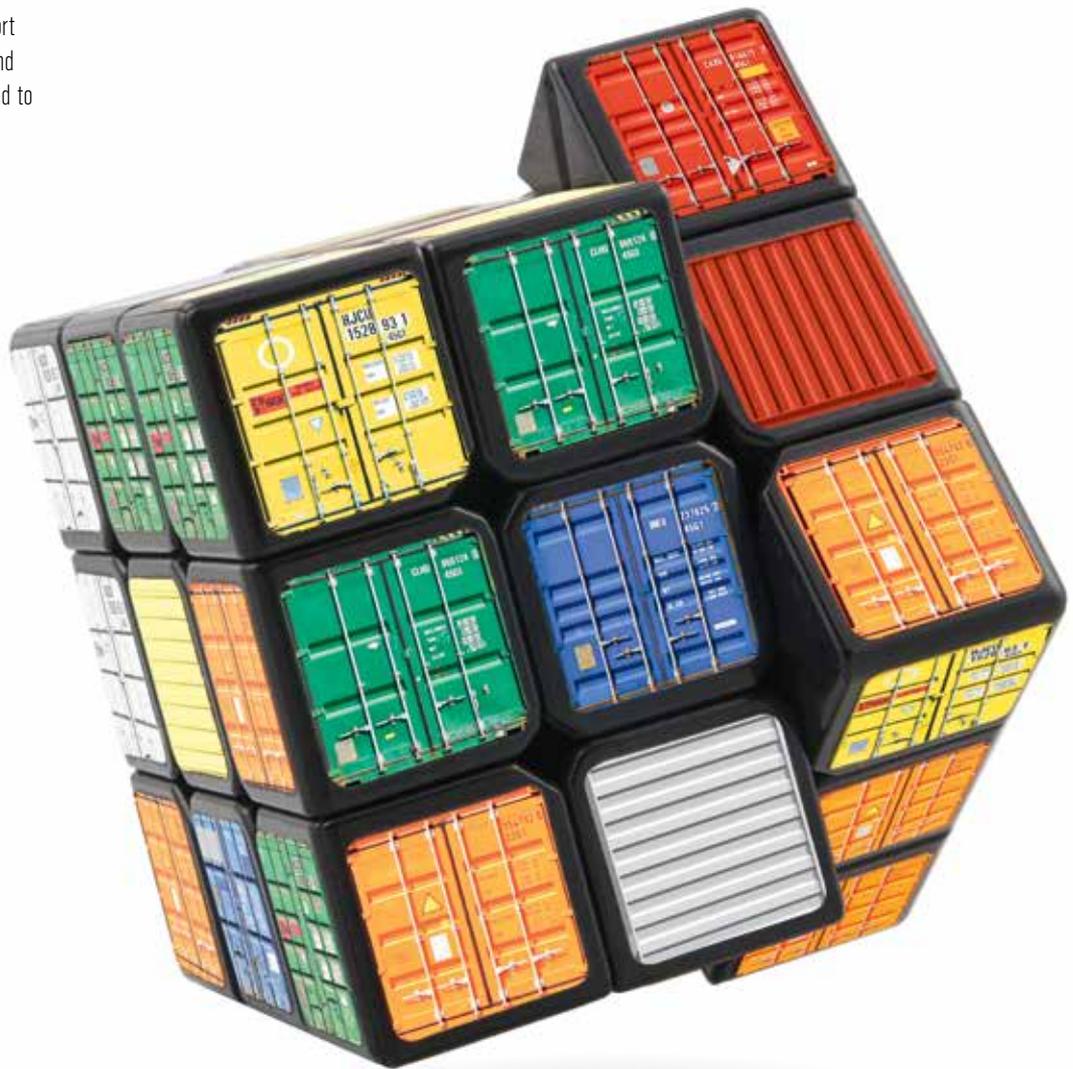


CHEAT SHEET

- *Educate the sales team.* Exporting samples, travelling internationally with technological specifications on laptops or hand-carrying demo equipment are considered shipments that are subject to export regulations and could require government authorization.
- *Classify products for export.* If you do not understand the export controls regulating your products, then you could be hit with unexpected fees and delays.
- *Institute a compliance program.* If your company is an active exporter, the US government will expect you to have policies and procedures in place regarding your export program.
- *Assign an Empowered Official.* Accountability for adhering to export regulations throughout the sales and shipping cycle needs to be assigned to certain personnel.



COMMON PITFALLS OF

EXPORT COMPLIANCE

By Katia Bloom and Julie Gibbs When it comes to export compliance, in-house counsel have a long to-do list. Unless you have dealt with export compliance at a prior job, have seen it rear its head during a prior merger and acquisition, are aware that you are shipping your product to certain “high risk” countries, or that a particular product is likely to require an export license, this topic can slowly creep down toward the bottom of your list. In reality, as counsel, whether at a small, large or mid-size company, you need to be aware of export licensing issues, as they affect almost any US-based company. In fact, it applies to companies of all sizes – including those that do not engage in direct exports.

Practically, you cannot unilaterally determine whether a certain technology or product is subject to US export restriction, or whether a particular product/technology requires a license prior to exporting it outside of the United States. Particularly for technology products that have encryption capabilities, you will need to involve your engineers and require that they fill out the complicated set of forms that ultimately get submitted to, reviewed and analyzed by the United States federal government.

Depending on the size of your organization and its technologies, export compliance can be a costly endeavor. It may be necessary to spend a portion of your resources to convince the powers that be to add a budget line for export compliance. Even if resources are tight, please remember that for less complex products, you may be able to do a lot with a small financial investment in the beginning and even smaller financial investments down the line. Because this is a matter of complying with federal law, failing to comply may result in your company being shut down and the federal government prohibiting the sale of your products. In addition to providing a basic overview behind some of the logistics associated with the export compliance process (which is incredibly complex, and therefore, this article is not meant to act as a foolproof guide — we advocate working with an expert in the field to complete the process), the goal of this article is to help you create some convincing reasons for implementing an export compliance program at your organization.

Many top-level executives and legal counsel have very little insight into what exactly export compliance means to their organizations, as well as the minimum compliance standards that they should be aware of, regardless of whether or not their organizations are already engaging in exporting from the United States. Though the export

compliance process is quite complex, feel reassured that most exports from the United States do not require an export license. With that in mind, this article will review the five biggest pitfalls that legal counsel need to be aware of to keep their companies out of trouble and allow them to thrive.

Pitfall #1: Untrained sales and business development teams

As in-house counsel, one of your responsibilities is to mitigate risk. Sales and business development teams are sometimes unknowingly a high risk for export compliance. The sales team needs to understand that certain entities, individuals, regimes and countries can be restricted or sanctioned such that any transaction, or even negotiation, can be prohibited without authorization from the US government, or prohibited altogether. During a sale, your sales and business development teams need to consider that the end user and end-use of the company's products could also warrant authorization from the US government for a number of reasons (e.g., if your products will be directly or indirectly involved with the production or use of chemical, biological or nuclear weapons).

In order to identify whether your company is at risk, screen all parties your company transacts with (e.g., employees, customers, vendors, banks, etc.) against government published lists¹ of entities and individuals who are known violators of export regulations, terrorists or supporters of sanctioned regimes.

These individuals are located globally, including in the United States, so parties to domestic transactions need to be screened as well.

Before your business development and sales teams start targeting certain countries or governments for new sales opportunities, they need to understand if there are any sanctions or embargoes that will cause legal barriers. These sanctions and embargoes are established by the Treasury Department's Office of Foreign Assets (OFAC)² and the Commerce Department's Bureau of Industry and Security (BIS)³. Transactions with embargoed or sanctioned countries or country nationals can require prior authorization from the US government.

Your sales team also needs to understand that exporting samples, traveling internationally with technological specifications on their laptops or hand-carrying demo equipment out of the country are also considered shipments subject to export regulations and could require government authorization.

Pitfall #2: Unknown product level export controls

Can you imagine if your organization wanted to export your most profitable product for the first time and then found out the shipment would be delayed for one or two months, or longer, because it requires an export license? This is what could happen if you have not classified your product for export and do not understand the export controls regulating it. The State Department's Directorate



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Key organizations, terms and resources

- Bureau of Industry and Security (BIS)/US Department of Commerce is the governmental body that oversees effective export control and compliance of “dual use” items, software, services and technology.
- US Department of State Directorate of Defense Trade Controls (DDTC) administers the International Traffic in Arms Regulation (ITAR), which primarily controls exports associated with defense and military goods, software, services and technology.
- The US Department of the Treasury Office of Foreign Assets Control (OFAC) administers the Foreign Assets Control Regulations, which controls the export to certain embargoed countries and designated entities.
- Export Administration Regulations (EAR) are the regulations governing export. (They can be found here: www.bis.doc.gov/index.php/regulations/export-administration-regulations-ear.) The EAR contains important definitions and the Commerce Control List — often a good starting point for getting a general sense of where your products fall within the export-licensing scheme. Generally speaking, your company’s products will be subject to the EAR if they: (i) are produced or originated in the United States; (ii) were made overseas but contain more than a specified percentage of US content, or contain certain technology/software that originated in the United States, and intended for shipment to particular countries; or (iii) were manufactured outside the United States, but the manufacturing facility is the direct product of certain US origin technology/software.
- Customer Identification Number (CIN) is needed in order to submit classification and license requests via the Department of Commerce/US Bureau of Industry and Security (BIS) SNAP-R System. In order to obtain the CIN, you need to complete a company registration: <https://snapr.bis.doc.gov/registration/Register.do>. This is a fairly straightforward form that should not require more than 10 minutes of your time. Once you obtain your CIN, you can use it to login into the SNAP-R system here: <https://snapr.bis.doc.gov/snapr/exp/welcome>.
- Export Control Classification Number (ECCN) is an alpha-numeric code (e.g., 3A001) that describes the item and indicates licensing requirements. All ECCNs are listed in the Commerce Control List (CCL) (Supplement No. 1 to Part 774 of the EAR).
- A key in determining whether you need an export license is knowing whether the item you intend to export has a specific ECCN. The Commerce Control List (CCL) is divided into 10 broad categories of ECCN’s, and each category is further subdivided into five product groups. If a certain item falls within the EAR, but is not listed within the CCL, it receives the “EAR99” designation, which usually means such an item will not need to have a license in most situations (unless your company wants to export to an embargoed country, prohibited entity or for a prohibited end use). You can quickly access the CCL here: www.bis.doc.gov/index.php/regulations/commerce-control-list-ccl.
- The Commerce Country Chart (CCC) classifies the reasons for export controls for each country (e.g., national security, regional stability, crime control, etc.). When you look at a specific category within the CCL, you’ll see the reasons for control in an abbreviated manner. For example, if you look at ECCN 5B002 within the CCL, under “License Requirements,” the “Reason for Control” is “NS, AT,” and the CCL further provides guidance that NS Column 1 and AT Column 1 applies. If you cross reference this with the CCC, you can look down the respective columns and see which countries are impacted by these requirements. Again, this is a simplified explanation, and you need to read the full CCL entry to obtain the specific toward your products, but this will provide you with some initial guidance.

of Defense Controls (DDTC) and BIS both publish lists of classifications that cover products, software, technology, materials and services for military and civil end-use items, respectively. Any given item will fall under the jurisdiction of the DDTC or BIS, but not both. The classification assigned to an item will determine the export-related controls (e.g., export licenses, authorizations, reporting, etc.) that must be adhered to for exportation.

When we traditionally think of “export,” we tend to imagine that this means exporting to a particular country. However, did you know that for the purpose of US export license regulations, if you hire an individual from a certain country, and this individual is exposed to certain technologies, you are engaging in “exporting?”

In the case of technology, there is a US rule regarding “deemed exports,” or in other words, providing non-US nationals controlled technology while

such individuals are in the United States. Yes, you read that correctly: Even if the non-US national works in a US office, the “export” falls within the EAR regulations. The non-US national might require an export license to use or view the technology because he will eventually return to his native country and therefore “export” the technology with him. Working with the human resources department during the visa application process can identify if an export license will be required based

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on an individual's nationality and the type of technology this individual will be exposed to. It behooves any company, even if it does not export physical product, to at least classify its technologies, including software available for download (whether for sale or free), to appropriately handle these types of legal liabilities.

Pitfall #3: Lack of policy and procedures

If your company is an active exporter, the US government will expect you to have policies and procedures in place regarding your export program (e.g., entity/sanctions/end use screening, classification, license determination, etc.). Exporting is a privilege, and if the US government determines that gross negligence or fraud has occurred in relation to an export, it can literally take that privilege away and ban your company from exporting for a certain period of time or even indefinitely. Having proper policies and procedures in place that are used in daily operations is a way to mitigate any fines or penalties the US government might issue if it finds your company is out of compliance. It is also important to note that there are very specific recordkeeping requirements for exporters. All shipping documents, correspondence,

proof of restricted party screening, etc., must be kept for five years from the date of activity. Your company, rather than your freight forwarder, is responsible for maintaining these records.

Pitfall #4: Lack of roles and responsibilities

As legal counsel to your company, you might be the Empowered Official as defined by the Code of Federal Regulations⁴ — whether you know it or not. An Empowered Official is a US person who is legally empowered to sign export license applications and understands export regulations, penalties and liability applicable to his company. An Empowered Official is also the person who will interface with the government in the event of an inquiry or audit. If an Empowered Official has not been identified at your company, then export compliance roles and responsibilities may not be clearly determined. Accountability for adhering to export regulations throughout the sales and shipping cycle needs to be assigned to certain personnel in order for an export compliance program to work effectively.

Pitfall #5: Lack of export compliance strategy

Do you know what the greatest risk to your company is in terms of exporting?

Is your company aware of any export-related controls and procedures to ship to new countries or governments? Are there ways to lessen the export compliance burden by lowering the level of unnecessary technology in your products (e.g., high-level encryption, high thresholds or capacities, using Mil Spec for civilian-use products, etc.)? When interfacing with upper management, you should be discussing these questions regularly.

As you can see, export compliance is more than just shipping products from the United States to other countries. Even certain activities within the United States must adhere to US export regulations. Export compliance must be an integral part of not only daily operations, but also business development and strategy. Ignoring US export compliance requirements may impede your organization's long-term success, resulting in possible penalties, fines, bad press or worse: the inability to export. Ensure your company avoids the pitfalls discussed here by learning what the export compliance requirements are, staying abreast of developments and establishing an export compliance program, even if it is a relatively simple one to start. Most important, for any program to be successful, the message and commitment must come from the top — so get your management team involved in the process early and often. **ACC**

ACC EXTRAS ON... Export regulations

ACC Docket

What International Travelers Should Know About Border and Airport Electronic Equipment Searches (June 2009). www.acc.com/docket/air-search_jun09

QuickCounsels

Export Controls: An Introduction (June 2011). www.acc.com/qc/ex-con_jun11

EU Export Regulations for Dual Purpose Goods (Aug. 2011). www.acc.com/qc/ex-con_aug11

Top Ten

Top Ten Things to Know About Export Control Reform (June 2011). www.acc.com/top10/ex-con_jun11

Articles

Exports and Re-exports of US-controlled Technology and Software Under the EAR (Aug. 2010). www.acc.com/export-EAR_aug10

Overview of US Export Regulatory Regime (July 2010). www.acc.com/us-export_jul10

ACC HAS MORE MATERIAL ON THIS SUBJECT ON OUR WEBSITE. VISIT WWW.ACC.COM, WHERE YOU CAN BROWSE OUR RESOURCES BY PRACTICE AREA OR SEARCH BY KEYWORD.

NOTES

- 1 Consolidated List: http://export.gov/ecr/eg_main_023148.asp.
- 2 OFAC Sanctions: www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx.
- 3 BIS Sanctions: www.bis.doc.gov/index.php/forms-documents/doc_view/746-746.
- 4 CFR Empowered Official: www.law.cornell.edu/cfr/text/22/120.25.

Key issues in export compliance

While there are countless ways to approach export licensing, below is an overview of some of the typical issues you will need to consider as part of the export-compliance process. At a minimum, you should evaluate the following: Where is the export coming from? (On a related note, you also will need to consider where your suppliers' products are coming from.) What is your company exporting? To whom and where is your company exporting its product? What is the end use of the product?

WHERE IS YOUR EXPORT COMING FROM?

US export regulations can apply domestically and also follow US origin goods as they ship around the world. This means that the export laws assert jurisdiction over US origin goods and/or technology even after they have been exported to another country. This is the notion of re-exporting or re-transferring goods and/or technology, which, practically speaking, subjects such goods to the same restrictions as if they were not being re-exported. It is also important to remember that, for the purpose of determining what the license requirements are for re-exports, you will need to look at the ultimate destination of a particular item, as well as the one where the item is being sent (e.g., if your company exports a certain product to Canada, but knows that, ultimately, it will end up in Iran, Iran will be the destination country).

WHAT KIND OF PRODUCT ARE YOU EXPORTING?

This refers to product classification. Per the EAR, depending on what your product consists of (e.g., encryption technology, high-speed cameras, etc.), you will obtain a different ECCN, and that will determine whether you need an export license — which, in many cases, your company will not — and the type of restrictions your company will be subject to. Ensuring that your company properly classifies its products per the various categories within the CCL is the key in determining the licensing requirements found in the EAR.

WHERE ARE YOU EXPORTING YOUR GOODS?

Practically, if your company is planning on exporting to or hiring nationals from Cuba, Iran, Iraq, North Korea, Rwanda, Sudan or Syria, you have your work cut out for you.

- *Exporting to denied persons and entities.* The export control requirements discussed in this article are related to, but separate from, the denied persons, entities and embargoed countries lists. The Denied Persons List consists of individuals and entities who have been denied any export privileges, and, as such, if your company deals with these parties in any manner, it would constitute a violation of the denial order. The Entity List is very important because it identifies individuals, businesses, research institutions or government organizations to which your company cannot

export (as they are prohibited from receiving some or all items subject to the EAR) unless your company secures the appropriate license. Keep in mind that, in most instances, license exceptions are unavailable for the export of products subject to the EAR to a party on the Entity List without meeting some stringent requirements. In addition to the Entity List, the Unverified List identifies those parties where the BIS could not verify the end user in some prior transaction. If your company wants to export to any of these parties, you should resolve this with the BIS prior to beginning such export. For more detailed information, or to download the lists themselves, please visit: www.bis.doc.gov/index.php/policy-guidance/lists-of-parties-of-concern or http://export.gov/ecr/eg_main_023148.asp (this link has the Consolidated Screening List that consolidates export screening lists of the Departments of Commerce, State and the Treasury in one spreadsheet). The Office of Foreign Assets Control (OFAC) also publishes a Specially Designated Nationals List that your company has to comply with: www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx.

- *Exporting to embargoed countries.* In addition to the list of prohibited countries found in the International Traffic in Arms Regulations (ITAR), OFAC administers a number of different sanctions programs that can be comprehensive or selective. For a full list and further information about OFAC's sanction program, please visit: www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx. The US Department of State also publishes a helpful list on the state of country policies and embargoes: www.pmdtc.state.gov/embargoed_countries/index.html.

WHAT WILL YOUR PRODUCT BE USED FOR?

Prohibited end use. The EAR require a license for certain kinds of end uses and simply prohibit exporting products with certain end uses. As an example, regardless of what kind of product your company exports, if it is being used as a component in a weapon of mass destruction, such an item will either require special permission for export, or such export may be prohibited to certain entities.