

## Identifying and Working with Government Regulations

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Regulations regarding exports from the United States are abundant. In reviewing the regulations how does one discern whether our company should be following the Export Administration Regulations, Office of Foreign Asset Control (OFAC) Regulations, Foreign Trade Regulations, International Traffic in Arms Regulations, none of these or all of these?

### Foreign Trade Regulations

In understanding export controls, one must first understand the concept of the USPPI. The U.S. Principal Party in Interest is the party in the United States that derives the greatest benefit of the export transaction. That is generally the U.S. manufacturer, U.S. seller or U.S. order party. A foreign company cannot be shown as the USPPI unless they are physically in the U.S. at the time the goods are purchased for export. A freight forwarder cannot be the USPPI.

The USPPI definition becomes confusing in the situation of a routed export. In a routed export, the USPPI is not controlling the freight aspect of the freight. A routed export is where the foreign consignee is responsible for

compliance with the Foreign Trade Regulations, yet the USPPI has responsibility to ensure accuracy of data is provided to the AES filer. In these situations, the USPPI generally utilizes a letter of instruction which is then provided to the AES filer to demonstrate the “accurate” data was provided to the AES filer. The AES filer is required to receive authorization from the foreign consignee to file the AES on their behalf, even though the USPPI is listed on the AES. The AES filer is also required to provide a copy of the AES filing to the USPPI upon their request.

The concept of USPPI is dictated by the Foreign Trade Regulations. The Bureau of Census monitors and gathers trade statistics. The key to trade statistics is accuracy of data. Therefore, Census regulations mandate the data received for statistical filing under the Automated Export System (AES) is accurate. Additionally, if information should change after the initial filing, the regulations also state the data must be updated for accuracy if necessary.

In addition to collecting trade data, the AES filing is also used for reporting export licenses under Commerce, State and OFAC

as well as license exceptions. This filing has visibility to other government agencies, such as Customs and Border Protection (CBP) that enforces the export regulations. The system also permits decrementing under Department of State licenses.

As with any government regulation there are record keeping requirements required for both USPPI and the actual AES filer, which is in many cases the freight forwarder. There are also significant fines for penalties such as late filing, inaccurate data and record keeping violations.

#### Office of Foreign Asset Control Regulations

Another set of regulations requiring diligence on the part of exporters is the Office of Foreign Asset Control (OFAC) Regulations. OFAC administers and enforces economic sanctions programs against countries, organizations and individuals. OFAC has the authority for blocking assets and restricting trades in order to accomplish US foreign policy and national security goals.

This requires a company to be diligent in knowing their customers, knowing the destination of their products as well as the end-users. Additionally, companies sending payments overseas must be screening the financial institutions involved in the transfers as well. This would be particularly applicable to supplier payments for import shipments.

#### Export Administration Regulations

The Export Administration Regulations (EAR) cover a broad scope including direct exports from the US, re-exports, transfers of technology to a foreign national by any method, foreign subsidiaries of US companies, US components in foreign made products, foreign made products of US technology and actions of US persons abroad.

When discussing export compliance and the EAR, a company should ask themselves the following questions:

- What is my product
- Where is it going
- What is the quantity and value
- Who is it going to and
- What is my customer doing with the product

The answers to these questions provide the basis for export compliance programs in a company.

The first step is to determine whether your product falls under the EAR. This is done by reviewing the Commerce Control List (CCL). This is best done with the assistance of those with technical expertise in the organization. The Commerce Control List consists of ten categories including Nuclear Materials, Chemicals, Electronics, Computers, Telecommunications, Lasers, Navigation, Marine and Propulsion Systems. Within

the Commerce Control List are groupings relating to the actual product, production equipment to produce the product, materials to produce a product, as well as software and technology to develop the product.

Once a determination has been made as to whether the product is under the control of an Export Commodity Control Number (ECCN) then the destination and even transiting countries must be examined for potential risk under the particular reason for control for that product.

This is determined by examining the Commerce Country Chart and understanding the reason the product is restricted to particular destinations. Typically, a product may be restricted to a destination but this does not mean the product is prohibited from that destination. This simply means the US company must apply for authorization from the US government to export the product from the US.

If a product is not controlled by an applicable ECCN then the product is considered to be EAR99. EAR99 means the product is subject to the Export Administration Regulations but does not have a specific control.

In some instances a license exception may be available and may be used in place of a license. License exceptions must be carefully reviewed to ensure full compliance with the EAR as the person making the license exception

determination technically becomes the “licensing” person in deciding not to apply for a license and use a license exception in its place.

The license application is managed electronically by the government. The application is reviewed by the Department of Commerce as well as any other government agencies that may have an interest in that particular commodity, Nuclear Regulatory Commission for example, and once the license application has been approved, a license is issued. Licenses are generally issued with conditions. These provisos must be followed in order for the license to be used properly.

The government takes the position that every exporter must understand all elements to the export transaction. There are ten General Prohibitions to which exporters must adhere.

General Prohibition Number One covers exports and re-exports. You may not, without a license or license exception, export any item subject to the EAR to another country or re-export any item of US origin, if the item is controlled by an ECCN on the Commerce Control List and the export to the country of destination requires a license based on the Commerce Country Chart.

General Prohibition Number Two covers parts and components. You may not, without a license or license exception, re-export or export from abroad, any foreign-

made item incorporating US origin commodities, software or technology respectively that is controlled to the country of ultimate destination if the foreign-made item meets all three of the following conditions:

- If incorporated into a product more than the de minimis amount of controlled US content as defined in 734.4
- If it is controlled for a reason indicated in the applicable ECCN
- If its export to the country of destination requires a license for the control reason as indicated in the Country Chart in Part 738.

General Prohibition Number Three covers foreign produced direct products re-exports. You may not, without a license or license exception, re-export or export from abroad foreign-made items to Cuba, North Korea or a destination listed in Country Group D if:

- The items are subject to national security controls AND they are the direct product of technology or software that require a written assurance in support of a license application or as a precondition for use of license exception TSR or;
- The foreign-made items are the direct product of a plant or

component subject to national security controls AND the plant or component is the direct product of technology or software that required a written assurance in support of a license application or as a precondition for use of license exception TSR.

General Prohibition Number Four covers denial orders. You may not, with or without a license exception take any action prohibited by a denial order issued under part 766.

General Prohibition Number Five covers end-use/end-users. You may not without a license knowing export or re-export any item subject to the EAR to an end-user or for an end-use that is prohibited by Part 744.

General Prohibition Number Six covers embargoes. You may not without a license or license exception, export or re-export any item subject to the EAR to a country that is embargoed by the US or otherwise made subject to controls as described in Part 746.

General Prohibition Number Seven covers US person's proliferation activity. You may not as a US person, without a license from the BIS, engage in any activities that you know will assist in certain proliferation activities described in Part 744 or provide technical assistance to foreign persons with respect to encryption items.

General Prohibition Number Eight covers in-transit shipments. You may not export an item through or transit through countries as outlined in the EAR Part 744.

General Prohibition Number Nine covers violations of orders, terms and conditions. You may not violate terms or conditions of a license or of a license exception issued under or made a part of the EAR AND you may not violation any order issued under or made a part of the EAR.

General Prohibition Number Ten covers proceeding with knowledge that a violation has occurred or is about to occur. You may not sell, transfer, export re-export, finance, order, buy remove, conceal, store, use, loan, dispose of, transfer, transport, forward or otherwise service, in whole or in part, any item subject to the EAR and exported or to be exported with knowledge that a violation of the EAR or any order, license, license exception or other authorization issue there under has occurred, is about to occur or is intended to occur in connection with the item. Nor may you rely upon any license or license exception after notice to you of the suspension or revocation of that license or exception.

These ten General Prohibitions boil down to knowing all parties to the export transaction, knowing all destination and transiting countries and knowing how the product will ultimately be used by the ultimate end-user. If an exporter has not cleared a red flag to the transaction or the exporter has reason to believe the product

will be used in violation of US regulations the exporter is responsible to stop the transaction.

### International Traffic in Arms Regulations

The Arms Export Control Act authorized the President to control the export and import of defense articles and defense services. The International Traffic in Arms Regulations cover defense articles. Licenses or other approval for these types of transaction are granted ONLY to US persons and foreign government entities in the US. Application for license or other requests will be considered through a license application submitted by a company registered with the Department of State.

The US Munitions List covers defense articles. The Commerce Control List covers commercial items which are also considered to be “dual-use” items. The difference is the USML covers items specifically designed, configured or adapted for military use and do not have a predominantly civil application and does not have a performance equivalent (form, fit and function) to those of an article used for civil applications. There are twenty-one categories of product considered to be defense articles ranging from firearms to launch vehicles to submarines and artillery.

The differences between the EAR and ITAR are primarily that if a product is covered by the ITAR it will require an export license. ITAR exemptions are used

primarily for items already licensed under a Department of State license. ITAR licenses require registration of a company. Commerce licenses do not require a specific registration or registration fee to be paid. The ITAR is shorter and therefore more vague and open for interpretation than the EAR which is essentially black and white. Fines are higher under the ITAR and an “empowered official” must be selected by the company to be responsible in the event a violation occurs within a transaction by the company.

Activities controlled by the ITAR include exports, re-exports, transfer of defense articles or technical data, furnishing a defense service, temporary imports, re-exports of a defense article that is the product of US technical data or incorporates any percentage of US defense articles, proposals to sell significant military equipment and dealing with prohibited parties. Agreements and proposals for defense articles must also follow the ITAR and require prior approval before entering into those agreements and furnishing data.

We have reviewed the complications of dealing with the various government regulations. It is incumbent upon a company to understand these regulations and to train all personnel on which regulations are applicable and how to comply with said regulations.

In managing a compliance program it is key to gain senior management support. Training requires time and money; senior

management must support the training. Revamping export control programs within a company may result in “push-back”. Senior management support helps to remove blockades in implementing a compliance program.

Another key point is to nominate a point person or compliance team to manage the process. Government regulations require there be knowledgeable personnel on staff to answer questions or to know where to find resources to get the answers.

Many companies address compliance initially by burying their head in the sand. Being proactive and assessing where the company stands in compliance is the best way to manage this. This can be done by internal personnel with expertise or by utilizing a third party to audit the company and create an action plan based on their findings.

Training personnel to understand their role in compliance is another key factor. All personnel are a link in the supply chain and therefore a link in the compliance chain. People must be trained on specific job functions related to the government regulations.

Procedures need to be implemented, reviewed and redrafted if necessary, to ensure the procedures are functional and understood. Procedures should identify key personnel, back-up persons, regulatory authorities, sample documentation, consequences of not following procedures and record keeping requirements.

Technology should also be a key factor in managing trade compliance. Technology eliminates human error and is typically used in denied party screening and embargo country screening.

Companies must exercise due diligence in their supply chain. They must understand the connectivity within the supply chain and develop internal expertise. Companies must also keep current with changing regulations. The company that manages its compliance will not only be successful in compliance but also in upholding US policies around the world.