

Supply Chains Rattled by Hidden US Sanctions Risks

Recent settlements have reminded non-US companies of the danger of failing to comply with US sanctions and export control laws. But strengthening a compliance programme will not provide complete protection when business partners are targeted by authorities. An aggressive enforcement action against a supplier or customer can threaten and destroy commercial relationships without warning.

Global Dependencies

As has been shown in several recent cases, an unexpected enforcement action taken against a key supplier or financial institution can disrupt the flow of goods and services along global supply chains and threaten well-established trading networks.

Customers, lenders, manufacturers, and retailers, among others, are taking a closer look at their counterparties' compliance programmes and asking for stronger legal protections against follow-on sanctions and export control risks.

Extraterritorial Power

The US Government has an impressive arsenal of tools for enforcing laws against non-US persons for conduct taking place outside the United States, especially in the areas of sanctions and export controls.

The Office of Foreign Assets Control (OFAC) has long been known for its ability to impose sanctions on non-US

actors who threaten US national security and policy. Individuals and entities who appear on the OFAC list of Specially Designated Nationals (SDNs) are virtually excluded from the US financial system, not to mention the growing number of non-US banks that "voluntarily" follow OFAC regulations in order to lessen the risk inside their operations.

Following OFAC's model, the Commerce Department's Bureau of Industry and Security (BIS) has used the Entity List to restrict non-US persons' access to US-origin goods to achieve regulatory objectives. BIS has used the Entity List to target and force extreme penalties on non-US persons doing business with sanctioned countries, in circumstances where they would otherwise have less leverage to extend their jurisdiction.

The point has been driven home by US Commerce Secretary Wilbur Ross, who said recently: "*Those who flout our economic sanctions and export control laws will not go unpunished – they will suffer the harshest of consequences.*"

Key issues

- Critical suppliers and key customers outside the United States can be rendered inoperable by severe US sanctions penalties or trade restrictions with little warning.
- New enforcement theories and techniques are giving US authorities greater enforcement reach as attention shifts to Asia.
- Sanctions compliance is becoming a core component of supply-chain risk assessments, with contractual protections sought from higher risk vendors and customers.

Follow-on Risks

Being placed on the OFAC SDN List or BIS Entity List is a virtual death warrant for non-US companies that rely on access to the US financial system or US-origin goods. There can also be severe knock-on consequences for their law-abiding

counterparties that are unprepared to lose a newly sanctioned commercial partner.

Recent high-profile cases involving Chinese companies have highlighted the issue. Surprise actions by US regulators can leave manufacturers and retailers scrambling to replace a key purchaser or supplier. Lenders can be forced to accelerate outstanding loans. Employees of the sanctioned entity - but also those of the suppliers and customer - inside and outside the United States, face employment uncertainty, while shareholders see their value evaporate.

US regulators can limit the domino effects of new sanctions designations by issuing general licences that permit certain limited activities or provide a wind-down period for existing relationships. However, these measures are discretionary, difficult to obtain, almost always temporary in nature, and limited in scope. Moreover, they are not guaranteed and can come with severe conditions.

As global trade linkages deepen, these follow-on sanctions risks are bound to increase. This is particularly so as Iran re-integrates into the global economy following the implementation of the Joint Comprehensive Plan of Action in January 2016. Meanwhile, US authorities are sharpening their focus on non-US persons who support the government of North Korea.

Know Your Counterparties

Companies seeking to reinforce their level of protection while operating in increasingly global networks have made sanctions questionnaires a standard feature of the due diligence

process, thereby demonstrating their own compliance efforts if they are targeted by enforcement.

Yet, in practice, many companies fail to closely scrutinise and recognise their counterparties' true potential for disruptive sanctions risk. Evidence of dealings with sanctioned countries or persons, the existence (or not) of a sanctions compliance programme, and red flags concerning past business activities or regulatory investigations, means a closer look may be justified.

In some cases, an investigatory firm may be required for a deep dive into a potential counterparty's reputation for compliance. The goal is to become comfortable with the reliability of a commercial partner's compliance controls and their viability as a counterparty moving forward.

Competitive Compliance

Apart from the legal risks, companies that fail to live up to these standards could find themselves at a disadvantage against their risk-adverse competitors.

Entities with strong compliance controls are at a competitive advantage as they have better access to financing from financial institutions that are increasingly asking for sanctions compliance undertakings as a part of lending and underwriting agreements. Investors too demand to see strong sanctions controls within target companies.

Vendor contracts increasingly feature sanctions compliance clauses whereby suppliers and customers mutually agree to abide by applicable sanctions laws. These provisions are often backed by rights of termination and indemnity arising from violations.

A supply chain is only as strong as its weakest link. No matter how strong your own link is, a break along the line could threaten the whole structure.

Please also see our briefing [Asia Pacific puts sanctions due diligence to the test](#).

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