

Fried Frank International Trade and Investment *Alert*TM

Recent OFAC Enforcement Actions Highlight Sanctions Risk in Cross-Border M&A Activity

In the last two weeks, OFAC issued two enforcement actions for activities conducted by foreign subsidiaries that violated U.S. sanctions laws. On February 14, 2019, OFAC announced a \$5.5 million civil penalty against [AppliChem GmbH](#), a Germany company, for deliberately and surreptitiously continuing business with Cuba after being acquired by a U.S. company. On February 7, 2019, OFAC announced a settlement with [Kollmorgen Corporation](#), a U.S. company, because its Turkish subsidiary continued conducting business in and with Iran after it was acquired by Kollmorgen.

These settlements highlight the importance of U.S. companies conducting enhanced sanctions due diligence on foreign targets during the M&A process, and implementing sanctions compliance policies at the new foreign subsidiaries. It is equally important to monitor the foreign subsidiaries' compliance with U.S. sanctions laws and internal policies. Failure by foreign subsidiaries to comply with OFAC regulations could result in significant penalties for both the parent and subsidiaries.

AppliChem

In 2012, Illinois Tool Works, Inc. (ITW), a U.S. company, acquired AppliChem, a Germany company. While conducting due diligence during the acquisition process, ITW found that AppliChem transacted with Cuba, and instructed AppliChem to cease such transactions post-closing. Foreign subsidiaries of U.S. companies are directly subject to the U.S. sanctions against Cuba. The former owners of AppliChem stayed on as managers, and despite the original notice and a subsequent warning, AppliChem continued its Cuban business. After ITW discovered this, it sent a third warning and submitted a voluntary self-disclosure to OFAC in January 2013. In that disclosure, ITW stated that AppliChem had ceased all Cuba-related transactions.

Three years later, ITW received an anonymous tip on its ethics hotline that AppliChem had still been conducting business in Cuba. ITW began an investigation and found that the former AppliChem owners had used various methods to conceal the Cuba business from ITW, including using an external logistics company and an independent consultant to prepare the necessary transaction documents. AppliChem had created policies to remove references to Cuba in documents relating to the Cuban business, and AppliChem senior management had even conducted trainings for staff to carry out these policies and to conceal the Cuba business from ITW. ITW voluntarily self-disclosed these violations to OFAC. Additionally, the former owners of AppliChem are no longer ITW employees.

OFAC determined that these violations constituted an egregious case, which is relatively uncommon in OFAC enforcement actions. In particular, OFAC found that aggravating factors included the use of written procedures to engage in willful violation of sanctions laws, the volume of sales over the course of five years—which was significantly harmful to the objective of maintaining an embargo on Cuba—and the sophistication of the company. OFAC found ITW’s cooperation, voluntary self-disclosure, and internal investigation to be mitigating factors. OFAC noted in the enforcement action that it was important for companies to ensure subsidiaries are complying with OFAC regulations, and to conduct follow-up due diligence on acquired foreign persons who have transacted with sanctioned persons and jurisdictions in the past. This includes conducting regular audits and remedial measures, as necessary, to address any negative sanctions compliance efforts.

Kollmorgen

Kollmorgen is a U.S. corporation with a Turkish affiliate, Elsim Elektroteknik Sistemler Sanayi ve Ticaret Anonim Sirketi (Elsim). Kollmorgen acquired Elsim in early 2013. During the due diligence process, Kollmorgen learned that Elsim conducted business with Iran. To prevent future business with Iran, Kollmorgen implemented various U.S. sanctions compliance measures. Under the Iran sanctions program, foreign subsidiaries of U.S. companies are directly subject to the U.S. sanctions against Iran, and the U.S. parent company is responsible for the subsidiary’s compliance. However, between July 2013 and July 2015, after the acquisition, Elsim willfully violated those compliance policies by sending employees to Iran to fulfill service agreements and then falsifying the travel records. If employees refused, Elsim threatened to fire them. Elsim also conducted other Iran-related transactions in that time.

Upon learning of these practices in late 2015, Kollmorgen began an investigation and reported the findings to OFAC. Elsim managers attempted to obstruct the investigation by deleting emails related to Iran, misleading Kollmorgen’s attorneys, and even directing employees to delete references to Iran in company records. After the violations became known, Kollmorgen took various remedial measures such as creating a training program to educate Elsim employees on compliance with U.S. trade laws and requiring Elsim to seek pre-approval from an officer based outside of Turkey for foreign service trips.

OFAC found the violations constituted a non-egregious case, and that Kollmorgen’s extensive preventative and remedial measures were mitigating factors. However, OFAC determined that a monetary penalty was appropriate because Elsim’s conduct had been egregious. The monetary penalty was fairly low because the transactions had been relatively low-value. As in AppliChem, OFAC noted that it was important to conduct and maintain heightened due diligence on related parties that have transacted with sanctioned parties or countries in the past, and to impose proactive controls after a U.S. company acquires such a business.

Additionally, in an apparent first, OFAC named an involved individual as a foreign sanctions evader. OFAC designated an Elsim manager primarily responsible for the conduct as a blocked person pursuant to Executive Order 13608.

Key Takeaways for Business

The AppliChem and Kollmorgen actions present important sanctions compliance lessons, especially for cross-border M&A activity. In order to mitigate the risk of successor liability for a target’s previous sanctions violations, acquirers should conduct thorough due diligence during the acquisition process to find any history of engagement with sanctioned entities or countries. The U.S. company should also implement clear U.S. sanctions compliance policies at the foreign subsidiary, particularly if the foreign company has conducted business with sanctioned parties in the past. After acquisition, U.S. companies

should also conduct regular audits of foreign subsidiaries to ensure compliance with OFAC regulations, and impose proactive controls and conduct follow-up due diligence to confirm that sanctioned country business has in fact been terminated.

While U.S. persons are prohibited from conducting or facilitating business in or with sanctioned countries, foreign subsidiaries of U.S. companies (including foreign portfolio companies of U.S. private equity funds) are generally directly subject to the U.S. sanctions against Iran and Cuba. As such, sanctions compliance issues often arise in the M&A context. While most acquirers focus on liability for past violations, it is also important to focus on future compliance by target companies that may not be familiar with U.S. sanctions laws. The AppliChem and Kollmorgen actions show that both the foreign subsidiary and the U.S. parent, and even employees, can be subject to enforcement actions.

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