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Eight Steps to Export Compliance

In evaluating foreign market opportunities, many U.S. companies do not properly address international trade requirements. This is particularly true in consideration of U.S. laws that restrict exports, known as "export controls."

Export controls are broad, complex, and constantly changing. Faced with the daunting challenge of these laws, some companies limit the availability of their products abroad or decide to forego international opportunities entirely. At their own peril, other companies enter foreign markets without knowledge or any care of export controls.

Eliminating market access without a full understanding of the law is hasty and unwise. Similarly, failing to assess applicable laws before entering foreign markets risks heavy fines, lengthy terms of imprisonment, and other penalties. While export controls are indeed complex, taking eight preliminary steps to compliance is the proper approach.

Summary of U.S. Export Controls

Export controls promote U.S. national security interests and foreign policy, often at the cost of private enterprise. They restrict exports from the United States, and re-exports from one foreign location to another of U.S. origin commodities, software, and technology (collectively referred to as "items"). Export controls also restrict the provision of certain services to foreign persons and to foreign destinations. They require licenses and other forms of advance approval, the submission of certain applications, forms of agreements, reports, and the maintenance of these and other types of records related to exporting and related activities.

Some of the controls come as no surprise. For example, the implementing regulations restrict exports of military items, temporary imports of military items, exports of nuclear materials and technology, and activities by U.S. persons related to the proliferation of nuclear, chemical, and biological weapons, missile technology, and maritime nuclear propulsion systems. They also restrict activities of U.S. and foreign persons involved in brokering military items and services related to military items.

In perhaps their clearest application, export controls require vigilance in avoiding transactions with parties identified on various U.S. government lists of prohibited parties. These are blacklists with names, addresses, and other identifying information on narcotics traffickers, weapons proliferators, terrorists, members of oppressive regimes, export control law violators, malicious cyber criminals, and other bad actors with whom dealings are severely restricted and, in many cases, altogether prohibited.

Nevertheless, many of the regulations are surprising because they restrict exports of not just military items, but also restrict exports of a broad scope of commercial items, to include certain off-the-shelf valves, gauges, computers, optics, sensors, software, and other items of a seemingly commercial nature.

Items do not have to be solely of U.S. origin to be subject to control. In fact, among their most remarkable aspects, export controls apply not only to exports of items from the United States., but also

to exports from foreign countries that involve foreign-produced items containing more than a de minimis amount of U.S. origin content; and to foreign produced items that incorporate certain U.S. technology or software.

The definition of "exports" and other key terms under the regulations are very broad. An export means shipping export-controlled hardware outside the United States, shipping or electronically transmitting export-controlled software and technical information to a foreign location, and otherwise disclosing export-controlled information inside or outside the United States to a foreign person in any manner.

Disclosures of export-controlled technical information to foreign persons (known as "deemed exports") can occur visually, orally, or through the application of personal knowledge or technical experience. For instance, showing blueprints to a foreign person or allowing a foreign person to simply see a production line at a manufacturing plant in the United States would be considered an export to the foreign person's country of nationality if visual observation reveals controlled technical information. Similarly, disclosures of this information by email, telephone or in-person at meetings and presentations also constitute exports regardless of whether the foreign person is in the United States or a foreign country when they receive the information.

The Regulations and Agencies

Many statutes and regulations address export controls. These include those safeguarding national security and the various trade sanctions that form an integral part of U.S. foreign policy. Of all these, the three primary U.S. export control regulations most commonly encountered in everyday trade are the Export Administration Regulations ("EAR"), administered by the Department of Commerce's Bureau of Industry and Security; the International Traffic in Arms Regulations ("ITAR"), administered by the Department of State's Directorate of Defense Trade Controls; and the Foreign Assets Control Regulations administered by the Department of Treasury's Office of Foreign Assets Control ("OFAC"). Other regulations may apply to a particular export or service. These include the regulations administered by the Department of Energy, the Nuclear Regulatory Commission, the Food and Drug Administration, and the Patent and Trademark Office.

At times, the agencies share overlapping jurisdiction and a license may be required from more than one agency for the same transaction or service. Further, each agency's regulations set forth their own prohibitions, requirements, and processes. At times, this maze of regulatory red tape seems unfair to companies looking to conduct legitimate business abroad. However, fair or not, the penalties for violations can be significant.

Violators face seizure of their products by U.S. Customs and Border Protection agents, the loss of export privileges, debarment from U.S. government contracting, fines that can skyrocket into millions of dollars, and lengthy terms of imprisonment. These official sanctions, as well as the threat of bad publicity, the loss of customers, and the duty of being a good corporate citizen, are all reasons why a company must learn the regulations and comply.

THE EIGHT STEPS

Step 1: Learn the Rules

Step 2: Determine Jurisdiction and Classification

Step 3: Register as Required

Step 4: Screen Each Transaction

Step 5: Obtain All Necessary Authorizations

Step 6: Make and Keep Records and Reports

Step 7: Implement a Written Compliance Program

Step 8: Monitor Compliance

STEP 1

Learn the Rules

Same as for any other aspect of your business, you must learn and understand the scope of government regulations applicable to your international activities. Of course, in conducting international trade, this will involve much more than just U.S. export control regulations. Other U.S. laws, such as customs and import controls, antiboycott laws, restrictions on transactions with prohibited parties, asset blocking statutes, the Foreign Corrupt Practices Act, trade agreements, conventions, and various industry customs and usages apply to international trade operations. In addition, U.S. exporters must ensure that they comply with laws of the foreign country into which they are sending their exports. These foreign laws often include laws on competition, labeling, taxes, and tariffs of the destination country.

STEP 2

Determine Jurisdiction and Classification

Determining which U.S. government agency or agencies controls the item or service at issue is critically important. It is only by following this step and order of review that you can confidently assess any licensing and reporting responsibilities.

The items controlled by the Department of Commerce under the EAR are described in the EAR Commerce Control List ("CCL") – a categorical listing of commodities, technology, and software subject to control. Most items on the CCL are referred to as "dual use" items because they have both civilian and military applications. However, the CCL also contains many purely military items. Depending on the items being exported, end destination, end use, and parties involved in a particular transaction, the EAR may require a license for export unless there is an "exception" permitting an unlicensed export. EAR license exceptions come with very specific conditions for their use.

If requested, the Department of Commerce will provide written advice on how something is classified under the EAR. However, it only controls exports not subject to the exclusive export jurisdiction of another agency. So before assessing whether your item or service is controlled by the Department of Commerce under the EAR, you must first determine whether it is controlled by the Department of State under the ITAR or subject to exclusive control by regulations administered by another agency. The

complexity of export controls regulations and individual agency practices often make this a gut-wrenching process full of potential pitfalls.

The Department of State's ITAR contains the United States Munitions List ("USML"), which primarily controls items with military applications. The USML contains a categorical listing of these items, known as "defense articles." The ITAR also controls certain types of services related to defense articles, known as "defense services." It controls the provision of proposals to sell defense articles and defense services to certain prohibited destinations and end users, and it controls the brokering of defense articles and defense services. The ITAR requires a license or other form of written Department of State authorization as may be stated in the regulations for these exports and activities unless an ITAR license "exemption" applies. Similar to EAR license exceptions, each ITAR license exemption comes with its own set of very specific conditions for use.

If there is any doubt on which agency exercises control over an item or service, the best approach is to obtain a binding decision in writing from government agencies. Generally speaking, an agency can only be bound by its own written determination in a form expressly provided by it for that purpose. For instance, the Department of State is the only government agency that can provide a binding determination on whether something is subject to the ITAR. It does not consider opinions provided by its employees over the telephone or in emails to constitute binding agency determinations. Instead, it provides a structured mechanism, known as the "Commodity Jurisdiction" procedure, to use in obtaining a binding written determination on whether ITAR jurisdiction applies.

It is also critically important to comply with the many trade sanctions programs administered by OFAC. These sanctions consist of embargoes and targeted sanctions programs, which are incorporated into export controls and prohibit dealings between U.S. companies and sanctioned targets. Certain sanctions can also apply to dealings between foreign subsidiaries of U.S. companies and a sanctions target. As such, irrespective of an item's classification, if a prospective U.S.-origin export or service will be provided to a person, entity or country subject to trade sanctions administered by OFAC, the transaction is likely prohibited and/or a license from the Department of Treasury may be required in lieu of or in addition to a license from another agency.

STEP 3

Register as Required

With very few and narrow exceptions, the Department of State requires all persons and entities involved in the manufacture of defense articles, the export of defense articles, the provision of defense services, or the brokering of defense articles and defense services to register with the Department of State. Registration with online license application systems is also required to submit license applications and various other requests to respective agencies. In addition, registration with the U.S. Census Bureau's Automated Export System ("AES") is required to file Electronic Export Information reports. Such reports must be filed for all physical shipments from the United States unless an exception to the filing requirements applies.

STEP 4

Screen Each Transaction

Once you know which set of regulations apply and how your item or service is classified under them, you must screen each transaction to determine whether license or other pre-approval requirements or prohibitions apply. This is a very fact-specific analysis that must be completed separately for each and every international transaction.

You must answer questions on the who, what, where, and how of each transaction before you begin the screens. These questions include:

- What is the precise export classification of the item or service being provided?
- Are all aspects of the item encompassed in the particular classification relied upon?
- What is the country of final destination?
- In what countries will the item transit on its way to the final destination?
- Will the item be offloaded from any vessel prior to reaching its final destination?
- Who is the final end user of the item?
- How will the item be used by the final end user?
- Who will possess the item while it is in transit?
- Will there be any reexports of the item?

This information, along with valid names and addresses for all the parties involved, is necessary to screen the transaction against agency control lists, prohibited end uses, prohibited party lists, and to ensure that no risks of diversion or other situations that require a license are present.

While exports to countries subject to U.S. embargoes are generally prohibited without a license, exports of many items to other destinations also require a license. In fact, many items, particularly military and dual use items, often require a license to export to countries that are friendly with the United States because of the particular U.S. government interest attached to the item or technology.

As noted above, the prohibited end uses include end use in the proliferation of chemical, biological, nuclear weapons, and missile systems anywhere in the world. End use controls may also apply to exports of items intended for certain military and/or military-intelligence end uses and/or end users in certain countries.

You should further screen end users and other parties to the transaction, such as any brokers, shippers, insurers, involved financial institutions, and parties in your supply chain generally to ensure that they are not on any U.S. government prohibited party lists. The largest of these lists is the OFAC Specially Designated Nationals and Block Persons List (the "SDN List"). You should screen against the SDN List as well as others depending on the scope of the transaction, to include those maintained by the Department of Commerce, Department of State, and other agencies. Depending on the scope of the transaction, the necessary lists may also include those maintained by other countries and international organizations.

If your transaction involves ITAR defense articles or defense services, you should screen for unlicensed defense article brokers and ensure that all parties to the transaction are properly registered with the Department of State, as may be required.

You should also screen for risks of diversion to prohibited destinations, diversion to prohibited end users, and diversion for prohibited end uses. Here, the Department of Commerce provides particularly helpful guidance on how to spot diversion risks. It refers to this as its "Know Your Customer Guidance," which is available on its website at www.bis.doc.gov. This guidance contains a list of non-inclusive indicators of diversion risk such as:

- The customer is reluctant to offer information about the end use of the item.
- The capabilities of the item do not fit the buyer's line of business.
- The shipping route is not normal for the item or destination.

Many other indicators of diversion risk are also listed. The presence of any of these indicators, also known as "red flags," or similar suspicious circumstances establish knowledge of a possible diversion risk that must be resolved prior to any export.

You must also watch for changes to the transaction at issue. The appearance of new items, services, transit routes or parties will require additional screening and existing parties should be rescreened on a regular basis to keep up with frequent changes to prohibited party lists.

STEP 5

Obtain All Necessary Authorizations

If a license or other form of advance approval is required and the export or service does not qualify for an applicable EAR exception (if the transaction is subject to the EAR) or ITAR exemption (if the transaction is subject to the ITAR), you must obtain a license. Other forms of required advance approval may consist of Department of State approved general correspondence, technical assistance or manufacturing license agreements for defense services, warehousing and distribution agreements, offshore procurement agreements, and OFAC specific licenses.

STEP 6

Make and Keep Records and Reports

Step 6 requires you to make and keep records and reports of exports. Written records of exports normally include a collection of documents, such as air waybills, bills of lading, AES submissions, and other documents that evidence the items exported, date and mode of transport, services provided, and parties to the transaction.

The regulations may further require the completion of other documents, such as non-disclosure agreements, non-transfer and use certificates, and reports required by multilateral treaties and regimes. You should also make and maintain records of all due diligence performed relating to transactions and maintain any correspondence with government agencies on international activities.

You must keep copies of all export records for no less than five years from the date of export, reexport, transshipment, termination of the transaction, license expiration, expiration of technical assistance agreement or manufacturing license agreement or other export related activity that is last in time.

Regardless of whether stored in electronic or paper format, these records must be accessible, legible, and accurate. In any event, you must always maintain and must not destroy records of any matter, regardless of the last date of export activity, which relates to a violation, government investigation, or other official inquiry.

STEP 7

Implement a Written Compliance Program

An effective export compliance program, carried out in written policies and procedures, endorsed by senior management, and supported by regular employee training is the best way to identify and address risks, minimize the chance of inadvertent violations, and, when properly implemented and followed, can serve as a mitigating factor in agency enforcement actions.

Many of the agencies offer guidance on their websites on how to develop effective compliance programs. In fact, the Department of Commerce's guidance on "Elements of an Effective Compliance Program" (see agency link above) is over a hundred pages long and quite detailed. The Department of State's "Compliance Program Guidelines" (www.pmddtc.state.gov) are more concise, and additional guidance is provided by OFAC in its Framework for Compliance Commitments (https://home.treasury.gov) and by the Department of Justice (www.justice.gov) in its guidance on "Evaluation of Corporate Compliance Programs."

The government guidelines establish core requirements to an effective export compliance program. Consistent with them, export compliance programs must be in writing, include performance of the eight steps described in this article, and further include:

- A policy, to include a written statement from senior management, establishing a corporate commitment to compliance, backed by policies and procedures, and sufficient staffing and other resources that foster a corporate culture of compliance.
- A clear delegation of responsibilities for carrying out export compliance functions within the company.
- Regular employee training on the program and general procedures utilizing daily checklists, memoranda, notices, or other means to maintain employee awareness of the regulations, the program, and the need for compliance.
- A means by which employees can report suspected violations to management and a clear statement that employees can report violations without fear of reprisal.
- A procedure for handling gaps in compliance measures identified in employee reports, internal assessments, and in regular audits.

The policies and procedures should contain a sufficient level of detail and be written in plain language that is understood by rank and file employees. Otherwise, it is unlikely to serve as a useful tool for compliance. Along the same lines, the program must be something that actually works and sufficient resources must be committed to carry out its requirements.

Keep in mind that these are only some of the minimum requirements and are not offered as an exhaustive list. There is no one-size-fits-all and you must review the standards and map the approach to compliance best suited to the way your company operates and its specific trade compliance risks.

You must also regularly review and adapt your compliance program to changes in the scope of your company's operations and to changes in company technologies, and you will need to make updates to timely reflect any changes in the law relevant to your operations.

The prohibited party lists, export control lists and other parts of the regulations are subject to frequent revisions. These are necessary to reflect changes in U.S. foreign policy, national security concerns, and other government interests. Accordingly, much like the regulations they address, your company compliance program and internal forms should be treated as living documents subject to change.

STEP 8

Monitor Compliance

A written compliance program is a great start, but it is definitely not enough. Stating the obvious, your company and its employees must follow the written compliance program and document compliance. You should accomplish this through comprehensive record-making and record-keeping, regular internal testing, and periodic audits performed by outside experts. Preferably, legal counsel should supervise audits and communicate findings to senior management under the attorney-client privilege.

Regardless of who performs them, the audits should identify any and all compliance gaps. These must be corrected, and written documentation should create a record of all corrective actions. Where actual violations of the regulations are discovered, immediate notification should be provided to your company's legal department and company senior management. Swift action must be taken and proper determinations made as to whether notification to relevant U.S. government agencies is appropriate through a voluntary disclosure.

CONCLUSION

In many respects, export controls are just another cost of doing business in today's global marketplace. They cannot be ignored. Senior leadership should fully commit to compliance. Compliance personnel must stay informed of changes to export controls and other laws applicable to international operations and adjust compliance measures as needed. While this may all seem very complex, the eight steps described in this article present an organized approach to compliance that can minimize risks and open foreign markets.

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