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The times (and folk) they are a-changin'

Less the end of an administration than the end of an era. Donald Trump's nascent presidency signals significant departures in almost all areas of United States policy, including tax, the environment and climate change, trade, foreign affairs, treatment of refugees and migrants – as the new man in the White House vows to 'make America Great Again'.

Significant departures, also, from a number of the agencies responsible for administering export controls and sanctions, have either happened or are on their way.

On 19 January, OFAC announced: 'To ensure the smooth continuity of leadership at the Department of the Treasury, Acting Under Secretary Adam Szubin will serve as Acting Secretary of the Treasury, effective January 20, 2017. He will serve in that capacity until a new Secretary is confirmed and in place. At that point, Mr. Szubin will leave government service to pursue other endeavors.'

Meanwhile, at the Bureau of Industry and Security, Kevin Wolf (Assistant Secretary of Commerce for Export Administration for seven years at the Department of Commerce) is joining law firm Akin Gump, taking with him his senior advisor Steve Emme. Given that Wolf is as close to being a household name in the world of export controls as there is, the hire will be seen as a coup for the firm.

The inauguration of President Trump heralds a new era in U.S. trade.

Andrew Keller, formerly Deputy Assistant Secretary for Economic and Business Affairs at the State Department, left his post the day before Donald Trump's inauguration. As at time of writing, however, *WorldECR* understands that other senior officials, including Brian Nilsson (Deputy Asst. Secretary of State for Defense Trade Controls at the State Department), Ambassador Daniel Fried, State Department Coordinator for Sanctions Policy), John Smith (Acting Director of OFAC), and Dan Glaser, Treasury Asst. Secretary for Terrorist Financing, will be remaining in their current posts – at least for the time being.

End of term flurry

As at writing time, OFAC has yet to post a single notification since 17 January, leaving the world of sanctions and compliance professionals on tenter-hooks as to what the Office's first Trump-era action will look like.

The last week of President Obama's administration, conversely (and chronologically in reverse), saw a flurry of activity:

17 January: OFAC designated Milorad Dodik, President of Republika Srpska, one of the two entities that makes up Bosnia and Herzegovina. OFAC said Dodik was sanctioned for 'his role in defying the Constitutional Court of Bosnia and Herzegovina in violation of the rule of law, thereby actively obstructing the Dayton Accords; Dodik was also designated for conduct that poses a significant risk of actively obstructing the same.'

Dodik's 'defiance' lies in his recent attempts to garner support for a public holiday to celebrate 'Republika Srprka Day' – banned by the Constitutional Court of Bosnia and Herzegovina for being discriminatory against the country's non-Serbian Orthodox population. Observers say that the action – a reminder that tensions remain in the once war-torn Balkans – is unlikely to be echoed by the government in Belgrade.[1]

13 January: On this day, OFAC announced that the Toronto-Dominion Bank ('TD Bank') had 'agreed to remit $516,105 to settle its potential civil liability for 167 apparent violations of the Cuban Assets Control Regulations ('CACR') and the Iranian Transactions And Sanctions Regulations ('ITSR')[2] and that, separately, it had issued a finding of violation to TD Bank, the parent company of wholly owned subsidiaries Internaxx Bank SA and TD Waterhouse Investment Services (Europe) Limited, for 3,491 violations of the CACR and ITSR. (See Timothy O'Toole's analysis in this issue's Bulletins.)

On the same day, it also announced its amendment to the Sudanese Sanctions Regulations ('SSR') 31 C.F.R. part 538 to authorise all transactions prohibited by the SSR and by executive orders 13067 and 13412 – a move which in large part now opens Sudan to business for U.S. companies.[3]

12 January: OFAC published guidance[4] 'on the

Links and notes

1 https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20170117.aspx

Footage of Dodik singing is available here: https://www.youtube.com/watch?v=71Y-a7MKN-8

2 https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20170113_td_bank.pdf)

3 https://www.treasury.gov/resource-center/sanctios/Programs/Documents/SSR_amendment.pdf

4 https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20170112_33.aspx

5 https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20170112.aspx

6 https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20170111.aspx

7 https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20170109.aspx

8 https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20170110.aspx

9 https://www.whitehouse.gov/the-press-office/2017/01/23/presidential-memorandum-regarding-hiring-freeze

provision of certain services relating to the requirements of U.S. sanctions laws'. The guidance addresses some questions that had been troubling, amongst others, lawyers advising on sanctions-related law – but leaves others unanswered (See this issue's Bulletins for analysis by Jacobson Burton Kelley.)

Also on 12 January, OFAC made a number of designations[5] under the Syria sanctions – including of individuals linked to the country's military intelligence, and entities including Syria's air force, navy, defence forces and the Syrian Arab Republican Guard.

It also deleted Zimbabwe's 'Zimre Holdings' from the SDN list. Zimre is, according to its website, '[an] investment and coordinative company, holding a number of synergistically linked subsidiary companies operating in Zimbabwe and within Africa with insurance as the Group's core business.'

11 January: OFAC added North Korean individuals and two entities, the Ministry of Labor and State Planning Commission, to its SDN list[6].

9 January: OFAC designated[7] – under the Magnitsky Act – Andrey Lugovoi, wanted by British police in connection with the death in 2006 from poisoning by the radioactive substance polonium of Alexander Litvinenko, a former KGB and later FSB officer.

Four others, Alexander Bastrykin, Dmitri Kovtun, Stanislav Gordievsky and Gennady Plaksin, are also now included on OFAC's Specially Designated Nationals ('SDN') list as a result of the action.

OFAC also designated four individuals whom it describes as 'Australian and SE Asian ISIL operatives and leaders' – and, pursuant to a separate executive order, an Indonesia-based terror group, Jamaah Ansharut Daulah ('JAD'), and British citizen, Alexanda Amon Kotey. [8]

OFAC said that JAD, formed in 2015, 'is composed of almost two dozen Indonesian extremist groups that pledged allegiance to ISIL leader Abu Bakr al-Baghdadi,' and that Kotey 'is one of four members of the ISIL execution cell known as "The Beatles" [which was] responsible for detaining and beheading many Western nationals, including Americans Peter Kassig, James Foley, and Steven Sotloff.'

And now?

Clearly, export controls and sanctions issues per se have been eclipsed by broader trade issues – especially President Trump's demolition of the Trans-Pacific Partnership, and it may take some time before his policies are clearly reflected in the trade control area. But one question that it is at least pertinent to ask is: 'What happens to Export Control Reform'?

Right up until recently, if there was any consensus as to what the answer to that question might be, it was, inevitably, another question: 'Who knows?'

That said, reporting by *Defense News* suggests that one important trade association, the Aerospace Industries Association, will be urging the administration to proceed with the changes because, says the association's Remy Nathan, 'continued action on it is going to offer significant job creation in the US. The US aerospace and defense industry consistently generates the largest manufacturing trade surplus, and we're capable of doing more provided that the technology controls are appropriate.'

That chimes with an observation made by lawyers at DC firm Jacobson Burton Kelley that, '[T]he export control reform process has made enough progress, and has enough momentum and support both in industry and in the government, that it is unlikely to be rolled back or to greatly change course at least in the next couple years.'

On the other hand, they point out, progress may be 'significantly slowed' by Trump's order of a regulatory 'freeze on the hiring of Federal civilian employees[9] to be applied across the board in the executive branch.'

'This will have an immediate impact as we understand that the export control agencies had planned to issue a number of amendments to the regulations in the coming weeks and months to advance export control reform,' say lawyers at the firm.

In sum, while the past may be a foreign country, the present is starting to look pretty unfamiliar too. And in the realm of export controls and sanctions, the phrase book may be in the process of being rewritten.

BIS was likewise busy in the run-up to President Trump's inauguration...

On 19 January, BIS published 'Amendments to the Export Administration Regulations Implementing an Additional Phase of India-U.S. Export Control Cooperation' – a final rule which amends the Export Administration Regulations ('EAR') to implement the India-U.S. Joint Statement of 7 June 2016, which recognised the United States and India as major defence partners 'by establishing a licensing policy of general approval for exports or reexports to or transfers within India of items subject to the EAR and controlled only for National Security or Regional Stability reasons.'

It also published (on the same day) a new rule requiring 'persons intending to export or reexport to Hong Kong any item subject to the Export Administration Regulations (EAR) and controlled on the Commerce Control List (CCL) for national security (NS), missile technology (MT), nuclear nonproliferation (NP column 1), or chemical and biological weapons (CB) reasons to obtain, prior to such export or reexport, a copy of a Hong Kong import license or a written statement from the Hong Kong government that such a license is not required.' (For more, see the Bulletin provided by Akin Gump in this issue).

Other recent rules published by BIS include:

- A final rule reflecting changes to licensing policy toward Sudan: https://www.bis.doc.gov/index.php/regulations/federal-register-notices#fr4781
- A final rule relating to an increase in controls on the export of infrared detection Items: https://www.bis.doc.gov/index.php/documents/regulations-docs/federal-register-notices/federal-register-2017/1633-82-fr-4287/file
- A final rule (in tandem with a corresponding rule published by the Directorate of Defense Trade Controls) relating to the Control of Spacecraft Systems and Related Items the President Determines No Longer Warrant Control under the United States Munitions List ('USML'): https://www.bis.doc.gov/index.php/regulations/federal-register-notices#fr4781

Obama to Trump: Don't muddle Russia disarmament with sanctions

In his final press conference as President of the United States of America on 18 January, Barack Obama said that his successor should not confuse the current sanctions programme against Russia with issues around nuclear disarmament. Donald Trump has intimated that he would consider lifting sanctions against Russia if the country were to reduce its nuclear stockpile.

The outgoing President said: 'The reason we imposed the sanctions, recall, was not because of nuclear weapons issues. It was because the independence and sovereignty of a country, Ukraine, had been encroached upon, by force, by Russia…What I've said to the Russians is, as soon as you stop doing that the sanctions will be removed. And I think it would probably best serve not only American interest but also the interest of preserving international norms if we made sure that we don't confuse why these sanctions have been imposed with a whole set of other issues.

It is in the 'interest of preserving international norms' not to confuse sanctions against Russia with other matters, said Obama.

'On nuclear issues, in my first term we negotiated the START II treaty. And that has substantially reduced our nuclear stockpiles, both Russia and the United States. I was prepared to go further. I told President Putin I was prepared to go further. They have been unwilling to negotiate. If President-elect Trump is able to restart those talks in a serious way, I think there remains a lot of room for our two countries to reduce our stockpiles. And part of the reason we've been successful on our nonproliferation agenda and on our nuclear security agenda is because we were leading by example.'

Laura Rockwood, executive director of the Vienna Center for Disarmament and Non-Proliferation told *WorldECR* that while the Center has not taken a formal position on Trump's announcement, she was 'personally sceptical that such a proposal would be workable or acceptable.'

She said: 'Russia does not seem to be interested in discussions about arms control or disarmament at the moment. Moreover, the issue of sanctions is more complicated than nuclear weapons, relating as they do to Ukraine. If President Trump believes that he can "jump-start" relations with Russia, he could start with renewing disarmament discussions – a development that would actually be seen as positive in the international community.'

UK: Tougher penalties for breach of financial sanctions

On 18 January, the Policing and Crime Bill was passed by the UK Parliament. It is currently awaiting royal assent to come into force. Part 8 of the Bill introduces tougher enforcement measures for breaches of financial sanctions, and also allows for the easier implementation of EU and UN sanctions.

The key provisions are:

- **Higher maximum penalties for breaches of financial sanctions** The current maximum penalty for breaches of financial sanctions is two years. The Bill provides for an increased maximum penalty of seven years' imprisonment.
- **New civil monetary penalties** Under the new framework, HM Treasury's Office of Financial Sanctions Implementation ('OFSI') will have the power to impose civil monetary penalties of up to £1m or 50% of the total value of the breach, whichever is greater, where 'action short of prosecution' is appropriate.
- **Deferred prosecution agreements** Where a business is charged with a criminal offence for breach of sanctions, prosecution may be suspended subject to conditions imposed by the court, such as the introduction of a compliance regime or a financial penalty. If the agreement is breached, then proceedings may be resumed.
- **Serious Crime Prevention Orders ('SCPOs')** The courts will have the power to impose restrictions to prevent or deter a serious crime. Breach of a SCPO is a criminal offence, and punishable by up to five years in prison and an unlimited fine.
- **Temporary UK sanctions legislation** The UK government can adopt temporary legislation to cover any hiatus between the adoption of new sanctions by the UN and their implementation by the EU.

Daniel Martin, a partner at the London office of law firm Holman Fenwick Willan, told *WorldECR*: 'The powers granted to the UK's Office of Financial Sanctions Implementation (OFSI) pursuant to the Policing and Crime Bill are significant for three main reasons. Firstly, the burden of proof is lowered, as these are civil measures, rather than criminal measures, meaning that OFSI only needs to prove a breach on a balance of probabilities, rather than beyond reasonable doubt. The second is that the financial penalties are capped (£1million or 50% of the relevant funds and economic resources), as opposed to being potentially unlimited. The third is that the fines are administrative, rather than judicial, with OFSI, rather than a judge, determining whether a fine should be imposed, and the level of fine (albeit with scope for review).

'The changes do not change the legal restrictions, and businesses should maintain their existing due diligence and other procedures to ensure they do not breach sanctions. In its consultation on the monetary penalties, OFSI has confirmed that it "construes prohibitions widely, as do Member States".

'Businesses should however be aware of these changes to the enforcement framework, particularly because of the likelihood that we will see increased enforcement and financial penalties as a result.'

The text of the Bill can be found here:
http://services.parliament.uk/bills/2015-16/policingandcrime.html

Canadian parliamentary committee reviews its sanctions policy

In November 2016, the Standing Committee on Foreign Affairs and International Development of the Parliament of Canada conducted a review of Canada's sanctions policy. The remit of the review included the Special Economic Measures Act 1992 ('SEMA') and the Freezing Assets of Corrupt Foreign Officials Act 2011 ('FACFOA'). In particular, the Committee considered whether SEMA needs to be updated to take into account gross violations of internationally recognised human rights. This was the first parliamentary review of SEMA since it was enacted.

'We have not had a lot of change in our sanctions legislation in a long time,' says Cyndee Todgham Cherniak, from Toronto firm Lexsage. 'The world has become more complex since the most recent changes to the Special Economic Measures Act. We are dealing with issues, such as transfers and re-export to foreign jurisdictions, which require more guidance and clarification in the law. So I see one of the purposes of the review is to see where the legislation can be improved.'

SEMA allows Canada to impose sanctions against a foreign state in cases where the United Nations Security Council has not issued a resolution. This may occur when an international organisation to which Canada is part calls on its members to take economic measures against a foreign state, or when a serious breach of international peace and security has arisen.

FACFOA enables the freezing of the assets of a state's government officials – or former officials – where that country is experiencing turmoil or political upheaval. Other pieces of sanctions legislation – the United Nations Act 1985 and the Export and Import Permits Act 1985 – were not included in the review.

The Standing Committee on Foreign Affairs and International Development has conducted a review of Canada's sanctions policy.

Witness statements

The Committee heard testimony from a number of witnesses, and incorporated into the review previously heard testimony from witnesses including William Browder (founder of Hermitage Capital investment fund and critic of Vladimir Putin), Russian democracy advocate Vladimir Kara-Murza, and Zhanna Nemtsova, journalist and daughter of assassinated Russian politician Boris Nemtsov.

'I think that the review was initiated by a push to get Canada to implement sanctions that are based on human rights violations, as opposed to our current regime, which is largely based on either UN Security Council sanctions or under our SEMA,' comments John Boscariol, leader of the international trade and investment law group at law firm McCarthy Tétrault, who gave testimony before the Committee. 'Some believe that human rights violations do not sit neatly within SEMA, and, as you can see from some of the discussion before the Committee, there is some concern that we need to broaden those measures to allow human rights violators to be targeted, as under European and U.S. sanctions.'

Unlike the U.S., which adopted the Magnitsky Act in 2012, Canada has not yet imposed 'Magnitsky' sanctions. The U.S Act targets Russian officials, and is named after lawyer Sergei Magnitsky, who died after alleged beatings in a Russian prison in 2009. In Canada, a bill entitled Justice for Victims of Corrupt Foreign Officials ('Sergei Magnitsky Law') had its second reading in October 2016.

Practical matters

The Committee also heard testimony on the operation of sanctions in practice. 'There are a number of witnesses and other interested parties here in Canada that wanted to take the opportunity to ensure that a very significant problem in the administration and enforcement of sanctions is addressed,' says Boscariol. 'We have very talented and skilled bureaucrats that do work on the sanctions measures, but the problem is that the government has not devoted the resources to a true administrative structure that is responsive to Canadian companies. In Canada we don't have the same guidance that you see in the U.S., EU or Australia, so it is challenging, especially for SMEs.'

Boscariol cites the example of blacklisted individuals: 'The U.S. and other jurisdictions have consolidated lists; you only need to go to one place to reach those lists when you are doing business abroad. There is no website you can go to in Canada to search against all the blacklisted entities, and that is something really basic.'

The Committee reviewed a report based on the testimony of the witnesses at the end of January. 'There are a whole series of issues that have been raised, and are being raised, so we don't know if the work of the Committee is done yet,' says Todgham Cherniak. 'We have a new minister for Foreign Affairs, and the Committee is under the foreign affairs umbrella, so it may be that we have more work to do.'

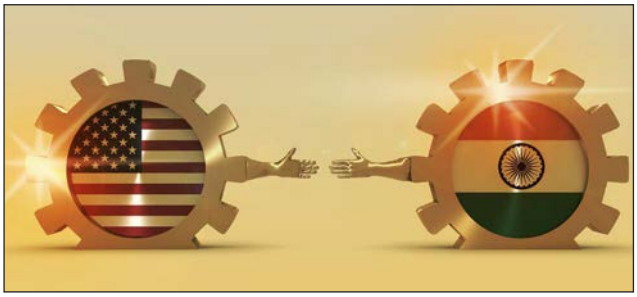
Former journalist Chrystia Freeland was appointed to the role in January 2017, replacing Stéphane Dion.

BIS amends EAR to ease export restrictions to India

The U.S. Bureau of Industry and Security ('BIS') has amended the Export Administration Regulations ('EAR') to facilitate further co-operation over export control between the U.S. and India.

The final rule establishes a licensing policy of general approval for exports or re-exports to (or transfers within) India, and means that licence applications to export to India items subject to the EAR for national security or regional stability reasons, including '600 series' military items and satellites, will be presumptively approved.

The rule has established a new paragraph (b) (8) in section 742.2 (National Security) and a new paragraph (b) (5) in section 742.6 (Regional Stability) in the EAR.



The changes follow the Obama administration's designation of India as a major defence partner to the United States.

BIS has also expanded its Validated End User ('VEU') programme to include the production of military items in India. The scheme allows U.S. exporters to ship designated items to pre-approved entities under a general authorisation, rather than under multiple export licences. Items under VEU authorisation in India may be used for either civil or military end uses, other than in nuclear, 'missile' or chemical or biological weapons activities.

The changes follow the Obama administration's designation of India as a major defence partner to the U.S. in a joint statement issued by the two countries on 7 June 2016, entitled 'The United States and India: Enduring Global Partners in the 21st Century.' It is the first major change to the India VEU programme since 2009.

The BIS rule can be found here:
https://www.gpo.gov/fdsys/pkg/FR-2017-01-19/pdf/2017-00439.pdf

Canada: no overturn of Saudi LAV sale decision, but professor did have standing

In a decision that calls time on a long-running saga between a professor of law and Canada's foreign ministry (and which will be welcomed by exporters of defence products) the country's Federal Court has dismissed an application for judicial review of a decision by the Minister of Foreign Affairs ('the Minister') approving the issuance of permits for the export of light armoured vehicles to Saudi Arabia.

Daniel Turp, professor of international law at the Université de Montréal, brought the application in April 2016, when it transpired that the then foreign minister, Stéphane Dion, had signed off on a deal to export light armoured vehicles ('LAVs'), manufactured by General Dynamics Lands Systems Canada, to Saudi Arabia.

The application argued that the issue of export permits for the vehicles constituted a breach not only of Canada's own Export and Import Permits Act, RSC 1985, but also the Geneva Convention, given Saudi Arabia's track record of violating human rights, and the likelihood that the LAVs might be used against its own civilian population.

The General Dynamics Lands Systems Canada's LAV 6.0. The applicant argued that exports of LAVs breached the Export and Import Permits Act.

Ministerial discretion

In its decision, the Federal Court concluded that the provisions of the EIPA confer 'a broad discretionary power on the Minister over the assessment of the relevant factors relating to the granting of export permits for goods on the Export Control List.' The court said that the Minister had considered 'the economic impact of the proposed export, Canada's national and international security interests, Saudi Arabia's human rights record and the conflict in Yemen before granting the export permits, thereby respecting the values underlying the Conventions,' but that, 'The role of the Court is not to pass moral judgment on the Minister's decision to issue the export permits but only to make sure of the legality of such a decision. His broad discretion would have allowed him to deny the permits, but the Court was of the opinion that the Minister considered the relevant factors. In such a case, it is not open to the Court to set aside the decision.'

Nonetheless, the decision will not be entirely without comfort for campaigners against the arms trade. Cyndee Todgham Cherniak of law firm LexSage points out that the court did grant Professor Turp public interest standing, restating the public the test for granting it, viz,

'1. whether there is a serious justiciable issue raised;
2. whether the plaintiff has a real stake or a genuine interest in it; and
3. whether, in all the circumstances, the proposed suit is a reasonable and effective way to bring the issue before the courts.'

According to Todgham Cherniak, 'In so finding, the presiding judge said: "I am of the view that the question of the issuance of export permits for controlled goods is sufficiently important from the public's perspective to meet the first criterion. As for the second criterion, the applicant is a professor of constitutional and international law for whom the principles of the rule of law, respect for fundamental rights and international humanitarian law are of particular concern. Among other things, through several interventions before the courts, he has shown himself to be an engaged citizen with a genuine interest in issues involving fundamental rights around the world. I also find that this judicial review is a reasonable and effective way to bring the issue before the Court. Aside from the administrative avenues that have already been exhausted, there exists no other way to bring such a challenge before the Court. No other party has a higher interest than the applicant when it comes to challenging the approval of export permits by the Minister, with the possible exception of a Canadian living in Saudi Arabia or Yemen."'

Important decision

The decision is, says Todgham Cherniak, an important one: 'The issues discussed in this case are being discussed in Canada and other developed countries. The discussion about controlling exports is important. Discussion about the role Canadian companies play in the world is important. These discussions have historically been carried on by a limited number of people. Now, the discussions are taking place in a larger community. Canadian businesses must be aware that things are changing and be more vigilant in their export controls compliance. It is possible that their transactions may be put under a microscope of public opinion and judicial review.'

For further information, see:

https://theintercept.com/wp-uploads/sites/1/2016/03/Turp-Lawsuit-1.pdf

http://cas-cdc-www02.cas-satj.gc.ca/rss/t-462-16%20Bulletin%20jan-2017%20(Eng).pdf

And, for deeper analysis by Cyndee Todgham Cherniak:

http://www.canada-usblog.com/

Italian bank fined $235m for sanctions and anti-money laundering violations

On 15 December, the New York State Department of Financial Services ('DFS') fined Italy's largest retail bank, Intesa Sanpaolo SpA, $235 million for alleged violations of sanctions and anti-money laundering ('AML') provisions going back to 2002.

According to the regulator, the violations included systemic 'compliance failures over several years stemming from deficiencies in the implementation and oversight of its transaction monitoring system,' mismanagement of its transaction monitoring system, and failure to identify suspicious transactions.

According to the New York State Department of Financial Services, the violations included systemic 'compliance failures over several years'.

An investigation led by DFS also revealed that the bank had acted in a deliberately non-transparent manner in its transactions, and repeatedly represented Iranian clients and other entities possibly subject to U.S. economic sanctions, therefore subverting controls designed to detect illegal activities.

In addition, the investigation found that the bank intended to conceal information from bank examiners, and had trained certain employees specifically to obfuscate money-processing activities involving Iran so as to avoid them being flagged as tied to a sanctioned entity.

The transactions conducted on behalf of Iranian individuals and other entities possibly subject to U.S. economic sanctions over the years amounted to more than $11 billion.

The regulator also said that the action highlighted 'the importance of DFS's new risk-based anti-terrorism and anti-money laundering regulation that requires regulated institutions to maintain programmes to monitor and filter transactions for potential [...] violations and prevent transactions with sanctioned entities.'

As part of the settlement, the bank must submit to DFS:

- A revised compliance programme;
- A programme to ensure the identification and timely reporting of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities;
- An enhanced customer due diligence programme;
- A revised internal audit programme; and
- A plan to enhance oversight by bank management of the New York branch's compliance with BSA/AML requirements, state laws and regulations, and OFAC regulations.

Further information is at:

http://www.dfs.ny.gov/about/press/pr1612151.htm

Iran Air and Airbus go to 'next decisive phase'

Iran Air took delivery on 11 January of its first A321 Airbus aircraft – under a contract signed in December following an agreement reached in January of 2016.

The agreement, impossible prior to the signing of the Joint Comprehensive Plan of Action ('JCPOA') in November 2015, covers 46 A320, 38 A330, and 16 A350 XWB aircraft.

In a joint press statement released in December by Iran Air and Airbus, Iran Air chairman Farhad Parvaresh said: 'I am delighted that we have reached an agreement to go to the next decisive phase and start taking delivery of new aircraft. I am gratified that this new round of cooperation with Airbus has come to fruition and brought us closer with more practical steps to follow for Iran Air's fleet renewal. Iran Air considers this agreement an important step towards a stronger international presence in civil aviation. We hope this success signals to the world that the commercial goals of Iran and its counterparts are better achieved with international cooperation and collaboration.'

Airbus president and CEO Fabrice Brégier described the agreement as 'paving the way for Iran Air's fleet renewal' and 'a significant first step in the overall modernisation of Iran's commercial aviation sector'.

The statement noted: 'The agreement is subject to U.S. government Office of Foreign Assets Control (OFAC) export licences which were granted in September and November 2016. These licences are required for products containing 10 per cent or more U.S. technology content. Airbus coordinated closely with regulators in the EU, U.S. and elsewhere to ensure understanding and full compliance with the JCPOA. Airbus will continue to act in full compliance with the conditions of the OFAC licences.'

OFAC sanctions Syrian officials for use of chemical weapons on civilians

The U.S. Treasury's Office of Foreign Assets Control ('OFAC') has responded to findings by JIM – the OPCW (Organisation for the Prohibition of Chemical Weapons)-UN Joint Investigative Mechanism – that the Syrian regime used chemical weapons on civilians. JIM was established in August 2015 by the United Nations Security Council to identify those behind chemical weapons attacks in Syria. In reports released in August and October 2016, JIM found that Syrian government forces used helicopters to drop barrel bombs containing chlorine gas in three separate gas attacks in 2014 and 2015.

OFAC has designated 18 senior regime officials and identified five Syrian military branches as part of the Syrian government. This is the first time Syrian military officials have been sanctioned for involvement in the regime's use of chemical weapons.

'The Syrian regime's use of chemical weapons against its own people is a heinous act that violates the longstanding global norm against the production and use of chemical weapons,' said Adam J. Szubin, Acting Under Secretary for Terrorism and Financial Intelligence. '[This] action is a critical part of the international community's effort to hold the Syrian regime accountable for violating the Chemical Weapons Convention ('CWC') and UN Security Council Resolution 2118.'

According to Reuters, JIM's report prompted Britain and France to prepare a draft resolution for the United Nations Security Council, proposing a ban on the sale or supply of helicopters to the Syrian government, and the blacklisting of 11 Syrian military commanders and officials over the use of chemical weapons. The resolution has yet to come before the Council.

The full list of individuals and entities listed by OFAC is here:
https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20170112.aspx

EU amendment to anti-torture regulation

On 16 December 2016, Regulation (European Union) 2016/2134 came into force. The Regulation concerns goods that can be used for capital punishment, torture or other cruel, inhuman or degrading treatment or punishment. It updates Regulation 1236/2005 and its annexes, introducing new controls on brokering services and technical assistance, a ban on the advertising of certain goods, and amends the definition of other cruel, inhuman or degrading treatment or punishment. The original regulation lists the equipment/goods that are banned for export or import in Annex II. The new Regulation imposes a ban on the brokering of such equipment subject to an import or export ban, to cover transfers of goods that are not located in the EU.

Specific licences are required for the exports of equipment/goods that could be used for illicit purposes but also have legitimate applications. These goods – which are subject to a case-by-case assessment – are listed in Annexes III and IIIA (formerly Annex III). The new Regulation bans the provision of brokering services by any broker who is aware that goods listed in Annex III and IIIA may be used for torture or capital punishment. Additionally:

- The supply of technical assistance (concerning goods in Annex III or IIIA) by anyone who is aware that the equipment may be used for torture or capital punishment is banned.
- The new Regulation provides a general authorisation for exports to countries that are party to international conventions on capital punishment, but indicates that these countries must have abolished capital punishment, and the goods are not re-exported to other countries.
- The new Regulation introduces an urgency procedure for amendment of the annexes when new goods enter the market.
- The new licensing requirements for trafficking and brokering transactions and technical assistance (Article 7a and Article 7e) enter into force on 17 March 2017.

A copy of the regulation can be found at:
data.consilium.europa.eu/doc/document/PE-27-2016-INIT/en/pdf

Talking export controls with JUDITH KELLY

Judith Kelly is a trade and customs manager and empowered official at the Fort Worth, Texas office of Pattonair, a UK aerospace and defence supply chain provider, headquartered close to the town of Derby. Pattonair describes itself as 'the service provider of choice for many of the world's top aerospace and defence companies, providing tailored business solutions for aftermarket and MRO needs'. Prior to joining Pattonair, Kelly worked for Meggitt, and BAE Systems in the trade compliance function.

WorldECR: Tell us something about Pattonair, its business and the sanctions and export control challenges most pertinent to the company – and the industry?

Judith Kelly: Every year, over 2,000 customers trust Pattonair to provide products and services in support of their global operations. To many MRO [maintenance, repair and operations], airframe, systems and engine OEMs [original equipment manufacturers], we offer a truly global presence in the aerospace sector.

Because Pattonair has a steadily growing footprint, we must continuously work to provide a solid trade compliance presence in all areas of the world in which we do business. Every country has its own export and import regulations and requirements for trade, so Pattonair must adapt and learn in order to be successful.

Developing collaborative relationships with suppliers and customers is a game changer because so few firms really accomplish true win-win partnerships. Customer service and relationships are vital to our continued success. There are both external forces and internal interests at work, and we must share the desired outcome of our customers if we are to achieve common goals.

WorldECR: What's the big issue you're confronting right now?

Judith Kelly: The implementation of the Joint Comprehensive Plan of Action, and the lifting by the Office of Foreign Assets Control ('OFAC') of secondary sanctions in line with that, has caused a rush of non-U.S. companies now wanting to do business with Iran.

Our customers are worldwide and our end-user verification process has had to grow substantially in a short period of time. Being that we are a foreign-owned company with subsidiaries in the United States means that adhering to all the relevant regulations can be challenging.

And, of course, while the United States has relaxed many of its sanctions against Iran, Washington still demands that even non-U.S. manufacturers wishing to sell to Iran obtain an export licence if their products include materials made in the United States – bear in mind that Airbus, the first large aerospace and defence company to sign a direct contract with Iran, sources more than 40% of its aircraft parts from the United States.

Another area we find ourselves having to manage is the prospect of the diversion of U.S. origin parts to other embargoed countries. With well-known companies acknowledging in settlements with U.S. agencies that they have committed intentional acts to hide or deceive companies in order obtain U.S. origin parts for their customers in embargoed countries, we have to continuously be on our guard.

WorldECR: What are the kinds of responsibilities that take up most of your time: e.g. training, licence applications? And where does your team sit within the corporate structure?

Judith Kelly: Trade compliance is a continuously growing requirement that touches every part of a business, from clearing imports to managing exports, compliance with customs regulations, and ensuring our employees all around the world are able to understand trade compliance requirements in their day-to-day jobs. Bear in mind that sales, procurement, finance, human resources, inventory, and all areas of management are responsible for some part in the compliance arena.

I sit in the United States, and my counterpart is in the United Kingdom. We split the management of the company's trade compliance and also cross over to support as needed in every area. With our growth expected to double and triple, I can imagine that our compliance need will grow, too.

We report directly to the vice-presidents directly responsible for the company's supply chains. We're supported 100% by our corporate and executive management teams, and we're fully confident that they will provide us with the resources, and any assistance, to ensure that we're fully compliant in all areas.

WorldECR: What are the trends that you're detecting that are most relevant to you (supply chain security seems to be increasingly high-profile)? Would you say that there are changes in the nature of the supply chain?

Judith Kelly: Interesting question! One trend is C-TPAT – which is increasingly becoming more and more of a necessity for exporters in the United States. What we're seeing is that C-TPAT-certified companies are putting pressure on their customers and suppliers to also become certified because of the security requirements that they themselves must adhere to.

C-TPAT is a voluntary public-

private sector partnership programme which recognises that Customs and Border Protection ('CBP') can only provide the highest level of cargo security through close cooperation with the principle stakeholders of the international supply chain, such as importers, carriers, consolidators, licensed customs brokers, and manufacturers. When an entity joins C-TPAT, an agreement is made to work with CBP to protect the supply chain, identify security gaps, and implement specific security measures and best practices. Applicants must address a broad range of security topics and present action plans to align security throughout the supply chain.

Pattonair continues to receive these questionnaires from our suppliers and customers to help them meet their C-TPAT security requirements. Becoming C-TPAT-certified – and thus adding to the security of the U.S. supply chain – is a long-term goal of our company.

WorldECR: Pattonair has a footprint across the world. Does this mean that you have to stay up to date with multiple compliance regimes? If so, how do you do that?

Judith Kelly: Yes – and it can be difficult. It requires that I read the news on a daily basis and keep up to speed with changing legislation, always trying to understand how changes in one country can have an impact elsewhere. A perfect example of this of course is the U.S. Export Control Reform initiative – aimed at reducing controls on some ITAR (International Traffic in Arms Regulations) parts and components by placing them under the EAR. This has created new licence requirements in non-U.S. countries for products that we control as EAR99 or 9A991.d [thus regulated by the Export Administration Regulations under the authority of the administration of the Bureau of Industry and Security] but which in other jurisdictions remain on military control lists. And some countries have even more stringent export and import regulations than the United States – whether that's relating to special documentation, pre-approval for entry, or specific licensing.

Possessing an understanding of the regulations of the countries to which your country exports or in which it does business is a basic requirement and an automatic skillset for any trade compliance manager and programme.

'I believe that, at least in the United States, there are many businesses and companies that have no idea what compliance is or what role those in the compliance function perform.'

Judith Kelly

WorldECR: The sanctions landscape has changed dramatically during the final year of President Obama's Administration, opening up new opportunities, perhaps, but also, some would say, putting more pressure on compliance teams. Could we talk briefly about Iran, Russia and Cuba how those stories have impacted?

Judith Kelly: Well, as I noted above, Iran has been the recent focal point for compliance controls and changes. Russia and Cuba have not been so much of a concern as we have yet to have any business directly with customers from those countries. That does not mean that we never will, or that our customers are not reselling or re-exporting parts to those countries – they just might be. But we can only manage what we can and hope that our due diligence protects U.S. origin parts from ending up in embargoed countries or in the hands of a denied party.

The compliance function is continually trying to stay abreast of sanctions-related news, and assessing how the addition or removal of sanctions affects our business. Our executive management teams look to us to give them the nod as to whether or not the company can do business in a particular place – which makes it incumbent upon us to be experts in an area where both shifts in the direction of the political wind – and inconsistency – are frequently encountered.

WorldECR: Could we talk about expectations that companies have of compliance standards with other companies within the supply chain: i.e. suppliers, service companies, clients. Is it always clear as to where responsibility lies?

Judith Kelly: I believe that, at least in the United States, there are many businesses and companies that have no idea what compliance is or what role those in the compliance function perform. They seem to have self-blinders on, and keep their heads in the proverbial sand when it comes to doing anything beyond making money and trying to survive.

I've often encountered aggressive and angry responses from U.S. companies when I've suggested that they maintain even minimal levels of compliance, or at least, demonstrate an understanding of their responsibilities regarding classification and controls of U.S. origin parts. I have had some companies actually tell me that they don't export, and that they've received legal advice to the effect that they are not required to provide any classification or compliance information! There are actually attorneys out there advising companies to ignore the regulations and saying that [if they do so] they can't be found liable for anything.

Some companies are not even asking about the classification of the parts they are manufacturing or distributing inside the United States, and by ignoring this whilst handling ITAR-controlled products, they are engaging in ITAR-regulated activity without fulfilling registration requirements, which is a violation of the Arms Export Control Act ('AECA') and ITAR section 122.

That is so wrong in so many ways – ignorance of the law is no defence, especially when export control and compliance news is everywhere. You really cannot live in the U.S. without hearing or reading about some form of controls on U.S. origin goods.

I have come across cases where companies who were registering under the Joint Certification Program ('JCP') were being advised by

government inspectors that they were not required to be registered with the Directorate of Defense Trade Controls ('DDTC') even though they were manufacturing, selling and/or distributing ITAR products. I once had to get DDTC enforcement teams involved, the way that these inspectors were advising companies was so inaccurate – completely misleading a number of companies.

'Ironically, among the biggest offenders when it comes to violating the ITAR and EAR are government entities themselves.'

Judith Kelly

WorldECR: Do you think this is an area where greater enforcement might be warranted?

Judith Kelly: Oh yes. But in my opinion, ironically, among the biggest offenders when it comes to violating the ITAR and EAR are government entities themselves.

Over the years, small and medium-sized business have been allowed to operate under the radar and have not been following the rules. This makes life very difficult for businesses who are trying to follow the rules. Instead, the government tends to go after the larger companies first, making them examples to industry.

But DDTC and BIS [Bureau of Industry and Security at the Department of Commerce] are always ready to help a company get into compliance and will not hold against a company an honest mistake that happens in the learning process. Many times, I have been asked to help companies with their learning curves and provide support as I am able. Again and again, you see the head in the sand approach – if they stay quite long enough they won't have to worry about anything.

Often, government agencies fail to verify that companies they purchase from are actually registered with the DDTC and authorised to manufacture, sell or distribute ITAR products. I run into these companies all the time, and I don't necessarily blame them, because one way or another they have been misled.

But the rules are not ambiguous or unclear: under ITAR section 122, U.S. companies engaged in the defence trade (manufacturing or exporting) must register with the Department of State. This requirement includes manufacturers who do not even export, but only sell domestically.

Some federal agencies are either not familiar with or – for whatever other reason – not enforcing other agencies' regulatory requirements. The Defense Logistics Agency and other parts of the Department of Defense, as well as other federal agencies, issue contracts that have general clauses about contractors fulfilling all requirements under federal law or regulation. Engaging in ITAR-regulated activity without fulfilling registration requirements is a violation of the AECA and ITAR, and those companies [that fail to meet those requirements] should be denied the ability to do business requiring it. We have a chasm between what is expected legally and what is actually known or understood logically.

Companies that are registering and following the law because they do not want to be fined or penalised, or, in a worst case scenario, debarred from operating in or exporting to or from the United States, should be getting the business. The rules cannot be applied selectively; they should be applied uniformly, and all U.S. businesses to whom they apply should be complying with them. In industry, we need to support each other and realise that our success is not just about me, our success is about us helping each other and doing everything we can to ensure that we know how our products are controlled and where they are going.

WorldECR: How easy is it to recruit good candidates into trade compliance? Do you think it's perceived as an attractive profession?

Judith Kelly: Attractive? Yes and no. Easy? No. One of the hardest things to do is get a great compliance candidate. The scope of regulations is vast, and they are open to many varying interpretations – so the expectations of trade compliance professionals is high, as is the potential for personal liability, and that is scary.

Knowing that your decisions can stop a transaction, or prevent your company from doing business, or that it could be wrong and you could be fined, makes for some nail-biting moments. This is where sales and trade compliance usually butt heads – and make no mistake, the potential for conflict is very real.

So while there is an appetite among candidates to do the work, the scale of responsibility also creates some apprehension. I always feel like I am practising law without a degree, and the regulations and legal requirements of compliance are heavy! Companies must continually invest in their professionals to ensure that they are getting what they're paying for. Knowledge really is power in this field.

WorldECR: The United States has a new President! Little seems to be known about his foreign policy outlook. What do you expect from his Administration?

Judith Kelly: Honestly, I don't know what to expect. Let's hope for a great future.

WorldECR welcomes your news and comments.
Write to the editor, Tom Blass, at tom.blass@worldecr.com

EU

EU 'guidance' on controls on Information Security items and the Cryptography Note

By Gerard Kreijen and Bert Gevers, Loyens & Loeff

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On 25 October 2016, the EU published its brief Guidance Note 1/2016 concerning FAQs on controls of 'Information Security' items and implementation of the Cryptography Note exemption.

As is commonly known, 'Information Security' items (such as software, application specific electronic assemblies, modules, and integrated circuits) employing cryptography may be controlled under Category 5 Part 2 of Annex I to the Dual-use Regulation (Regulation (EC) 428/2009).

In recognition of the general commercial availability to the public of encryption, which has become a common functionality of information and communication technology, Note 3 to Category 5 Part 2 (the 'Cryptography Note') provides that the controls set out in 5A002 and 5D002 of the EU dual-use control list, do not apply to exports of goods or software that meet all of the following:

a) Generally available to the public by being sold, without restriction, from stock at retail selling points by means of any of the following:
   1. Over-the-counter transactions;
   2. Mail order transactions;
   3. Electronic transactions; or
   4. Telephone call transactions;
b) The cryptographic function cannot easily be changed by the user;
c) Designed for installation by the user without further substantial support by the supplier; and
d) When necessary, details of the goods are accessible and will be provided, upon request to the competent authorities of the Member State in which the exporter is established, in order to ascertain compliance with conditions described in paragraphs a. to c. above.

The EU Cryptography Note, which originates in the Wassenaar Arrangement, has unfortunately often led to discussions and uncertainties. This is not only due to the complexity of the items, but, to a large extent, also to the lack of guidance. The EU regulator itself did not provide any specific guidance on key concepts in the Note such as 'without restriction' or 'substantial support' and the different national regulators often adhered to conflicting interpretations of the Note.

Operators who had hoped that the EU Commission would not wait for the Recast of the Dual Use Regulation to speed up the process of harmonising the varying interpretations of the regulation held by each Member State, may be disappointed as this guidance does not provide any clarification of the concepts embedded in the Note. Nevertheless, the clarifications provided by the Guidance Note may prove useful to many exporters as it basically explains the obligations of the exporter, who is ultimately responsible to determine whether an item is controlled or not, and those of the

competent national authorities in situations where they are called upon to assess the applicability of the Cryptography Note.

If things are not already complicated enough, another layer of 'cryptography complexity' can be found in the fact that export control authorities outside the EU have sometimes broader exemptions, which can lead to situations where (foreign) companies that operate in the EU wrongly assume that because an export licence for a particular item is not required in their home jurisdiction, an EU licence is not required either. That could, for example, be the case for products that come under the ECCN 5A992 in the U.S. (e.g. no licence is required because the item is considered 'mass market'), but for which no equivalent classification exists in the EU. Needless to say that this can easily lead to compliance gaps within a company's trade control compliance programme. In its recent Recast proposal, the EU Commission intends to 'repair' these gaps via the introduction of a new open licence (UGEA) for encryption.

This article first appeared on the blog www.worldtradecontrols.com

Links and notes

The Guidance Note is at: http://trade.ec.europa.eu/doclib/docs/2016/october/tradoc_155052.pdf

U.S.A.

United States lifts Sudan sanctions

By Ajay Kuntamukkala, Beth Peters, Adam Berry, Stephen Propst and Aleksandar Dukic, Hogan Lovells

www.hoganlovells.com

On 13 January 2017, the White House, the U.S. Department of Treasury's Office of Foreign Assets Control ('OFAC'), and the U.S. Department of Commerce's Bureau of Industry and Security ('BIS') announced a host of policy changes that, as of Tuesday 17 January 2017, will result in the significant easing of Sudan sanctions. As explained below, OFAC issued authorisation for most transactions involving Sudan that previously were prohibited, while BIS announced changes in policy that will enable licensing of certain exports/re-exports to Sudan. Also, funds and other property of the government of Sudan and its entities that were previously blocked (frozen) will be unblocked as a result of this action.

The White House indicated that these changes are the result of ongoing U.S.-Sudan bilateral engagement and reflect developments related to bilateral cooperation, the ending of internal hostilities, regional cooperation, and improvements to humanitarian access. If the Sudanese government 'sustains the positive actions' by 12 July 2017 and certain other conditions are met, prior executive orders imposing sanctions on Sudan will be revoked. In the interim, U.S. persons including U.S. companies can rely on a general licence issued by OFAC to engage in Sudan-related activities previously prohibited by OFAC regulations but must comply with the general recordkeeping requirements.

Before making changes to internal compliance policies, companies should consider whether these developments may be affected by the new administration even before 12 July, and whether adverse developments in Sudan may affect this easing by the summer.

Key industry-specific impacts

Food/medicine/medical devices

Exporters of food no longer need to rely on OFAC's prior general licence for food, which had conditions related to payment terms and restrictions on military/law enforcement importers. Exporters of medicine and EAR99 medical devices are no longer required to obtain specific OFAC licences for sale to non-exempt areas of Sudan. Pharmaceutical and medical device companies will no longer be prohibited from engaging in a range of marketing and promotional, educational, and service and repair activities related to sales of EAR99 medicine and medical devices that previously were prohibited.

Financial institutions, (re)insurers, and other service providers

These entities are no longer restricted from processing U.S. dollar payments or other transactions involving Sudan, including the provision of financing, (re)insurance, or other services for Sudan-related trade so long as the activity does not involve parties designated under another OFAC sanctions programme (e.g., parties in Sudan targeted under Darfur sanctions or for supporting terrorism or weapons proliferation activities).

Aviation/transportation

Exporters of certain items subject to U.S. law intended to ensure the safety of civil aviation or the safe operation of fixed-wing commercial passenger aircraft are still required to obtain an export licence from BIS, but now can benefit from a general policy of approval. Such a policy also applies to certain items that will be used to inspect, design, construct, operate, improve, maintain, repair, overhaul, or refurbish railroads in Sudan. Sales of aircraft remain subject to a general policy of denial.

OFAC issues general licence authorising most transactions

OFAC's announcement concerns

amendments to the Sudanese Sanctions Regulations ('SSR'), 31 C.F.R. part 538. The amendments, which add a general licence to section 538.540 of the SSR, authorise all transactions previously prohibited by the SSR and executive orders 13067 and 13412.

These changes allow U.S. persons to generally conduct transactions with individuals and entities in Sudan, including dealings with the government of Sudan and its entities. They also unblock property of the government of Sudan subject to United States. jurisdiction. Although Sudan remains designated as a state sponsor of terrorism, the OFAC regulations in Part 596 targeting terrorism list governments already contain a general licence that authorises financial transactions with the Sudanese government in light of this new general licence in the SSR.

Therefore, as of 17 January 2017, the following activities will be authorised:

- Processing of transactions involving persons in Sudan;
- Importation of goods and services from Sudan;
- Exportation of EAR99 goods, technology, and services to Sudan;
- Transactions involving property in which the government of Sudan has an interest, including the release of funds previously blocked.

As OFAC has clarified in new FAQ 492, the new general licence supersedes other general licences in the SSR, and companies are therefore no longer required to abide by the more stringent requirements of those general licences (such as restrictions on payment terms for those relying on a general licence in section 538.523 for sale of food to Sudan). However, companies must continue to abide by OFAC's general recordkeeping and reporting obligations.

It should be noted that the changes do not affect transactions prohibited under any other OFAC sanctions programme, including the Darfur Sanctions Regulations, the South Sudan Sanctions Regulations, or executive orders 13400 or 13664.

BIS eases some export control restrictions

Most transactions involving goods, software, or technology (items) on the Commerce Control List ('CCL'), that is, non-EAR99 items subject to U.S. law, continue to require separate BIS authorisation, although companies will now benefit from a more favourable licensing policy for certain items.

The BIS changes implement a general policy of approval for applications for licences to export or re-export to Sudan items on the CCL that are controlled only for anti-terrorism ('AT') reasons that are:

1. Parts, components, materials, equipment, and technology intended to ensure the safety of civil aviation or the safe operation of fixed-wing, commercial passenger aircraft, or
2. Items used to inspect, design, construct, operate, improve, maintain, repair, overhaul or refurbish railroads in Sudan.

The general policies of approval for

both of these categories apply only to civil uses by non-sensitive end-users within Sudan, which does not include military, police, or intelligence end-users. In addition, the civil aviation and railroad items described above remain subject to a general policy of denial if they are controlled for any other reason (e.g., missile technology) in addition to antiterrorism.

There is also a new case-by-case review policy for applications to export or re-export four specific categories of items to Sudan:

1. Transactions involving the re-export of items to Sudan where Sudan was not the intended ultimate destination at the time of original export from the U.S., provided that the export from the U.S. occurred prior to the applicable contract sanctity date;
2. Transactions where the 'U.S. content of foreign-produced commodities is 20% or less by value' (we note that BIS amendments do not appear to limit this to 'controlled' U.S. content);
3. Transactions in which the commodities are medical items (effectively, this applies only to non-EAR99 medical items); and
4. Transactions in which the items are telecommunications equipment and associated computers, software, and technology for civil end use, including items useful for the development of civil telecommunications network infrastructure.

Companies seeking to take advantage of this case-by-case review policy must explain in their licence applications how their proposed transactions are consistent with one or more of these four situations.

Future revocation of executive orders

The White House announced that President Obama has signed an executive order, 'Recognizing Positive Actions by the Government of Sudan and Providing for the Revocation of Certain Sudan-Related Sanctions,' that calls for the revocation of sanctions provisions in prior executive orders 13067 and 13412 on 12 July 2017 if the government of Sudan 'sustains the positive actions' that gave rise to this executive order and certain other conditions are met.

U.S.A.

Canadian bank faces penalties for OFAC violations and lack of OFAC compliance programme

By Timothy O'Toole, Miller Chevalier

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On 13 January 2017, the Office of Foreign Assets Control ('OFAC') of the U.S. Department of the Treasury issued an enforcement action against Toronto-Dominion Bank ('TD Bank'), a Canadian company and its Luxembourg-based subsidiaries, that involved apparent violations of the Cuban Assets Control Regulations (the 'CACR') and the Iranian Transactions and Sanctions Regulations (the 'ITSR').

The group of apparent violations all stem from the activity of TD Bank's Canadian operation.

First, TD Bank failed to screen U.S.$1.165m dollars of transactions for 'any potential nexus to an OFAC-sanctioned country or entity prior to processing related transactions though the U.S. financial system'.

Second, TD Bank maintained accounts in Canada for a sales agent for an entity placed on the Specially Designated Nationals ('SDN') list based on the Iran Sanctions Program. In maintaining this account, TD Bank processed 39 transactions totaling U.S.$515,071 to or through the U.S. financial system.

Third, TD Bank maintained accounts on behalf of 62 Cuban nationals residing in Canada and processed 99 transactions totalling less than half a million dollars, again through the U.S. financial system. As a result of these activities, which are valued at approximately $2m – and which TD Bank voluntarily disclosed – OFAC reached a settlement for remittance of U.S.$516,105.

In addition to this settlement, OFAC issued a finding of violation against TD Bank's Luxembourg-based online brokerage and banking subsidiary, Internaxx. OFAC found that Internaxx 'provided U.S. securities-related products and services for customers resident in countries subject to comprehensive OFAC sanctions programs' – namely to persons residing or based in Cuba or Iran. Internaxx processed 3,491 securities-related transactions valued at approximately U.S.$92.869 million.

Key mitigating factors considered by OFAC in connection to the apparent violations included:

- Voluntary disclosure;
- No actual knowledge by TD Bank managers and supervisors in the conduct that led to most of the violations;
- VTD Bank also had a robust remedial response, which included change in policies and procedures;
- No prior history, substantial remediation, and providing detail in response to OFAC requests.

Key aggravating factors considered by OFAC in connection with the apparent violations include:

- Several employees of TD Bank were aware that TD Bank processed U.S.

dollar transactions on behalf of Cuban entities;
- Several employees were aware of the gap in TD Bank procedures permitting such transactions to clear through the U.S. financial system;
- TD Bank had no compliance controls in place to detect and prevent violations of U.S. sanctions;
- TD Bank is a large and sophisticated financial institution.

Key mitigating factors considered by OFAC in connection to the finding of violation included:

- Internaxx took remedial action prompted by the parent and swiftly improved its OFAC compliance procedures;
- Internaxx is a small institution with little business outside of Luxembourg;
- No pattern of misconduct;
- The violation was detected through an annual anti-money laundering risk assessment by TD Bank's AML compliance team.

Key aggravating factors considered by OFAC in connection to the finding of violation included:

- Internaxx did not have an OFAC compliance programme in place to detect and prevent violations until October 2011.

Key takeaways
- Both the apparent violation and the finding of violation reflect the extensive extraterritorial reach of U.S. sanctions programmes. This reach is highlighted by the fact that these actions are targeted at a parent entity doing business in a jurisdiction with a strong blocking statute, which prohibits compliance with U.S. sanctions by Canadian entities.
- Both of these actions also serve as a strong reminder of the need for companies and their subsidiaries to implement and enforce robust OFAC compliance programmes, even in foreign countries.
- The published enforcement action and penalties occurred despite the remote U.S. nexus and the relatively small number and value of the transactions, signifying that foreign companies should not presume there is a materiality threshold for triggering OFAC enforcement actions.
- Companies must critically weigh the value of voluntary disclosures, cooperation, and timely and well-organised investigations in deciding how to address any issues that arise in the sanctions context.

U.S.A.

Sanctions imposed on Russian spy entities for U.S. election interference

By Margaret Gatti and Louis Rothberg, Morgan, Lewis & Bockius

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Five entities and six individuals have been sanctioned for interference with the 2016 U.S. election. On 29 December 2016, President Obama issued a new executive order that expands the authority of the U.S. Secretary of Treasury to impose sanctions on individuals and entities for cyber-attacks under Executive Order 12694. The new executive order also specifically sanctioned five entities and four individuals in Russia for cyber operations aimed at the US election.

Amended sanctions authority under EO 13694

The sanctions were imposed in response to cyber activities taken by the Russian government during the 2016 U.S. election. Under the new executive order, 'Taking Additional Steps to Address the National Emergency with Respect to Significant Malicious Cyber-Enabled Activities,' sanctions may now be imposed on individuals and entities that the U.S. Secretary of Treasury, in consultation with the U.S. Attorney General and U.S. Secretary of State, determines are responsible for or complicit in, or have engaged in, directly or indirectly, cyber-enabled activities originating from or directed by persons outside the United States, that result in a significant threat to the United States, and have the purpose or effect of 'tampering with, altering, or causing a misappropriation of information with the purpose or effect of interfering with or undermining election processes or institutions.'

Sanctioned parties

In the annex to the new executive order, two Russian intelligence agencies, the Main Intelligence Directorate ('GRU') and the Federal Security Service ('FSB'), four GRU officers, and three companies that provided material support to GRU's operations were identified. These parties will be added to the Office of Foreign Assets Control ('OFAC')'s list of Specially Designated Nationals and Blocked Persons ('SDN List'), along with two more individuals that OFAC identified for using cyber-enabled means to cause misappropriation of funds and personal identifying information. As a result, the assets of these parties are blocked and 'U.S. persons' are prohibited from dealing with them.

One notable consequence of the designation of the FSB specifically is that U.S. persons may now be prohibited from applying to this agency to obtain licences to distribute IT products containing encryption in

Russia. Such an application by a U.S. person, directly or indirectly, would appear to be a prohibited dealing with an SDN. 'U.S. Persons' include any United States citizen or national, permanent resident alien, an entity organised under the laws of the United States (including its foreign branches), or any person within the United States. If a U.S. person engages in prohibited dealings with an SDN, such person can face a maximum civil penalty of $284,582, or twice the value of the underlying transaction to which the violation relates, whichever is greater.

U.S.A.

New requirements for exports and re-exports to and from Hong Kong

By Thomas McCarthy, Tatman Savio and Rebekah Jones, Akin Gump

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On 19 January 2017, the Department of Commerce's Bureau of Industry and Security ('BIS') published a final rule increasing compliance requirements associated with the export and re-export of items controlled under the EAR to and from Hong Kong. Specifically, the new rule requires that exporters and re-exporters obtain from their customers or consignees, prior to shipment, a valid import licence or written authorisation from the Hong Kong government that no such licence is required. Similarly, the rule also prohibits the re-export of EAR-controlled items from Hong Kong, unless the re-exporter obtains an export licence or other written authorisation from the Hong Kong government.

The amendments to the EAR do not impose any new licensing burdens on exports or re-exports that are in compliance with Hong Kong export and import control regulations. Rather, they leverage the EAR to effectively compel compliance with Hong Kong export and import control laws by requiring proof of compliance with Hong Kong law as a support document necessary for shipping under an EAR licence or licence exception. Concurrent with the publication of the final rule, BIS published Frequently Asked Questions ('FAQs'), available on its website, which describe the purpose and effect of the new regulatory requirements.

This novel rule has a 90-day delayed effective date, which apparently is designed to give those affected by it time to ensure that their customers or consignees in Hong Kong are in compliance with existing Hong Kong export and import control laws and also to develop procedures to regularly provide the required Hong Kong licences or other written confirmations. For those involved in controlled trade with Hong Kong, the failure of counterparties to provide documentation consistent with EAR requirements will likely result in delays and the possibility of penalties once the rule becomes effective.

Background on export controls related to Hong Kong

Pursuant to the United States-Hong Kong Policy Act of 1992, the U.S. government treats Hong Kong and China as two separate destinations for export control purposes. Like the United States (and unlike China), Hong Kong's list of items requiring a licence to export is based on the lists created by the multilateral export control regimes, specifically the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies, the Missile Technology Control Regime, the Nuclear Suppliers Group and the Australia Group. Because the Hong Kong control list and most of the U.S. Commerce Control List ('CCL') are developed from the same sources, the lists have significant overlap in the items subject to control. Unlike the United States, Hong Kong requires that importers of items controlled by one of these regimes have a permit to do so.

Changes to requirements for exports and re-exports to Hong Kong

The changes to the EAR apply to items subject to the following reasons for control under the CCL: NS, MT, NP column 1 and CB. Under the rule, exporters and re-exporters using EAR licences or licence exceptions to ship such items to Hong Kong must obtain a written authorisation or copy of a valid import licence from Hong Kong's Trade and Industry Department ('TID') prior to export. If no licence is required, a copy of a 'No License Required' ('NLR') notification for the item or other written communication from the Hong Kong government will satisfy the requirement. These NLRs may be publicly available on the TID website. Analogous changes also affect re-exporters using EAR licences or licence exceptions to export controlled items from Hong Kong. Specifically, such re-exporters must obtain a valid TID export licence or a written statement from the Hong Kong government that no export licence is required before the re-export takes place.

While a valid TID licence or NLR is required, it is not a precondition for application to BIS for a licence. As clarified in BIS's FAQs, exporters and re-exporters may apply for licences before receiving documentation of the requisite approval from the government of Hong Kong. However, the Hong Kong approval must be obtained before export or re-export. As noted above, these changes go into effect on 19 April 2017.

Significance and impact of changes

This rulemaking marks a step forward in BIS efforts to combat unauthorised diversions in transshipments through

Hong Kong. In the recently published FAQs, BIS states that the rule is intended 'to provide greater assurance that U.S. origin items that are subject to the multilateral control regimes . . . will be properly authorized by the United States to their final destination, even when those items first pass through Hong Kong'. Like other major trade hubs in the region, Hong Kong has been considered a problematic transshipment point for the United States. In the past, BIS has even published targeted guidance for exporters on conducting due diligence to prevent unauthorised transshipments through Hong Kong to China. The new rule appears to reinforce those enforcement priorities.

Notably, the new rule will essentially require those shipping EAR-controlled items to or through Hong Kong to justify their use of EAR licences and licence exceptions under Hong Kong standards. By lending the enforcement capabilities of the United States to the export and import control system of the government of Hong Kong in this way, the changes present a serious compliance risk for companies using EAR licences and licence exceptions in Hong Kong. These companies will now have to prove continued compliance with Hong Kong law as a matter of recordkeeping. While the changes do not add any licensing requirements under U.S. or Hong Kong laws, companies – particularly those that are unfamiliar with existing Hong Kong import and export licence requirements – will nonetheless face an increased compliance burden when the new rule takes effect.

The new rule makes clear the U.S. government's position that increasing compliance with TID licensing policy and requirements will further limit the unauthorised transshipment of EAR-controlled goods through Hong Kong. In the context of the new regulatory requirements, familiarity with the Hong Kong import and export system will greatly reduce burdens and delays for those entities that have, or expect to have, a significant volume or regular trade with Hong Kong in controlled items. We regularly advise companies engaged in export and import activities involving Hong Kong. We recommend that such companies assess their regulatory obligations under Hong Kong law and implement compliance protocols to ensure compliance with both Hong Kong and U.S. laws in light of these regulatory changes.

U.S.A.

BIS amends licensing requirements for certain CNC machines and valves, pumps

By Jennifer Horvath, Braumiller Law Group

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Effective 25 November 2016, the Bureau of Industry and Security ('BIS') of the Department of Commerce implemented a rule to decrease the level of licensing required for certain turning machines or combination turning/milling machines, valves and pumps, among other named items. The changes in licensing requirements aim to be more in line with export controls on such items promoted by other countries who are also members of the Nuclear Suppliers Group ('NSG'). The NSG is a multilateral export control group with 48 participating countries. One action of the NSG is to maintain a list of dual-use items that could be used for nuclear proliferation activities. The list of these (potentially subject) items is found in the annex to the NSG's 'Guidelines for Transfers of Nuclear Related Dual-Use Equipment, Materials, Software and Related Technology'.

The covered items include certain pressure tubes, pipes, fittings, pipe valves, pumps, numerically controlled machine tools, oscilloscopes, and transient recorders on the Commerce Control List ('CCL'). The licensing changes focus on removing Nuclear Proliferation ('NP') column 2 controls from the items. The amendments result in some of these items no longer being listed under an export control classification number ('ECCN') on the CCL. However, the items remain subject to the EAR under the designation EAR99. It is important to keep in mind that the subject items could still be controlled under the EAR due to other reasons, such as end use, end-user, embargoes or other special controls.

This rule also creates four new ECCNs to maintain anti-terrorism ('AT') controls on certain affected commodities and related 'software' and 'technology.' One item is also controlled under chemical/biological ('CB') reasons. Specifically, the enumerated valves still require a licence to destinations listed on the Commerce Control Chart for CB reasons, under CB column 2.

The new rule eliminates four ECCNs: 2A292, 2A293, 2B290 and 3A292. New ECCNs which have been created in their place include: 2B350, 2A992, 2A993 and 2B991. Although the new ECCNs and control changes are now effective for the enumerated items, implementation has a delayed start date for software specially designed for the production, use or development of items previously controlled under 3A292, such as software related to oscilloscopes and transient recorders. This software will continue to be controlled under EAR99 through 31 January 2017. As of 1 February 2017, the software for these items will be controlled under 3D991.

Overall, these changes lessen restrictions on the specified items, although a few reasons for control remain which may require a licence.

U.S.A.

OFAC guidance clarifies open questions on sanctions advice (to an extent…)

By Doug Jacobson, Michael Burton and Glen Kelley, Jacobson Burton Kelley

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On 12 January, the Office of Foreign Assets Control ('OFAC') of the U.S. Department of the Treasury published guidance 'on the provision of certain services relating to the requirements of U.S. sanctions laws' by U.S. persons, which aims to address a number of open questions in this regard.

Essentially, all OFAC sanctions regulations contain general licences authorising legal advice to sanctioned governments, companies and individuals ('sanctioned persons') on the requirements of and compliance with U.S. law, and in connection with U.S. legal and administrative proceedings. These licences do not authorise U.S. persons to 'facilitate' transactions in violation of' the sanctions. Except for Iran and Cuba, the licences do not authorise receipt of payment for the authorised services (those payments must be separately licensed by OFAC).

The legal services licences also do not expressly cover the following situations, though OFAC practitioners have generally assumed that they will not be penalised by OFAC:

- U.S. persons providing the same services to non-sanctioned persons (such as companies based in an EU Member State) transacting with sanctioned countries or persons; and
- the same services provided by U.S. persons who are compliance professionals and others who are not lawyers.

The licences do not cover a number of other standard legal and compliance services, such as the following (OFAC's position on these issues has been somewhat unclear):

- A confirmation by a non-lawyer that a transaction does not violate sanctions;
- counterparty and transaction due diligence; and
- providing legal and business market intelligence on sanctioned countries.

The guidance published 12 January covers several of these open issues. It authorises:

- Advice by U.S. persons on the requirements of and compliance with U.S. sanctions when provided to non-sanctioned persons.
- A confirmation by a U.S. person that a transaction is permissible under U.S. sanctions, including providing a formal opinion, certification or compliance clearance. (See OFAC's related FAQ #497.)
- Due diligence by U.S. persons to determine whether a transaction complies with U.S. sanctions, as explained in OFAC's FAQ #498.
- U.S. person compliance professionals who are not lawyers providing the above services.

However, other and broader legal and compliance services by U.S. persons, including drafting and negotiating agreements for transactions with sanctioned countries or persons, and legal and business market intelligence on sanctioned countries or persons, are not covered by the guidance.

There are arguments for and against viewing these activities as prohibited under the sanctions as a form of 'facilitation', or under other provisions of the sanctions regulations.

Back to the Iron Age

'We zig and zag and sometimes we move in ways that some people think is forward and others think is moving back. And that's okay.'
Barack Obama, December 2016

106 years ago, the French sociologist Robert Michel formulated a theory that all organisations, no matter how democratic their credentials might be at the outset, will, in time, develop oligarchic tendencies. He called it the 'Iron Law'.

Many – especially governments – go to great lengths to disguise such a trend. Now, as the United States takes stock of its 45th president, there is a clear message: wealth and power go hand in hand, and that's nothing to be ashamed of. Let the iron law prevail. Perhaps, just as the king's touch once cured scrofula, so too can a property moghul and reality TV show presenter's financial success (however he came by it) bestow blessings on those subjected to him.

It isn't just avarice that we're now free to guiltlessly celebrate. Indeed, 2017 appears to be the year that nations around the world will declare the love for themselves that had previously not dared speak its name.

'America First' trumpets Trump.

As the United States takes stock of its 45th president, there is a clear message: wealth and power go hand in hand.

'This page in the history of the world is turning. We will give back to nations reasoned protectionism, economic and cultural patriotism,' says Trump fan, presidential contender and French National Front leader Marine Le Pen.

Meanwhile, across the Channel, the United Kingdom Independence Party leader cautions, 'woe betide' those that 'subvert' the will of the people by placing judicial checks on the implementation of BREXIT.

The 18th century man of letters Samuel Johnson was well acquainted with stuff like this. 'Patriotism is the last refuge of the scoundrel,' he said. It seems so prevalent nowadays that it isn't the 'patriots' that need the refuge. (Perhaps there ought to be an International Society of Patriots – or does that sound too dangerously multilateral?)

As Barack Obama pointed out, everything depends on your point of view. If, in all this stuff-strutting and chest-beating you hear dangerous echoes of the past, there are avenues available to you – exploit the existing democratic processes to their fullest, demonstrate peaceably, articulate your case. Tweet truth to power.

But if the drumbeats are music to your ears – march on. 'Cos this is your zig.

Tom Blass, January 2017
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Circumvention of EU sanctions: a rose by any other name

Circumvention is not the same as violating a sanctions prohibition. Instead, it refers to actions that 'frustrate' a prohibition, without technically violating it. But, writes Paul Whitfield-Jones, the meaning of frustration is ambiguous and can lead to thorny compliance issues in practice.

European Union sanctions typically include provisions designed to prevent 'circumvention' of their prohibitions. Instinctively, we feel we know what this means – arrangements that try to step around the prohibitions on technical grounds – but it is difficult to be more specific, in part because there is only a modest amount of relevant case law and official guidance in the EU and UK.

Fundamentally, however, there is an important distinction to be made between violating a prohibition and circumventing it, because circumvention involves conduct that *frustrates* a prohibition by undermining its effectiveness, *without* technically violating it. What matters then is not whether the conduct meets a particular description, but – as we shall see – whether its aim or result is frustration.

In this article we will focus in particular on the circumvention provisions in EU sanctions against Russia under Council Regulation (EU) No 833/2014 ('the Regulation') because the EU Commission has published related guidance which provides useful examples of what the Commission believes constitutes circumvention (Commission Guidance note on the implementation of certain provisions of Regulation (EU) No 833/2014, 'Commission Guidance').

Circumvention provisions

EU and UK sanctions legislation contains relatively standard wording for circumvention. Article 12 of the Regulation is an example of this language: it prohibits the participation 'knowingly and intentionally, in activities the object or effect of which is to circumvent' the relevant prohibitions. This provision is transcribed into UK implementing legislation[1], but the UK legislation is broader because it also criminalises participation in activities whose object or effect is to 'enable or facilitate the contravention' of the prohibitions (as explained in more detail below).

Circumvention involves conduct that frustrates a prohibition by undermining its effectiveness, without technically violating it.

Violation of a prohibition vs circumvention of a prohibition

Circumvention can only exist in relation to some other particular prohibition (the 'primary' prohibition), but it must be also distinct from the primary prohibition, since otherwise it would serve no purpose.

This point was made in a key European Court case on circumvention, C-72/11 *Afrasiabi and Others* [2011] ECR I-0000, which was a reference to the European Court by the German courts for a preliminary ruling on certain matters. The case related to an asset freeze under EU sanctions against Iran, in particular articles 7(3) and (4) of the former Council Regulation (EC) No 423/2007, which prohibited, respectively, making funds or economic resources available to an asset-freeze target and circumvention of the asset-freeze provisions.

The Court found that articles 7(3) and 7(4) were mutually exclusive: '... Article 7(4)...refers to activities which cannot be regarded as acts of making available [sic] prohibited under Article 7(3)'. The Court said that this interpretation ensured the effectiveness of article 7(4) and also an

Links and notes

[1] The Ukraine (European Union Financial Sanctions) (No 3) Regulations 2014 and the Export Control (Russia, Crimea and Sevastopol Sanctions) Order 2014.

autonomous scope for article 7(3) in combating nuclear proliferation in Iran. Thus, 'activities' within article 7(4) 'are distinguished from acts which formally infringe the prohibition on making available an economic resource laid down in Article 7(3)'.

In practice, however, it can be difficult to draw the line, especially where primary prohibitions also capture 'indirect' violations. For example, article 5(3) of the Regulation prohibits 'indirectly…be[ing] part of any arrangement to make new loans or credit with a maturity exceeding 30 days' to designated entities. Given that article 5(3) also applies to entities acting on behalf or at the direction of designated entities, it is difficult to see what autonomous scope a circumvention prohibition could have. Notably, however, article 12 prohibits circumvention of article 5 'including by acting as a substitute for the entities referred to in Article 5'. One kind of circumvention would therefore be to receive loans or credit on behalf of a designated entity, which makes sense because article 5(3) does not itself prohibit this.

But if circumvention does not involve an infringement of a primary violation, what does it involve?

Circumvention as 'frustration' of a prohibition

In *Afrasiabi* the Court stated that Article 7(4) (circumvention) referred to:

'activities in respect of which it appears, on the basis of objective factors, that, under cover of a formal appearance which enables them to avoid the constituent elements of an infringement of Article 7(3) of the regulation…none the less they have, as such or by reason of their possible link to other activities, the aim or result, direct or indirect, of frustrating the prohibition laid down in Article 7(3).'

Here the Court defines circumvention as the 'frustration' of a prohibition. The Court referred in passing to two earlier judgments which it regarded as being analogical to its concept of circumvention: Case C-110/99 *Emsland-Stärke* [2000] ECR I-11569 and Case C-255/02 *Halifax and Others* [2006] ECR I-1609.

In the former, Emsland-Stärke exported certain agricultural products from Germany to Switzerland and was granted an export refund in connection with the fact that the export was to a non-EU country. However, immediately after release in Switzerland, the products were exported back to Germany or on to Italy, indicating that the only purpose of the exports may have been to obtain the refunds. The Court stated that 'that the scope of Community regulations must in no case be extended to cover abuses on the part of a trader.' Two things were necessary for a finding of 'abuse'. First, 'a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved' (a similar point was made in *Halifax* in relation to a tax dispute); and second, 'a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it.'

Circumvention refers to a situation where the rules are formally complied with but the purpose of the rules is not achieved.

The Court's reference to this case suggests, by analogy, that circumvention refers to a situation where the rules are formally complied with but the purpose of the rules is not achieved.

Another example is given in Case T-434/11 *Europaisch-Iranische Handelsbank AG v Council of the European Union* [2013] ECR (confirmed on appeal in Case C-585/13P), which concerned the sanctions listing of Europäisch-Iranische Handelsbank for (*inter alia*) circumvention of the Iranian sanctions, by settling the debts of, and making payments on behalf of, designated Iranian banks via non-designated Iranian banks. The Court in this case relied on *Afrasiabi*. Although it did not expand expressly on the meaning of 'frustration' it did speak in terms of 'compromising the effectiveness' of a prohibition.

Perhaps another way to express this is that circumvention is conduct that makes a prohibition ineffective or pointless. On that basis, we tentatively suggest – in the absence of fuller treatment in case law and official guidance – that it must refer at least to activities which, considering their substance rather than their form (which after all does not infringe the law), involve effectively similar conduct, or obtain an effectively similar result, to that which is proscribed by the prohibition – a rose by any other name – so that the effectiveness of the prohibition is undermined.

If we take article 5(3) as an example, circumvention must involve some activity that undermines the effectiveness of article 5(3). Recital (5) of the Regulation makes clear that the purpose of article 5 is not to prevent designated entities receiving any funds at all, or even funds by way of loans, except as prohibited by article 5: 'Other financial services such as deposit business, payment services and loans to or from the institutions covered by this Regulation, other than those referred to in Article 5, are not covered by these restrictions'. Article 5(3) is not therefore aimed at some wider category of conduct than what it explicitly targets. This is a relatively discrete objective. In the case of a broader prohibition, such as an asset freeze, it may be necessary to look to the overall objective of the sanctions to determine whether certain conduct could undermine that objective.

Consider deposit services: FAQ 21 of the Commission Guidance says that deposit services 'as such' are not covered by article 5(3), except where they are used to circumvent the prohibition on new loans. One can imagine how a loan might be provided to a designated entity under the guise of deposit. But there must necessarily be something on the facts to distinguish this from a deposit service 'as such'; and the differences must be such that, considering the substance of the arrangement, it amounts to

something that is substantially similar to what article 5(3) is trying to prohibit. This will depend on all the circumstances, but indicative factors could perhaps include an unusually long term, or contract terms or security arrangements that are unusual for a simple deposit but more usual for a loan agreement.

Another example is an agreement to roll over a loan. FAQ 25 says that a 'succession' of rollover agreements of less than 30 days maturity could comprise circumvention. On our reading, circumvention potentially could arise with just one rollover: for example, if the parties intend to make a loan of 60 days and it is structured as two 30-day periods with a rollover in the middle. That clearly defeats the purpose of article 5(3). It is difficult to think of circumstances where such a rollover, agreed in advance, would not constitute circumvention. This suggests that rollovers are only possible where, in substance, they represent a succession of individual agreements of less than 30 days maturity, rather than one agreement broken up into different periods.

We have indicated that circumvention involves the frustration of a primary prohibition. But does the activity have to be designed for this purpose, or is it enough that the prohibition could be frustrated as a result of the activity?

'Object or effect'

Unlike a primary prohibition, circumvention is not characterised by a specific kind of conduct, such as exporting certain items or making certain funding available. What matters is whether the activities have the 'object or effect' or the 'aim or result' of frustrating the primary prohibition. This means that the activities themselves could, in theory, be anything.

The Court in *Afrasiabi* did not further elaborate on the meaning of 'object or effect' or 'aim or result'. Read naturally, 'object' or 'aim' suggests purpose, an activity that is specifically calculated to frustrate a prohibition by one or more – but not necessarily all – of the participants. By contrast, 'effect' or 'result' indicates an activity that has the practical effect of circumventing a prohibition, even though it has not been set up by the participants with that purpose (although it is perhaps difficult to conceive of a practical example of an activity that 'inadvertently' frustrates a prohibition, without being designed in any way to do so).

Whilst these terms are reminiscent of the competition terminology in article 101(1) of the Treaty on the Functioning of the European Union, we suggest that this is of limited relevance in the sanctions context. Article 101(1) prohibits agreements that affect trade between EU Member States that have as their 'object or effect' the restriction of competition within the EU. Restrictions 'by object' are those that inherently have such a high potential for negative effects on competition that it is unnecessary to demonstrate any actual or likely effects, whereas restrictions 'by effect' have those effects in practice. When considering the 'object' of an agreement, its content, objectives and economic and legal context are relevant, but not necessarily the subjective intention of the parties.

In the sanctions context, however, where the 'object' or 'aim' of the activity is to frustrate a prohibition, there

Activities outside the scope of EU sanctions

An activity will not frustrate a prohibition if it falls outside the scope of the prohibition, in particular on jurisdictional grounds.

The case of R v R [2015] EWCA Civ 796 concerned an order by an English judge requiring a Russian citizen, who was subject to an EU asset freeze, to make a maintenance payment to his wife, who was also a Russian citizen but lived in the UK, into the account of a Russian bank in Russia. The husband argued inter alia that the order constituted circumvention of the asset freeze, since it ordered payment in Russia, with the result that the wife could bring funds into the EU free from the asset freeze, without having to obtain an HM Treasury licence to deal with them. The 'normal route' in this case would be for the judge to order payment in England, which would require HMT authority. The selection of an 'abnormal' route – payment in Russia – allegedly circumvented the requirement to obtain authority.

Briggs LJ disagreed and said the key issue is 'whether the common objective sought to be achieved by the so-called normal and abnormal routes is itself one which the relevant regulatory regime seeks to prohibit or control'. He noted the jurisdictional provisions of the asset freeze, in particular that it did not apply to the conduct of non-EU nationals or bodies outside the EU in relation to property outside the EU. He concluded that the purpose of the asset freeze is not to regulate payments by Russian persons to their Russian wives or the exercise by EU judges of their jurisdiction over such payments. It would catch actual payment into the EU, after the making of a court order, but not payment in Russia. Thus an 'abnormal' route is not circumvention where it is 'merely a lawful route to a lawful objective' – in this case, payment of maintenance was a lawful objective, and order for payment in Russia was a lawful route.

Thus an activity cannot frustrate a prohibition if it is outside the scope of the prohibition. In R v R, there was a choice between two activities: one would have brought the funds within the jurisdictional scope of the sanctions, but the other avoided that outcome. This indicates that a person does not circumvent sanctions by taking steps to avoid becoming subject to them. As Briggs LJ stated: 'One may and should take care to avoid breaking the law, but that does not mean that avoidance is a circumvention of it.'

For example, a non-EU company may wish to export controlled dual-use items to the military in Russia, which is prohibited for an EU company under the Regulation. It should not constitute circumvention for that company to choose to use a non-EU subsidiary rather than an EU subsidiary as the contracting party, since neither the parent nor the non-EU subsidiary are subject to EU sanctions. However, it would likely be circumvention for an EU parent company to direct a controlled non-EU subsidiary to be the contracting party (and indeed there is current EU best practice guidance to this effect).

appears to be a much closer connection to the intention of one or more of the participants than in the competition context. It seems strange to speak of an activity that *inherently* has the potential to circumvent sanctions, where the actual intention of the parties is a secondary consideration in the assessment. Indeed the use of the term 'aim' as an alternative to 'object', in both *Afrasiabi* and *Europäisch-Iranische Handelsbank*, supports this reading. However, circumvention has a distinct and separate mental element – 'knowingly and intentionally', see further below – and 'object' should not be conflated with this. Rather, it seems that 'object' should be understood as a feature of the activity itself, i.e. one that is designed to frustrate a prohibition, but at that same time this implies that one or more participants *intentionally* designed it that way.

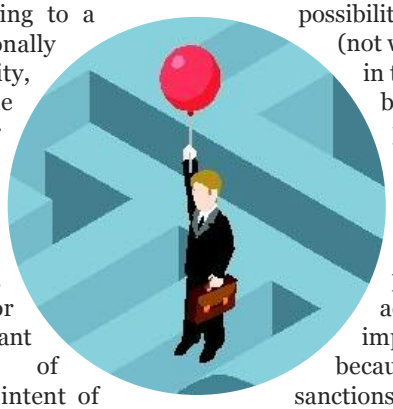
Where an activity is designed in this way, an interesting consequence is that a person could be liable where they participate in the activity even if the activity has not yet reached a sufficiently advanced stage to actually frustrate the prohibition. For example, under article 12 of the Regulation, if a scheme had been devised to provide a designated entity with a new loan, with an EU company acting as a substitute to receive the loan, and the participants had begun to put the scheme into effect, but the loan had not yet been given, an offence would have already been committed.

The mental element of circumvention

The mental element of circumvention involves participating 'knowingly and intentionally' in the relevant activity. The Court in Afrasiabi determined that 'knowingly and intentionally' meant both a situation where (i) the person who is participating in an activity that has a relevant object or effect, deliberately seeks that object or effect, and also one where (ii) that person is at least aware that his participation may have that object or effect and he accepts that possibility. Thus a person can participate in an activity which is not intended to circumvent sanctions, and yet they know, or accept the possibility, that this will be the direct or indirect effect.

Why is there a reference to both knowledge and intention here? We suggest that, in the UK at least, the intention should be read to refer to the participation, whereas the knowledge relates to the object or effect of the activity. Whilst both the Export Control (Russia, Crimea and Sevastopol Sanctions) Order 2014 and the Ukraine (European Union Financial Sanctions) (No 3) Regulations 2014 contain the 'knowingly and intentionally' requirement, the regulations separate the terms by referring to a person who intentionally participates in activity, knowing about the relevant object or effect.

We ought to make a distinction here between the mental element, which is required for an individual participant to be guilty of circumvention, and intent of one or more participants that underlies the 'object', as discussed above. This distinction is important, partly because the participants with the intent relating to the 'object' of the activity may not be required to comply with EU sanctions, and so cannot circumvent the sanctions themselves; and also because some participants in the activity may not be seeking to frustrate a prohibition, but are prepared to accept that as a possibility.



Indeed the second limb (ii) of the Court's definition of the mental element is potentially very broad, since it amounts to the acceptance of a possibility that something may (not will) be the case. Thus in theory a person could be liable where they participate in an activity, being aware that circumvention may be an indirect result of (their participation in) that activity. This is important in practice, because the targets of sanctions will often attempt to involve unwitting parties in their schemes to frustrate prohibitions. For those parties to be at risk, it is not necessary that they share this objective, only that they see it as a (reasonable) possibility.

Circumvention vs 'facilitation'

Under UK sanctions law, frustrating a prohibition is not the same as facilitating or enabling a contravention of the prohibition (as referred to at the beginning of this article). The latter requires the contravention of a primary prohibition, whereas (as we have seen) circumvention does not. Take, for example, a situation where a non-EU subsidiary of an EU parent company enters a transaction with a target of EU financial sanctions, and the EU parent takes some action to facilitate the transaction, such as administrative support. The EU parent would not in principle be facilitating a contravention under UK law, because the non-EU subsidiary would not (generally speaking) be subject to EU sanctions and would not therefore contravene them by dealing with the sanctions target. However, the EU parent could be circumventing the sanctions.

It is worth noting this concept of facilitation is quite different to the concept of facilitation under U.S. sanctions. The latter covers (broadly speaking) actions by U.S. persons that facilitate transactions by non-U.S. persons which would be prohibited for a U.S. person to conduct directly. For the U.S. person to be liable, it is not necessary for the non-U.S. person to violate the sanctions.

That said, in the UK under the Serious Crime Act 2007, it is prohibited in certain circumstances to encourage or assist actions outside England and Wales that would be offences if they took place there. This could have implications for UK parents of non-UK subsidiaries (for example). Conversely, any person can be liable for encouraging or assisting offences in England and Wales, wherever they are located, which could have implications for a non-UK parent of a UK subsidiary. Other forms of secondary and inchoate criminality, such as aiding and abetting, and conspiracy, could also be relevant, but we do not have space to discuss them here.

For example, FAQ 27 of the Commission Guidance indicates that EU subsidiaries of Russian entities designated under article 5 are not generally intended to be caught by article 5, except where they are used to obtain funding for the targeted entity and thereby circumvent Article 5. If such a subsidiary requested a loan of more than 30 days from an EU bank, with the intention of circumventing the sanctions, they would likely not make this known to the bank; however, the bank might discern this as a possibility on the facts of the case, and could be at risk by making the loan even if it did not share the borrower's aim.

Conclusion

We have seen that the circumvention refers to an activity that frustrates a prohibition without technically violating it. Frustration is a slippery concept that is in need of further elaboration in official guidance and case law. What is clear, however, is that it is drawn in very broad terms, since what matters is not whether the activity involves certain specified actions, but whether its aim or effect is frustration. This can raise thorny compliance issues for companies. If a proposed transaction is structured to avoid a violation of a primary prohibition, it can be difficult to determine whether, in substance, one or more of the parties are really trying to obtain the same practical result by a different route, or whether the transaction now actually falls outside the scope of the sanctions.

There is no single formula for identifying 'frustration' that can be applied in all cases, and each case needs to be considered on its particular facts.

Companies also need to be alert to any proposed transactions that could have the object or effect of circumventing sanctions, since (as we have seen) a person who participates in such a transaction can be liable for circumventing sanctions even if they do not actively seek to do so. It could be the target of the sanctions that initiates the transaction; but it could also be a well-meaning company employee, who wants to service a customer but also at the same time wishes to stay 'onside' of sanctions. However, as will now be clear, there is no single formula for identifying 'frustration' that can be applied in all cases, and each case needs to be considered on its particular facts.

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Mitigating Customs risks: Establishing trade compliance processes on customer orders

Whilst Customs is not the bread-and-butter work of all *WorldECR* readers, they can sometimes find themselves involved with related issues that require know-how on tariff classification, country of origin, valuation, and Incoterms. Jeffrey Odenwald and Cristina Anderson's case study identifies the challenges and good practice in one such issue.

Many changes are taking place in the Customs world and a good number of those will affect trade compliance professionals. In the last year, the U.S. implemented the Trade Facilitation and Trade Enforcement Act, impacting many aspects of trade in every industry, and increasing trade enforcement activities. Most of the reforms aim to increase compliance with regulations and to protect the U.S. in the global marketplace. While always in a state of flux and subject to the political environment, global trade is generally moving toward the free and secure movement of goods, while maintaining necessary national security (i.e. trade with government-sanctioned entities).

Complex compliance challenges

For companies that do business in the global marketplace, international trade is an important part of their compliance programme. Ideally, Export, Import and Logistics departments are working closely together to bring consistency and stability to the supply chain. It is sometimes difficult to measure, but similar to export regulations, Customs issues can directly impact your bottom line. Margins can be quickly eroded by storage fees, unexpected duties and taxes, or even penalties, long after the shipment was delivered to your customer.

Trade professionals spend a great deal of time managing the sanctions and export controls programme at their company. However, they are often also pulled into Customs issues that require practical know-how on tariff classification, country of origin, valuation, and Incoterms.

The following example of a Customs-focused issue contains many common themes that companies face in today's complex global trade environment.

Case study

One of the U.S. manufacturing facilities you, the export compliance professional, are responsible for receives a customer request to replace some defective products under warranty. The goods are urgently needed, and fortunately they are in stock and can be shipped immediately. The local shipping department handles the packing and preparation of the export documents. The shipment leaves the facility the same day.

It is sometimes difficult to measure, but similar to export regulations, Customs issues can directly impact your bottom line.

The next day, you receive a call from U.S. Customs. They are questioning the declared product classification (ECCN) due to a poor product description on the invoice, and have pulled your shipment for examination. Upon review of the shipment, Customs also discovered that the packaging did not include an origin marking and as a result the shipment was opened for further examination. Customs explains that the actual product shows two contradictory origin markings, U.S. and Taiwan, but the commercial invoice shows the origin as U.S. As a result, Customs is unclear as to the origin of your product.

You immediately inspect the documentation to review the items requested by Customs. You find other potential issues:

- The invoice value does not match the aftermarket price of the goods.
- The documents show Incoterm 'FCA' (free carrier) as per the original order from the customer, but as it is a warranty order, DDP (delivered duty paid) terms were requested by the customer. They are not willing to pay the duties again and want your company to handle all of the costs to get the products to their door.
- When reviewing the destination requirements, you realise that the duty rate for your product is 14% and a non-resident importation is not allowed in that country. Also, a trade agreement is available to use, however, the analysis for qualification was not performed.

Immediate actions you should take:

1. The export classification must be confirmed by providing the proper supporting documentation to Customs. This requires a review to determine how the classification was obtained, and ensure an analysis was done correctly. It is important to provide a complete description and any available literature to Customs.
2. The origin issue is two-fold: first you must explain the origin marking on the product, and second you must explain the lack of an origin marking on the outer packaging.
   a. The bill of materials of the assembly shipped shows that one of the larger components was purchased in Taiwan. According to your origin policy, all suppliers are required to mark the product shipped to you, and in this case, the origin of the component is visible after the finished product is assembled.

Issue	Best practice	Mitigation/remedy
Product classification (ECCN)	Obtain written confirmation of the jurisdiction and / or classification from the government or outside counsel.	Request government confirmation of product classification. Verify classification with back-up documentation as needed. Provide a complete description of the goods.
Origin/origin marking	Have written corporate policies and local level procedures that cover origin declaration and physical marking.	Implement a corrective action with the shipping department at this facility. Advise Supply Chain to review the location of the origin marking on components and consider the marking location after assembly. Review and update procedures as needed.
Valuation	Have a global valuation guide that covers valuation of no sale items.	Revise the commercial invoice to reflect the correct value. Be prepared to back up that value.
Incoterms	Have a basic understanding of Incoterms and the effects of EXW and DDP on trade.	Revise the commercial invoice to show DDP and import by 'sister facility' or by freight forwarder. Review with Supply Chain to determine how these shipments will be handled in the future.
Free trade agreements (FTAs)	Have written corporate policies and local level procedures that allow for accurate and timely qualification of goods for any preferential trade agreement/ arrangement.	Import the shipment without the FTA or rush to obtain supporting documents if possible. Ensure the site has a programme in place to obtain back-up documentation for FTA qualification early in the process.

b. Since your company policy includes a requirement that outer containers are marked, you have to mitigate the failure of the shipping department to follow the procedure by implementing additional controls and providing training.

Prior to responding to Customs, the other issues identified must also be resolved, and the commercial documents must be revised to reflect the correct information.

A. The value of the product should be the fair market price even though there is no sale. The fair market value cannot be nominal, zero, or the cost of production.
B. Since the customer does not want to handle the import, show DDP Incoterms and arrange import clearance with a local 'sister facility' or the freight-forwarder. All charges will be billed back to the exporting facility. Check with your Tax department, as this scenario may have tax consequences.
C. For the free trade agreement ('FTA') issue, if you are not able to process the qualification now, you can ship the item without the free trade certificate and pay the duties. Qualifying a product for duty-free preference can take a few days or longer, especially if the facility does not have a process in place to collect the appropriate back-up from suppliers.

As a result of the issues above, this shipment remained at the U.S. port for several days at the expense of the exporting facility which resulted in a late delivery to the customer who is very displeased. In addition, you have now spent a significant amount of time correcting and explaining the errors made. All of this could have been avoided by incorporating certain key concepts (as shown in the table above) in your export programme training.

Good practice

As you can see from this example, the improper handling of orders may cause issues with Customs such as delays, penalties, seizures, audits, and/or enforcement activities and should not be taken lightly by trade compliance professionals.

It is important to have proper policies and procedures in place, train applicable personnel, and document compliance activities such as classification and compliance with FTAs.

Knowing that any one of the issues identified above may cause your company costly and time-consuming issues as well as your customer not to receive goods on time should be motivation to ensure compliance with Customs regulations.

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When exporters and freight-forwarders partner for compliance, both stand to benefit


Exporters and freight-forwarders should work together and share their knowledge to ensure that their transactions comply with applicable regulations, which will in turn help mitigate the risk of an export violation, write Jamie Joiner and Ashley Moore.

In the United States, every party to an export transaction is responsible for complying with the U.S. Export Administration Regulations ('EAR'). The source of this requirement is found in part 758 of the EAR which provides that '[a]ll parties that participate in transactions subject to the EAR must comply with the EAR'. This means that both U.S. exporters and U.S. freight-forwarders handling exports out of the U.S. bear liability, or risk of penalty exposure, if a given export transaction turns out to involve an unlicensed shipment or other EAR violation.

In this article, we make the case for U.S. exporters and freight-forwarders to view one another as partners in compliance and to approach export compliance as a shared responsibility. First, we outline the general compliance responsibilities of U.S. freight-forwarders and U.S. exporters. Next, we discuss the unique compliance challenges that freight-forwarders and exporters face. Third, we discuss the particular compliance challenges that routed exports pose for both U.S. freight-forwarders and U.S. sellers. And, finally, we make the case for a collaborative approach to export compliance. At the same time, we provide practical tips for U.S. exporters in working with freight-forwarders and for freight-forwarders in working with U.S. exporters and sellers.

While this article focuses on exports from the U.S. and the relationship between U.S. exporters and U.S. freight-forwarders, we view these principles as useful to global export transactions as well.

Compliance responsibilities of U.S. freight-forwarders

Freight-forwarders are individuals or companies that organise shipments, including coordinating the logistics, to transport goods from one party and location to another. According to guidance for freight-forwarders provided by the U.S. Department of Commerce's Bureau of Industry and Security ('BIS') on its website, 'forwarding agents have compliance responsibilities' under the EAR 'even when their actions are dependent upon information or instructions given by those who use their services.'[1] In this published guidance, BIS goes on to say: 'Agents are responsible for the representations they make in filing export data. ...no person, including an agent, may proceed with any transaction knowing that a violation of the EAR has, is about to, or is intended to occur. It is the agent's responsibility to understand its obligations.'

This responsibility of freight-forwarders is primarily rooted in general prohibition 10 ('GP 10') of the EAR, which prohibits freight-forwarders and others from participating in a transaction with knowledge that a violation of the EAR has occurred or is about to occur.

Within the last ten years or so, we have seen BIS issue penalties against freight-forwarders and point to these cases as examples to illustrate that freight-forwarders bear a responsibility for export compliance in connection with the export transactions they handle. Until those penalty cases began

occurring, it was clear that exporters bore responsibility and liability for compliance but it seemed that forwarders were not held responsible for violations. That has clearly changed in recent years.

Freight-forwarders' responsibility for export compliance can also be found in the Foreign Trade Regulations ('FTR') of the U.S. Census Bureau. The FTR provide that the person who files electronic export information ('EEI') in the Automated Export System ('AES'), including a freight-forwarder, is responsible for the representations made in the AES. This means that both the freight-forwarder and the principal party in interest who has authorised the forwarder are responsible for the accuracy of each data element submitted in the AES.

An interesting case from July 2016 demonstrates that the U.S. government will hold freight-forwarders liable for false export declarations. In this case, a freight-forwarder in Jamaica, New York, and its owner and president, agreed to pay $500,000 (with $350,000 conditionally suspended) to settle charges that they violated the EAR by concealing and misrepresenting the identity of the exporter, or U.S. principal party in interest, on the electronic export declaration and submitting false statements to BIS in the course of the investigation.

BIS advises freight-forwarders in its published guidance that, while good faith reliance on information obtained from the principal party in interest can help protect a forwarding agent, the careless use of 'No License Required,' or unsupported entries, can get a freight-forwarder into trouble.

Compliance responsibilities of U.S. exporters

The responsibility for compliance that exporters bear is now so well established that we will not spend much time discussing this topic. Yet, even today, there are still many U.S. exporters who believe that by hiring a freight-forwarder or other agent to move their goods they can fully depend on the freight-forwarder to meet all the regulatory requirements and to alert them (the exporter) to any export licensing requirements.

As BIS describes in its guidance, while freight-forwarders have compliance responsibilities under the EAR, the principal parties in interest, the U.S. seller and non-U.S. buyer, have primary responsibility for compliance and the hiring of an agent, including a freight-forwarder, does not absolve the U.S. exporter from its primary responsibility to comply with these regulations. There are numerous penalty cases against exporters that can be viewed on the BIS' website to illustrate this point.

Compliance challenges faced by freight-forwarders

Freight-forwarders face particular challenges when it comes to export compliance because they virtually never have direct access to the information necessary to make an export licensing determination and are dependent upon their customer to provide them with complete and accurate information regarding the exports they handle.

Freight-forwarders typically have neither the technical expertise to verify an export classification nor do they, realistically, have the time necessary to classify or verify the classifications of all the items included within an export shipment they are handling.

To illustrate this point, consider the key facts needed to make an export licensing determination:

1. the export classification of the items being exported;
2. the country of ultimate destination;
3. the end-user (ultimate consignee); and
4. the end use.

Freight-forwarders are generally not privy to the sales or other business discussions that exporters and their overseas customers, or recipients, conduct. It is through these discussions and communications that exporters come to learn (or should come to learn) the country of ultimate destination of their goods, the identity of the end-user (who is often not the customer or initial recipient of the goods), and the intended end use for the goods. In addition, to determine or confirm the accuracy of an EAR99, Commerce Control List ('CCL'), or U.S. Munitions List ('USML') classification of the goods to be exported, one needs access to technical specifications of those items given that many CCL and USML entries contain technical parameters to describe the items that are intended to be classified in those provisions.

Freight-forwarders often lack access to such technical specifications and, even where technical data sheets for the exported items are publicly available online, the published data sheets often lack the full listing of technical parameters required to accurately classify an item on the CCL or USML. Freight-forwarders typically have neither the technical expertise to verify an export classification nor do they, realistically, have the time necessary to classify or verify the classifications of all the items included within an export shipment they are handling. BIS recognises this and advises that freight-forwarders without the appropriate technical expertise should avoid making commodity classifications, and all freight-forwarders should obtain support documentation for commodity classifications.

This lack of access to the information necessary to make an export licensing determination is one of the main reasons most freight-forwarders require the export/shipper to complete and submit a shipper's letter of instructions ('SLI') which often mirrors the EEI data elements required to be filed for most exports leaving the U.S. The freight-forwarder's lack of access to the information necessary to verify or 'look behind' the data provided by the exporter in the SLI occasionally leads to an unquestioned reliance on the information provided by the exporter and a failure to question the information provided by the exporter, even when there are 'red flags' indicating that the exporter lacks the requisite understanding of the EAR to provide complete and accurate information about their export transaction and, in some cases, even where there are 'red flags' that a violation could be about to occur.

In our view, there are at least four

Practical tips for exporters in selecting and working with freight-forwarders

We are often perplexed by the lack of due diligence and vetting that U.S. exporters undertake in identifying and selecting a freight-forwarder service provider. Likewise, we are often surprised by the lack of monitoring and oversight that exporters exercise over their freight-forwarders once selected. For some reason, exporting companies often do not put freight-forwarders through the same rigorous request for proposal ('RFP') and similar processes that they apply to virtually all other types of vendors and service providers they use. In fact, U.S. sellers frequently allow their foreign customers to designate a U.S. freight-forwarder to handle an export shipment out of the U.S. (a routed export) and the U.S. seller is content to let that forwarder, with whom they have no commercial relationship, file certain EEI (electronic export information) through the AES (Automated Export System) that identifies the U.S. seller as the U.S. principal party in interest.

In many instances, the U.S. exporter has never met their freight-forwarder (or designated account representative) in person. Freight-forwarders carry great responsibilities and the filings they make either on behalf of U.S. exporters (in non-routed transactions), or referencing U.S. sellers (in routed transactions), can lead to tremendous liability and/or costs if those filings contain incorrect or incomplete information.

The following are some practical tips for U.S. exporters and sellers in both non-routed and routed export transactions:

- Carefully vet potential freight-forwarders by either visiting their office or having them visit your office, and request a presentation on their company, their approach to export compliance, and their commitments to you as a service provider.
- Request a copy of the export compliance programme of any freight-forwarder you are considering engaging.
- Request monthly electronic reports and copies of export filings made on your behalf.
- Create key performance indicators ('KPIs'), or other performance metrics against which to measure the performance of your freight-forwarder and provide the results to them on a periodic basis.
- Include in your KPIs or other methods by which you communicate your service expectations to your freight-forwarder a request that they serve as a 'second set of eyes' and that they question any transaction that appears to them to contain a 'red flag' or missing information.
- Require the forwarder to provide you with their proposed corrective actions in response to any performance failures or areas for improvement identified.
- Ensure that your own export compliance programme includes a post-export audit procedure under which you are reviewing all or a sampling of the export filings made on your behalf.
- Ensure that any errors identified through your post-export audit procedure are promptly reported for appropriate corrective action.
- If you have medium to high export volumes, request no-cost additional value-adds from your freight-forwarder such as bi-annual presentations on updates to export regulations.
- Ensure that your own export compliance programme includes obtaining signed ultimate destination, end-user, and end use statements that are vetted by you, and provide a copy to your freight-forwarder to maintain in their shipping files associated with your organisation.
- If you choose to engage in routed export transactions, consider maintaining control over the AES filing either by filing it yourself or by having your own selected agent complete the filing. This is perfectly permissible and does not change the commercial terms or legal qualification as a routed export transaction but has the benefit of keeping you in control of a U.S. government filing that will designate you as U.S. principal party in interest.
- If you choose to engage in routed export transactions and you decide to assume the risk of allowing your customer's forwarder to complete and file AES, only provide the 12 data elements required under the Foreign Trade Regulations ('FTR') of the U.S. Census Bureau and do not issue a power of attorney to your customer's freight-forwarder.
- Ensure that your shipper's letter of instructions ('SLI') is customised to your needs and your situation. Though forwarders will always provide you with their 'form' SLI, you can be sure that it is written in their favour and often does not conform to commercial and legal realities. For example, in a routed export transaction, you are not required to provide all of the data elements that appear on most forwarders' standard SLIs. Rather, you are required to provide only the 12 data elements specified in the FTR.
- Ensure that you always receive copies of filings made on your behalf and filings that reference your organisation. Even in routed export transactions where your customer's forwarder files the EEI in AES, you are entitled to receive a copy of that portion of the AES filing that reflects the 12 data elements that you as the U.S. principal party in interest were required to provide. You should scrutinise these filings for accuracy and report any errors for correction.

other important contributors to 'blind reliance' by freight-forwarders on the data provided by exporters on SLIs, and the reluctance of freight-forwarders to question shippers on the accuracy of the data provided:

- time pressure;
- customer service or sales pressure;
- fear of incurring liability by asking too many questions; and
- lack of knowledge of the regulations or lack of a sufficient appreciation of the importance of export compliance.

Time pressure and customer service, or sales pressure, are closely linked. The shipping business is fast-paced. Move too slowly or delay the process by asking too many questions and a forwarder can, quite literally, 'miss the boat'. Logistics can be, depending on a given provider's business model, a volume business. Many freight-forwarders and customs brokers charge a flat rate per export filing or entry filing and taking the time to question the information a shipper has provided on a SLI can take time that does not increase the revenue earned on that transaction. Customer service or sales pressure plays a role for many account representatives of freight-forwarders when they receive 'push back' from their shipper customers who complain about the forwarder asking so many questions.

A common refrain from such misinformed exporters is that their previous forwarder 'just handled' their exports and did not require the exporter to provide so many details about their export shipments. Such 'push back' can turn into complaints of alleged poor customer service by the freight-forwarder. This is extremely short-sighted.

Another contributor to the reluctance of some freight-forwarders to question the data provided by shippers on SLIs is the fear that, if they ask too many questions, they may create liability for themselves personally and for their employer. This is not an unrealistic or inaccurate fear given that GP 10 incorporates a 'knowledge' requirement – a violation of GP 10 occurs when the forwarder proceeds 'with knowledge' that a violation is about to occur. However, it is far better in our view to ask the questions that will help lead to confirming that no violation will occur at all. This is because, even where a freight-forwarder is not ultimately held liable or penalised for their role in an export violation, there are lost opportunity and other costs associated with being involved in a violation. The forwarder will almost certainly be interviewed by the enforcement agents who are investigating the exporter/shipper. This often involves receipt by the forwarder of a subpoena for documents and records associated with the export that is under investigation. This leads to legal fees and other costs both internal and external.

A final reason why some freight-forwarders do not ask questions of exporters designed to help ensure that the transaction at issue does not violate the export regulations is a lack of awareness or knowledge of the regulations by the freight-forwarder. Unfortunately for nearly everyone involved, there are many U.S. freight-forwarders who do not invest in learning or staying current on U.S. export regulations and they do not make their customers aware of their compliance obligations simply because they themselves are either unaware or they lack a sufficient understanding and appreciation of these requirements and the consequences of violating them.

Not all freight-forwarders approach export compliance equally and many freight-forwarders are to be commended for the value they place on export compliance. Compliance-focused forwarders today have their own export compliance programmes, train their account representatives to ask compliance-related questions of their customers, and some have in-house compliance personnel who review transactions for compliance and, in some cases, provide compliance advice to customers.

In our experience, many exporters over-rely on their freight-forwarders for export compliance. These are the shippers who still have not got the message that they may not simply 'outsource' export compliance to a forwarder or other agent. It is incumbent upon exporters to play an active role in gathering complete and accurate information required under U.S. export regulations for their export transactions and to convey that information fully and accurately to any freight-forwarder or other agent the exporter has engaged to file EEI on their behalf and to arrange for shipping.

Unfortunately for nearly everyone involved, there are many U.S. freight-forwarders who do not invest in learning or staying current on U.S. export regulations.

Compliance challenges faced by exporters

Exporters are in a much better position than freight-forwarders to know or to be able to obtain the key facts needed to make an export licensing determination. In practice, though, there are many exporters who, for various reasons, lack the experience or the knowledge to understand their export compliance obligations. Freight-forwarders, whose business pertains solely to international logistics and exporting, are doing their inexperienced customers a disservice by not raising these issues and making their customers aware of their obligations.

Routed export transactions pose particular compliance challenges

U.S. routed export transactions pose particular compliance challenges for both the U.S. principal party in interest (the U.S. seller) and the U.S. freight-forwarder.

In a routed export transaction, the foreign (non-U.S.) principal party in interest (typically, the purchaser), is responsible for controlling the sending of the goods out of the U.S. This is effected in practice through logistics agents. Commonly, the non-U.S. buyer has purchased goods from the U.S. seller under *ex works* or similar terms of sale under which the buyer is responsible for arranging (and paying) for export clearance out of the U.S. and shipment from the seller's premises in the U.S. to the buyer's premises or desired delivery location outside the United States.

The non-U.S. buyer typically engages the services of its local customs broker to clear the goods for import into the buyer's country and the customs broker will often 'sub-contract' a U.S. freight-forwarder within their network of agents to clear the goods for export from the U.S. and to arrange for transportation of the goods out of the U.S. In routed export transactions, therefore, the U.S. freight-forwarder's 'customer' in reality is the foreign customs broker. There is no direct commercial relationship between the U.S. freight-forwarder and the U.S. seller.

Yet it is the U.S. seller who is most likely to possess the information necessary to appropriately classify the goods for export and it is the foreign buyer who is in the best position to know the intended country of ultimate destination, end-user, and end use of the goods. The U.S. seller in these types of sales has specifically contracted to deliver their goods to the foreign buyer within the U.S. and, for commercial purposes, has little to no motivation or desire to ask about the country of ultimate destination, end-user, and end use.

In a properly structured routed export transaction, the U.S. freight-forwarder becomes the 'exporter' under the EAR for export compliance purposes. This means that the freight-forwarder is the one responsible for determining if an export licence is required and the freight-forwarder is the one responsible for applying to BIS for that export licence. The fact that the U.S. seller is being listed as the U.S. principal party in interest in the AES filing does not absolve the U.S. freight-forwarder of its export compliance responsibilities in these types of transactions.

It is true that, under the EAR and

Practical tips for freight-forwarders in working with U.S. exporters/shippers

As discussed in this article, freight-forwarders typically do not have access to the four key facts needed to make an export licensing determination and generally must rely on the U.S. exporter or the principal parties in interest to obtain and provide this information. However, there are several steps that freight-forwarders can take in both non-routed and routed export transactions to help ensure export compliance and to protect themselves and their customers against penalty risks:

- Require your customers to provide the four key facts (export classification of the goods being exported, country of ultimate destination, end-user, and end use) to you in writing and maintain that in your files.
- Do not blindly rely on the accuracy of the four key facts provided by your customer. Ask questions about how the facts were obtained and educate your customers on the meaning of the four key facts particularly given that there is widespread misunderstanding of the meaning of the terms country of ultimate destination, end-user, and end use.
- Educate your customer on regulatory changes including that the country of ultimate destination does not mean an intermediate country. With the 2016 revisions to the EAR, section 734.13(c) now provides: 'The export of an item that will transit through a country or countries to a destination identified in the EAR is deemed to be an export to that destination.'
- Advise your customers to obtain signed ultimate destination, end use, and end-user statements and request and retain a copy of such statements in connection with the export transactions you handle.
- Investigate 'red flags' that indicate an unlawful diversion may be planned, or that raise questions in your mind about the accuracy of the export classification, country of ultimate destination, end-user, or end use provided.
- Do not be naïve to the reality that there are many bad actors who operate trading rings and a host of schemes aimed at getting around the restrictions on exporting to certain countries, end-users, and end uses.
- Be alert to the fact that there are procurement agents operating within the U.S. and that 'trading houses' and 'export companies' whose business consists only of buying products domestically in the U.S. and exporting them, pose increased risks and merit additional scrutiny and due diligence.
- Attend BIS export compliance seminars and review the BIS website frequently to stay informed of regulatory changes and updates.
- Educate yourself on the risks of engaging in routed export transactions and be aware that these carry special risks and concerns for U.S. freight-forwarders because the forwarder in a routed export becomes the 'exporter' for EAR purposes.
- Take precautionary compliance steps, including the implementation of an export compliance programme, to help prevent violations and to mitigate the risk of exposure in connection with the export transactions you handle.

With some planning and careful due diligence, freight-forwarders can make compliance a value add for their customers which will let them know that the freight-forwarder is looking out for their interests and is raising questions the customer needs to consider to protect themselves. This also protects the freight-forwarder in the process.

the FTR, the foreign buyer (the foreign principal party in interest), is required to assume in writing the responsibility for determining export licensing requirements. However, in reality, the foreign buyer often does not understand or appreciate what, to the buyer, are foreign legal requirements. The U.S. freight-forwarder is left working to obtain the best possible information from the U.S. seller (with whom the forwarder has no commercial relationship), and the U.S. seller is not highly motivated to provide accurate export classification and other information about the export because they are often selling under *ex works* or similar terms because they are not particularly comfortable with international sales and shipping. In practice and in our experience, this can lead to routed export transactions involving incomplete or inaccurate information and, again based on our experience, violation exports in many cases turn out to be routed (as opposed to regular) export transactions.

As BIS says in its published guidance, forwarders, especially those acting as the 'exporter' in routed export transactions, should understand the 'Know Your Customer' guidance and 'red flags' found in supplement number 1 to part 732 of the EAR. Forwarding agents and exporters should determine if 'red flags' are present, exercise due diligence in inquiring about them, and ensure that suspicious circumstances are not ignored. Failure to do so could constitute a violation of the EAR. Freight-forwarders should also review the ten general prohibitions found in part 736 of the EAR, as well as the EAR violations described in part 764 of the EAR.

A collaborative approach to compliance

Exporters and freight-forwarders should work together to help mitigate their risks of exposure and to ensure that their export transactions comply with the applicable regulations and not just because both parties stand to lose if there is a violation. Many of the enforcement investigations and cases we are seeing in the U.S. involve either (1) an intentional effort by someone, often a foreign company (but increasingly from our perspective by a U.S. company), to conceal the true destination of a shipment or the true end-user or recipient, or (2) a lack of sufficient effort or interest in conducting adequate due diligence to identify the true destination country, the true ultimate end-user, or the true intended end use. The more eyes and ears on a transaction, the greater the likelihood of identifying attempts at diversion.

Links and notes

[1] See: https://www.bis.doc.gov/index.php/forms-documents/doc_view/620-new-freight-forwarder-guidance

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Wins all round: China and its implementation of the JCPOA

The Chinese government has given vigorous support to the process leading up to the signing of the Joint Comprehensive Plan of Action and it will reap the rewards, writes Johnny Xie.

On 14 July 2015, the P5+1 (China, France, Germany, Russia, the United Kingdom, and the United States), the European Union ('EU'), and Iran reached a Joint Comprehensive Plan of Action ('JCPOA') to ensure that Iran's nuclear programme will be exclusively peaceful. 18 October 2015 was Adoption Day, the date on which the JCPOA came into effect and participants began taking steps necessary to implement their JCPOA commitments. This was followed on 16 January 2016 by Implementation Day of the JCPOA, the point at which, as a result of Iran verifiably meeting its nuclear commitments, countries started to lift nuclear-related sanctions on Iran, as outlined under the terms of the JCPOA.

As readers of *WorldECR* will know, sanctions against Iran are numerous. Generally, these sanctions can be divided into two categories: those imposed by the United Nations ('UN'), and those that have not been mandated by the United Nations.

UN sanctions are those resulting from the resolutions passed by the UN Security Council, such as resolutions 1696, 1737, 1747, 1803, 1835, and 1929 etc. They are nuclear-focused and limited to certain areas in general. The European Union and the United States, of course, have imposed additional, unilateral sanctions – which have the potential to easily escalate from pure non-proliferation controls to comprehensive embargoes – against Iran.

The turning point came in 2009 when EU-Iran trade dropped significantly and China replaced EU to become Iran's largest trading partner.

By contrast, China, in practice, only recognises and implements the UN sanctions, and by itself has not imposed any unilateral sanctions on Iran. This policy disparity has actually made China the biggest winner in the Iranian nuclear issue because when the EU and U.S. closed the door on trading with Iran by ratcheting up the sanctions, China became a viable alternative trading partner – both able to absorb Iran's oil output, and supply it with industrial products and technologies.

For example, before 2009, EU-Iran trade constituted 90% of Iran's total foreign trade. The turning point came in 2009 when EU-Iran trade dropped significantly and China replaced the EU to become Iran's largest trading partner. The gap has widened ever since. In 2014, China-Iran trade amounted to 51.8 billion US dollars. In line with that trajectory, the two nations expect the figure to total some 600 billion U.S. dollars over the next ten years.

At face value, such a state of affairs constituted a 'win' for China – nonetheless, it was also a cause of significant concern for the country.

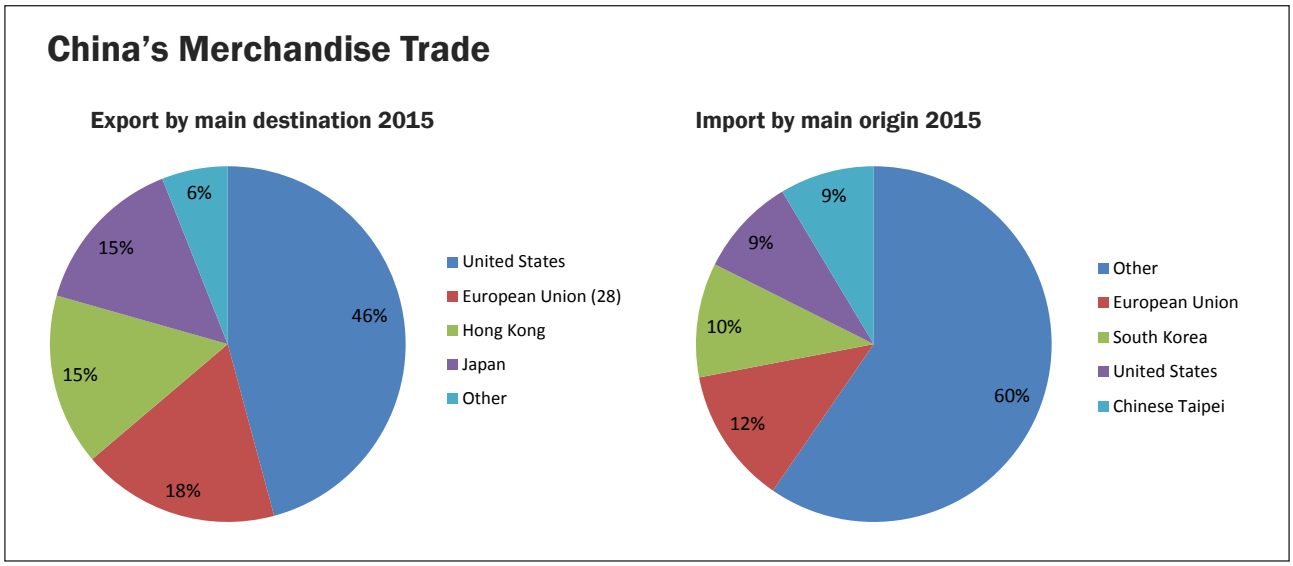
Why? Because if we take a step

EU trade with Iran

Period	Imports			Exports			Balance	Total trade
	Value Euro(m)	% Growth	% Extra - EU	Value Euro(m)	% Growth	% Extra - EU	Value Euro(m)	Value Euro(m)
2005	11,538		1.0	12,994		1.2	1,456	24,532
2006	14,376	24.6	1.1	11,295	-13.1	1.0	-3,082	25,671
2007	14,052	-2.3	1.0	10.125	-10.4	0.8	-3,926	24,177
2008	15,942	13.5	1.0	11,341	12.0	0.9	-4,601	27,283
2009	9,384	-41.1	0.8	10,434	-8.0	1.0	1,050	19,818
2010	14,528	54.8	1.0	11,319	8.5	0.8	-3,210	25,847
2011	17,329	19.3	1.0	10,497	-7.3	0.7	-6,832	27,826
2012	5,652	-67.4	0.3	7,379	-29.7	0.4	1,727	13,031
2013	783	-86.1	0.0	5,446	-26.2	0.3	4,662	6,229
2014	1,158	47.8	0.1	6,424	18.0	0.4	5,267	7,582
2015	1,233	6.5	0.1	6,488	1	0.4	5,255	7,721

Key: % Growth: relative variation between current and previous period
% Extra - EU: imports/exports as percentage of all EU partners i.e. excluding trade between EU Member States

Source: Eurostat Comext - Statistical Regime 4



back, the big picture will show that for China itself, the most important trading partners at the macro-level are the European Union and the United States – not Iran; China's divergent, but profitable trade policy toward Iran came at the cost of a loss incurred by the country's more significant partners.

A 'penny wise and pound foolish' approach is unacceptable to China. In order to secure its vested interest and at the same time avoid irritating partners, China needed a mechanism that would legitimise its gains in Iran. The JCPOA provided just that device, removing the sanctions imposed so that doing business with Iran would become a natural and decent thing.

Investment in the JCPOA

China is a true supporter of the JCPOA. It has participated in the whole negotiation process, and contributed ideas and approaches to the settlement of difficult issues such as uranium enrichment and lifting sanctions.

Since reaching the JCPOA, China has actively made preparations for the implementation of the agreement with all parties. For instance, in the case of the Arak heavy water reactor renovation, China has put a lot of effort into communication and cooperation with all the parties, facilitated the reaching of the 'official document' and 'memorandum of understanding', and helped the smooth arrival of the 'Implementation Day'. China also donated 4 million RMB (more than US$500,000) to the International Atomic Energy Agency ('IAEA') for its relevant inspection tasks under the JCPOA. China even earmarked over 2 million RMB in its government budget 2016 just for the travel costs of Chinese experts and officials participating in the implementation of JCPOA.

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With respect to the business sector, the JCPOA requires that all nuclear-related transactions shall be under the supervision of the UN Security Council for ten years. In line with the principle for trade compliance, China's Ministry of Commerce, Ministry of Foreign Affairs, China Atomic Energy Authority, and the General Administration of Customs made a Joint Announcement (No. 13 of 2016)[1] on 1 April 2016, which requires Chinese exporters to:

- For each and every export of nuclear dual-use items and technologies to Iran, file a licence application in advance to the Ministry of Commerce;
- Provide end-user and end-use certificates issued by Iranian official entities;
- Present the dual-use licence to Customs when making the export declaration;
- Submit the cargo transport information to Commerce before shipping;
- Keep both the application and the approval information confidential.

In summary, at both the policy level and the practical level, the JCPOA is fully implemented by China.

Moving forward

Now almost one year from the Implementation Day, we are happy to see that the JCPOA has been honoured by the parties and is working as intended. IAEA chief, Yukiya Amano commented in December 2016 that 'Iran has been committed to its obligations. We are satisfied with the trend of the JCPOA's implementation, and hope for this trend to continue.' Consequently, the risk that Iran could suddenly produce significant quantities of nuclear-weapon materials has been reduced. Peace and economic prosperity takes form.

Looking forward, in dealing with similar issues, we know that engagement and negotiation rather than isolation and sanction is more likely to produce solutions.

Links and notes

[1] http://www.mofcom.gov.cn/article/b/g/201606/20160601330619.shtml

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