Regulatory Developments Impacting Export Controls and Economic Sanctions

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The United States imposes export controls and economic sanctions that impact a wide range of international business activities. These restrictions present significant compliance challenges and enforcement risks.

Over the past several months, Congress, the White House and different federal agencies have all pursued important initiatives in this area of law. On the one hand, they have increased penalties for violations, imposed greater compliance burdens on companies and stepped up the enforcement of existing regulatory requirements. On the other hand, the President has issued new directives seeking to streamline and improve agency decision-making on key export control matters. These proposed reforms come in response to growing criticism that current export licensing policies lack transparency and result in costly delays that place US industry at a competitive disadvantage.

Taken together, these recent actions reflect a continuing struggle within the US government to strike an effective balance between facilitating US international transactions and protecting national security interests--all at a time of significant flux in global business requirements and international economic relations.

This memo provides a brief overview of recent regulatory developments and initiatives.

Increased Penalties and Stepped-Up Enforcement

On October 16, 2007, the President signed into law the International Emergency Economic Powers Enhancement Act,1 which greatly increased maximum civil penalties for export violations to $250,000 per transaction, or twice the value of the transaction at issue. Maximum criminal penalties also increased to $1 million and/or 20 years imprisonment, up from $50,000 and/or 10 years in prison. During this same period, the Department of Justice announced an "export enforcement initiative" focused on investigating and prosecuting illegal exports of controlled goods and technology; recent investigations have shown an increasing focus on so-called "soft" exports, such as transfers of controlled technical data and technology. These initiatives go hand-in-hand with other developments involving the allocation of greater resources to export enforcement; for example, the proposed FY 2009 budget includes increased Commerce Department funding to combat the transshipment of sensitive technologies and nuclear proliferation. These added resources follow prior-year increases in agency funding to ramp up enforcement activities.

Notable recent enforcement actions include the following:

- In March 2008, Northrop Grumman entered into a consent agreement with the State Department to pay $15 million in civil penalties and remedial programs due to numerous International Traffic in Arms Regulations (ITAR) violations relating to the unauthorized export of controlled inertial navigations systems.
- In December 2007, Mine Safety Appliances of Pennsylvania was ordered to pay $470,000 for 107 violations of the Export Administration Regulations (EAR) involving unlicensed exports to Iran and Syria through its UAE branch.
- Also in December 2007, ITT Corporation was assessed an additional $20 million in penalties, beyond the earlier imposition of $100 million in penalties and research commitments, due to ITAR violations involving unauthorized exports of its night vision equipment.

At the same, the Treasury Department's Office of Foreign Assets Control (OFAC) has stepped up its enforcement of various sanctions regulations, which prohibit most transactions by US persons with embargoed countries (e.g., Iran, Cuba and Sudan) or with certain specially designated persons. For example:

- In May 2008, York International Corporation paid $669,507 in connection with alleged violations involving Iraq, Iran and Sudan, including improper payments for sales of refrigeration equipment licensed under the UN Oil-for-Food program.
- In May 2008, Engineering Dynamics Inc. paid $132,791 to settle allegations of unauthorized exports and imports of engineering software to and from Iran.
- In April 2008, Cryostar SAS agreed to pay $500,000 in criminal fines and serve two years of probation for exporting goods to Iran without an OFAC license.
- In February 2008, Key Bank remitted $200,000 in penalties for processing funds involving persons and entities in Iran without an OFAC license.
- As part of a global multi-agency $30 million settlement, in December 2007 Chevron paid $2 million for OFAC violations it committed with respect to the UN Oil-for-Food Program.

Presidential Directives Issued

On January 22, 2008, President Bush issued a series of presidential directives [2] designed to streamline and improve export control policies and procedures, incorporating many of the proposals introduced in March 2007 by a group of US business associations: the Coalition for Security and Competitiveness. Although these proposals were formulated as a comprehensive package of needed reforms, they are likely to be implemented in a piecemeal fashion--a process that may impede their overall success in removing many of the inefficiencies currently impacting agency decisions on US export control matters.

Proposed Improvements to the State Department's ITAR Licensing Process

The presidential directives seek to address longstanding complaints about costly delays in processing license applications required under the ITAR. They include:

- Directing more resources to the licensing process, in the form of both financial and intelligence support.
- Mandating the issuance of guidelines requiring that requested authorization be decided upon within 60 days, unless there is a "strong reason for additional time." The State Department recently published a list of exceptions to this 60-day period, including instances where Congressional notification is required or end-use checks have not been completed.
- Upgrading and expanding the scope of the electronic licensing system (D-Trade), including the provision of interagency access to the same information.

These proposed reforms seek to provide welcome relief to many exporters facing long turn-around times for ITAR licensing, but they may come at a direct cost to applicants. State Department officials have proposed higher fees on heavy users of the defense export licensing system to fund these improvements.

The presidential directives also instruct the Secretary of State to ease ITAR licensing requirements applicable to dual and third-country nationals from allied countries, such as NATO members. The State Department has already has implemented certain reforms in this area by amending the ITAR so that foreign signatories/sublicensees to authorized agreements are not required to obtain additional approval for transfers of certain information and technology to certain third party/dual national employees.[3] However, other recent actions raise questions about the State Department's movement towards liberalizing license requirements. For example, it issued an advisory opinion in June 2008 that photographs of military equipment available on the Internet do not automatically qualify as being in the public domain, thereby subjecting the disclosure or transfer of such photographs to possible ITAR licensing.

Proposed Improvements to the Commerce Department's EAR Licensing Program

The proposed reforms also contain a number of initiatives seeking to update and liberalize EAR licensing requirements. They include:

- Systematic review of the Commerce Control List (CCL) to ensure that only the "most sensitive items" remain subject to licensing requirements. The Commerce Department recently announced a series of updates to the CCL as part of this review.
- License exception permitting companies to transfer certain previously-controlled technology to their overseas affiliates without requiring individual licenses for the transfers. Advance approval by the Commerce Department would be required under the proposal.

- Revision/review of encryption and re-export controls.

The exporting community has long sought to revise the EAR in these different areas, but such initiatives have bogged down in the past. It remains to be seen if the Commerce Department can successfully implement the current presidential directives. Some proposed reforms (e.g., easing of encryption controls or instituting license exceptions for certain inter-affiliate transfers) may be more ripe for change and easier to implement than others (e.g., full-scale CCL reform). However, even partial changes in these areas could still result in significant gains facilitating export transactions subject to the EAR.

With respect to export documentation, the Census Bureau finally implemented a long-planned requirement in June 2008 mandating the use of Automated Export System (AES) filings to report exports from the United States. As part of this implementation of mandatory AES filings, Census increased the penalty level for violations to $10,000 and added criminal penalties for the first time.

Continued Focus on Foreign End-Users

The presidential directives also give continued focus to the importance of foreign end-users, both as a means to ease licensing requirements and to strengthen export enforcement. Proposed measures in this area include:

- Expanding the Validated End User (VEU) program beyond China and India to other countries. The goal is to differentiate foreign end-user risks and reward established records of EAR compliance. However, the Chinese VEU program has already encountered significant criticism and controversy,[4] leading the Commerce Department to essentially shelve the program for now, ceasing to approve new applications.
- Enforcement of the Commerce Department's proposed rule expanding the criteria for placement on the Entity List to include more parties with "a record of activities contrary to US foreign policy and national security interests." This proposal reinforces the need for exporters to remain vigilant about the conduct and attributes of foreign end-users in transactions subject to the EAR.

Increased Transparency

For many years, exporters have complained about the failure of the Commerce Department to provide adequate information and guidance about its interpretation and implementation of EAR licensing provisions. The presidential directives attempt to address this problem and promote greater transparency by mandating that the Commerce Department publish both advisory opinions and lists of suspect foreign parties on its website. However, action in this area may prove difficult because, among other reasons, such publication must overcome issues relating to the release of confidential information and lengthy interagency reviews. Nevertheless, even incremental steps in this direction would help exporters sort through complicated regulatory requirements and avoid costly errors caused by common misunderstandings about applicable EAR licensing provisions.

Moving to Enhanced Interagency Cooperation

The presidential directives also seek to resolve longstanding issues about interagency coordination on export licensing matters. A key element of the problem is the Commodity Jurisdiction (CJ) process, wherein an exporter may request a determination from the State Department to determine whether an item is subject to ITAR or EAR controls. Exporters have often complained about long delays, interagency squabbling and inefficiencies within this process. To address these concerns, the presidential directives propose the creation of:

- "Formal interagency dispute mechanism" to resolve jurisdiction issues involving the departments under the CJ procedure. As part of this mandate, the National Security Council has been directed to review the CJ process to ensure that it is running efficiently and smoothly.
- "Multi-agency working group" to enhance export enforcement investigations. This step goes beyond the CJ process and ties back to recent action increasing penalties for export violations and the Department of Justice's new enforcement initiative.

In sum, the presidential directives generally track longstanding concerns raised by the US exporting community, but they are unlikely to break significant new regulatory ground in this area of law. Nevertheless, even if US policymakers achieved only modest success in implementing these proposals, they could yield real practical benefits for exporters.

Proposed Legislation on Iran Sanctions

Legislation that would expand financial sanctions against Iran, prohibit the US from entering a nuclear cooperation agreement with Russia, and subject US parent companies to sanctions if the parent company knowingly participates in violations of the Iran Sanctions Regulations by its foreign subsidiaries was approved in the Senate Finance Committee on June 18, 2008. The bill, based on S.970 but modified by Sen. Max Baucus (D-Mont.), will be considered by the Senate Foreign Relations Committee and the Banking Committee before it reaches the floor. The legislation would also inflict tax penalties on oil companies that violate Iran sanctions laws and codify the current trade embargo.

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1 50 U.S.C. § 1705.

2 The Office of Legal Counsel has taken the position that a presidential directive has the same legal effectiveness of a more formal executive order. "Legal Effectiveness of a Presidential Directive, as Compared to an Executive Order," U.S. Department of Justice, Office of Legal Counsel, January 29, 2000, accessible at http://www.usdoj.gov/olc/predirective.htm.

3 This covers such nationals from countries in NATO and the EU, Australia, New Zealand, Japan and Switzerland.

4 See, e.g. Letter from US Representative Edward J. Markey to Commerce Secretary Carlos M. Gutierrez, January 29, 2008, accessible at http://markey.house.gov/docs/defense/012908_veu_china.pdf.

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