

EXPORT COMPLIANCE UPDATE

July 2005

Volume 8 Issue 6



FD ASSOCIATES, INC.

7926 Jones Branch Drive, Suite 260

McLean, VA 22102

TEL (703) 847-5801 FAX (703) 847-1523

EXPORT COMPLIANCE FOCUS: SUCCESSOR LIABILITY

FOREIGN PARTIES AND THE U.S. EXPORT REGULATIONS

As evidenced by a number of recent fines and denial of export privileges imposed upon foreign companies (*see Fines and Penalties on Page 3*), foreign parties who receive, handle and sell U.S. origin equipment and technology are bound by many of the same restrictions that apply to U.S. exporters, and the U.S. government can and will take action against foreign parties that violate these regulations and laws.

In addition to transfers of controlled equipment to unlicensed parties, there are several places in the U.S. export regulations where specific restrictions apply. Countries that are excluded from receiving articles on the U.S. Munitions List are found at ITAR §126.1. Citizens, companies, organizations and entities of these countries may not have access to or be provided with any ITAR-controlled hardware, software, technical data or defense services. These restrictions apply to physical exports, as well as proposals or offers to sell any ITAR controlled articles or services. They also apply to the employment of citizens or transfers of technical data to visitors from these countries.

The Export Administration Regulations (EAR) also places restrictions on exports and re-exports to certain countries, often based on the level of technology involved and the country of destination. There are several lists identifying restrictions on exports and re-exports to specific groups of countries found in Part 744, Supplement #4 of the EAR. In addition, the "Ten Prohibitions" found at Part 736 and the Denied Parties List found at Part 764, Supplement #2, of the EAR place further restrictions on transfers and retransfers to proscribed countries and persons.

The Office of Foreign Assets Controls of the U.S. Department of Treasury (OFAC) Sanctions Regulations also prohibit U.S. companies from exporting even the lowest-level commodities to certain specified countries and in most instances, these restrictions apply to foreign companies wishing to retransfer any U.S. origin equipment, technology or services.

Foreign Parties, Continued on Page 2

The ITAR § 122.4 requires that any changes to a company's registration information must be communicated to the Office of Defense Trade Controls, Compliance and Registration Branch (ODTCC) in writing within five days of the event. This includes the requirement to provide information concerning mergers, acquisitions and divestitures. Any company contemplating acquiring another company should ensure that an export compliance due-diligence review is performed prior to and subsequent to the acquisition.

Any export violations that are uncovered and not disclosed and/or resolved prior to the acquisition may become the responsibility of the acquiring company. Recent charging letters and related fines have identified that government has established precedence in so-called "successor liability" cases, even though the violations have occurred under someone else's watch. One such example is the recent acquisition of part of General Motors Corporation by General Dynamics Corporation (GD). Both companies paid fines in the total amount of \$20 million and GD was required to implement a mandated export compliance plan, under State Department direction. In 2000, Boeing Satellite Systems acquired Hughes Space and Communications, a division of Hughes Electronics Corporation. In 2003, both Hughes and Boeing were fined a total of \$32 Million for the export infractions committed by Hughes in 1995-1996, well before Boeing acquired the company.

In any merger or acquisition activity, pre-acquisition export reviews are critical and should be detailed enough to uncover any general compliance issues that may need further review or investigation. Companies should also plan to conduct an in-depth post-acquisition audit to assess any specific compliance violations. In many instances, the ODTCC is requiring companies that acquire other U.S. companies to conduct post-acquisition export compliance audits and provide reports of any non-compliant activities to ODTCC within 90 days of the required registration notification. As in all things pertaining to an acquisition, when it comes to export compliance, "Buyer Beware" should be the motto.

RECENT AMENDMENTS TO THE ITAR

On June 15, 2005 the Department of State issued a Federal Register Notice (*70 Fed. Reg. 34652*) that amended certain sections of the International Traffic in Arms Regulations (ITAR). Changes include: 1) a transfer in responsibility for Commodity Jurisdiction reviews from Office of Defense Trade Controls Licensing to the Office of Defense Trade Controls Policy; and 2) a revision to reflect the increased threshold amounts for Congressional Notification for licenses and agreements (Note: This change formally reflects current thresholds previously implemented.)

The Canadian exemption (*ITAR § 126.5*) has also been revised to clarify the specific defense articles, related technical data, and defense services that will continue to require an authorization for export to or temporary import from Canada. The changes include: 1) noting title changes for USML Categories I and XVI, 2) specifying that all types of aircraft covered by Category VIII (a) of the USML require an export license, 3) identifying that nuclear radiation measuring devices manufactured to military specifications are now controlled in Category XVI, and 4) clarifying that the exclusion from the exemption also includes Man-Portable Air Defense Systems (MANPADS), and related parts, components, and technical data for such systems that are controlled in USML Category IV.

Foreign Parties, Continued from Page 1

What can the U.S. government do to enforce U.S. export laws with foreign companies or governments? They can restrict access to U.S. origin commodities, technical data, software or services, and in some instances levy fines against these companies, either directly or through their U.S. subsidiaries, if any. If a foreign party is found to have violated the U.S. export and re-export laws, the U.S. government may add the company to any of the various lists, restricting export-related business in the U.S. Penalties may also be applied to U.S. companies who facilitate the illegal actions of a foreign company.

The ITAR (Sec. 123.9) and the EAR (Part 758.6) identify certain re-export statements that exporters are required to place on their invoices when exporting goods and technology controlled by these regulations. This is the minimum requirement for a U.S. exporter. Companies should also consider including re-export restrictions clearly in their quotations and subsequent sales orders and contracts to ensure that the foreign party is fully aware of the restrictions of U.S. export and re-export laws.

ITAR ANSWER

A The change requires an amendment to the agreement as it affects the ownership of the acquired company and the foreign parties must acknowledge this change.

Agreement novations must include an amendment transmittal letter, an empowered official letter per ITAR § 126.13 and a proposed amendment which includes certain language reflecting the liabilities of the acquiring and divesting companies. Per ITAR §122.4 (c)(4), an amendment must be submitted signed by all parties, foreign and U.S. within 60 days of notification to the Office of Defense Trade Controls Compliance of the acquisition.

State Department Prepares Charges Against The Boeing Company

According to several press releases including a *Seattle Times* articles on July 6, the U.S. State Department has been in discussions with The Boeing Company (Boeing) regarding alleged export violations of the Arms Export Control Act (AECA). The charges stem from Boeing's inclusion of the QRS-11 gyrosopic microchip (a product with missile applications) in its commercial jet airliners that are sold throughout the world.

REGULATORY UPDATES

Defense Department

June 13, 2005 – *70 Fed. Reg. 34096 and 34100*: The Department of Defense notified Congress of two proposed sales of missiles, weapons systems, and support to Australia.

July 1, 2005 – *70 Fed. Reg. 38108, 38111, and 38116*: The Department of Defense notified Congress of a proposed sale of Tornado aircraft operations services to the German Air Force and sales of military equipment and helicopters, support equipment, and services to the Government of Egypt.

State Department

June 15, 2005 – *70 Fed. Reg. 34652*: The Directorate of Defense Trade Controls (DDTC) amended various sections of the ITAR. *See related article on this page.*

Treasury Department

June 13, 2005 – *70 Fed. Reg. 34060*: The Office of Foreign Assets Control (OFAC) restated Section 538.507 of the Sudanese Sanctions Regulations (SSR) to clarify the conditions under which goods or technology exported from the U.S. may be re-exported to Sudan by non-U.S. persons.

REGULATORY UPDATES

Fines & Penalties

May 17, 2005: The U.S. District Court in Minnesota sentenced Valtex International Inc. of Palo Alto, CA, to five years probation and a \$250,000 criminal fine and Valtex president and owner Vladimir Alexanyan of Los Altos, CA to 3 years probation during which he will be forbidden from engaging in any international business activities and a \$12,000 criminal fine after their guilty pleas to charges involving illegal exports of a product with ballistic missile applications to China. Valtex and Alexanyan earlier settled civil charges by BIS involving the same exports. See *February Update*.

June 1, 2005: Mobil Services Co., Ltd. of London, England agreed to pay a \$19,500 civil penalty for aiding three unlicensed reexports of Dell laptop computers and servers from England to Sudan, via Egypt, and for failing to retain export documents related to one of the reexports. Mobil International Petroleum Corp. of Irving, TX, the then owner of Mobil Sudan, agreed to pay a \$12,000 civil penalty for causing the same reexports.

June 3, 2005: Wilden Pump & Engineering Co., LLC of Grand Terrace, CA agreed to pay a \$700,000 civil penalty to settle charges of 71 violations of the Export Administration Regulations (EAR) involving unauthorized exports of controlled diaphragm pumps to Iran, Israel, China, Syria, and the United Arab Emirates without the required export licenses with knowledge that violations of the EAR would occur, as well as false statements on export control documents.

June 6, 2005 – 70 Fed. Reg. 32743: Petrom GmbH International Trade of Munich, Germany, was fined \$143,000 and received a 20-year denial of exports for conspiring with a U.S. front company to order U.S.-origin EAR 99 items for ultimate delivery to Iran via Ger-

many and actually ordering the items for shipment to Iran with knowledge that the shipment would occur without the required authorizations.

June 6, 2005: The US. Department of Homeland Security announced that it had deported Jinghua Zhuang of Thousand Oaks, CA to China following his completion of a 30-month prison sentence for attempting to illegally export components for U.S. fighter jets and missile systems to China. Zhuang's wife, Xiuwen Liang, was convicted with Zhuang and is now serving her 30-month prison sentence, following which she also will face deportation.

June 13, 2005: Lufthansa German Airlines agreed to pay a civil penalty of \$18,000 to settle charges that in 1999 it had aided and abetted one shipment and one attempted shipment to the Department of Atomic Energy of India, an organization listed on the Entity List, and had transported or stored the items in the attempted shipment with knowledge that a violation of the Regulations was about to occur.

June 16, 2005: Hord Crystal Corporation of Pawtucket, RI agreed to pay a civil penalty of \$12,500 to settle allegations that it had violated the antiboycott provisions of the EAR in connection with an export to the United Arab Emirates by certifying on shipping documents that the goods were not of Israeli origin, did not contain Israeli materials, and were not being exported from Israel. Hord was also charged with failing to report the UAE request for boycott information.

June 23, 2005: Arif Ali Durrani of Pakistan, after his arrest upon entering the U.S. from Mexico, pleaded innocent in Federal District Court in Los Angeles to a 1999 indictment charging that he had illegally exported military jet engine parts to Iran in May 1994.

June 28, 2005: Elan Pharmaceuticals,

Inc. of South San Francisco, CA, agreed to pay a \$31,000 civil fine and to perform an internal audit of its export compliance program to settle charges arising out of four exports of a controlled biological toxin to Belgium with reason to know that the required authorizations from the Commerce Department would not be obtained.

Sanctions & Denial Orders

Commerce Department

June 30, 2005 – 70 Fed. Reg. 37748: BIS issued a 5-year denial order against Mohammed Arastafar of Leidschendam, The Netherlands, in accordance with an agreement to settle charges involving solicitation of exports of EAR 99 gas processor parts ultimately intended for Iran with knowledge that a violation of the EAR was intended to occur.

State Department

June 17, 2005 – 70 Fed. Reg. 35333: The State Department indefinitely extended the administrative debarment already in force against Hughes Network Systems (Beijing) Co. Ltd. HNS (Beijing) is prohibited from participating in brokering or exporting of any item covered by the International Traffic in Arms Regulations (ITAR).

Treasury Department

June 1, 9, 10, 17, 29, and 30, 2005 – Various Fed. Reg. Notices: The Office of Foreign Assets Control (OFAC) added a total of 20 individuals and 11 entities to the Specially Designated Nationals (SDN) list and deleted one individual from the list.

July 1, 2005 – 70 Fed. Reg. 38255: OFAC amended Appendix A to 31 CFR Chapter V by restating the entire 244-page SDN list, updated to June 1, 2005.

EXPORT COMPLIANCE UPDATE

FD Associates, Inc.
7926 Jones Branch Drive, Ste. 260
McLean, VA 22102

July 2005 Export Compliance Update



**Published by
FD Associates, Inc.
7926 Jones Branch
Drive, Suite 260
McLean, VA 22102**

**Ph: (703) 847-5801
www.fdassociates.net**

ITAR QUIZ

Q A U.S. company is acquired by another U.S. company. The acquiring company will close out the target company's Defense Trade Controls registrant code and assume responsibility for all the outstanding licenses and agreements of the acquired company. The acquired company will maintain their name and there are no other changes involved.

Will this change require an amendment to the open agreements or can this be handled as a minor amendment since there is no change in the name and address of the acquired company?