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## Coping With The New Export Control Paradigm

*Law360, New York (September 10, 2009)* -- Although the United States has long maintained controls on the export of goods, services and technology, these controls have become a special focus in the post-9/11 world.

The number of enforcement actions is steadily increasing and potential fines have gone up sharply, including through a 2007 increase by the International Emergency Economic Powers Enhancement Act (which applies to dual-use export and sanctions regulations) of the maximum civil penalty from \$50,000 per violation to the greater of \$250,000 or twice the amount of the violation.

With criminal penalties also increasing to as much as 20 years per violation, it has become critical for companies to focus on compliance with U.S. export controls.

This article provides an overview of how to cope with these heightened export control risks. In light of the increased stakes, exporters who do not adapt risk being trapped by the ever-evolving web of export control restrictions.

### **21st Century Best Practices**

Export control requirements are principally imposed by three U.S. Government agencies.

The Treasury Department's Office of Foreign Assets Control ("OFAC") administers most economic sanctions regulations, which prohibit or restrict transactions and investments in countries with adverse foreign policies or persons taking actions inimical to U.S. interests (e.g., terrorists and narcotics traffickers).[1]

The State Department's Directorate of Defense Trade Controls ("DDTC") administers the International Traffic in Arms Regulations ("ITAR"), which cover the export and brokerage of defense-related articles, services and technology.[2]

The Commerce Department's Bureau of Industry and Security ("BIS") administers the Export Administration Regulations ("EAR"),<sup>[3]</sup> which pertain to the export of goods and technologies not covered by the ITAR, which are "dual use" items subject to varying controls depending upon the product, destination and user.

All three regimes need to be taken into account when implementing a compliance program.

The new compliance paradigm is a reaction to the inadequacies of the old mindset. Previously, exporters would put in place off-the-shelf programs, in which compliance would be considered mostly at shipment, generally based on mechanical devotion to classification lists.

Export controls were stand-alone programs, updated only sporadically, that typically focused on the exportation of goods while paying short shrift to controls on information or technology dissemination.

Such cavalier implementation, even then neglectful, is downright reckless in the current enforcement environment. Better compliance is possible. This article provides an overview of the key best practices that exporters are implementing to give insights for firms looking to comply with the new export control paradigm.

## **Creating a Culture of Compliance**

Too often, exporters have viewed export compliance as a necessary evil — a legally mandated intrusion into the money-making goal of the corporation.

Proper compliance reverses this attitude by creating a company-wide culture of compliance that recognizes that export control risks are not worth short-term sales gains.

Proper risk management addresses intentional violations (get-the-sale-at-any-cost mentality), unintentional ones (get-the-shipment-out-now violations) and negligent ones (that's-how-we've-always-done-it violations). These goals are effectuated by close attention to the following:

### *Giving Compliance Internal Status*

Creating a culture of compliance starts with education and attention from the top. Compliance needs to be a funding priority, so that there are sufficient resources to run the program.

Compliance must have the authority to stop transactions and shipments, without question, until red flags are satisfied.

Compliance must be independent of sales or business generation, since people there can be more concerned with finishing sales than investigating red flags.

Most importantly, there must be a clear chain of communication to ensure that compliance problems get the ear of top management, whether through the general counsel's office or otherwise.

### *Tailoring Compliance*

In times past, it was common to find compliance programs that were similar from company to company. The better practice, however, is to tailor the program.

All facets of the business need to be examined, including the goods sold, the technology exported, and the technology used in production.

Sales patterns need to be examined — does the company sell products in controlled industries, or to controlled environments or people? Does it rely on restricted technology? Does it primarily sell to end users, resellers, or to companies that incorporate U.S. technology into other products?

### *Moving Beyond Shipping*

Traditionally, exporters cordoned off compliance to a corner of the company, bringing compliance into play only when it came time to ship.

A better mindset, however, is to use an “A/B/C” training mentality — basic, perhaps online only, C-level training for most employees, more detailed training for people involved in sales, and intensive, A-level training for the people on the front lines of compliance.

Common red flags should be known throughout the corporation so that every employee can help prevent costly export control violations.

### **Taking Advantage of Technology**

Technological innovations have penetrated the compliance realm. The value of the tools cannot be disputed, since they automate a lot of time-intensive screening. There is, however, a fine line between responsible implementation and over-reliance on automated tools.

### *Screening Software*

In prior incarnations, the heart of compliance was a matrix that listed every product sold and its export status. This was cumbersome and thankfully is automated by widely available export screening software. Still, despite its usefulness, care must be taken.

The program needs to be frequently updated to take into account changes in the regulations, alterations in blocked persons, and the products exported. There also must be sensible oversight.

The goal is a system that routinely catches most problems, but with easily involved human intervention to avoid mechanical over-reliance on fallible systems.

### *Intranet*

Most large corporations use intranets to disseminate information efficiently. But intranets can be used for much more.

Best practices include putting basic training online, to allow far more people to be trained; providing plain-English summaries of applicable laws; providing lists of real-world examples, frequently asked questions, and forms and checklists; providing links to the EAR, ITAR and OFAC regulations; quickly disseminating updates to the regulations; informing people about changes in products and technology that could impact the exportable status of goods; setting up links to allow ready reporting of potential problems; and reporting on the resolution of tricky issues.

### *Automated Recordkeeping*

Exporting always has required numerous tracking responsibilities. Today, however, requirements to transmit information about exports electronically via the Automated Export System make keeping good records critical, because AES data is shared among numerous U.S. agencies, including BIS, DDTC and OFAC, which can, and do, request supporting documentation for certain transactions.

Purchase orders, invoices, bills of lading and other export documents need to be maintained. Documents relating to the transaction also should be maintained, such as orders, e-mails, notes, contracts, and results of any due diligence. Records should be organized so that the complete chain of documents corresponding to a transaction can be easily retrieved.

## **Moving Beyond a “Goods” Mentality**

Export control typically has focused on goods because no export meant no violation. But this is becoming less true. The twin trends of export controls increasingly focusing on technology and technology often being a key value-added component means more time must be spent dealing with technological issues.

### *Technology*

Export compliance for technology requires a different mindset, with the focus as much on the process of creation and the use of the product as the good itself.

For example, where software is at issue, the focus is not the physical medium but rather such issues as the method of export (which could be over the internet and thus not involve any good in traditional form) and the potential uses of the software (which might be incorporated into a controlled product by the purchaser). Goods with encryption raise a host of related issues.

### *Non-Traditional Exports*

Technology also brings into play nontraditional means of export. Such issues as whether there is a “deemed export” (i.e., communication of controlled information to a non-U.S. national, whether by oral discussion, visual inspection, or otherwise), export by access to a company’s information systems, issues relating to the employment of non-U.S. nationals, or even whether the mere exposure of a foreigner to a “data-rich environment” is a violation are all amplified where highly technological goods and services are at issue.

A good export compliance program requires a review of all business operating processes and procedures for involvement of U.S. persons in transactions involving embargoed destinations and carefully monitors the access of non-U.S. nationals to information and technology.

Controls also are needed for computer networks, particularly where ITAR-controlled technology is involved, as well as for transfers of data among affiliates, between R&D partners, and for collaborations with other companies.

## **Implementing Modern Best Practices**

Best practices are constantly evolving and vary from company to company. But certain elements tend to apply, including:

### *Knowing Your Products*

A proper compliance program requires significant input from personnel familiar with the technical parameters of the products and their components. Procedures need to be in place to ensure proper classification of items on the Commerce Control List so that proper controls on export can be put in place for items with more than 10% U.S. content by value.

### *Moving Beyond the Company*

Traditionally, companies viewed compliance as being complete when the product went out the door. No longer. Exporters today need intimate knowledge about their freight forwarders, shippers, agents, and distributors. With the U.S. government aggressively going after transshipment and re-export, they all are part of the risk profile and need to be integrated into compliance.

### *Expanding Due Diligence*

With internet and computerized databases providing vastly increased research possibilities, the government's expectation that exporters "know their customers" takes on increased urgency.

Exporters need to look beyond the actual destination entity and take into account all affiliations and cross-ownership of companies that might reveal suspect end users or re-export risks.

With OFAC now treating an entity that is 50% or greater owned by a blocked person as itself blocked, the importance of due diligence is magnified and often requires more than just use of automated computer checks.

### *Quickly Updating*

Traditionally, many companies updated their compliance programs quarterly to take into account changes on the OFAC list of Specially Designated Nationals and Blocked Persons, the BIS List of Denied Persons, Entity List and Unverified End-User List, and the DDTC List of Debarred Parties.

This would be considered slow today, as it allows too much leeway for inadvertent violations. The best practice is to include nearly real-time incorporation of changes, not only of blocked persons, but also changes to laws and regulations.

### *Auditing*

Traditionally, most effort was put into implementing the compliance program, with little thought given to spot-checking its effectiveness. The best practice, however, is to implement periodic self-assessments of risks and audits.

While this is partially driven by the increasing Sarbanes-Oxley focus on corporate controls requirements, it also makes sense from a pure export control perspective.

Policies that are well designed in theory can be poorly implemented, and there is a tendency for compliance to go into autopilot. Periodic audits can curtail these problems before they begin.

### *Licensing Exceptions and Opportunities*

Finally, it should not be forgotten that there sometimes are legitimate ways to engage in otherwise prohibited transactions.

These include situations where an export might be allowed under de minimis content rules, exceptions for exports of medical and agricultural products to certain destinations,

and use of the Validate End-User program, which allows the export of some kinds of controlled items to approved companies in China and India.

A well run compliance program identifies and allows the use of these exceptions where available.

## **Conclusion**

The days of taking a plain vanilla export control program, implementing it in one corner of a corporation, and then leaving it to run on autopilot are long over.

Only a tailored program, created based upon a deep understanding of the firm and its products, processes and customers, and fully integrated into the fabric of the corporation, will successfully minimize the risk of an export control violation.

An exporter that is not incorporating many of the preceding elements into its compliance programs needs to take a serious look at its compliance measures and update them to meet the requirements of 21st century business and regulations.

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*The opinions expressed are those of the author and do not necessarily reflect the views of Portfolio Media, publisher of Law360.*

[1] See 31 C.F.R. Parts 500-598.

[2] See 22 C.F.R. Parts 120-130. The DDTC also oversees registration requirements for manufacturers, exporters, and brokers of defense articles, as well as temporary imports of defense articles.

[3] See 15 C.F.R. Parts 730-774.