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See page **16**

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Export compliance: Challenges and best practices

» The United States government continues to vigorously enforce its export and sanctions laws against both entities and individuals.

» US export and sanctions laws have a broad reach and can cover conduct occurring entirely outside the United States and actions undertaken by non-US parties.

» Third parties, such as agents, distributors, freight forwarders, and other representatives, can create liability for exporters on whose behalf they act.

» Technical data and technology can move easily across international borders, which makes controlling technology a particular challenge for many companies.

» Establishing a robust culture of compliance, including tone from the top and clear policies and procedures, is an essential part of effective compliance.

It may seem odd to write about effective export compliance in the midst of political upheaval resulting, in part, from people's concerns about too much globalization. In June 2016, the United Kingdom voted to leave the European Union and the supposed benefits of being part of a pan-European customs union. In November 2016, the United States elected a new president, Donald Trump, who scorned US trade agreements throughout his campaign. Other populist movements—from France, to Germany, to Poland, and beyond—have made gains by heaping criticism on the cross-border movement of people, jobs, and goods.

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Regardless of the current trend against globalism, the world is as interconnected as it has ever been, and that seems unlikely to change. It is hard to imagine much of a diminution—let alone a cessation—of the global movement of products, services, and money. Exporting enables companies to sell more products and help grow our country's economic base. Given this reality, any individual or entity engaged in international trade needs to understand their obligations as well as practices necessary to comply with those obligations. This article is an effort to identify the issues to address to ensure successful export transactions. Note that this article is focused on US export controls and sanctions laws. It is important to recognize that other countries increasingly are implementing and enforcing their own trade laws. Although the compliance best practices summarized in this article should generally be effective regardless of which laws apply to a particular transaction, compliance measures always need to reflect applicable laws.

Applicable laws

Many US laws impact export activities, but there are several sets of regulations that govern most US exports. The following is a brief summary of those regulations, including a short overview of how they are enforced.

The Export Administration Regulations

The EAR regulate the export and re-export of most commercial, as well as all "dual-use" goods, technology, and software. The U.S. Department of Commerce, Bureau of Industry and Security (BIS) administers the EAR.[1]

"Dual-use" means the item has both commercial and military applications. The good news is that relatively few exports of commercial and dual-use items require an export license. However, there are different requirements to export lawfully, depending on the product or service being exported.

In order to ascertain if a commercial or dual-use item requires an export license, the product's Export Control Classification Number (ECCN) must first be determined. This is done by searching the Commerce Control List (CCL), which is part of the EAR. ECCNs identify reasons for control and also indicate specific licensing requirements to certain destinations. If the item being exported falls under U.S. Department of Commerce jurisdiction but is not listed on the CCL, it is designated as "EAR99." EAR99 items generally include low-technology or consumer goods, and do not require a license in many situations. However, if the item is to be exported to an embargoed country, to an end-user of concern, or in support of a prohibited end-use, an export license will often be required (and may not be granted). Therefore, in addition to checking the CCL for an item's ECCN, exporters are required to identify the destination country for the item being exported, as well as the end user and the end use of the item.

In order to ascertain if a commercial or dual-use item requires an export license, the product's Export Control Classification Number (ECCN) must first be determined.

For example, license requirements may be significantly different when exporting to a Russian private party on the one hand and a Russian police force on the other. In addition, information about all parties to an export transaction must be checked against the various comprehensive lists of individuals and entities who are denied export privileges or who have export restrictions in place. These lists are maintained by BIS and the U.S. Department of Treasury, Office of Foreign Assets Control (OFAC) (see more on OFAC below).

The International Traffic in Arms Regulations

The ITAR control exports of "defense articles," a term generally defined to cover any article specifically designed or modified for a defense application. The U.S. State Department, Directorate of Defense Trade Controls (DDTC) administers the ITAR.[2]

In addition to controls on defense articles, the ITAR govern exports of defense technical data and defense services. Those

items controlled under the ITAR are listed on the U.S. Munitions List. But unlike the EAR, under which most exports can be made without a license, under the ITAR, virtually every export requires a specific license or other authorization. There are a few license exceptions under the ITAR, but they are very fact-specific and do not apply in many cases. With very limited exceptions, any party that engages in manufacturing, exporting, and/or brokering defense articles must register with DDTC on an annual basis; unless registered, a party cannot obtain ITAR authorization.

The US government also maintains arms embargoes on a number of countries, including China. Generally speaking, DDTC will not authorize any exports of defense articles to a country subject to an arms embargo. Similarly, DDTC maintains a list of debarred parties, both in the United States and beyond, that are prohibited from engaging in ITAR-controlled activities.

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U.S. Economic Sanctions administered by OFAC

Through OFAC, an agency within the U.S. Treasury Department, the US government administers economic sanctions programs against designated countries, governments and other entities, individuals, and even vessels. Sanctioned parties are designated based on their involvement in drug trafficking, terrorism, weapons proliferation, or other activities deemed to cause a threat to US national security.[3]

Some US sanctions programs are comprehensive; for example, current US sanctions on Iran and Syria restrict US persons from conducting nearly any transaction with or in those countries. Most US sanctions programs are selective, however. For example, under current US sanctions on Zimbabwe, OFAC only prohibits certain types of transactions with specific individuals and entities.

In some respects, US sanctions extend beyond US export controls, as US sanctions regulations govern transactions involving both goods and services. For example, many US sanctions programs prohibit the export to a designated country or party of financial, business, consulting, or marketing services, even if no physical item is provided in conjunction with the services. And US sanctions programs also prohibit facilitation of prohibited transactions, meaning you cannot do something indirectly or support something that you cannot do directly.

Enforcement

Understanding and complying with US export regulations and laws have been made all the more important because of vigorous US government enforcement of those laws. Under the EAR, ITAR, and OFAC regulations, civil penalties in the amount of $250,000 or more can be imposed for each violation. Criminal penalties may also be imposed, including against individuals, who can face jail time for serious violations. And administrative penalties can also be imposed. The most severe of these penalties is debarment, where an entity or individual loses its export privileges. This can be the death penalty

for a company whose business is heavily export-dependent.

In recent years, large and well-known companies have been penalized tens of millions of dollars and more for violations. Often these companies have also been required to take specific steps to improve compliance, at additional cost, for a set period of time after the violations have been resolved. With these penalties comes the added cost of reputational damage, because violations and penalties are made public. Needless to say, it is not good business when the local newspaper reports on your company because of activities deemed to threaten US national security!

The EAR and ITAR follow US-origin items, wherever located, so that US export laws often apply to transactions involving US-origin goods that are being transferred between two non-US countries.

Compliance challenges

There are myriad challenges when exporting products, technology, data, or services. Those challenges differ depending on the nature of the export. For example, the challenges a defense contractor will encounter if it wants to ship a piece of hardware to a non-US military end-user are much different than the considerations for a financial institution seeking to transfer funds across the border separating two business partners. Nonetheless, certain compliance challenges are pervasive and are, in our experience, the ones of which exporters need to be most aware.

Jurisdiction

Under both export and sanctions laws, jurisdiction is broad. The EAR and ITAR follow US-origin items, wherever located, so that US export laws often apply to transactions involving US-origin goods that are being transferred between two non-US countries.

The EAR at least includes a *de minimis* provision. Thus, for example, an item manufactured in South Korea that incorporates less than a *de minimis* amount of US-origin content is no longer controlled under the EAR (but would likely be controlled under South Korean export laws). And if the US-origin components in the item break and need to be replaced, it may be necessary to get an export license to export those replacement parts to the end-user.

The ITAR go even further than the EAR. As a general matter, an item manufactured outside the United States that contains any ITAR-component is controlled under the ITAR in addition to controls imposed by the country in which the item was manufactured. This is one reason why a number of non-US companies (particularly in Europe) have sought to design products without ITAR components and technologies.

Jurisdiction under US sanctions regulations is also broad. Whereas US export controls focus on the origin of items involved in a transaction, US sanctions turn on the involvement of US persons, a term defined to include any person in the United States, regardless of nationality, and any US citizen or lawful permanent resident, wherever located. In the case of US sanctions on Cuba and Iran, jurisdiction also extends to non-US companies owned or controlled by US persons. And the US government can pursue penalties against any person, whether a US person or not, who causes a US sanctions

violation. Thus, the US government can (and often will) pursue enforcement action against non-US persons who deceive US persons into prohibited transactions.

As is apparent, the US government takes an expansive view of its jurisdiction under US export controls and sanctions regulations. Indeed, many of the biggest export enforcement actions the US government has pursued to date have involved non-US companies that either deal in US-origin goods or engage in transactions in the United States through US affiliates or partners. This will likely continue to be a trend.

Agents, distributors, integrators, customers, and any other party to an export transaction can trigger violations and penalties, both for themselves and other parties to the transaction.

Technology transfers

Both the EAR and ITAR control exports of technology and technical data. This presents a peculiar challenge given the ease with which technology and data can cross national boundaries. For example, technology and data can be exported via phone, fax (to the extent anyone ever sends a fax anymore), e-mail, file transfer protocol (ftp) sites, and through in-person communications. And under US law, non-US persons in the United States, even if authorized to be in the country, are treated as part of their home nation. Thus, sharing data with graduate students, temporary workers, or non-US customers can trigger export violations, even when the non-US recipient of the data is specifically authorized to be in the United States.

Technology sharing can also present a challenge under US sanctions. As discussed above, US sanctions reach conduct by US persons wherever located, and cover many transactions that involve the provision of services. Thus, for example, if an Iranian IT administrator were to seek assistance from a technician with a US software maker, and the US technician provided technical guidance to the Iranian administrator, it would likely constitute a sanctions violation. Given that a US technician supporting a customer would not ordinarily seek—or be able—to identify the nationality of the customer's IT administrator, it is easy to see how this sort of technical exchange could occur.

Third parties

Many export and sanctions problems arise because of the conduct of third parties. Agents, distributors, integrators, customers, and any other party to an export transaction can trigger violations and penalties, both for themselves and other parties to the transaction.

The United States maintains restrictions and prohibitions on a number of specific entities and individuals. Some of these restrictions are imposed by the Commerce Department (in accordance with the EAR), some are imposed by the State Department (in accordance with the ITAR), and some are imposed by OFAC (in conjunction with U.S. sanctions regulations). The extent of these restrictions differs. For example, in the case of the Denied Persons List maintained by the Commerce Department, no denied person may engage in any export transaction that is subject to the EAR. Similarly, under the ITAR, no debarred party may engage in an export transaction that is subject

to the ITAR. And most restrictive of all is the List of Specially Designated Nationals (SDNs) and Blocked Persons, which is maintained by OFAC. As a general matter, US persons may not conduct any business with an SDN.

Customers, distributors, and other third parties can create challenges when they fail to understand and adhere to their own obligations under US export and sanctions laws. For example, a non-US party to an export license may be authorized to receive a controlled product from the United States, but not re-sell it further without additional specific authorization. Absent clear communication with third parties, these restrictions can easily be missed.

And of course, a third party might intentionally divert an export or other cross-border transaction in violation of US law. The third party would be on the hook for their action, but the US exporter may also be subject to penalties if the US government decides that the US party did not conduct adequate due diligence on the third party prior to conducting business with them.

Export compliance best practices and key takeaways

Tone at the top

Senior management (e.g., board of directors, CEO, president) must empower individuals charged with the daily responsibilities for ethics and compliance, as well as provide the appropriate resources to those individuals, in order to reduce risk to the organization and build trust with all employees. This is essential for all aspects of ethics and compliance, including export. Additionally, the best compliance programs don't just stop with tone at the top. They have a positive culture of integrity that permeates through the middle of the organization and down to employees at all levels.

Policies and procedures to comply with export laws

Starting with a formal code of conduct, export compliance must be included as a basic tenet of an organization's expectations for its employees. An assessment should be completed to determine whether the organization is exporting EAR and/or ITAR designated items, which country the items are being exported to, who the end-users are, and what the end use is of the items being exported. And the results of the assessment should help drive areas where export compliance procedures are necessary.

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It is vital that resulting business processes and procedures be easy to understand and user-friendly for the employees responsible for export compliance. This can be best accomplished by working with internal business clients to fully understand the cradle-to-grave process when making a sale of an item to be exported. Understanding this process will help determine where to interject export compliance procedures with minimal impact to the business, which in turn will lead to greater compliance with the internal export procedures and reduce overall risk to the organization.

Training

Once export compliance processes and procedures are in place, it is crucial to

properly train employees on export compliance expectations. Once properly trained, employees should receive periodic refresher training, as well as updated training whenever procedures change due to process improvements or changes in export laws or regulations. The goal of training may differ depending on the audience; for instance, an administrative assistant probably does not need the same level of training as the shipping manager. But regardless of rank or title, all personnel should be equipped with: (1) adequate knowledge to spot potential compliance issues, and (2) confidence that they can report any good faith issue without fear of retaliation. Employees really are the eyes and ears of the enterprise; to make sure they function that way, appropriate training is a must.

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Documentation

Maintaining all documents pertaining to export transactions is an essential element of a robust export compliance program. (It is also required under the applicable regulations.) In the event of an export-related issue, failure to maintain proper documentation of export transactions and due diligence procedures can result in severe fines and penalties for an organization, but being able to produce such documentation to the US government can actually help mitigate damages.

Monitoring/Auditing

Monitoring and auditing are also among the most critical elements of an effective export compliance program. Ongoing monitoring and auditing for compliance to export policies and procedures demonstrates a commitment to export compliance by the organization and are also key methods to gain information about deviations in internal export procedures and discover potential systemic or material compliance risks. Monitoring and auditing also serves as a way to elevate the importance of the requirements for compliance with export procedures. When employees know that a procedure will be formally monitored and audited, they are more likely to comply with the requirements.

Conclusion

The export laws and regulations of the United States are complex and not always easy to navigate. Fines and penalties can be significant for companies that violate these various laws and regulations. Companies can promote compliance programs by ensuring a positive corporate culture and commitment to compliance from the top of the organization. Otherwise, the benefits of a lucrative export business can be quickly lost if appropriate compliance measures are not in place and are not being followed. ✳

1. Bureau of Industry and Security: Export Administration Regulations (EAR). Available at http://bit.ly/bis-php
2. U.S. State Department, Directorate of Defense Trade Controls: The International Traffic in Arms Regulations. Available at http://bit.ly/arms-reg
3. U.S. Department of Treasury, Office of Foreign Assets Control: Sanctions Programs and Information. Available at http://bit.ly/assets-control

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