EXPORT VIOLATIONS IN THE POST-ECR ENVIRONMENT

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Agenda

1. Ten Tips to Avoid Export Control Violations in the Post-ECR Environment
2. Internal Investigations
3. Voluntary Self-Disclosures
Ten Tips to Avoid Export Control Violations in the Post-ECR Environment

Tip 1: Correct Classifications More Important than Ever
Intersil Consent Agreement

- Intersil Corporation accepted civil penalty of $10 million in connection with 339 alleged ITAR violations
  - Entered into Consent Agreement with DDTC effective June 16, 2014
  - $4 million suspended if DDTC approves expenditures for remedial compliance costs
- Conduct involved violations of various ITAR sections because of improper classification of radiation-hardened defense articles as EAR-controlled
- Voluntary self-disclosure to DDTC revealed 3,125 export transactions to distributors in Europe and Asia
  - Reexports by distributors on 91 occasions to China, including to 771 Research Institute

Tips to Avoid Intersil’s Fate in the Post-ECR Environment

- Don’t avoid “classification exercise”
  - Because of ECR, many items have shifted from USML to CCL
  - EAR licensing requirements quite different from ITAR requirements
- Evaluate necessity of continued registration with DDTC
  - Small to medium sized subcontractors/suppliers to U.S. Government agencies and their prime contractors may no longer have USML-controlled items
  - DDTC registration however may still be necessary/advisable
- Reports of U.S. Government agencies not following ECR logic in certain commodity jurisdiction (CJ) determinations
- If company acquires another entity, ensure export control compliance has been handled appropriately
Tip 2: There’s Nothing Like a Robust Compliance Program

Esterline Consent Agreement

- Esterline Technologies Corporation accepted civil penalty of $20 million in connection with 282 alleged ITAR violations
  - Entered into Consent Agreement with DDTC effective March 5, 2014
  - $10 million suspended if DDTC approves expenditures for remedial compliance costs
- Involved unauthorized exports of defense articles (aviation electronics, control devices, subsystems for military airplane cockpits and vehicles), unauthorized temporary imports of defense articles, violations of terms and conditions of licenses, and improper use of exemptions
- DDTC determined that Esterline exercised inadequate corporate oversight and failed to establish adequate ECP within companies it had acquired
Tips to Avoid Esterline’s Fate in the Post-ECR Environment

- Management commitment is most important element in establishing “culture of compliance”
- Ensure appropriate investment of compliance resources
  - In post-ECR company, important to understand how life under EAR is different than life under ITAR
  - When integrating new company, past practices of acquired company must be assessed and practices of acquirer evaluated for best practices
- Strong, centralized compliance staff important
- Planned audits important but unannounced spot-checks critical
- Importance of extensive due diligence in any acquisition
  - If company intends to be “target,” ensure strong compliance efforts

Tip 3: Importance of Adequate Resources
Avoid the Fate of Bad Actor Compliance Managers

• On November 25, 2013, DDTC administratively debarred LeAnne Lesmeister for three years
  – Lesmeister was former export compliance officer at Honeywell International, Inc.

• Lesmeister was charged with repeatedly counterfeiting DDTC authorizations she furnished to Honeywell personnel
  – Personnel relied on false authorizations when exporting ITAR-controlled defense articles and defense services

Avoid the Fate of Bad Actor Compliance Managers (contd.)

• On January 17, 2013, Timothy Gormley sentenced to 42 months in prison, three years supervised release and $1,000 fine for five counts of violating IEEPA
  – Gormley had been export control manager at Amplifier Research, which had filed voluntary self-disclosure in November 2011

• Gormley pleaded guilty on October 17, 2012 in connection with illegal export of over 57 microwave amplifiers admitting he had
  – Altered invoices and shipping documents
  – Listed false license numbers
  – Lied to fellow employees

• On December 27, 2013, Amplifier Research agreed to pay civil penalty to BIS of $500,000
  – Penalty will be suspended for two years and then waived, if company commits no further violations
  – Company must hire consultant to complete external audit of export controls compliance program
Tips to Avoid Becoming a Bad Actor in the Post-ECR Environment

• If you are in management, ensure that appropriate resources are invested in export control compliance staff, policies, etc.
• If you are in compliance, ensure that you discuss perceived resource and budgetary shortfalls with management
• Management and compliance must together handle pressures from sales
• Realize that everyone’s fate is tied together
• Consider regular external audits and training

Tip 4: Beware of the Rise of the Global Settlement
Weatherford International Ltd.

• On November 26, 2013, Weatherford International Ltd. and four subsidiaries ("Weatherford") entered into $50 million settlement with BIS
  – Largest penalty ever levied by BIS

• Settlement was for allegations that Weatherford
  – Exported oil and gas equipment to Cuba, Iran and Syria in violation of EAR and Iranian Transactions and Sanctions Regulations (ITSR)
  – Knowingly transferred equipment from the United States to Iran via Weatherford’s Dubai-based subsidiary and to Cuba via Canada
  – Exported items controlled for nuclear non-proliferation reasons to Venezuela and Mexico without licenses

Weatherford International Ltd. (contd.)

• BIS settlement was part of global settlement in which Weatherford agreed to pay $253 million in criminal and civil penalties
  – Settlement included violations of EAR, Foreign Corrupt Practices Act (FCPA) and economic sanctions laws
  – Illustrates inter-agency cooperation

• Weatherford also agreed to engage independent third party to audit compliance with export control and economic sanctions laws during 2012 through 2014

• Reported that through 2012 Weatherford had spent nearly $200 million in outside legal and professional fees and costs in ceasing operations in embargoed countries
Tips to Take from Weatherford

• Export control laws are closely related
  – In particular, FCPA and ITAR are often closely linked
• Violations under one set of regulations may easily give rise to violations under another set of regulations
• Ensure compliance program addresses all applicable regulations

Tip 5: Importance of Prohibited Persons Screening
Importance of Prohibited Persons Screening

• Citigroup settled with OFAC for $217,841 for eight charges of violating Iranian and other U.S. economic sanctions
  – Violations resulted from improper Specially Designated National (SDN) List screening
• Kintetsu World Express (U.S.A.) Inc. (KWE), New Jersey freight forwarder, settled with BIS for $30,000 for export of EAR99 items to SDN
  – Kintetsu had failed to check SDN List or any other prohibited persons database

Tips to Take from Citigroup and Kintetsu

• Prohibited persons screening must be done
• If performed manually, realize stakes of improper screening can be high
• Screening software can make job easier
• Ensure software is not over-filtering
• Don’t just rely on your freight forwarder
• Understand potential impacts on your banking relationships
Tip 6: Understand that the World is Always Changing

OFAC Economic Sanctions

- Current near total embargoes on Crimea, Cuba, Iran, Sudan and Syria
- Less restrictive sanctions on individuals, groups and entities in other nations including the Balkans, Belarus, Central African Republic, Congo, Côte d’Ivoire, Iraq, Lebanon, Liberia, Libya, Myanmar (Burma), North Korea, Somalia, South Sudan, Russia, Ukraine, Venezuela, Yemen and Zimbabwe
- Prohibitions as to SDNs
Tips Regarding OFAC Compliance

- Media headlines may have less than casual observers believing that Cuba and Iran are now ripe for U.S. investment
- Media headlines may also have less than casual observers believing that most all business with Russia is off limits
- Media has not focused as much on Syria, Ukraine, Venezuela

Tip 7: Understand the Impact of the FCPA on Your Business
FLIR FCPA Matter

- On November 17, 2014 two ex-employees of FLIR’s Dubai office agreed to pay Securities and Exchange Commission penalties for charges of violating FCPA by taking Saudi Government officials on “world tour” in 2009 to secure business
  – Involved falsification of records and circumvention of FLIR’s policies and controls
  – After caught by FLIR, lied about purpose and promised to invoice Saudi Government for travel but failed to do so
- Separately, FLIR agreed to pay $9.5 million to settle allegations that it had violated FCPA

Tips Regarding FCPA Compliance

- Understand what constitutes an FCPA violation
  – Anti-bribery provision
  – Books and records provision
- Ensure compliance program addresses FCPA if company is involved in international sales
  – Beware of state-owned enterprises
- FCPA violations often go hand-in-hand with EAR and ITAR violations
Tip 8: Understand EAR License Exceptions

- Even if export license is required under CCL classification and EAR’s Country Chart, “license exception” might apply
- Examples
  - LVS (shipments of limited value)
  - GBS (shipments to Country Group B countries)
  - CIV (civil end-users)
  - TSR (technology and software under restriction)
  - TMP (temporary imports, exports and reexports)
  - GOV (purchase by trusted government for official internal use)
  - TSU (technology and software – unrestricted)
  - ENC (encryption commodities and software)
  - BAG (baggage)
  - STA (strategic trade authorization)
SECTION 740.2 RESTRICTIONS

• Exporter may not use any license exception if any of following apply
  – Authorization to use license exception has been suspended or revoked or intended export does not qualify for license exception
  – Export is subject to one of ten General Prohibitions and has not been authorized by BIS
  – Item is primarily useful for surreptitious interception of wire, oral or electronic communications
  – Item is subject to license requirements in EAR Section 742.7 and is not otherwise authorized
  – Item is on enumerated list of items controlled for MT reasons
  – Export is to sanctioned destination and is not otherwise specifically authorized in EAR or by BIS
  – Item is on enumerated list of “space qualified” items, items controlled by certain ECCNs in Categories 0, 2, 7

License Exemption STA

• BIS’s implementation of STA implements part of Obama Administration’s ECR initiative
• Authorizes, with conditions, export, reexport and transfer of certain items to destinations that pose “low risk” of unauthorized uses
• Intended to benefit
  – Exporters by reducing delays associated with BIS review of license applications
  – BIS by focusing licensing resources on transactions with greater risk
• Only relevant to exports, reexports and transfers for which license would be required under EAR
• Use of STA is optional
  – Exporters may use other license exceptions that authorize planned transaction (e.g., GBS)
  – Exporters may apply for license
• Use of STA subject to restrictions found in EAR Section 740.2
Tip 9: Understand Forbidden Activities under EAR’s Anti-Boycott Provisions

FORBIDDEN ACTIVITIES UNDER ANTI-BOYCOTT LAWS

- Refusing to do business with certain persons due to any illegal boycott or blacklist
- Discriminating
  - In employment or otherwise against any individual on basis of race, religion, sex or national origin
  - Against any business that is a U.S. person due to race, religion, sex or national origin of any owner, officer, director or employee
- Furnishing information about
  - Race, religion, sex or national origin of any U.S. persons or owner, officer, director or employee thereof
  - U.S. person’s past, present or proposed business relationships with or in boycotted country or with any person or business therein
  - Whether any person is member of, has made contributions to or is affiliated with any charitable or fraternal organization that supports boycotted country
- Paying, honoring, confirming or otherwise implementing letter of credit with terms or conditions prohibited by U.S. anti-boycott laws
Tip 10: Changes are Still Coming

Future Amendments Certain/Possible

- Final rules still not published for USML Categories I (Firearms), II (Artillery), III (Ammunition), XII (Fire Control/Sensors/Night Vision), XIV (Toxilogical Agents) and XVIII (Directed Energy Weapons)
- Certain definitions under reform right now
- Inevitable “kinks” to be ironed out
- Key Tip: Can’t self-blind to ongoing changes
Tip 11: Breathe!

Internal Investigations
Basic Steps of Internal Investigation

1. Detection of issue
2. Preliminary assessment
3. Initial mitigation of potential violations
4. Thorough investigation
5. Corrective actions
6. Filing of VSD

Initial Detection of Issue

• Issues should surface with effective compliance program
  – Internal complaint and consultation mechanism
  – Red flag system
  – Risk assessment procedures
  – Internal audits and spot-checks
• Issues also may surface through whistleblowers or third party report
  – May lose control of internal investigation
Conducting Preliminary Assessment of Possible Violations

• Immediate response necessary upon issue detection
• Must ask
  – What controlled items involved and how were they transmitted?
  – Did any foreign person have unauthorized access?
  – Did license, authorization or exemption cover action?
• Once violation confirmed
  – Determine extent of problem (recent Intersil matter)
  – Ensure all documents preserved ("litigation hold" memo)

Initial Mitigation

• Stop in-process transactions
• Recall sent items
• Reassign foreign persons/block access to IT systems
• Notify affected personnel, non-U.S. subsidiaries, third-parties
• Consider filing initial VSD with relevant U.S. Government agency(ies)
Investigation Necessary for Full Disclosure

- Outline scope of investigation
  - Determine necessary employee interviews and third party contacts; geographic focus
  - Analyze written documents, including electronic records
- Ensure investigation is robust and that all suspected violations are examined
- Consider statute of limitations
- Determine potential monetary and other fines involved
  - May involve many parts of company
  - May involve government/public relations

Results of Investigation

- Maintain ongoing chronology of facts and issues
  - Should be kept confidential and distributed on “need-to-know” basis
- Consider preparing investigation report
  - May help inform internal discussions and discussions with senior management/Board
  - If report is prepared, ensure it is attorney-client protected
- Report to senior management/Board
- Determine how to interact with relevant U.S. Government agencies
Voluntary Self-Disclosures

Mitigation from VSD

- **DDTC**
  - No penalty guidelines
  - May consider VSD to be mitigating factor in light of all other relevant information
  - Failure to report may be considered an adverse factor
  - Penalties rarely imposed when company makes comprehensive VSD
- **BIS**
  - No penalty guidelines
  - VSD is mitigating factor of “great weight” but considered with other factors
  - Penalties typically mitigated by at least 50% for VSD
  - Over 90% of VSDs result in warning letter (i.e., no penalty)
- **OFAC**
  - Penalty guidelines
  - Base penalty reduced by 50% for VSD
To Disclose or Not To Disclose

Possible Benefits
- No/mitigation of penalty
- Reduced risk of criminal penalty
- Demonstrates strength of ECP
- Control message to U.S. Government
- Avoid U.S. Government investigation
- Assist national security
- Mental relief

Possible Risks
- Cost and disruption to business
- Impact on business relationships
- Discovery of additional violations
- Increased scrutiny by U.S. Government
- Penalties
- Possible debarment
- Mitigation may be outweighed by aggravating factors

Timing of Disclosure
- VSDs valid only if U.S. Government notified before it has learned of same or substantially same information from another source
- Initial notification should include sufficient detail to afford complete understanding of circumstances
- Full disclosure provided once all facts are readily available (could be simultaneous with initial notification)
Corrective Actions

- Identify corrective actions and outline steps to ensure completion
- Ensure corrective actions communicated to all relevant stakeholders
- Confirm implementation
- Ongoing spot-checks and audits

Drafting VSD

- Include summary or narrative account that answers “who,” “what,” “where,” “why,” “when” and “how”
- Full discussion of all potential violations
- Discuss mitigating factors and certain aggravating factors
- Disclose all remedial and corrective actions taken or scheduled to be taken
- Include all relevant attachments
QUESTIONS? THANK YOU!