

The logo for Drinker Biddle, featuring the company name in a white serif font against a dark blue background.

Drinker Biddle

A decorative graphic consisting of a grid of squares in various shades of blue and grey, located on the left side of the slide.

Update on U.S. sanctions, export controls, and national security law compliance

Mollie Sitkowski

May 2018

Agenda

- Scope of U.S. export controls and economic sanctions
 - OFAC Sanctions
 - International Traffic in Arms Regulations
 - Export Administration Regulations
- Recent compliance cases
- Other trade-related national security investigations
- Recap

A fundamental reassessment and realignment of U.S. trade and national security policy is underway

- Multiple but interrelated concerns:
 - China's trade and national security policies
 - Erosion of the U.S. defense-industrial base
 - Trade deficits
 - Re-prioritizing U.S. manufacturing
 - Foreign availability of technologies previously unique to U.S. forces
- Sanctions, export controls, and national security laws and enforcement cases are some of the Trump Administration's most important "go-to" tools to address these issues

OFAC Sanctions

OFAC sanctions

- U.S. Department of the Treasury's **Office of Foreign Assets Control** administers and enforces U.S. economic sanctions against particular:
 - Countries/territories (e.g., Cuba, Iran, Syria, Crimea)
 - Individuals (e.g., terrorists, narcotics traffickers)
 - Entities (e.g., drug front companies, charities financing terrorist groups)
 - Practices (e.g., trade in noncertified rough diamonds)
- Currently over 25 such programs, and they change frequently



OFAC's Headquarters in Washington, D.C.

Near the DBR offices, White House and Treasury Building

Each set of OFAC sanctions is different

- Wide variation in the scope of each set of OFAC sanctions
- Some, like the sanctions on Iran, are very broad in scope
- Others, like restrictions on Somalia, are limited to certain transactions

What do the OFAC sanctions prohibit?

- All transactions with sanctioned persons or dealings in their property or interests in property
- Direct or indirect
- Interpreted broadly
- Not hyper-technical rules that can be easily navigated or circumvented
- Most of the time, all “property and interests in property” of the designated person are “blocked” and the provision or receipt of any goods or services is prohibited
 - E.g., a funds transfer to or from the personal bank account of an ordinary individual who has an account at a designated bank will be blocked (*i.e.*, frozen) because OFAC views the bank as having a property interest in the accounts it holds for clients

OFAC's authority is broad and significant

➤ **Sanctions are not normal financial or trade regulations**

- These are presidential national emergency powers
- Sanctions regulations are not subject to normal administrative procedures
- No *de minimis* exceptions — even a donation is specifically prohibited
- Good faith effort, diligence, or lack of knowledge not enough to avoid all liability
- Don't assume that because the sanctioned party is not financially better off that there are no sanctions concerns

Facilitation and evasion

- **Facilitation:** OFAC's regulations often prohibit "facilitation" by a U.S. person of a non-U.S. person's transactions with a sanctions target and can include:
 - Structuring transactions around the sanctions programs
 - Assisting or supporting transactions by or with a sanctioned party
 - Approving, financing, facilitating or guaranteeing a transaction by a foreign person where the transaction, if performed by a U.S. person or within the United States, would be prohibited
 - Referring business involving a sanctions target to any other non-U.S. person (e.g., a colleague at a foreign subsidiary)
 - Changing policies or procedures, or those of a foreign affiliate, to enable the foreign affiliate to engage in a transaction that would otherwise require the approval of a U.S. person. Policies must have general applicability
 - But General License H explicitly allows this in the Iran sanctions context
 - **Evasion:** OFAC's regulations prohibit transactions that "evade or avoid, have the purpose of evading or avoiding, or attempt to violate" any other prohibition
-

U.S. Export Controls

Multiple Statutes, Regulations, Enforcement Agencies

- International Traffic in Arms Regulations (ITAR)
- Export Administration Regulations (EAR)
- Other U.S. laws and regulations controlling the export/re-export of U.S. goods, technology, and services
 - ❖ Nuclear Regulatory Commission (NRC), Department of Defense (DOD), National Nuclear Security Administration (NNSA), Census Bureau, Customs and Border Protection (CBP)

The EAR and ITAR apply very broadly

- Physical products
 - Software
 - Technology and technical data (e.g., manufacturing “know-how”)
 - Products made outside the United States that are based on or use U.S.-origin content/technology
 - Activities by U.S. persons
 - Exports, reexports, and transfers of the above
 - Revealing controlled products, software, or technology to a foreign person in the United States
- ❖ ***As a result, almost every transaction may have a U.S. export controls component to it***

Significant penalties for violations

➤ Civil

- ❖ **ITAR:** Effective January 2018, civil penalties were set at **up to \$1,111,908 per violation**
- ❖ **EAR and OFAC sanctions:** Effective January 2018, civil penalties are set at up to **\$295,141 or twice the amount of the value of the underlying transaction (whichever is higher)**

➤ Other Administrative Penalties

- ❖ Denial of export privileges
- ❖ Listing on the Entity List
- ❖ Debarment from government contracting

➤ Criminal

- ❖ **ITAR:** Up to \$1 million per violation for corporations; up to \$1 million per violation and up to 10 years in jail for individuals
 - ❖ **EAR and OFAC sanctions:** Up to \$1 million per violation for corporations; up to \$1 million and up to 20 years in jail for individuals
-

Violations can be very costly

- **ZTE Corporation:** \$1.19 billion combined civil penalties & plea agreement + denial order
- **Weatherford International Ltd.:** \$100 million combined civil penalties and criminal fines
- **BAE Systems plc:** \$79 million settlement under consent agreement
- ***And there are other bad consequences . . .***

\$1.19 billion penalty for OFAC and EAR violations

ZTE

PHONES

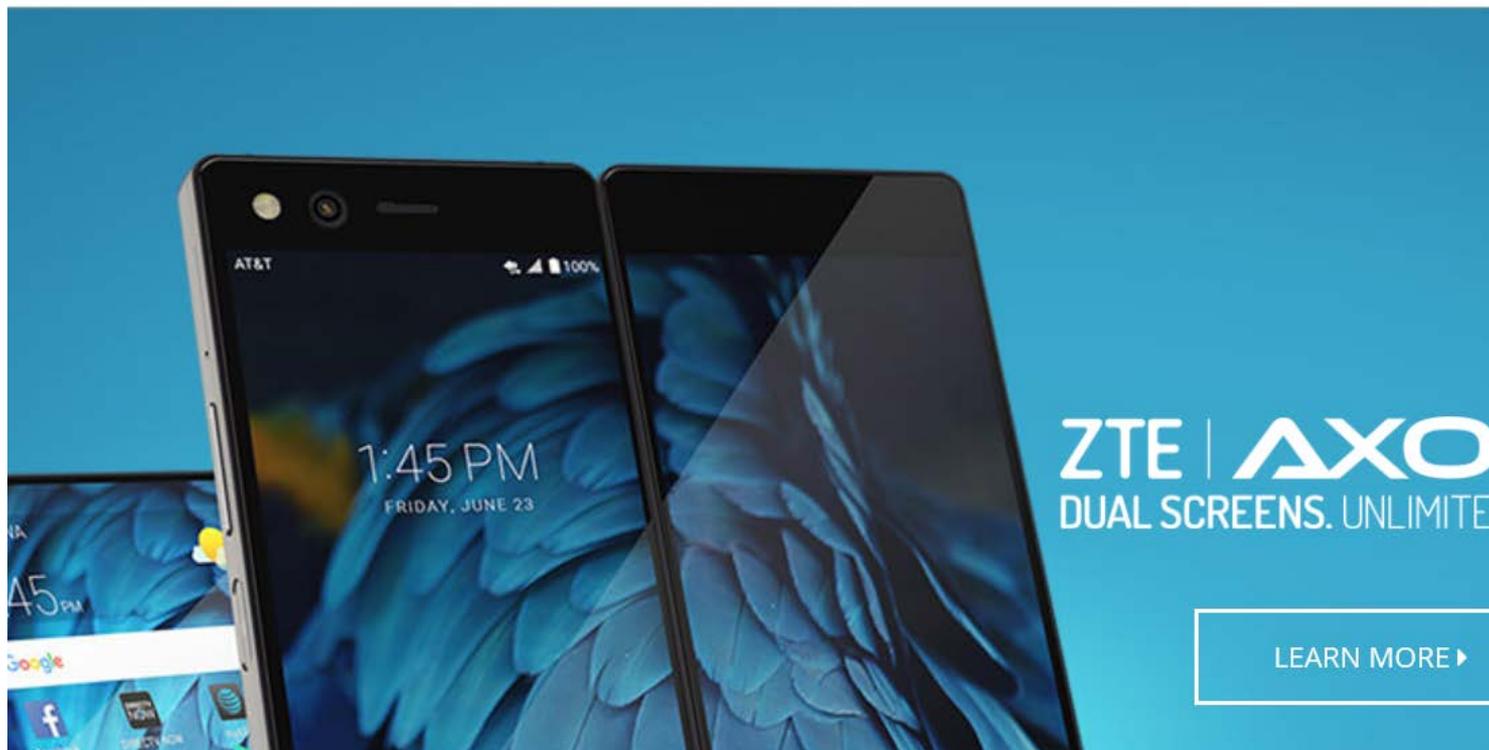
MORE PRODUCTS

SUPPORT

BLOG

FORUM

STORE



OFAC Sectoral Sanctions - Russia

- OFAC has implemented “Sectoral Sanctions” for specific Russian industries, entities in those industries, and actions.
- Directives 1, 2, and 3 prohibit the issuance of new debt longer than 30 days to specifically-named entities in the finance, energy, and defense sectors.
- Directive 4 prohibits the provision, export, or reexport of goods, services or technology used in oil and gas projects owned 33% or more by specifically-named entities.
- The specifically named entities can be found on the “Sectoral Sanctions List,” which is different from the “Specially Designated Nationals” (“SDN”) List in that not all transactions are prohibited, just the ones listed in the Directive.

OFAC Sanctions - Russia

- OFAC has also begun listing Russian entities on the SDN list, prohibiting U.S. persons from engaging in any transactions with those entities.
- The largest is Rusal, an “aluminum giant” with whom many U.S. companies transact business.
- OFAC has issued general licenses to allow U.S. companies to wind down their transactions with these SDNs, including extending the Rusal general license through October.

BUSINESS & FINANCE

[< Previous](#) | [Next >](#) | [Table of Contents](#)



Rocky Mountain exits bankruptcy, settles ITAR case

01 Nov 2010

Optics company Rocky Mountain Instrument to repay all creditors following Chapter 11 reorganization, final settlement of ITAR violation.

Rocky Mountain Instrument (RMI), the Colorado-based manufacturer of optical components and laser assemblies, is to pay \$1 million to the US federal government to finally settle all charges relating to its violation of **International Traffic in Arms Regulations (ITAR) export controls**.

The settlement, which brings the case to a close following a three-year investigation, is closely linked to RMI's recent emergence from bankruptcy protection. RMI filed for Chapter 11 protection in June 2009, impacted badly by both the economic downturn and the uncertainty caused by the ITAR investigation.

RMI's plan for reorganization was approved by the US Bankruptcy Court on October 15. According to CEO

Stephen Hahn, both RMI and its affiliate RMI Laser, which makes laser marking systems and did not file for Chapter 11 bankruptcy, have performed strongly in recent months, enabling the successful reorganization. Following the final settlement of the ITAR case, Hahn said that the company plans to repay all of its creditors in full when the plan becomes effective on November 15.



RMI laser optics



ACT NOW

- » [Do you suspect fraud against the government?](#)
- » [Do you know of tax fraud or underpayments?](#)
- » [Are you aware of securities law violations?](#)

Success For Our Clients:

- [P&C's Successful Whistleblower Cases](#)
- [Our Approach](#)
- [Our Expertise](#)
- [P&C News](#)
- [P&C Cases in the News](#)

» [Home](#) » [Success for Clients](#) » [2010](#)

» [Rocky Mountain Instrument agrees to pay \\$1 million to resolve False Claims Act case alleging illegal export of military information](#)

Rocky Mountain Instrument agrees to pay \$1 million to resolve False Claims Act case alleging illegal export of military information

DENVER, COLORADO, Oct. 29, 2010 -- Rocky Mountain Instrument Co. has agreed to pay \$1 million to the federal government to settle civil charges related to the illegal export of sensitive military information for the manufacture of certain equipment overseas.

The civil settlement announced today was reached between Rocky Mountain Instrument (RMI), based in Lafayette, Colorado, and the federal government and a client of Phillips & Cohen LLP.

The case apparently is the first time the False Claims Act has been used in connection with violations of International Traffic in Arms Regulations (ITAR) and the Arms Control Export Act, said Claire M. Sylvia, a San Francisco attorney with Phillips & Cohen.

RMI pleaded guilty to a related criminal charge in June and was sentenced at that time to forfeit \$1 million and spend five years on probation. The criminal plea agreement said that RMI exported from 2005 to 2007 prisms and technical data related to various optics used in military applications to Turkey, South Korea, China and Russia without having first obtained from the U.S. Department of State a license or written authorization for such exports as required under ITAR.

The civil settlement today covers a related allegation that RMI caused defense contractors to submit false claims for payment to the Pentagon in violation of the False Claims Act by illegally exporting technical data that was used to manufacture parts used in certain military equipment the contractors sold to the Pentagon.

Other Trade-Related National Security Investigations

Section 232 national security investigations

- **Section 232(b)(1)(a) of the Trade Expansion Act of 1962** allows the President to direct the Department of Commerce (DOC) to initiate investigations to determine the national security impact of imports.
- In 2017, DOC initiated two Section 232 investigations in 2017, largely addressing imports from **China** and inclusive of all steel and aluminum products.
- The U.S. has now imposed duties of 25% on steel imports and 10% on aluminum imports from most countries
- Some countries, including Argentina and South Korea have negotiated exemptions from the tariffs in exchange for quotas

Section 301 investigation of China

- Since August 2017, USTR has been investigating alleged harm done to U.S. trade and U.S. companies from Chinese policies such as “Made in China 2025” and forced technology transfers as well as IP infringement in China
- Section 301 of the Trade Act of 1974 authorizes the President to take all appropriate action, including retaliation, to obtain the removal of any act, policy, or practice of a foreign government that violates an international trade agreement or is unjustified, unreasonable, or discriminatory, and that burdens or restricts U.S. commerce.
- On March 22, President Trump announced the results of the investigation and ordered USTR to take various trade actions against China
- USTR’s Section 301 Report details the findings and basis for the proposed trade actions

OFFICE of the UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT

**FINDINGS OF THE INVESTIGATION INTO
CHINA'S ACTS, POLICIES, AND PRACTICES
RELATED TO TECHNOLOGY TRANSFER,
INTELLECTUAL PROPERTY, AND INNOVATION
UNDER SECTION 301 OF THE TRADE ACT OF 1974**



March 22, 2018

CONTENTS

- I. Overview 3
 - A. Core Elements of Section 301 3
 - B. Background to the Investigation 4
 - 1. Initiation of the Investigation 5
 - 2. China's Bilateral Commitments to End its Technology Transfer Regime and to Refrain from State-Sponsored Cyber Intrusions and Theft 6
 - 3. Input from the Public 9
 - C. China's Technology Drive 10
- II. China's Unfair Technology Transfer Regime for U.S. Companies in China 19
 - A. Introduction 19
 - 1. Key Elements of China's Technology Transfer Regime 19
 - 2. A Persistent Problem for U.S. Business 22
 - B. Foreign Ownership Restrictions as Used in China's Technology Transfer Regime 23
 - 1. The Foreign Investment Catalogue and Technology Transfer 24
 - 2. Illustrative Examples of China's Use of Investment Restrictions to Pressure Technology Transfer 29
 - C. Administrative Review and Licensing Processes as Used in China's Technology Transfer Regime 35
 - 1. Technology Transfer Pressure in Administrative Approvals and Licensing 36
 - 2. Forced Disclosure of Sensitive Technical Information 41
 - D. China's Acts, Policies, and Practices Are Unreasonable 43
 - E. China's Acts, Policies, and Practices Burden or Restrict U.S. Commerce 45
- III. China's Discriminatory Licensing Restrictions 48
 - A. Introduction 48
 - B. Foreign Licensing Restrictions and China's Technology Transfer Regime 48
 - 1. Different Outcomes for U.S. Companies versus Chinese Competitors 51
 - 2. Indemnification Against Infringement Claims 51
 - 3. Ownership of Improvements to Licensed Technology 52
 - 4. Use of Technology after the Technology Contract Expires 53
 - C. Concerns Raised by Other Trading Partners 54
 - D. China's Acts, Policies, and Practices are Discriminatory 55
 - 1. Justifications for Discrimination 55
 - 2. Acts, Policies, and Practices of Other Countries 57
 - E. China's Acts, Policies, and Practices Burden U.S. Commerce 60
- IV. Outbound Investment 62
 - A. Introduction 62
 - B. Policy and Regulatory Framework 66
 - 1. Major Policies to Acquire Foreign Technology 66
 - 2. The Chinese Outbound Investment Approvals System 70
 - 3. Sectors "Encouraged" for Outbound Investment 77
 - 4. Outbound Investment Policy in Technology and Sectoral Policies 78
 - 5. State-Backed Actors 80

Results of the Section 301 investigation against China

1. USTR will propose additional tariffs on imports of products “supported by China’s unfair industrial policy.”

- These are intended to be mainly products of the industries targeted for promotion under China’s “Made in China 2025” program
- USTR issued its proposed list of dutiable products on April 6
- Approximately 1,300 categories of imported products are included
- The list targets the products of Chinese companies and Chinese subsidiaries of non-Chinese companies

2. USTR has filed a WTO dispute settlement proceeding against China’s technology licensing practices

3. The U.S. Treasury Department is in negotiations with China to open China to more unrestricted foreign investment

- If these negotiations fail, Treasury is authorized to restrict Chinese investments in “sensitive U.S. technology”
- The restrictions may apply to Chinese investment in the United States and joint ventures and other agreements with Chinese companies outside the United States

Scope of the proposed tariff list

USTR's list of items potentially subject to Section 301 tariffs covers a wide range of articles.

- Certain pharmaceuticals and chemicals;
- Certain steel/aluminum articles (significant overlap with Section 232 tariffs);
- Certain consumer electronics (including televisions and recording media);
- Certain measurement instruments and medical devices;
- Certain mechanical machinery and electronic components and parts thereof (excluding wireless and telecommunications devices);
- Certain vehicles, including automobiles, passenger and commercial watercraft, and rail locomotives and rolling stock;
- Certain military explosives, firearms and artillery;
- Certain engines, boilers, nuclear reactors, and parts thereof; and
- Certain aircraft and parts thereof.

Section 232/301 will be enforced by CBP

- 19 U.S.C. § 1592 - Penalties for Fraud, Gross Negligence, and Negligence Penalties for non-compliance are as follows:

Culpability	Violations Resulting in Revenue Loss	Non-Revenue Loss Violations
Fraud	up to the domestic value of the entry(ies)	up to the domestic value of the entry(ies)
Gross Negligence	4 times the loss of duty	40% of the dutiable value of the entry(ies)
Negligence	2 times the loss of duty	20% of the dutiable value of the entry(ies)

Timeline and comments

Stakeholders can voice their comments to USTR during a notice and comment period:

- April 23, 2018: Due date for filing requests to appear and a summary of expected testimony at the public hearing, and for filing pre-hearing submissions.
- May 11, 2018: Due date for submission of written comments.
- May 15, 2018: Public hearing at the U.S. International Trade Commission
- May 22, 2018: Due date for submission of post-hearing rebuttal comments
- USTR will take comments into account in determining next steps, but there is no set timeline for imposition of the proposed tariffs and other measures

Comments being sought from both sides of the issue

- Some companies may find that the Section 301 actions would harm their interests and may wish to oppose or propose modifications to the tariff list and other measures
- Other companies may determine that Section 301 measures promote their interests and may wish to comment in favor or to press USTR to go further
- If comments are not filed, companies will lose an important opportunity to get their comments on the record and before key decision makers in the Administration and Congress
- Both sides should also be prepared to consider filing rebuttal comments after they have reviewed the affirmative comments
 - Rebuttal comments will be due by May 22nd

Recap

- ✓ Almost any transaction can involve export control and OFAC sanctions issues
- ✓ Penalties are severe and there is successor liability
- ✓ National security scrutiny of cross-border investments and imports is intensifying and affecting many more transactions
- ✓ Early analysis and pre-planning are keys to success

Questions?

Mollie D. Sitkowski
Drinker Biddle & Reath LLP
191 N. Wacker Dr., Ste. 3700
Chicago, IL 60606-1698
(312) 569-1502 *office*
(312) 569-3502 *fax*
Mollie.Sitkowski@dbr.com

