

Thinking Strategically about International Trade Compliance

By Eric R. McClafferty (Kelley Drye & Warren)

Many companies have international trade compliance programs, but surprisingly few have thought strategically about their respective programs.

A few companies think strategically when they first implement a program and then they fail to adapt the program thereafter, even if circumstances change. Perhaps they now have foreign subsidiaries that they didn't previously have, or they have engaged in selling agents in countries with significant compliance risks, among hundreds of other potential changes to their risk profile. Part of strategically thinking about a compliance program is building it to adapt to a changing company and changing rules.

To be clear, here we are referring to an international trade compliance system that accounts for global customs, export control and economic sanctions, anti-bribery, third party intermediary and associated regulatory risks. For the sake of brevity, most of the examples cited in this article will focus on export controls. Along with anti-bribery enforcement, export controls and economic sanctions enforcement have recently seen some of the biggest penalties issued to U.S.-based and non-U.S.-based corporations and criminal penalties doled out to individuals.

Compliance articles always include a section on penalties designed to motivate the reader to take the regulatory issues seriously and implement improvements. When it comes to export controls and anti-bribery, such motivation should be easy to generate. For example, penalties for economic sanctions violations have recently exceeded \$600 million. Multinational anti-bribery penalties have exceeded \$1 billion, and people do go to jail.

Choosing an Effective Trade Compliance Program

Many companies recognize the need for a trade compliance program, but too often they fill the gap with something that is expensive that fits them like a left glove on a right hand. They pick a program that has been prepared generically for "any company". These programs have multiple requirements that are often inappropriate in scope and subject matter. Too often, they do not address the real risks companies face.

Another common approach is to go "minimal". Some companies have an employee handbook that includes two lines on anti-bribery and two lines on export controls. You can see a beleaguered general counsel who has a thousand concerns considering the insufficiency of the minimal language. They know that there are many multinationals that are going without any language and that is certainly high-risk behavior.

The key to repairing the generic, the minimal, the zero policy, and multiple other partial approaches to trade compliance is to think stra-

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teggically about what the company needs. What risks does the company face in trade compliance? Three steps to determining risk are to look internally, look at the competition, and then look to the agencies.

Assessing Internal Risk

An internal risk assessment in the export control area can begin with an evaluation of export controls on products and technologies. The list of types of products controlled for export is extensive, more than ordinarily expected. Steel plate, snorkel fins, chemicals that go into makeup, ball bearings, and tractor motors all fall under this category and the list goes on. Many company leaders have a misplaced faith in their own powers of intuition when it comes to determining whether products the company makes—or buys and sells—are controlled for export. For example, some company executives inappropriately consider themselves exempt from export control concerns because they do not produce traditionally sensitive products, like technology or items related to national security. There are control lists to check. Though the control lists are somewhat complicated and take some time and attention to

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review, it is better than trying to guess or risk running into a problem following export. The export rules are basically a 'strict liability' set of regulations. You don't have to know you are violating them by knowingly shipping controlled products without a required license. If you violate the rules, a strict liability standard means the company can be penalized.

Even worse, companies that have figured out whether they have controlled products often ignore export controls on technology. Put simply, technology controls "know how" that is used to develop, produce and occasionally even to use a controlled product. Recipes, production procedures, certain drawings, conversations, etc., can be controlled technology. If your company has it, you have to watch access to your IT system, your engineers need to be trained about what they can discuss, and you have to pay attention to who you hire and what they look at. Can you put controlled data on the cloud? Unless you have a license, it is unlikely if the servers are outside the

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U.S. A critical internal look at company product and technology export classifications is a great first step toward thinking and acting strategically to develop a company specific compliance program. There are more steps in the internal risk analysis process, but you can see that the steps are specific to company products and technologies.

Evaluate Competitors

After completing an internal review process, look outside to competitors. You can often tell a good deal about how others in your industry are treating compliance these days from a review of public information on websites. Do your competitors classify products like you manufacture or services like those you sell as controlled for export? What does that mean for you? Is there an industry association that has expertise on export controls or access to experts on industry control issues?

Involvement of Government Agencies

You should also pay attention to agencies. More and more attention is being paid to inter-

national trade compliance, especially by the U.S. government. The number of trained investigators has skyrocketed in recent years as ICE (Immigration and Customs Enforcement), the FBI and other investigators have joined existing enforcement agencies in the hunt for violators. Big data is rearing its head as an enforcement tool. It used to be, for example, that export shipments were reported to the government on paper. Now there is an automated system. How much easier is it to look for shipments of widget X without an export license when the search is automated?

In addition, the global web of government agency enforcement is tightening. In many cases, for example, Hong Kong wants to know the export classification for products before they are imported. How long before global data webs of imports and exports are connected more completely—requiring enhanced compliance on the inbound and outbound shipment legs?

Also, when looking at the agencies, see who they are penalizing. Certain industries get 'hot' from a compliance enforcement perspective. If you are in a hot industry, you need to know it. Evaluating risk does not have to be tremendously time-consuming. A competent, experienced advisor can get it done for you in short order. It might take a little longer if you have a complex classification process, but that is typically a signal of a higher risk situation that merits additional attention in any event.

Only after evaluating risk in a systematic way can you determine what kind of compliance system really makes sense.

Let's say you have low risk on the export control side because no products or technology are controlled for export from the U.S. and no business units target sanctioned country destinations. However, let's say you are in the pharmaceutical or medical device industry and you sell internationally. This situation calls for a straightforward, short export compliance program that focuses on denied party screening, an anti-diversion program (to help prevent your products from being diverted to sanctioned countries like Cuba, Iran, North Korea, Sudan and Syria), anti-boycott controls and some additional key elements. Your anti-bribery program likely needs to be more robust given the increased risk of violations and a very hot agency enforcement environment. This is a simple example to encourage you to tighten compliance in order to properly face the risks the company faces. It is not that time-consuming and it will make more sense to the employees you depend on to keep the company out of trouble.

Final Thoughts

Too often, companies are accepting compliance risks that they should not accept simply because terms of sale, distributor agreements, and other arrangements with third parties have not been thought through or they have grown accustomed to the insufficient program. You have to be very mindful of the realities of the relationship that a document describes, but often it is possible to allocate—or reallocate—some of the risk of a penalty or violation away from your company and onto the more appropriate company.

Let's say a selling agent in China is responsible for dealing in the first instance with local government officials. While you cannot easily contract out of all anti-bribery (U.S. Foreign Corrupt Practices Act or UK Bribery Act) liability in all cases, you can spell out for the agent what their responsibilities are. You can also point an agency to such a document if a rogue selling agent has violated the agreement without your company's

knowledge. In this single example, you have not solved the entire problem by any means, but your risk recognition and allocation of responsibility in advance of any problems has put you in a better position than many other companies would find themselves. That type of strategic, focused approach will help reduce the real risks the company faces and, should a problem arise and an enforcement agency start asking questions, the company can point to its tailored compliance program as evidence of the attention they have paid to trade compliance. □

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Round Up

Trade & Customs Round Up

By Linda Zhang (Thomson Reuters)

South Korea Moves Closer to Joining TPP Talks

South Korea, the world's seventh-largest exporter, said it will soon enter the 12-nation Pacific Rim talks in a statement released at the end of November, according to Reuters. South Korea has already signed bilateral free trade agreements with the U.S. and has pending talks with China and Australia, after which South Korea will make a final decision on whether to formally join the Trans-Pacific Partnership negotiations.

U.S. and Bangladesh Sign Trade and Investment Cooperation Forum Agreement

In late November, Bangladesh and the U.S. signed a bilateral Trade and Investment Cooperation Forum Agreement, aiming to expand trade and investment and discuss areas of cooperation, according to the Sandler, Travis & Rosenberg Trade Report. U.S. Trade Representative Mike Froman said that the new agreement will allow

the U.S. to track and discuss Bangladeshi efforts to improve worker safety.

Russia Proposes Package of Trade Agreements with U.S

Russia has submitted to the U.S. a package of proposals that include a potential deal for a bilateral investment treaty and pacts on regulations and standards, according to the Sandler, Travis & Rosenberg Report. Moscow believes that the bilateral investment treaty could be completed by the end of 2014 while the discussion on regulations and standards could last for five years. A Russian official also said that this set of proposals could lead to a negotiation of a free trade agreement, though this could take 10-15 years.

China Seeks to Boost Trade with Ex-communist Europe

China aims to double trading volumes with central and eastern members of the European

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