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New Risks For US Cos. Inadvertently Supporting North Korea

By **Harry Clark, Ellen Murphy, Matthew Moses and Elizabeth Morgan** (July 24, 2018, 4:01 PM EDT)

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Many businesses no doubt think that they face minimal exposure under U.S. sanctions against North Korea. But many should reassess this view and take steps to reduce the risk of unwittingly and unlawfully relying on North Korean supplies or labor — particularly if they do business in high-risk jurisdictions such as China, Russia or African countries. An advisory issued on July 23, 2018, by the U.S. Department of State, with the U.S. Department of Treasury's Office of Foreign Assets Control and other federal agencies, highlights evasion tactics used by North Korea that could expose companies and financial institutions to very real compliance sanctions risks.[1]

The advisory aims to help businesses manage the risk of violating the North Korea sanctions prohibitions and the risk of being sanctioned under the "secondary" sanctions provisions of the Korean Interdiction and Modernization of Sanctions Act of the Countering America's Adversaries Through Sanctions Act, which became law on Aug. 2, 2017. President Donald Trump subsequently issued an executive order on Sept. 21, 2017, "Imposing Additional Sanctions with Respect to North Korea."[2] The executive order laid the groundwork for expanded U.S. sanctions targeting North Korea, including by imposing secondary sanctions on foreign financial institutions.

In light of the robust U.S. sanctions regime against North Korea, the advisory highlights two primary risks: (1) inadvertent sourcing of goods, services or technology from North Korea and (2) the presence of North Korean citizens or nationals in companies' supply chains, whose labor generates revenue for the North Korean government.

Identifying Goods or Services With a Link to North Korea

Companies conducting business abroad should consider enhancing their due diligence and monitoring to be on the lookout for several areas of heightened risk that may have a nexus to North Korea, as delineated in the advisory:

- Subcontracting or consignment firms who may shift work to a North Korean factory without informing the customer.

- Mislabeled goods, services or technology, which are produced in North Korea but affixed with labels that identify a third country (e.g., "Made in China").

- Joint ventures between firms in third countries (notably China) and North Korean firms in various industries, such as apparel, construction, small electronics, hospitality, minerals, precious metals, seafood and textiles. The advisory includes a list of joint ventures that have operated or are currently operating in North Korea established prior to 2016.[3]

- Raw materials or goods provided with artificially low prices from North Korean exporters who often sell goods and raw materials well below market prices to intermediaries and other traders.

- Information technology services sold by North Korea, including website and app development, security software, and biometric identification software that have military and law enforcement applications. North Korean firms disguise their footprint through a variety of tactics including the use of front companies, aliases and third country nationals who act as facilitators.

Heightened Risk Factors for Use of North Korean Labor

Companies should also consider reviewing their supply chains for the concealed presence of North Korean overseas labor to the extent that such labor is organized, managed and overseen by, and produces revenue for, the North Korean government. In particular, the advisory identifies several industries and countries that involve an increased risk that proceeds from labor are being funneled to the North Korean government, including in industries like IT services, medical and pharmaceutical, among others. Although China and Russia host more North Korean laborers than all other countries combined, the advisory identifies more than 40 other countries in which North Korean laborers are known to be present.

When reviewing supply chains, companies should be on the lookout for certain red flags associated with use of North Korean overseas labor, including unusual restrictions on how wages are paid, employment contracts that require large upfront payments to the North Korean government, unsafe and unsanitary housing conditions for laborers, exercise of excessive control by employers over laborers, and lack of transparency regarding the employment arrangement.

Penalties for Violations of Sanctions and Enforcement Actions

Penalties under the relevant statutes and regulations can be severe. Moreover, sanctions violations are subject to strict liability, meaning that businesses may be liable even if they did not know or intend to conduct business with North Korea.

Companies or individuals who violate U.S. sanctions with respect to North Korea can be subject to civil monetary penalties and/or referred for criminal prosecution. The monetary penalties are equal to the greater of twice the value of the underlying transaction or $295,141 per violation.

Mitigating Risk and Liability Through Due Diligence Best Practices

Businesses — particularly those operating in high-risk countries or industries — should closely examine their supply chains for North Korean laborers and goods, services or technology. Moreover, well-documented due diligence policies and practices may be considered mitigating factors in determining the appropriate enforcement response. For specific recommendations of due diligence practices and potential mitigating factors, the advisory refers businesses to CAATSA Title III Section 321(b) FAQs[4] and OFAC's Economic Sanctions Enforcement Guidelines.[5]

Spotlight on Secondary Sanctions — Sanctions on Foreign Financial Institutions

Foreign financial institutions should also be cognizant of risks related to conducting or facilitating business with North Korea. Pursuant to Executive Order 13810, the United States now imposes sanctions on foreign financial institutions that knowingly conduct or facilitate significant transactions on behalf of certain blocked persons or in connection with trade with North Korea.[6] Such sanctions can include restrictions on correspondent or payable-through accounts or full blocking sanctions. As Treasury Secretary Steven Mnuchin noted in his remarks announcing EO 13810, "foreign financial institutions are now on notice that, going forward, they can choose to do business with the United States or with North Korea, but not both."[7]

Concluding Recommendations

North Korea is actively engaging in deceptive practices to disguise the origin of North Korean goods, services and technology, and the nationality of its overseas workers. With the recent advisory, U.S. businesses and foreign financial institutions are now on notice that the U.S. government expects them to mitigate those risks though effective due diligence policies, procedures and internal controls.

Companies should consider a risk-based reassessment of their policies, procedures and internal controls in light of the red flags identified in the advisory. Such a review may include, among other things, screening counterparties against the list of North Korean joint ventures listed in Annex 2 (even though it is not a "sanctions list"), increasing due diligence and monitoring in high-risk jurisdictions and with business partners in high-risk industries, considering whether to exercise audit rights with respect to certain third-country suppliers, reviewing and updating risk assessments, and conducting additional training to highlight deceptive practices employed by North Korea and related supply-chain risks.

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[1] See North Korea Sanctions & Enforcement Actions Advisory, "Risks for Businesses with Supply Chain Links to North Korea," Department of State (July 23, 2018), available at https://www.treasury.gov/resource-center/sanctions/Programs/Documents/dprk_supplychain_advisory_07232018.pdf

[2] Executive Order ("E.O.") No. 13810, 82 Fed. Reg. 184 (Sept. 25, 2017)

[3] See Advisory, Annex 2, at 9–15

[4] CAATSA Title III Section 321(b) FAQs, FAQ 8 (March 30, 2018), available at https://www.dhs.gov/news/2018/03/30/caatsa-title-iii-section-321b-faqs

[5] OFAC's Economic Sanctions Enforcement Guidelines, 31 C.F.R Part 501, Appendix A, available at https://www.ecfr.gov/cgi-bin/text-idx?SID=eb4199fbd93e57f24a6a56c897157957&mc=true&node=ap31.3.501_1901.a&rgn=div9

[6] OFAC FAQs, North Korea Sanctions, FAQ 525, available at https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx#nk

[7] Remarks Delivered at United Nations General Assembly Press Briefing by Steve Mnuchin, U.S. Treasury Secretary (Sept. 21, 2017), available at https://www.treasury.gov/press-center/press-releases/Pages/sm0162.aspx