PHILADELPHIA, MONDAY, NOVEMBER 17, 2008

The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES

An incisivemedia publication

Assessing and Addressing Risk in the International Marketplace

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Special to the Legal, PLW

Increased globalization and the opening of national markets to international trade — a cornerstone in today's economic policies around the world — has greatly expanded the role of international trade in the U.S. economy in recent years. In light of this expanded role, the U.S. government has implemented various international trade regulations to synergize open trade with domestic economic objectives, national security and foreign policy.

Increasingly complex trade regulations, however, create a challenge for exporting companies, as many are not sufficiently aware of the rudiments of these regulations. Companies, therefore, struggle with imposing export compliance controls sufficient to avoid potentially serious monetary and criminal non-compliance penalties.

It is essential to understand the basics of assessing a company's risks in the export area. Proper guidance on how to implement an efficient and cost-effective risk management program can help companies avoid export sanctions while promoting business growth.

The three major directives that govern export compliance in the U.S. are the Export Administration Regulations (EAR), certain embargo controls administered by the U.S. Department of the Treasury's Office of Foreign Asset Controls (OFAC) and the Directorate of Defense Trade Controls (DDTC). These regulations aim to ensure that exports are not shipped outside of the United States without a proper export license and diverted to improper end-users.

The definition of controlled "exports," however, is very broad and complex, covering products, activities and regulations that one may not ordinarily acknowledge as an "export." An employee's oral disclosure or demonstration of technology to a non-U.S. citizen, for example, may be deemed a controlled export. A thorough understanding of these regulations is essential for export compliance.

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EXPORT REGULATIONS

The EAR are provided by the U.S. Department of Commerce's Bureau of Industry and Security (BIS). The EAR regulates the export and re-export of most commercial items. Certain characteristics of the products to be exported determine the products' Export Control Classification Number (ECCN) within the Commerce Control List. Products associated with certain ECCNs require an export license from the BIS depending on the destination nation and the "reasons for control" of the item. Items not specifically classified on the Commerce Control List may generally be shipped without a license unless they are shipped to an embargoed country, to an end-user of concern, or in support of a prohibited end use (i.e., nuclear, chemical or biological weapons systems or missile systems).

Under the EAR, no product may be exported where the exporter knows that the product will be directly used in prohibited activities, such as the development or production of nuclear weapons or chemical/biological weapons, in a long list of countries in Asia, Africa, South America and the Middle East. End use/end user restrictions focus on the customer rather than the product to be exported. An exporting company must have the honest cooperation of sales and marketing personnel who have the most direct contacts with potential customers. If suspicious activities arise during any transaction or if a potential customer is involved in nuclear, chemical/biological weapons or missile-related activities, no exports should be made to that customer.

The OFAC is part of the U.S. Department of the Treasury and administers and enforces economic and trade sanctions against targeted foreign countries, terrorists, international narcotics traffickers and those engaged in activities related to the proliferation of weapons of mass destruction. The OFAC's embargos generally block all trade with a particular country without a specific license.

In addition, the OFAC compiles a list of "Specially Designated Nationals" — both individuals and parties who are deemed to be agents of sanctioned governments. An exporting company may not, without a license or

license exception, export or re-export any item to a country embargoed by the United States or otherwise made subject to controls or to any Specially Designated National. Whether a license must be sought from the OFAC, the Commerce Department or (in rare instances) both may vary depending upon the particular embargo.

The DDTC is within the U.S. Department of State. The DDTC has authority over defense articles and defense services identified on the U.S. Munitions List (USML). Such items are subject to export controls stated in the Arms Export Control Act and the International Traffic in Arms Regulations (ITAR). Any exports of arms or other defense articles and services are subject to the ITAR and are generally controlled.

COMPLIANCE WITH REGULATIONS

Compliance with the U.S. export regulations consists of three primary components. First, a company must assess the product to be exported for applicable licensing requirements. Next, a company must assess the potential end user and product destinations for applicable prohibitions. Finally, a company must assess the end use for applicable prohibitions. The law not only regulates controlled products, but also mandates that exporting companies refuse to sell controlled products to anyone that they suspect may divert the products from their stated destination or stated use.

The definition of controlled "export," however, is very broad and covers a large variety of activities and products. There are generally two situations in which an exporting company could potentially export its products or knowledge regarding these products: international sales and divulging product information to foreign nationals.

To prevent improper exports, an exporting company should implement a screening system to determine whether the exported product is controlled; assess the customer and the product destination; and assess the use of the product.

In determining whether an exported product is controlled, its licensing status must be determined according to an export compliance manual that each exporting company should have and update regularly.

In assessing the customer and the product destination, the exporting company must detect "red flags" regarding the legitimacy of a customer or transaction. To do this, sales, shipping and managerial personnel must become familiar with prospective customers and product destinations. Red flags include information relating to prospective customers' identities, locations, purported occupations, the period of establishment in the industry and whether the product is to ship to the customer's location or to another site. Checking the parties to the transaction (including freight forwarders, intermediate consignees and the ultimate consignee) against the most recent versions of the Denied Persons List, the Unverified List and the List of Specially Designated Nationals is essential.

The exporting company's export control administrator should demand a completed presale questionnaire from customers involved in a prospective international sale. The export control administrator must use the information from the presale questionnaire to compare prospective customer and end-user names and locations against published lists of prohibited end users and sales destinations. No quotation should be issued to the prospective buyer until the export control administrator verifies that the prospective sale has cleared all export control screens. Red flags include the prospective customer's failure to provide complete and accurate information and/or indications that the exported products may be diverted from their stated destination or use. If such red flags arise, the sale process must be halted immediately.

The presale questionnaire also should solicit information regarding the end use of the exporting company's product. This information determines whether and to what extent the prospective export is controlled. Again, no quotation should be issued to the prospective buyer until the export control administrator verifies that the prospective sale has cleared all export control screens.

All employees of a company are responsible for understanding when export control issues may be applicable and for raising all concerns and providing all pertinent information to the proper company export control administrator. Though the majority of such screening efforts occurs shortly following the initial contact with the prospective customer, if any employee is ever uncertain whether export controls or embargoes apply in a particular situation, they should immediately contact their immediate manager and/or the export control administrator.

The exporting company should send copies of all end-use letters, export licenses, export notification letters and records of all audits and audit results to the designated export control administrator for filing and record keeping. The export control administrator should keep all records of licensing applications for the company or an individual, records of company registrations for the U.S. Department of State and the U.S. Department of Commerce and/or any other registrations concerning exports.

REPORTING SUSPECTED VIOLATIONS

Each employee of the exporting company is required to notify the export control administrator whenever a suspected violation has occurred. The export control administrator must review the claim to determine the course of action.

The consequences for violating export control regulations are very serious and can result in both civil and criminal disciplinary actions. Penalties can range from loss of business for the exporting company to substantial monetary penalties and/or jail time for any individual violating these regulations. A loss of "exporting" privileges (usually for between 30 and 90 days) could greatly hinder the normal activities of the exporting company.

Disciplinary actions for non-compliance can include up to 10 years in prison and seizure and forfeiture of articles, revocation of exporting privileges and fines of up to $500,000 per violation under the State Department (ITAR); fines of $50,000 to $1 million or five times the value of the export, whichever is greater, per violation and up to 10 years in prison under the Commerce Department (EAR); and up to $1 million per violation and up to 10 years in prison under the Treasury Department (OFAC). Violations of specific sanctions laws may add additional penalties. Penalties for violations can apply to both individuals involved in the violation and to the exporting company.

SUMMARY

With the rapid growth of international trade, a true understanding of the laws and practices that govern international transactions has never been more important in navigating the global marketplace. Increasingly complex trade regulations demand the implementation of meticulous export compliance programs in companies involved in international trade.

Proper guidance in implementing efficient and cost-effective export compliance programs is essential in avoiding export sanctions and promoting business growth. •