

# US court confirms limits on OFAC's power



The success of Exxon in challenging a \$2 million penalty from OFAC has caught the attention of industry in the US and overseas. What, ask Barbara Linney, Ragan Updegraff and Orga Cadet, can be learned from the court's judgment in the case?

The decade ended on a low note for the US Office of Foreign Assets Control ("OFAC") when the US District Court for the Northern District of Texas issued its decision in the Exxon Mobil case on New Year's Eve. With a celebratory air befitting the season, the court framed the essential question before it as follows: 'Which party receives the benefit of having its cake and eating it, too – the regulating agency that failed to clarify, or the regulated party that failed to ask[?]'. In the result, the court overturned the \$2 million penalty OFAC had imposed on Exxon Mobil Corporation and certain of its subsidiaries (collectively 'Exxon') on the basis that OFAC had violated Exxon's constitutional right to fair notice.

In addition to emphasising that the long tradition of judicial deference to national security agencies is limited by constitutional principles, the court's decision scrutinised OFAC's interpretation of important language common to executive orders issued under many OFAC programmes. The court also examined the relevance of OFAC 'FAQs' and public statements by the media and other government agencies to the question of whether fair notice had been given.

## Background

The case arose out of a dispute between OFAC and Exxon regarding the application of Executive Order 13661 (the 'Executive Order') and related provisions of the Ukraine-Related Sanctions Regulations (the 'Regulations') to certain contracts entered into by Exxon. Like many other executive orders that form the basis for designations of blocked persons ('SDNs') under a myriad of OFAC sanctions programmes, Executive Order 13661 prohibits any dealings by

US persons with property of persons blocked under the Executive Order, including 'the receipt of any contribution or provision of ...

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services.' The Regulations – again, in language identical to that used in regulations under other OFAC sanctions programmes – define 'property' and 'property interest' to include 'services of any nature whatsoever [and] contracts of any nature whatsoever.' In addition, as do

other OFAC regulations, the Regulations disclaim that '[d]iffering foreign policy and national security circumstances may result in differing interpretations of similar language' in regulations governing other OFAC sanctions programmes.

OFAC alleged that Exxon violated the Executive Order and the Regulations when it entered into a series of contracts with a non-blocked Russian entity that were signed on the Russian entity's behalf by its president, who had been designated as an SDN under the Executive Order.

However, it was not until 13 August 2014, some weeks after the signing of the contracts and after OFAC commenced its investigation into the alleged violations with the issuance of an administrative subpoena, that OFAC issued 'FAQs' clearly articulating OFAC's view that 'US persons may not ... enter into contracts that are signed by a blocked individual.'

More than three years after the



signing of the contracts, OFAC's investigation culminated in the issuance of a penalty notice assessing a civil monetary penalty of \$2 million, which Exxon challenged immediately by filing the lawsuit that led to the court's decision.

### **The right to fair notice**

Citing a 2012 decision of the US Supreme Court, the court held that under the due process clause of the Fifth Amendment to the Constitution of the United States, 'laws that regulate individuals or entities "must give fair notice of conduct that is forbidden or required."' Or, as stated in another Supreme Court opinion, cited by the court,

'It is one thing to expect regulated parties to conform their conduct to an agency's interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency's interpretations in advance or else be held liable when the agency announces its interpretations for the first time.'

The court then concluded that the regulated party must be able to 'identify with "ascertainable certainty", the standards with which the agency expects parties to conform.'

In considering whether OFAC had communicated its interpretation with 'ascertainable certainty', the court first examined whether the Executive Order and the Regulations gave Exxon 'fair notice ... that [the SDN's] signing of the contracts was a service *received* by Exxon' (emphasis added) and concluded that 'the text of the Regulations does not provide fair notice that a US entity is prohibited from signing contracts that are also signed by an SDN.'

The court then went on to examine whether other factors warranted a finding of fair notice. After dismissing the suggestion that 'non-public' evidence of an agency's 'internal deliberations' or 'uncertainty' regarding its interpretation of the Executive Order and Regulations have any bearing on a fair-notice claim, the court went on to consider the potential significance of Exxon's failure to seek clarification from OFAC prior to executing the contracts.

The court found that Exxon's failure to seek guidance from OFAC before the

contracts were signed was a 'relevant – though not dispositive – factor' in assessing whether Exxon received fair notice of OFAC's interpretation. In particular, the court acknowledged that while the failure to seek guidance was 'risky – and perhaps imprudent' and 'weighs in favor' of a fair-notice finding, 'the burden of providing fair notice remains with the agency – not the regulated party.'

Finally, the court considered whether the lack of fair notice had been

### ***The court considered whether the lack of fair notice had been remedied by public statements issued by OFAC and by the press and other administration officials.***

remedied by public statements issued by OFAC and by the press and other administration officials. The court agreed with OFAC's contention 'that a regulated party could not reasonably rely, "in good faith", upon statements from third-party news outlets.' However, the court went on to conclude that 'a regulated party, in good faith, might rely upon statements issued by the executive branch, even if not necessarily issued by OFAC itself.' Nevertheless, the court concluded that various statements issued by the administration did not provide additional clarity, and thus did not contribute to fair notice of OFAC's position.

It then remained to consider the import of an FAQ issued under the Burmese sanctions programme prior to the issuance of Executive Order 13661 and the Regulations. OFAC pointed to

this FAQ as evidence of fair notice of its position. The court disagreed, noting that 'by including ... a disclaimer [such as that described above] in both the Burma and Ukraine sanctions regulations, OFAC forfeited the right to claim that the interpretation of the former provided fair notice of its interpretation of the latter. While OFAC may reserve the opportunity to interpret sanctions programs differently, it may not then claim that a regulated party should know that OFAC interprets the programs identically without OFAC's explicit clarification.'

### **OFAC's interpretation of the Executive Order and Regulations**

Having concluded that Exxon's right to fair notice had been violated, the court declined to consider two other challenges brought by Exxon – one being that Exxon's conduct was not prohibited by the Executive Order and Regulations and that OFAC's interpretation was not entitled to deference.

Although the court declined to rule on the deference issue, it did consider the parties' arguments 'regarding the propriety of deference relevant to its fair-notice determination.'

Moreover, in the course of considering whether the Executive Order and the Regulations clearly prohibited the alleged violations, the court held that Section 4 of the Executive Order 'unambiguously indicates that Section 1 [of the Executive Order] prohibits the receipt of services from a blocked person.' The court also held that 'the signing of a contract could be a service'. However, as noted above, it stopped short of finding that OFAC had given fair notice of its interpretation that by signing contracts on behalf of a non-blocked party, the SDN would 'benefit' the other party, such that the other party would 'receive' a service from the SDN.

While the court's decision on these points was good news for Exxon, it would appear that publication of the 13 August 2014 FAQs has remedied any lack of fair notice to parties engaging in similar transactions after that date.

### **Was imposition of the penalty 'arbitrary and capricious'?**

Again, the court declined to consider this ground of Exxon's complaint against OFAC. However, it did note



that ‘when reviewing constitutional claims under the [Administrative Procedures Act (‘APA’)], the courts apply a de novo standard of review.’

This approach distinguishes the Exxon case from the decision of the US Court of Appeals for the District of Columbia in the Epsilon Electronics case, which applied an ‘arbitrary and capricious’ standard to its review of an OFAC penalty imposed on Epsilon. Under that standard, the court noted that although it was required to take a ‘highly deferential’ approach by which it could ‘set aside OFAC’s action “only if it is arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law” ... [t]hat deference has a caveat: although the APA does not permit us to substitute our judgment for the agency’s, [the court] must ensure that the agency has articulate[d] a satisfactory explanation for its action including a “rational connection between the facts found and the choice made.”’

In Epsilon, the court remanded the matter to OFAC for further consideration, based on a finding that it had failed to give reasons for the

assessed penalty. Following remand, OFAC rescinded the penalty notice and entered into a settlement agreement

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under which Epsilon agreed to pay a reduced penalty (\$1.5 million compared to the \$4,073,000 penalty originally assessed).

However, in light of the Exxon decision, the final footnote to Judge Silberman’s judgment in Epsilon gives future litigants food for thought:

‘I would have been inclined to reject liability entirely rather than remand had appellant made the argument that imposing a penalty pursuant to an ambiguous regulation is inappropriate if you interpret it for the first time in a

penalty proceeding ... But as the government pointed out at oral argument, appellant did not take that position.’

Even if parties aggrieved by OFAC’s decisions are successful in an APA challenge on ‘arbitrary and capricious’ grounds, the outcome likely will be remand and an opportunity for OFAC to issue a more well-reasoned decision. On the other hand, as the Exxon case shows, OFAC will not be granted this opportunity if it is found to have violated a party’s constitutional right to due process.

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