

Exports: Staying Out of Trouble

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As the economy continues to become more global and the workplace becomes more technological, companies and individuals are increasingly likely to find themselves subject to the United States' Export Administration Regulations ("EAR"). The regulations may come into play through such diverse activities as selling overseas, performing a U.S. or foreign government contract abroad, exchanging information with a foreign subsidiary, hiring foreign workers to work in the United States, and engaging in mergers-and-acquisitions talks with a foreign company. In short, any time that a tangible item or even just scientific or technical data leaves the United States, an "export" may be occurring that may be subject to the EAR.

What is an "export"?

As defined in the EAR, any item that is sent from the United States to a foreign destination is an export. "Items" include commodities, software or technology, such as clothing, building materials, circuit boards, automotive parts, blueprints, design plans, retail software packages and technical information.

The way in which an item is transported outside the United States does not matter in determining export license requirements. For example, the term "export" can include an item sent by regular mail or hand-carried onto an airplane. A set of schematics sent via facsimile to a foreign destination, software uploaded to or downloaded from an Internet site, and "technology" transmitted via e-mail or even during a telephone conversation all can be considered "exports" for export control purposes. An item also is considered an export even if it is leaving the United States temporarily, if it is leaving the United States but is not for sale (e.g., a gift) or if it is going to a wholly owned U.S. subsidiary in a foreign country. Even a foreign-origin item exported from the United States, transmitted or transshipped through the United States or being returned from the United States to its foreign country of origin is considered an export. Finally, the release of technology or source code subject to the EAR to a foreign national within the borders of the United States is deemed an export to the home country of the foreign national under the EAR.

How do I determine what my obligations are?

The EAR are administered by the Bureau of Industry and Security ("BIS"; formerly the Bureau of Export Administration) within the U.S. Department of Commerce, and it regulates so-called "dual use" items, i.e., items that can have either a commercial or a military application. Export of items that have a predominantly military application is governed by the International Traffic in Arms Regulations ("ITAR"), which are administered by the State Department.

Items controlled by the EAR are found on the "Commerce Control List" ("CCL").¹ The CCL is a catalog of items and the export controls applicable to each. Each item on the CCL has an Export Control Classification Number ("ECCN"). For each ECCN, the CCL lists one or more "reasons for control." For example, an item with the reason for control "CC" is restricted for "crime control" reasons. Other reasons for control include, to name a few, nuclear nonproliferation, chemical and biological weapons, and missile technology. In turn, the EAR contain a "reasons for control" table that lists each country to which exports are restricted (though not necessarily prohibited) based on that particular reason for control.

For example, exports to Portugal are subject to the following "Reasons for Control": CB1 (Chemical and Biological weapons), NS1 (National Security), MT1 (Missile Technology), and RS1 (Regional Stability).² This list illustrates that exporters should not assume that exports to friendly nations do not require a license. Portugal is a friendly nation with no known designs on the territory of any of its neighbors. Nevertheless, any ECCN that cross-references these particular "Reasons for Control" would indicate an item that may not be exported to Portugal without a license or a license exception.

Most items will not fit any of the item descriptions on the CCL; instead, such items are assigned the default ECCN of "EAR99." EAR99 is "a 'basket' for items not specified under any CCL entry."³ For example, many common software products fall under EAR99. When would-be exporters are in doubt, BIS allows them to submit classification requests to receive definitive guidance on whether their products are regulated and what the proper classification is.

Once an item's ECCN and the country to which it will be exported are known, the next step is to determine whether any of the EAR's ten "general prohibitions" apply to that ECCN and to that country. Take, for example, the export of a software product to Portugal. Specifically, the EAR's General Prohibition No. 1 prohibits export of controlled items to listed countries. This does not apply to EAR99 because that ECCN has no reasons for control.

General Prohibition No. 2 prohibits reexport and export from abroad of certain foreign-made items. Again, this does not apply to EAR99. Also, this prohibition does not apply to U.S.-made products.

General Prohibition No. 3 prohibits reexport and export from abroad of certain foreign-made items to Country Group D and certain other countries. Portugal is in Country Groups A and B, but not in D. Also, this prohibition does not apply to EAR99.

General Prohibition No. 4 prohibits actions that are subject to a Denial Order pursuant to 15 C.F.R. § 766. Exporters must consult the Denied Persons List published periodically in the Federal Register or at <http://www.bis.doc.gov/dpl/Default.shtm> to determine whether a party to the contemplated transaction is subject to a Denial Order. Note that the Denied Persons List is not country-specific but rather focuses on entities within a country—even a friendly or neutral country—that are known or believed to engage in particular activities that are of concern to the U.S. government, for example, nuclear weapons research.

General Prohibition No. 5 prohibits knowingly exporting any item to a prohibited end user or for a prohibited end use. Prohibited end uses relate to various weapons of mass destruction. In the absence of any "red flags" (see below), an exporter may presume that no prohibited end use is contemplated.

General Prohibition No. 6 prohibits exports to embargoed destinations. Portugal is not an embargoed destination.

General Prohibition No. 7 prohibits activities by U.S. persons that support certain weapons proliferation activities by certain countries. Therefore, an exporter needs to know the anticipated use of the product by the buyer.

General Prohibition No. 8 prohibits exporting an item in transit through certain countries. Therefore, the exporter needs to know the route that the item will take to reach Portugal.

General Prohibition No. 9 prohibits violating BIS General or Administrative Orders printed in the C.F.R. An exporter needs to examine these orders, as they may change from time to time.

Finally, General Prohibition No. 10 prohibits exporting with knowledge that any violation of the EAR has occurred or is about to occur. For example, an exporter could not export a product to Portugal knowing that the buyer planned to reexport the product to Cuba.

If none of these ten prohibitions applies, then (as of the date of this writing) an EAR99 item may be exported to Portugal without a license.⁴ Different items and/or different destinations may produce different results.

As noted above, an exporter must look for "red flags." The EAR list the following twelve red flags:⁵ (Note, an additional eleven have been proposed along with a change to the "knowledge" standard.)

1. The customer or purchasing agent is reluctant to offer information about the end use of a product.
2. The product's capabilities do not fit the buyer's line of business; for example, a small bakery places an order for several sophisticated lasers.
3. The product ordered is incompatible with the technical level of the country to which the product is being shipped. For example, semiconductor manufacturing equipment would be of little use in a country without an electronics industry.
4. The customer has little or no business background.
5. The customer is willing to pay cash for a very expensive item when the terms of the sale call for financing.
6. The customer is unfamiliar with the product's performance characteristics but still wants the product.
7. Routine installation, training or maintenance services are declined by the customer.
8. Delivery dates are vague, or deliveries are planned for out-of-the-way destinations.
9. A freight-forwarding firm is listed as the product's final destination.
10. The shipping route is abnormal for the product and destination.
11. Packaging is inconsistent with the stated destination or method of shipment.
12. When questioned, the buyer is evasive or unclear about whether the purchased product is for domestic use, export or reexport.

Special rules for encryption technology

A special category of exports includes software that includes encryption technology. Whether such software may be exported at all and under what circumstances depends on the technical details of the product, such as the key length. See generally <http://www.bis.doc.gov/encryption/default.htm>.

Protect yourself through contract language

Exporters can be liable not only if they violate the law, but also if buyers downstream from them violate the law. For this reason, some exporters include a clause in their reseller agreements requiring the resellers to comply with U.S. export laws. A sample clause might be the following:

Reseller warrants that it will not sell, resell, license, transfer, export or reexport any product covered by this agreement in any manner, to any person, to any country, or for any use prohibited by the laws or regulations of the United States, including but not limited to the Arms Export Control Act and the Export Administration Act and their implementing regulations. Reseller hereby indemnifies Seller and shall hold Seller harmless from and against any and all damages; claims; losses; civil penalties; criminal penalties; and other costs, including attorney fees, arising from or in connection with any violation by Reseller of the aforesaid laws and regulations.

Remember, exporting is a privilege, not a right, and thus the government can deny any company its exporting privileges. Knowing which products can be exported to which countries is critical to any United States-based business that hopes to derive revenues from overseas sales. Understanding the laws applicable to exports is an essential part of a company's business plan and risk analysis.

ENDNOTES

¹ 15 C.F.R. Part 774, Supplement 1.

² 15 C.F.R. Part 738, Supplement 1.

³ 15 C.F.R. § 732.3(b)(3).

⁴ 15 C.F.R. Part 732, Supplement 1.

⁵ 15 C.F.R. Part 732, Supplement 3.

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