

July 23, 2020

## **DOJ and OFAC Enforcement Actions Against Essentra FZE Signal New Sanctions Risks for Non-U.S. Companies Utilizing the U.S. Financial System**

On July 16, 2020, the U.S. Department of Justice (“DOJ”) and the U.S. Department of the Treasury’s Office of Foreign Assets Control (“OFAC”) announced parallel resolutions with Essentra FZE Company Limited (“Essentra FZE”), a global supplier of cigarette products incorporated in the United Arab Emirates (“UAE”).<sup>1</sup> Two Essentra FZE personnel sold cigarette filters that they knew were destined for North Korea (the “DPRK”) and used false documentation reflecting front companies as the nominal purchasers and the ultimate destination as Dalian, China. In connection with these sales, the company received three payments from front companies, one in U.S. dollars and two in United Arab Emirates Dirham (“AED”), in its bank accounts held at a non-U.S. branch of a U.S. financial institution.<sup>2</sup> Essentra FZE agreed to enter into a deferred prosecution agreement (“DPA”) with DOJ and pay a fine of \$666,544—twice the value of the transactions at issue—for willfully violating the North Korea Sanctions Regulations (“NKS”).<sup>3</sup> Essentra FZE entered into a settlement with OFAC for \$665,112, which was deemed satisfied by its payment to DOJ.<sup>4</sup>

In announcing its resolution with Essentra FZE, DOJ stated that this was the first DOJ corporate enforcement action for violations of the NKS.<sup>5</sup> Notably, this also appears to be the first DOJ criminal resolution with a non-U.S., non-bank company for selling ordinary products or services to a sanctioned jurisdiction where the only U.S. nexus was use of the U.S. financial system (including use of a non-U.S. branch of a U.S. bank). Previously, such conduct was generally not treated as warranting DOJ criminal enforcement.

The DOJ action may be viewed as the criminal parallel of OFAC’s groundbreaking 2017 enforcement action against CSE TranTel Pte. Ltd. (“TransTel”), which involved a Singaporean company that utilized U.S. dollar wires in connection with the provision of telecommunications goods and services to Iran.<sup>6</sup> OFAC viewed the company’s sending of U.S. wires in support of this business as “causing” intermediary U.S. financial institutions to export services to Iran. The Essentra FZE action, however, goes one step further given that both DOJ and OFAC found that Essentra “caused” sanctions violations by *receiving* payments that flowed through the U.S. financial system resulting from sanctioned-country business.

Non-U.S. companies are now on notice of the risk of criminal enforcement in addition to OFAC enforcement for the use of U.S. dollar transactions (or transactions denominated in other currencies utilizing non-U.S. branches of U.S. banks) in connection with sanctioned-country business. To reduce their risks, non-U.S. companies should consider strengthening their sanctions compliance programs, including training, controls and employee oversight. Likewise, for companies that engage in M&A transactions with non-U.S.

companies, their risk assessment may now have to account for the possibility of criminal liability in the event that the target company engaged in U.S. dollar transactions involving sanctioned countries.

### **The DOJ Deferred Prosecution Agreement**

Essentra FZE entered into a DPA with the U.S. Attorney's Office for the District of Columbia and DOJ's National Security Division in which Essentra FZE admitted that it had knowingly and willfully conspired to violate the International Emergency Economic Powers Act ("IEEPA")<sup>7</sup> and defraud the United States government,<sup>8</sup> and agreed to pay a \$665,543.88 fine.<sup>9</sup>

According to the DPA and accompanying Statement of Facts, starting in December 2017, an employee of a third-party company introduced an Essentra FZE supervisor to an employee of a state-run tobacco company located in North Korea.<sup>10</sup> Later, in early 2018, a customer-facing Essentra FZE employee and the North Korean employee had a meeting in Dubai, UAE, during which the North Korean employee discussed purchasing Essentra FZE tobacco filtration products for export to North Korea.<sup>11</sup>

During the course of subsequent conversations via an encrypted messaging platform, the DPRK national told the Essentra FZE supervisor not to "mention that customer is in my country . . . You just mention China or [some]where else. Contract will be signed by other foreign company."<sup>12</sup> In response, the Essentra FZE supervisor said he understood.<sup>13</sup> Later, in the course of discussing the supply of such items, the North Korean employee told the Essentra FZE employee, "[Y]ou just tell them the destination is China, don't mention about my country," which the Essentra FZE employee acknowledged.<sup>14</sup> In April 2018, the Essentra FZE employee received a "revised contract" identifying a front company as the producer and exporter of cigarette filter rods, and stating that the goods would be exported from the UAE to China, and would be imported by another front company for the North Korean company.<sup>15</sup>

According to the Statement of Facts, the North Korean company that imported Essentra FZE's products into the DPRK used financial cutouts and front companies to conceal the North Korean nexus to the transactions.<sup>16</sup> As a result, Essentra FZE and its co-conspirators' practices "tricked U.S. correspondent banks into processing transactions that would not have otherwise been processed" due to U.S. sanctions, which prohibit U.S. banks, including their overseas branches, from processing U.S. dollar wire transactions on behalf customers located in the DPRK.<sup>17</sup> Essentra FZE was aware that its products were destined for North Korea, addressed commercial invoices to a front company, and "falsely listed a company in China as the consignee in order to not alert regulators, banks, or shippers that the true customers were in North Korea."<sup>18</sup> As just one example, a draft bill of lading falsely stated that goods were ultimately bound for Dalian, China.<sup>19</sup> Essentra FZE was aware that U.S. sanctions prohibited transacting with North Korea through the use of U.S. dollar wire transfers, and the two relevant company employees regularly conducted compliance reviews of customers to comply with U.S. sanctions laws.<sup>20</sup>

Essentra FZE's DPA has a three-year term, and provided the company complies with its obligations under the DPA, DOJ has agreed to dismiss the criminal information at the conclusion of the term.<sup>21</sup> The \$666,543.88 agreed-upon fine represents twice the value of the three transactions.<sup>22</sup> Similar to the OFAC resolution described below, Essentra FZE agreed to continue to implement a sanctions compliance program for it, its subsidiaries, and any majority-owned or controlled joint ventures whose operations are subject to OFAC sanctions.<sup>23</sup> Essentra FZE also agreed to cooperate with other DOJ investigations and any investigations by foreign authorities relating to the conduct described in the DPA and Statement of Facts if requested by DOJ.<sup>24</sup>

### **The OFAC Settlement**

OFAC's settlement agreement is largely premised on the same facts as the DOJ DPA. OFAC concluded that Essentra FZE's receipt of the three payments into its bank accounts at the non-U.S. branch of a U.S. bank "caused" U.S. persons to export, directly or indirectly, financial services to the DPRK, or otherwise facilitate export transactions that would have been prohibited if engaged in by U.S. persons in apparent violation of the NKSR.<sup>25</sup> The OFAC announcement states that the Essentra FZE personnel's conduct was in violation of company policies and procedures.<sup>26</sup>

As part of the settlement, Essentra FZE agreed to cooperate with OFAC, including with respect to OFAC's investigations of related conduct by the company or other persons.<sup>27</sup> Essentra FZE also agreed to implement for at least five years the 23 compliance commitments that are now a standard part of OFAC settlements.<sup>28</sup>

### *Factors Affecting OFAC's Penalty Determination*

Pursuant to the NKSR, Essentra FZE faced a maximum civil monetary penalty of approximately \$923,766.<sup>29</sup> Because the company did not make a voluntary self-disclosure of the apparent violations and the apparent violations constitute an "egregious case," OFAC determined that the base penalty was equal to the maximum penalty.<sup>30</sup>

In determining the ultimate penalty amount of \$665,112, OFAC considered a number of aggravating factors:

- "Essentra FZE willfully violated the NKSR when its senior manager and a customer-facing employee agreed to conceal the DPRK nexus to the export of its cigarette filters, and agreed to transact with non-DPRK front companies despite the fact that the company's compliance policy warned that its banks would not handle transactions with sanctioned jurisdictions such as the DPRK";
- "The senior manager and customer-facing employee at Essentra FZE had actual knowledge that the conduct at issue concerned the sale of cigarette filters to the DPRK";

- “Essentra FZE significantly harmed U.S. foreign policy objectives when it caused U.S. persons to confer economic benefits to the DPRK while providing goods that are often combined with tobacco or tobacco products”; and
- “Essentra FZE is part of a sophisticated commercial group operating in international filters markets around the world.”<sup>31</sup>

OFAC also noted mitigating factors: its lack of a penalty or cautionary letter in the last five years and its substantial cooperation with OFAC.<sup>32</sup>

### Implications

While non-U.S. companies are generally not prohibited by U.S. sanctions from engaging in transactions with sanctioned persons or jurisdictions, the Essentra FZE enforcement actions serve as an important reminder that virtually any U.S. nexus to such transactions can trigger a criminal or civil sanctions enforcement action. DOJ’s criminal resolution appears to be the first of its kind, targeting a non-U.S., non-bank company selling ordinary goods and services to a sanctioned jurisdiction, with the only apparent U.S. nexus being the use of the U.S. financial system. Until recently, such conduct was generally not seen as warranting criminal enforcement. Under the Essentra FZE DPA, the company admitted that it was aware that U.S. sanctions prohibited transacting with North Korea by using U.S. dollar wires. Still, in most matters involving sanctioned jurisdictions and the use of the U.S. financial system, there will likely be present some level of non-transparency in the transactions or payments, including deliberate acts such as the use of intermediary third parties or front companies. Otherwise, such payments would ordinarily be stopped by U.S. financial institutions. While the facts will differ in each case, non-transparency in transactions or payments could in some cases give rise to an inference by DOJ that the employees at issue had the requisite willfulness to support a criminal sanctions charge.

It is also notable that Essentra FZE was targeted for criminal and civil enforcement for *receiving* U.S. dollar or other currency payments into accounts held at a non-U.S. branch of a U.S. bank. By contrast, OFAC’s 2017 landmark TransTel enforcement action involved a company *initiating* U.S. dollar payments involving Iranian business and thereby causing U.S. intermediary banks to export financial services to a sanctioned country. Here, DOJ and OFAC make clear that, regardless of which way funds flow, the facts may support criminal and civil sanctions liability.

Finally, it is notable that, in this case, both the senior manager and employee were aware of company policies and procedures that prohibited trade with DPRK and restricted the use of U.S. dollars in certain transactions, but still knowingly engaged in sanctions violations. This highlights that merely instituting a sanctions compliance policy and program will not be sufficient. Rather, ongoing implementation and monitoring of the compliance program, as well as more frequent training of sales staff and managers and enhanced oversight over employees, is equally important. Additionally, companies may wish to strengthen

their compliance programs by applying enhanced scrutiny to transactions involving certain jurisdictions, including Dalian, China and the Liaoning province of China generally. For example, in 2017 the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") issued an advisory highlighting that the DPRK frequently uses front or shell companies located in the Liaoning province to facilitate trade with the DPRK.<sup>33</sup>

We will continue to monitor sanctions developments and look forward to providing you with further updates.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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- <sup>1</sup> See U.S. Dep't of Justice, *Essentra Fze Admits to North Korean Sanctions and Fraud Violations, Agrees to Pay Fine* (July 16, 2020), available [here](#) ("DOJ Press Release"); Settlement Agreement between the U.S. Department of the Treasury's Office of Foreign Assets Control and Essentra FZE Company Limited (July 16, 2020) available [here](#) ("OFAC Settlement Agreement"). Essentra FZE is currently a subsidiary of a U.K. company with global operations. Spencer Hsu, *Cigarette-Filter Maker Settles Allegations of Violating North Korea Sanctions*, THE WASH. POST (July 16, 2020), available [here](#).
- <sup>2</sup> Deferred Prosecution Agreement and Statement of Facts at 36, *United States v. Essentra FZE Company Limited*, 20-cr-00112-RC, ECF No. 2 (July 16, 2020 D.D.C.) available [here](#) ("DOJ DPA").
- <sup>3</sup> *Id.* at 1, 7.
- <sup>4</sup> U.S. Dep't of Treasury, OFAC, "OFAC Settles with Essentra FZE Company Limited with Respect to Potential Civil Liability for Apparent Violations of the North Korea Sanctions Regulations" at 2, available [here](#) ("OFAC Web Notice").

- 5 DOJ Press Release.
- 6 Paul, Weiss, OFAC Breaks New Ground By Penalizing Non-U.S. Companies for Making U.S. Dollar Payments Involving a Sanctioned Country (July 28, 2017), available [here](#).
- 7 50 U.S.C. §§ 1701–07.
- 8 In violation of 18 U.S.C. § 371.
- 9 DOJ DPA at 1, 32.
- 10 *Id.* at 31, 33.
- 11 *Id.* at 33-34.
- 12 *Id.* at 34.
- 13 *Id.*
- 14 *Id.* at 34-35.
- 15 *Id.* at 35.
- 16 *Id.* at 32.
- 17 *Id.* at 32-33.
- 18 *Id.* at 33.
- 19 *Id.* at 35.
- 20 *Id.* at 33.
- 21 *Id.* at 2, 13.
- 22 *Id.* at 7.
- 23 *Id.* at 9.
- 24 *Id.* at 4.
- 25 OFAC Web Notice at 2-3 (citing 31 C.F.R. §§ 510.212, 510.206 and 510.211). Pursuant to § 510.326 of the NKSR, a foreign branch of any entity organized under the laws of the United States or any jurisdiction within the United States is a U.S. person subject to the prohibitions of the NKSR.
- 26 OFAC Settlement Agreement at 3.
- 27 *Id.*
- 28 *Id.* at 3-9.
- 29 OFAC Web Notice at 2.
- 30 *Id.*
- 31 *Id.*
- 32 *Id.* at 2-3.
- 33 U.S. Dep't of Treasury, FinCEN, Advisory on North Korea's Use of the International Financial System at 3, 6–7 (Nov. 2, 2017), available [here](#).