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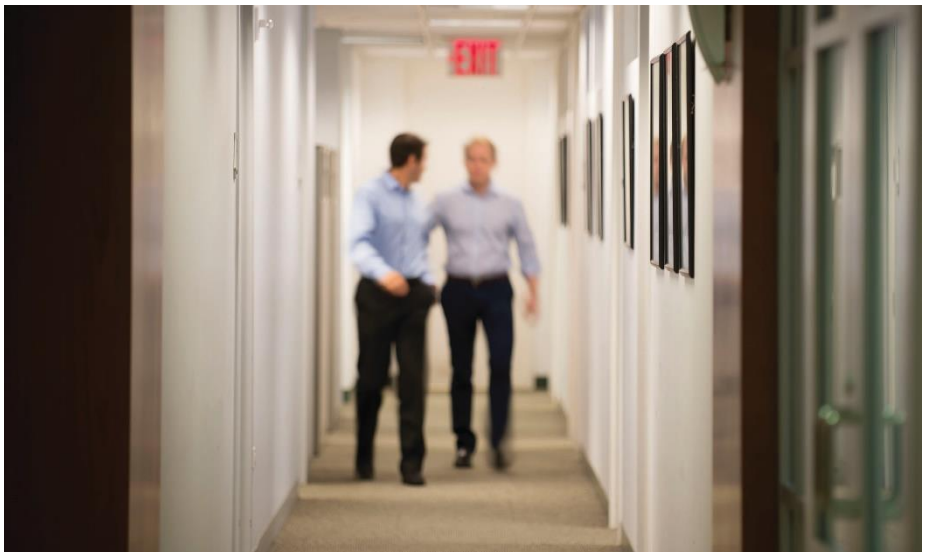
BRIEFING

EXXONMOBIL PENALTY ASSESSMENT ILLUSTRATES PERILS OF DEALING WITH SANCTIONED OFFICERS AND DIRECTORS

JULY 2017

- OFAC HAS ASSESSED A $2M PENALTY AGAINST EXXONMOBIL FOR VIOLATING RUSSIAN SANCTIONS
- THE COMPANY HAS DEALT WITH A SANCTIONED PERSON AT A COMPANY NOT ITSELF SUBJECT TO SANCTIONS.
- THE CASE IS A REMINDER TO EXERCISE CAUTION WHEN DEALING NOT JUST WITH COMPANIES BUT ALSO THEIR OFFICERS AND DIRECTORS.



On July 20, 2017, the US Department of Treasury's Office of Foreign Assets Controls (OFAC) assessed a $2m penalty against US oil conglomerate ExxonMobil for its violation of US sanctions on Russia enacted in response to Russia's 2014 intervention in Ukraine (the "Russia-Ukraine sanctions"). The penalty was assessed because of ExxonMobil's dealings with a sanctioned officer of a Russian company, even though the company itself was not subject to these sanctions. ExxonMobil is challenging the assessment, and has filed suit to have the penalty set aside.

"US SANCTIONS PROGRAMS CONTAIN BROAD PROHIBITIONS ON THE ABILITY OF US PERSONS TO DEAL WITH SPECIALLY DESIGNATED NATIONALS."

The assessment illustrates the importance of diligence, representations and covenants in dealings with not only counterparty companies, but also the company's officers and directors, as well as the limits of informal guidance in dealing with sanctions.

Russia-Ukraine sanctions

In March 2014, OFAC enacted a new US sanctions regime in response to Russia's military intervention in Ukraine. The sanctions included limited "sectoral sanctions," which prohibited only certain types of transactions with major Russian energy and financial companies, but also included more traditional sanctions, which designated certain individuals (mostly those loosely affiliated with President Vladimir Putin or his administration) as "specially designated nationals" (SDNs). US sanctions programs (including the Russia-Ukraine sanctions) contain broad prohibitions on the ability of US persons to deal with SDNs, and generally require all payments to and from SDNs that transit through a US financial institution to be blocked.

In April 2014, as part of the Russia-Ukraine sanctions program, OFAC designated Rosneft, a state-owned Russian oil company, as subject to limited sectoral sanctions that generally prohibited US persons from providing financing to Rosneft or engaging in certain transactions with Rosneft relating to Arctic offshore, deepwater or shale oil. OFAC also designated Igor Sechin, CEO of Rosneft, as an SDN.

Transactions at issue

In May 2014, after the Russia-Ukraine sanctions had been implemented and Rosneft and Mr. Sechin had been designated, officers of ExxonMobil and Rosneft signed eight legal documents related to oil and gas projects in Russia. As described in ExxonMobil's complaint responding to the assessment, the documents related to pre-existing business relationships that ExxonMobil had had with Rosneft. Seven of the documents memorialized the completion of certain conditions precedent related to joint projects in the Arctic, and the eighth memorialized the extension of a pre-existing agreement related to natural gas development in the Russian Far East.

The documents were signed by officers of ExxonMobil and by Mr. Sechin on behalf of Rosneft.

OFAC's Assessment of Penalties

The Russia-Ukraine sanctions prohibit a US person from having any dealings in property of an SDN. The related OFAC regulations define "property" broadly to include services. OFAC determined that Mr. Sechin's signing of the documents constituted a service, and that ExxonMobil had "dealt in" such services in violation of the sanctions. OFAC rejected ExxonMobil's argument that Mr. Sechin's actions were taken in his professional capacity as CEO of Rosneft, and not in his personal capacity, claiming that no such distinction was made in the regulations. OFAC also cited a frequently asked question relating to the Burma/Myanmar sanctions program (which has since been repealed) in which OFAC advised that a contract of a non-prohibited entity that is signed by an SDN may result in a violation. OFAC dismissed contemporaneous informal government guidance cited by ExxonMobil suggesting that the transaction would not be prohibited.

"THE MAXIMUM STATUTORY CIVIL PENALTY FOR A US SANCTIONS VIOLATIONS IS EQUAL TO THE GREATER OF $250,000 AND TWICE THE AMOUNT OF THE TRANSACTION THAT IS THE BASIS OF THE VIOLATION."

Interestingly, OFAC did *not* cite two additional frequently asked questions (FAQ #398 and 400), which make very clear its view that receiving a signed contract and engaging in other business transactions with an SDN working on behalf of a non-sanctioned entity is prohibited. These FAQs were probably not cited because they were issued in August 2014, in conjunction with OFAC's new guidance regarding the treatment of an entity that is owned or controlled by an SDN, and therefore were not available when the ExxonMobil transactions at issue occurred.

The maximum statutory civil penalty for a US sanctions violations is equal to the greater of $250,000 and twice the amount of the transaction that is the basis of the violation. It is unclear how the "amount" of the transactions at issue would be calculated, so presumably the $2m penalty was calculated by multiplying $250,000 by the eight documents. OFAC determined that the violation was egregious with aggravating factors, and therefore did not reduce the maximum penalty amount.

ExxonMobil's response

On the same day as OFAC issued its assessment, ExxonMobil filed suit in US federal district court in the State of Texas, seeking to have the assessment set aside. ExxonMobil cited several government statements released in conjunction with the

Russia-Ukraine sanctions, arguing that these make clear that the sanctions against Mr. Sechin and the other SDNs were intended to target their personal wealth and not their business actions, and applied to Mr. Sechin only in his individual capacity. ExxonMobil further argued that Mr. Sechin's "services" in signing the documents were to his employer Rosneft, not to ExxonMobil. Finally, ExxonMobil argued that the Burma/Myanmar frequently asked question did not apply, as it related to a separate sanctions program.

"EXXONMOBIL'S COMPLAINT MAKES CLEAR THAT OFAC'S DETERMINATIONS IN THIS CASE WERE FORMULATED, IN PART, DURING THE ADMINISTRATION OF FORMER PRESIDENT BARACK OBAMA, SO IT APPEARS THAT THE CASE IS NOT *JUST* ABOUT POLITICS."

Political and business contexts

This case cannot be separated from its political and business contexts. At the time of the transactions at issue, the CEO of ExxonMobil was Rex Tillerson, current US Secretary of State under President Donald Trump. Mr. Tillerson was a friend of Mr. Sechin, and vocally opposed the sanctions when they were enacted (he has recused himself from the current matter, and OFAC's position is effectively represented by US Secretary of Treasury Steven Mnuchin). Nevertheless, ExxonMobil's complaint makes clear that OFAC's determinations in this case were formulated, in part, during the administration of former President Barack Obama, so it appears that the case is not *just* about politics.

Also of interest is the amount at issue. For a company as large as ExxonMobil, $2m is a relatively small figure, and one might expect it to settle with OFAC rather than litigating. However, ExxonMobil may wish to establish a precedent giving it the unfettered right to deal with Rosneft and other non-SDN companies without worrying about violating sanctions.

Importance of diligence, representations and covenants

While the ExxonMobil case is somewhat unique owing to the political and business contexts, it contains an important lesson regarding dealings with non-sanctioned entities whose directors or officers are SDNs.

In the wake of multiple high-profile penalty assessments for sanctions, parties entering into cross-border transactions such as loans, leases and joint ventures are increasingly performing significant due diligence to confirm that their counterparties are not subject to sanctions. Contracts also frequently include a representation that the counterparty companies are not subject to sanctions, and a provision permitting the contract to be terminated if the company becomes sanctioned.

Parties also often perform diligence regarding a counterparty's officers and directors, and include contractual protective language that the counterparty's officers and directors are not subject to sanctions. However, less attention is generally paid to directors and officers. This case demonstrates the importance of also covering directors and officers in diligence and contracts.

As a best practice, before commencing any new transaction with a company, US persons and others who wish to comply with US sanctions should perform a search of both the company's name and its officers and directors, confirming that none of them are subject to sanctions. Then, in negotiating the agreement, the parties should include representations and covenants designed to prevent prohibited transactions with officers or directors that are SDNs. The agreement may include representations that none of the officers or directors of the counterparty entity (and potentially its subsidiaries and/or affiliates) are sanctioned persons. Covenants that no such directors or officers *will become* sanctioned persons may be more difficult to

negotiate, since this is often beyond the parties' control. At the very least, parties should include a notification obligation if any directors or officers become sanctioned persons, so that they can exercise caution going forward.

"PARTIES THAT WISH TO AVOID BEING SUBJECT TO SIMILAR PROCEEDINGS SHOULD CAREFULLY MONITOR THEIR TRANSACTIONS WITH DIRECTORS AND OFFICERS OF A NON-SANCTIONED COUNTERPARTY."

Reliance on informal guidance and administrative intent

Another useful lesson that the ExxonMobil case illustrates is parties' limited ability to rely on informal guidance and administrative intent in interpreting sanctions. In its complaint, ExxonMobil cited numerous verbal and written statements by Obama administration officials in support of its contentions that the Russia-Ukraine sanctions should be narrowly construed, were intended to target the personal assets of the listed individuals, not the companies they manage, and would not impede the ability of US persons to do business with Rosneft. OFAC was apparently unmoved by these arguments, even going so far as to call ExxonMobil's actions egregious, rather than good faith reliance on government statements. Parties should exercise caution in relying on any such informal guidance in the face of contrary official regulations or interpretations.

It remains to be seen how the ExxonMobil case will turn out. Nevertheless, parties that wish to avoid being subject to similar proceedings should carefully monitor their transactions with directors and officers of a non-sanctioned counterparty and should limit their reliance on informal guidance.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with the author below or your regular contact at Watson Farley & Williams.

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