



Export control is a virtual minefield

Without a solid compliance system to address changing export controls, US companies that ship chemicals risk damage to their reputation and the bottom line

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Did you hear about the company that thought it was exporting an ingredient for hand lotion, but was penalized over \$250,000 (€189,000) for shipping a chemical weapons precursor? What about the company that is facing the potential indictment of four executives and between \$110m–210m in penalties for illegal exports?

These companies didn't have effective systems to address one of the most important international regulatory issues facing the chemical industry – export control. What can you do to avoid similar mistakes?

If your company moves chemicals, petroleum products or fertilizers around the world, and especially if you ship those products or related equipment outside the US, you need a simple, solid compliance system to deal with changing export controls. Companies moving these products, certain specialized shipping containers or equipment for manufacturing chemicals are increasingly subject to big penalties, shipment seizures and shipping delays related to export control regulations issued by the US and other countries.

Violations of export control rules – which have almost no relation to hazmat transport regulations – can have a devastating effect on your company's reputation and the bottom line. The penalties for a single error can involve criminal charges, and civil penalties have been raised to \$250,000 per shipment or twice the value of the shipment, whichever is higher.

These penalties apply whether your company knows the relevant rules or not. And frankly, too many companies in the industry have inadequate systems for dealing with export control rules no real compliance system at all. Instead, they depend on freight forwarders who don't really know the rules relating to your company's products, or they depend on Jim or Gladys in shipping to handle it. No offense to Jim or Gladys, but often they have not had the training required to do the job properly. If your company is in that situation, this article provides more background and some suggestions to help reduce this potentially significant risk.

A SMALL MISTAKE, A MAJOR LOSS

On December 19, 2011, the US Commerce Department issued an order requiring payment of a \$275,000 civil penalty to settle export violations that occurred between 2007 and 2010. The violations involved 16 unlicensed shipments of triethanolamine (TEA), a relatively common chemical compound used in cosmetics, photograph processing, and many other applications. The shipments went to an affiliate entity in Brazil, and were valued at less than a quarter of the penalty amount.

This wasn't an unusual case: in recent years, well over 70 companies in the chemical and allied industries have been penalized for export control violations. The number of criminal cases is exploding, enforcement agents pay announced and unannounced visits to companies, hundreds of new ICE and FBI agents are now enforcing export control

regulations, and two new enforcement coordination centers were created in recent months.

Why such a big penalty for a seemingly benign chemical? It turns out that in addition to its use as an ingredient in lotions, TEA can also be used to make nitrogen-based vesicants similar to mustard gas, which is regulated under the 1993 Chemical Weapons Convention.

Because it is a chemical weapon precursor, TEA, along with roughly 90 other chemicals, is controlled for export under the US Export Administration Regulations (EAR) and many other countries' export control regulations. The US regulations, which are administered by the Department of Commerce's Bureau of Industry and Security (BIS), apply to "dual-use" items that have both commercial and military or weapons proliferation applications. While most items in the marketplace are subject to the EAR in one way or another, only certain listed chemicals, fertilizers, and petrochemical items are controlled for export

DON'T MIX UP YOUR NUMBERS!

Some freight forwarders confuse Export Control Classification Numbers (ECCNs), which are used to determine export licensing, with Harmonized Tariff System numbers (also known as Schedule B numbers), which are used purely for tracking trade statistics on outbound shipments. This is a common – and potentially very costly – error.

– meaning a license is required for export to listed destinations.

As in other classification systems, controlled items are listed under specific Export Control Classification Numbers (ECCNs) on the Commerce Control List (CCL). Each ECCN is controlled for different reasons, and those reasons dictate where and to whom a controlled product can be exported.

TEA happens to fall under ECCN 1C350, which means that it and mixtures containing it in specified amounts require licenses for export to most countries in the world. Mixtures composed of lesser amounts are controlled under ECCN 1C995 and must be licensed for export

Does your company have an up-to-date product and technology export classification document?

to a smaller list of countries. Many companies have not classified TEA as controlled, and some have been penalized after they were caught exporting it without required licenses.

HIDDEN SHOALS OF RESPONSIBILITY

The classification process may sound straightforward, but identifying just what controls apply to which chemicals and in what amounts requires wading through terms of art, cross-references to other sections of the regulations and clusters of double-negatives that even seasoned professionals struggle with.

Near-identical controls (and similar headaches) apply to re-exports, or shipments from the initial destination country to a second country. These have proven particularly vexing for chemical companies, which too often operate under the misguided assumption that export responsibilities end at the US border.

Think of the US export rules as a string that attaches to products exported from the US, following the product from location to location. The first shipment from the US may not need a license because it is made to a close ally, but shipment to the next country may well require a license from the US Commerce Department.

And responsibilities don't end with chemi-

cal products alone – related technology is controlled as well.

Technology under the EAR is the “recipe” information required to develop, produce (and sometimes even to use) controlled items, and it is just as heavily controlled for export as the items themselves. Export license requirements for technology apply even when technology is being shared with your international affiliates. A license may also be required to share recipe technology with non-US persons located within the US, including non-US employees otherwise approved to work in the country (e.g., H1-B visa holders).

THE CLASSIFICATION CONUNDRUM

Technology controls aren't collected under a single classification. ECCNs 1E001, 1E350 and 1E351 all control different forms of technology related to TEA and other chemicals. Still more technology control categories (e.g. ECCN 2E002) apply to associated items and equipment.

If your company exports products in shipping containers made of certain anticorrosive materials (e.g. certain nickel alloys or plastics), the containers may also need export licenses. If your company exports certain chemical handling equipment such as reactor vessels, storage tanks, valves, pumps, piping and other types of fluid handling equipment, those items may need export licenses when shipped to any of over 150 countries.

Serious enforcement efforts have recently targeted the equipment side of the chemical business, and over 50 companies have been penalized for exports and re-exports of controlled equipment. We just worked with one company that received a \$2.9m penalty associated with equipment shipments.

None of these controls is static. The equipment rules have been amended several times in recent years in important ways – for example, over 100 countries were added to the control category – and there are more changes coming that have not been published yet. A significant reform of US export controls now underway should make some things easier, but it does so at the cost of increasing complexity in these already complex rules.

With all this to think about, it is easy to see how companies ship without necessary govern-

ment authorizations. Unfortunately, because the penalties are assessed on a “strict liability” basis, the government has little sympathy for companies unfamiliar with the regulations.

The first step to compliance is knowing with certainty whether chemicals, petrochemicals, fertilizers, equipment or know-how related to your company's products are controlled for export or not. This knowledge can only be generated by carefully examining the regulations with experienced assistance.

Does your company have an up-to-date product and technology export classification document? If your company does not have an explicit, regularly updated process to classify products and technology that are exported, you are likely not handling export compliance risks appropriately.

Getting to full compliance with export control regulations can be complicated, but it is well worth the effort, given what is at stake for both companies and individuals. In addition to the penalties already mentioned, companies can lose eligibility to do business with the US government, and they can have export privileges revoked altogether.

The risks of non-compliance only increase when chemicals identified as being specifically designed or modified for defense applications are involved. These fall under a completely different set of rules, the International Traffic in Arms Regulations (ITAR), and they almost always require licensing for export anywhere outside the US.

Given the potential financial and reputational costs, every company should determine whether it has an adequate export compliance system and, in particular, whether the product classification component is up to date. If you need help, seek out counsel with experience in the area to ensure the efficient and reliable identification of key risk areas for your company. ■



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