

End Users, Due Diligence & Necessary Documentation in the Event of an Audit, Best Practices

**Lizbeth C. Rodriguez-Johnson
Holland & Hart, LLP
555 17th Street, Denver CO
303-295-8399
lrodriguez@hollandhart.com**

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REGULATORY SCHEME

- U.S. export controls apply to all international business
 - ◆ National security and foreign policy
- Understanding the regulatory scheme
 - ◆ The consequences of failing to comply with the regulations
- Taking steps to minimize the risk of a violations
 - ◆ Compliance and risk mitigation

WHY SHOULD YOU CARE ABOUT U.S. TRADE CONTROLS?

- **Many countries** have trade control laws that regulate international conduct
- **The United States** trade control laws not only impact U.S. companies; they have extraterritorial application
- **Penalties** can be assessed by the U.S. Government against both U.S. and non-US companies that violate U.S. trade laws (including monetary fines, loss of access to the U.S. commercial and financial markets and other penalties)

UNDERSTANDING THE CONSEQUENCES

- **Criminal prosecution** of executives (up to 20 years in jail).
- **Denial** of U.S. export privileges.
- For foreign companies, violations can result in denial of entry to **U.S. market** or access to U.S. technology.
- **Debarment** from U.S. Government contracts.

UNDERSTANDING THE CONSEQUENCES

- **Monetary Penalties in the Millions**
 - ◆ **Commerce Department/Treasury Department**
 - Up to \$ \$289,238 civil penalty per violation
 - \$1,000,000 for willful violations (criminal) for corporations (or 5 x the value of the export, whichever is greater).
 - In the past, transactions **parsed** then violations stacked
 - ◆ **State Department = Up to \$1,094,010 per violation**

UNDERSTANDING THE CONSEQUENCES

- If things go wrong:
 - ◆ Strict liability for trade sanctions violations
 - ◆ Cost of investigating potential violations in the event of self-disclosure
 - Legal fees, other expenses
 - ◆ “Involuntary Investigation” – by the U.S. Government may result in three times the legal costs



COMPLIANCE PROGRAM BUSINESS CASE

- **Cost Effective Measure**
 - ◆ A compliance program designed to protect against inadvertent violations is an effective defensive tool (if implemented)
 - ◆ Good business in case of acquisition, merger
 - ◆ In the event of a potential violation, demonstrable training and good recordkeeping can divert an investigation
 - ◆ Avoid expensive legal fees

ROADMAP TO THE AGENCIES THAT REGULATE U.S. EXPORTS AND SPECIAL RISKS



U.S. EXPORT CONTROL LAWS IN GENERAL

- With whom we conduct business?
- What we export, i.e., services, know-how, data?
- How we conduct business?
- How we can demonstrate compliance?

U.S. EXPORT CONTROL LAWS IN GENERAL

What's Covered?

- ◆ Physical commodities, products, components
- ◆ Software
- ◆ Technology / technical data
- ◆ Know-How
- ◆ Services, including training, teaching, etc.

THE AGENCIES AND THE REGULATIONS

- U.S. Commerce Department Bureau of Industry and Security (BIS)
- Export Administration Act (Expired)
 - ◆ International Emergency Economic Powers Act (IEEPA)
- Export Administration Regulations (EAR)



THE AGENCIES AND THE REGULATIONS

- U.S. State Department Directorate of Defense Trade Controls
- Arms Export Control Act (AECA)
- International Traffic in Arms Regulations (ITAR)



THE AGENCIES AND THE REGULATIONS

- U.S. Treasury Department Office of Foreign Assets Control (OFAC)
- International Emergency Economic Powers Act (IEEPA)
- Trading with the Enemy Act
- Foreign Assets Control Regulations



THE AGENCIES AND THE REGULATIONS

- Specially Designated Nationals (SDN) and Blocked Persons List
 - ◆ Drug traffickers
 - ◆ Terrorists
 - ◆ Others
- Other lists of sanctioned parties
- Many sanction programs/many different restrictions
 - ◆ Comprehensive vs. Targeted
 - ◆ ITAR Section 126.1 countries

OFAC: SPECIAL COMPLIANCE RISKS

- Non-listed Sanctioned Parties
 - ◆ Parties with an interest (e.g., ownership, control) in a blocked party
 - ◆ Foreign ownership changes
- Facilitation of a prohibited transaction
 - ◆ Financing, legal/compliance support or counseling
- Mandatory financial institution reporting (Suspicious Activity Reports)
- Exceeding the scope of a General License or exemption

UNDERSTANDING THE EXPORT COMPLIANCE PROCESS



UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

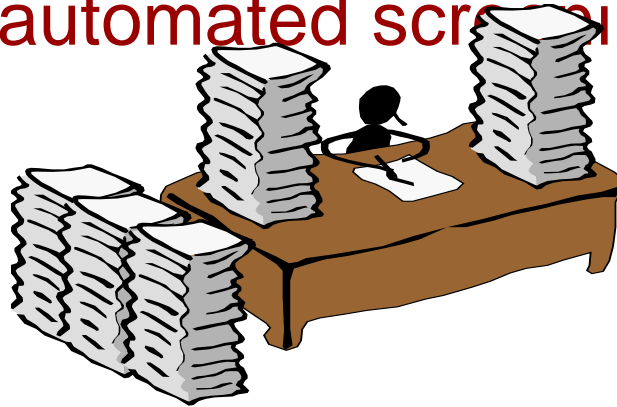
- **Know your business partners:** Before conducting any business, SCREEN
 - **U.S. Lists of Prohibited Parties**
 - ❑ Specially Designated Nationals List
 - ❑ Foreign Sanctions Evaders List (Syria or Iran)
 - ❑ Sectoral Sanctions Identification List
 - ❑ Denied Persons List
 - ❑ Unverified List
 - ❑ Entity List
 - ❑ Debarred Parties List
 - ❑ Non-Proliferation List
 - ❑ Others

UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

- Multinational sanctions should also be considered:
 - Consolidated list of persons, groups and entities subject to EU financial sanctions
 - https://eeas.europa.eu/headquarters/headquarters-homepage_en/8442/Consolidated%20list%20of%20sanctions
 - United Nations Security Council Sanctions Lists
 - <https://www.un.org/sc/suborg/en/sanctions/un-sc-consolidated-list>
- Other countries may have sanctions in place that should be considered.

UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

- End-use/End-user screening
 - License requirements may apply depending on the expected end-use or end-user of the product to be exported
 - Non-proliferation concerns
 - Non-automated screening



UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

- **Understand your business offering: Jurisdictional / Licensing Determination**
 - ◆ **Commerce Department**
 - Commercial goods, dual use, technology
 - License requirement will vary depending
 - ◆ **State Department**
 - Defense articles, technical data and services – Generally license required
- **Jurisdiction and classification need to be addressed prior to export to determine license requirements**

UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

- **Problem Solvers Creating Problems: Technical Services**
 - ◆ **The “Deemed Export” Rule**
 - Technology exported when divulged to non-U.S. person, even if that person is in the U.S. and has no intention of returning to his native country
 - Technology exported when emailed



UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

- To prevent deemed exports, classification of technology (not just products and including technical services) is a must
 - ◆ Licensing requirement determination contingent on classification
 - ◆ License application process
- Employee training is the key to compliance

UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

- Technology exported when divulged to non-U.S. person, even if that person is in the U.S. and has no intention of returning to his native country
- Visa holders
- Form I-129 Certification Requirement aims is to identify potential exports of U.S. origin controlled technology
- Affirmative duty to certify to existing compliance requirement

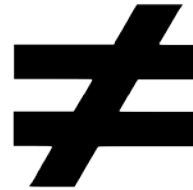
UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

Special Rules: Transshipments and Re-exports

- ◆ U.S. origin technology remains subject to U.S. export control laws regardless of title transfers, re-sales, etc.
- ◆ Re-exports may require licensing (could technology have gone directly to ultimate destination NLR?)
- ◆ Sending technology “through” a country can equal “to” a country

UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

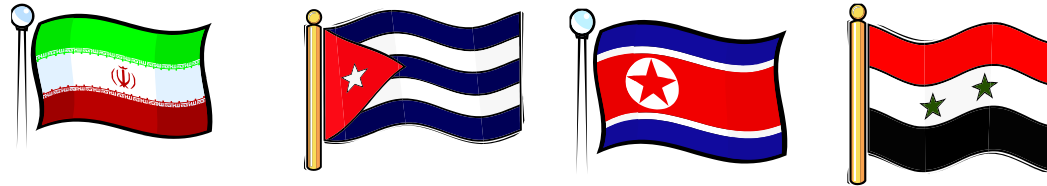
- Sanctioned destinations and parties remain an enforcement priority (High Risk)



- Sanctioned countries may change as foreign policy develops.

UNDERSTANDING THE EXPORT COMPLIANCE PROCESS

- Sanctioned countries



- ◆ Each sanction program is different
- ◆ Sanction programs are modified as foreign policy evolves.



OFAC: COUNTRY SANCTIONS

- Other countries subject to OFAC targeted sanctions include:
 - ◆ Balkans
 - ◆ Belarus
 - ◆ Burundi
 - ◆ Central African Republic Sanctions
 - ◆ Democratic Republic of the Congo
 - ◆ Iraq
 - ◆ Lebanon
 - ◆ Liberia
 - ◆ Libya
 - ◆ Somalia
 - ◆ South Sudan
 - ◆ Yemen
 - ◆ Zimbabwe

TRADE AND EXPORT COMPLIANCE PROGRAMS

Implementing Effective Measures



COMPLIANCE PROGRAMS

- **U.S. Law Recognizes Value of Compliance Programs:** U.S. Sentencing Guideline § 8B2.1 expressly states that proof of an effective compliance program will result in a reduction in penalties
- Focus on developing a compliance plan that meets your organization's needs
- No "One Size Fits" All
 - ◆ ***“There is no single compliance program suitable for every financial institution. OFAC is not itself a bank regulator; its basic requirement is that financial institutions not violate the laws that it administers...”***

COMPLIANCE PROGRAMS

- Defensive data may include:
 - ◆ **Proof of Policy Review:** Signed acknowledgment by each employee who has reviewed anti-corruption policies and procedures
 - ◆ **Proof of Compliance Training:** Compliance training minutes and attendees
 - ◆ **Proof of Testing:** Online compliance training testing data
 - ◆ **Proof of Due Diligence:** Risk-based due diligence records performed on third parties
 - ◆ **Certifications:** Compliance certifications provided by third-party contractors and agents as required by contract
 - ◆ **Assessments:** Internal and external audit reports

COMPLIANCE PROGRAMS

At a minimum, a program should include:

- ◆ Compliance policy and export responsibility
- ◆ Proper classification, licensing and checks
- ◆ Screening of denied parties, end-uses/end-users and red flags
- ◆ Training, audits, and updates
- ◆ Technology control plan
- ◆ Safety valve for reporting violations

COMPLIANCE PROGRAMS

- **Screening – Automated and Centralized**
 - Consolidated List:
https://build.export.gov/main/ecr/eg_main_023148
- **Non-Automated Screening**
 - ◆ End-Use and End-User Restrictions to prevent nuclear, missile and chemical and biological weapons proliferation; should be part of getting to know the customer

COMPLIANCE PROGRAMS

Non-Automated Screening

- ◆ Analysis of “Red Flag” factors prevent diversion
- ◆ Can have checklists, but your education is the most important aspect of compliance



COMPLIANCE PROGRAMS

Dealing with risk areas -Technology Control Plan (TCP):

- ◆ Facility Access Control
- ◆ Hiring
- ◆ Exposed technology in the work area
- ◆ Visits by Foreign Persons
- ◆ Discussions with Foreign Persons anywhere

COMPLIANCE PROGRAMS

Recordkeeping/Reporting

- ◆ If it is not in writing, how can you prove it?
- ◆ Company policy for record retention essential
- ◆ Routine destruction of documents, when allowed by law
- ◆ Strict adherence to reporting requirements (anti-boycott)
- ◆ Voluntary disclosure option reviewed

COMPLIANCE PROGRAMS

Training

- ◆ Initial training sessions by Outside Counsel
- ◆ Web-based training
- ◆ Face to Face training
- ◆ On-going training



How Do You Know a Disclosure is Needed? Conducting Internal Investigations



CONDUCTING INTERNAL INVESTIGATIONS

- **Choice of investigators**
 - ◆ In-House vs. Outside
- **Interview protocol**
 - ◆ Civil Miranda
 - ◆ Proof – Witness, Documented
- **Documenting the Findings**
 - ◆ Interview memoranda
- **Plan investigation with risk of waiver in mind**
- **Mission creep**

RECORD COLLECTION AND DATA PRESERVATION

- **Avoiding Obstruction of Justice**
 - ◆ Issue a “Document Hold”
 - ◆ Do not destroy documents if under investigation
- **Document Review**
 - ◆ Maintain Privilege
- **Review Documents**
 - ◆ Create Log
 - ◆ Leave “No Trace”
- **Privilege Log**

DOCUMENTING THE RESULTS OF AN INTERNAL INVESTIGATIONS

- **Identify and assess potential violations**
 - ◆ Avoid speculation – “the facts speak for themselves”
 - ◆ Consider time frame
 - ◆ Review for regulation changes
 - ◆ Ensure jurisdiction/classification is confirmed
- **Validate/confirm interview facts through support documentation**

NEXT STEPS: DEVELOP AN ACTION PLAN

- **Develop an action plan**
 - ◆ Stop any ongoing violations
 - ◆ Is a disclosure required/advised?
 - ◆ Document action plan in a close-out privileged “Memo to File”
 - ◆ Monitor completion of action plan items



Reporting and Disclosures to Federal Agencies (Treasury, State & Commerce Departments)



Voluntary vs. Directed Disclosures

- To Disclose or Not To Disclose?
 - ◆ Sometimes you have no choice
- Timing issues
- Initial notification
 - ◆ Qualify
- Full disclosure
 - ◆ What, Whom, Where, When, Why and How
- Importance of reviewing all documents prior to submitting to the government
 - ◆ Caution with False Statements
- FOIA protection request

Corrective Action After a Violation is Discovered

- Address “root cause”
- Must be operational to be “implemented”
- Owners/responsible parties must be assigned
- Must be timely
- Monitor effectiveness (ongoing)

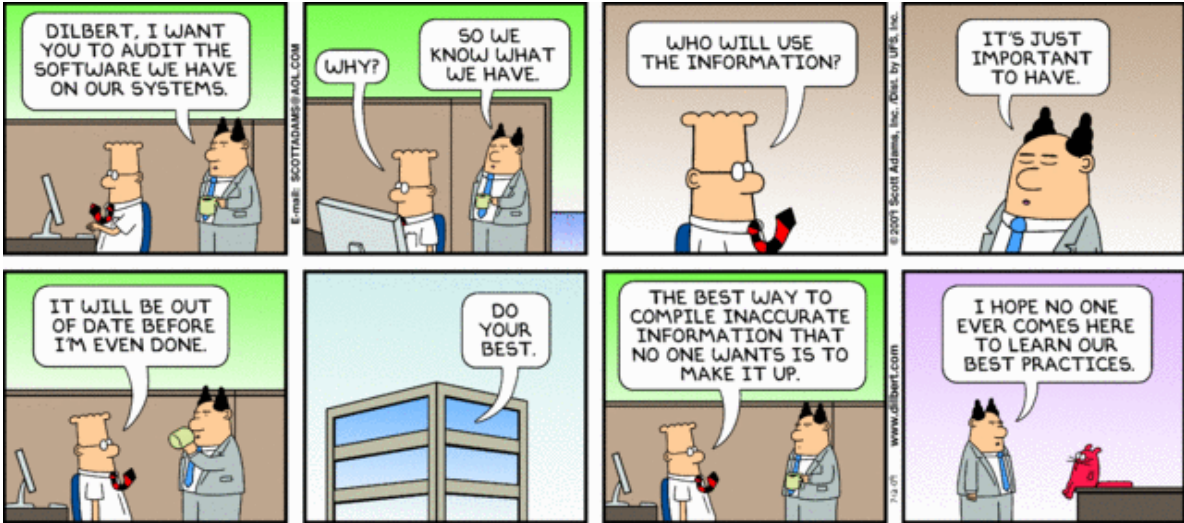


Employee Communications for Remediation and Prevention

- Senior management directive for full compliance
- Characterize as “enhancements to the compliance program”
- Assign responsibilities for execution



Compliance Program Audits



AUDITS

- Critical element of effective compliance program
- U.S. Sentencing Guidelines §8b2.1- Effective Compliance and Ethics Program
 - ◆ *(b)(5) The organization shall take reasonable steps- ... (B) to evaluate periodically the effectiveness of the organization's compliance and ethics program....*
- BIS Core Elements of Export Management and Compliance Program (EMCP)
 - ◆ **Element 7 – Internal and External Compliance Monitoring and Periodic Audits**
- DDTTC Guidance for Registrants
 - ◆ **Recommended designation of an Ombudsman “to provide independent evaluation (reports) on overall implementation of the company’s compliance program.”**

TYPES OF EXPORT AUDITS

■ Self-Initiated Audit

- ◆ Comprehensive vs. Focused Review
- ◆ Internal vs. External
- ◆ On-Going vs. Annual

■ Directed Audits

- ◆ Investigation (Directed disclosure)
- ◆ Settlement (administrative or criminal)
- ◆ No-Action Resolution



Preparing for a Third Party Audit

- **Understand the scope**
 - ◆ Type of testing
 - ◆ Timing
 - ◆ Directed or Self-Initiated
- **Document production**
 - ◆ Review documents before producing
 - ◆ Determine means of production (electronic vs. paper)
- **Prepare for the audit visit (Hint: Before the audit)**
 - ◆ Pre-Audit employee meetings
 - ◆ Availability of relevant personnel
 - ◆ Points of contact

Audit Plans and Report

- **Develop an audit plan and follow it**
- **Directed Audits – The regulators will review and approve the audit plan prior to the audit**
- **Determine if an audit report will be produced**
 - **For a directed audit, audit report is presented to regulators – No privilege**
 - **Voluntary external audit by counsel – Potential privilege**

Follow-Up on Audit Results

➤ Written Reports

- ◆ When are they required?
- ◆ What to include in a written audit report?
- ◆ Risks and benefits

➤ Findings and Recommendations

- ◆ Review them carefully
- ◆ Develop an action plan and stick to it
- ◆ Do not point fingers, find solutions –
Voluntary Disclosures

***Remember: You have to live with the
Audit Report ... Do not ignore it.***

Summary- Tips for Handling Export Violations

- Stop the bleeding
- Plan & conduct an internal investigation
 - ◆ Consider who should investigate
 - ◆ Establish a defined, repeatable protocol
 - ◆ Document, document, document
 - ◆ Attorney-Client privilege
- Preserve all records
- Seek professional assistance
- Disclose with care
- Corrective actions – do what you say and verify effectiveness
- Audit and then ... Audit again

AVAILABLE RESOURCES



AVAILABLE RESOURCES

- Principal websites
 - ◆ www.bis.doc.gov
 - ◆ www.pmddtc.state.gov
 - ◆ www.treasury.gov/ofac
- Utilize these resources.
- Contact information for relevant personnel
- Establish relationships in the industry, join trade organizations
- Subscribe to the Federal Register ListServ, agency newsletters for Updates

QUESTIONS?



COMPLIANCE PROGRAM BUSINESS CASE

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