



OFAC Will See You Now

December 2020

Your company may face increased likelihood of sanctions investigation and enforcement following the unprecedented MOU signed between the Office of Foreign Assets Control and the Delaware Department of Justice. Whether it's scrutiny from the feds or the state or both, the question is: Are you prepared?

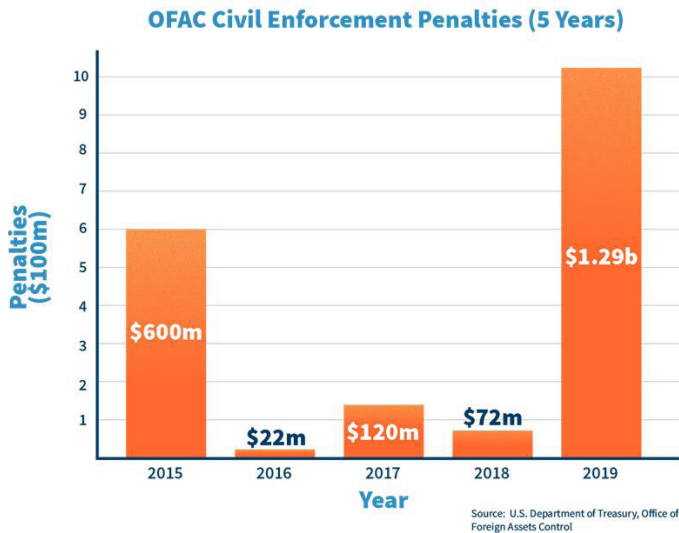
The September Memorandum of Understanding (MOU) entered into between the U.S. Office of Foreign Assets Control (OFAC) and the Delaware Department of Justice (DOJ) could be a game changer for both domestic and foreign corporations.

The MOU appears to be the first of its kind ever entered into between OFAC and a state law enforcement agency. (Previous OFAC MOUs concerned primarily federal and state banking and financial service regulators.) As such, it appears that OFAC and the State of Delaware are gearing up to increase scrutiny of entities registered in Delaware.

The Treasury Department's press release regarding the MOU indicates several reasons for collaboration between OFAC and Delaware. They include improving transparency into corporate structures, promoting sharing of critical information, facilitating coordinated sanctions investigations, protecting national security, and disrupting illicit activity that is inconsistent with U.S. foreign policy (i.e., "entities that should not be operating in the United States").

Watch Your Step

The MOU presents numerous potential pitfalls for corporations. First, the information-sharing agreement puts corporations under scrutiny on two fronts: If one entity investigates, the other becomes aware of a potential concern and, if it decides to open its own case, you could find yourself contending with investigations from multiple agencies simultaneously.



Second, if OFAC and the DOJ uncover and pursue more coordinated or joint sanctions-related cases, penalties for case subjects could become quite significant. Because each entity charges separately under different authorities, the same activity could result in both federal and state penalties. Last year, OFAC civil enforcement penalties alone totaled a record \$1.29 billion.¹

Think it can't happen to you? Guess again.

Your company may or may not be registered in Delaware, but chances are it has "business" there — tangentially or otherwise. Consider that more than 1 million business entities claim the First State as their legal home, and more than 66% of the Fortune 500 are based there.^{2,3} (See sidebar "What's the deal with Delaware?")

This development is particularly notable for non-financial companies because the MOU by its very nature casts a wider net for scrutinizing and identifying potential violators. Historically, financial institutions have been subject to higher scrutiny than companies in industries outside of finance because of the additional relevant requirements, examinations and oversight imposed by self-regulated organizations in the financial industry, as well as state and

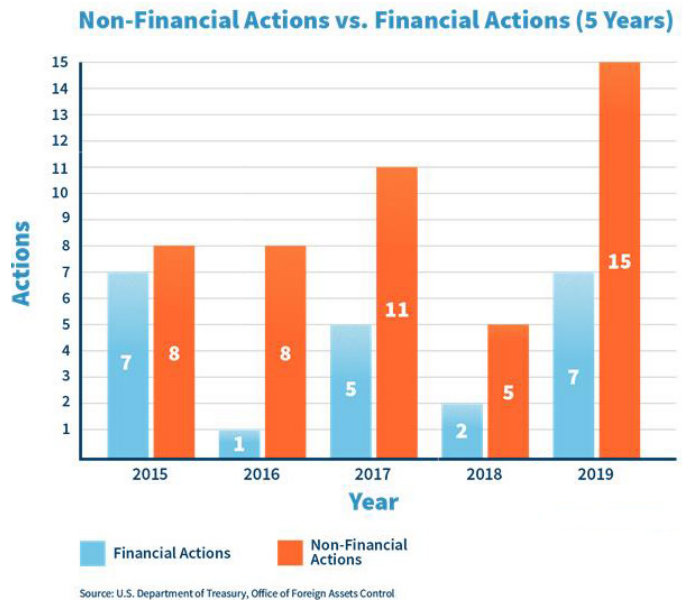
What's the deal with Delaware?

The second-smallest U.S. state wields outsized influence

- Most incorporated public companies in U.S.
- Corporations have more privacy
- Investors are comfortable with DE corporations
- State is focused on business
- Court system designed for resolving complex corporate cases
- Attorneys are familiar with DE case law; potential cost savings

Source: Davis Wright Tremaine

federal banking regulators. Now, non-financial companies may find themselves under scrutiny by federal and/or state authorities because of greater visibility and heightened scrutiny for potential sanctions concerns across multiple industries. That could present particular challenges for non-financial companies, which sometimes have less mature compliance programs than financial industry counterparts.



So far this year, OFAC enforcement penalties for non-financial industries have reached \$22.3 million, far outpacing financial institutions (\$583,100).⁴

Who Must Comply?

Under the authority of U.S. sanctions laws, almost anyone engaged in a transaction with a U.S. touchpoint can be accountable. That includes U.S. persons (i.e., any company organized under U.S. law, individuals and entities located in the U.S., in some cases the non-U.S. subsidiaries of such companies/entities) and, as a practical matter, non-U.S. parties involved in transactions that have some U.S. nexus.⁵

As an example, parties based outside the U.S. can face potential sanctions if they run afoul in these three areas:

- **1.** Transactions in U.S. dollars. Payments in USD must eventually clear through the United States even if all other aspects related to the transaction (e.g., the sender; receiver; sending and receiving banks; and the underlying goods, services or technology) originate outside of the U.S.⁶
- **2.** Exports or re-exports of U.S.-origin goods. Items, products, or services that are from the U.S. or transship through the U.S. may not be sent directly or indirectly to comprehensively sanctioned countries or persons; non-U.S. persons who export U.S. goods to a third country with knowledge or reason to know that the goods are intended for re-exportation to a sanctioned country, such as Iran, may be liable for an OFAC violation.⁷
- **3.** Registration/organization of an entity under U.S. law. When non-U.S. persons organize a company under U.S. law (e.g., incorporating in Delaware), that company is considered a U.S. person and must comply with U.S. sanctions laws even if the company is operating and controlled or managed by persons outside the U.S.⁸

What You Can Do Now

If you are incorporated in Delaware, doing business with organizations incorporated in Delaware, or involved in due diligence with a company based in the state, get ready and get compliant. Make sure you have appropriate mechanisms in place to ensure OFAC compliance. Among other actions you should take, place these three at the top of your to-do list.

- **1.** Assess and enhance your internal controls to identify and prevent sanctions violations, including reporting/whistleblowing channels to identify internal bad actors and program testing/audits to ensure the program is functioning as intended.
- **2.** Evaluate your due diligence processes and implement enhanced due diligence procedures where appropriate, even for entities that are incorporated in Delaware, to identify the

beneficial owners of such entities. While companies organized in the U.S. are typically considered low risk, look out for red flags or risk factors associated with Delaware companies that warrant enhanced review, particularly regarding beneficial ownership.

- **3.** Ramp up training for senior management and other parties who are responsible for sanctions compliance and other relevant business or operational processes. Your top officers should be aware of the potential impacts of the new MOU.

Cost-Efficient

You may be hesitant to proactively spend on compliance, but no company — financial or non-financial — should sit back until they are faced with a compliance issue. Taking action now to build an OFAC-compliant program is far more cost-efficient than dealing with potential financial penalties.

Further, when you assess and enhance your program proactively, you can control the pace of establishing the program and determine the risk-based processes and controls appropriate for your business. After you have an apparent violation and regulators and law enforcement become involved, you have less control over timing and may lose some or much of your discretion to build or remediate your program. Regulators can fill in those blanks in your program where you previously may have had options to make your own risk-based decisions. And, if you do get into trouble despite your best efforts, with a proactive approach you may receive some credit for having a program in place under OFAC's enforcement guidelines, which may include penalty mitigation.⁹

1. <https://home.treasury.gov/policy-issues/financial-sanctions/civil-penalties-and-enforcement-information/2019-enforcement-information>

2. <https://corp.delaware.gov/aboutagency/>

3. <https://www.dwt.com/blogs/startup-law-blog/2020/07/why-do-so-many-startups-form-corporations-delaware>

4. <https://home.treasury.gov/policy-issues/financial-sanctions/civil-penalties-and-enforcement-information>

5. <https://home.treasury.gov/policy-issues/financial-sanctions/frequently-asked-questions/ofac-consolidated-frequently-asked-questions>. See FAQ #11.

6. See, e.g., OFAC settlement with foreign entities CSE TransTel Pte. Ltd. ("TransTel") and CSE Global Limited dated Jul. 27, 2017, in which OFAC found that USD payments initiated by TransTel from its account at a non-U.S. financial institution were apparent violations of U.S. sanctions because the payments (1) related to transactions that, although conducted outside of the United States, involved Iran, and (2) were processed through the United States without any reference to Iran.

7. <https://home.treasury.gov/policy-issues/financial-sanctions/frequently-asked-questions/ofac-consolidated-frequently-asked-questions>. See FAQ #11.

8. *Ibid.*

9. See OFAC Enforcement Guidelines, <https://home.treasury.gov/policy-issues/financial-sanctions/civil-penalties-and-enforcement-information..>

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