

THE U.S. CRACKS DOWN ON VALVE EXPORT CONTROLS

By Eric McClafferty

Many valve manufacturers, distributors, and users are risking significant criminal and civil penalties by failing to comply with export controls on valves and other fluid handling products. The controls recently were made considerably tougher and penalties for violations have been increasing. If your company ever sells or ships valves internationally, failing to comply with these rules could cost you dearly.

A major surge of export control penalty cases involving valves and related fluid handling products is now underway. One company recently received a criminal fine of \$6,000,000 and was banned from exporting from the United States for three years. The president of the company personally was hit with both criminal and civil penalties. In July 2005 another company received a penalty of \$700,000 and was prohibited from exporting from the United States for three years. This export prohibition was suspended, but could be re-imposed if another violation is discovered.

Since 2003 other export violations by fluid handling companies have resulted in fines of \$700,000; \$500,000; \$171,000; and \$123,500. All of these cases involved press releases, with the names of offending companies and executives published on the Commerce Department's website. A recent case also generated negative comments about a company's international sales prospects from a stock analyst. There are more enforcement cases in the works.

These cases amount to an announcement that the U.S. government is serious about enforcing controls on valves and related fluid handling products when the export of those products has been identified as a threat to U.S. security. Chemical and biological weapons proliferation, nuclear proliferation, and other threats to U.S. security are just some of the reasons for controls on exports of valves and other fluid handling equipment, including pumps, storage tanks, agitators, heat exchangers, piping, and a number of other products. In many cases, parts for these products are also controlled for export.

The Rules Have Gotten Stricter

Perhaps most importantly, the enforcement cases listed above were based on the "old" rules. In the last five months, the rules governing exports of valves and other fluid handling products have tightened significantly. For example, in April 2005 the U.S. Department of Commerce drastically changed the scope of export controls that apply to valves which can be used to handle corrosive and volatile chemicals. Before April, shipments of those valves required licenses for export to 37 countries. Now, specific export licenses are required for every shipment of these valves to 157 different countries.

Moreover, the April 2005 rule change followed an expansion of the types of valves controlled for export that hit during 2002. Chemical processing valves currently controlled for export by Commerce under the 2002 rule now include valves with a nominal size greater than 1.0 cm, with "wetted surfaces" made from one or more of the following materials: high nickel content alloys; fluoropolymers (PVDF, PTFE, Teflon, Kynar, etc.); glass; tantalum; titanium; and zirconium (or

alloys of these last three metals). Again, note that the rule also covers certain parts of these valves, not just completed valves. Exports of spare and replacement parts also often require export licenses.

Valve Users Affected Too

The combination of the changes in the types of valves controlled for export and in the number of countries for which an export license is required has dramatically increased export license requirements for valve manufacturers, distributors, and valve users. Valve users, for example, are required to obtain export licenses for shipments to affiliates in many instances. These rule changes have significantly increased the licensing burden on companies that are complying with the rules and typically have delayed shipments for 3-6 weeks while license applications are processed. The failure of non-complying companies to react to these rule changes has increased the chance their illegal exports will be discovered.

In addition to controls on chemical processing valves, two additional separate sets of controls exist for all bellows seal valves. A number of types of pipes and pipe valves for high-pressure applications also are separately controlled. Monel valves, 304 and 316 stainless-steel valves, and vacuum valves are controlled for export under other provisions of the U.S. export rules.

Don't Assume Exemption!

These are very general identifications of just some of the export restrictions that apply to valves and other chemical processing equipment. Valve export controls are the most complex of all those that apply to fluid handling products, and great care is required to determine whether products and parts are controlled for export. Assuming your products are not controlled for export is a recipe for receiving a penalty. As part of a simple export compliance system, each valve company should have a product matrix that identifies which of its products are controlled for export and which are not. This is just one strategy that will help when export enforcement personnel come to your company to review your operations and compliance system—which they are doing with increasing frequency, according to numerous industry contacts.

In addition to export controls on products that can be used for typical commercial uses—but are also useful for certain military, proliferation, or terrorist uses—the U.S. Department of State controls and licenses exports of valves that are designed or modified for use in military or certain security applications.

The Nuclear Regulatory Commission and the Commerce Department control the export of many valves for nuclear uses. Technology for products that can be used in nuclear applications may also be controlled for export by the Department of Energy.

Controls Include Technology

One of the major errors in valve company compliance programs is the failure to recognize that in addition to product controls, technology for the development, production, or use of controlled valves is also controlled for export. This means technical drawings, production instructions, test protocols, and in many cases user's manuals for valves (and many other items) often require

export licenses when shipped overseas (including by FedEx or even by email or a discussion in an international phone call). Among other controls, this means valve companies cannot export technical drawings for a controlled valve or for controlled parts to China or to India for production in those countries without an export license.

The export control agencies read their technology controls broadly and this is creating export licensing concerns for many companies. Moreover, Commerce's rules indicate that technology for an item controlled at a "low" level may also be controlled for export at a higher level of control and require a license for shipment to more countries if that technology can also be used to produce an item at a higher level of control.

Sound confusing? It is. As an example, suppose your company makes a 304 or 316 stainless-steel valve. That valve is controlled for export under the Commerce Department's ECCN 2B999 category. If the drawing for that valve is also used to make a high-nickel content version of that valve, the drawing may be controlled for export to 157 countries. Applying this rule properly requires a close examination of the facts of the proposed export and a close reading of several technology export control provisions.

Employee Access a Concern

Furthermore, under the new April 2005 rules, companies have to worry more about employee access to technology. This applies with particular force to foreign national employees, such as H-1B and L visa holding engineers. For example, the Department of Commerce requires U.S. companies to get export licenses to release controlled technology to many foreign national employees, even if those personnel live and work in the United States. If your company employs engineers, production, sales personnel, and other foreign nationals from the new list of 157 controlled export destinations, and those personnel are to be exposed to controlled technology (a technical drawing for a Hastelloy C, Alloy 20, Teflon, Kynar, or titanium valve, for example), the company almost certainly requires what is called a "deemed export license" to expose those personnel to that controlled technology.

So What Should You Do?

What can your company do to respond to these changes and make a serious effort to ensure compliance? Even if you have an existing compliance system, consider talking with experienced export control legal counsel about the potential need for a quick external audit of company operations. Too many companies think they understand valve export controls, but they are missing important aspects of the rules that create risk for the company. This is particularly true when it comes to the interplay of the various valve export classifications. The new April 2005 rules and Commerce's "lower level" technology language are causing even experienced export compliance personnel difficulties with technology and deemed export issues.

Communications with attorneys have the advantage of the attorney-client privilege protection and an experienced export control attorney can provide advice on the appropriate strategy for responding to potential violations, including the advantages and disadvantages of voluntary disclosures. Counsel can also provide training "from the ground-up" for companies that have not

been compliant, help design or refine compliance systems, and assist with product classifications and export licensing issues. These are among the minimum steps necessary to avoid export violations under the intense scrutiny currently facing the fluid handling industry.

This article does not constitute legal advice. Contact experienced export counsel for assistance in addressing your particular situation.

Biography

Eric McClafferty is an attorney with many years of experience advising fluid handling industry clients regarding export controls. He has published and spoken widely on export controls and has handled many export enforcement matters for industry members. McClafferty recently was named by the Hydraulic Institute to assist with its newly approved Export Control Task Force. He has volunteered to discuss export (and other international trade) issues with interested readers. Please contact him at emcclafferty@colliershannon.com, or at 202-342-8400.