

Transaction Due Diligence

The Office of Foreign Assets Control (OFAC), a sub-agency of the U.S. Department of the Treasury, administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy or economy of the United States. OFAC acts under Presidential national emergency powers, as well as authority granted by specific legislation, to impose controls on prohibited transactions. Many of the sanctions are based on United Nations and other international mandates, are multilateral in scope, and involve close cooperation with allied governments.

It is critical to understand that the regulated activities are ***not limited to only a function of export/import transactions***. The OFAC regulations require screening of persons and entities **prior** to conducting business activities, without regard to whether an export will occur or not. There are various legal authorities for U.S. sanctions programs including the Trading with the Enemy Act ([50 U.S.C. §§ 1-44](#), “TWEA”), which is the primary statutory authority for U.S economic sanctions; the International Emergency Powers Act ([50 U.S.C. §§ 1701-1706](#) “IEEPA”), the primary legal authority for new U.S. sanctions programs including ones relating to terrorism and regime-based threats; United Nations Participation Act ([22 U.S.C. § 287\(c\)](#), “UNPA”), implementing sanctions required by U.N Security Council resolutions; Foreign Narcotics Kingpin Designation Act ([21 U.S.C. §§ 1901-1908](#) and [8 U.S.C § 1182](#)); terrorism related statutes such as the International Security and Development Cooperation Act ([22 U.S.C. § 2349\(a\)](#)) and Antiterrorism and Effective Death Penalty Act ([8 U.S.C. § 231](#)); and various jurisdiction-based statutes, including statutes involving Cuba and Iran. The implementation authorities are found in Executive Orders and the OFAC regulations at [31 C.F.R. Chapter V](#).

Conducting comprehensive due diligence analysis prior to entering into an international transaction is critical to a company’s risk management strategy to avoid potential violations and hefty penalties.

Who Must Comply?

All U.S. persons must comply with OFAC sanctions. In the context of the regulations, “U.S. person” means:

- All U.S. citizens and permanent resident aliens, regardless of where they are located in the U.S.;
- All persons and entities in the U.S. regardless of nationality; and
- All U.S. incorporated entities and organizations, including foreign affiliates of U.S. entities.

In some circumstances, the OFAC regulations may also apply to foreign subsidiaries “owned or controlled” by U.S. entities, as well as to foreign persons in possession of U.S. origin goods. “Owned or controlled” by a U.S. person or entity means a U.S. person or entity:

- Holds a 50% or greater equity interest by vote or value in the foreign entity;
- Holds a majority of seats on the board of directors of the entity; or
- Otherwise controls the actions, policies, or personnel decisions of the entity.

How Do I Determine Who is a Party of Concern?

[Title 31 of the U.S. Code of Federal Regulations](#) is the principal set of rules and regulations issued by U.S. federal agencies regarding money, finance, and the treasury. Chapter V of Title 31 establishes governing procedures for transactions regulated under Title 31, as well as the OFAC’s administration of economic sanctions and penalties. The regulations are predominantly country specific and block or prohibit all U.S. persons or business entities from participating or facilitating, or conspiring with others to participate or facilitate, transactions with the country, person, or entity listed. The sanctions vary in scope from completely blocking all transactions with a country or entity, to blocking only specific types of transactions.

To avoid violations of these regulations, U.S. businesses should perform a review or “screening” of persons and business entities *prior* to engaging in the proposed business activity. In addition to the regulations themselves, the primary resource for sanctions screening is the Specially Designated Nationals and Blocked Persons list (SDN list) maintained by OFAC. Details about the SDN list and other OFAC sanctions lists, and access to a search tool, is available on the OFAC website: [OFAC SDN & Sanctions Lists and Search Tool](#). The SDN list is very lengthy and is amended and updated frequently so it is important to check the list regularly.

Other U.S. agencies maintain similar lists of restricted or denied persons and entities. For example, the Department of Commerce, Bureau of Industry and Security (BIS) administers other lists with parties of concern such as the “Denied Persons List,” “Entity List,” and “Unverified List.” The BIS lists identify individuals, entities, research institutions and government organizations that have been denied export privileges, are prohibited from receiving some or all U.S. export-controlled items due to a high risk of diversion to terrorists, or whose identity or purpose cannot be verified. Additional information and access to the BIS consolidated screening lists is available on the [BIS website](#).

The [Consolidated Screening List](#) (CSL) is a useful tool that may be used to conduct denied party screening. The CSL lists parties for which the U.S. Government maintains restrictions on certain exports, reexports, or transfer of items and is inclusive of BIS, OFAC, and Department of State lists.

Restricted, denied, and prohibited parties screening is only one aspect of transaction due diligence. Leveraging information provided by the party you intend to engage with, combined with independent

research, is also effective for reducing risk and complying with the trade regulations. Additionally, parties engaging in export transactions should obtain documentary evidence pertaining to the nature of, and parties to, the transaction; in particular, information pertaining to the ultimate end use, end user, and country of destination of the exported commodity (*i.e.*, physical items, technical data, and services).

Know Your Counterparty

A basic question to answer when performing transaction due diligence is “Who am I doing business with?”. Performing some independent research to gather information on a prospective business party can reveal potential risk factors that will help your company to determine if it is prudent to proceed with a transaction. For example:

- Perform an internet search of the person or entity to the transaction. A legitimate business’ website will generally contain clear and obvious information about the business. In most cases, legitimate foreign business websites in a native language will offer an English translation.
- Evaluate the entities credit worthiness and business licenses. Ask for financial references and copies of legal business registrations or licenses.
- If possible, visit the location provided by the person or business. If a physical visit is not possible, perform an internet map lookup of the location.

Red Flag Identification

When performing transaction due diligence, encountering information that seems inconsistent or abnormal for the given circumstances is referred to as a “Red Flag.” In general, Red Flags are anything that gives you pause or concern about the legitimacy of the person or entity with which you are considering engaging. For example:

- The company has no website or the information on the website about the nature of the business seems incongruent with the type of transaction you are potentially initiating with the entity;
- Transshipment of items in the transaction is requested through a country identified as a high risk for diversion for terrorism activities; or
- Payment terms of the transaction are inconsistent with standard accounting practices, such as a cash transaction for a significant business purchase.

For more details on Red Flag identification, refer to Torres Law Practice guide ***Red Flags in Transaction Due Diligence*** available in the Mondaq Advice Centre.

Unlawful Boycott Requests

All persons and businesses must abide by any lawful financial or economic sanctions or embargoes that apply to the relationship or country of the parties involved. But, under U.S. law, some embargoes and boycotts are unlawful. In performing transaction due diligence reviews, it is important to watch for conditions in the transaction that encourage or require support for prohibited embargoes or boycotts. For reference, BIS publishes a list of illustrative examples of transaction language indicative of unlawful boycott requests ([Unlawful Boycott Examples](#)).

Because sanctions, embargoes, and boycotts differ by country, it is important to understand those that will apply to each transaction. Is it recommended that you engage qualified legal counsel for advice on the boycotts or sanctions applicable in a particular jurisdiction.

Torres Law provides additional guidance in understanding sanctions, embargoes, and unlawful boycotts in the context of transaction due diligence in our *U.S. Export Controls And Sanctions Overview* available in the Mondaq Advice Centre.

What Business Activities Require Screening?

In general, when it is determined that a person or entity will (i) enter into a business transaction; (ii) conduct a monetary exchange (receive or pay money or other articles of monetary value); or, (iii) exchange any form of property, with another person or entity, a transaction due diligence review must take place.

Transaction due diligence should be performed prior to engaging in business activities and repeated at any point in the transaction where a new party or country is introduced into the transaction.

What do I do if an Issue is Discovered?

Stop and hold! Transaction due diligence procedures should include a direction to halt the transaction at any point when screening reveals a denied or restricted person or entity, where there are negative indicators, or unverifiable information is detected.

The Tip of the Iceberg

Transaction due diligence is a mission-critical task for any business. The information presented here is an overview of the basic tenets of transaction due diligence from a U.S. perspective, but is far from exhaustive or comprehensive. The complexities of the applicable laws and regulations involved can be quite difficult to navigate. It is highly recommended that you engage with qualified trade professionals and legal counsel to determine the appropriate due diligence to undertake for your business transactions.

As a companion to this Practice Guide, Torres Law also offers a *Transaction Due Diligence Checklist* available in the Mondaq Advice Centre.