



OFAC Violations From Sales Through Distributors and Sales Agents

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One of the most common methods of exporting is sales through overseas distributors, sales representatives and marketing agents. However, this also is one of the greatest areas of export compliance risk ? if your distributor sells to a prohibited country or prohibited party, your company can have liability in many instances.

A recent OFAC enforcement case drives this point home. In that case,[1] a U.S. company based in San Antonio, Texas sold live production and 3D animation hardware and software systems. According to the OFAC release, the company exported products and services to foreign distributors located in France and Dubai, UAE, and the distributors then resold the products to a purchaser in Iran. The Iranian purchaser resold a number of the products to a party on the OFAC List of Specially Designated Nationals (SDN List). In addition, on at least three occasions the U.S. company provided support, software updates, reseller training and other services in support of sales to customers located in Iran. OFAC alleged that, when the company sold the products to the distributors, it had ?knowledge or reason to know? that the products would be resold by the distributors to Iran and charged the company with 52 apparent violations of the OFAC Iranian Transactions and Sanctions Regulations. OFAC provided the following assessment of the reasons behind the violations:

NewTek did not have export control or sanctions compliance policies or procedures in place during the relevant time period and did not provide training to personnel regarding export control or sanctions compliance. NewTek incorrectly believed that its product sales through third-party distributors to the Iranian Reseller were in accordance with applicable sanctions regulations in part because NewTek did not deal directly with Iran, but rather through a third-country intermediary. (Emphasis added.)[2]

In this case, OFAC presented evidence that the exporter had *actual* knowledge that the products would be resold to Iran.[3] However U.S. companies can also be liable for sales through distributors *even if they do not have actual knowledge that the distributors would be reselling the product to a prohibited country or prohibited party.* This is addressed in the well-known OFAC enforcement case involving Epsilon Electronics.[4] In that case, the U.S. exporter sold products to a company in the UAE, and the UAE company resold the product to purchasers in Iran. OFAC alleged that, while the U.S.

company may not have had actual knowledge that the products would be sold to Iran, it had "reason to know" that they would be. OFAC had identified significant information that was available to the public showing 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 showing that the UAE company distributed products in Iran, had an address in Iran and engaged in other activities in Iran. OFAC concluded that, based upon this information being available to the public through the Internet, 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. Based on these violations, the company was penalized for \$4,073,000 (this penalty was later reduced to \$1,500,000). OFAC's guidance on this issue is 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, but includes those situations where the seller had reason to know that the goods were specifically intended for Iran, 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[5]

There are steps that a company can take to help reduce the likelihood of such violations. Perhaps the most important is conducting careful due diligence reviews of distributors, sales representatives, agents and other third-party intermediaries to identify any information suggesting that they conduct business with prohibited countries or prohibited parties or have a reputation for other law enforcement problems. Other compliance steps to consider include: (i) using contract clauses or export certifications in which the distributor agrees not to export the U.S. product to prohibited countries/parties; and (ii) requesting the distributor to obtain end use statements from ultimate purchasers which would then be provided to the U.S. exporter. Of course, OFAC's compliance guidelines also recommend the use of compliance programs and conducting employee training. However, no single step by itself automatically relieves the U.S. exporter from responsibility for export violations, and there is no substitute for a heightened level of care in the compliance process.

Sales through third party intermediaries can be a valuable strategy for international sales. But a sale to a third party intermediary, by itself, does not get you off the hook if your product winds up in the hands of a bad guy or in a bad country.

For additional resources for small and mid-sized government contractors and suppliers on ITAR compliance please see:

- Understanding the OFAC Sanctions Laws
- Avalanche of Recent Export Requirements for China, Russia And Other Countries
- Dealing with Violations in Export and Import Transactions

To learn about how Williams Mullen can assist your company in ITAR compliance, please click [here](#).

[1] See OFAC Enforcement Release: September 9, 2021, OFAC Settles With NewTek, Inc. For Its Potential Civil Liability For Apparent Violations of the Iranian Transactions and Sanctions Regulations, available on the OFAC website (Enforcement Release).

[2] See Enforcement Release, p. 2.

[3] See Enforcement Release, p. 2.

[4] See (i) OFAC Enforcement Information For July 25, 2014: Epsilon Electronics Inc. Assessed a Penalty for Violating the Iranian Transactions and Sanctions Regulations, available on OFAC website; (ii) OFAC Enforcement Information For September 13, 2018: Epsilon Electronics, Inc. Settles Potential Civil Liability for Alleged Violations of the Iranian Transactions and Sanctions Regulations and Related Claims, available on OFAC website; (iii) Epsilon Electronics, Inc., v. U.S. Department of the Treasury, Office of Foreign Assets Control, 168 F. Supp. 3d 131 (D.D.C. 2016); and (iv) Epsilon Electronics, Inc., v. U.S. Department of the Treasury, Office of Foreign Assets Control, 857 F.3d 913 (D.C. Cir. 2017).

[5] See OFAC's Guidance On Transshipments To Iran? available on the OFAC website at:

<https://home.treasury.gov/system/files/126/iranship.pdf>.

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