

**THE USA PATRIOT ACT AND EXECUTIVE ORDER 13224:
A SUMMARY AND SAMPLE CLAUSES FOR THE REAL ESTATE
PRACTITIONER**

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Introduction

On September 24, 2001 President Bush issued Executive Order 13224 (“**Executive Order**”) as a response to the terrorist attacks of September 11, 2001. A copy of the Executive Order can be obtained at <http://www.ustreas.gov/offices/enforcement/ofac/sanctions/terrorism.html>. In addition to the Executive Order, on October 26, 2001, the USA Patriot Act of 2001 (“**Patriot Act**”) was signed into law, which along with the Executive Order, is designed to combat terrorist activities by restricting terrorist groups’ access to financial resources in the United States. Both the Executive Order and the Patriot Act contain broad-sweeping measures that affect all U.S. companies, including those in the real estate industry. The full text and select provisions of the Patriot Act can be obtained at http://www.fincen.gov/pa_main.html. While the Patriot Act has yet to be applied directly to the real estate industry, it is clear that those in the real estate industry must comply with the Executive Order or face severe penalties for violations.

Executive Order 13224

The Executive Order mandates that no U.S. company shall do business with any person that is subject to the prohibitions of the Executive Order. Such persons include those who have been determined to have committed, or pose a risk of committing or supporting terrorist acts, and those identified on the list of Specially Designated Nationals and Blocked Persons, generated by the Office of Foreign Assets Control (“**OFAC**”). The OFAC list is updated regularly, and an up-to-date OFAC list can be obtained by visiting the U.S. Department of the Treasury website at <http://www.ustreas.gov/ofac>.

One problem that has been encountered by those attempting to comply with the Executive Order is that the OFAC list contains several names that are fairly common, so some companies have experienced difficulties in determining if the person they are doing business with is in fact the person featured on the OFAC list.

Penalties for violations of the Executive Order can be severe. Violators can have their assets frozen or forfeited. Corporations can face up to \$500,000 in penalties, while individuals can face up to \$250,000 in penalties and ten years’ imprisonment for violations. If they have not already taken such measures, all U.S. real estate companies should implement programs which allow them to quickly access the OFAC list to ensure that they are not violating the Executive Order by selling to or buying from any person on the list. Any attempt to complete a transaction or contact from any listed party should be reported to OFAC immediately.

The USA PATRIOT Act

Anti-Money Laundering Programs

The Patriot Act contains several provisions, which could impact the real estate industry. Financial institutions are required, pursuant to Section 352 of the Patriot Act, to adopt anti-money laundering programs that include:

- (i) the development of internal policies, procedures, and controls;
- (ii) the designation of a compliance officer;
- (iii) an ongoing employee training program; and
- (iv) independent audit functions to test the anti-money laundering programs.

The definition of “financial institutions” for this section of the Patriot Act includes entities that are typically thought of as financial institutions and are already subject to federal regulation, such as banks, savings associations, and credit unions. It also includes several other entities, which are not normally considered financial institutions including some in the real estate industry, such as “*persons engaged in real estate closings and settlements*” and “*loan or finance companies.*” Many of the more traditional financial institutions have been subjected to regulation under the provisions of the Patriot Act; however, most of the categories of non-traditional financial institutions, including those mentioned above, have been temporarily exempted from regulation. Regulations requiring compliance by all financial institutions were to have been issued by the Treasury Department by October 25, 2002; however, this deadline has been extended indefinitely to give the Treasury Department and other regulatory bodies more time to properly assess the risk associated with each type of financial institution and issue risk-appropriate regulations.

On April 10, 2003, the Financial Crimes Enforcement Network (“**FinCEN**”) of the Treasury Department published an advance notice of proposed rule making (the “**Advance Notice**”) to solicit public comment on, among other issues, how to define the phrase “persons engaged in real estate closings and settlements,” the risks posed by such persons, and whether any such persons should be exempted from the requirement of adopting anti-money laundering policies and procedures. Several real estate industry groups, including the Real Property, Probate, and Trust Law Section of the American Bar Association, submitted comments to the Treasury Department. A copy of the Advance Notice can be obtained at http://www.fincen.gov/352_real_estate_04102003.pdf. As of December of 2004, FinCEN had not determined whether to issue proposed rules that would affect persons engaged in real estate closings and settlements. FinCEN also expects to issue proposed rules for loan or finance companies in the near future.

Cooperation and Information Sharing with the Government

The Financial Crimes Enforcement Network has issued a final rule implementing Section 314 of the Patriot Act (the “**Final Rule**”). A copy of the Final Rule can be obtained at <http://www.fincen.gov/section314finalrule.pdf>. The purpose of this section of the Patriot Act is to facilitate the exchange of information between federal law enforcement agencies and financial institutions concerning individuals and entities that may be engaging in terrorist acts or money laundering activities. The final rule allows FinCEN, on behalf of other federal law enforcement agencies, to require financial institutions to search their records and identify accounts of, or transactions with, individuals or entities that have been certified as, or reasonably suspected of,

engaging in money laundering or terrorist activity. “Financial institutions,” as defined for the purposes of this Final Rule, includes all entities that are defined as “financial institutions” for the purposes of the anti-money laundering requirements; however, unlike the anti-money laundering regulations, the Final Rule states that, “all financial institutions should be on notice that FinCEN may contact them for information.” While FinCEN has stated that, as a practical matter, only those entities, which currently are subject to suspicious activity reporting requirements under the Bank Secrecy Act will be contacted with requests for information, FinCEN does reserve the right to contact any entity that qualifies as a “financial institution” with requests for information and records of accounts and transactions.

The records subject to inspection under the Final Rule are not limited to the financial institutions’ customers or clients -- the language of the rule includes information on employees as well as those entities with which the financial institution does business. Much of the information that may be requested may be information that the company, its employees, or its customers would prefer be kept confidential.

As with the Executive Order, penalties for violations of the Patriot Act can be quite severe. Depending on which provision of the Patriot Act has been violated, companies can have their assets frozen and face up to \$1,000,000 in fines. Individuals can be fined up to \$500,000 and face up to twenty years’ imprisonment for violations.

Conclusion

Compliance with the Executive Order currently is required of all U.S. businesses and, as stated earlier, violations of the Executive Order may result in substantial fines and penalties against the violating party or even imprisonment. All real estate industry participants should have some method or program in place, which allows them to ensure that they are in compliance with the Executive Order and are not doing business with any person on the OFAC list.

At present, none of the regulations issued pursuant to the Patriot Act have been enforced against real estate companies. However, compliance with these regulations in one form or another may be required at some point. Because violations of the Patriot Act can be quite costly, real estate companies and lawyers conducting real estate transactions may wish to begin considering what programs or policies that they may need to develop.

I. SAMPLE CLAUSES

Attorneys representing participants in the real estate industry, including those involved in loan or finance transactions and those participating in real estate closings and settlements, should be sure that the documents that they draft provide protection with respect to compliance with the Executive Order and the Patriot Act. Real estate documents should: (i) contemplate and permit compliance with the Executive Order and the Patriot Act; and (ii) require the other parties to the transaction to comply with the Executive Order and the Patriot Act. Some general sample clauses are contained below:

- Termination of Agreement with Blocked Persons. Pursuant to United States Presidential Executive Order 13224 (“**Executive Order**”), Seller/Lessor/Lender is required to ensure that it does not transact business with persons or entities determined to have committed, or to pose a risk of committing or supporting, terrorist acts and those identified on the list of Specially Designated Nationals and Blocked Persons (“**List**”), generated by the Office of Foreign Assets Control of the U.S. Department of the Treasury. The names or aliases of these persons or entities (“**Blocked Persons**”) are updated from time to time. In the event Seller/Lessor/Lender learns that Purchaser’s/Lessee’s/Borrower’s name appears on the List, Seller/Lessor/Lender reserves the right to delay the closing/lease/loan contemplated by this Agreement pending Seller’s/Lessor’s/Lender’s investigation into the matter. If Seller/Lessor/Lender is advised and/or determines that Purchaser/Lessee/Borrower is a Blocked Person, Seller/Lessor/Lender reserves the right to terminate this Agreement and/or to take all other actions necessary to comply with the requirements of the Executive Order. The provisions of this paragraph will survive closing and/or termination of this Agreement.
- Compliance with Executive Order and USA PATRIOT Act. At all times prior to closing/throughout the term of the lease/loan contemplated by this Agreement, Purchaser/Lessee/Borrower and all of its respective Affiliates: (i) shall not be a Prohibited Person (defined below); and (ii) shall be in full compliance with all applicable orders, rules, regulations and recommendations promulgated under or in connection with Executive Order No. 13224 – Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit, or Support Terrorism, effective September 24, 2001 (“**Executive Order**”) and the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (“**Patriot Act**”).

The term “Prohibited Person” shall mean any person or entity:

(a) listed in the Annex to, or otherwise subject to the provisions of, the Executive Order;

(b) that is owned or controlled by, or acting for or on behalf of, any person or entity that is listed to the Annex to, or is otherwise subject to the provisions of, the Executive Order;

(c) with whom Seller/Lessor/Lender is prohibited from dealing or otherwise engaging in any transaction by any terrorism or money laundering law, including the Executive Order;

(d) who commits, threatens or conspires to commit or supports “terrorism” as defined in the Executive Order;

(e) that is named as a “specially designated national and blocked person” on the most current list published by the U.S. Department of the Treasury, Office of Foreign Assets Control at its official website, www.treas.gov/ofac or at any replacement website or other replacement official publication of such list; or

(f) who is an Affiliate of a person or entity listed above.

“Affiliate” means, as to any person or entity, any other person or entity that, directly or indirectly, is in control of, is controlled by or is under common control with such person or entity or is a director or officer of such person or entity or of an Affiliate of such person or entity. “Control” means the possession, directly or indirectly, of the power to direct or cause the direction of management, policies or activities of a person or entity, whether through ownership of voting securities, by contract or otherwise.

or

- Compliance with Executive Order and USA PATRIOT Act. Neither Purchaser/Lessee/Borrower, nor to Purchaser’s/Lessee’s/Borrower’s knowledge, any of Purchaser’s/Lessee’s/Borrower’s respective officers, directors, shareholders, partners, members or associates, and no other direct or indirect holder of any equity interest in Purchaser/Lessee/Borrower is an entity or person: (i) that is listed in the Annex to, or is otherwise subject to the provisions of United States Presidential Executive Order 13224 issued on September 24, 2001 (“**Executive Order**”); (ii) whose name appears on the U.S. Department of the Treasury, Office of Foreign Assets Control’s (“**OFAC**”) most current list of “Specifically Designated National and Blocked Persons” (which list may be published from time to time in various mediums including, but not limited to, the OFAC website, www.treas.gov/ofac/); (iii) who commits, threatens to commit or supports “terrorism”, as that term is defined in the Executive Order; or (iv) who is otherwise affiliated with any entity or person listed above (any and all parties or persons described in clauses (i) through (iv) above are herein referred to as a “**Prohibited Person**”). Purchaser/Lessee/Borrower covenants and agrees to use commercially reasonable efforts to ensure that neither Purchaser/Lessee/Borrower, nor any of its respective officers, directors, shareholders, partners, members or associates, and no other direct or indirect holder of any equity interest in Purchaser/Lessee/Borrower will: (a) conduct any business, or engage in any transaction or dealing, with any Prohibited Person, including, but not limited to, the making or receiving of any contribution of funds, goods, or services, to or for the benefit of a Prohibited Person; or (b) engage in or conspire to engage in any transaction that evades or avoids, or has the purpose of evading or avoiding, or attempts to violate, any of the prohibitions set forth in the Executive Order or the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001. On request by Seller/Lessor/Lender from time to time, Borrower further covenants and agrees promptly to deliver to Seller/Lessor/Lender any such certification or other evidence as may be requested by Seller/Lessor/Lender in its sole and absolute discretion, confirming that, to Purchaser’s/Lessee’s/Borrower’s knowledge, no violation of this Section shall have occurred.

II. SAMPLE LEASE DISCLOSURES¹

EVOLUTION OF LEASE DISCLOSURE

1. Tenant's Initial Proposal [Tenant is a national brokerage company]

Prohibited Persons and Transactions. Tenant and Landlord (each, a "Representing Party") each represents and warrants to the other (i) that neither the Representing Party nor any person or entity that directly owns a 10% or greater equity interest in it nor any of its officers, directors or managing members is a person or entity (each, a "Prohibited Person") with whom U.S. persons or entities are restricted from doing business under regulations of the Office of Foreign Asset Control ("OFAC") of the Department of the Treasury (including those named on OFAC's Specially Designated and Blocked Persons List) or under any statute, executive order (including Executive Order 13224 (the "Executive Order") signed on September 24, 2001 and entitled "Blocking Property and Prohibiting Transactions with Person Who Commit, Threaten to Commit, or Support Terrorism), or other governmental action, (ii) that the Representing Party's activities do not violate the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 or the regulations or orders promulgated thereunder (as amended from time to time, the "Money Laundering Act"), and (iii) that throughout the term of this Lease the Representing Party shall comply with the Executive Order and with the Money Laundering Act.

2. Landlord's Response

Prohibited Persons and Transactions. Tenant and Landlord (each, a "Representing Party") each represents to its current and acknowledge to the other that the Representing Party is not a person or entity (each, a "Prohibited Person"), nor owns property or interests in property, which is blocked pursuant to Executive Order 13224 signed on September 24, 2001 and entitled "Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit, or Support Terrorism" or under any rules and regulations related thereto (collectively, the "Executive Order").

3. Final Negotiated Lease Provision

Prohibited Persons and Transactions.

- A. Tenant's Representation. Tenant represents to Landlord that, (i) neither Tenant nor any person or entity that directly owns a 10% or greater equity interest in it nor any of its officers, directors or managing members is a person or entity (each, a "Prohibited Person") with whom U.S. persons or entities are restricted from doing business under regulations of the Office of Foreign Asset Control ("OFAC") of the Department of the Treasury (including those named on OFAC's Specially Designated and Blocked Persons List) or under Executive Order 13224 (the "Executive Order") signed on September 24, 2001, and entitled "Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit, or Support Terrorism), or other governmental action, (ii) that Tenant's activities do not violate the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 or the regulations or orders promulgated thereunder (as amended from time to time, the "Money Laundering

Act”), and (iii) that throughout the term of this Lease, Tenant shall comply with the Executive Order and with the Money Laundering Act.

- B. Landlord’s Representation. Landlord represents to Tenant that, (i) neither Landlord nor any of its officers, directors or partners nor any person or entity that to its current actual knowledge, directly owns more than 10% beneficial interest in it, as described in the Schedule 14A Information Required in the Proxy Statement of Crescent Real Estate Equities Company dated as of May 28, 2004, is a Prohibited Person with whom U.S. persons or entities are restricted from doing business under regulations of OFAC or under the Executive Order, or other governmental action, and (ii) that throughout the term of this Lease, Landlord shall comply with the Executive Order and with the Money Laundering Act, if, when and to the extent Landlord may become subject to the Money Laundering Act.

DEVELOPER’S LEASE PROVISION

Prohibited Persons and Transactions. Tenant represents and warrants to Landlord that Tenant is currently in compliance with and shall at all times during the Term (including any extension thereof) remain in compliance with the regulations of the OFAC of the Department of the Treasury (including those named on OFAC’s Specially Designated and Blocked Persons List) and any statute, executive order (including the September 24, 2001, Executive Order Blocking Property and Prohibiting Transactions with Person Who Commit, Threaten to Commit or Support Terrorism), or other governmental action relating thereto.

SAMPLE LEASE PROVISION

Lessee’s Funds.

- (a) Lessee has taken, and shall continue to take at all time following the execution of the Lease, as required by law to ensure that the funds invested in the Lessee and/or used to make payments under this Lease are derived (i) from transactions that do not violate U.S. law or, to the extent such funds originate outside the United States, do not violate the laws of the jurisdiction in which they originated; and (ii) from permissible sources under U.S. law or to the extent such funds originate outside the United States, under the laws of the jurisdiction in which they originated.
- (b) **[Optional – To Lessee’s current actual knowledge after making due inquiry,]** Lessee (i) is not under investigation by any governmental authority for, or has been charged with, or convicted of, money laundering, drug trafficking, terrorist-related activities, any crimes which in the United States would be predicate crimes to money laundering, or any violation of any Anti-Money Laundering Laws; (ii) has not been assessed civil or criminal penalties under any Anti-Money Laundering Laws; (ii) has not been assessed civil or criminal penalties under any Anti-Money Laundering Laws; or (iii) has not had

any of its funds seized or forfeited in any action under any Anti-Money Laundering Laws.

- (c) “Anti-Money Laundering Laws” means those laws, rules, regulations, orders and sanctions, state and federal, criminal and civil, that (a) limit the use of and/or seek the forfeiture of proceeds from illegal transactions; (b) limit commercial transactions with designated countries or individuals believed to be terrorists, narcotic dealers or otherwise engaged in activities contrary to the interests of the United States; c) require identification and documentation of the parties with whom a financial institution conducts business; or (d) are designed to disrupt the flow of funds to terrorist organizations. Such laws, regulations and sanctions shall be deemed to include the Executive Order Number 13224 on Terrorism Financing (September 23, 2001), the Patriot Act, the Bank Secrecy Act, Pub.L. No. 91-508, 84 Stat. 1305 (1970), the Trading with the Enemy Act, 50 U.S.C. Appx. Section 1 et seq., the International Emergency Economics Powers Act, 50 U.S.C. Section 1701 et seq., and the sanction regulations promulgated pursuant thereto by OFAC, as well as laws relating to prevention and detection of money laundering in 18 U.S.C. Sections 1956 and 1957, as amended.
- (d) “Patriot Act” means the USA PATRIOT Act of 2001, Pub. L. No. 107-56, together with all laws, rules, regulations and orders issued in connection therewith.

III. SAMPLE SNDA DISCLOSURE

LENDER'S INITIAL SNDA PROVISION

Tenant represents and warrants that Tenant, all persons and entities owning (directly or indirectly) an ownership interest in Tenant and all guarantors of all or any portion of the Lease: (i) are not, and shall not become, a person or entity with whom Lender is restricted from doing business with under regulations of the Office of Foreign Asset Control ("OFAC") of the Department of the Treasury (including, but not limited to, those named on OFAC's Specially Designated and Blocked Persons list) or under any statute, executive order (including, but not limited to, the September 24, 2001 Executive Order Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten to Commit, or Support Terrorism), or other governmental action; (ii) are not knowingly engaged in, and shall not engage in, any dealings or transaction or be otherwise associated with such persons or entities described in (i) above; and (iii) are not, and shall not become, a person or entity whose activities are regulated by the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 or the regulations or orders thereunder.

NEGOTIATED SNDA PROVISION (REJECTED BY TENANT)

Tenant represents and warrants that (i) Tenant and all record shareholders of Tenant as of _____, 2004 are not, and Tenant shall not become, listed on the Specially Designated Nationals and Blocked Persons List maintained by OFAC (as defined below) pursuant to the Order (as defined below) and/or on any other list of terrorists or terrorist organizations maintained pursuant to any of the rules and regulations of OFAC or pursuant to any other applicable Orders (such lists are collectively referred to as the "Lists"); (ii) Tenant and all record shareholders of Tenant as of _____, 2004 are not, and Tenant shall not become, a person who has been determined by competent authority to be subject to the prohibitions contained in the Orders; (iii) Tenant and all record shareholders of Tenant as of _____, 2004 are not, and Tenant shall not become owned or controlled by, _____, any person on the Lists or any other person who has been determined by competent authority to be subject to the prohibitions contained in the Orders; and Tenant and all record shareholders of Tenant as of _____, 2004 does not act for or on behalf of such a person and Tenant shall not act for or on behalf of such a person; (iv) Tenant and all record shareholders of Tenant as of _____, 2004 are not, and Tenant shall not become, knowingly engaged in any dealings or transaction, or associated with such persons or entities described in (i) or (ii) above; or (v) Tenant and all record shareholders of Tenant as of _____, 2004 are not, and Tenant shall not become, a person or entity with whom Lender is prohibited from doing business under the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 or the regulations or orders thereunder. The term "Order" shall mean the requirements of Executive Order No. 13224, 66 Fed. Reg. 49079 (Sept. 25, 2001) and other similar requirements contained in the rules and regulations of the Office of Foreign Assets Control, Department of the Treasury ("OFAC") or any other agency of the Federal government and in any legislation or other Executive Orders or regulations with respect to terrorism and homeland security (the Order and such other rules, regulations, legislation, or orders are collectively called the "Orders").

¹ Reprinted with permission by Patrick T. Sharkey, Esq., Jackson Walker L.L.P., 1401 McKinney, Suite 1900, Houston, Texas 77010, from the article, “Patriot Games: Impact on Leases, SNDAs and Management Agreements” for Section of ABA Real Property, Probate and Trust Law Committee Chair Orientation, Tampa, Florida, November 13, 2004.