"Reason To Know" - A Chilling Term For Exporters

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It?s a simple question ? if a U.S. exporter sells its product to a foreign customer, and the customer resells the product to a prohibited country such as Iran, can the U.S. exporter have liability for an export violation? The U.S. District Court for the District of Columbia handed down an important decision regarding obligations of U.S. exporters in such situations. This is a sobering decision that every exporter should read.

The case involves U.S. exporter Epsilon Electronics and its subsidiaries. According to the decision, Epsilon had sold its retail electronics products to a customer in the United Arab Emirates. The UAE customer, in turn, resold the products to customers in Iran. OFAC learned about the sales, initiated an investigation, and eventually levied a civil penalty against Epsilon for $4,073,000.

In its defense in the case, Epsilon argued that OFAC failed to provide any evidence that Epsilon had knowledge that the goods would be resold to Iran. However, under OFAC?s Guidance On Transshipments to Iran[2] (?Guidance?), a U.S. company can have liability if it had direct knowledge or if it had ?reason to know? that the products were intended to be resold to Iran. Thus, even if the U.S. company did not have actual knowledge of a potentially illegal transaction, if facts are present that the goods would be shipped to Iran this is sufficient to constitute a violation. OFAC?s Guidance provides as follows:

It is important to note that prohibited sales to Iran through a non-U.S. person in a third country are not limited to those situations where the seller has explicit knowledge that the goods were specifically intended for Iran, <u>but includes those situations where the seller had reason to know that the goods were specifically intended for Iran</u>, including when the third party deals exclusively or predominantly with Iran or the Government of Iran.

?Reason to know? that the seller?s goods are intended for Iran can be established through a variety of circumstantial evidence, such as: course of dealing, general knowledge of the industry or customer preferences, working relationships between the parties, or other criteria far too numerous to enumerate . . . .

A violation involving indirect sales to Iran may be based upon the actual knowledge of the U.S. supplier at the time of its sale, or upon determination that the U.S. supplier had reason to know at the time of sale that the goods were specifically intended for Iran. OFAC would consider all the relevant facts and circumstances in order to determine the actual or imputed knowledge on the part of the U.S. supplier[3]

Epsilon challenged OFAC?s decision in a suit in the US District Court[4] and the court reviewed the ?reason to know? standard in cross-motions for summary judgment. In its decision, the court confirmed that OFAC did not find any direct evidence that Epsilon?s shipments to the UAE customer were eventually sold to Iran. However, the court found that OFAC had identified significant information that was available to the public that showed that the UAE company conducted a substantial amount of its business in Iran. As part of this, OFAC had located an English language website for the UAE company that showed that the UAE company distributed products in Iran, had an address in Iran and engaged in other activities in Iran. The court concluded that based upon this information being available to the public, even if Epsilon did not have explicit knowledge of such information, this was sufficient to find that Epsilon had ?reason to know? that the goods would be resold in Iran and upheld OFAC?s determination.[5]

This is an important decision for U.S. exporters. First, it provides a rare glimpse into judicial review of the U.S. export control laws.[6] More importantly, the case reinforces the validity of the ?reason to know? standard under OFAC?s Iran regulations[7] (and arguably under other export laws as well) and provides insight into its application. Under this standard, U.S. exporters appear to have an affirmative obligation to review the facts surrounding export transactions. If facts are present that point to the risk of an illegal transaction, if something later goes wrong in the transaction the U.S. company could have liability, even if it did not participate in or support the illegal activity and even if it did not have actual knowledge of the suspicious facts. Simply stated: bad facts equal big risks.

Thus companies should conduct careful due diligence reviews in their export transactions. Such reviews should include some or all of the following as is appropriate for your company and transaction: (i) having clearly written due diligence procedures for compliance personnel; (ii) identifying specific red flags that are appropriate for your company?s industry and risk analysis; (iii) training employees to spot red flags and bring these to the attention of compliance staff; (iv) developing heightened compliance steps in high risk countries (such as due diligence questionnaires for customers to complete); (v) cross-referencing reviews with data collected elsewhere in your company (such as credit reports obtained by your finance department); (vi) use of export compliance certifications in transaction documentation; (vii) maintaining records of due diligence reviews; (viii) conducting restricted party screening; and (ix) strong visible support from senior management.

As the old maxim goes: lie down with dogs, get up with fleas. Sometimes it is better to just walk away from a bad deal.

NOTE: This article contains general, condensed summaries of actual legal matters, statutes and opinions for information purposes. It is not meant to be and should not be construed as legal advice. Readers with particular needs on specific issues should retain the services of competent counsel. For more information, please visit our website at www.williamsmullen.com or contact Thomas B. McVey, 202.293.8118 or tmcvey@williamsmullen.com. Additional articles on ITAR and export controls are available here.

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[1] Mr. McVey advises clients on the federal regulation of international business transactions including under the International Traffic In Arms Regulations, Export Administration Regulations and the U.S. sanctions programs. Additional articles on ITAR and export controls are available here.

[2] This is available at: https://www.treasury.gov/resource-center/sanctions/Programs/Documents/iranship.pdf

[3] Guidance p. 2.

[4] Epsilon Electronics, Inc. v. United States Department of the Treasury, Office of Foreign Assets Control, et al., Civil Action No. 14-2220 (RBW), In the U.S. District Court For the District of Columbia.

[5] The court?s opinion is available at: https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2014cv2220-26

[6] There are many published decisions of U.S. agency enforcement

actions for violations of the U.S. export laws, including the U.S. sanctions laws, Export Administration Regulations and International Traffic In Arms Regulations. However judicial review of such determinations is limited. This case provides a rare glimpse into how federal courts view enforcement of the U.S. sanctions laws under the Administrative Procedures Act.

[7] The Guidance was initially adopted by OFAC under the Iran Transaction Regulations.

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