Protecting Against WMD Proliferators

To thwart weapons of mass destruction (WMD) proliferators, the United States imposes sanctions on them and their support networks. A primary goal is to prevent proliferators from accessing the U.S. financial system. But recent law enforcement actions show that often, notwithstanding sanctions, wrongdoers are able to conduct U.S. financial transactions. How do sanctioned parties slip past the gatekeepers of the U.S. financial system - typically large banks - to make and receive payments in dollars? What can, and should, U.S. financial institutions do to help catch those trying to circumvent U.S. sanctions laws?

The Office of Foreign Control Assets (OFAC), an office of the Treasury Department, is responsible for administering U.S. sanctions programs. OFAC maintains a list of those banned from engaging in U.S. transactions on non-proliferation and other grounds - known as specially designated nationals (SDNs). Such SDNs include not just proliferators, but also those who abet them. To cool Iran's nuclear ambitions, for example, the United States blacklists not only Iran's Atomic Energy Organization, but also Iranian banks believed to assist with payments, and non-Iranian companies believed to supply technology and raw materials essential to weapons development.

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Once an entity is listed as a SDN, no U.S. person wherever located, including a U.S. financial institution, may conduct business with that entity. Indeed, if a U.S. bank receives a deposit or a transfer of funds in which a SDN has an interest, the bank must block (freeze) the assets in a special segregated account, and must report to OFAC that it has done so. The duty to eschew SDNs is a strict liability obligation upon U.S. financial institutions (parallel criminal prohibitions, on the other hand, require willful misconduct). As a practical matter, however, OFAC has not pursued enforcement actions against U.S. financial institutions for unwittingly processing transactions on behalf of SDNs: a wise, fair, and frankly essential policy if banks are to function.

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But OFAC can, and will, go after banks that lack adequate procedures, including in many cases automated systems, to detect transactions involving SDNs. In assessing the adequacy of such systems, OFAC can be expected to consider prevailing industry norms. If a bank falls below the norm of its peers, it could be in trouble if it fails to detect a transaction with a SDN.

Most international dollar payments - the type that, for example, Iran might well use to buy missile technology from China - are conducted by wire. But, large U.S. financial institutions may process tens of thousands of wire transfers every day. So, what most U.S. banks that process large volumes of wire transfers on behalf of foreign parties do to police against SDNs is to employ automated filters. These filters, sometimes known as interdiction software, screen incoming wire transfer data against lists compiled from various sources including OFAC's list of SDNs and sanctioned country names. Thus, U.S. banks, on whose shoulders the burden of preventing WMD proliferators from accessing the U.S. financial system often falls, at least in the first instance, are only as effective as their technology. That technology, in turn, is only as effective as the accuracy of the incoming wire transfer data being screened allows.

Several recent prosecutions highlight how SDNs and others who wish to evade interdiction software and make dollar-denominated wire transfers can deceive U.S. banks by manipulating the wire data, so that U.S. banks clear transfers that they would have blocked if they had known that SDNs were involved. At least three such techniques have been identified: stripping, fronting and nesting.

Stripping occurs when an SDN's name initially appears in the wire transfer data, but before it reaches the United States, it passes through a foreign bank that strips out the identifying information. The U.S. bank receives only the sanitized version, and thus clears the transaction. In January of this year, for example, the New York District Attorney and the U.S. Dept. of Justice announced a joint $350 million settlement with Lloyds Bank, based on admissions including that, from 2002 to 2004, on behalf of Iranian banks and their customers, Lloyds intentionally altered wire transfer information to hide the Iranians' identity from U.S. banks processing wire transactions for Lloyds. At the time, the New York District Attorney said nine other major foreign banks were under investigation for using the same technique to disguise illegal money transfers.

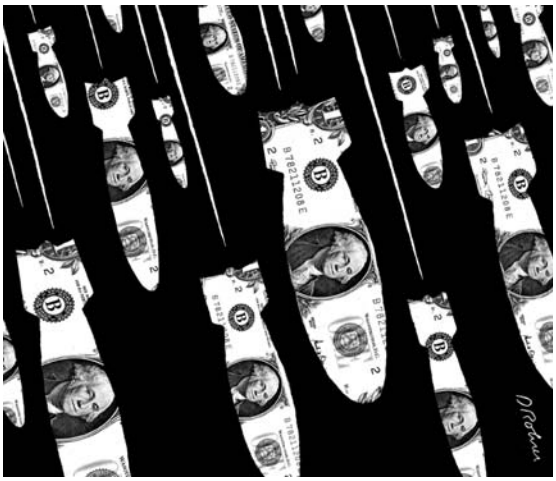
Fronting occurs when an SDN uses an alias, pseudonym or front company to obscure its identity and dupe U.S. banks into processing wire transfers for its benefit. For example, the Chinese company LIMMT was listed as a SDN in 2006 for providing material support for Iran's missile program. In April of this year, New York issued a 118 count indictment against LIMMT and its Chinese principal, alleging that between 2006 and 2008, LIMMT used a number of front companies to clear dollar transactions through U.S. banks without being flagged by their OFAC filters.

Nesting occurs when a foreign financial institution gains access to the U.S. financial system by operating through an account belonging to a second foreign financial institution. Only the second financial institution - which has the direct relationship with the U.S. bank - is visible to the U.S. bank. Thus, the U.S. bank is not positioned to guard against wrongful use of the account by the first institution.

What can U.S. banks do in the face of such conduct deliberately designed to fool their systems? Options are limited. The problems typically originate overseas, so U.S. banks may wish to ensure that their contracts with foreign banks address these issues. That means ensuring that foreign banks will not forward to the United States any wire transfers that violate OFAC sanctions, and imposing an obligation on foreign banks to ensure that their customers who want to access the U.S. financial system are not SDNs. Indeed, foreign banks could be asked to obtain a certification from their customers who transmit wires destined for the United States that they understand OFAC requirements and agree to comply with them. Another good idea is to follow up, with talks and visits, to gain comfort that foreign banks have adequate systems to make good on their commitments, and to see to it that foreign banks and their customers are not engaged in shenanigans aimed at evading OFAC sanctions.

U.S. banks can also cooperate with their peers to share information about entities they believe may be engaged in stripping, fronting or nesting conduct. And, they can engage in some smart spot checking. For example, if a transaction is blocked, the SDN may try the exact same payment a second time, only this time relying on stripping, fronting or nesting to get the funds through. U.S. banks periodically can review transactions for a day or two after a blocked transaction to see if another transaction for the same amount, perhaps even involving some of the same parties, but without any sign of the same SDN, has come through.

At the end of the day, banks may be ill-positioned to prevent conduct carefully crafted to deceive them. But banks are making valiant efforts to stop such conduct nevertheless, and prudent measures can be taken to help minimize the risk that U.S. banks will unwittingly transact business with proliferators or other prohibited parties.



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Environmental Impact Statement, It Matters

The United States Court of Appeals for the 9th Circuit recently issued an opinion that serves as a warning to landowners, developers, and public/private land partnerships regarding creation and implementation of an environmental impact statement. The lesson emerging from the case is that the preparation of an environmental impact statement is not merely an exercise in compliance, but serves as a tool which a court will examine in detail to determine whether a challenged project can legally proceed.

In *National Parks & Conservation Association v. Kaiser Eagle Mountain Inc.* (2009 DJDAR 15950), the court addressed two overarching issues, the sufficiency of the environmental impact statement for the Eagle Mountain Landfill Project, and the legality of the proposed land exchange from public to private ownership. The court ruled that the environmental impact statement did not sufficiently address the relevant environmental issues, that it did not take into account the "highest and best use" of the subject property, and found that the land exchange was not appropriately executed.

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By way of background, Kaiser and others sought to develop the largest landfill project in the United States, which would have brought around 20,000 tons of trash from various Southern California communities daily for approximately 117 years. The nearly 5,000 acre site is surrounded by Joshua Tree National Park, and is less than two miles from the Park's boundaries. The proposed site served as open pit iron ore mines from 1948 until 1983, and has largely been dormant for 25 years. Some of the proposed land to be used in the landfill was public land, which Kaiser had proposed a public/private land swap with the Bureau of Land Management with other areas of the parcel owned by Kaiser. Large portions of this land contain high quantities of mine tailings, which have not been reclaimed.

Though the court affirmed the lower court's ruling, it also rejected most of the project opponents' arguments. However, this was a 2-1 decision, and the third judge on the panel issued a scathing 50-page dissent, very critical of the majority's opinion.

Nonetheless, the majority specifically held: the discussion in the environmental impact statement surrounding the effects of introducing additional nutrients to the site, was not adequately addressed; in the overview section, the environmental impact statement inadequately analyzed the "reasonable range of alternatives" relating to the land exchange; and the environmental impact statement failed to take into account in the "highest and best use" of the subject site in terms of using public lands as landfill space.

Despite the overall dissent, all three panel members of the court determined that the there was substantial evidence that the potential impacts to Bighorn sheep had been appropriately analyzed in the environmental impact statement, reversing the lower court's decision. The court also unanimously rejected a cross-appeal relating to other allegedly incomplete areas of the environmental impact statement. In particular, it found the environmental impact statement complied with applicable law in areas including: desert tortoise issues, visual impacts, noise, night lighting impacts, groundwater quality, and air quality.

Judge Stephen Trott fiercely rejected the majority's opinion in his lengthy dissent from the majority. Beginning by alluding to Greek mythology, Judge Trott essentially concludes that the environmental impact statement was more than adequate, and that the relevant (and "well meaning") environmental laws were interpreted by the majority as requiring much more than Judge Trott thinks reasonable or appropriate. He concludes by pointing out that the ultimate irony in this case is that on remand, this matter will go back to the Bureau of Land Management to determine the value of the land as a landfill, something Judge Trott sees as duplicative and unnecessary.

This decision serves as an important reminder to all individuals, corporations, and partnerships seeking to develop public lands, or engage in land swaps. The essence of this decision resonates the importance of implementing a rock-solid environmental impact statement, which addresses every known issue and potential caveat in dealing with a proposed project. As seen in this case, even a simple failure to explicitly evaluate an issue so obvious as the value of the public land as a landfill can lead to time-consuming and costly steps to rectify the deficiencies.

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