INFORMATION REVIEW

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FROM THE INTERNATIONAL ECONOMIC COMPLIANCE PRACTICE

WHY AN EQUIPMENT PRODUCER MAY BE LIABLE FOR THE DISTRIBUTION OF ITS PRODUCT TO A THIRD PARTY AND HOW SANCTIONS ARE INVOLVED

IN BRIEF

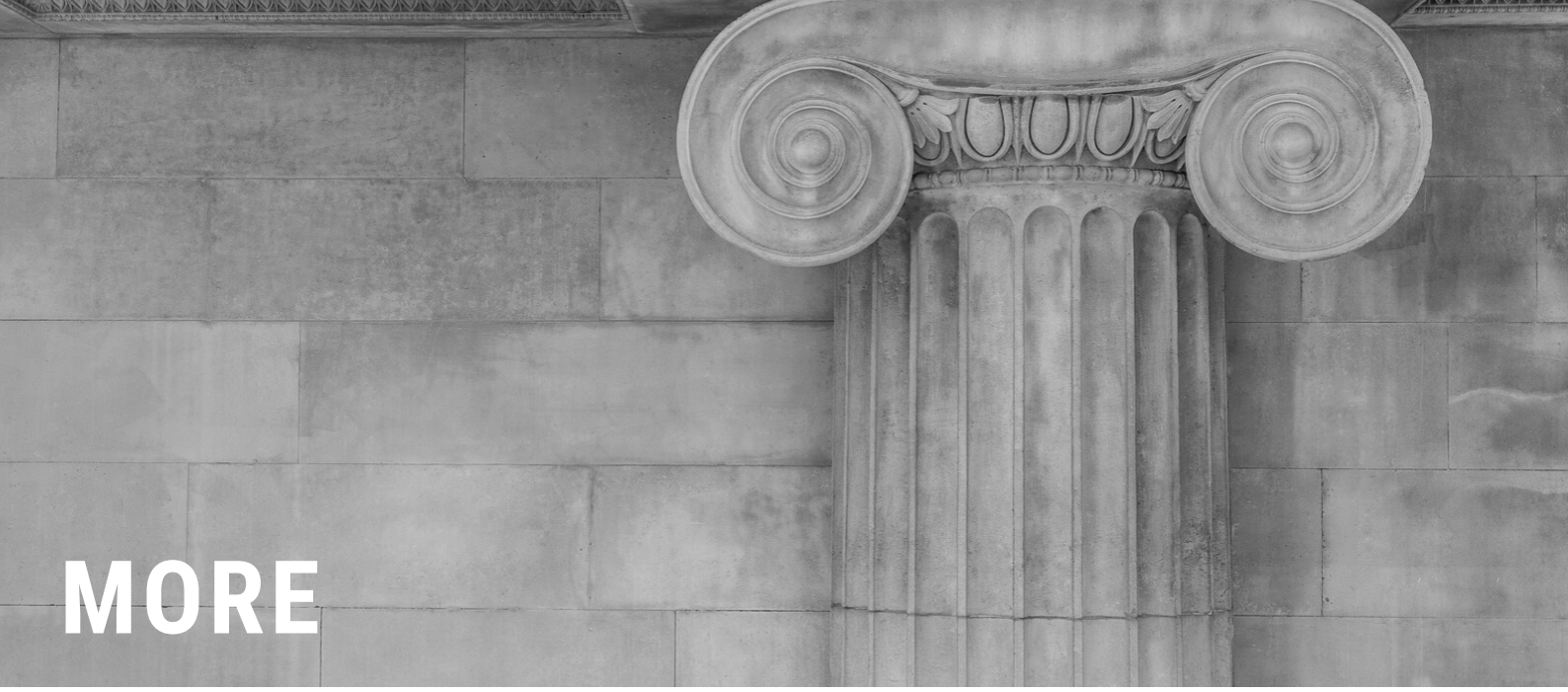
On November 7, 2019, OFAC announced a settlement agreement with Apollo Aviation Group LLC. While distributing its product, aviation engines, the company failed to track the end-user, which appeared to be an SDN-entity, and thereby violated U.S. sanctions against Sudan. This incident resulted in a USD 210,000 settlement.

Due to its compliance system implemented before the incident, the company managed to reduce the penalty. OFAC emphasized the importance of compliance-system efficiency, along with other mitigating factors.

This case indicates how the precise identification of the end-user of any product is of utmost importance, because it can give clear signals of sanctions risks to companies (Russian ones included) that are doing business internationally.

Should the company ignore this signal, consequences may include SDN designation or liability of the entire delivery chain to participate in any resulting financial settlement, or both.

On top of that, as was demonstrated by the recent Nikitin case, criminal liability is a real additional risk for sanctions evasion.



MORE

In 2013-2015, Apollo Aviation Group, a U.S. company, leased three aviation engines to a company registered in the UAE. The UAE company subleased these engines to a company in Ukraine, that, in turn, leased them to Sudan Air, an SDN entity. The core lease agreement, to which Apollo was a party, had a sanctions clause that barred a transfer of the aviation engines to countries under United Nations or U.S. sanctions. Sometime later, Apollo managed to find out about the aviation engines transfer on its own and demanded their immediate return.

The U.S. Sudan sanctions (Sudanese Sanctions Regulations) bar this kind of operation. Acknowledging that and following its compliance policy, the company reported the situation to OFAC.

In its analysis of the situation, OFAC cited both aggravating and mitigating factors.

The aggravating factors are:

- the company is big, specialized, and thus subject to heightened expectations for compliance;
- and the company failed to monitor the end-user of the engines during the entire term of the lease.

The mitigating ones are:

- the company's personnel did not participate in any malicious activity;
- the company undertook efforts, including investments into commitments to better compliance, to prevent future incidents;
- and the company cooperated with the authorities in a good and efficient manner.

The meaning of this case has both material and procedural aspects. The material aspect is that an owner of the product (in this case, sophisticated technological equipment) can be held liable for sanctions violations in its use by third parties. The procedural aspect is that OFAC, while dealing with the case, provided links to its Economic Sanctions Enforcement Guidelines and the recent OFAC's Framework for Compliance Commitments, which help businesses to understand better the regulatory logic of OFAC.

The case is also of great interest in the situation when a company, its products, or components are not American. This can be applied to supply activities where the end-users are SDN persons designated due to the events in Venezuela, Iran, or the DPRK. These regimes are often called regimes of wide sanctions applications, as they may (1) go beyond so-called "U.S. persons" and (2) have grounds for secondary sanctions application.

As an example, one can imagine a situation in which a product was distributed to a non-SDN person but eventually used by SDN-persons in Venezuela, Iran, or the DPRK without the producer's knowledge or consent. In that case, the liability for the lack of due diligence or willful regulatory blindness can be imposed upon the producer of the goods. Should the case reach the settlement stage, all members of the delivery chain may be included in it. Should Russian companies be a part of such transactions, the sanctions risks would skyrocket.

The additional aggravating factor in the case is a use of a U.S. financial instrument for the apparent, main transaction. This can be interpreted as the use of the U.S. dollar as a currency for settlement of accounts or trade finance by a bank in the United States.

The core mitigating factor is a presence of an effective sanctions clause in the contract and an overall sanctions compliance system, aimed to detect and avoid possible adverse international public consequences in a company's activity. This would be considered an example of a company's due diligence in the transaction.

There is also a pressing issue of the risks that arise with an application of the Russian sanctions. As was demonstrated by the Niktin case, an attempt at sanctions evasion also may trigger criminal liability, with up to 20 years of imprisonment and up to a USD 1 million penalty.

In this case, the U.S. Department of Justice is investigating an alleged attempt at Russian sanctions circumvention with the aim of acquiring a Vectra 50G turbine for USD 17.3 million for use in deep-water drilling in the Arctic.

Five citizens (two Russian, two Italian and one U.S.), along with several companies, are charged with violating a number of laws in the realms of sanctions, export controls, and money laundering.

It is a bit early to analyze the case, as it is ongoing. However, it can be said for certain that civil and criminal risks in connection with evasion of the Russian sanctions are on the rise.

RECOMMENDATIONS

Russian and international business should seriously consider the issue of the end-user tracking, as well as the need for maintenance of their sanctions compliance programs. The efficient functioning of embargo and restrictions policies in the company, as well as well-established and accurate end-user tracking mechanisms, substantially decrease sanctions risks.

Moreover, participants in international commerce should completely avoid participation in any schemes to evade regulations on foreign trade.

Dmitry Magonya

Managing Partner
Advocate
Head of International Economic Compliance Practice
magonya@artdelex.ru
+7 903 795-73-11

Marat Samarskiy

Associate
International Economic Compliance Practice

m.samarskiy@artdelex.ru
+7 495 937-71-23

Our office is located at:
Office 25, Bld. 1, 4/17 Pokrovsky Boulevard, 101000 Moscow, Russia
Phone/Fax: +7 (495) 93-77-123
E-mail: info@artdelex.ru