

Conflicting Advice May Cause Real Estate Lawyers To Violate Anti-terrorism Regulations

by Christopher A. Myers and James H. Rodio

Multiple regulatory schemes and conflicting advice regarding compliance with anti-terrorism regulations have caused considerable confusion among real estate lawyers and their clients, both in Virginia and elsewhere. This article was written to help clarify the situation. It also responds to an article by the Virginia State Bar ethics counsel, James McCauley, “Feds Draft Lawyers to Fight War on Terrorism: Anti-Money Laundering Laws and the USA Patriot Act,” published in the May 2003 issue of the *Virginia Lawyer Register* and in *The Fee Simple* newsletter (the Article). Unfortunately, uncertainty about obligations arising from the war on terrorism may result in failure to comply—and subject real estate lawyers and their clients to substantial civil and criminal penalties, blocked, frozen or forfeited assets and the possibility of jail.

In the wake of the September 11 attacks, the government has enlisted private businesses as agents and allies in the war on terrorism. Most Americans are happy to assist in this effort, but overlapping agencies and differing requirements have caused considerable confusion about what it is the government expects us to do.

Since September 11, two significant regulatory actions took place. First, on September 24, 2001, President Bush issued Executive Order 13224, which prohibits all “U.S. Persons” from engaging in business of any kind with persons or entities designated as terrorists or their associates. Compliance with this executive order is overseen by the Treasury Department’s Office of Foreign Assets Control (OFAC). The terrorist list provided on September 24, 2001, has since been supplemented approximately 50 times. In addition, it has been combined with another list of “Specially Designated Nationals” (the SDN List)—also supervised by OFAC. (We will refer to these combined lists as the OFAC List.) The OFAC List now is nearly 100 pages and contains several thousand names, aliases and “doing business as” designations.

Second, in October 2001, Congress passed the USA PATRIOT Act (the Patriot Act). Among other things, the Patriot Act created substantial new anti-money laundering obligations on entities identified as “financial institutions” under the Bank Secrecy Act (BSA). “Persons involved in real estate closings and settlements” are designated as BSA “financial institutions.” There is a problem, however: The BSA does not define what it means by “persons involved in real estate closings and settlements.” The Treasury Department (through the Financial Crimes Enforcement Network, or FinCEN) is working on such regulations through a Notice of Proposed Rulemaking issued on April 10, 2003. Final regulations are not expected for several months.

The risk for lawyers and their clients has resulted from confusion and contradictory advice regarding compliance with the Patriot Act and the executive order. Based on recent con-

versations with the chief counsel’s office at OFAC and analyses of the relevant statutes and regulations, it appears that certain portions of the Article and similar advice may confuse or mislead Virginia lawyers involved in real estate transactions.

Many real estate lawyers reading the Article, or attending related CLE programs, have concluded that not only are they not obligated to check names of persons involved in real estate transactions against the OFAC list, but that it might be an ethical violation to do so. This advice has the potential to expose real estate lawyers and their clients to civil, and possibly criminal, sanctions. While it is true that the Department of the Treasury has not yet proposed Patriot Act-specific regulations for persons involved in title insurance or real estate closings, the requirement to check persons involved in real estate transactions against the OFAC list is not a Patriot Act requirement.

Pursuant to the executive order and related regulations, all U.S. persons, including those associated with real estate transactions and their lawyers, are prohibited from conducting any kind of business with persons or entities on the OFAC list. Failure to comply with OFAC requirements could subject all parties, including attorneys, to substantial civil, and potentially, criminal penalties.


A statement in the Article refers to a conversation with the “OFAC compliance officer” and his apparent statement that a requirement to check persons involved in real estate transactions against the OFAC list is “implicit from the executive orders issued by President Bush, which apply to *all* citizens” (emphasis in original). The Article states that “executive orders are general” and that Treasury has “temporarily exempted persons involved in real estate closings and settlements” pending public comment and rulemaking under the Patriot Act. This analysis confuses the requirements of the executive order and OFAC regulations with the completely unrelated Treasury rulemaking under the Patriot Act. The president’s authority to issue executive orders such as 13224 comes not from the Patriot Act, but from the Trading with the Enemy Act and the International Emergency Economic Powers Act, both of which have been in place for many years. OFAC prohibitions are in effect now, and have been, since September 2001 and before.

In a recent discussion with a representative of the chief counsel’s office at OFAC, it was made clear that OFAC expects real estate lawyers and their clients to run checks against the OFAC list of all persons and entities involved in real estate transactions. It was also stated unequivocally that this requirement also applies to companies offering title insurance. While it is true that there is no obligation to run OFAC list checks, OFAC violations are a “strict liability” offense: Knowledge is not an element of a civil OFAC violation. Persons conducting prohibited transactions are subject to significant fines, asset freezes and potential forfeiture of the property involved in the illegal transaction. Criminal violations do require an element of

knowledge, but that requirement may be satisfied by a finding of “willful blindness,” a deliberate failure to check the OFAC List. In separate conversations, both the OFAC counsel’s office and its counterpart at the Financial Crimes Enforcement Network (FinCEN), which enforces the Patriot Act, each stated that OFAC requirements are separate from, and unrelated to, regulations under the Patriot Act.

We have not attempted to analyze the conclusion in the Article that reporting an OFAC violation by a client may be an ethical violation under Virginia Bar rules. The point that must be made, however, is that real estate lawyers and their clients should be checking the OFAC list before closing on any real estate transaction. This obligation is in effect now and has not been deferred, pending the Patriot Act rulemaking. Neither lawyers nor their clients may proceed with a transaction that violates OFAC regulations. The reporting obligation applies to the client, even if the lawyer may not report it without a client’s consent. Lawyers who fail to advise their clients of these obligations may be exposing the client to investigation and penalties. Lawyers who proceed with a transaction involv-

ing a person or entity on the OFAC list are personally subject to the same penalties.

For further information on these issues, including information about software products available to help comply with OFAC obligations, please contact Christopher Myers or James Rodio in the Tysons Corner office of Holland & Knight L.L.P., at (703) 720-8600. 

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What is Expected of a Real Estate Settlement Attorney Under Executive Order 13224 and the USA Patriot Act?—A Reply to Myers and Rodio

by James M. McCauley, VSB Ethics Counsel

There is no doubt that OFAC interprets Executive Order 13224 (September 21, 2001) to require that persons involved in real estate closings run their clients names through the SDN lists. Nevertheless, nothing in Executive Order 13224 imposes such a requirement, and whether such a requirement is implied is a matter of interpretation and debate. Executive Order 13224 prohibits any transaction or dealing by persons in the United States in property or interests which are “blocked” under the terms of the order. While it is clear that the executive order imposes a general duty for all citizens to avoid transactions involving blocked property, there is nothing in the order that specifies any particular affirmative actions that must be taken to avoid prohibited transactions. Certainly the federal government cannot reasonably expect all citizens or persons in the United States to run the lists containing thousands of names every time a commercial, real estate or other transaction is contemplated. While regulated industries, such as banks and insurance companies, may be expected to implement procedures to detect and avoid transactions with suspected terrorists, the average citizen cannot reasonably be expected to understand or implement such procedures.

Further, notwithstanding OFAC’s aggressive and strict enforcement of Executive Order 13224, the Treasury Department, of which OFAC is a part, temporarily exempted “persons involved in real estate transactions” from the anti-money laundering rules applicable to other “financial institutions.” During and after my article (*Virginia Lawyer Register*, May 2003) was written, Treasury was seeking public comment on how the real estate industry might be affected if similar rules were applied to that industry. Although those rules and regulations were pursuant to the USA Patriot Act rather than Executive Order 13224, it is the federal government, and not

my article, that is to blame for the unnecessary and unfortunate confusion about what anti-money laundering procedures are expected of the real estate settlement industry.

That being said, lawyers and persons who conduct closings without checking the lists run the risk that the OFAC will pursue civil or criminal sanctions for dealing with blocked property or persons suspected of engaging in terrorist activity. If a settlement attorney or agent finds that a party to a transaction is on the list, he or she should not complete the closing and must notify the parties that the transaction cannot be closed. The attorney should withdraw from the engagement pursuant to Rule 1.16. However, until the federal government implements a final rule requiring a settlement attorney or agent to report a “match” on the SDN list to OFAC, an attorney cannot make such a report without violating Rule 1.6. Rule 1.6 permits disclosure of information detrimental or embarrassing to a client only if required by law or court order. Further, the “no tip off” rule applicable to other financial institutions conflicts with a lawyer’s duty under Rule 1.4 to inform the client of matters related to the representation. No such requirement can be implied from Executive Order 13224, and no regulations applicable to persons involved in real estate closings have included a “no tip off” provision.

If the federal government expects lawyers to breach their ethical and fiduciary duties to their clients, the federal government, at the very least, should be clear and explicit in terms of what is required of those who conduct real estate settlements. This, of course, has not happened and that is why there is confusion over the settlement attorney’s duties under Executive Order 13224 and the USA Patriot Act. 