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U.S. Imposes Additional Sanctions on North Korea

by
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On September 20, 2017, President Trump issued Executive Order ("E.O.") 13810, "Imposing Additional Sanctions with Respect to North Korea." As you know, the existing North Korean sanctions already precluded U.S. persons and companies from doing business with that country. This new E.O. 13810 issues broad secondary sanctions against North Korea that are comparable to the secondary sanctions regime imposed against Iran by the U.S. prior to the Joint Plan of Action ("JPOA") and Joint Comprehensive Plan of Action ("JCPOA") nuclear agreements and accordingly affect both U.S. and non-U.S. companies.

In short, the new secondary sanctions against North Korea target non-U.S. individuals and companies engaged in trade with North Korea, and 13810 is a significant executive action that combines a range of secondary sanctions measures used in the past against Iran, along with some new sanctions policies. In addition, it raises due diligence issues for both non-U.S. and U.S. companies.

I. Designation Risks and Blocked Persons

Section 1(a) of E.O. 13810 grants the Secretary of the Treasury (*i.e.*, the Office of Foreign Assets Controls or "OFAC") the power to designate as a Specially Designated National ("SDN") any person, whether U.S. or foreign, who meets one of the following designation criteria:

- The person does business with one of the following industries in North Korea: construction, energy, financial services, fishing, information technology, manufacturing, medical, mining, textiles, or transportation.

- The person owns, controls, or operates any seaport, airport, or land port in North Korea.

- The person has engaged in at least one significant export or import of goods, services, or technology to or from North Korea.

- The person is a North Korean citizen, resident, or entity.

- The person has materially assisted or provided goods or services to or in support of any person blocked or designated under E.O. 13810.

- The person is an agent of, or a company owned or controlled by, a person blocked or designated under E.O. 13810.

With the ongoing tensions between the U.S. and North Korea, we expect that OFAC will use these new criteria to begin designating parties involved in international trade with North Korea as SDNs. As you are aware, SDNs are prohibited from engaging in trade with the U.S. and all of their assets are blocked, including bank accounts, wire transfers, and cargo.

II. Aircraft and Vessel-Specific Sanctions

One of the new secondary sanctions measures included E.O. 13810 is a set of aircraft- and vessel-specific restrictions.

Section 2 of E.O. 13810 prohibits the following aircraft and vessels from landing in the U.S. or calling at a port in the U.S., respectively, for 180 days:

(a) Any aircraft in which a foreign person has an interest that has landed at a place in North Korea.

(b) Any vessels in which a foreign person has an interest that has called at a port in North Korea.

(c) Any vessel in which a foreign person has an interest that has engaged in a *ship-to-ship transfer* with a vessel described in (b) above.

Accordingly, it is important that companies engaged in shipping, logistics, transportation, and international trade take steps to screen aircraft and vessels being used to be sure they are not calling at North Korean ports and airports. If a carrier uses a plane or vessel that has somehow been involving in calling a North Korean airport or port within the previous 180 days, both the carrier and persons using its services are at risk of violating these new sanctions.

III. Financial Transactions and Heightened Facilitation

Section 3(a) of E.O. 13810 blocks all funds that originate from, are destined for, or pass through a foreign bank account that either (1) is owned or controlled by a North Korean person or (2) has been used to transfer funds in which a North Korean person has an interest.

As the definition of "interest" as used in U.S. economic sanctions is extremely broad, this section blocks funds from all foreign bank accounts that have been involved in a transaction connected to a North Korean citizen, resident, or entity. This means that any foreign bank account that is involved in a North Korea-related transaction is in jeopardy. Once a foreign bank account has been part of a North Korea-related transfer, U.S. persons are prohibited from dealing with any funds from that bank account and any funds from that bank account that enter the U.S. will be blocked.

This creates a potential risk even to parties not engaging in trade with North Korea, as wire transfers using U.S. dollars as currency routinely travel through an intermediary financial institution in the U.S. to clear, even when the originating and beneficiary parties and banks are all non-U.S. persons. Accordingly, any foreign bank account that is involved in a North Korea-related transaction will be effectively cut off from transactions with U.S. persons.

Moreover, Section 3(b) also prohibits U.S. persons from facilitating a transaction by a foreign person "where the transaction by that foreign person would be prohibited by [Section 3(a)] if performed" by a U.S. person. In practice, this facilitation prohibition extends the reach of the secondary sanctions to foreign companies involved in a transaction with a foreign bank account described in Section 3(a). Foreign companies doing business with parties whose bank accounts that have been involved in a North Korea-related transaction are also at risk of being cut off from U.S. trade and having assets blocked.

> **Example 1**: Company X in China holds Bank Account A at a Hong Kong bank. Bank Account A has, in the past, been used to transfer funds as part of a North Korea-related transaction. Under Section 3(a), U.S. persons are now prohibited from in any way dealing with any funds that originate from, are destined for, or pass through Bank Account A. In addition, all funds that originate from, are destined for, or pass through Bank Account A are now considered blocked.
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> **Example 2:** Company X tries to send $1,000,000 USD to Company Y in Italy as part of a transaction with no relation to North Korea. Company Y holds Bank Account B at an Italian bank. The transfer is structured by the Hong Kong bank as a *U-Turn Transaction*, in which the USD amount is transferred from Bank Account A at the Hong Kong bank to an intermediary bank in the U.S., after which the funds are destined for Bank Account B at the Italian bank. As the funds have originated from Bank Account A, which has been used in the past to transfer funds in a North Korea-related transaction, the funds are blocked by the U.S. intermediary bank pursuant to Section 3(a).
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> **Example 3:** Later, as part of a separate transaction, Company X hires Company Y to provide export-related services in a transaction with no relation to North Korea. Company Y sub-contracts part of the services to Company Z in Germany, which holds Bank Account C at a German Bank.
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> Company Y in Italy attempts to transfer $1,000,000 USD from Bank Account B to Company Z's Bank Account C. The $1,000,000 USD did not originate or pass through Bank Account A, and they are destined only for Bank Account C. The Italian bank structures the transfer as a *U-Turn Transaction*, in which the funds will transfer from Bank Account B to a U.S. intermediary bank, after which the

> funds are destined for Bank Account C. The intermediary bank sees that Company X is listed on documents accompanying the transfer. In order to avoid facilitating the transaction between Company X and Company Y, in which Company Y will receive payment in Euros from Bank Account A, the U.S. intermediary bank blocks the funds pursuant to Section 3(b).

As demonstrated in the examples above, foreign companies who have never been part of a North Korea-related transaction are still at risk of losing U.S. partners and having fund transfers blocked by merely doing business with parties who have engaged in North Korea trade in the past.

The goal of these sanctions is to isolate North Korea by isolating all companies that engage in trade with North Korea. To effectuate this, the new sanctions increase the costs and risks for foreign companies that do business with companies engaged in trade with North Korea.

Accordingly, it is important for companies to conduct rigorous screening of all parties to make sure no party to a transaction has previously engaged in North Korea trade.

IV. Secondary Sanctions for Foreign Financial Institutions

Section 4 of E.O. 13810 targets foreign financial institutions ("FFI") that knowingly engage in transactions related to North Korea. FFIs that violate these sections are subject to a range of restrictive measures, from caps on correspondent account transfers with U.S. banks to potential designations as blocked persons.

Specifically, this section of E.O. 13810 prohibits FFIs from the following:

- Knowingly conducting or facilitating any significant transaction on behalf of a person blocked pursuant to a North Korea-related executive order.

- Knowingly conducting or facilitating any significant transaction in connection with trade with North Korea.

Please note that the term "knowingly" includes activity where OFAC believes an FFI *should have known* of a connection to a blocked person or North Korea. Accordingly, FFIs may be at risk of secondary sanctions even in cases where they were unaware of any connection to North Korea.

In the event that an FFI is blocked for engaging in North Korea trade, this could jeopardize all bank accounts at the FFI. It may be very difficult to obtain funds held at a blocked FFI and, in some cases, an OFAC specific license may be required.

Accordingly, it is important for all U.S. and foreign companies to conduct due diligence on FFIs to make sure the FFI is not engaging in trade with North Korea. Some important questions to ask include the scope of the FFI's sanctions compliance policy and the FFI's policy toward foreign customers engaged in North Korea-related trade.

V. Conclusion

E.O. 13810 issues a number of new secondary sanctions related to North Korea. These sanctions not only prohibit foreign individuals and companies from engaging in trade with North Korean persons, but in some cases also prohibit foreign persons from transactions with third parties that have separately done business with North Korea.

We suggest that you incorporate these new secondary sanctions into your sanctions compliance programs, policies, and procedures. If you have any questions regarding these designations or U.S. economic sanctions, please feel free to contact us.