Tuesday, October 26
11:00am-12:30pm

604 - Effective Export Compliance - The Hidden Minefields of Trade Sanctions, Import-Export and Anti-Boycott

Panagiotis Bayz
Of Counsel
Morrison & Foerster LLP

Mark Ehrlich
Managing Director, Ethics and Compliance
The AES Corporation

Nancy Heafey
Vice President, Deputy General Counsel and Chief Compliance Officer
Con-way Inc.

Kimberly White
Director, Business Ethics & Senior Corporate Counsel
Underwriters Laboratories Inc.

Session 604

Faculty Biographies

Panagiotis Bayz
Morrison & Foerster LLP

Mark Ehrlich

Mark Ehrlich is the managing director for ethics and compliance at The AES Corporation in Arlington, Virginia. His responsibilities include providing compliance advice regarding international transactions and activities, managing internal investigations, developing policies and training programs, and monitoring and measuring the progress of ethics and compliance initiatives.

Prior to joining AES, Mr. Ehrlich served as director, ethics and business conduct, at MCI WorldCom where he helped to create a comprehensive ethics and compliance program in the wake of financial improprieties. In addition to his ethics and compliance work, Mr. Ehrlich has extensive litigation and regulatory experience. He held litigation and regulatory support positions with MCI, served as an attorney-advisor at the Federal Communications Commission, and was a trial attorney with the US Department of Justice.

Mr. Ehrlich received a BS from the University of Michigan and is a graduate of Harvard Law School.

Nancy Heafey

Nancy Heafey is the vice president, deputy general counsel and chief compliance officer for Con-way Inc., headquartered in San Mateo, California. Ms. Heafey has primary responsibility for oversight of Con-way's corporate compliance program, including developing and implementing compliance and ethics policies and procedures, monitoring employee complaints, overseeing ethics and compliance investigations and risk assessments, and developing and implementing employee communications and training progrms. In addition, Ms. Heafey's responsibilities including managing labor, employment, and complex litigation matters for the company.

Prior to joining Con-way, Ms. Heafey was in private practice in San Francisco with the law firms of Pettit & Martin and Thelen Reid & Priest, where she specialized in labor and employment law and litigation.

Ms. Heafey received her law degree from the University of California, Berkeley, and her undergraduate degree from Stanford University.

Kimberly White

Kimberly W. White is director of business ethics and a senior corporate counsel at Underwriters Laboratories (UL) in Northbrook, Illinois, a global provider of product safety certification and verification services. As director of business ethics, Ms. White is responsible for the management and implementation of UL's Global Ethics and Compliance program.

Before joining UL, Ms. White served as an assistant Illinois attorney general and was law clerk to Justice Carl McCormick (ret.) of the Illinois Appellate Court, 1st District.

She is the immediate past chair of the ACC Compliance and Ethics Committee.

Ms. White received a BS from Northwestern University and is a graduate of the University of Notre Dame Law School.

OFAC Trade Sanctions

Legal Authority

General Prohibitions

Facilitation and Evasion

Specific Sanctions

Compliance Program Issues

Penalties and Enforcement

Comprehensive Iran Sanctions, Accountability, and Divestment Act

Legal Authority for U.S. Trade Sanctions

The Office of Foreign Assets Control ("OFAC") is responsible for administering U.S. economic sanctions and trade embargoes.

The legal authority for U.S. economic sanctions and trade embargoes is based on various laws, including:

- Trading with the Enemy Act *(Cuba; N. Korea; Vietnam)*
- International Emergency Economic Powers Act *(most embargoes)*
- United Nations Participation Act *(Iraq; Diamond Trading)*
- Cuban Democracy Act
- Cuban Liberty and Democratic Solidarity (Liberated) Act
- Iraqi Sanctions Act
- International Security and Development Cooperation Act
- Foreign Narcotics Kingpin Designation Act

The scope of the U.S. embargoes, including countries covered, can change at any time.

- July 1, 2010 Comprehensive Iran Sanctions, Accountability and Divestment Act

General Prohibitions

An OFAC sanctions program will utilize various tools to achieve specific policy objectives, including:

- asset blocking;
- import prohibitions;
- export prohibitions;
- financial sanctions; and
- new investment sanctions.

OFAC also identifies specially designated nationals ("SDNs"), which includes terrorists, narcotic traffickers, and foreign terrorist organizations. Over 6,000 SDNs currently identified.

Program-Specific Regulations

Each embargo is unique with its own regulatory regime.

Several common themes and provisions:

- Applicable to U.S. Persons. The jurisdictional scope of each embargo extends to "U.S. persons," which is generally defined to mean any U.S. citizen; permanent resident alien; juridical person organized under the laws of the United States or any jurisdiction within the United States, including foreign branches; and any person in the United States. **Note:** Under the Cuban Asset Control Regulations, the definition of "U.S. person" includes foreign subsidiaries of the above.
- Limited Exemptions. Most of the trade embargoes have limited exemptions under a "general license," which permits transactions related to the provision of information materials (e.g., books and records) and food donations. OFAC exemptions are very narrowly construed.
- No facilitation or evasion. Each embargo has a provision prohibiting "facilitation" or "evasion" of a prohibited transaction.

Facilitation and Evasion

Iranian Transaction Regulation (31 CFR 560.208)

"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."

Sudanese Sanctions Regulations (31 CFR 538.210)

"Any transaction by any United States person or within the United States that avoids, or has the purpose of avoiding, or attempts to violate, any of the prohibitions set forth in this part is prohibited. Any conspiracy formed for the purpose of engaging in a transaction prohibited by this part is prohibited."

Compliance Program Issues

No OFAC-mandated form of compliance program; OFAC recognizes risk-based compliance.

An OFAC compliance program usually includes the following components:

- Adopting, implementing and maintaining formal compliance program.
- Appointment of a Compliance Officer.
- Maintenance of a monitoring process to ensure the specific provisions of the compliance program are being followed.
- Implementation of a reporting process with respect to identified blocked assets and prohibited transactions.
- Appropriate training and compliance program review.

Identifying SDNs

A U.S. person cannot engage in any transaction with or for a person or entity named on the SDN list.

Careful attention should be paid to ensure the person or entity is the same as the one named on the SDN.

- Diligence may be necessary to determine if "false positive" hit.

Reliance on identification software not without risk.

Screening Accounts/Parties/Entities:

- New accounts and customers screened at time account established.
- Existing accounts and customers should be screened periodically or upon law change/SDN list updates.

Identifying SDNs (continued)

Screening Transactions and Transaction Counterparties.

- Identity of individuals, companies (including owners, beneficial owners).
- Determine purpose or predominant purpose of transaction, use of equity, or financing proceeds to evaluate sanctioned activity risk.

Screening to cover persons "*owned or controlled*" by, or acting for or on behalf of, sanctioned party:

- Control exists if 50% or more ownership (bright line threshold pursuant to (OFAC Feb. 2008 interpretation/guidance). Such entities are blocked even though not identified in SDN list.
- Control based on facts and circumstances test can have minimal ownership but exercise control, e.g., voting and nonvoting share situations.

Letter of Credit Issues

Letters of credit need to be examined carefully for any OFAC issues.

- Is the account party, beneficiary, issuing bank, or confirming bank, an SDN or blocked person?
- Does the bill of lading indicate that the goods were shipped by a blocked vessel or blocked shipping company?
- Does the certificate of origin indicate the goods originated from an embargoed country?
- Does the invoice indicate the participation of an SDN or blocked person in the transaction?

Blocking of Funds; Rejecting Transactions

U.S. persons must freeze the assets of SDNs and blocked countries in their possession or control.

Blocked funds must be placed into an interest-bearing account of a domestic bank from which only OFAC-authorized debits may be made.

Bank be permitted to debit blocked accounts for normal service charges.

Reject transaction where there is no asset freeze but the underlying transaction is prohibited.

Blocked v. Rejected Transactions Examples

A U.S. bank interdicts a commercial payment destined for the account of ABC Import-Export at Mashreq Bank, Khartoum, Sudan. Unlike the Bank of Khartoum, Mashreq Bank, Khartoum is a private sector entity so there is no blockable interest in this payment. However, processing the payment would mean facilitating trade with Sudan and providing a service in support of a commercial transaction in Sudan. This payment must be rejected.

A U.S. bank interdicts an unlicensed commercial payment going to a private-sector entity in Cuba. Under the Cuban Assets Control Regulations, all property and property interests of Cuban nationals—defined to include any person or entity in Cuba—are blocked. This payment must be blocked.

A U.S. bank interdicts a commercial payment destined for the account of XYZ Import-Export Co. at the Bank of Khartoum in Khartoum, Sudan. The Bank of Khartoum is wholly owned by the government of Sudan and, accordingly, is an SDN. This payment must be blocked.

Reporting Blocked and Rejected Transactions

A report on blocked property must be filed with OFAC within 10 days.

Annual reports on blocked property must be filed with OFAC by September 30 of each year, covering blocked property as of June 30.

A report on a rejected transaction must be filed with OFAC within 10 days.

Suspicious Activity Report may be required.

- December 2004 FinCEN Guidance considers reports of certain blocked SDN assets to OFAC as satisfying SAR reporting obligations if the transaction would not be reportable under the SAR rules, if there was no OFAC match, and the institution does not have any other information about the transaction.

Penalties—Civil and Criminal

Civil penalties (per violation):

- $250,000 or two times the value of the transaction (IEEPA)
- $65,000 (ITWEA)
- $275,000 (Iraqi Sanctions Act)
- $1 million (the Kingpin Act)

Criminal penalties:

- 20 years imprisonment; $1,000,000 (IEEPA)
- 20 years imprisonment; $1 million (TWEA)
- 30 years imprisonment; $10 million corporations; $5 million individuals (Kingpin Act)

Penalties can also be assessed under the Criminal Code.

Significant Enforcement Actions

Maersk Line, Limited $3 million: providing unlicensed shipping services for shipments of cargo originating in or bound for Sudan and Iran (July 2010).

Innospec Inc. $2.2 million (part of $40.2 million comprehensive criminal and civil settlement): transacting business in Cuba through acquired subsidiary (March 2010).

Balli Group PLC $15 million (plus $2 million criminal fine): exporting U.S. airliners to Iran (Feb 2010).

Lloyds TSB Bank, plc: $217 million; **Credit Suisse AG**: $536 million: deliberate manipulation of wire transfer information to cancel OFAC sanctioned transaction (Dec. 2009).

Total OFAC penalties Jan – July 2010: $23.3 million

Enforcement Activity

OFAC can self-initiate inquiry.

If possible violation found, consider voluntary disclosure option.

Enforcement options:

- demonstrate no violation;
- demonstrate violation warrants only a warning letter;
- mitigate penalties; and
- avoid expanded investigation.

Economic Sanctions Enforcement Guidelines Final Rule Issued November 9, 2009

Amended definition of "voluntary self-disclosure."

Voluntary self-disclosure means self-initiated notification to OFAC of an apparent violation by a Subject Person that has committed, or otherwise participated in, an apparent violation of a statute, Executive order, or regulation administered or enforced by OFAC, prior to or at the same time that OFAC, or any other federal, state, or local government agency or official, discovers the apparent violation or another substantially similar apparent violation. For these purposes, "substantially similar apparent violation" means an apparent violation that is part of a series of similar apparent violations or is related to the same pattern or practice of conduct. Notification of an apparent violation to another government agency (but not to OFAC) by a Subject Person, which is considered a voluntary self disclosure by that agency, may be considered a voluntary self-disclosure by OFAC, based on a case-by-case assessment.

Enforcement Guidelines Final Rule (continued)

Notification to OFAC of an apparent violation is not a voluntary self-disclosure if:

- a third party is required to and does notify OFAC of the apparent violation, regardless of when OFAC receives such notice from the third party and regardless of whether the Subject Person was aware of the third party's disclosure;
- the disclosure includes false or misleading information;
- the disclosure is materially incomplete;
- the disclosure is not self-initiated (including when the disclosure results from a suggestion or order of a federal or state agency or official); or,
- when the Subject Person is an entity, the disclosure is made by an individual in a Subject Person entity without the authorization of the entity's senior management.

Penalty of $50,000 for failure to maintain OFAC required records.

Enforcement Guidelines Final Rule (continued)

Listing of "General Factors" to be considered in penalty assessment:

- Willful or Reckless Conduct
- Awareness of Conduct at Issue
- Harm to Sanctions Program Objectives
- Individual Characteristics (e.g., commercial sophistication, size of operations, volume of transactions, sanctions history)
- Compliance Program
- Remedial Response
- Cooperation with OFAC
- Timing of Violation in Relation to Imposition of Sanctions
- Other Agency Enforcement Action
- Future Compliance/Deterrence Effect
- Case by Case Factors

Base Penalty Matrix

Voluntary Self-Disclosure	Egregious Case: NO	Egregious Case: YES
YES	(1) One-Half of Transaction Value (capped at $125,000 per violation/$32,500 per TWEA violation)	(3) One-Half of Applicable Statutory Maximum
NO	(2) Applicable Schedule Amount (capped at $250,000 per violation/$65,000 per TWEA violation)	(4) Applicable Statutory Maximum

Where the base penalty amount would otherwise exceed the statutory maximum civil penalty amount applicable to an apparent violation, the base penalty amount shall equal such applicable statutory maximum amount.

U.S. Export Controls

Overview

Export Administration Regulations

Encryption China Rule

Export Compliance Program

Penalties and Enforcement

Overview

Export Administration Regulations ("EAR") comprise regulatory controls on the export and re-export of U.S. origin commodities, software, and technology ("items").

The Commerce Department Bureau of Industry and Security ("BIS") is primarily charged with the enforcement of the U.S. export control laws.

Other agencies with export control jurisdiction over EAR include:

- Office of Foreign Assets Control
- State Department Directorate of Defense Trade Control
- Patent and Trademark Office
- Department of Energy/Nuclear Regulatory Commission

Overview

There are several elements to the export controls regulation, including:

- key controls; scope
- restrictions and prohibitions
- license exceptions; license requirements
- knowledge requirements

Company export compliance programs are expected to adhere to the EAR and require the development of a comprehensive compliance policy including governance model and reporting requirements.

The EAR also includes the U.S. anti-boycott prohibitions (Part 760), enforced by the Office of Antiboycott Compliance.

BIS Export Controls

BIS Export Controls impose restrictions on a wide variety of items and countries

Three Primary Tasks

1. Enforcement of export control regulations.
2. Export classification of items within its jurisdiction.
3. Issuing export licenses.

Scope of Coverage

- Products, software, and technology in the United States and any item made in the United States wherever located in the world.
- Foreign products incorporating more than a *de minimis* amount of U.S. origin components or technology.
- Products manufactured outside the United States that are a direct product of U.S. origin technology.

BIS Export Controls

Commerce Control List

Identifies specific items that are subject to some level of export control, and determines that level of control by looking at:

- the level of sophistication of the item;
- the reason the item is subject to export controls; and the country to which the item may be exported.

Assigns an ECCN to such items

ECCN

The primary way to determine which export restrictions apply. Identifies the reasons for control that apply to a particular item and whether certain licenses exceptions apply.

Must also use the Country Chart to determine whether an export license is required for a particular country.

NB: Different ECCN classifications apply to a commodity and to the technology or software associated with that commodity.

Items not specifically identified covered by "EAR 99"

If ECCN unclear, apply for classification request

Country Chart

Identifies each country and the reasons for control applicable to a particular ECCN.

Reasons for Control:

- Chemical and Biological ("CB")
- Nuclear Non-proliferation ("NP")
- National Security ("NS")
- Missile Technology ("MT")
- Regional Stability ("RS")
- Firearms Convention ("FC")
- Crime Control ("CC")
- Anti-Terrorism ("AT")

Exports and Deemed Exports

Deemed Export Rule:
The disclosure of technology anywhere in the world, including within the United States, to someone who is not a U.S. national or a permanent resident alien.

- **Example 1:** If a U.S. engineer working in California goes on a business trip to Japan to present certain technology, the disclosure of what the engineer knows to a non-U.S. national, even without providing any written material, in an export of technology.
- **Example 2:** If an engineer from China is visiting California and tours a production facility, the disclosure of information to the visiting engineer (and even the viewing of the production facilities) is an export of technology.

Re-Export Restrictions

Purpose:
Prevents indirect exports to a prohibited country when such export could not be made directly.
A company must ensure that U.S. export restrictions do not apply to a third country when re-exporting products.

Test: Could the item be exported directly from the United States to the third country without an export license?

Also consider items that either:
- incorporate more than a "*de minimis*" level of controlled U.S. items; or
- are a "direct product" of controlled U.S. technology or software.

Re-Export Restrictions

Key Terms

"**Controlled U.S. origin**" means that the re-export of an item to a particular country would require an export license if it was exported directly from the United States.

"**Direct product**" is defined in the BIS regulations as an item that is the immediate product (including processes and services) produced directly by the use of controlled U.S. origin technology or software.

Consider certain exceptions and restrictions to the EAR

***De Minimis* Exception:** re-exports of a foreign-made product or software incorporating controlled U.S. origin commodities valued at 25% or less of the total value of the foreign made product or software (except that for the embargoed and terrorist designated countries, the *de minimis* level is set at 10%).

Direct Product Restrictions: re-exports that are a direct product of controlled U.S. origin technology or software to a limited number of countries (generally the communist and former communist countries).

The 10 General Prohibitions Under the EAR

1. Export and re-export of controlled items to prohibited countries.
2. Re-export and export from abroad of foreign-made items using more than a *de minimis* amount of controlled U.S. content.
3. Re-export and export from abroad of foreign-produced direct products of U.S. technology and software to certain designated countries.
4. Export to persons on BIS' table of denial orders (which lists natural and legal persons denied export privileges due to prior violations of the EAR).
5. Export or re-export to prohibited end-uses or end-users (primarily military uses and users).
6. Export or re-export to embargoed destinations.
7. Actions that would support proliferation activities.
8. Permitting in-transit shipments or items to be unladen from vessels or aircraft in certain prohibited countries.
9. Violating any BIS order, term or condition of an export license or license exception.
10. Proceeding with a transaction with knowledge that a violation has occurred or is about to occur.

Special Rules for Encryption Items

Encryption items can be generally classified into two broad categories:

- encryption items that can be exported without prior BIS review or in certain cases only prior notice; and
- encryption items that can be exported only upon prior BIS review, or with a BIS export license.

Unless there is a specific exemption, BIS prior review is necessary for any item where the encryption used is (a) a symmetric algorithm employing a key length in excess of 56 bits or (b) an asymmetric algorithm where the security of the algorithm is based on (i) factorization of integers in excess of 512 bits (e.g., RSA), (ii) computation of discrete logarithms in a multiplicative group of a finite field of size greater than 512 bits (*e.g.*, Diffie-Hellman over Z/pZ), or (iii) discrete logarithms in excess of 112 bits (*e.g.*, Diffie-Hellman over an elliptic curve).

Encryption Items Eligible for Export Without BIS Prior Review

The encryption functionality is limited to authentication and digital signature functions.

Encryption items with limited encryption functionality (e.g., certain personalized smart cards; functionality limited to banking use).

Mass market items employing a key length of 64 bits or less for the symmetric algorithm; provided (a) the item is generally available to the public; the cryptographic functionality cannot be easily changed by the user; and (c) is designed for installation by the user without further substantial support by the supplier.

Products with short range wireless encryption (e.g., with a nominal operating range not exceeding 100 meters according to the manufacturer's specifications).

Exports to U.S. subsidiaries and "Supplement No. 3 Countries" (developed country allies) for internal use and product development.

Encryption that is publically available.

Registration Required for Certain Mass Market Products

New BIS rule issued June 25, 2010, permits export of certain mass market encryption items upon submitting a company encryption registration to BIS, and an annual self-classification report.

Export Licenses

Export Licenses

Required to export an item to a particular country if such item is identified on the CCL and subject to export control restrictions, and no license exemption applies.

Information Required

- The item to be exported (including detailed technical data on the item and ECCN).
- The country of importation.
- The parties to the transaction (including any intermediate consignees).
- Certain applications may require signed statements from the importer or the trade regulatory authority of the importing country.

License application to be made electronically using SNAP-R

- No filing fee
- Processing time 6-8 weeks

License Exceptions

"List-based" License Exceptions

- Limited Value Shipment ("LVS")
- Shipment to Country Group B ("GBS")
- Civil End-Users ("CIV")
- Restricted Technology and Software ("TSR")
- Computers ("APP")
- Encryption Commodities and Software ("ENC")

Additional License Exceptions

- Temporary Imports, Exports, and Re-exports ("TMP")
- Technology and Software Unrestricted ("TSU")
- Additional Permissive Re-exports ("APR")

Knowledge Requirement

"***Knowledge***" of a circumstance (the term may be a variant, such as "know," "reason to know," or "reason to believe") includes not only positive knowledge that the circumstances exists or is substantially certain to occur, but also an awareness of a high probability of its existence or future occurrence. Such awareness is inferred from evidence of the conscious disregard of facts known to a person and is also inferred from a person's willful avoidance of facts.

Revision and Clarification of Controls for China

- Establishes a control, based on knowledge of a "military end-use," on exports and re-exports to China of certain items on the CCL that otherwise do not require a license to China.
- Includes a revision to the license application review policy for items destined for China that are controlled on the CCL for reasons of national security.
- Revises the license review policy for items controlled for reasons of chemical and biological weapons proliferation, nuclear nonproliferation, and missile technology for export to China, requiring that applications involving such items be reviewed in conjunction with the revised national security licensing policy.
- Revises the circumstances in which end-user statements, issued by China's Ministry of Commerce, must be obtained, requiring them for transactions that both require a license to China for any reason and (for most exports) exceed a total value of $50,000.

Revision and Clarification of Controls for China

"China Rule"

- Presumption of denial for license applications to export, re-export, or transfer items that would make a direct and significant contribution to China's military capabilities.

China's military capabilities include:

- **Battle tanks**
- **Armored combat vehicles**
- **Large-caliber artillery systems**
- **Combat aircraft**
- **Attack helicopters**
- **Warships**
- **Missiles and missile launchers**
- **Offensive space weapons**
- **Precision guided munitions**
- **Night vision equipment**

- Authorization for validated end-users ("VEU") to which specified items may be exported or re-exported without a license.

End-User Review Committee (the "ERC") considers:

- **The entity's record of exclusive engagement in civil end-use activities.**
- **The entity's compliance with U.S. export controls.**
- **The need for an on-site review prior to approval.**
- **The entity's relationships with U.S. and foreign companies.**
- **Status of export controls and the support and adherence to multilateral export control regimes of the government of the eligible destination.**

Scope of Export Compliance

Determining Scope of the Export Compliance Program

- Review and classify the company's products and technology according to the classifications provided under the CCL.
  - *If any ambiguity as to proper classification, file classification request.*
- Have a general export control policy and compliance program to cover the applicable general export restrictions in order to avoid inadvertent export violations and penalties.

Components of Compliance Program

Formal adoption of a compliance program emphasizes the seriousness of the company's compliance obligations and should include the following:

- Statement of corporate policy stating that:
  - the company's policy is to export in compliance with applicable laws;
  - the program was developed to ensure that under no circumstances shall the company sell or transfer goods or technology in contravention of the U.S. export control laws and regulations; and
  - the company employees are responsible for complying with the procedures of the program and will be sanctioned for violating the policy.
- Appointment of export compliance officer
- Specific measures such as:
  - ensuring proper classification against the CCL;
  - screening export customers and export orders against prohibited export destinations and denied persons;
  - training procedures to ensure proper implementation of the policies;
  - procedures for obtaining appropriate export approvals; and
  - reporting processes for possible prohibited transactions.

Record Keeping Requirements

Key Requirements

- BIS regulations require exporters to retain all records in connection with an export for five years.
- The record retention system should keep all documentation related to the transaction usually produced in the regular course of business (e.g., purchase order, invoice, and shipping documents, including the Shipper's Export Declaration), along with any BIS correspondence, such as a classification ruling or an export license.

Penalties and Enforcement

Civil Penalties: $250,000 per violation or twice the amount of the transaction that is the basis of the violation.

Denial of Export Privileges: A denial of export privileges prohibits a person from participating in any way in any transaction subject to the EAR, and it is unlawful for other businesses and individuals to participate in any way in an export transaction subject to the EAR with a denied person.

Criminal Penalties: 20 years imprisonment and $1 million per violation.

Voluntary disclosure of potential violation considered significant mitigating factor.

Anti-Boycott Compliance

Overview

Prohibitions

Exemptions to Prohibitions

Reporting Requirements

Reportable Boycott Requests

Evasion

Tax Reform Act Prohibitions

Anti-Boycott Compliance Overview

Enforced through two sets of laws:

- Export Administration Act (Commerce Department Office of Anti-Boycott Compliance) EAR penalties.
- Internal Revenue Code Tax Reform Act.

Prohibits compliance with any foreign trade boycott that the U.S. has not sanctioned.

- Requires "intent" and "intent" can be established by facts and circumstances.
- Applies to entities located in the U.S., their foreign affiliates and "controlled in fact" entities, and U.S. citizens.
- Covers activities in the interstate or foreign commerce of the U.S.

Primary Focus

Arab League Boycott of Israel.

- Boycotting Members: Bahrain; Iraq; Kuwait; Lebanon; Libya; Oman; Qatar; Saudi Arabia; Syria; United Arab Emirates; Yemen.
- Egypt and Jordan recognize Israel and requests are presumed not boycott-related.
- Non-Arab League Countries: Iran; Bangladesh; Pakistan; Malaysia; Nigeria.

Any other unsanctioned embargoes are also covered.

Prohibitions

Refusal to Do Business

A U.S. person cannot refuse to do business with a boycotted firm or country (*e.g.,* exclude entity or person from transaction for boycott reason).

Discrimination

A U.S. person cannot discriminate against U.S. persons based on race, religion, sex, or national origin.

Certain Information

A U.S. person cannot furnish information about race, religion, sex or national origin of a U.S. person; business relationship with a boycotted country; or charitable or fraternal organizations that support a boycotted country.

Letters of Credit

A U.S. person cannot implement (defined broadly) letters of credit containing boycott-prohibited conditions.

Letters of credit can be amended to remove boycott prohibited provision.

Exemptions to Prohibitions

Exemptions usually tied to boycotting country requirements:

- Compliance with import and local law requirements.
- Requirements on shipment of goods to boycotting country.
- Import and shipping documents compliance.
- Unilateral specific selection of goods and services.
- Shipments and transshipment of exports.
- Immigration, passport, or employment requirements.
- Activities exclusively within a foreign country.

Exemptions narrowly construed and very fact specific.

Minor changes to specific facts make the difference between prohibited versus permitted conduct.

Reporting Requirements

Requires reporting any request (written or oral) to further or support an unsanctioned boycott.

Reports (on form BIS-621P or BIS-6051P) must be submitted by last day of the month following calendar quarter in which the request was received.

Commerce Anti-Boycott Reporting Hotline: (202) 482-2381.

Reporting Requirements—Exemptions

Certain requests and transactions exempt from reporting requirements

- Receipt of unsolicited RFP that is not responded to.
- Refrain from shipping on boycotted country flag carrier.
- Ship via proscribed route.
- Affirmative country of origin certification.
- Affirmative manufacturer or service provider certification.
- Comply with country's laws if boycott laws not mentioned.
- Individual personal information for immigration purposes.
- Affirmative certification of export destination.
- Certificate of vessel eligibility (if from vessel owner).
- Certifying that insurance company has in-country agent.

Reportable Boycott Requests

Freight Forwarder and Customs Documents:

"*Certificate from insurance company stating that they are not blacklisted.*" (Saudi Arabia)

"*[The vessel entry document asks the ship's captain to certify that,] no goods, dry cargo, or personal effects listed on the document of Israeli origin or manufactured by a blacklisted firm or company are to be landed as they will be subject to confiscation.*" (Kuwait)

"*The supplier must comply with the Israel boycott conditions.*" (Oman)

Purchase Order and Contract Conditions:

"*The seller shall not supply goods or materials which have been manufactured or processed in Israel nor shall the services of any Israeli organization be used in handling of transporting the goods or materials.*" (Yemen)

Letter of Credit Conditions:

"*A signed statement from the shipping company, or its agent, stating the name, flag and nationality of the carrying vessel and confirming…that it is permitted to enter Arab ports.*" (Bahrain)

Evasion Prohibited

"*No United States person may engage in any transaction or take any other action, either independently or through any other person, with intent to evade the provisions of this part. Nor may any United States person assist another United States person to violate or evade the provisions of this part.*" *(15 CFR 760.4)*

Tax Reform Act Prohibitions

Participation in an unsanctioned boycott

Prohibits agreement not to do business with:

- Boycotted country or nationals.
- A U.S. person who trades or cooperates with a boycotted country.
- A company owned or managed by individuals to whom a boycotting country objects.
- Any person who does not participate in or cooperate with a boycott.

TRA Reporting/Penalties

Reporting required for operations in, with, or related to a boycotting country or its nationals and request to participate in or cooperate with an unsanctioned boycott—even if refused.

Reporting on IRS Form 5713.

Penalties for violations

- Civil: loss of foreign tax credit and other tax benefits under provisions related to international operations.
- Criminal: fine of up to $25,000 and imprisonment up to one year.

MEMORANDUM

TO:

FROM:

DATE: July 2010

RE: Overview of U.S. Export Regulatory Regime

This memorandum provides an overview of the U.S. export control regulations. In particular, this memorandum discusses the Export Administration Regulations ("EAR") issued by the Commerce Department Bureau of Industry and Security ("BIS"), formerly known as the Bureau of Export Administration. Part I of this memorandum gives an overview of BIS export controls, including general export prohibitions, license requirements and a brief discussion of the recently published new BIS rule on China. Part II of the memorandum outlines the elements of an export compliance program.

I. Overview of U.S. Export Controls

The United States government imposes regulatory controls on the export and re-export of U.S. origin commodities, software and technology. The BIS is primarily charged with the enforcement of the U.S. export control laws.[1] However, other agencies also have jurisdiction over export control matters. For example, the Office of Foreign Assets Control ("OFAC") of the U.S. Treasury Department is responsible for administering the U.S. trade embargoes in effect against various countries. Under the OFAC regulations, U.S. companies and U.S. persons are prohibited from dealings with the U.S. embargoed countries (currently consisting of Burma (Myanmar), Cuba, Iran, Syria, and Sudan) and individuals and entities identified by OFAC as "Specially Designated Nationals."[2] In addition, the U.S. State Department Office of Defense Trade Controls has jurisdiction over military and defense related items on the U.S. Munitions List.[3] The U.S. Patent and Trademark Office ("PTO") also has its own export control provisions which are designed to permit otherwise restricted

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[1] *See* Export Administration Regulations, 15 C.F.R. Parts 730-774.

[2] *See* 31 C.F.R. Parts 500-598. It is important to note that the scope of each embargo is different, and that the countries subject to an embargo can change at any time. An online version of the sanctions program, country summaries and the "Specially Designated Nationals" list can be found online at http://www.ustreas.gov/offices/eotffc/ofac/sdn/index.html.

[3] *See* 22 C.F.R. Parts 120-130.

exports under certain circumstances for the purposes of obtaining patent protection in foreign countries.[4]

U.S. companies involved in export activities are advised to implement and maintain some type of export compliance program in order to avoid an inadvertent export violation as the penalties for export violations can be severe. Under the BIS regulations, monetary sanctions for export violations can be as high as $250,000 or twice the value of the transaction for each export violation.[5] BIS may also deny a company export privileges if it finds the export violation was willful.[6] The penalties under the OFAC regulations can be as high as $1,000,000.[7] BIS and OFAC can also impose criminal sanctions, including jail terms, for export violations.[8] Thus, there is a strong incentive for companies to comply with applicable export control requirements.

A. BIS Export Controls

BIS is charged with three primary tasks:

- Enforcement of export control regulations;
- Export classification of items within its jurisdiction; and
- Issuing export licenses.

The BIS regulatory regime is complex and detailed (consisting of 25 different chapters in the EAR) as it attempts to impose a myriad of export control restrictions on a wide variety of items and countries. In general, any "item" (defined in the export control context to include products, software and technology) in the United States and any item made in the United States wherever located in the world, is subject to U.S. export control restrictions. In addition, foreign products incorporating more than a "*de minimis*" amount of U.S. origin components or technology and products manufactured outside the United States that are a direct product of U.S. origin technology are also within the U.S. export control jurisdiction. The exporter should examine the Commerce Control List ("CCL"), determine the Export Control Classification Numbers ("ECCNs") applicable to its items and review the Country Chart to determine whether: (a) the item to be exported is a restricted export item; (b) the country to which the item is to be exported is a restricted export destination; and (c) if the item is controlled, whether any export license exceptions apply.

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[4] *See* 37 C.F.R. §§ 5.11, 5.15 and 5.19(a). The PTO export authorization provisions are not discussed in this memorandum.

[5] *See* 15 C.F.R. § 764.3(a).

[6] *See id*.

[7] *See* 31 C.F.R. § 500.701(a).

[8] *See id*. *See also* 15 C.F.R. § 764.3(b).

1. The Commerce Control List

The CCL, maintained by the BIS, identifies specific items that are subject to some level of export control, and assigns an ECCN to such items.[9] It is important to note that the level of export control applicable to an item will depend on (a) the level of sophistication of the item, (b) the reason the item is subject to export controls, and (c) the country to which the item may be exported. Thus, it is often the case that a particular item may be exported to developed countries without an export license, but the same item may require an export license to be exported to developing countries. The CCL does not list items subject to the jurisdiction of other federal agencies and it does not list specifically items that are within a "basket category."[10]

2. Basket Category/EAR99

If an item is not specifically identified and assigned an ECCN, it falls within the "basket category" of the CCL. Such basket category items are classified under the ECCN "EAR99."[11] While EAR99 items are not subject to any of the reasons for control identified on the country chart, exporters should be aware that an export license may still be required for some of the items falling within EAR99 based on the general export prohibitions contained in the EAR (discussed in section I.D below).

3. Export Control Classification Number

The ECCN designation of an item is the primary means of determining what export restrictions apply. The ECCN listings also identify the reasons for control that apply to a particular item and whether certain license exceptions are applicable.[12] The ECCN is designed to work in tandem with the Country Chart to determine whether an export license may be required for a particular country.

The exporter should be aware that different ECCN classifications apply to a commodity and to the technology or software associated with that commodity. Accordingly, different export restrictions may apply to each. It is common to have situations where the export of a commodity to a particular country is permitted while the export of the technology associated with that commodity to the same country is prohibited without an export license.

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[9] The CCL set forth at Part 774 of the EAR is divided into ten categories. An online version can be found at http://w3.access.gpo.gov/bis/ear/ear_data.html.

[10] *See* 15 C.F.R. § 774.1.

[11] *See* 15 C.F.R. § 734.3.

[12] *See* 15 C.F.R. § 730.8.

4. The Country Chart

The BIS regulations contain a comprehensive Country Chart identifying, on the vertical axis, the countries of the world and on the horizontal axis, the "reason for control" that may be applicable to a particular ECCN. The reasons for control appearing on the country chart (and their abbreviated designation) are: Chemical and Biological Weapons ("CB"); Nuclear Non-proliferation ("NP"); National Security ("NS"); Missile Technology ("MT"); Regional Stability ("RS"); Firearms Convention ("FC"); Crime Control ("CC"); and Anti-Terrorism ("AT").[13] Each ECCN identifies the reason(s) for control over the export of the item, which may include reasons in addition to those identified on the country chart.[14] Some reasons for control have more than one column, in which case the ECCN will identify the appropriate column for that product. For example, the ECCN may list as a reason for control "NP column 2." The Country Chart will then identify whether, for the control reason given in the ECCN, exports to a particular country are permitted without a license. If an "x" appears in the box intersecting the designated country and the reason for control, then an export license is required unless a license exception is applicable. The ECCN also states whether, and under what conditions, certain license exceptions apply.

B. Exports and Deemed Exports

In addition to the physical export of an item, the definition of "export" under the BIS regulations covers the disclosure of technology anywhere in the world, including within the United States, to someone who is not a U.S. national or a permanent resident alien.[15] This is the so-called "deemed export" rule. Thus, if a U.S. engineer working in California goes on a business trip to Japan to present certain technology, the disclosure of what the engineer knows to a non-U.S. national, even without providing any written material, would be an export. Similarly, if an engineer from China is visiting California and tours a production facility, the disclosure of information to the visiting engineer (and even the viewing of the production facilities) would be an export. In both cases, if the technology "exported" was subject to export controls, the disclosure of the technology could be a violation of the BIS regulations if no export license was acquired from BIS prior to the export.[16]

C. Re-Export Restrictions

As noted above, the scope of the U.S. export controls also extends to re-exports of U.S. origin products from abroad to other countries. This export restriction is in place in order to prevent an indirect export to a prohibited country when such export could not be made directly. Thus, because a particular item can be exported to Japan without any export

[13] *See* 15 C.F.R. § 738 Supplement No. 1.

[14] *See* 15 C.F.R. § 738.2.

[15] *See* 15 C.F.R. § 734.2(b).

[16] *See id*.

restrictions, it does not necessarily mean that this same product can be re-exported from Japan to a third country. U.S. export restrictions may apply to that third country (*i.e.*, that item could not be exported directly from the United States to that third country without an export license).

In addition, a second type of re-export prohibition relates to items that either (i) incorporate more than a "*de minimis*" level of controlled U.S. items or (ii) are a "direct product" of controlled U.S. technology or software. In this context, an item that is "controlled U.S. origin" means that the re-export to a particular country would require an export license if it was exported directly from the United States.[17]

1. *De Minimis* Exception

In general, re-exports of a foreign-made product or software incorporating controlled U.S. origin commodities valued at 25% or less of the total value of the foreign made product or software are considered *de minimis* and thus outside the scope of the EAR and not subject to U.S. export controls (except that for the embargoed and terrorist designated countries, the *de minimis* level is set at 10%).[18] The *de minimis* restriction is designed to avoid the circumvention of export controls by exporting components to a permitted destination and then using these components to produce items to be exported to a prohibited destination.

2. "Direct Product" Restriction

The "direct product" restriction applies only to re-exports that are a direct product of controlled U.S. origin technology or software to a limited number of countries (generally the communist and former communist countries).[19] "Direct product" is defined in the BIS regulations as an item that is the immediate product (including processes and services) produced directly by the use of controlled U.S. origin technology or software.[20] Unfortunately, the regulations do not give much more guidance on this issue, and the exporter must make a determination of whether an item is a "direct product" within this definition. This restriction becomes relevant to the extent the research and development activities are undertaken in the United States and the results of that research are exported to another country for the manufacture and sale of a particular item.[21] It is likely that the item

[17] *See* 15 C.F.R. §§ 736.2(b)(3), 738.3(a).

[18] *See* 15 C.F.R. § 734.4(c)-(d).

[19] *See* 15 C.F.R. § 736.2(a)(3).

[20] *See* 15 C.F.R. § 734.3(a).

[21] The BIS does, however, differentiate between fundamental research where the results are published and shared with the scientific community at large, and proprietary research. *See* 15 C.F.R. § 734.8.

manufactured from the U.S. origin technology would be considered a "direct product" subject to U.S. export control restrictions.

D. General Prohibitions under the EAR

The regulations consolidate into ten "general prohibitions" export restrictions that apply to all items, including those that fall within a specific ECCN, as well as all EAR99 items that are not subject to any CCL-specific export licensing requirements. These ten general prohibitions are as follows:[22]

1. Export and re-export of controlled items to prohibited countries.
2. Re-export and export from abroad of foreign-made items incorporating more than a *de minimis* amount of controlled U.S. content.
3. Re-export and export from abroad of foreign-produced direct products of U.S. technology and software to certain designated countries.
4. Export to persons on BIS's table of denial orders (which lists natural and legal persons denied export privileges due to prior violations of the EAR).
5. Export or re-export to prohibited end-uses or end-users (primarily military uses and users).
6. Export or re-export to embargoed destinations.
7. Actions that would support proliferation activities.
8. Permitting in-transit shipments or items to be unladen from vessels or aircraft in certain prohibited countries.
9. Violating any BIS order, term or condition of an export license or license exception.
10. Proceeding with a transaction with knowledge that a violation has occurred or is about to occur.

These prohibitions serve as a check-list to determine whether a particular export or re-export may be in violation of the EAR.

Although BIS asserts jurisdiction over virtually every item within the United States and controlled U.S. origin items wherever located, it is important to note that the actual number of items subject to export licensing requirements is limited, as are the number of countries to whom exports are restricted.[23] Further, the trend has been to decontrol products and technology since the end of the Cold War. This trend has also been helped by the acceleration of technological change. However, the current "war on terrorism" has caused

[22] *See* 15 C.F.R. § 736.2(b).

[23] *See* 15 C.F.R. § 730.7. It is important to note that an item or activity may be subject to EAR as well as control programs of other agencies such as the OFAC. *See* 15 C.F.R. § 734.2(a).

the U.S. to strengthen its export control regime and place greater emphasis on export compliance.

E. Export Licenses

If an item is identified on the CCL and subject to export control restrictions, and no license exemption applies, a BIS export license is required in order to permit that item to be exported to a particular country.[24] Obtaining an export license requires the submission of an export license application to BIS. The license application is fairly straightforward. In general, the information required for the license application includes the item to be exported (including detailed technical data on the item), the country of importation, and the parties to the transaction (including any intermediate consignees).[25] For certain applications it may be necessary to obtain signed statements from the importer or the trade regulatory authority of the importing country.

There is no filing fee associated with the license application and its preparation does not take a significant amount of time. The application requires information on the item to be exported, its ECCN, and the parties to the transaction, along with supporting documentation on the transaction and the item to be exported. BIS requires that license applications be submitted electronically on its SNAP-R system. Processing a license application usually takes at least six to eight weeks. Therefore, the time delay in getting the export license, and the risk that the license could be denied, should be factored into any export transaction that requires a license.

It is also possible to request a license from OFAC to engage in a transaction with an embargoed country. As a practical matter, however, such licenses are generally not granted.

F. License Exceptions

The CCL indicates whether certain license exceptions may be applicable to the item covered by a particular ECCN.[26] The "list-based" license exceptions which may appear under each ECCN include:

- Limited Value Shipment ("LVS"): This exception applies to shipments valued under a certain dollar amount as specified in the ECCN listing for that product.
- Shipment to Country Group B ("GBS"): This exception permits exports and re-exports to Country Group B destinations (which are most of the countries of the world other than the communist and former communist countries).

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[24] *See* 15 C.F.R. § 736.2(b)(1)-(3).

[25] *See* 15 C.F.R. §§ 748.4, 748.6.

[26] *See* 15 C.F.R. Part 740.

- Civil End-Users ("CIV"): This exception authorizes exports and re-exports only to civil end-users for civil end-uses in Country Group D:1 (which are the communist and former communist countries not listed in the GBS group).
- Restricted Technology and Software ("TSR"): This exception permits exports and re-exports of certain technology and software to destinations in Country Group B provided that a prior written assurance is obtained from the importer that the technology or software will not be re-exported to Country Groups D:1 or E:1 (the embargoed countries) or to nationals of countries in those groupings.
- Computers ("APP"): This exception permits exports and re-exports of computers to certain countries depending on (1) the specific country involved and (2) the operating capacity of the computer measured in Weighted TeraFLOPS ("WT").
- Encryption Commodities and Software ("ENC"), covering export and re-export of encryption items and "information security" test, inspection and production equipment.

The Country Group listings are used by BIS to classify countries according to similar export control concerns.[27] Thus, former COCOM members (Group A:1) are exempt as a group from many export restrictions while the communist and former communist countries (Group D:1) are subject to more stringent export controls.

In addition to the above license exceptions which appear on the specific ECCN itself, the regulations also contain additional license exemptions that may be available. These include, for example:

- Temporary Imports, Exports, and Re-exports ("TMP"): This license exception permits various temporary exports and re-exports, exports and re-exports of items temporarily in the U.S.; and exports and re-exports of beta test software.
- Technology and Software Unrestricted ("TSU"), covering certain operating and sales technology and software updates, and "mass market" software.
- Additional Permissive Re-exports ("APR"), covering for example, exports to and among Country Group A:1.

An exporter therefore should be aware of these additional license exceptions which, if applicable, may permit an export that would otherwise be restricted. These license exceptions, if applicable, are identified by the exporter on the Shipper's Export Declaration ("SED") which must accompany the shipping documentation of the export.

G. The Knowledge Requirement

BIS takes a very aggressive stance on enforcing U.S. export control requirements and the penalties for violating export control laws can be severe, involving potentially millions of dollars and up to 10 years in jail. Therefore, the exporter must be responsible for "knowing" whether an export violation has occurred or is about to occur (this knowledge requirement

[27] *See* 15 C.F.R. § 738.1.

relates to general prohibition 10 above). In addition, the exporter should have in place a record keeping system to be able to demonstrate that its exports did not cause any violation of the EAR.

In evaluating whether the exporter is liable for an export violation BIS will often need to determine the exporter's "knowledge" that a violation has or is about to occur. Knowledge is defined in the EAR as follows:

> Knowledge of a circumstance (the term may be a variant, such as "know," "reason to know," or "reason to believe") includes not only positive knowledge that the circumstances exists or is substantially certain to occur, but also an awareness of a high probability of its existence or future occurrence. Such awareness is inferred from evidence of the conscious disregard of facts known to a person and is also inferred from a person's willful avoidance of facts.[28]

Thus, an exporter cannot merely say that they did not have affirmative knowledge of a violation, because there may be circumstances where the exporter would have "reason to know" that a violation would occur if the export was shipped.

H. Revisions and Clarification of Export and Reexport Controls for China

The BIS has amended, as of June 19, 2007, the EAR in an effort to revise and clarify its export control policies regarding China (the "China Rule").[29]

The China Rule establishes a control, based on knowledge of a "military end-use," on exports and reexports to China of certain items on the CCL that otherwise do not require a license to China. The China Rule also includes a revision to the license application review policy for items destined for China that are controlled on the CCL for reasons of national security, and revises the license review policy for items controlled for reasons of chemical and biological weapons proliferation, nuclear nonproliferation, and missile technology for export to China, requiring that applications involving such items be reviewed in conjunction with the revised national security licensing policy.

The China Rule introduces a presumption of denial for license applications to export, reexport, or transfer items that would make a direct and significant contribution to China's military capabilities such as, but not limited to, major weapons systems such as battle tanks, armored combat vehicles, large-caliber artillery systems, combat aircraft, attack helicopters, warships, missiles and missile launchers, offensive space weapons, precision guided

[28] 15 C.F.R. § 772.1

[29] *See* 15 C.F.R. Parts 742, 743, 744, 748, 750 and 758.

munitions, and night vision equipment.[30] This presumption of denial is not limited to the items referenced above; it also encompasses items subject to controls for chemical, biological, nuclear and missile technology.[31]

The China Rule, moreover, creates a new authorization for validated end-users (the "VEU") to which specified items may be exported or reexported without a license. Validated end-users will be placed on a list in the EAR after review and approval by the United States government. The VEU permits the export, reexport, and transfer of specified items to end-users that have been previously validated by the BIS without having to obtain licenses for each export.[32] In evaluating the eligibility of an end-user for VEU status, the End-User Review Committee (the "ERC") will consider a range of information, including such factors as: the entity's record of exclusive engagement in civil end-use activities; the entity's compliance with U.S. export controls; the need for an on-site review prior to approval; and the entity's relationships with U.S. and foreign companies.[33] In addition, the ERC will also consider the status of export controls and the support and adherence to multilateral export control regimes of the government of the eligible destination.[34] If a request for VEU authorization for a particular end-user is not granted, no new license requirement is triggered. Such a result, moreover, does not render the end-user ineligible for license approvals from the BIS.[35] The VEU authorization is subject to revision, suspension or revocation entirely or in part.[36]

The China Rule also revises the circumstances in which end-user statements, issued by China's Ministry of Commerce must be obtained, requiring them for transactions that both require a license to China for any reason and (for most exports) exceed a total value of $50,000.[37]

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[30] *See* 15 C.F.R. § 742.4(b)(7). For the complete list of the above referenced items see Supplement No. 7 to 15 C.F.R. § 742.

[31] *See id.*

[32] *See* 15 C.F.R. § 748.15.

[33] *See* 15 C.F.R. § 748.15 (a)(2).

[34] *See id.*

[35] *See* 15 C.F.R. § 748.15.

[36] *See* 15 C.F.R. § 748.15(a)(3).

[37] *See* 15 C.F.R. § 748.10(b)-(c).

II. Export Compliance Program

A. Scope of an Export Compliance Program

The scope of a company's export compliance program will depend on the particular items that the company manufactures and exports (or intends to develop and export). For companies that provide general commercial use products without any particularly sophisticated technology, it is likely that the company's products and technology would not be subject to any particular country specific restrictions (other than dealings with the embargoed countries). Conversely, a company with sophisticated technology or products may find that its items are identified on the CCL and thus subject to some type of export control restrictions.

Thus, the first step in determining what type of export compliance program is appropriate for a particular company is to review and classify the company's products and technology according to the classifications provided under the CCL. Typically, this task would be undertaken by an engineer at the company who would review the relevant category of the CCL (*e.g.* Category 4 for computers) to determine whether an item is on the list. Reviewing and classifying the company's products and technology will enable the company to know whether its products can be exported without any specific restrictions, or whether the company will need to adopt more detailed export compliance measures to ensure that it does not engage in any inadvertent export violation. To the extent a company's products are subject to export licensing requirements, the company could apply for the appropriate export license for such items as described above.

Even if the company's exports do not involve any items on the CCL, it is still advisable for a company to have a general export control policy and compliance program to cover the applicable general export restrictions, such as the prohibition on dealings with persons on the BIS Table of Denial Orders and dealings with the embargoed countries.

B. Components of an Export Compliance Program

As noted above, the specific provisions of an export compliance program will depend on the particular needs and requirements of the company based on the export restrictions applicable to its products. The general components of an export compliance program are the following:

- Formal adoption of the compliance program and a statement of corporate policy, typically done by the board of directors, the executive officer, or the legal department. Formal adoption is recommended in order to give emphasis to the seriousness of the company's compliance obligations. The statement of corporate policy usually notes that it is the company's policy to export in compliance with applicable laws, and that the export compliance program was developed to ensure that under no circumstances shall the company sell or transfer goods or technology in contravention of the U.S. export

control laws and regulations. The policy statement should also note that company employees are responsible for complying with the procedures of the program and will be sanctioned for violating the policy.

- Appointment of an individual as being responsible for implementation of the compliance program (the "Export Compliance Officer"), which individual should have sufficient authority to permit proper enforcement. The role of the Export Compliance Officer would be to ensure that the program is effectively implemented and to serve as a contact person to resolve any export related transaction issues.

- The compliance program itself would detail the specific measures to be undertaken, such as:

  - Ensuring that each item to be exported by the company is properly classified against the CCL;
  - Screening of export customers and export orders against prohibited export destinations and denied persons;
  - Training procedures to ensure that employees properly implement the policies;
  - Procedures for obtaining appropriate export approvals; and
  - Implementation of a reporting process with respect to possible prohibited transactions.

In establishing a company-specific export program, the objective should be to minimize the compliance burden by adapting the compliance obligations to the company's existing sales and export review and approval procedures.

C. Record Keeping Requirements

Under the BIS regulations, exporters must retain all records in connection with an export for five years.[38] The record retention system should keep all documentation related to the transaction usually produced in the regular course of business (e.g., purchase order, invoice, shipping documents, including the Shipper's Export Declaration), along with any BIS correspondence such as a classification ruling or an export license.[39]

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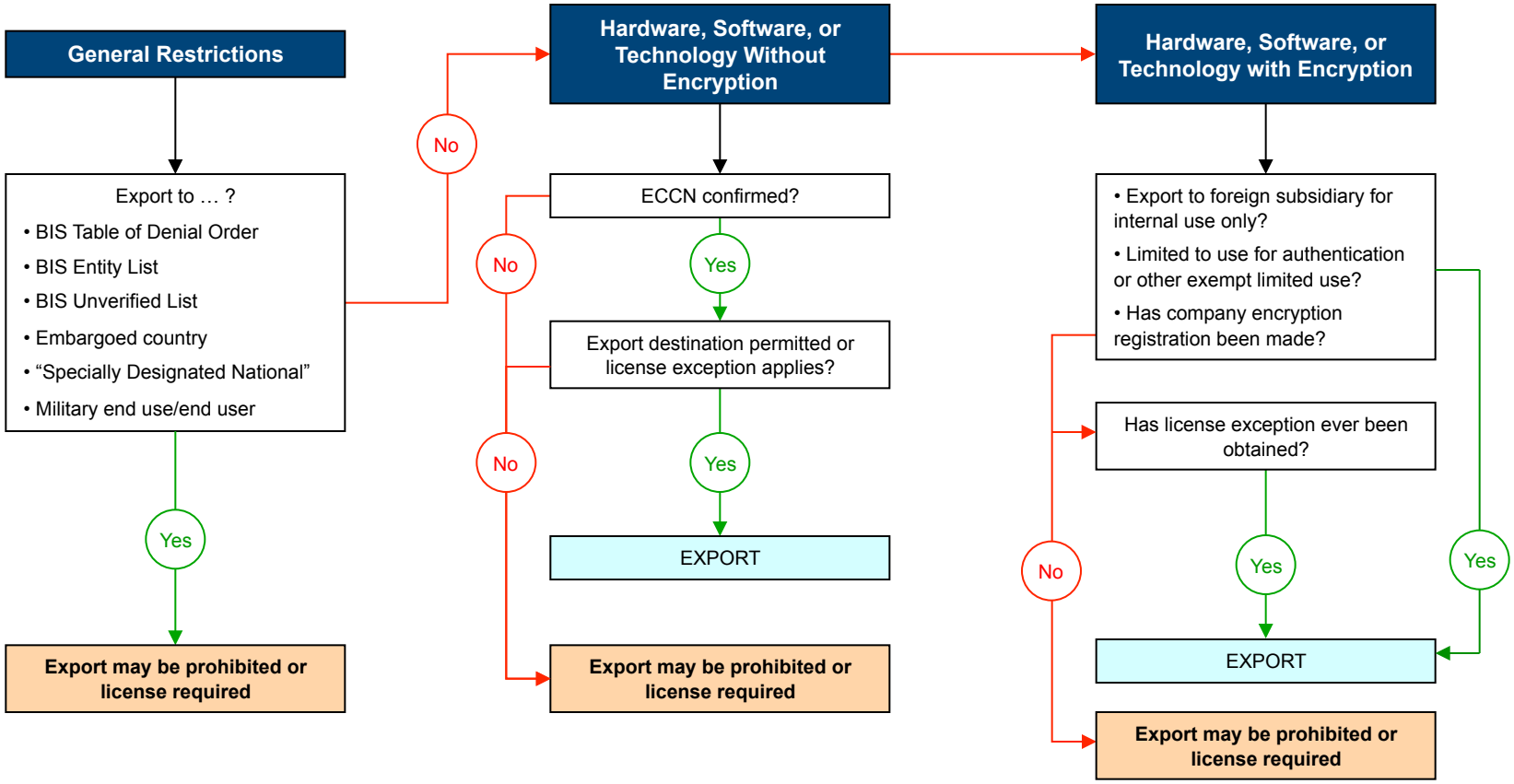
We hope this overview of export control regulations is helpful. Additional information on the BIS regulations can be found on the BIS web page: http://www.bis.doc.gov. Please note that given the complex and detailed nature of the BIS

[38] *See* 15 C.F.R. § 762.6.

[39] For a complete list of records to be retained, *see* 15 C.F.R. § 762.2.

regulations, this overview is limited to highlighting the salient features and requirements of the regulations and should not be construed as legal advice.

Export Control Review Checklist



Trade Sanctions and Economic Embargo Summary (Country Programs)

PROGRAM	BLOCKING TARGETS	TRADE RESTRICTIONS
Burma (Myanmar)	SDNs	No new investments by U.S. persons. Import/export restrictions. No financial services (except for pre-May 21, 1997 contracts).
Cuba	Cuba, Cuban nationals, and SDNs	Full embargo (limited exemptions).
Iran	No blocking provisions	Full embargo (limited exemptions).
Iraq	SDNs	Many exports require Commerce approval.
North Korea	No blocking provisions (existing blocked property remains blocked)	Export and Import restrictions.
Sudan	SDNs	Full embargo (limited exemptions). Transactions with southern Sudan designated areas permitted.
Syria	SDNs	Most exports require Commerce approval.

Trade Sanctions and Economic Embargo Summary (Products and SDNs)

PROGRAM	BLOCKING TARGETS	TRADE RESTRICTIONS
Belarus	SDNs	SDNs
Balkans	SDNs	SDNs
Congo (Democratic Republic)	SDNs	SDNs
Cote d'Ivoire	SDNs	SDNs
Diamond Trade	No blocking provisions	Restrictions on non-KPCS rough diamonds.
Lebanon	SDNs	SDNs
Liberia	SDNs	Restrictions on non-KPCS rough diamonds and timber.

Trade Sanctions and Economic Embargo Summary (Products and SDNs) (continued)

PROGRAM	BLOCKING TARGETS	TRADE RESTRICTIONS
Narcotics	SDNs	SDNs
Somalia	SDNs	SDNs
Terrorism	SDNs	No dealings in support of Specially Designated Terrorists, Global Terrorists, or Foreign Terrorist Organizations.
WMD	No blocking provisions	No imports into the U.S. of goods, technology, or services produced or provided by foreign persons designated by the Secretary of State who promote proliferation of weapons of mass destruction.
Zimbabwe	SDNs	SDNs

Client Alert.

Enactment of New Comprehensive Iran Sanctions with Broad Extraterritorial Reach

By Nicholas J. Spiliotes, Andrew W. Winden, and Justin G. Jamail

I. OVERVIEW

On July 1, 2010 President Obama signed into law a dramatic expansion of the Iran-Libya Sanctions Act of 1996 (the "**ISA**"), imposing new penalties on financial institutions and other companies doing business with Iran, the "Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (H.R. 2194)" (the "**Act**"). The new sanctions are intended to discourage financial and other support for the Iranian refined petroleum sector, Iranian financial institutions suspected of financing Iran's nuclear program, and various organizations related to the government of Iran.

A number of key provisions and definitions in the legislation require implementing regulations to be promulgated by the U.S. Department of the Treasury within 90 days of enactment of the law. Hence, this client alert provides only a preliminary view of the new legislation. We will issue an additional alert following the implementation of Treasury regulations.

This client alert notes the key provisions of the Act and reviews several in more detail.

Key New Provisions:

Petroleum Industry

_____. The original ISA sanctions targeted the development of Iranian petroleum resources. The Act broadens the scope of sanctions to include: (1) Iran's development of petroleum refining capacity, and (2) Iranian imports of refined petroleum products. "Transactions" falling within the scope of these measures now expressly include financial, insurance, reinsurance and transportation services that support the Iranian energy sector; inclusion of these services significantly increases the scope of the Act.

Financial Services. In addition to amending the original ISA definition of "person" to include "financial institution, insurer, underwriter, guarantor, and any other business organization," the Act requires the Treasury Department to issue regulations prohibiting or strictly restricting the opening of accounts (correspondent or payable-through) for non-U.S. financial institutions that do business with specially designated Iranian individuals and entities. The Act also requires U.S. financial institutions to perform certain auditing and certification activities with respect to accounts maintained by non-U.S. financial institutions.

Government Procurement. The Act requires prospective U.S. government contractors to certify that they, and any entity they own or control (including foreign subsidiaries), do not engage in any activity sanctioned by the Act.

Diversion Risks. The Act includes measures for identifying governments which allow diversion of regulated goods and services to Iran. Such governments will be subject to license requirements which will, in practice, cut off exports of such goods and services to the diverting country.

Presidential Waivers. The Act requires the President to impose sanctions on persons violating the prohibitions of the ISA and limits the President's ability to waive the requirement to situations "necessary to" rather than "important to" the national interest.

Additional Sanctions. The Act adds the following 3 sanctions to the 6 sanctions previously provided for in the ISA: (1) prohibition of any transactions in foreign exchange in which the sanctioned person has an interest; (2) prohibition of any banking transactions involving any interest of a sanctioned person which are subject to US jurisdiction; and (3) prohibition on holding, using, transporting or transacting with respect to any property subject to US jurisdiction. Additionally, the Act requires the President to impose at least 3 of the 9 sanctions now available, rather than that he impose at least 2.

Affected Parties. In addition to persons (whether U.S. or non-U.S.) engaged in prohibited activities, the Act reaches: (1) successors in interest to an entity that engaged in a prohibited activity; (2) persons who own or control the entity that engaged in such activity, if they had actual knowledge or should have known of the violation; and (3) entities owned or controlled by, or under common ownership with, an entity that knowingly engaged in prohibited conduct. Significantly, these provisions provide for the potential imposition of ISA sanctions on companies affiliated with a sanctionable entity *even if they are not subject to the ownership or control of that entity*.

Enhanced Penalties. The Act increases criminal penalties for violations of a variety of statutes, including the United Nations Participation Act (up from $10,000 to $1 million and from 10 to 20 years), the Arms Export Control Act (up from 10 to 20 years), the Trading with the Enemy Act (raised to 20 years). The Act also requires the US Sentencing Commission to report on the viability of imposing mandatory minimum sentences for violations of these laws. The call for such a report may signal an intention to increase enforcement against individuals.

II. BACKGROUND

In 1996, the U.S. Congress passed, and President Clinton signed, the ISA. Among other provisions, the ISA authorized the President to impose penalties on “persons” (meaning individuals or entities) that agreed to make investments over a certain threshold in the Iranian petroleum industry. However, neither the Clinton Administration nor any successive administration implemented these penalties, despite the fact that several companies were known to have made investments within the scope of the ISA.

In recent weeks, increasing political frustration with the Iranian government’s response to international criticism regarding, among other things, its uranium enrichment program resulted in a number of new developments concerning sanctions against Iran. On June 9, the United Nations Security Council approved Resolution 1929, strengthening U.N. sanctions against Iran, and on June 24, the U.S. Congress approved the Act. President Obama signed the Act into law on July 1. New provisions in the Act particularly target the Iranian Revolutionary Guard Corporation **(“IRGC”)**, the Central Bank of Iran, and foreign persons who transact business with them.

In passing the Act, Congress expressed dissatisfaction with the persistent unwillingness of successive administrations to apply the ISA and also explained that expanded extraterritorial application of the ISA was intended to force non-U.S. persons to choose between doing business with sanctioned Iranian entities and enjoying access to the U.S. financial system.

III. PETROLEUM INDUSTRY SANCTIONS

The Act renews existing extraterritorial sanctions against parties making new investments of $20 million or more in a 12-month period connected to the development of Iran’s oil and gas resources and expands the law’s provisions to include punitive sanctions against any party (U.S. or non-U.S.) that supplies or supports the supply of refined petroleum products to Iran or facilitates development of Iran’s domestic refining capacity. Crucially, the Act revises the definition of an “investment” to include the entry into, performance, or financing of a contract to sell or purchase the targeted goods, services or technology - such activities had formerly been expressly excluded. In addition, the Act clarifies and effectively expands the scope of

parties that may be subject to penalty for ISA violations by, for example, defining a person's acting "knowingly" to include both acting with *actual knowledge* and where a person "*should have known* of the conduct, circumstances or result."

The Act requires imposition of penalties against parties which:

Development of Iranian petroleum resources. Invest $20 million or more in Iran's energy sector or make a combination of investments in a 12-month period of USD 5 million each if they reach a combined total of $20 million.

Export of refined petroleum products to Iran. Knowingly sell or provide: (i) refined petroleum products (e.g., gasoline) valued at $1 million or more, or with an aggregate value of $5 million or more in a 12-month period; or (ii) goods, services, technology, information or support that facilitate Iran's ability to import refined products. Such activity includes financial, insurance, reinsurance and transportation services. A limited exception is provided for underwriters and insurance providers that conduct due diligence against prohibited involvement that indicates no basis for knowledge that a provision of services is associated with prohibited transactions.

Development of Iranian Refinery Capacity. Knowingly sell, lease or provide goods, services, technology, information or support valued at $1 million or more, or with an aggregate value of $5 million or more in a 12-month period, that facilitate the maintenance or expansion of Iran's refined petroleum production capability.

Penalties

With respect to financial institutions, the Act permits the President to prohibit a financial institution from access to the U.S. financial system by blocking transfer of credit or payments by, through or to the financial institution, which would in effect block all foreign exchange transactions involving United States dollars.

Enforcement

The legislative history of the Act reveals that Congress intended to provide an incentive for companies to withdraw from Iran, so it authorized the executive branch to decline to launch a formal investigation of suspected violations if it obtains reliable and verifiable assurances that the relevant firm will not knowingly engage in these activities in the future. Firms apparently may avoid sanctions for prohibited activities by taking steps to curtail and eventually eliminate these activities. The Treasury Department's enforcement policies and procedures should reflect this congressional intent.

IV. FINANCIAL SERVICES SANCTIONS

The Act includes a sweeping prohibition of significant extraterritorial scope on transactions with much of the Iranian banking sector pursuant to which the Treasury Department is required to issue regulations that prohibit (the Treasury regulations must clarify whether the prohibition will apply to U.S. financial institutions, non-U.S. financial institutions or both) or impose strict conditions on the opening or maintenance of a U.S. correspondent account or payable-through account by non-U.S. financial institutions that knowingly:

1. facilitate Iran's efforts to develop weapons of mass destruction;
2. facilitate activities of persons subject to U.N. Security Council Resolutions;
3. engage in money laundering to facilitate such activities;
4. facilitate efforts by the Central Bank of Iran or any other Iranian financial institution to carry out the foregoing activities; or
5. provide significant financial services for the IRGC.

This prohibition does *not* require any nexus or connection between such correspondent accounts and prohibited activity. Thus, if a foreign bank facilitates any "significant transaction" or provides any "significant financial services" for Bank Melli, Bank Saderat, or one of several other Iranian banks, including the Central Bank of Iran, anywhere in the world, it would be prohibited from opening or maintaining *any* correspondent or payable-through account in the United States. We also note that the definition of the U.S.-based accounts prohibited under this provision is quite broad and would include intra-bank services of, for example, a non-U.S. bank with U.S. operations. The legislative history explains: "In effect, the Act presents foreign banks doing business with blacklisted Iranian entities a stark choice -- cease your activities or be denied critical access to America's financial system."

In light of the potential liability for "causing" a U.S. person to violate a regulation under the International Emergency Economic Powers Act, which is the statutory basis for most U.S. sanctions programs, merely having a correspondent account in the U.S. while performing transactions on behalf of sanctioned Iranian banks (even with no U.S. or dollar nexus) could subject a foreign financial institution to substantial penalties, depending on how the Treasury Department implements the prohibitions on such accounts.

The Act also requires U.S. financial institutions to perform certain auditing and certification activities with respect to accounts maintained by non-U.S. financial institutions. Any U.S. financial institution that maintains a correspondent or payable-through account for a foreign financial institution is now required to: (i) perform an "audit" of the prohibited activities which "may" be carried out by the foreign client, (ii) certify to the Department of Treasury that, to the best of its knowledge, the foreign client institution is not knowingly engaged in prohibited activities, and (iii) establish procedures and controls designed "to detect whether the Secretary of the Treasury has found the foreign client to knowingly engage in prohibited activity." Again, the Treasury regulations will have to clarify how a U.S. bank (or a non-U.S. bank with operations in the U.S.) should conduct the "audits" or be able to provide the "certification" required under the Act.

Penalties

Financial institutions engaging in prohibited activity supporting the Government of Iran and its nuclear program, terrorist activities and the IRGC can be prohibited from maintaining correspondent and payable-through accounts. In addition, civil penalties may be imposed in an amount not to exceed the greater of $250,000 or an amount that is twice the amount of the relevant transaction. Criminal violations can result in fines of up to $1,000,000 and imprisonment of up to 20 years.

Civil violations of the audit, reporting and certification provisions of the Act can result in fines of up to the greater of $100,000 or 50% of the amount of the relevant transaction. Criminal violations can bring fines of up to $500,000 and 10 years in prison.

V. IMPORT AND EXPORT RESTRICTIONS

The Act contains a sweeping prohibition on exports of U.S. goods, services or technology from the U.S. or by a U.S. person to Iran. These restrictions apparently eliminate exceptions for reexport of U.S. goods subject to Export Administration Regulations as well as the *de minimis* rule which had allowed reexport to Iran of products which incorporated some (usually up to 10 percent) U.S. components, materials or technologies. We note, however, that similar sweeping language was used in a ban on exports to Syria (enacted in 2003), and in that case the Department of Commerce retained the *de minimis* exceptions. In any event, the new export ban will curtail a significant portion of the U.S.-origin goods traded to Iran through third countries. The only exceptions to these rules are for agricultural commodities, food, medicine and medical devices subject to Trade Sanctions Relief Act licensing, humanitarian assistance exports, certain information and informational materials, exports related to the exchange of personal communications over the Internet, exports related to safe operation of aircraft, exports to support activities

of non-governmental organizations promoting democracy in Iran and (under an "escape clause") exports that the President determines are in the U.S "national interest."

The Act also imposes a sweeping ban on importation of products from Iran, which ends the OFAC general licenses allowing the importation of Iranian luxury goods and foodstuffs (such as Persian carpets and pistachios).

VI. U.S. GOVERNMENT PROCUREMENT

The Act amends the Federal Acquisition Regulations by barring U.S. government agencies from contracting with persons engaged in sanctionable activities or that export to Iran technologies used to restrict communications or access to information. In addition, the Act requires any prospective government contractor to certify that neither it, nor any person owned or controlled by it, engages in any sanctionable activity with respect to Iran. The President may waive the certification requirement upon a written declaration that such a waiver is in the national interest.

VII. DIVERSION RISKS

Congress has also used the Act to address suspicions that some countries which maintain significant commercial relationships with Iran allow reexport of sensitive U.S.-origin products to Iran. Specifically, the legislation requires the Director of National Intelligence to submit to the President and Secretaries of Defense, Commerce, State, Treasury, and appropriate congressional committees a report that identifies each country that is allowing the diversion of U.S.-origin goods, services, or technology that: (1) materially contribute to Iran's nuclear, biological, chemical, ballistic missile, or advanced weapons systems capabilities, or its support for international terrorism; and (2) are on the Bureau of Industry and Security's Commerce Control List or the Department of State's United States Munitions List. If a country allows "substantial" diversion of such goods, services, or technology, the Director of National Intelligence shall designate it a "Destination of Diversion Concern," triggering enhanced export licensing controls relating to those countries. Most assume that applications for the newly required licenses will be denied. We note, however, that the President has the option to delay the application of these provisions by determining that the government of the country in question is taking certain listed steps to improve its compliance.

VIII. INCREASED ENFORCEMENT

One of Congress's stated purposes in the Act is to encourage enforcement of the ISA. To this end, Congress included measures which (1) increase the number of sanctions available and the minimum which must be applied, (2) require that the President investigate all credible claims of sanctionable activity, (3) narrow the President's authority to waive enforcement, and (4) require the President to report to Congress on the energy sector in Iran. The initial report on the energy sector is retroactive to January 1, 2006, and further reports are required semi-annually thereafter. This reporting requirement seems designed to force the President to acknowledge and identify parties engaged in sanctionable activity, which Congress hopes will in turn spur the President to enforce the sanctions despite the questionable acceptability of such sanctions under WTO rules.

Although Congress' intention is clear, it is important to note that the President's signing statement emphasized the importance of the waiver authority and did not acknowledge that this authority had been narrowed by the Act. The signing statement characterized the waiver provisions in the Act as follows: "The Act permits the President to exercise this authority flexibly, as warranted, and when vital to the national security interests of the United States."

IX. CONCLUSION

The Act contains many dramatic and subtle changes to U.S. sanctions targeting Iran. In many instances a more precise understanding of the scope of these new measures must await implementation through new and revised regulations. However, it is clear that the extraterritorial reach of sanctions has been greatly expanded and that financial institutions, in particular, should carefully review their ties with sanctioned Iranian parties. In the past, the ISA generated considerable tensions in the WTO and other diplomatic forums, but recent statements by the EU of an intention to follow the U.S. lead in augmenting new U.N. sanctions indicates that US policy on Iran may be more closely aligned with international attitudes than in the past and this alignment may contribute to a willingness to utilize the extraterritorial reach provided by the Act.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

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