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U.S. Investment Firms' Stakes in Non-U.S. Companies Lead to Sanctions Violations and OFAC Penalties

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What You Need To Know:

- **U.S. investment firms and their portfolio companies are subject to U.S. economic sanctions regulations.**
- **Such firms are subject to OFAC penalties even if they are not aware of or involved in the actions of their portfolio companies overseas.**
- **U.S. investment firms and each portfolio company should have OFAC compliance programs.**

In April 2019, the U.S. Department of the Treasury's Office of Foreign Assets Controls (OFAC) settled an enforcement case with Acteon Group Ltd. (Acteon), a UK oil and gas subsea service company, and its non-U.S. subsidiaries in Malaysia and the UK. The apparent violations of Cuba sanctions stemmed from an engineering analysis conducted by Acteon and its non-U.S. subsidiaries in Cuban territorial waters and associated workshops they conducted in Cuba.

Importantly, Acteon, a non-U.S. company, was majority owned by funds associated with an unnamed U.S. investment firm when Acteon and its subsidiaries were conducting activities in Cuba. As a result of the U.S. firm's majority holdings in Acteon, OFAC determined that Acteon was a "person subject to the jurisdiction of the United States" at the time of the Cuba-related activities. This conferred U.S. jurisdiction over Acteon and its subsidiaries' Cuba-related activities, which violated OFAC's Cuban Assets Control Regulations, allowing OFAC to penalize Acteon.

In a related and concurrent settlement, OFAC penalized Acteon and KKR & Co Inc. (KKR), a global investment firm based in New York, for three violations of OFAC's Iranian Transactions and Sanctions Regulations that involved another non-U.S. Acteon subsidiary. This Acteon subsidiary rented or sold equipment to customers that used it on vessels in Iranian territorial waters while KKR-affiliated investment funds owned a majority stake in Acteon. Just as in the Cuba-related case, KKR's majority holdings in Acteon conferred U.S. jurisdiction over Acteon and its subsidiaries' Iran-related activities and allowed OFAC to penalize Acteon and KKR.

These cases show that U.S. hedge, investment, and private equity funds are susceptible to OFAC penalties and adverse publicity as a result of their holdings in foreign companies, despite having no direct involvement in the actual sanctions violations.

According to OFAC's regulations, any entity organized or located outside of the U.S., but *either owned or controlled* by a U.S. person, is subject to U.S. jurisdiction for purposes of OFAC's sanctions programs. Since KKR and the unnamed U.S. investment firm were "U.S. persons" by virtue of the fact that they were organized under the laws of a U.S. state, their holdings in Acteon gave OFAC the needed jurisdictional hook.

This begs the question, what does it mean to be *owned or controlled* by a U.S. person? While each country-specific sanctions program is slightly different, an entity is generally "owned or controlled" by a U.S. person if the U.S. person:

- Holds a 50 percent or greater equity interest by vote or value in the entity; OR
- Holds a majority of seats on the board of directors of the entity; OR
- Otherwise controls the actions, policies, or personnel decisions of the entity.

The terms of both of the settlements discussed above included corrective and compliance commitment measures that affected the U.S. funds' use of their financial resources as well as the funds' personnel, training, and audit decisions.

To avoid such pitfalls, all U.S. investment firms should ensure that the U.S. and foreign entities they own or control are compliant with OFAC's sanctions, as these relationships can lead to hefty penalties for the entities and the funds. In fact, OFAC's Iran sanctions regulations expressly authorize it to impose civil penalties directly on the U.S. fund. Accordingly, U.S. investment funds and the companies they own or control should prioritize the implementation and maintenance of robust OFAC compliance programs that are tailored for the risks their particular industries present.

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