations, it is often appropriate to consider whether to employ a technological solution to detect and prevent future violations. For example, companies may wish to discuss with providers of accounting, shipping, e-mail, and other automated systems the possibility of implementing controls that prevent transactions involving prohibited parties or countries. Although such systems should not be relied upon exclusively to prevent future violations, coupled with enhanced policies and increased education, they can help shore up a company's sanctions compliance program.

Step 5 – Negotiate with OFAC

A company's decisions regarding whether to self-disclose, the scope of its internal investigation, and the remedial actions it implements all will be relevant to the ultimate action (or lack thereof) that OFAC takes in response to a sanctions violation. The agency will also consider the following factors, among others:

- **Mens rea.** What was the company's awareness of the conduct giving rise to the apparent violation? Was the violation the result of willful or reckless conduct?
- **Concealment.** Did the company hide or purposely obfuscate problematic conduct in order to mislead OFAC, other regulators, or other parties involved in the conduct about an apparent violation?
- **Pattern of conduct.** Did the apparent violation constitute or result from a pattern or practice of conduct, or was it relatively isolated and atypical?
- **Prior notice.** Did the company know or have reason to know that the conduct at issue, or similar conduct, constituted a violation of U.S. law?
- **Management involvement.** At what level within the organization did the conduct occur? Were supervisory or managerial level staff aware, or should they reasonably have been aware, of the conduct?
- **Harm to sanctions program objectives.** Did the conduct giving rise to the violation cause actual or potential harm to sanctions

program objectives (e.g., an economic or other benefit to a sanctioned country, entity, or individual)?

- **License eligibility.** Would OFAC likely have licensed, under current policy, the conduct constituting the apparent violation?
- **Humanitarian activity.** Was the conduct at issue in support of a humanitarian activity?
- **Commercial sophistication, size of operations, and financial condition.** What is the company's level of commercial sophistication and experience? What is the size of the company's business operations and overall financial condition?
- **Volume of transactions.** What is the proportion of transactions constituting violations as compared with a company's total annual business?
- **Sanctions history.** Has the company been the subject of prior penalties, findings of violations or cautionary, warning, or evaluative letters, or other administrative actions (including settlements) in the past five years?
- **Compliance program.** Does the company employ an adequate OFAC compliance program?
- **Cooperation with OFAC.** Did the company cooperate with and provide all relevant information to OFAC during the course of the investigation?
- **Timing of the violation.** Did the violation occur immediately after relevant changes in the applicable sanctions program?

After considering these and other factors, OFAC will determine how to respond to the violation or apparent violation. The agency's response will consist of one or more of the following:

- **No action.** If OFAC determines that there is insufficient evidence to conclude that a violation has occurred and/or that the conduct at issue does not warrant an administrative response, no action will be taken. In this case, OFAC generally will issue a letter indicating that the investigation is being closed with no action.
- **Request for additional information.** If OFAC determines that additional information regarding the apparent violation is needed, it may request further information, including through an administrative subpoena. Upon receipt of additional information, OFAC will then decide whether or not to pursue further enforcement action.
- **Cautionary letter.** If OFAC determines that there is insufficient evidence to conclude that a violation has occurred or that a finding of violation or a civil monetary penalty is not warranted under the circumstances, but believes that the underlying conduct could lead to a violation in other circumstances, or that a company is not exercising appropriate due diligence, the agency may issue a cautionary letter outlining its concerns.
- **Finding of violation.** If OFAC determines that a violation has occurred and considers it important to document the occurrence of a violation but that a civil monetary penalty is not the most appropriate response, OFAC may issue a finding of violation. A finding of violation may also convey OFAC's concerns about the violation, a company's compliance policies or procedures, and/or identify the need for further compliance steps.
- **Civil monetary penalty.** If OFAC determines that a violation has occurred and warrants the imposition of a monetary penalty, the agency may impose a civil monetary penalty.
- **Criminal referral.** In particularly egregious cases, OFAC may refer a matter to law enforcement agencies for criminal investigation and/or prosecution. Such violations also may be subject to an OFAC civil penalty or other administrative action.
- **Other administrative actions**. In addition to or in lieu of other administrative actions, OFAC may order a company to cease and desist from prohibited conduct and/or may withhold, deny, suspend, modify, or revoke authorization to engage in a transaction pursuant to a general or specific license.

It is impossible to predict the outcome of particular OFAC enforcement matters. While the vast majority of OFAC matters are resolved on an administrative or civil basis, it is not always clear how OFAC arrives at its determination about how to resolve the matter. Penalty decisions are made public, but beyond a summary treatment of how the penalty was calculated, it can be hard to discern how OFAC decided upon the ultimate settlement amount.

To illustrate the variation, in the first six months of 2016, OFAC announced civil settlements in amounts ranging from $107,691 on the low end, to $11,270,087 on the high end. In one of those cases, announced in June 2016, involving North Carolina–based *Hyper Branch Medical Technology, Inc.*, OFAC imposed a civil penalty of $107,691 for violations of U.S. sanctions on Iran. OFAC opted for a civil penalty, despite finding that the violations were willful (and thus potentially could have been pursued criminally), seemingly

based on a few factors, including (1) that the products at issue likely would have been licensed had the company applied for a license, (2) that this was the company's first violation, and (3) that the company cooperated—including by taking robust remedial action—in response to the violations.

For more information see 31 CFR PART 501 APPENDIX A—Economic Sanctions Enforcement Guidelines.

In those cases in which OFAC determines that a civil penalty is appropriate, it will issue a pre-penalty notice proposing the amount of the proposed penalty. A company will then have the opportunity to submit a written response to the pre-penalty notice, either agreeing to the proposed penalty or setting forth the reasons why no penalty, or a lesser penalty, would be appropriate. As a practical matter, however, the pre-penalty notice is not really a negotiable document. There may be some ability to discuss the proposed penalty, but it is generally something that OFAC expects the recipient to take or leave. Following OFAC's review of the response, the agency will issue a penalty notice setting forth the final penalty amount.

To determine the base amount of civil penalty, OFAC will first determine whether the violation at issue was "egregious." Pursuant to its Enforcement Guidelines, OFAC calculates egregiousness with particular focus on whether (1) the violation was willful or reckless, and (2) the actor was aware that their conduct constituted a sanctions violation. OFAC will also consider the harm to sanctions program objectives caused by the violation and the individual characteristics of the violation. OFAC will then review those factors to assess whether the violation is "particularly serious" and therefore requires a strong enforcement response.

Next, OFAC will consider whether the violation was brought to the agency's attention by way of a voluntary self-disclosure. For an egregious case that is not self-disclosed, the base penalty is the statutory maximum, whereas the base penalty for a non-egregious case that is self-disclosed is generally one-half of the value of the underlying transaction. OFAC will then adjust the civil penalty to reflect the mitigating or aggravating factors discussed above.

During the course of an investigation or imposition of a penalty, OFAC or the company may initiate settlement discussions. In some cases, OFAC may condition the entry into or continuation of settlement negotiations on the execution of a tolling agreement with respect to the statute of limitations (a tolling agreement is an agreement by which a party agrees to extend the statute of limitations beyond its normal duration). If settlement discussions occur prior to the issuance of a pre-penalty notice, a company may request that OFAC withhold issuance of a pre-penalty notice until discussions have concluded. If settlement discussions are continuing in good faith, and the statute of limitations is not at risk of expiring, OFAC will typically agree to such a request. As a general matter, this is the approach that companies should take, as communication with OFAC—while often frustrating because of the slow pace of such communications—is the best means by which to ensure an appropriate resolution of the matter. If a matter is settled after a pre-penalty notice has been issued, but before a final penalty notice is issued, OFAC will not make a final determination as to whether a sanctions violation has occurred. This is usually the best approach for a company to take, and candidly one that OFAC itself may pursue to avoid the additional steps needed to reach a more formal, final determination.

Finally, OFAC may enter into a global settlement with a company regarding multiple apparent violations. These apparent violations may or may not already be covered by other pre-penalty notices, or may be apparent violations that were reported to OFAC during the pendency of the investigation that were previously unknown. Whether to settle globally tends to be a very fact-specific calculation, but often makes sense because companies like to resolve all outstanding matters at one time and, at least in theory, may be able to obtain some sort of penalty discount for addressing all violations and corresponding obligations (e.g., compliance improvements, etc.) in a single resolution.