

Billion Dollar Fine Signals the White House's Agenda for Export Controls Enforcement

The law firm of Tucker Arensberg contributes this quarterly column focused on the legal issues that may impact our readers. Tucker Arensberg is a full-service law firm headquartered in Pittsburgh, Pa., USA. Servicing the legal needs of the iron and steel industry, Tucker Arensberg has also provided legal counsel to the Association for Iron & Steel Technology.



Author

Mark C. Hamilton
attorney, Tucker Arensberg
Attorneys, Pittsburgh, Pa., USA
mhamilton@tuckerlaw.com

TUCKER ARENSBERG
Attorneys

If you have any questions about this topic or any other legal topics, contact attorney Thomas P. Peterson at +1.412.594.3914 or tpeterson@tuckerlaw.com. Please include your full name, company name, mailing address and email address in all correspondence.

Views expressed in Legal Perspectives do not necessarily reflect those of *Iron & Steel Technology*.

During the recent presidential election, Donald Trump frequently inveighed against China for unfair trade practices, currency manipulation and theft of American intellectual property. While U.S. export regulations was not a campaign topic, an early move by the Trump administration signals that export controls enforcement may be a key part of the administration's strategy for dealing with economic competitors who run afoul of American laws.

In March, the U.S. government levied a US\$1.19 billion fine against China's Zhongxing Telecommunications Equipment Corp. and ZTE Kangxun Telecommunications Ltd. (known collectively as ZTE) for the illegal shipping of telecommunications equipment to Iran and North Korea. This is the largest fine ever imposed for violation of American export regulations, and it involves separate penalties assessed by the Commerce, Treasury and Justice Departments.

The penalties were revealed during a press conference in which Secretary of Commerce Wilbur Ross announced that enforcement of export controls would be a priority for the Trump administration:

With this action, we are putting the world on notice: improper trade games are over. Those who flout our economic sanctions, export control laws, and any other trade regimes, will not go unpunished — they will suffer the harshest of consequences. But this case is just the beginning: Under President Trump's leadership, we will be aggressively enforcing strong trade policies with the dual purpose of protecting American national security and protecting American workers.

In addition to the monetary penalties, ZTE has been added to the Commerce Department's Entity List, which makes it subject to specific license requirements for the export of specified items. ZTE also agreed to cooperate with certain audit and compliance requirements in conjunction with a seven-year suspended denial of its export privileges, which can be activated if ZTE fails to meet its obligations under the deal.

So what did ZTE do wrong and what are the lessons for American exporters? The answers to these questions require some background information on the relevant export regulations.

A Primer on U.S. Export Controls

The United States maintains export control regulations to advance its national security, foreign policy and economic objectives. These regulations are detailed, complex and far-reaching. They concern products and technologies that originate in the United States, but the regulations actually govern activities that occur in the U.S. and abroad. Moreover, export regulations cover both physical exports and the sharing of certain types of technical information, whether verbally or through the electronic transmission of data. Thus, an unlicensed "export" can occur inside the United States if controlled information is provided to a foreign national.

These regulations are collectively administered by more than 10 separate federal agencies, with the Commerce Department and State Department having the lion's share of export control authority, while the Treasury Department oversees economic and

trade-related sanctions through its Office of Foreign Assets Control (OFAC).

There are two main sets of export control regulations: the International Traffic in Arms Regulations (ITAR) and the Export Administration Regulations (EAR).

ITAR is administered by the State Department's Directorate of Defense Trade Controls. ITAR is mainly concerned with military hardware and technology. If a specific defense article or service is on the U.S. Munitions List (located at Part 121 of Title 22 of the Code of Federal Regulations), a license is required in order for it to be legally exported.

In essence, the EAR covers everything else. The EAR is administered by the Commerce Department's Bureau of Industry and Security. The main purpose of the EAR is to regulate the export of "dual-use" items and technology. A dual-use item is something that was designed for a commercial or civil use, but also has a potential military application.

To determine whether a license is required under the EAR, the item must first be classified correctly by reviewing it against the Commerce Control List (EAR Part 884, Supplement 1) and identifying the appropriate Export Control Classification Number (ECCN). At that point, the ECCN must be cross-referenced against the Commerce Country Chart. The Government regulates items differently depending on its destination.

In addition to the above regulations, the Government also maintains various lists, such as the Debarred List, Denied Persons List, Entity List, Unverified List, Lists of Parties of Concern, and Specially Designated Nationals and Blocked Persons List. In some cases, dealings with a party on one of these lists is prohibited. In other cases, specific license requirements or other restrictions apply.

How the Government Adjudicates Export Violations

Needless to say, given all the interlocking regulations, it is easy for companies to unwittingly commit export violations. Yet these regulations are important to American national security and the government takes them seriously.

So what exactly did ZTE do? In a nutshell, ZTE knowingly shipped telecommunications equipment to Iran and North Korea in violation of both the EAR and the specific OFAC regulations pertaining to those two countries. To make matters worse, ZTE engaged in evasive conduct to prevent the detection of its violations and took affirmative efforts to impede the government's investigation. The fact that ZTE acted deliberately to violate U.S. export control laws and attempted to deceive law enforcement goes a long way to explaining the unprecedented punishment handed down by the Trump administration.

But make no mistake: Even accidental violations can carry stiff penalties. Civil ITAR penalties can be assessed at up to US\$500,000 per violation. Civil penalties for EAR violations range considerably, but maximum civil penalties are the greater of US\$250,000 or twice the value of the transaction per violation. The Commerce Department has considerable leeway in assessing penalties based on the circumstances of the transaction and whether the offending party voluntarily self-disclosed the offense.

Implications for Steel and Metal Exporters

Given Washington's renewed emphasis on enforcement, it is time for specialty steel and metal exporters to re-examine their own compliance efforts.

A large number of specialty steel and metal products and technologies are regulated by EAR. To give just a few examples, certain metal alloys, metal alloy powders, and alloyed materials are classified under ECCNS 1C002 and 1C202. Certain magnetic metals are also classified at ECCN 1C003 and maraging steels are classified at either ECCN 1C116 or 1C216.

The Commerce Department has and will enforce EAR regulations against U.S. metal exporters. Consider the following:

- In 1997, a producer was assessed with a US\$122,500 penalty for shipping titanium alloy and maraging steel products without the required export licenses.
- In 2005, another producer agreed to pay a civil penalty of US\$12,000 for three EAR violations involving the unlicensed export of titanium rods to Israel and Mexico.
- In 2009, a company agreed to a US\$700,000 settlement for making 15 unlicensed shipments of nickel powder to China, Singapore, Taiwan, Thailand, India, Israel, the Dominican Republic and Mexico.

So how do exporters protect themselves? The most important thing is to follow a written export compliance program. If your company manufactures or exports any potentially controlled products, it needs a compliance program. And it is important to remember that since even the sharing of technical information is subject to EAR control, the employment of foreign nationals can be problematic even in the manufacturing context.

If your company already has a written compliance program, now would be a good time for an audit to make sure the program is being implemented as intended. Even a company that has a time-tested compliance program can benefit from an audit. The very fact that your company went through this process may have mitigation value with the government in the event of a future export violation.

Short of an audit, a targeted risk assessment is another option to consider. A risk assessment is designed to examine a specific export transaction to make sure the product is being accurately classified and the customer has been properly vetted. Risk assessments are particularly appropriate when your company is shipping a new product type or engaging with a new overseas customer for the first time.

Compliance training for employees is another good idea. Are your employees familiar with the relevant company policies relating to export controls and do they document their compliance with these policies as a regular part of their job? Such documentation would be another mitigating factor in the event of an accidental export violation.

Finally, does your company have a strategy for dealing with potential violations? Quality internal investigations followed by timely and coordinated disclosure to the government are crucial to avoiding harsh penalties and bad press.

In the export control world, the proverbial ounce of prevention is definitely worth a pound of cure. Given the winds from Washington, there is no time to waste. ♦