August 31, 2020

Second Circuit Rejects Evasion-of-Secondary-Sanctions Theory; Upholds DOJ's Use of Bank Fraud Statute in Sanctions Prosecution

On July 20, 2020, the U.S. Court of Appeals for the Second Circuit upheld Mehmet Hakan Atilla's convictions for conspiracy to violate the International Emergency Economic Powers Act ("IEEPA"), conspiracy to defraud the United States, bank fraud and money laundering in connection with a scheme to evade U.S. economic sanctions against Iran. Atilla, a Turkish citizen and the former Deputy General Manager of Halkbank,[1] was convicted in January 2018 in connection with his role in providing the Government of Iran with access to the U.S. financial system in violation of Iran sanctions.

The Second Circuit decision provides greater clarity on what sanctions-related conduct is, and is not, subject to criminal prosecution. Notably, the Second Circuit rejected the government's argument that an IEEPA charge can be based on a defendant's conspiracy to evade the future imposition of secondary sanctions—a theory at issue in the pending prosecution of Halkbank. The Second Circuit, however, upheld Atilla's IEEPA conviction on an alternative theory of liability. The decision also affirms that DOJ may proceed with a bank fraud prosecution in connection with schemes to evade U.S. sanctions. To do so, DOJ must prove that the defendant knew that U.S. banks were impacted by the scheme, but this knowledge can be demonstrated by circumstantial evidence. The Second Circuit—for the first time—also upheld the government's theory that the defendant's conduct defrauded OFAC's enforcement of economic sanctions laws. Bank fraud and defrauding OFAC are now common companion charges in sanctions prosecutions, and may form alternate theories of prosecution if the government lacks sufficient evidence of a willful sanctions violation.

Background

In his role at Halkbank, Atilla oversaw the bank's international corporate finance efforts and was responsible for the bank's relationships with U.S. correspondent banks, Iranian banks and the Central Bank of Iran.[2] While Atilla was the Deputy General Manager, Halkbank held accounts for the Central Bank of Iran and Iran's government-owned petroleum company, the National Iranian Oil Company (both Specially Designated Nationals, or "SDNs").[3]

In 2016, DOJ charged former Halkbank client Reza Zarrab with conspiracies to violate IEEPA, to defraud the United States, to commit bank fraud and to commit money laundering, and for circumventing U.S. sanctions by conducting transactions worth millions of dollars on behalf of the Iranian government and Iranian businesses through an international network of front companies located in Iran, Turkey and other countries in order to conceal that the transactions were conducted on behalf of Iranian entities.[4] Zarrab

pleaded guilty to these charges in October 2017, agreed to cooperate with DOJ, and served as one of the government's principal trial witnesses against Atilla.[5]

Atilla was charged with multiple counts of conspiracy.[6] According to the Second Circuit, the evidence at Atilla's trial established that he conspired with Zarrab and others to evade Iran sanctions by laundering billions of dollars' worth of Iranian oil proceeds out of Halkbank by disguising the National Iranian Oil Company's oil funds as permissible private trade and humanitarian assistance.[7] Atilla, Zarrab and others used an international network of front companies located in Iran, Turkey and other countries to conceal that the U.S. dollar transactions associated with this scheme were actually on behalf of and for the benefit of Iranian entities in violation of U.S. sanctions.[8] Atilla also repeatedly lied to senior U.S. Treasury Department officials to hide the scheme and shield Halkbank from the imposition of U.S. secondary sanctions.[9] Following a three-and-a-half week jury trial, Atilla was convicted on five of the six counts: conspiracy to violate IEEPA; conspiracy to obstruct the lawful functions of Treasury; bank fraud; conspiracy to commit bank fraud; and conspiracy to commit money laundering.[10] Atilla was sentenced to 32 months' imprisonment and a $500 special assessment.[11] After Atilla completed his term of imprisonment, he was deported to Turkey.[12]

Atilla appealed his convictions on four grounds, three of which are relevant here: (i) the district court wrongly instructed the jury that it could convict him of conspiring to violate the IEEPA if Atilla agreed to evade or avoid the future imposition of secondary sanctions;[13] (ii) the government presented no evidence that Atilla knew the sanctions avoidance scheme would involve the use of U.S. banks, and, accordingly, the evidence was insufficient for the jury to convict him of conspiracy to violate the IEEPA, bank fraud, conspiracy to commit bank fraud and conspiracy to commit money laundering; and (iii) Atilla's conviction for conspiring to defraud the United States fails because the statute of conviction, 18 U.S.C. § 371, does not reach agreements to obstruct the United States' enforcement of economic sanctions laws.[14] Although the Second Circuit agreed with Atilla that the jury was improperly instructed on the evasion-of-secondary-sanctions issue, the panel found that instructional error harmless, and rejected the other grounds for appeal.

Key Points of the Second Circuit's Decision

- *Avoiding the Future Imposition of Secondary Sanctions Alone Cannot Form the Basis of A Criminal IEEPA Violation*. On appeal, Atilla argued that the district court wrongly instructed the jury that it could convict him of conspiring to violate IEEPA based on the theory that he conspired to evade or avoid the U.S. government's future imposition of secondary sanctions.[15] Specifically, Atilla argued that the relevant IEEPA and regulatory provisions forbid only transactions that evade or avoid *existing* prohibitions, not efforts to evade or avoid the *potential* imposition of secondary sanctions.[16]

  The Second Circuit agreed with Atilla that IEEPA and the relevant regulatory provisions do not make it unlawful for an individual (and by extension, a company) to conspire to evade or avoid the prospective

imposition of secondary sanctions.[17] In doing so, the panel explicitly rejected the government's theory of liability that conspiracy to avoid the future imposition of secondary sanctions violates IEEPA.[18]

Nevertheless, the Second Circuit held that the lower court's improper jury instruction was harmless error because the jury found Atilla guilty on a different, properly instructed theory of liability—*i.e.*, that he conspired to violate IEEPA by exporting services (including the execution of U.S.-dollar transfers) from the United States to Iran in violation of Iran sanctions.[19]

- *Knowledge of the Involvement of U.S. Banks Is Required to Establish a Bank Fraud Violation and Conspiracies to Violate IEEPA and to Commit Money Laundering, But This Knowledge Can Be Established Circumstantially*. Atilla next argued that there was insufficient evidence showing that he knew that the scheme would involve the use of U.S. banks, an element that neither Atilla nor the DOJ disputed was necessary to each of his convictions for bank fraud and conspiracies to violate IEEPA, to commit bank fraud and to commit money laundering.[20] For example, to prove bank fraud, DOJ must show that the defendant knowingly executed or attempted to execute a scheme to defraud a financial institution or to obtain funds or property by means of false pretenses, representations or promises; that the defendant did so with the intent to defraud the financial institution; and that the scheme was directed at a financial institution whose deposits were insured by the FDIC.[21] Thus, touchpoints to U.S. banks and knowledge of the same are required to prove bank fraud. In particular, Atilla argued that the only evidence of his knowledge of the use of U.S. banks was Zarrab's testimony that Atilla knew that after the funds were removed from Halkbank, they would be used to "fulfill 'international money orders' or make 'international payments' for Iran," which Atilla argued was insufficient to convict him for certain counts.[22]

  The Second Circuit disagreed that the evidence was insufficient,[23] and it pointed to evidence tending to show that: the purpose of the scheme was to convert Iranian oil proceeds held at Halkbank into a form that could be used to fund international payments on behalf of the Government of Iran and Iranian entities; these international payments were likely to pass through the U.S. financial system and the jury could "reasonably infer" that Atilla knew about the "role of U.S. correspondent banks in processing U.S.-dollar transactions"; senior-level executives at Halkbank knew the particulars of the scheme, including the importance of the international payments and of U.S.-dollar transactions; Atilla knew that the international payments involved in the scheme were payments on behalf of Iranian clients that Halkbank itself refused to process directly; and Atilla repeatedly lied to U.S. Treasury officials to conceal the sanctions avoidance scheme, including by representing to OFAC's then Director that Halkbank was only financing gold exports to private Iranian citizens.[24] The panel concluded that a "rational jury could have found, beyond a reasonable doubt, that Atilla knew the sanctions avoidance scheme would involve the use of U.S. banks."[25]

- *Conspiracy to Defraud Statute ("Section 371") Does Reach Conspiracy to Obstruct Sanctions Enforcement*. Atilla argued that he could not be convicted for conspiring to "defraud" the U.S.

government because obstructing the enforcement of economic sanctions does not constitute a "depri[vation] of property rights."[26] The panel rejected this argument, holding that a Section 371 charge is not limited to circumstances where the government is defrauded of property, but also applies when a defendant participates in "any conspiracy for the purpose of impairing, obstructing, or defeating the lawful function of any department of Government," including OFAC.[27] The panel also rejected Atilla's argument that, under *United States* v. *Klein*, [28] prosecutions under the "defraud" clause of Section 371 are limited to conspiracies relating to income tax evasion.[29]

Implications

The Second Circuit's decision is notable because it delineates with greater clarity DOJ's authority to prosecute conduct involving U.S. economic sanctions.

With respect to secondary sanctions, which the U.S. government can impose on non-U.S. persons for engaging in certain types of conduct, such as engaging in a "significant transaction" involving Iranian oil,[30] the Second Circuit held that DOJ may not prosecute non-U.S. individuals and companies for engaging in conduct that evades the U.S. government's potential imposition of secondary sanctions.

The Second Circuit's decision also appears to be the first appellate decision affirming the use of the bank fraud statute in the sanctions context. Although Atilla did not challenge DOJ's use of bank fraud charges premised on the same predicate conduct as the underlying sanctions charges, the Second Circuit endorsed DOJ's theory of prosecution, and held that, while there must be proof that the defendant knew the scheme impacted U.S. banks, such proof could be established through circumstantial evidence.

For non-U.S. companies, this decision points to an important enforcement risk: DOJ may be able to rely on a bank fraud theory of prosecution if DOJ's investigation cannot establish the willful violation of U.S. sanctions—*i.e.*, proof that the defendant knew that its conduct violated U.S. law—which is required to support a criminal IEEPA charge,[31] but is not necessary to support a criminal bank fraud charge. For a bank fraud charge, DOJ takes the position that it need only show, generally speaking, that the defendant knowingly engaged in conduct that induced U.S. banks to conduct financial transactions that the banks would not have otherwise undertaken. DOJ's ability to bring these claims also increases DOJ's leverage in plea negotiations. Moreover, the fact that the bank fraud statute carries a 10-year statute of limitations, as opposed to five years for a criminal IEEPA violation, potentially gives DOJ additional time to investigate and prosecute sanctions-related conduct.[32]

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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1 Halkbank was indicted on October 15, 2019 on fraud, money laundering and sanctions offenses related to the bank's alleged participation in a multibillion-dollar scheme to evade U.S. sanctions on Iran. *See* U.S. Dep't of Justice, Press Release, Turkish Bank Charged in Manhattan Federal Court for Its Participation in a Multibillion-Dollar Iranian Sanctions Evasion Scheme (Oct. 15, 2019), available here.

2 *United States* v. *Atilla*, 966 F.3d 118, 122 (2nd Cir. 2020).

3 *Id.*

4 U.S. Dep't of Justice, Manhattan U.S. Attorney Announces Arrest Of Turkish National For Conspiring To Evade U.S. Sanctions Against Iran, Money Laundering, And Bank Fraud (Mar. 21, 2016), available here.

5 Benjamin Weiser, Reza Zarrab, Turk at Center of Iran Sanctions Case, Is Helping Prosecution, *The New York Times* (Nov. 28, 2017), available here. We discussed the Zarrab prosecution in previous memorandums. *See* Economic Sanctions and Anti-Money Laundering Developments: 2017 Year in Review (Jan. 23, 2018), available here; The Regulatory and Enforcement Outlook for Financial Institutions in 2017: Trends in Sanctions, Anti-Money Laundering and Cybersecurity (Feb. 22, 2017), available here.

6 *Atilla*, 966 F.3d at 122.

7 *Id.*

8 *Id.*; *see also supra* note 4.

9 *Atilla*, 966 F.3d at 122.

[10] *Id.*

[11] *Id.* at 123.

[12] *Id.*

[13] Secondary sanctions target conduct by non-U.S. individuals or entities that does not have a nexus to the United States. Under secondary sanctions, the U.S. government threatens to place a non-U.S. individual or entity on the SDN List (or impose other, lesser sanctions) if the non-U.S. person or entity engages in certain identified activities. *See* Paul, Weiss, International Comparative Legal Guides: Sanctions 2020 (1st ed.), available here.

[14] *Atilla*, 966 F.3d at 123. The fourth ground for appeal was that the district court abused its discretion on an evidentiary issue excluding from evidence a transcript of a jailhouse phone call between Zarrab and Zarrab's uncle.

[15] *Id.*

[16] *Id.*

[17] *Id.* at 124.

[18] *Id.* at 125–26.

[19] *Id.* at 127.

[20] *Id.*

[21] *United States* v. *Bouchard*, 828 F.3d 116, 123 (2d Cir. 2016) (citing 18 U.S.C. § 1344).

[22] *Atilla*, 966 F.3d at 127.

[23] *Id.* at 128.

[24] *Id.* at 128–29.

[25] *Id.* at 129. The court noted elsewhere in the opinion that to find Atilla guilty of bank fraud and bank fraud conspiracy, the jury was required to find that he obtained or agreed to obtain, through deceit, funds in the custody of one of several named federally insured banks located in the United States. *Id.* at 127.

[26] *Id.* at 129.

[27] *Id.* at 130.

[28] *United States* v. *Klein*, 247 F.2d 908, 915 (2d Cir. 1957).

[29] *Atilla*, 966 F.3d at 130.

[30] *See, e.g.*, Paul, Weiss, Economic Sanctions and Anti-Money Laundering Developments: 2019 Year in Review (Jan. 31, 2020), available here.

[31] 50 U.S.C. § 1705(c).

[32] *Compare* 18 USC S. 3293(1) (10-year statute of limitations for bank fraud) *with* 18 U.S.C. S 3282(a) (five-year statute of limitations for non-capital criminal offenses, such as IEEPA).