

Preventing Unlawful Diversion of U.S. Exports by Foreign Transaction Parties: U.S. Exporters Take Heed

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Recent outreach symposiums undertaken by the State Department's Directorate of Defense Trade Controls (DDTC), the Treasury Department's Office of Foreign Assets Control (OFAC), and Commerce Department's Bureau of Industry and Security (BIS) have disclosed an *important and coordinated shift in the focus of U.S. export control investigation and enforcement*:

U.S. export control agencies are increasing their focus on ensuring that controlled and uncontrolled items originating from the U.S. are not later transshipped (i.e., within a country) or re-exported by a Foreign Transaction Party to an unlicensed or a prohibited destination country, end-user, or end-use (each, a Prohibited Transaction).

U.S. exporters who knowingly engage in Prohibited Transactions, whether directly or indirectly, or who do not otherwise take reasonable precautions (as part of an Export Control Compliance Program) to prevent their businesses from engaging in Prohibited Transactions may be construed as violating U.S. export control laws and be subject to civil and criminal enforcement by U.S. government export control agencies (i.e., DDTC, OFAC and/or the BIS).

"Foreign Transaction Parties" (or foreign parties-in-interest) that the U.S. government has noted as being the subject of monitoring include a U.S. exporter's foreign distributors, customers, freight-forwarders, and other intermediate consignees involved in a U.S. export transaction. U.S. export control monitoring is particularly intense for U.S. exports to countries identified as main re-export hubs, such as United Arab Emirates (UAE) for the Middle East, the Netherlands for Europe, and Malaysia for Southeast Asia.

U.S. exporters should note that the U.S. government deploys U.S. Export Control Officers (ECOs) abroad at key U.S. embassies in Beijing and Hong Kong, China; Abu Dhabi, UAE; New Delhi, India; and Moscow, Russia. The principal mission of the ECOs is to ensure that controlled items entering the region are used in accordance with U.S. export control laws. Compliance verification is accomplished through targeted end-use checks and by working with the host governments and local businesses to ensure that they understand and comply with U.S. export control laws.

With that being said, what reasonable precautions should a U.S. exporter undertake to distinguish between lawful U.S. export transactions and Prohibited Transactions to avoid being a party to an unlawful diversion of U.S. exports by Foreign Transaction Parties?

In 2011, the BIS addressed this very issue by publishing what it considers to be best practices to guard against the risk of unlawful diversion of U.S. exports by Foreign Transaction Parties. While published by the BIS to comply with the EAR, these benchmarks can serve as part of an overall Export Control Compliance Program to buttress compliance with all U.S. export control laws.

Best Practice No. 1 - U.S. exporters should pay heightened attention to the Red Flag Indicators published on the BIS Website. The existence of red flags in a proposed U.S. export transaction may signify a Prohibited Transaction. U.S. exporters should communicate red flags throughout their U.S. operations and to foreign affiliates, particularly when: (a) a U.S. exporter denies an order placed by a foreign distributor or customer based on red flags or (b) a freight forwarder suddenly declines to provide export services after being notified that the items for export are subject to U.S. export

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controls.

Best Practice No. 2 - U.S. exporters and their foreign affiliates should seek to utilize only those trade facilitators/freight forwarders that administer sound export management and compliance programs, which include best practices for re-export and transshipment in compliance with U.S. export control laws.

Best Practice No. 3 - U.S. exporters and their foreign affiliates should “know their customers” by obtaining detailed information on their bona fides (credentials) to measure the risk of diversion and engaging in a Prohibited Transaction. Specifically, U.S. exporters and their foreign affiliates should obtain information about their foreign customers that enables them to protect controlled and uncontrolled items originating from the U.S. against unlawful diversion as part of a Prohibited Transaction, especially when the foreign customer is a broker, trading company or distribution center.

Best Practice No. 4 - U.S. exporters and their foreign affiliates should avoid routed export transactions (i.e., shipments to unknown third-party destinations) when exporting and facilitating the movement of controlled and uncontrolled items originating from the U.S., unless a long standing and trustworthy relationship has been built with the foreign distributor/customer and other Foreign Transaction Parties.

Best Practice No. 5 - When a Destination Control Statement (DCS) is legally required for the export of a controlled item, the U.S. exporter should provide the appropriate CCL Export Control Classification Number (ECCN) under EAR or the appropriate USML category under ITAR, the final destination country, the intended end-user and end-use and, where relevant, the ultimate consignee. An exporter can use a DCS even when it is not required as part of its overall export compliance program. At a minimum, BIS suggests providing this export information to Foreign Transaction Parties on bills of lading, air waybills, buyer/seller contracts and other export documentation.

Best Practice No. 6 - U.S. exporters should provide the ECCN, USML category, or the EAR99 classification to freight forwarders, and should report the ECCN, USML category, or the EAR99 classification in the Automated Export System (AES) for U.S. Customs and, when applicable, include a “No License Required” designation in the AES entry, certifying that no export control license is required.

Best Practice No. 7 - U.S. exporters and their foreign affiliates should use information technology to the maximum extent feasible to augment “know your customer” and other due-diligence measures in combating the threats of unlawful diversion and helping to ensure that U.S. export shipments will only reach authorized end-users for authorized end-uses.

Also, we suggest the following additional best practices:

Best Practice No. 8 - U.S. exporters should screen all Foreign Transaction Parties before engaging in a U.S. export transaction using the Consolidated Screening List. U.S. exporters and their foreign affiliates are prohibited from engaging in U.S. export transactions with Foreign Transaction Parties listed on the Consolidated Screening List, regardless of whether the items exported are controlled or uncontrolled. Engaging in a U.S. export transaction with a Foreign Transaction Party who is a listed party is a significant red flag that almost certainly would constitute a Prohibited Transaction.

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The Consolidated Screening List is comprised of the six constituent screening lists from the DDTC, OFAC, and BIS. Check each of the constituent screening lists as an added precaution, because the Consolidated Screening List is not immediately updated for additions of entities and persons to the constituent screening lists.

Best Practice No. 9 - U.S. exporters and their foreign affiliates should be aware of and observe (a) OFAC's export controls for sanctioned countries and (b) EAR's export controls for sanctioned countries and end-use based export controls. In many instances, U.S. exporters and their foreign affiliates are prohibited from engaging in U.S. export transactions involving sanctioned countries or controlled end-uses, regardless of whether the exported items are themselves controlled or uncontrolled. Engaging in a U.S. export transaction involving sanctioned countries or controlled end-uses are significant red flags and would constitute a Prohibited Transaction, absent specific compliance with the applicable OFAC or EAR export controls. Sanctioned countries subject to OFAC export controls and sanctioned countries and controlled end-uses subject to EAR export controls should be listed as red flags and communicated throughout a U.S. exporter's operations and to its foreign affiliates as standing red flags. If a U.S. exporter encounters a red flag, the export in question should be halted until compliance can be achieved.

While there is no explicit legal requirement on U.S. exporters to comply with these best practices (except to the extent set forth in the U.S. export control laws), a consistent pattern of following these best practices may be considered a significant mitigating factor by the DDTC, OFAC, and the BIS in addressing violations and potential civil and criminal remedies.

For further information please contact Miller Canfield's Export Control Team. Visit our Export Control webpage at millercanfield.com/exportcontrols for prior articles and alerts, as well as subsequent updates on U.S. Export Control Reform and other export control articles.

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