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ALERT

Export Controls | August 2014

U.S. Treasury Raises Bar on Corporate Compliance Obligations

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) recently expanded its guidance for determining whether an entity is considered to be owned by a sanctioned person, and therefore is the target of U.S. economic sanctions (the 50 Percent Rule). The expanded guidance increases the already complicated task of screening business partners to prevent dealings with sanctioned entities and individuals. Companies engaged in international business transactions should review, and update if needed, their existing sanctions screening and business partner due diligence processes to adhere to the new guidance. The new guidelines (and OFAC regulations) do not specify how companies must screen business partners. Instead, OFAC simply prohibits U.S. persons from engaging in transactions with sanctioned entities and individuals. So it is up to companies to design and develop risk-based compliance programs to effectively prevent violations.

Although OFAC guidance has long established that any entity in which a single blocked or sanctioned person owns a 50 percent or greater interest is a blocked entity, OFAC had never specified its policy on entities in which multiple blocked persons hold non-majority ownership shares. The new guidance explains that any entity in which multiple blocked persons own an <u>aggregate</u> share of 50 percent or greater will be blocked. For example, if *Company A*, an entity not listed on OFAC's Specially Designated Nationals (SDN) List, is owned 25 percent by SDN-listed *Person B* and 25 percent by SDN-listed *Entity C*, then *Company A* will be deemed a blocked entity.

The OFAC FAQ accompanying the new guidance explains that OFAC applies the same analysis when applying the 50 Percent Rule to the new Sectoral Sanctions, a set of limited restrictions recently imposed on certain Russian entities in response to the ongoing instability in Ukraine. Although the Sectoral Sanctions are limited in nature, they generally prohibit U.S. persons from dealing in "new debt" by, on behalf of, or for the benefit of the sanctioned entities. Under the new OFAC guidance, an entity owned

50 percent or more in the aggregate by one or more persons designated on the Sectoral Sanctions Identification (SSI) List will itself be a target of the Sectoral Sanctions restrictions.

Additionally, when determining whether an entity is a blocked person for U.S. sanctions purposes, ownership percentages are not deemed "diluted" when the SDN or SSI's interest is indirect. Instead, an intermediary entity (subsidiary of the SDN or SSI) is considered fully blocked (if owned 50 percent or more by an SDN or SSI entity), and in turn the intermediary's percentage of ownership is what should be considered in determining whether an ultimate subsidiary (indirect subsidiary of SDN or SSI) is also a blocked entity.

In light of the new OFAC guidance, we strongly advise companies engaged in international business transactions to review their existing sanctions screening and business partner due diligence procedures and enhance their compliance programs to adequately address this new legal risk.

Based in Washington, D.C., our Export Controls team advises and represents clients on the full range of international goods, software, and technology transfer issues. We have broad experience providing export controls and related regulatory counsel to both U.S. and foreign businesses. Our industry-specific experience includes assisting companies in a wide range of industries such as aerospace, defense, firearms and ammunition, electronics, software and information technology, food, consumer products, biotechnology, medical device, and engineering services.

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