Export Control Laws for the General Counsel

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EXPORT CONTROL LAWS FOR THE GENERAL COUNSEL

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Introduction. You are the chief legal officer of a U.S. company. Your CEO walks into your office and announces that your company is about to conclude its first international sale. In addition, the company has just appointed distributors in Hong Kong and Dubai and expects to begin selling products throughout Europe, Asia and the Middle East over the coming year. He asks you to determine the U.S. legal requirements that will apply to this business. "Also," he adds, "I've heard there are civil and criminal penalties for violations of the export laws, including for our employees, officers and directors, so it is important that we get this right."

You have heard that there are a number of U.S. laws that could apply, but you are not sure if you can come up to speed as quickly as required. What to do?

The following article will assist you in tackling this assignment. Part I provides an overview of the major U.S. laws that regulate exports as a foundation for your analysis. Part II provides ten practical compliance steps that you will need to take in your first export transaction. You have known for some time that all business is going international and you really need to understand this area of the law - here is your chance. Get ready and hold on for the ride.

PART I – OVERVIEW OF THE US EXPORT LAWS

There is a broad array of U.S. laws that regulate export transactions. Of these, the most significant are the Export Administration Regulations, the International Traffic In Arms Regulations and the U.S. trade and economic sanctions programs. The following is a summary of the major provisions of these laws.

Note: The provisions discussed in this article are undergoing ongoing amendments under Export Control Reform, harmonization of various export regulations and diplomatic negotiations involving Iran, Cuba and other countries. Readers are advised to confirm if provisions have been amended at the time of reviewing this material.

A. Export Administration Regulations.

(1) Overview. The United States regulates the export of most products, software and technology under the Export Administration Regulations ("EAR").[1] The EAR are administered by the Bureau of Industry and Security ("BIS"), an agency within the U.S. Department of Commerce. The EAR set forth requirements regarding the export of "dual use" and military[2] products, software and technology from the United States and the reexport of such items in foreign countries. In addition, they set forth a number of requirements that apply broadly to almost all U.S. export transactions. The purpose of the EAR is to protect the national security and foreign policy interests of the United States.[3]

(2) Scope of the EAR.

(a) *Items "Subject to the EAR"*. The EAR apply to items that are "subject to the EAR." This is a defined term set forth at 15 CFR §734.3 that describes those items and activities over which BIS exercises regulatory jurisdiction. Items subject to the EAR include: (i) all items in the U.S., (ii) all U.S. origin items located in foreign countries; and (iii) certain foreign-made items that incorporate or are based upon defined levels of U.S.-origin commodities, software and technology.[4] The EAR apply both to U.S. persons[5] and foreign persons if the item in the transaction is subject to the EAR as set out above.

(b) *Nature of Controls Under the EAR*. The EAR set forth export restrictions on a number of levels. Under the CCL-Based Controls, the EAR provide a list of products (called the Commerce Control List) and items on this list are subject to export licensing requirements. In addition, the EAR set forth provisions that restrict exports: to prohibited destinations (15 CFR Part 746), prohibited end users (Part 744 and other sections) and for prohibited end uses (Part 744) – these generally apply to all export transactions subject to the EAR, even if the item is not on the CCL. There are also other specialized sets of controls such as Chemical Weapons Convention (Part 745), Short Supply Controls (Part 754) and restrictive trade practices (the "antiboycott requirements") (Part 760). Finally, the EAR regulate the performance of services

[1] 15 CFR Chapter VII, Subchapter C.

[2] The EAR regulate exports of military items listed in the "600 Series" of the Commerce Control List. Military products are also regulated by the Directorate of Defense Trade Controls under the International Traffic In Arms Regulations discussed in Section I.B. below.

[3] The EAR were originally promulgated under the Export Administration Act of 1979, as amended (Pub. L. 96-72, 93 Stat. 503, 50 U.S.C. app. 2401 - 2420), which has expired. The EAR are currently promulgated under the authority of the International Emergency Economic Powers Act, as amended (Pub. L. 95-223, 91 Stat. 1628, 50 U.S.C. 1701 - 1706), and various Executive Orders and other authorities.

[4] The EAR do not apply to items that are exclusively controlled for export or reexport by other U.S. government agencies, the content of certain printed books and other published materials and technology and software that is "publically available" except as set forth in 15 CFR §734.3(b)(3). See also special rules for encryption software and technology at 15 CFR §734.3(b).

[5] The term "U.S. person" is defined in 15 CFR Part 772 as follows: "U.S. person. (a) For purposes of §§744.6, 744.10, 744.11, 744.12, 744.13 and 744.14 of the EAR, the term U.S. person includes: (1) Any individual who is a citizen of the United States, a permanent resident alien of the United States, or a protected individual as defined by 8 U.S.C. 1324b(a)(3); (2) Any juridical person organized under the laws of the United States or any jurisdiction within the United States, including foreign branches; and (3) Any person in the United States. (b) See also §§ 740.9, 740.14 and parts 746 and 760 of the EAR for definitions of "U.S. person" that are specific to those parts."

by U.S. persons related to activities such as the development of chemical or biological weapons and missile technology.[6]

(c) *Commodities, Software and Technology*. The EAR apply to the export of tangible items (called "commodities") as well as intangible items such as software and technology. The term "technology" is defined broadly at 15 CFR Part 772 as "specific information necessary for the development, production, or use of a product."[7] Thus "technology" includes, among other things, technical drawings, designs, processes, "know-how," formulas and many other types of information. As such, the EAR can apply to the licensing of technology, the transmission and downloading of data on computers, the licensing of software, the distribution of training materials and other transfers of information in many forms. Technology that is "publicly available" (except software classified under ECCN 5D002[8]) is not subject to the EAR.[9]

Under the EAR, an export of technology and software can occur through a number of means including if (i) the item is released in a foreign country, or (ii) the technology or source code is released to a foreign party[10] within the U.S. (referred to as a "deemed export"). (Special rules apply to encryption source code and object code software.[11]) Such release can occur through a number of means including through the disclosure or transfer of documents or files to foreign parties (including in paper and electronic form), through oral exchanges/conversations with foreign parties, the demonstration of physical items such as through models or providing plant tours to foreign parties, electronic communications with foreign parties such as through e-

[6] See 15 CFR §744.6.

[7] The complete definition of "Technology" is set forth at 15 CFR Part 772 as follows: "Technology". (General Technology Note)-- Specific information necessary for the "development", "production", or "use" of a product. The information takes the form of "technical data" or "technical assistance". Controlled "technology" is defined in the General Technology Note and in the Commerce Control List (Supplement No. 1 to part 774 of the EAR). "Technology" also is specific information necessary for any of the following: operation, installation (including on-site installation), maintenance (checking), repair, overhaul, refurbishing, or other terms specified in ECCNs on the CCL that control "technology." **N**.B.: Technical assistance--May take forms such as instruction, skills training, working knowledge, consulting services. NOTE 1**:** "Technical assistance" may involve transfer of "technical data". NOTE 2**:** "Technology" not elsewhere specified on the CCL is designated as EAR99, unless the "technology" is subject to the exclusive jurisdiction of another U.S. Government agency (see § 734.3(b)(1)) or is otherwise not subject to the EAR (see § 734.4(b)(2) and (b)(3) and §§ 734.7 through 734.11 of the EAR).

[8] Encryption source code classified under 5D002 remains subject to the EAR even when made publicly available in accordance with part 734 of the EAR. However, publicly available encryption object code software classified under ECCN 5D002 is not subject to the EAR when the corresponding source code meets the criteria specified in 15 CFR §740.13(e). See ECCN 5D002 and also 15 CFR § 734.3(b)(3).

[9] The definition of "publically available" technology and software is set forth at 15 CFR §772.1 as follows: "*Publicly available technology and software.* Technology and software that are already published or will be published; arise during, or result from fundamental research; are educational; or are included in certain patent applications (see §734.3(b)(3) of the EAR)."

[10] The term "foreign party" is not defined in the definitions section of the EAR (15 CFR Part 772), however the definition of the term "U.S. person" is set forth in footnote 5 above.

[11] See 15 CFR §734.2(b)(9) for the export of encryption source code and object code software.

mails, telephone calls or faxes, and allowing foreign parties to have access to computer devices or networks where the person can access data files, software and e-mails.[12]

An "export" can occur as described above even if the foreign party is an employee of your company who can access these files through your company's computer network.

(d) *Reexports, "In Country" Transfers And Products Manufactured Abroad*. In addition to regulating the export of commodities, software and technology from the United States, the EAR also apply to the "reexport" of such items from one foreign country to another, and to the export from a foreign country of products manufactured abroad which incorporate certain levels of U.S. components or are based on certain levels of U.S. technology.[13] If a product is manufactured abroad and incorporates a controlled U.S. origin component, the export of the product manufactured abroad may be subject to the EAR depending upon the percentage of the value of the finished product that is attributable to the U.S. component. The determination of whether a product manufactured abroad that incorporates U.S. origin components is subject to the EAR is determined based upon the "de minimis" rules set forth at 15 CFR § 734.4.

The EAR apply to the company's U.S. operations as well as its foreign subsidiaries and branches, as well as to transfers to it foreign joint venture partners and other affiliates.

(3) Export Restrictions Under the Commerce Control List-Based Controls.

(a) General CCL-Based Items. The cornerstone of the EAR is the Commerce Control List (the "CCL"), which is set forth at 15 CFR Part 774. The CCL is a detailed list of products, technologies and software that are subject to export restrictions. If an item is listed on the CCL, the exporter may be required to obtain an export license or comply with other requirements in exporting or reexporting the item, depending upon the country to which the item will be exported and other factors. To determine if an export requires a license under the CCL-based controls, the exporter must review the CCL entry for the item in question and then refer to the "Commerce Country Chart" at 15 CFR Part 738 Supplement No. 1. The numbers designating items on the CCL are referred to as the Export Control Classification Numbers (ECCN's).

To analyze if an item is subject to CCL-based controls, the exporter must first determine the export jurisdiction and classification of the item to be exported. This involves determining if the export is subject to the jurisdiction of the Department of State (under ITAR) or the Department of Commerce (under the EAR), and if it is subject to the EAR determining the

[12] Technology is "released" for export when it is available to foreign nationals for visual inspection (such as reading technical specifications, plans, blueprints, etc.); when technology is exchanged orally; or the application to situations abroad of personal knowledge or technical experience acquired in the United States. See 15 CFR §734.2(b)(3).

[13] Specifically, EAR reexport restrictions may apply to: (i) the "reexport" of commodities, technology and software from one foreign country to another; (ii) the "in country transfer" of commodities, technology and software from one foreign party to another foreign party within the same foreign country; and (iii) the export of goods manufactured in a foreign country based on products or technology that originated in the United States above a certain threshold level. A separate analysis must be conducted to determine whether each transaction in each foreign country is subject to the EAR.

ECCN for the item. If an item is subject to the EAR and not listed on the CCL, it is referred to as "EAR99." The steps involved in determining the export jurisdiction and classification of an item under the EAR are discussed in further detail in Section II. Step 1 below.[14]

The EAR also set forth certain license exceptions at 15 CFR Part 740. In certain instances, if an export license is required for a transaction the exporter may be permitted to export the item without a license if the transaction fits within the parameters of a license exception.

If a company intends to export an item that is subject to the EAR, the company should review the CCL, the Commerce Country Chart, the license exceptions and other applicable EAR provisions for the transaction in question to determine if an export license is required or if other requirements apply under the CCL-based controls. If an export license is required, the exporter cannot proceed unless a license is obtained or a license exception is available. If an export license is required the item can only be shipped in accordance with the country, parties and other terms specified on the license. If a license exception is to be utilized, the company should verify that the exception is available and the company will be required to maintain records of such exception.

(b) Special Controls For 600 Series and 9x515 Items. The CCL has historically listed "dual use" products, ie, items that are commercial in nature but also useful in military applications. However under the recent Export Control Reform amendments,[15] many military items that were previously listed on the U.S. Munitions List ("USML") under the International Traffic In Arms Regulations ("ITAR") were transferred to the CCL to be regulated under the EAR. As part of this process, BIS established a new section of the CCL referred to as the "600 Series" to capture military items transferred from the USML. If an item is listed on the 600 Series it is subject to a higher level of export restriction than other items on the CCL.[16] Items on the 600 Series include many parts, components, accessories, attachments and software that are "specially designed" for military products listed elsewhere on the 600 Series or on the USML. The term "specially designed" is a defined term that was adopted in the EAR and ITAR as part of Export Control Reform.[17]

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[14] In determining the export jurisdiction and classification of an item the exporter should always (i) first determine if it is listed on the USML and subject to State Department jurisdiction under ITAR; and if it is not then (ii) assess if it is subject to the EAR. See the discussion of the process of determining export jurisdiction and classification set forth at Part II, Step 1 below.

[15] At the time of this writing, the Departments of Commerce, State and Defense are in the process of revising the U.S. export laws through a process that has become known as Export Control Reform. Under this process, the State and Defense Departments are reviewing the U.S. Munitions List ("USML") and transferring certain items listed on the USML to the CCL to be regulated under the EAR. BIS has established a separate category of items on the CCL for munitions items that have been transferred from the USML under Export Control Reform that is referred to as the "600 Series."

[16] Certain items transferred from the USML related to satellites and spececraft have been classified on the CCL as 9x515 items – these items are also subject to a higher level of control than other items listed on the CCL.

[17] The definition of "Specially Designed" that is included in the EAR is set out at 15 CFR Part 772. The definition of "Specially Designed" that is included in ITAR is set out at 22 CFR § 120.41.

Items listed in the 600 Series include many open-ended "catch-all" categories that are designed to capture a broad array of items incorporated in military products. One example of such a "catch-all" is ECCN 3A611.a which provides as follows:

> 3A611 Military electronics, as follows (see List of Items Controlled).
> *****
> a. Electronic ''equipment,'' ''end items,'' and ''systems'' ''specially designed'' for a military application that are not enumerated or otherwise described in either a USML category or another ''600 series'' ECCN.
>
> Note to 3A611.a: ECCN 3A611.a includes any radar, telecommunications, acoustic or computer equipment, end items, or systems ''specially designed'' for military application that are not enumerated or otherwise described in any USML category or controlled by another ''600 series'' ECCN.[18]

Through the adoption of new 600 Series ECCN's such as 3A611 under Export Control Reform, responsibility for the issuance of thousands of export licenses per year for military items has been transferred from the State Department to the Commerce Department. (BIS has even established the new Munitions Control Division that focuses exclusively on 600 Series licenses.) Thus BIS has added the licensing of military products to its already broad portfolio of export control responsibilities.

(4) Transactions With Restricted Parties. In addition to export restrictions on items listed on the CCL, the EAR provides a number of other controls that apply to all items that are subject to the EAR, even if the items are not listed on the CCL. One of these is the limitation on entering transactions with restricted parties. BIS maintains a number of lists of persons and entities that have been identified by BIS for engaging in export violations or who present other national security or foreign policy risks. These are the Denied Persons List, the Entity List and the Unverified List. If a party is listed on one of these lists, export restrictions apply to entering transactions with such party as follows:

- Denied Persons List: Persons and entities that have been denied export privileges. Any dealings with a party on this list that would violate the terms of its denial

[18] As referenced in the Note, in addition to electronics products the new ECCN 3A611 also covers computers, telecommunications equipment, radar, navigation, avionics equipment, acoustic systems and software that are "specially designed" for military applications. In the BIS rulemaking in which ECCN 3A611 was adopted, BIS explained that it included equipment from all of these areas that were "specially designed" for a military use in a single CCL category rather than in separate categories to be consistent with the USML and to simplify the classification process. Thus, these products are all included under ECCN 3A611. To assist readers, BIS is placing notices in CCL Categories 4, 5, 6 and 7 to advise readers that such products that were "specially designed" for military use are covered under ECCN 3A611.a. For example, Category 4A611 provides the following notice for computers and related parts and components: "4A611 Computers, and ''parts,'' ''components,'' ''accessories,'' and ''attachments'' ''specially designed'' therefor, ''specially designed'' for a military application that are not enumerated in any USML category are controlled by ECCN 3A611." Similar notices are provided for telecommunication equipment, avionics and navigation systems and radar and acoustic systems which designate that these items will be controlled under ECCN 3A611.

order are prohibited. The list can be found at: http://www.bis.doc.gov/index.php/policy-guidance/lists-of-parties-of-concern/denied-persons-list

- Entity List: Foreign parties that present a heightened risk of diversion under weapons of mass destruction (WMD) programs, terrorism, or other activities contrary to U.S. national security or foreign policy interests. The specific restrictions applicable to parties on the list are set forth on the list. U.S. persons are prohibited from entering transactions with such parties in violation of the restrictions set forth on the list unless the exporter obtains a license. The list can be found at: 15 CFR Part 744 Supplement No. 4.

- Unverified List: End-users who BIS has been unable to verify in prior transactions. The presence of a party on this list in a transaction is a "Red Flag" that should be resolved before proceeding with the transaction. The list can be found at: Supplement No. 6 to Part 744 of the EAR.

BIS consolidates the parties on the various BIS restricted parties lists on the Consolidated Screening List which can be found at: http://export.gov/ecr/eg_main_023148.asp

Companies are advised to screen all of the parties to their export transactions against the BIS restricted party lists prior to entering transactions to verify that none of the parties are identified on such lists. If a party is identified on a list, the exporter should review the provisions associated with the list in question to determine the export restrictions that apply – in most instances the exporter will be prohibited from entering transactions with the listed party unless a license has been issued or other applicable compliance requirement has been satisfied.

(5) End Use Based Controls. The EAR also set forth a listing of prohibited end uses at 15 CFR Part 744 (the "Prohibited End Uses"). As a general matter, U.S. companies are prohibited from engaging in export transactions if the products being exported, reexported or retransferred will be used in one of these Prohibited End Uses. The Prohibited End Uses include the design, development or use of nuclear products and technologies, chemical and biological weapons, certain unmanned air vehicles and rocket systems, maritime nuclear propulsion, missile delivery systems, weapons of mass destruction, terrorist activities and other activities. (There are approximately eighteen Prohibited End Uses in Part 744.) In addition, 15 CFR §744.6 provides that U.S. persons are prohibited from performing any contract, service or employment (including financing) that the U.S. person knows will assist in the design, development, production or use of items used in missiles, chemical warfare or biological warfare in certain designated countries. These controls apply to all items subject to the EAR, even if the items are not listed on the CCL The Prohibited End Uses are set forth at 15 CFR §744.1-744.20 (which can be found at: http://www.bis.doc.gov/policiesandregulations/ear/744.pdf.) Companies should verify that their exports will not be used in one of the Prohibited End-Uses prior to export.

The controls on Prohibited End Uses in Part 744 include provisions related to the "military end use" of certain products in the People's Republic of China ("PRC"), Russia and

Venezuela. Specifically, §744.21 provides that a company may not export, reexport or transfer (in-country) any items subject to the EAR listed in Supplement No. 2 of Part 744 without a license to the PRC, Russia or Venezuela if the company has "knowledge" that the item is intended for a "military end use" in the PRC or for a "military and use" or a "military end user" in Russia or Venezuela. In addition, companies are prohibited from exporting, reexporting or transferring (in-country) any items that are listed in the 600 Series or 9x515 items on the CCL (including items described in a ".y" paragraph of a 9x515 or 600 Series ECCN), to the PRC, Russia or Venezuela without a license.[19]

(6) Embargoes And Other Special Controls. 15 CFR Part 746 sets forth restrictions on entering certain export, reexport and retransfer transactions with countries subject to BIS embargoes. These countries include Iran, Syria, Cuba, N. Korea, Sudan, Russia (for certain industry sectors), the Crimea region of Ukraine, Iraq, Central African Republic, Cote d'Ivoire (Ivory Coast), Democratic Republic of the Congo, Eritrea, Lebanon, Liberia, Libya and North Somalia. Certain of these embargoes are comprehensive and prohibit effectively all export transactions with the country involved (subject to certain exceptions) while certain of the embargos prohibit only limited types of transactions. The terms of each of these embargo programs are different and exporters should review 15 CFR Part 746 for the specific terms of each program. These embargoes overlap with the sanctions programs administered by OFAC, however while in most cases the OFAC sanctions programs apply to "US persons,"[20] the EAR embargo provisions apply to items that are "subject to the EAR" and as such apply to transactions by both U.S. and foreign persons. Companies should review their proposed transactions to verify that the transactions are not restricted under the BIS embargoes under Part 746.

As part of these embargo programs, under §746.5, a license is required to export, reexport or transfer (in-country) any items listed in §746.5 or Supplement No. 2 to Part 746 when the exporter knows that the items will be used in exploration for, or production of, oil or gas in Russian deepwater or Arctic offshore locations or shale formations in Russia or the exporter is unable to determine whether the item will be used in such projects. Such items include drilling rigs, drilling completion equipment and other items commonly used in the energy sector.

(7) Due Diligence "Red Flag" and "Know Your Customer" Requirements. As discussed above, licensing requirements are imposed throughout the EAR based upon numerous factors including classification on the CCL, end use, end user and ultimate destination. These requirements are often dependent upon a person's knowledge of facts related to such issues. 15 CFR Part 732 provides guidance to exporters regarding the process for evaluating information about customers, end uses and end users in applying this knowledge standard. This guidance is set forth in Supplement No. 3 to Part 732, entitled BIS's "Know Your Customer Guidance and Red Flags" (hereinafter the "Guidance").

[19] See also provisions related to certain microprocessors and associated software used for military end uses and by military end users under 15 CFR §744.17.

[20] Note that certain U.S. sanctions program apply to parties beyond those that fit within the definition of "U.S. persons" such as with Iran and Cuba. See Section I.C.2. below.

The Guidance states that exporters should review their export transactions to determine if any suspicious facts or "abnormal circumstances" are present. If there are, the exporter is required to make further inquiry into the suspicious facts. Specifically, the Guidance provides: "…when "red flags" are raised in information that comes to your firm, you have a duty to check out the suspicions circumstances and inquire about the end-use, end-user, or ultimate country of destination."[21] If after deeper investigation the suspicious facts are resolved and the "red flag" eliminated, the company is permitted to proceed.[22] The Guidance sets forth examples of suspicious circumstances that are referred to as "Red Flags," although this is not an "all-inclusive" list of suspicious circumstances. This requirement applies to all export transactions subject to the EAR, even if the product being exported is not listed on the CCL.

The BIS "Know Your Customer" Guidance creates, in effect, a requirement to conduct a limited due diligence review in each export transaction. While at first blush this appears to be an minor requirement, it is actually an important compliance activity. If the exporter conducts a proper review, in the event the company inadvertently has an export violation, the use of "Red Flag" reviews can be extremely valuable in attempting to reduce or avoid potential enforcement liability. Such reviews, especially if conducted on a consistent basis, can help to demonstrate the company's good faith efforts to comply with the export laws. Even if a violation is found, such reviews might represent the difference between a civil penalty or no penalty on the one hand, and a willful violation and criminal penalty on the other. As such these reviews can be a valuable asset for the company in its compliance arsenal. We recommend conducting "Red Flag" reviews for each export transaction and maintaining records to be able to demonstrate that such reviews were conducted. The company should also consider adding additional red flag factors to the list that are specific for its particular industry or geographic market as a further precaution.

Most exporters used to consider the CCL-based controls as the most significant export requirements under the EAR. However in recent years the other areas of controls – prohibited end user, prohibited end use and prohibited destination restrictions – have become equally important. In fact, BIS enforcement officials have recently stated that the majority of recent BIS export enforcement cases involve EAR99 items – ie., products that are not listed on the CCL. Hence adopting compliance protocols for these areas of controls is a critical component of a company's export compliance activity.

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[21] See Supplement No. 3 to Part 732, §(a)(2).

[22] Section (a)(2) of the Guidelines provides in pertinent part: "*If there are "red flags", inquire*. If there are no "red flags" in the information that comes to your firm, you should be able to proceed with a transaction in reliance on information you have received. That is, absent "red flags" (or an express requirement in the EAR), there is no affirmative duty upon exporters to inquire, verify, or otherwise "go behind" the customer's representations. However, when "red flags" are raised in information that comes to your firm, you have a duty to check out the suspicious circumstances and inquire about the end-use, end-user, or ultimate country of destination. The duty to check out "red flags" is not confined to the use of License Exceptions affected by the "know" or "reason to know" language in the EAR. Applicants for licenses are required by part 748 of the EAR to obtain documentary evidence concerning the transaction, and misrepresentation or concealment of material facts is prohibited, both in the licensing process and in all export control documents. You can rely upon representations from your customer and repeat them in the documents you file unless red flags oblige you to take verification steps."

(8) Export Recordkeeping Requirements. Exporters are required to maintain records of their export transactions in accordance with the EAR recordkeeping requirements set forth at 15 CFR Part 762. This includes maintaining copies of a lengthy list of records related to export transactions set forth in §762.2 (including paper and electronic records) for a period of five years from the latest time set forth in §762.6. The exporter must maintain the original records in the form in which that person receives or creates them unless that party meets all of the conditions of §762.5 relating to reproduction of records. In addition, records are required to be available to be provided to officials of BIS, U.S. Customs and other U.S. government agencies if requested.

Clients sometimes ask about the importance of the EAR recordkeeping requirements. The answer is that they are quite important. If an enforcement official from BIS, Customs or the Federal Bureau of Investigation ever requests that you produce records related to a transaction, if your records are disorganized or incomplete you are already at a significant disadvantage in the investigation (and most likely already in violation, at least for recordkeeping violations). If conversely your records are organized, indexed, tabbed and produced in a timely manner, the investigator will see that you are highly organized and well prepared and he/she will have an uphill battle in investigating your company.

(9) Other Requirements Under the EAR. The EAR also set forth a number of other specialized export requirements including:

(a) Restrictive Trade Practices and Boycotts. Exporters are prohibited from participating in certain foreign restrictive trade practices and foreign boycotts as set forth at 15 CFR Part 760. Under such requirements, exporters are prohibited from responding to certain foreign boycott requests, participating in foreign boycotts and are required to report boycott requests to BIS and the Department of the Treasury, subject to certain exceptions.

(b) Chemical Weapons Convention Requirements. Companies may be subject to export restrictions on chemicals, chemical mixtures and chemical compounds under the Chemical Weapons Convention requirements as set forth at 15 CFR Part 745 and the Chemical and Biological Weapons controls set forth at 15 CFR § 742.2. Such restrictions are imposed to restrict the proliferation of certain chemicals utilized in chemical warfare activities. Companies exporting chemical products should review: (i) the provisions of the CCL (and in particular the chemicals listed in Category 1); (ii) the provisions related to the Chemical Weapons Convention controls set forth at 15 CFR Part 745 (including the Chemical Weapons Convention Schedule of Chemicals listed therein) and 15 CFR § 742.18; and (iii) the provisions related to the Chemical and Biological Weapons controls set forth at 15 CFR § 742.2.

(c) Short Supply Controls. Companies' exports may be subject to restrictions under the EAR Short Supply Controls as set forth at 15 CFR Part 754. Such restrictions may be imposed if BIS determines that there is a shortage of certain items in the U.S. and the export of such items would be detrimental to U.S. national interests.

(d) Export Clearance and Supporting Documentation Requirements. In addition to placing restrictions on certain export transactions, the EAR establish other requirements related to the export process. These include the requirement for the electronic submission of Automated Export System (AES) records in connection with export transactions as set forth in 15 CFR Section 758.1, obtaining and/or filing End-User Statements, Statements By Ultimate Consignee and Purchaser, Import Certificates and other supporting documents in certain transactions and the use of "destination control statements" on export documents in certain transactions. Such requirements are set forth at 15 CFR Part 758, Part 748 and elsewhere throughout the EAR.

(10) Penalties. Sanctions for violations of the EAR include (i) civil penalties and (ii) criminal penalties (for knowing or willful violations). Penalties include monetary fines up to $1,000,000 per violation and imprisonment of up to 20 years. BIS is also authorized to impose other sanctions for export violations including seizures and forfeitures, cross-debarment and denial of export privileges. Sanctions can be imposed upon corporate entities as well as individuals who are involved in violations, and persons who have aided or assisted others in committing violations. Specifically, sanctions can be imposed for:

- Engaging in conduct which is prohibited by the EAR;
- Aiding or abetting a violation, or conspiring to cause a violation;
- Acting with knowledge of a violation;
- Possession with intent to illegally export;
- Misrepresentation and concealment of facts;
- Evasion;
- Acting contrary to the terms of a denial order;
- Failure to comply with reporting and recordkeeping requirements.

(11) Export Compliance Programs. Due to the breadth and complexity of the requirements under the EAR, and the severe criminal and civil sanctions for the company and its employees, companies frequently adopt Export Compliance Programs to manage their compliance activities and reduce the likelihood of violations. An Export Compliance Program is a formal company-wide program to foster compliance with export requirements, and typically covers requirements under the EAR, the OFAC sanctions program and if applicable ITAR. The provisions included in a typical Export Compliance Program are set forth in Exhibit A below (including advanced components). If a company is found to have committed an export violation, prosecutors, enforcement officials and the courts will often reduce or "mitigate" penalties for companies that have adopted compliance programs.[23]

B. Arms Export Control Act and International Traffic In Arms Regulations (ITAR).

(1) Overview. The United States regulates the export and temporary import of goods, technical data, software and services designated by the State Department as having

[23] See, eg., Section 8B2.1 of the U.S. Sentencing Guidelines Manual, and the United States Attorney's Manual Principles of Federal Prosecution of Business Organizations. See also OFAC Economic Sanctions Enforcement Guidelines available at: http://www.treasury.gov/resource-center/sanctions/Documents/fr74_57593.pdf.

military significance under the Arms Export Control Act[24] and the International Traffic in Arms Regulations ("ITAR")[25]. ITAR is administered by the Directorate of Defense Trade Controls ("DDTC"), an agency within the U.S. Department of State ("State"), in coordination with the Defense Technology Security Administration and other agencies within the Department of Defense. The purpose of the AECA and ITAR are to protect the national security and foreign policy interests of the United States.

(2) U.S. Munitions List. ITAR contains a detailed list of items that are subject to ITAR export controls called the U.S. Munitions List[26] (the U.S. Munitions List, the accompanying interpretations and annex are referred to herein as the "USML"). If an item is listed on the USML, the manufacturer or exporter of such item is subject to a number of obligations under ITAR as discussed below.

The USML sets forth 21 categories of items subject to controls. The list contains many end-items that are used in military applications, such as aircraft, vessels, satellites, vehicles and protective equipment. In addition, the list includes many subsystems of military items such as radar systems, communications systems, navigational systems and computer systems, and certain parts, components, accessories, attachments and software that are "specially designed" to be used in such items.[27] Thus while the USML appears at first blush to be short, it actually covers a large number of products across a wide spectrum of industries - many products that manufacturers do not consider to be inherently military are included since they may be utilized in a defense system at some level in the supply chain. The intended use of an item at the time of export is not relevant in determining whether an item is on the USML.

ITAR has historically applied to the defense and government contracts industries. However, as many products and technologies that were originally developed for the military are transformed into commercial products, these regulations have come to apply far beyond the military field to many other industries. These include electronics, communications, chemical, optical, energy, navigation, high performance materials and engineering/technical services. They also apply beyond commercial firms to universities, research institutions and other not-for-profit organizations involved in technology research and development.[28] Since the evolution of products from the military to commercial sectors is so prevalent in our society (satellites, GPS and encryption, to name just a few), ITAR reaches into many corners of our economy.

(3) Amendments Under Export Control Reform and 600 Series. As referenced above, at the time of this writing the Departments of Commerce, State and Defense are in the process of revising the U.S. export laws through Export Control Reform. Under this process, the

[24] 22 U.S.C.A. §§ 2778-2799.
[25] 22 C.F.R. Chapter I, Subchapter M, Parts 120-130.
[26] The Munitions List is set out at 22 C.F.R. Part 121.
[27] In addition, under Export Control Reform many parts, components, accessories, attachments and software that were "specially designed" for items on the USML were transferred to the 600 Series on the CCL. See Section I.2 (c) below.
[28] The Department of Defense has also been increasing defense procurement from traditionally commercial firms to reduce costs and broaden the defense industrial base, further drawing companies into ITAR jurisdiction.

State and Defense Departments are reviewing the USML and transferring certain items listed on the USML to the CCL to be regulated under EAR. (BIS has established a separate category of the CCL for items that have been transferred from the USML that is referred to as the "600 Series.") Items transferred to the 600 Series include many parts, components, accessories, attachments and software that are "specially designed"[29] for items on the 600 Series or items listed on the USML. Thus many items that were previously regulated under ITAR are now regulated under EAR.

(4) Regulation of Software and Technical Data. ITAR applies not just to tangible products, but also intangible items such as software and technical data. Specifically, technical data and software related to products on the USML are also included on the USML for most items and subject to ITAR controls. Technical data is defined at 22 CFR § 120.10 as: (i) information which is required for the design, development, production, manufacture, assembly, operation, repair, testing, maintenance or modification of defense articles (including information in the form of blueprints, drawings, photographs, plans, instructions or documentation); (ii) classified information relating to defense articles and defense services; (iii) information covered by invention secrecy orders; and (iv) software as defined in 22 CFR §121.80(f)(iii) directly related to defense articles. Technical data does not include information concerning general scientific, mathematical or engineering principles commonly taught in schools, colleges and universities or information in the public domain as defined in 22 CFR §120.11. Technical data also does not include basic marketing information on function or purpose or general system descriptions of defense articles.[30]

ITAR provides a very broad definition of how technical data and software can be exported. This includes sending or taking such items out of the U.S. and disclosing such items to Foreign Persons[31] in the United States. Examples of instances in which technical data and software are exported include:

- Such items are transported out of the U.S. by mail, courier or similar means;
- A person travels abroad and brings such items with him/her (including releasing the information in a foreign location through oral or written means or through personal demonstration or merely bringing such items in a laptop or other mobile comunications device);

[29] The term "specially designed" is a precisely defined term that was adopted in the EAR and ITAR as part of Export Control Reform. The definition of "Specially Designed" that is included in EAR is set out at 15 CFR Part 772. The definition of "Specially Designed" that is included in ITAR is set out at 22 CFR § 120.41.

[30] See 22 CFR § 120.10.

[31] The term "Foreign Person" is defined at 22 CFR § 120.16 as follows: "Foreign person" means any natural person who is not a lawful permanent resident as defined by 8 U.S.C. 1101(a)(20) or who is not a protected individual as defined by 8 U.S.C. 1324b(a)(3). It also means any foreign corporation, business association, partnership, trust, society or any other entity or group that is not incorporated or organized to do business in the United States, as well as international organizations, foreign governments and any agency or subdivision of foreign governments (e.g., diplomatic missions).

- Such items are transmitted through electronic communications with Foreign Persons such as through a telephone call, e-mail, fax or posting an item on a website; or
- Such items are released to Foreign Persons in the United States.

Disclosure can occur through oral, visual or documentary disclosure, and can occur through written or electronic communication. Thus electronic sales/licensing of software, electronic posting of technical manuals, electronic transmission of training materials constitute exports if a Foreign Person can have access to such materials. In addition, posting such items in chatrooms, "intranets" or on the Internet or storing items in computer networks constitute an export if a Foreign Person can have access to such items.

As with the EAR, ITAR regulates the transfer of physical products as well as software and technical data. This includes transfers to the company's foreign affiliates as well as to foreign employees in its U.S. facilities. As with technology regulated under the EAR, the export of ITAR-controlled technical data and software can occur if such items are stored in your company's computer system and employees in your foreign office can access such items through your computer network.

(5) Regulation of Defense Services. ITAR also applies to "defense services," i.e. the furnishing of assistance, including training and other services, to Foreign Persons related to the design, development, engineering, manufacture, production, assembly, testing, repair, maintenance, modification, operation, demilitarization, destruction, processing or use of items listed on the USML ("Defense Services").[32] Defense Services also include providing military training and military advice to Foreign Persons. Parties are prohibited from performing Defense Services for Foreign Persons unless they obtain export authorization from DDTC by filing a Technical Assistance Agreement ("TAA").

(6) Requirements Under ITAR. If a physical article, software, technical data or service is listed on the USML, the company will be subject to a number of requirements under ITAR. The following is a summary of the most important of these requirements, and there may be additional requirements applicable to the company as set forth elsewhere in the AECA or ITAR.

[32] The definition of "Defense Service" is set forth at 22 CFR § 120.9 as follows: (a) "Defense service" means:
(1) The furnishing of assistance (including training) to foreign persons, whether in the United States or abroad in the design, development, engineering, manufacture, production, assembly, testing, repair, maintenance, modification, operation, demilitarization, destruction, processing or use of defense articles;
(2) The furnishing to foreign persons of any technical data controlled under this subchapter (see §120.10), whether in the United States or abroad; or
(3) Military training of foreign units and forces, regular and irregular, including formal or informal instruction of foreign persons in the United States or abroad or by correspondence courses, technical, educational, or information publications and media of all kinds, training aid, orientation, training exercise, and military advice. (See also §124.1.)

(a) Product Exports. Physical products (articles) that are ITAR-controlled cannot be exported from the United States unless an export license has been obtained from DDTC or a license exemption is available. In addition, physical articles that are ITAR-controlled cannot be transferred to representatives of foreign governments (including members of foreign military) within the United States unless a license has been obtained or an exemption is available. If a license is obtained the item can only be shipped in accordance with the country, parties and other terms specified on the license. If a license exemption is to be utilized, the company must verify that the exemption is available and the company will be required to maintain records of such exemption. *Unlike the EAR, where export licenses may be required for products on the CCL depending upon the country to which they will be exported, items on the USML require export licenses for exports to every country.*

(b) Technical Data. Technical data that is ITAR-controlled cannot be (i) sent or taken out of the United States; or (ii) transferred or disclosed to Foreign Persons inside the United States, unless an export license has been obtained from DDTC or a license exemption is available. If a license is obtained the item can only be transferred/disclosed to the Foreign Persons in accordance with the country, parties and other terms specified on the license. If a license exemption is to be utilized, the company must verify that the exemption is available and the company will be required to maintain records of such exemption.

Even the transfer of ITAR-controlled products and technical data by U.S. companies to U.S. Government officials outside the United States requires a license unless a license exemption is available.

(c) *Software*. Software that is ITAR-controlled cannot be (i) sent or taken out of the United States; or (ii) transferred or disclosed to Foreign Persons inside the United States, unless an export license has been obtained from DDTC or a license exemption is available. If a license is obtained the item can only be transferred/disclosed to the Foreign Person in accordance with the country, parties and other terms specified on the license. If a license exemption is to be utilized, the company must verify that the exemption is available and the company will be required to maintain records of such exemption.

(d) Services. Defense Services that are ITAR-controlled cannot be performed for Foreign Persons (i) outside the United States; or (ii) inside the United States, unless an export authority (called a Technical Assistance Agreement, or TAA) has been obtained from DDTC or a license exemption is available. If a TAA is obtained, the services can only be performed for the Foreign Person in accordance with the country, parties and other terms specified in the TAA. If a license exemption is to be utilized, the company must verify that the exemption is available and the company will be required to maintain records of such exemption.

Services related to USML items performed for international organizations such as NATO and the United Nations are considered Defense Services and regulated under ITAR.

(e) Reexports and Retransfers. Physical articles, software, technical data and services cannot be reexported or retransferred unless an export license or other authorization has

been obtained from DDTC or a license exemption is available for such reexport or retransfer transaction. (A "reexport" is when an item is shipped to a foreign country, and then shipped to another foreign country. A "retransfer" is when an item is shipped to a party in a foreign country, then shipped to another party in the same foreign country.) If a license is obtained the item can only be shipped or disclosed in accordance with the country, parties and other terms specified on the license. If a license exemption is to be utilized, the company must verify that the exemption is available and the company will be required to maintain records of such exemption.

(f) Registration. Companies that manufacture or export items on the USML, perform Defense Services or perform brokering activities[33] are required to register with DDTC. It is important to note that the registration requirement arises even if the company does not export the item in question – merely being a manufacturer of the item in purely domestic commerce triggers the registration requirement.[34]

(g) Import Transactions. The company is prohibited from importing defense items listed on the U.S. Munitions List in temporary import transactions without obtaining a temporary import license from DDTC unless an exemption is available. (In addition, if the company imports defense items listed on the U.S. Munitions Import List in permanent import transactions, it will be required to comply with import regulations promulgated by the Bureau of Alcohol, Tobacco, Firearms and Explosives.)

(h) Brokering. The company is prohibited from facilitating, assisting with or "brokering" the sale of defense items without complying with the DDTC brokering requirements as referenced in 22 CFR Part 129 and as discussed further below.

(i) Payment of Fees, Commissions And Political Contributions. The company is subject to reporting requirements and other obligations related to the payment of sales commissions, fees and political contributions made in connection with defense transactions at 22 CFR Part 130.

(j) Transactions With Debarred Parties. The company is prohibited from entering transactions subject to ITAR with certain debarred parties identified on the State Department's two Debarred Party Lists as set forth at 22 CFR § 120.1 or who have been convicted of violations set forth at 22 CFR §120.1(c)(2) .

(k) Recordkeeping Requirement. The company is required to maintain records in accordance with the ITAR recordkeeping requirements as set forth at 22 CFR § 122.5.

(7) Classified Items. Articles, technical data and Defense Services that are classified are listed on the USML under Category XVII and hence are subject to ITAR controls. A request

[33] See Section I.B. (8) below.

[34] While there are a number of exemptions from the registration requirement under 22 CFR Part 122, if the Company is exempt from the registration requirement it may still be subject to many of the other requirements under ITAR.

for authority to export defense articles, including technical data, classified by the U.S. Government or a foreign government must be submitted to DDTC for approval.

(8) Regulation of Munitions Brokers. Persons engaged in the business of "brokering activities" under ITAR are required to register as a munitions broker with DDTC and comply with the other requirements set forth at 22 CFR Part 129. The term "brokering activities" is defined in 22 CFR §129.2 (b) as follows:

> (b) Brokering activities means any action on behalf of another to facilitate the manufacture, export, permanent import, transfer, reexport, or retransfer of a U.S. or foreign defense article or defense service, regardless of its origin.
> (1) Such action includes, but is not limited to:
> (i) Financing, insuring, transporting, or freight forwarding defense articles and defense services; or
> (ii) Soliciting, promoting, negotiating, contracting for, arranging, or otherwise assisting in the purchase, sale, transfer, loan, or lease of a defense article or defense service.[35]

Parties subject to the ITAR brokering regulation are subject to the following requirements (subject to applicable exemptions):

- Registration – Parties are required to register as a broker with DDTC under 22 CFR §129.3;
- Prohibited Transactions – Parties are prohibited from entering into brokering transactions involving countries set forth in §§ 126.1 or 129.7(c) without DDTC approval (it is DDTC's policy that requests for such approvals shall be denied);[36]
- Advanced Approval For Transactions – For certain brokerage transactions, the broker is required to obtain "approval" from DDTC prior to engaging in such transactions under §§ 129.4 and 129.6;

[35] 22 CFR 129.2(b)(2) provides the following exemptions from the definition of "brokering activities": (2) Such action does not include: (i) Activities by a U.S. person in the United States that are limited exclusively to U.S. domestic sales or transfers (e.g., not for export); (ii) Activities by employees of the U.S. Government acting in an official capacity; (iii) Activities by regular employees (see §120.39 of this subchapter) acting on behalf of their employer, including those regular employees who are dual nationals or third-country nationals that satisfy the requirements of §126.18 of this subchapter; Note to paragraph (b)(2)(iii): The exclusion does not apply to persons subject to U.S. jurisdiction with respect to activities involving a defense article or defense service originating in or destined for any proscribed country, area, or person identified in §126.1 of this subchapter. (iv) Activities that do not extend beyond administrative services, such as providing or arranging office space and equipment, hospitality, advertising, or clerical, visa, or translation services, collecting product and pricing information to prepare a response to Request for Proposal, generally promoting company goodwill at trade shows, or activities by an attorney that do not extend beyond the provision of legal advice to clients; (v) Activities performed by an affiliate, as defined in §120.40 of this subchapter, on behalf of another affiliate; or (vi) Activities by persons, including their regular employees (see §120.39 of this subchapter), that do not extend beyond acting as an end-user of a defense article or defense service exported pursuant to a license or other approval under parts 123, 124, or 125 of this subchapter, or subsequently acting as a reexporter or retransferor of such article or service under such license or other approval, or under an approval pursuant to §123.9 of this subchapter.

[36] This prohibition is applicable to "brokering activities" defined in §129.2 regardless of whether the person involved in such activities is exempt from registration as a broker under §129.3.

- Reporting – parties registered with DDTC as munitions brokers are required to file annual reports with DDTC pursuant to ITAR §129.10; and
- Recordkeeping – parties registered with DDTC as munitions brokers are required to maintain records of their brokering activities under 22 CFR § 122.5.

(9) ITAR See-Through Rule. DDTC has a general policy that, if an item is on the USML and it is used as a component in an end-product, the entire end-product is then considered to be on the USML and subject to ITAR. This rule, called the "See-Through Rule," is not set forth in any regulation but rather is applied through DDTC's licensing practices. The "See-Through Rule" has significant ramifications for companies that both sell and purchase ITAR-controlled products in the supply chain. For example, if a company purchases parts, components, software or technical data that are ITAR-controlled and uses these as components in a commercial end-product that it manufactures, the entire end-product will become ITAR-controlled and subject to ITAR requirements. Companies should carefully review their components to verify if they have been "classified" for export control purposes and if they are ITAR-controlled. Often product labeling, invoices or other documents will state if an item is ITAR-controlled or, upon request, a vendor may advise you of the export jurisdiction/classification of the product.

Foreign manufacturers often avoid purchasing components from U.S. suppliers if the components are on the USML and subject to ITAR. If a foreign manufactured product incorporates an ITAR-controlled component, the entire foreign end-product becomes subject to ITAR and regulation by the State Department. This practice of designing out ITAR-controlled components is referred to as designing the foreign product to be "ITAR free."

(10) Government Research Funding. If a product, technology, software or service is developed using government military funding, such as under SBIR research contracts, the items developed under such contracts are often classified on the USML. This includes products, software and technical data developed under such contracts. In some cases the SBIR contract will actually state if the subject matter and work product developed under the contract are covered under ITAR. However, if the contract is silent, companies should not presume that the work product is not covered – they should conduct their own analysis of whether ITAR applies to make this assessment.

This is a major issue for universities that receive research funding from the U.S. government – in one recent case a university professor was convicted of ITAR violations and sentenced to four years imprisonment for violations related to university research involving technical data listed on the USML.[37]

(11) Defense Services Using EAR-Controlled Items. In certain instances if a company is performing services using a commercial product for a foreign military organization or related to a foreign military system, such services could constitute a "defense service" under 22 C.F.R. §120.9 and be subject to ITAR even if the product is not listed on the USML. For

[37] See United States v. John Reece Roth, 628 F.3d 827, U.S. Court of Appeals for the Sixth Circuit (2011).

example, in a well known DDTC enforcement case involving Analytics Methods, Inc.,[38] the company was performing services for a foreign military organization involving commercial software programs that were "dual-use" and not on the USML. DDTC claimed that the services were "defense services" regulated under ITAR, even though the software programs were dual-use, and charged the company with ITAR violations.[39] The company eventually entered a Consent Agreement related to the violations. Companies should review their service contracts carefully – even if products provided are not listed on the USML, services related to military systems or performed for military customers could trigger ITAR obligations.

(12) Recordkeeping Requirements. Parties that are manufacturers or exporters of items on the USML and munitions brokers under 22 CFR Part 129 are required to comply with the ITAR recordkeeping requirements set forth at 22 CFR §122.5. These requirements provide that the company must retain copies of records related to its ITAR activities for a period of five years. This includes records in paper as well as electronic form, including contracts, proposals, invoices, bills of lading and other shipping documents, export control documents, correspondence and e-mails. In the event the company obtains an export license from DDTC, the five year record retention period begins to run at the time of expiration of the license.

(13) Penalties. Penalties for violations of ITAR include fines of up to $1,000,000 per violation and imprisonment for up to 20 years. Penalties can be imposed both on companies as well as individuals in their personal capacities. Violations may arise from one or more of the following:

(a) Exporting or attempting to export or reexport a defense article or technical data or furnishing a Defense Service without an export license;

(b) Importing or attempting to import a defense article that requires a license without obtaining a license;

(c) Conspiring to export, import, reexport or cause to be exported, imported or reexported, any defense article or to furnish any Defense Service for which a license or written approval is required without first obtaining the required license or approval;

(d) Violating any of the terms or conditions of licenses or approvals;

(e) Engaging in the United States in the business of either manufacturing or exporting a defense article or furnishing Defense Services without complying with the DDTC registration requirements discussed above. For

[38] See United States Department of State, Bureau of Political-Military Affairs, In the Matter of: Analytics Methods, Inc. Copies of the Proposed Charging Letter, Consent Agreement and Order are available on the DDTC website.
[39] In the Analytics Methods, Inc. Proposed Charging Letter DDTC stated: "Although some of the Respondents CFD programs have been ITAR-controlled, the majority of the Respondent's CFD software programs are dual-use. However, these dual-use software programs can be used in providing an ITAR regulated defense service when consulting on military systems." See Analytics Methods Proposed Charging Letter at p. 3.

purposes of this section, engaging in the business of manufacturing or exporting defense articles or Defense Services requires only one occasion of manufacturing or exporting a defense article or furnishing a Defense Service; or

(f) Engaging in the business of brokering activities for which registration, a license or written approval is required without first registering or obtaining the required license or written approval. For purposes of this section, engaging in the business of brokering activities requires only one occasion of engaging in such activity.

Parties are also prohibited from knowingly or willfully causing, or aiding, abetting, counseling, demanding, inducing, procuring or permitting the commission of any act prohibited by, or the omission of any act required by, 22 U.S.C. 2778, 22 U.S.C. 2779, or any regulation, license, approval, or order issued thereunder.

(14) Compliance Programs. Companies that are subject to ITAR are advised to incorporate ITAR compliance provisions into their Export Compliance Programs. See Section I.A. above and Exhibit A for further discussion of Export Compliance Programs.

C. U.S. Economic Sanctions and Embargoes

(1) Overview. The United States maintains a series of trade and economic sanctions programs that prohibit certain business transactions with targeted countries by companies subject to the sanctions (the "U.S. Sanctions Programs"). The U.S. Sanctions Programs are administered by the Office of Foreign Assets Control ("OFAC") within the U.S. Department of the Treasury. The purpose of these programs is to further the foreign policy interests of the United States and fulfill our obligations under various United Nations Security Council resolutions. A number of the sanctions programs prohibit most business transactions with the targeted countries (the "Comprehensive Sanctions Programs"), while others restrict only certain types of business activities (the "Partial Sanctions Programs"). In addition, the U.S. Sanctions Programs contain blocking and asset freeze requirements related to persons and entities who have been targeted by the U.S. in response to certain foreign policy or national security risks. These requirements apply to U.S. companies and in certain instances such companies' foreign subsidiaries on a worldwide basis.

(2) Comprehensive Sanctions Programs. The United States maintains Comprehensive Sanctions Programs involving Iran, Syria, Sudan, Cuba, North Korea and the Crimea Region of Ukraine. Companies subject to these sanctions are prohibited from entering into most business transactions involving these countries, including the export, sale, reexport, supply, import and licensing of goods, technology and services, financial transactions and other business transactions[40]. These programs also block and prohibit dealing in any property or

[40] See the discussion below regarding recent amendments of the comprehensive sanctions programs involving Iran and Cuba.

property interests of certain targeted individuals and entities located in or associated with such countries. The terms of each Comprehensive Sanctions Program are different and consequently each program must be evaluated separately.

In addition to the general restrictions described above, these sanctions typically provide that any transaction that evades or avoids or attempts to evade any of the prohibitions set forth in the Comprehensive Sanctions Programs or any conspiracy to do so is prohibited.

The Comprehensive Sanctions Programs typically apply to "United States persons" or "persons who come within the jurisdiction of the United States," and to property that is in the U.S. or comes within the possession or control of U.S. persons. The term "United States person" is defined similarly under most of the programs to include: entities organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), United States citizens, permanent resident aliens, and any person in the United States. See, eg, 31 CFR §560.314 for the definition of "United States Person" under the Iran Transactions and Sanctions Regulations. In addition, certain of the Comprehensive Sanctions Programs (such as Iran and Cuba) apply to foreign subsidiaries that are owned or controlled by United States persons and may also apply to other foreign parties.

Further, the programs also prohibit the "facilitation" by a U.S. person of activities that violate provisions of a Comprehensive Sanctions Program. For example, 31 CFR §560.208 within the Iran sanctions program provides that "no United States person, wherever located, may approve, finance, facilitate, or guarantee any transaction by a foreign person where the transaction by that foreign person would be prohibited by this part if performed by a United States person or within the United States." Consequently, if a U.S. company's foreign subsidiary engages in activities that are proscribed under a Comprehensive Sanctions Program and the U.S. parent provides the requisite level of "support" for the transaction, this could constitute a violation of the Sanctions Program in question.

The Comprehensive Sanctions Programs often include a number of narrow exemptions, such as for certain personal communications, the sale or transfer of information materials, humanitarian donations of food, clothing and medicine, and the commercial sale of medicine, medical devices and agricultural commodities (for certain of the Comprehensive Sanctions Programs). In addition, OFAC may on a case-by-case basis grant specific licenses that permit activities that may otherwise be prohibited under the Comprehensive Sanctions Programs. However these exemptions vary for the individual country programs involved and are subject to detailed conditions, and consequently companies should not engage in activities subject to such exemptions unless they have reviewed the terms of the exemptions carefully and determined that such exemptions are available under the terms of the transaction in question.

As referenced above, any transaction or dealing in the property and interests in property of an entity or individual designated under one of the Comprehensive Sanctions Programs is prohibited. Such designation is usually accomplished by OFAC naming the targeted individual or entity in the List of Specially Designated Nationals and Blocked Persons or other OFAC

restricted party list.[41] According to OFAC guidance, the property and interests in property of an entity that is 50% or more owned, directly or indirectly, by such a person (or collectively owned by more than one designated person) are also blocked, regardless of whether the entity itself is designated pursuant to the Program.

On January 16, 2015 OFAC and BIS issued regulations amending portions of the Comprehensive Sanctions Program for Cuba as part of the U.S. efforts to normalize diplomatic relations with Cuba. Such amendments include provisions to liberalize certain travel restrictions, authorize certain exports and financial transactions and permit other activities involving Cuba that were previously prohibited.[42] Similarly, as of the date hereof the U.S. is in negotiations with Iran in connection with the development of Iran's nuclear program and the possibility exists that the OFAC sanctions program involving Iran will be amended at some time in the future based on the outcome of such negotiations. It is possible that the terms of these sanctions programs will be further amended in the coming months. Readers are advised to confirm if provisions have been amended at the time of reviewing this material.

(3) Partial Sanctions Programs. In addition to the Comprehensive Sanctions Programs, OFAC maintains a series of partial trade sanctions programs related to a number of countries and policy goals (the "Partial Sanctions Programs"). Under such programs, certain types of business activities are prohibited in the target countries but other business activities are permitted. Certain of the Partial Sanctions Programs are focused on individual countries (such as Libya, Burma and Iraq) and others are focused on certain policy goals (such as counter terrorism and non-proliferation). The terms of each Partial Sanctions Program are different, consequently each program must be evaluated separately when a company is contemplating entering transactions involving these countries and parties related to such countries.

The following is a list of the Partial Sanctions Programs administered by OFAC:

- Balkans-Related Sanctions
- Belarus Sanctions
- Burma Sanctions
- Central African Republic Sanctions
- Cote d'Ivoire (Ivory Coast)-Related Sanctions
- Counter Narcotics Trafficking Sanctions
- Counter Terrorism Sanctions
- Cyber-Related Sanctions
- Democratic Republic of the Congo-Related Sanctions
- Iraq-Related Sanctions
- Lebanon-Related Sanctions
- Former Liberian Regime of Charles Taylor Sanctions

[41] See Section I.C.(4) below.

[42] It should be noted, however, that despite these amendments the majority of the provisions of the OFAC Sanctions Program involving Cuba in effect prior to such amendments are continuing in effect following the adoption of these amendments.

- Libya Sanctions
- Magnitsky Sanctions
- Non-Proliferation Sanctions
- Rough Diamond Trade Controls
- Somalia Sanctions
- South Sudan-Related Sanctions
- Transnational Criminal Organizations
- Ukraine/Russia-Related Sanctions
- Venezuela-Related Sanctions
- Yemen-Related Sanctions
- Zimbabwe Sanctions

In addition to the general restrictions described above, these sanctions typically provide that any transaction that evades or avoids or attempts to evade any of the prohibitions set forth in the Partial Sanctions Program or any conspiracy to do so is prohibited.

The Partial Sanctions Programs typically apply to "United States persons" and to property that is in the U.S. or comes within the possession or control of U.S. persons[43]. In addition, the programs also often contain provisions that prohibit the "facilitation" by a US person of activities of foreign persons that violate the provisions of the Sanctions Program. Consequently, if a U.S. company's foreign subsidiaries engage in activities that are proscribed under the Sanctions Program and the U.S. parent provides "support" for the transaction, this could constitute a violation of the Sanctions Program.

A significant portion of the restrictions imposed under the Partial Sanctions Programs are restrictions on entering transactions with persons or entities who have been identified for blocking on the List of Specially Designated Nationals and Blocked Persons – these restrictions are discussed in Section I.C.(4) below.

(4) Restrictions On Transactions With Blocked Parties. OFAC maintains a number of lists of persons and entities who have been targeted for terrorist, weapons proliferation, foreign policy or other reasons. If a party is identified on one of such lists, restrictions apply in entering transactions with such parties. The most significant of these lists is OFAC's List of Specially Designated Nationals and Blocked Persons (the "SDN List"). If a person or entity is identified on the SDN List, the following requirements apply:

- U.S. Persons, including in certain instances their foreign subsidiaries**,** are prohibited from entering into any business transactions with the parties identified on the list anywhere in the world, including the sale or purchase of products,

[43] The term "United States person" is defined similarly under most of the programs to include: entities organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), United States citizens, permanent resident aliens, and any person in the United States. See, eg, See 31 CFR §537.321 for the definition of "United States Person" under the Burmese Sanctions Regulations.

services, technologies, exports, reexports, imports, investments, payments, extensions of credit, licensing, brokering and other transactions.

- If the property or property interests of such parties come into the possession or control of a U.S. person (and in certain instances the U.S. person's foreign subsidiary), the U.S. person is prohibited from transferring, paying, exporting or otherwise dealing in such property and is required to block such property or property interest, and file a report with OFAC.

- U.S. persons are prohibited from assisting, aiding and abetting such parties in entering transactions involving blocked property and in facilitating foreign parties in engaging in prohibited transactions involving such parties.

The SDN List can be found at: http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx.

OFAC also maintains a number of other lists of restricted parties and entities other than the SDN List – a description of these lists and the restrictions associated with them are as follows:

- Foreign Sanctions Evaders (FSE) List - A list of foreign individuals and entities determined by OFAC to have violated, attempted to violate, conspired to violate, or caused a violation of U.S. sanctions on Syria or Iran. It also lists foreign persons who have facilitated deceptive transactions for or on behalf of persons subject to U.S. sanctions. Transactions by U.S. persons or within the United States involving FSEs are prohibited. The FSE List is not part of the Specially Designated Nationals (SDN) List, however individuals and companies on the FSE List may also appear on the SDN List.[44]

- Sectoral Sanctions Identifications (SSI) List - A list of persons operating in sectors of the Russian economy identified by the Secretary of the Treasury pursuant to Executive Order 13662. Directives found within the list describe the specific prohibitions on dealings with the persons identified on the list. The SSI List is not part of the Specially Designated Nationals (SDN) List, however, individuals and companies on the SSI List may also appear on the SDN List.[45]

- Palestinian Legislative Council (NS-PLC) List - Section (b) of General License 4 issued pursuant to the Global Terrorism Sanctions Regulations (31 C.F.R. Part 594), the Terrorism Sanctions Regulations (31 C.F.R. Part 595), and the Foreign Terrorist Organizations Sanctions Regulations (31 C.F.R. Part 597) authorizes U.S. financial institutions to reject transactions with members of the Palestinian Legislative Council (PLC) who were elected to the PLC on the party slate of Hamas, or any other Foreign Terrorist Organization (FTO), Specially Designated Terrorist (SDT), or Specially

[44] Source: OFAC website.
[45] Source: OFAC website.

Designated Global Terrorist (SDGT), provided that any such individuals are not named on OFAC's list of Specially Designated Nationals and Blocked Persons (SDN List). The individuals in the following list are PLC members who were elected on the party slate of an FTO, SDT, or SDGT. They do not, however, appear on the SDN List. Transactions involving these individuals are prohibited.[46]

- The List of Foreign Financial Institutions Subject to Part 561 (the Part 561 List) - In order to implement certain provisions of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA), the National Defense Authorization Act of Fiscal Year 2012 (NDAA), the Iran Freedom and Counter-Proliferation Act of 2012 (IFCA) and certain executive orders, OFAC has developed this list of foreign financial institutions that are subject to sanctions under these laws and orders.[47]

- Non-SDN Iranian Sanctions Act (NS-ISA) List - On May 23, 2011, the President signed Executive Order ("E.O.") 13574, "Authorizing the Implementation of Certain Sanctions Set Forth in the Iran Sanctions Act of 1996, as Amended." E.O. 13574 states that the Secretary of the Treasury, pursuant to authority under the International Emergency Economic Powers Act ("IEEPA"), shall implement certain sanctions that the Secretary of State imposes and selects under the pre-existing authority of the Iran Sanctions Act of 1996 ("ISA") as amended by the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 ("CISADA"). Such parties are set forth on the NS-ISA List.[48]

The parties listed on the SDN List and the other restricted parties list identified above are consolidated by OFAC on one master list called the "Consolidated Sanctions List" and this can be found at: http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/consolidated.aspx .

U.S. companies (including their foreign branches and subsidiaries) are advised to conduct screenings of customers and other parties involved in transactions in which they will be involved against the restricted party lists prior to entering into such transactions. If a party to a proposed transaction is identified on one of the OFAC restricted party lists, the company should review the sanctions program that is applicable to such list designation to determine the specific legal requirements that will apply – in most instances the U.S. company will be restricted from entering transactions with the listed party.

It is OFAC's position that all property owned by a party on the SDN List is subject to blocking and prohibitions as set forth under the various OFAC Sanctions Programs. OFAC has advised that if a party or parties listed on the SDN List have an ownership interest of 50% or more in an entity (such as a company, partnership or other entity), such entity is also treated as if it is on the SDN List, even if not specifically named on the SDN List. This applies both if a single SDN owns greater than 50% of the equity interest, or if multiple SDN's each own less

[46] Source: OFAC website.
[47] Source: OFAC website.
[48] Source: OFAC website.

than 50% but their combined interest owned in such entity is greater than 50%. In addition, OFAC has provided guidance that under certain OFAC sanctions programs (e.g., Cuba and Sudan), there is a broader category of entities whose property and interests in property are blocked based on, for example, control over the entity. OFAC has also cautioned companies in interpretive guidance that in any instance in which an SDN or group of SDN's has indirect control over an entity (such as through control of the board of directors, contractual provisions or other means), such entity is at risk of being placed on the SDN List by OFAC and parties should use caution in entering business transactions with such entity.

(5) Penalties. Penalties for violations of the U.S. Sanctions Programs include civil penalties of up to the greater of $250,000 or twice the amount of the underlying transaction and criminal fines of up to $1,000,000, and imprisonment for up to 20 years.

(6) Compliance Programs. Companies are advised to incorporate OFAC compliance provisions into their Export Compliance Programs. See Section I.A. above and Exhibit A for a further discussion of Export Compliance Programs.

PART II – COMPLIANCE STEPS IN AN EXPORT TRANSACTION

Now that you have an understanding of the key U.S. export control laws it is time to put this new knowledge to work. The following are a number of the basic compliance steps to undertake as part of your first export transaction. Of course, every export transaction is different and there may be other steps involved depending on the country, product and other terms involved, but these will provide you with a solid foundation for your transaction. In the future your company may hire an export compliance specialist to take these steps for the company's exports on a regular basis, however since you will be overseeing legal compliance it will be valuable for you to have an understanding of each of these steps.

STEP 1 – Product Classification.

The first step in the export process is determining the export "classification" of the item to be exported. This involves: (i) determining whether the State Department or Commerce Department (or other federal agency) has jurisdiction in regulating the export of the item; and then (ii) determining the classification number for the item under the appropriate agency's control list. Since you use the classification number to determine if requirements apply to the export, determining this number is a critical first step in any export transaction.

The agencies have established a specific procedure for determining export classifications. As ITAR is considered the higher level of control, the exporter should first assess if the item is on the USML and subject to ITAR. If it is not, you then determine if it is subject to the EAR and listed on the CCL, and identify the precise number for the item (called the Export Control Classification Number or "ECCN'") on the CCL. If the item is subject to the EAR and not listed

on the CCL, it is classified as EAR99.[49] Exporters are cautioned, however, to not start first by reviewing the CCL and ignoring ITAR – this can result in incorrect classifications and potential errors (and possible violations) later on.[50]

There are a number of technical rules for performing classification functions.[51] Both ITAR and EAR provide an "Order of Review" which set forth steps in the classification process for items under their respective regulations – exporters should follow the procedures in the Orders of Review in undertaking classification assessments.

Companies are free to "self-classify" their products, ie, to determine the classification through internal review without an official determination by DDTC or BIS.[52] However in certain instances it may be unclear to the exporter which classification will apply to its product. In such cases, exporters can apply to the State Department and the Commerce Department to receive binding determinations by the agencies of the jurisdiction and classification of the item. The process for requesting a determination from State regarding whether an item is on the USML and subject to ITAR is referred to as a Commodity Jurisdiction request, and the process for requesting a determination from BIS regarding the classification of an item on the CCL under the EAR is called a Commodity Classification request (sometimes referred to as a Commodity Classification Automated Tracking System or "CCATS").[53]

Commodity Jurisdiction requests ("CJ's") and CCATS can be valuable for companies as they provide legal certainty regarding classifications and reduce the possibility of legal liability from incorrect classifications. In addition, they can be valuable for a company to provide to its

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[49] There may be other federal agencies that have jurisdiction over the regulation of exports, such as the U.S. Department of Energy, the U.S. Nuclear Regulatory Commission, the Patent and Trademark Office and Department of Defense (Foreign Military Sales Program). You can determine if the item is subject to export restrictions by other federal agencies such as these by reviewing such agencies' regulations.

[50] There are a number of enforcement cases in which an exporter incorrectly classified an item to be exported and then incorrectly exported the item over a number of years, resulting in multiple violations over the years and significant penalties. See, for example, DDTC Proposed Charging Letter In the Matter of Intersil Corporation, available on DDTC website; DDTC Proposed Charging Letter In the Matter of Esterline Technologies Corporation, available on DDTC website; DDTC Proposed Charging Letter In the Matter of Meggitt-USA, Inc., August 19, 2013, available on DDTC website; DDTC Proposed Charging Letter, In Re Aeroflex, Inc., July 25, 2013, available on DDTC website.

[51] The EAR provides an "Order of Review" at 15 CFR Part 774 Supplement No. 4 which sets forth the steps for classification of items under the EAR. In conducting classifications under the EAR, the exporter should review 600 series and 500 Series items first, and then the remaining items on the CCL. If your product is a part, component, attachment or accessory, you may be required to apply the "specially designed" definition to determine if an item is included as one of the "catch-all" categories on the CCL. The ITAR also contains the ITAR Order of Review at 22 CFR § 121.1(b) for classifying items on the USML and a definition of "Specially Designed" at 22 CFR § 120.41.

[52] Such classifications are frequently undertaken jointly by an engineer or other technical expert within the company who has familiarity with the product along with a person with expertise in export control regulation.

[53] As referenced above, there are legal principles under ITAR and EAR that are applied in making classification determinations. When companies apply for a Commodity Jurisdiction request or CCATS they are advised to address these principles clearly in the request and provide evidence to support their positions rather than simply describing the product and requesting a ruling – this will generally improve the likelihood of obtaining a favorable result. Incorrect classifications, especially if resulting in higher export control requirements for a product, can be disruptive and expense.

customers as the company rolls out sales of a new product as they provide legal assurance to the customer who may be contemplating exporting the item. We often encourage companies to obtain CJ's and CCATs in appropriate circumstances.

The results of the classification should be recorded in the company's export compliance records along with records of the basis of the classification. The company should determine the classification for each product that the company intends to export.

The enforcement cases are replete with instances in which companies made an incorrect classification decision in the early stages of selling a product and then exported the product in hundreds of shipments – in each case committing export violations.[54] *It is imperative to invest the proper attention to correctly classify the item at the outset to avoid big problems later in the export process.*

STEP 2 – Determine Licensing Requirements For Products on the USML and CCL.

Once you have determined the export classification of your item, you can then determine if there are export requirements that apply based upon the product being listed on the USML or the CCL.[55] For items listed on the USML and subject to ITAR, all exports of such items (including products, technical data, software and services) require an export license or similar authorization from DDTC. For items that are subject to the EAR, licensing requirements vary depending upon the item and country to which it will be exported. For items subject to the EAR, if you know the ECCN for the item you should review the CCL entry and the Commerce Country Chart set forth at 15 CFR Part 738 Supplement No. 1 to determine if a license is required for the item.

If a license is required, license exemptions may apply. For exports regulated under the EAR, license exceptions are set forth at 15 CFR Part 740. For exports regulated under ITAR, the license exemptions are set forth at 22 CFR § 123.16, 123.4, 124.2, 125.4, 125.5, 126.3 and elsewhere throughout the regulations. It should be noted that license exemptions frequently contain conditions and limitations so exporters should use care in analyzing the applicability of an exemption to a particular transaction. For example, under many ITAR license exemptions DDTC takes the position that the use of the exemption is contingent upon the exporter being registered with DDTC. Similarly, ITAR license exemptions are frequently not available for transactions involving the "proscribed countries" listed in 22 CFR §126.1, USML items that are designated as "Significant Military Equipment" or "Missile Technology Control Regime," exports for which Congressional notification is required under 22 CFR §123.15 or transactions involving persons who are ineligible to participate in ITAR transactions as described in 22 CFR §120.1(c).[56]

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[54] See Footnote 47 above.

[55] As described above, certain export restrictions apply to items based upon whether such items are listed on the USML or the CCL – these are referred to as "product-based" controls. Other types of controls that are based upon the destination, end use or end user are discussed separately below.

[56] See, eg., 22 CFR §123.16(a).

If a license is required for your proposed transaction and an exemption is not available, you should apply for the license. Licenses under the EAR are submitted to BIS through the electronic licensing system SNAP-R. Licenses under ITAR are submitted to DDTC through the electronic licensing system DTrade. In order for a party to submit licenses to DDTC the party must be registered with DDTC under 22 CFR Part 122. Licenses are typically either issued, denied, issued with conditions or provisos, or "returned without action" (referred to as "RWA").[57] The term of the license is typically four years, although TAA's can be issued for terms of up to ten years. If a license is issued, the exporter should export the item only in accordance with the terms, conditions and provisos set forth in the license.

STEP 3 – Comply With Sanctions and Embargoes

As mentioned above, the U.S. maintains embargoes and sanctions programs involving a number of countries. Some of these are comprehensive programs and restrict almost all business transactions with the targeted countries (such as Iran and Syria), while others are partial and limit only certain types of business activities (such as Russia and Burma). The terms of each sanctions program are different so each one must be reviewed separately. In most cases involving comprehensive sanctions, these requirements apply to the vast majority of products - not just those listed on the CCL or USML. The principal agency that administers the U.S. sanctions programs is OFAC, and BIS also maintains a number of embargo programs. Lists of the U.S. Sanctions Programs are set forth in Section I.C. and I.A.(6) above.

The company should review its proposed transaction and determine if it involves one of the countries subject to a U.S. sanctions program. If it does, you should review the terms of the individual sanctions program involved to determine if any restrictions apply to your proposed transaction. Under many of the sanctions programs there are exceptions, general licenses and specific licenses that may also be available that will permit the company to proceed with the transaction if it is otherwise prohibited. If your proposed transaction is prohibited under the terms of a sanctions program you should avoid proceeding with the transaction. As referenced above, the U.S. Sanctions Programs frequently prohibit not just engaging directly in transactions but also in aiding, abetting, conspiring to engage in and facilitating prohibited transactions.

Provisions of the various U.S. sanctions programs are amended frequently – sometimes on a weekly basis. Exporters should update their legal resources on a regular basis to be aware of such amendments.

STEP 4 – Screening Against Restricted Party Lists

As referenced above, the U.S. Government maintains a number of restricted parties lists - ie, listings of persons and entities who have been identified for foreign policy, law enforcement or other purposes. If a party is identified on one of these lists, U.S. companies are subject to restrictions on entering transactions with such parties. The best known of the restricted party

[57] License applications are Returned Without Action in instance such as where the applicant has not submitted sufficient information to support the application and it is returned to the applicant requesting the additional information – in such instance the applicant can resubmit the application.

lists is OFAC's List of Specially Designated Nationals and Blocked Persons. Separate restricted party lists are maintained by each of OFAC, Commerce and State - the number and purpose of these lists have increased within the last few years, and are creating growing confusion for U.S. companies.

At the time of this writing the restricted party lists promulgated by BIS, State and OFAC are as follows:

(a) Lists Promulgated By BIS.

- Denied Persons List – available at: www.bis.doc.gov/complianceandenforcement/liststocheck.htm
- Entity List (EAR Part 744 Supplement No. 4 – available at: www.bis.doc.gov/complianceandenforcement/liststocheck.htm
- Unverified List – available at: www.bis.doc.gov/complianceandenforcement/liststocheck.htm

(b) List Promulgated By OFAC.

- Specially Designated Nationals List– available at: http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx
- Foreign Sanctions Evaders List – available at: www.treasury.gov/resource-center/sanctions/SDN-List/Pages/fse_list.aspx
- Sectoral Sanctions Identifications List – available at: www.treasury.gov/resource-center/sanctions/SDN-List/Pages/ssi_list.aspx
- Palestinian Legislative Council List – available at: www.treasury.gov/resource-center/sanctions/Terrorism-Proliferation-Narcotics/Pages/index.aspx
- The List of Foreign Financial Institutions Subject to Part 561 (the Part 561 List) – available at: http://www.treasury.gov/ofac/downloads/561list.pdf and http://www.treasury.gov/ofac/downloads/561chg.pdf.
- Non-SDN Iranian Sanctions Act (NS-ISA) List – available at: http://www.treasury.gov/resource-center/sanctions/Programs/Documents/isa.pdf and http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/archive.aspx#nsisa.

(c) Lists Promulgated By Department of State.

- Statutory Debarred Parties List – available at: http://www.pmddtc.state.gov/compliance/debar_intro.html
- Administrative Debarred Parties List – available at: http://www.pmddtc.state.gov/compliance/debar_intro.html
- Nonproliferation Sanctions List – available at: http://www.pmddtc.state.gov/compliance/debar_intro.html
- State Department Sanctioned Entities List - available at: http://www.state.gov/e/eb/tfs/spi/iran/entities/ .

As a general matter, each list is adopted for a separate purpose and the restrictions on entering transactions with listed parties vary with each list.

The exporter should screen the parties to its proposed export transaction against the restricted parties lists that apply to its transaction.[58] In the event a party being screened is identified on one of the lists, the Company should review the list in question to determine the specific restrictions that will apply. In many instances if there is a match the U.S. exporter will be prohibited from entering the transaction with the party identified on the list, and may be subject to other requirements such as blocking the property or assets of the restricted party that come into the exporter's possession and filing reports with OFAC.[59]

The U.S. Government is in the process of consolidating parties on the various restricted parties lists to make it easier for companies to screen for restricted parties. For example, OFAC has consolidated all of the parties on the various OFAC sanctions lists onto the OFAC "Consolidated Sanctions List" which is available at: http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/consolidated.aspx. Similarly the Commerce Department is consolidating the prohibited party lists maintained by OFAC, Commerce and State onto the Consolidated Screening List which is currently available at http://export.gov/ecr/eg_main_023148.asp. Numerous commercial vendors also provide services for consolidating and updating the various lists for exporters.[60]

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[58] Exporters should screen all parties to the export transaction including the purchaser or other recipient of the item being exported, end-user, intermediate consignees and purchasers, sales representatives, agents and other intermediaries, brokers, transportation carrier(s), freight forwarder(s), banks providing financing and other parties who performed a role in effecting the transaction.

[59] Not all matches on a restricted party list mean that the exporter is prohibited from entering into all business transactions with the listed party. For example, if a party is listed on OFAC's Sectoral Sanctions List, U.S. persons are prohibited from entering into certain debt and equity financing transactions and/or transactions involving certain energy projects with such party but are not restricted for entering other transactions with the party.

[60] If the company has a small number of exports, this screening can be conducted by the company's export compliance officer through a manual screening process. Companies with a large number of export transactions often adopt automated processes for screening transactions – possibly using computer-aided screening tools build into the company's ERP or order processing system. Automated screening tools can also perform enhanced

Upon the completion of conducting a search as described above, the company should maintain records of the results of the search in the company's export compliance records.

As referenced above, OFAC has advised that if a party or parties listed on the SDN List have an ownership interest of 50% or more in an entity (such as a company, partnership or other entity), such entity is also treated as if it is on the SDN List, even if not specifically named on the SDN List.[61] Consequently companies should use care to assess proposed transactions with entities that have the potential to be owned by parties on the SDN List, especially in jurisdictions in which there are a large number of SDN parties (such as Russia, Ukraine and various Middle East countries), and conduct a heightened level of due diligence review of such entities.

STEP 5 – "Know Your Customer" and "Red Flag" Due Diligence Review

As discussed above, the BIS "Know Your Customer Guidance and Red Flags" (the "Guidance") states that exporters should review export transactions to determine if any suspicious facts or "abnormal circumstances" are present. If there are, the exporter is required to make further inquiry into the suspicious facts.[62] If the company cannot resolve the suspicious facts, it is cautioned not to proceed with the transaction. If after deeper investigation the suspicious facts are resolved and the "red flag" eliminated, the company is free to proceed. The "Guidance" sets forth examples of suspicious circumstances that are referred to as "Red Flags," although this is not an "all-inclusive" list of suspicious circumstances. This requirement applies to all export transactions subject to the EAR, even if the product being exported is not listed on the CCL.

Exporters should conduct a "red flag" review as described above for each export transaction. Once completed, it should maintain records of the review to be able to demonstrate its good faith efforts to comply with the law. The company should also consider adding additional red flag factors to the list that are specific for its industry and geographic market in which it is selling as an additional compliance safeguard.

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functions such as automated list updating, retroactive screening and screening of alias names and alternative spellings. Finally, the restricted party lists are frequently amended and new lists established, so the exporter should have a process for updating its searching activities on a regular basis.

[61] This applies both if a single SDN owns greater than 50% of the equity interest, or if multiple SDN's each own less than 50% but their combined interest owned in such entity is greater than 50%. In addition, OFAC has provided guidance that under certain OFAC sanctions programs (e.g., Cuba and Sudan), there is a broader category of entities whose property and interests in property are blocked based on, for example, control over the entity. OFAC has also cautioned companies in interpretive guidance that in any instance in which an SDN or group of SDN's has indirect control over an entity (such as through control of the board of directors, contractual provisions or other means), such entity is at risk of being placed on the SDN List by OFAC and parties should use caution in entering business transactions with such entity.

[62] Specifically, the Guidance provides: "…when "red flags" are raised in information that comes to your firm, you have a duty to check out the suspicions circumstances and inquire about the end-use, end-user, or ultimate country of destination." See Supplement No. 3 to Part 732, §(a)(2).

The Guidance advises companies not to take steps to cut off the flow of information that comes to it in the normal course of business.[63] The company should have a clear policy that when an employee receives red flag information, he/she should report it to company officials who have the authority to act on it in the compliance process. Information received by an employee can be imputed to the company and result in the company incurring liability arising from the actions of the employee.[64]

STEP 6 – Avoid Prohibited End Uses

15 C.F.R. § 744 prohibits exporters from entering transactions if the exported items will be used in one of the prohibited end use set forth in EAR Part 744. Such prohibited end uses include the design, development or use of nuclear products and technologies, chemical or biological weapons, certain unmanned aerial vehicles (drones), missile delivery systems and terrorist activities. (There are approximately eighteen prohibited end uses in Part 744.) In most instances these requirements apply to all export transactions that are subject to the EAR, even if the product in question is not listed on the CCL. EAR § 744.6 also prohibits the performance of services by U.S. persons related to activities such as the development and proliferation of chemical or biological weapons and missile technology. The Prohibited End Uses are set forth at 15 CFR §744.1-744.20 (which can be found at: http://www.bis.doc.gov/policiesandregulations/ear/744.pdf.)

The company should have a process to inquire about the end use of the products it exports and confirm that these will not be used in a prohibited end use. Such process may include one or more of the following steps: (i) making inquiries of consignees and customers regarding the end user, end use and country of ultimate destination for the exported product; (ii) conducting due diligence review for "red flags" that might disclose evidence of a prohibited end use; (iii) obtaining end use statements from consignees;[65] (iv) advising consignees of the export classifications of products being exported and the export requirements that apply; and (v) using an export compliance clause in its export agreement, terms and conditions or other documentation used in the transactions in which the purchaser warrants and agrees that the product being exported will not be used in a prohibited end use.

STEP 7 – Avoid Unauthorized Diversion Risk.

[63] Section (a)(3) of the Guidance provides: "For example, do not instruct the sales force to tell potential customers to refrain from discussing the actual end-use, end-user, and ultimate country of destination for the product your firm is seeking to sell. Do not put on blinders that prevent the learning of relevant information. An affirmative policy of steps to avoid "bad" information would not insulate a company from liability, and it would usually be considered an aggravating factor in an enforcement proceeding."

[64] Section (a)(4) provides: "Employees need to know how to handle "red flags". Knowledge possessed by an employee of a company can be imputed to a firm so as to make it liable for a violation. This makes it important for firms to establish clear policies and effective compliance procedures to ensure that such knowledge about transactions can be evaluated by responsible senior officials."

[65] While End Use/End User Statements are not required to be used in most export transactions, exporters should nonetheless attempt to obtain them if possible as this provides an extra level of risk mitigation for compliance with the prohibited end use restrictions and other export restrictions, especially for sensitive products and high risk destinations and customers.

Unauthorized transshipment, in its simplest form, can be defined as follows: your company exports your product to a customer in one country (eg, Turkey), and without your authorization your customer resells the product to another party in a prohibited country (eg, Iran) or to a prohibited party (eg., listed on the SDN list). In certain instances your company can have liability for export violations in these circumstances.[66] The exporter should have a process in place to prevent unauthorized diversion to reduce the likelihood of liability in such instances.

As discussed above, BIS enforcement officials have stated that the majority of recent BIS export enforcement cases involve EAR99 items – ie, products that are not listed on the CCL. These are violations of prohibited end use, prohibited end user and prohibited country controls. Based upon this we recommend that U.S. companies devote significant attention to attempting to reduce the likelihood of illegal diversion of their exports – even for EAR99 items – to reduce the risk of becoming inadvertently involved in an illegal transaction. The risks from illegal diversion are higher in certain "high risk" transshipment hubs including the Dubai/United Arab Emirates, Hong Kong, Singapore, Malaysia and Turkey.

There are a number of steps that a company can take to reduce these risks, including: (i) using export compliance clauses in its export agreements in which the consignee agrees that the product will only be shipped to a specific destination and/or party; (ii) conducting a due diligence review of the consignee and other parties to the transaction that might disclose evidence that a party has had previous law enforcement issues; (iii) obtaining End Use/End User statements from consignees;[67] (iv) advising consignees of the export classifications of products being exported and the export requirements that apply; (v) using only reputable freight forwarders that have robust export compliance processes; and (vi) making inquiries of consignees and customers regarding the end user, end use and country of ultimate destination. In addition, the company should "double down" on these compliance steps for sensitive products, high risk customers and high risk destinations, including the high risk transshipment hubs referenced above. The above is just an initial list of steps and exporters can adopt more detailed compliance measures to mitigate this risk. (The author will provide a listing of more detailed recommendations upon request.)

STEP 8 – Export Clearance Requirements

There are a number of export clearance requirements that may apply to your export transaction depending upon the product, destination, whether a license is required and other factors. For example, exporters are required to file information about most export transactions with the Bureau of the Census ("BOC") through the Automated Export System ("AES") under

[66] Liability of the exporter may arise, for example, (i) if it had knowledge of the illegal transshipment, (ii) through the conscious disregard of the facts of such transshipment, or (iii) through the willful avoidance of the facts related to the transshipment.

[67] While End Use Statements are not required to be used in many export transactions, exporters should nonetheless attempt to obtain them if possible as this provides an extra level of risk mitigation for compliance with the prohibited end use restrictions and other export restrictions, especially for sensitive products and high risk destinations and customers.

the BOC Foreign Trade Regulations.[68] Other requirements may include the use of Destination Control Statements, End-User Statements, Statement By Ultimate Consignee and Purchaser, and DSP-83 Nontransfer and Use Certificates. Exporters are advised to review 15 CFR Part 758 and 748 (for transactions subject to the EAR) and 22 CFR §123.10, 123.14 and other ITAR provisions (for transactions subject to ITAR) to determine the requirements that may be applicable to their transaction.

STEP 9 – Export Recordkeeping Requirements.

Companies are subject to recordkeeping requirements for export transactions under the EAR, ITAR and OFAC sanctions programs. In general, exporters are required to maintain copies of records from their export transactions for a five year period, however this period can be extended in certain instances.[69] Records to be preserved include export license documentation, proposals, shipping documents, correspondence, in paper, electronic and other media. Exporters are also required to be able to make such records available for inspection and copying if requested by BIS, DDTC or DDTC. The export recordkeeping requirements are set forth as follows: (i) for EAR – 15 CFR Part 762; (ii) for ITAR – 22 CFR §122.5; and for OFAC – 31 CFR Part 501, Subpart C.

STEP 10 – Export Compliance Program.

Perhaps the most important step in the export compliance process is the adoption of an Export Compliance Program. As is clear from this article, there is a wide array of requirements that will apply to your export transactions: controls based upon whether products are listed on the CCL or USML, prohibited country requirements, prohibited party requirements, prohibited end use requirements, specialized provisions for chemicals, short supply, boycott requests and other areas, along with due diligence, documentation, recordkeeping and other provisions. In light of the wide array of requirements, and the significant potential liability for violations, it is imperative for your company to have a process in place to manage compliance under these laws. Each of BIS, DDTC and OFAC recommend that exporters adopt and use export compliance programs for managing compliance in the export process. These serve two purposes: first they help the company organize its activities to comply with relevant laws. Second, if the company is ever involved in a potential violation, enforcement officials consider the adoption and use of an Export Compliance Program as a "mitigating factor" in assessing compliance penalties and often reduce applicable penalties (or sometimes impose no penalties) if the company has a compliance program and uses it.

Consequently, the exporter should consider an Export Compliance Program almost like an insurance policy for export violations.

[68] 15 CFR Part 30

[69] For example, if an export license is required in a transaction under ITAR, the five year recordkeeping period begins to run at the end of the four-year term of the license, thus extending the recordkeeping period to a total of nine years from the date the license is issued.

An Export Compliance Program consists of a number of components depending upon the company's size, business and countries to which it exports – a listing of the major components and advanced components of such programs are set forth in Exhibit A below. We strongly recommend that companies utilize these as the cornerstone of their compliance activities.

Other Areas of the Law. There are other areas of the law that may apply to your international transaction. For example, your company will be subject to (i) the Foreign Corrupt Practices Act in its overseas operations; (ii) commercial laws in setting up its relationships with its foreign distributors; and (iii) foreign laws in the countries in which it will be operating, among other alws. These are beyond the scope of this article, but the author will be pleased to provide additional materials on these upon request.

June 1, 2015

Note: This article contains general, condensed summaries of actual legal matters, statutes and opinions for information purposes. It is not intended and should not be construed as legal advice.

Note: The provisions discussed in this article are undergoing ongoing amendments under Export Control Reform, harmonization of various export regulations and diplomatic negotiations involving Iran, Cuba and other countries. Readers are advised to confirm if provisions have been amended at the time of reviewing this material.

EXHIBIT A

PROVISIONS OF AN
EXPORT COMPLIANCE PROGRAM

A. Basic Provisions. The provisions of an Export Compliance Programs typically include the following:

1. Risk assessment - identification of the highest areas of export compliance risk for the company based upon its particular industry, countries of operation, products and other factors.

2. Appointment of a company employee with the responsibility to oversee export compliance;

3. Determining the proper export classification of products being exported;

4. Adopting written policies and procedures for conducting export transactions, including checklists of compliance steps;

5. Screening transactions against prohibited party lists and prohibited country lists;

6. Conducting compliance training of employees involved in international transactions;

7. Adopting controls in the company's data network to restrict access to technical data and software that are subject to export controls;

8. Adopting recordkeeping procedures to comply with the export recordkeeping requirements;

9. Conducting annual compliance audits to confirm that the company's compliance program is functioning properly;

10. A procedure for actions to be taken if a violation is discovered;

11. A procedure for updating the Compliance Program due changes in the law and the company's business activities; and

12. Authorized and adopted by the company's board of directors or other senior management.

B. Advanced Provisions. Advanced features for an Export Compliance Programs include the following:

1. Automated screening processes to screen for prohibited parties and destinations, and advanced screening tools to perform enhanced functions such as automated list updating, retroactive screening and screening of alias names and alternative spellings.

2. Computer assisted training programs for employee compliance training;

3. Automated recordkeeping function;

4. Advanced data security controls;

5. Compliance intranet site for compliance program documentation, dissemination of amendments and update materials and training resources;

6. Compliance telephone "Hotline" and e-mail mailbox for questions and anonymous reports of possible violations.

7. Culturally appropriate translations of compliance materials for foreign offices.

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PRACTICE AREAS

- International
- ITAR, Export Controls & OFAC Sanctions
- Economic Development
- Foreign Corrupt Practices Act
- Unmanned Systems
- Firearms Industry
- White Collar and Investigations
- Business & Corporate
- Foreign Direct Investment (FDI)

Tom McVey is the Chair of the International Section at Williams Mullen. Mr. McVey focuses his practice on international business law, including the Export Administration Regulations, ITAR, Office of Foreign Assets Control sanctions programs, the Foreign Corrupt Practices Act, the anti-boycott laws and the Committee on Foreign Investment in the United States (CFIUS). He also advises on cross-border and domestic business transactions including mergers and acquisitions, private equity, joint ventures, corporate compliance and international business planning.

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