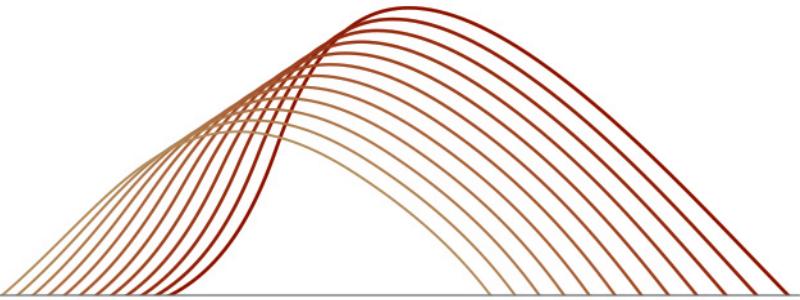


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United States of America v. Reza Zarrab: *The Long Reach of U.S. Sanctions May Have Just Gotten Longer*

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On March 19, 2016, two months after easing sanctions against Iran as part of the implementation of the so-called Joint Comprehensive Plan of Action ("JCPOA") nuclear accord, U.S. authorities arrested prominent Turkish businessman Reza Zarrab upon his arrival in Florida from Istanbul for a Disney World vacation with his wife and daughter.¹ Mr. Zarrab's arrest has garnered extensive media attention, focusing largely on the diplomatic implications of the case.² But the implications for other non-U.S. persons conducting business with governments and companies subject to the long reach of U.S. sanctions programs are equally significant, regardless of political profile.

The indictment unsealed at the time of the arrest alleged that Mr. Zarrab owns and operates a network of companies located in Turkey and the United Arab Emirates that he, along with two co-conspirators, used to provide a means for parties to transfer funds for dollar-denominated Iran-related transactions through U.S. financial institutions in violation of the sanctions.³ In a press release announcing the charges, the Department of Justice asserted that the defendants "engag[ed] in hundreds of millions of dollars-worth of transactions on behalf of the government of Iran and other Iranian entities, which were barred by U.S. sanctions, laundering the proceeds of those illegal transactions and defrauding several financial institutions by concealing the true nature of these transactions."⁴

In July, Mr. Zarrab's legal team moved to dismiss the indictment as an illegal and unwarranted attempt to extend the U.S. sanctions program to persons and activities they were never intended to cover. On October 17, 2016, Judge Richard Berman of the Southern District of New York denied the motion to dismiss in a ruling that is noteworthy on two fronts.

First, the Judge found that a domestic nexus between a foreign national and the United States can be established under U.S. sanctions laws where the foreign national's only "exportation of services from the United States" is a funds transfer through a U.S. bank. This sets the bar to establishing a domestic nexus in a case against a foreign national as low as it has ever been.

Second, Judge Berman's Order suggests that certain U.S. criminal sanctions laws may be applied far beyond U.S. borders, potentially even in cases where U.S. prosecutors fail to clearly establish any nexus between the criminal allegations in the indictment and the United States. While Judge Berman found a sufficient domestic nexus in the case against Mr. Zarrab, he went on to state that certain

U.S. sanctions laws apply extraterritorially and support a U.S. court's jurisdiction where the "law at issue is aimed at protecting the right of the government to defend itself." (See Decision and Order, dated October 17, 2016, at 18 ("Order").) Judge Berman's Order and discussion on the topic of extraterritoriality further illustrate that the reach of U.S. sanctions law has never extended so far.

The Long Reach of U.S. Sanctions

Even as it lifted restrictions against dealings with Iran by non-U.S. persons located outside the United States, the Office of Foreign Assets Control ("OFAC") underscored that sanctions remain in place against most Iran transactions by U.S. persons or involving the export of goods, technology or services, directly or indirectly, to Iran from the United States.⁵

On this basis, OFAC warned that "foreign financial institutions...need to continue to ensure they do not process U.S. dollar-denominated transactions involving Iran through the U.S. financial system or otherwise involve U.S. financial institutions (including their foreign branches), given that U.S. persons continue to be prohibited from exporting goods, services (including financial services), or technology directly or indirectly to Iran...."⁶

This aspect of the Iran sanctions program has been invoked by prosecutors to pursue transactions by non-U.S. persons located entirely outside the territory of the United States, should that conduct "cause" financial services—e.g., U.S. dollar clearing—to be "exported" from this country by U.S. financial institutions in support of Iran-related transactions.

Reza Zarrab's Motion to Dismiss

On July 18, 2016, Mr. Zarrab filed a motion to dismiss the Indictment in its entirety. (See Def.'s Motion to Dismiss, dated July 18, 2016 ("Mot. to Dismiss").) Mr. Zarrab argued that he is the victim of "prosecutorial overreach" and that the charges levied against him are an attempt by the U.S. government to apply U.S. sanctions laws extraterritorially in an unprecedented fashion. The motion notes that he is being "accused of violating U.S. law for agreeing with *foreign* persons in *foreign* countries to direct *foreign* banks to send funds transfers from *foreign* companies to other *foreign* banks for *foreign* companies." (Mot. to Dismiss at 1) (emphasis in original.) Finally, the motion asserts that Mr. Zarrab's business activities should not be subject to U.S. sanctions laws as "there is no allegation that [he], or the alleged conspirators, are either U.S. citizens or permanent residents, nor that they were physically located within U.S. territory at the time of the alleged overt acts." (Mot. to Dismiss at 10.)

Judge Berman's Order

On October 17, 2016, Judge Berman issued an Order denying Mr. Zarrab's motion to dismiss, thereby allowing the sanctions charges against him to move forward. Judge Berman's Order is not a ruling upon the ultimate merits of either party's claims. It does, however, illustrate that a judge in the influential Southern District of New York is willing to consider criminal sanctions penalties for alleged deceitful acts of a foreign national made primarily outside of the United States which target and involve the U.S. banking system.



I. Conspiracy to defraud the United States and to impede the lawful functions of the United States Department of Treasury, Office of Foreign Assets Control (“OFAC”) in violation of 18 U.S.C. § 371.

The first sanctions charge leveled against Mr. Zarbab alleged that he and his associates engaged in what is commonly referred to as a “Klein conspiracy;” they conspired to defraud the United States and to impede the lawful functions of OFAC in violation of 18 U.S.C. § 371. Judge Berman found that the prosecution proved the elements of a Klein conspiracy, which are “(1) that the defendant entered into an agreement (2) to obstruct a lawful function of the Government (3) by deceitful or dishonest means and (4) at least one overt act in furtherance of the conspiracy.” *United States v. Ballistrea*, 101 F.3d 827, 832 (2d Cir. 1996). Judge Berman found that the Indictment set forth “each of the elements of a Klein conspiracy.” (Order at 7.)

Judge Berman concluded that the Government sufficiently alleged that Mr. Zarbab and his co-conspirators deliberately concealed payments involving Iran behind a network of exchanges and companies, preventing both U.S. banks and the U.S. government from identifying the fact that he was transmitting prohibited payments on behalf of Iran through U.S. banks. Judge Berman also found persuasive the Government’s allegation that “the defendant willfully concealed information knowing that the screening functions implemented by [U.S.] banks seeking to comply with OFAC regulations would block the transactions in which he was engaging, and thereby explicitly obstructed the lawful function of OFAC regulations by deceitfully processing transactions with incomplete information.” (Order at 7.)

Ultimately, Judge Berman agreed with the Government’s contention that, under § 371, “all that is necessary is that the scheme had the object of making it more difficult for [OFAC] to carry out its lawful functions and that the scheme depend on dishonest or deceitful means.” (Order at 8.) In allowing the Government’s case to move forward, Judge Berman found that prosecutors had sufficiently alleged that Mr. Zarbab and his co-conspirators had engaged in business transactions where relevant information regarding sanctioned entities was withheld from U.S. banks in a deceitful manner that made it more difficult for both the banks to comply with the law and OFAC to carry out its lawful functions.

II. Conspiracy to violate the International Emergency Economic Powers Act (“IEEPA”), 50 U.S.C. §§ 1701-1706, and the Iranian Transactions and Sanctions Regulations (“ITSR”), 31 C.F.R. §§ 560.202-205.

The second sanctions charge leveled against Mr. Zarbab alleged that he and his associates conspired to violate the IEEPA and the ITSR. In finding that the Indictment clearly sets forth the elements of a conspiracy to violate those statutes, Judge Berman noted that the Indictment alleges facts that illustrate that Mr. Zarbab and his co-conspirators committed a series of overt acts, including “design[ing] layered transactions using intermediary shell companies in third countries and stripping Iran-revealing information from payment instructions that would be provided to U.S. Banks.” (Order at 14.) Judge Berman also appeared to find persuasive the Government’s allegation that Mr. Zarbab “knew that U.S. banks would block his transactions if the Iranian nexus were revealed, and, in fact, sometimes did block his transactions.” Id.

Mr. Zarbab’s motion to dismiss argues that “none of the executed or contemplated transactions trigger criminal liability because [he] did not export or conspire to export anything from the United States.” (Mot. to Dismiss at 11) The Government countered that “there is no doubt that a financial transaction [as here] in which a U.S. bank sends funds overseas is a ‘service’ [within the meaning of § 560.204]

that is exported or supplied from the United States or by a U.S. person." (Order at 12.) Judge Berman agreed with the prosecution team. He further agreed with the Government's contention that "the Indictment is not an extraterritorial application of the IEEPA and the ITSR...[because] Zarbab is charged in connection with his scheme to intentionally export and supply financial services from the United States and to cause U.S. banks to export and supply financial services—in other words, with causing conduct and effects in the United States." Id.

Mr. Zarbab further argued that "the mere fact that a U.S. bank cleared a payment originating and terminating at foreign banks...does not somehow transform the payment into a 'U.S. export' by [Mr. Zarbab]." (Mot. to Dismiss at 12.) Judge Berman disagreed, citing to a series of Second Circuit cases holding that the execution of money transfers from a U.S. bank constitutes the "exportation of a service" under U.S. sanctions laws. See *United States v. Banki*, 685 F.3d 99, 106 (2d. Cir. 2012), as amended (Feb. 22, 2012); *United States v. Homa International Trading Corp.*, 387 F.3d 144, 146 (2d Cir. 2004). While this is not a novel legal conclusion, Judge Berman's support for this interpretation of what "constitutes" a service under the IEEPA and the ITSR further clarifies that certain unlawful funds transfers will expose foreign nationals to criminal liability in U.S. courts. In other words, if U.S. prosecutors identify deceitful behavior by a foreign national acting abroad in connection with a funds transfer processed by a U.S. bank—such as the design of layered transactions using shell companies or the stripping of information that reveals information about an Iranian entity—then they can bring charges against said foreign national in U.S. courts under the IEEPA and the ITSR.

Key Takeaways

I. The "Domestic Nexus" Test: Low Bar for Prosecutors

In the case of Mr. Zarbab, U.S. prosecutors concede that neither he nor his alleged co-conspirators are U.S. citizens or permanent residents. Furthermore, the prosecution team presents no evidence that the participants in the conspiracy were physically located in the United States at the time of the alleged overt acts. Yet, a federal judge in the Southern District of New York found a sufficient domestic nexus to allow the case to move forward. What does this mean for a foreign national who engages in business that involves cross-border financial transactions?

- First, foreign nationals must recognize that if any part of a financial transaction involves or involved the participation of a U.S. bank, if there is evidence of intent to deceive U.S. banks, and if the transaction will or did ultimately benefit a sanctioned Iranian entity, then foreign nationals may be criminally liable in their personal capacity under the U.S. sanctions regime.
- Second, a long relied upon defense in the criminal sanctions context—that the jurisdictional arguments made by prosecutors to establish a domestic nexus are too attenuated—continues to be challenged. This is especially true in cases where the indictment alleges specific transactions through U.S. banks, transactions that may not have occurred but for some intentional effort to deceive those banks, a key factor in the Zarbab decision.
- Third, OFAC regulators, in-house bank compliance experts, and federal prosecutors are carefully scrutinizing cross-border financial transactions to determine whether any information related to a sanctioned entity involved in such transactions has been stripped or is being purposefully withheld. U.S. government officials are vigorously investigating and eager to prosecute attempts by companies and individuals to hide the involvement of sanctioned entities in cross-border financial transactions.

- Fourth, until there is more clarity under the JCPOA regarding how business can be lawfully conducted with Iranian entities, conducting business with such entities remains extremely risky, whether you are a foreign national or U.S. citizen.

II. Extraterritoriality: Cause for Future Concern?

Mr. Zarbab argued that the IEEPA and the ITSR do not apply extraterritorially to reach his actions. Judge Berman concluded that he did not have to address the question of extraterritoriality, as he found that the Indictment alleged a domestic nexus between Mr. Zarbab and his co-conspirators' conduct and the United States, i.e., the exportation of services from the United States. (Order at 17.)

Nonetheless, he appeared to agree with the Government that even if the Indictment were considered an extraterritorial application of the IEEPA and the ITSR, there is no presumption against extraterritoriality. (Order at 18 (noting that if the "issue of extraterritoriality were to be reached, Zarbab's argument that IEEPA and ITSR do not apply extraterritorially would likely prove unpersuasive.")) This is so, the Government argued, because the IEEPA and the ITSR are an exercise of the government's right to defend itself, and the IEEPA and the ITSR are part of Congress' delegation of authority to the President to deal with threats.

What does this mean for foreign businesspersons going forward? It is hard to say. The Judge did not have to reach the issue of extraterritoriality and discussed the issue in dicta, and it is hard to imagine U.S. prosecutors seeking to bring a case against a foreign national where they could not provide the scintilla of evidence required to establish a domestic nexus. Yet, given that the case of Reza Zarbab has already pushed the boundaries of when and where a foreign national can be charged under U.S. sanctions laws, an eager prosecutor may next set sights on bringing charges against a foreign national operating overseas where a domestic nexus is lacking entirely, under the theory that the IEEPA and the ITSR can be applied extraterritorially. Stay tuned.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington D.C. lawyers:

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- ¹ Despite zealous efforts by able counsel, Mr. Zarrab has been in custody since his arrest and is currently being held at a federal detention center in Lower Manhattan.
 - ² Mr. Zarrab is a high-profile figure in his native country. In 2013, Turkish authorities detained Mr. Zarrab as part of a wide-ranging corruption investigation of businessmen with ties to then Prime Minister Recep Tayyip Erdogan. Mr. Erdogan, now the Turkish president, has accused the U.S. government of trying to implicate him through their prosecution of Mr. Zarrab. See "Iran Sanctions Case against Turkish Trader Reza Zarrab to Move Forward," WALL STREET JOURNAL, October 17, 2016.
 - ³ Mr. Zarrab was charged in a four-count Superseding Indictment ("Indictment"), which included the following sanctions violations: (1) Conspiracy to Defraud the United States and to impede the lawful functions of the United States Department of Treasury, Office of Foreign Assets Control ("OFAC") in violation of 18 U.S.C. § 371; and (2) Conspiracy to violate the International Emergency Economic Powers Act ("IEEPA"), 50 U.S.C. §§ 1701-1706, and the Iranian Transactions and Sanctions Regulations ("ITSR"), 31 C.F.R. §§ 560.202-205.
 - ⁴ <https://www.justice.gov/opa/pr/turkish-national-arrested-conspiring-e evade-us-sanctions-against-iran-money-laundering-and>.
 - ⁵ The primary basis of this prohibition is found in the ISR, including 31 C.F.R. § 560.204 ("[T]he exportation, reexportation, sale, or supply, directly or indirectly, from the United States, or by a United States person, wherever located, of any goods, technology, or services to Iran or the Government of Iran is prohibited....").
 - ⁶ "Frequently Asked Questions Relating to the Lifting of Certain U.S. Sanctions Under the Joint Comprehensive Plan of Action (JCPOA) on Implementation Day" (Last Updated October 7, 2016) ("JCPOA FAQ") C.7. at 15, available at https://www.treasury.gov/resource-center/sanctions/Programs/Documents/jcpoa_faqs.pdf.

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