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A SPECIAL REPORT

## Export controls enforcement intensifies

Anything but strict compliance with regulations may expose a company to severe civil and criminal sanctions.

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Under the Obama administration, the U.S. government has significantly intensified its enforcement of U.S. export regulations, resulting in an extraordinary uptick in both civil and criminal penalties. The most prominent of these regulations are the International Traffic in Arms Regulations, enforced by the U.S. Department of State's Directorate of Defense Trade Controls; the Export Administration Regulations, administered by the U.S. Department of Commerce's Bureau of Industry and Security; and regulations administered by the U.S. Department of Treasury's Office of Foreign Assets Control. As discussed below, anything but strict compliance with these regulations may expose a company to debarment from U.S. government contracts as well as severe civil and criminal sanctions.

Under the Obama administration's watch, the Directorate of Defense Trade Controls has imposed staggering civil penalties for defense trade violations. In August 2010, the directorate announced that Xe Services LLC, formerly known as Blackwater, had agreed to enter into a consent order pursuant to which it would be subject to a civil penalty of \$42 million for various violations of the defense trade regulations, including unauthorized exports

of U.S.-controlled commodities and technical data; provision of defense services without a license; and employment of unauthorized foreign nationals. In May 2011, the directorate imposed a record-setting \$79 million civil penalty on U.K.-based BAE Systems PLC, the largest military contractor in Europe, to settle 2,591 brokering and report-related violations of the defense trade regulations.

Penalties imposed by the Bureau of Industry and Security for violations of the dual-use Export Administration Regulations also have reached record highs under the Obama administration. In fiscal year 2010, the bureau closed 53 administrative cases resulting in more than \$25.4 million in administrative penalties, as compared with \$3.6 million and \$14.5 million collected, respectively, in fiscal year 2008 and FY 2009. In 2010, Balli Group PLC and its subsidiary, Balli Aviation Ltd., agreed to pay one of the largest fines in the bureau's history, amounting to \$15 mil-

lion, to the bureau and the Office of Foreign Assets Control to settle civil allegations of conspiring to sell aircraft to a proscribed country.

Penalties assessed by the Office of Foreign Assets Control also have increased dramatically. In 2010, Barclays Bank PLC agreed to forfeit \$298 million to resolve its liability for willfully violating the office's regulations by handling unauthorized transactions involving entities from various countries subject to U.S. sanctions, including Cuba, Iran and Sudan. Significantly, Barclays submitted a voluntary

**AIR FORCE DRONE:** J. Reece Roth was convicted of violating defense trade regulations by letting a foreign grad student see technical data relating to drones.



U.S. AIR FORCE

self-disclosure to the office. In cases in which the target did not disclose violations voluntarily, the penalties have been even greater; in 2009, Credit Suisse A.G. agreed to forfeit \$536 million to resolve charges that it handled unauthorized transactions involving entities from countries subject to U.S. sanctions, including Iran, Sudan, Burma and Cuba.

The U.S. Department of Justice (DOJ) has likewise become increasingly aggressive in pursuing criminal charges for violations of export controls. Since the launching of a National Export Enforcement Initiative in 2007, hundreds of defendants have been charged with criminal violations of the defense trade regulations and the dual-use Export Administration Regulations. Convictions on such charges have resulted in staggering penalties. Earlier this year, the owner of Massachusetts-based Chitron Electronics Inc. was sentenced to 97 months in prison, and criminal penalties amounting to \$15.5 million were imposed on Chitron, for conspiring to export computer chips and other items to its Chinese affiliate in violation of both the defense trade and dual-use regulations. Significantly, courts have demonstrated that they will give considerable deference to determinations by agencies and DOJ as to what constitutes willful violations of export regulations. That was evidenced by the decision of the U.S. Court of Appeals for the 6th Circuit in January to affirm the conviction of Professor J. Reece Roth, a professor emeritus at the University of Tennessee, for violations of the defense trade regulations, including allowing unauthorized access by a foreign graduate student to technical data relating to an Air Force drone project—notwithstanding the fact that Roth was not aware that the technical data at issue were controlled under the defense trade regulations. *U.S. v. Roth*, 628 F.3d 827 (6th Cir. 2011).

Given the U.S. government's increasingly stringent enforcement posture, companies must understand what their compliance responsibilities are under the different U.S. export-controls regulations. A brief summary of these regulations is provided below.

#### OVERVIEW OF REGULATIONS

The defense trade regulations govern exports and re-exports of defense articles and defense services specified on the U.S. Munitions List. 22 C.F.R. 121.1. Defense articles encompass both commodities and technical data used for military purposes. Technical data include information that is required for the design, development or modification of items subject to the export defense regulations and, for example, can take the form of blueprints, plans, diagrams, photographs and instructions. Defense services refer to the furnishing of assistance to foreign persons relating to items controlled under the regulations. Significantly, the regulations restrict the oral and visual disclosure of controlled technical data to foreign nationals, whether here or abroad. In the absence of an

exemption specified under the regulations, companies must obtain the appropriate authorization from the directorate in order to export defense trade-controlled hardware or technical data.

Penalties for violations of the defense trade regulations can be severe. Civil violations carry a fine of up to \$500,000 for each violation, while criminal penalties can be assessed up to \$1 million and/or up to 10 years of imprisonment for each violation. See 22 U.S.C. 2780(j)-(k). Additionally, a company can be debarred from participating directly or indirectly in the export of defense articles or services. See 22 C.F.R. 127.7.

The Export Administration Regulations apply to exports and re-exports of certain commercial and dual-use U.S.-origin commodities



and technology. The licensing requirements under these regulations are both stringent and nuanced. In order to determine whether an export license may be required, it is necessary to review the Commerce Control List, 15 C.F.R. Part 774, to determine whether a commodity or technology is classified, and to refer to the Commerce Country Chart, 15 C.F.R. Part 738, Supp. 1. Even in cases in which a commodity or technology is not specifically identified on the Commercial Control List, it may be necessary to obtain a license if the end-user is located in one of the countries subject to comprehensive U.S. sanctions (e.g., Cuba, Iran, North Korea, Sudan or Syria); is a national of such a country; is identified on any proscribed entity lists maintained by the U.S. government; or intends to use the commodity or technology for a prohibited end use (e.g., nuclear, chemical or biological proliferation).

Failure to adhere to these multifaceted requirements can carry substantial sanctions, including administrative debarment (prohibiting direct or indirect participation in the exportation of regulated items); civil penalties of up to the greater of \$250,000 or twice the value of the transaction; and/or criminal penalties of up to \$1 million per violation, imprisonment for up to 20 years, or both. See 15 C.F.R. Part 764.

The Office of Foreign Assets Control administers regulations relating to countries (or regions) that are subject to comprehensive U.S. embargoes (e.g., Cuba, Iran, North Korea and Sudan) and limited sanctions (e.g., the Balkans, Belarus, Myanmar, Côte d'Ivoire, Iraq, Liberia,

North Korea and Zimbabwe), as well as ones relating to list-based sanctions programs (e.g., the Global Terrorism Sanctions Regulations and the Weapons of Mass Destruction Trade Control Regulations). 31 C.F.R. Part 500 et seq. Each of the countries and sanctions programs is governed by its own set of regulations that differ in terms of scope and substance. The office also maintains a List of Specially Designated Nationals; entities identified on this list are considered to be closely associated with sanctioned countries, terrorists or weapons or narcotics traffickers, and U.S. persons are generally prohibited from having any dealings with those entities.

Penalties for violations can be harsh and include civil penalties of up to the greater of \$250,000 or twice the value of the transaction; and/or criminal penalties of up to \$1 million for each violation, imprisonment for up to 20 years, or both. In addition, under various other regulations administered by the office, civil penalties may be up to \$1 million per violation, and criminal penalties per violation may range up to \$10 million against companies and \$5 million against individuals.

As the global marketplace continues to expand, there is no indication that the trend of intensified enforcement and unprecedented forfeitures will wane; earnest compliance and an engaged management are necessary defense tools for any entity subject to these regulations. Key elements of an effective companywide export-compliance program include a corporate environment of compliance directed by senior management; an organizational structure in which the company's trade function and control structure for tracking compliance are well defined; comprehensive training programs on key regulations; an export controls classification database to determine which items are regulated and subject to which U.S. government agency's jurisdiction; a screening process to ensure the company is not engaging in transactions with prohibited individuals and countries; a record-keeping system requiring export-control documents to be maintained for at least five years; and a system for implementing corrective measures when a violation is discovered, including a program for filing voluntary self-disclosures when warranted.

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