

## GLOBAL DISTRIBUTIONS: THE EFFECT OF EXPORT CONTROLS

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\* Associate, Locke Liddell & Sapp LLP. J.D. University of Houston 1997. This article was originally delivered in conjunction with the author’s presentation at the 14th Annual Computer & Information Law Institute Conference, Sep. 13–16, 2000. The author would like to thank Patrick J. Beaton, J.D. expected University of Houston 2001, for his assistance with this article.

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## I. INTRODUCTION

A. *Issue Spotting*

Export controls are not just for “exporters” anymore. The Census Bureau reports that in 1998, 205,188 companies exported \$554 billion in merchandise.<sup>1</sup> This is up significantly from the Bureau’s 1992 data, which showed that 112,854 companies exported \$349 billion in merchandise in that year.<sup>2</sup> Other Census Bureau data show that the export of “advanced technology products” is on the rise, growing from \$186 billion in

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1 U.S. DEPARTMENT OF COMMERCE, CENSUS BUREAU, FOREIGN TRADE DIVISION, A PROFILE OF U.S. EXPORTING COMPANIES, 1997–1998, *available at* <http://www.census.gov/foreign-trade/aip/index.html> (July 19, 2000) [hereinafter 1998 Profile].

2 U.S. DEPARTMENT OF COMMERCE, CENSUS BUREAU, FOREIGN TRADE DIVISION, A PROFILE OF U.S. EXPORTING COMPANIES, 1992, *available at* <http://www.census.gov/foreign-trade/aip/edbrel.html> (Aug. 22, 1997).

1998 to \$200 billion in 1999 and to nearly \$146 billion from January to August 2000.<sup>3</sup> These data are derived from traditional export documentation.<sup>4</sup>

Notably, however, traditional export documents are not filed when someone downloads a program from a web site maintained in the United States. The export data above do not reflect, for example, a customer service representative in Cleveland sending a PDF version of a technical services manual to a customer in Singapore via e-mail, a sales department giving software demonstrations to a delegation from China, or a lead programmer spending ten days in India teaching the latest trajectory analysis programming techniques to a software development subcontractor. Nonetheless, many federal agencies consider all of these acts to be “exports,” despite the fact that in such cases no tangible property ever leaves the United States.<sup>5</sup>

This paper is concerned with spotting export and trade regulation issues in the global e-marketplace. In particular, it addresses the following questions:

- What are the penalties for violation of trade laws?<sup>6</sup>
- What is an “export?”<sup>7</sup>
- Who licenses exports?<sup>8</sup>
- How does one comply with U.S. export and trade regulations?<sup>9</sup>

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3 BUREAU OF THE CENSUS, FOREIGN TRADE DIVISION, U.S. INTERNATIONAL TRADE IN GOODS AND SERVICES: NOV. 2000, available at [http://www.census.gov/foreign-trade/Press-Release/current\\_press\\_release/exh16.txt](http://www.census.gov/foreign-trade/Press-Release/current_press_release/exh16.txt) (Jan. 19, 2001).

4 See 1998 Profile, *supra* note 1 (explaining that the report is based on economic and survey data on file with the Census Bureau, administrative records from other government agencies, and documents filed for export clearances).

5 See discussion *infra* §§ II–III (defining “exports” and discussing what exports are “subject to” the Export Administration Regulations).

6 See discussion *infra* § I(B) (explaining penalties for export violations).

7 See discussion *infra* §§ II–III (defining “exports” and discussing what exports are “subject to” the Export Administration Regulations).

8 See discussion *infra* § IV (identifying a variety of licensing sources).

9 See discussion *infra* §§ V–VI (discussing compliance through specific procedures).

## B. Penalties

### 1. Administrative

U.S. government agencies have a number of administrative penalties available to punish the unwary. For example, under the Export Administration Regulations (“EAR”), civil fines of \$10,000 per violation can be levied for most types of infractions.<sup>10</sup> If the violation involves National Security Controls, the penalty can go as high as \$100,000.<sup>11</sup>

Another penalty is the denial of export privileges.<sup>12</sup> This penalty makes it illegal for a denied party to engage in any export transactions and for a third party to enter into an export transaction with a denied party.<sup>13</sup> The EAR further provides a special sanction for attorneys, accountants, consultants, freight forwarders, and others acting in any representative capacity for an exporter.<sup>14</sup> Such individuals can be “excluded by order” from participating in any license application or other activity before the Bureau of Export Administration<sup>15</sup> (“BXA”).

The Export Administration Act of 1979 (“EAA 1979”) granted the Secretary of Commerce broad powers to implement regulations for enforcement of the Act and to levy sanctions for violations of the Act.<sup>16</sup> One Court of Appeals has interpreted this to mean that the Secretary is authorized to impose civil sanctions on a strict liability basis (no knowledge or intent is required) once a person has committed the proscribed act.<sup>17</sup>

Penalties under the International Traffic in Arms Regulations (“ITAR”) are significantly greater than those of the

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10 Export Administration Regulations, 15 C.F.R. § 764.3(a)(1)(i) (2000).

11 *Id.*

12 *See* 15 C.F.R. § 764.3(a)(2).

13 *Id.*

14 *See* 15 C.F.R. § 764.3(a)(3).

15 *Id.*

16 *See* 50 U.S.C. app. § 2410(c) (1991).

17 *See* *Iran Air v. Kugelman*, 996 F.2d 1253, 1259 (D.C. Cir. 1993) (arguing the “knowingly” requirement of 50 U.S.C. § 2410(a) need not be read into the “civil penalties” of § 2410(c)); *but cf.* *United States v. Cardeon*, 898 F. Supp. 1563, 1568 (S.D. Fla. 1995), *aff’d sub nom.* *United States v. Johnson*, 139 F.3d 1359 (11th Cir. 1998) (requiring a finding of knowledge for EAR violations).

EAR.<sup>18</sup> A civil penalty of up to \$500,000 is authorized.<sup>19</sup> Under the ITAR, the civil penalties for violations of U.S. sanctions programs vary depending on the program. For example, civil penalties under the Cuban sanction program can be up to \$55,000 per violation.<sup>20</sup> The maximum under the Sudanese, Iranian, and Libyan sanctions is \$11,000,<sup>21</sup> while the maximum civil penalty for violating the Iraqi sanctions is \$275,000 per violation.<sup>22</sup>

## 2. *Criminal*<sup>23</sup>

Criminal penalties under the EAR for general violations can result in fines of up to \$50,000 or five times the value of the export, whichever is greater, and imprisonment for up to five years.<sup>24</sup> Willful violations by an organization can result in fines up to \$1,000,000 per violation or five times the value of the export, whichever is greater, and for individuals can result in fines of up to \$250,000 and up to ten years imprisonment.<sup>25</sup> ITAR violations can result in fines of up to \$1,000,000 and up to ten years imprisonment.<sup>26</sup>

Examples of criminal penalties for “willful violations” under the sanction programs are as follows:

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<sup>18</sup> See International Traffic in Arms Regulations, 22 C.F.R. § 127.10 (2000) (referring to 22 U.S.C. §§ 2778, 2779a, and 2780, where civil penalty maximums can reach \$500,000 per violation).

<sup>19</sup> 22 U.S.C. § 2780(k).

<sup>20</sup> Cuban Assets Control Regulations, 31 C.F.R. § 515.701(a)(3) (2000).

<sup>21</sup> Sudanese Sanctions Regulations, 31 C.F.R. § 538.701(a)(1) (2000); Iranian Transactions Regulations, 31 C.F.R. § 560.701(a)(1) (2000); Libyan Sanctions Regulations, 31 C.F.R. § 550.701(a)(1) (2000).

<sup>22</sup> Iraqi Sanctions Regulations, 31 C.F.R. § 575.701(a)(1) (2000).

<sup>23</sup> See generally Bruce Zagaris, *Avoiding Criminal Liability in the Conduct of International Business*, 21 WM. MITCHELL L. REV. 749 (1996) (discussing criminal liability in the export arena under the Foreign Corrupt Practices Act (15 U.S.C. § 78dd-2) and foreign law).

<sup>24</sup> Export Administration Regulations, 15 C.F.R. § 764.3(b)(1) (2000).

<sup>25</sup> 15 C.F.R. § 764.3(b)(2).

<sup>26</sup> 22 U.S.C. § 2778(c).

Program	Company Fines	Individual Fines	Prison Time	31 C.F.R.
Cuban Assets	\$1,000,000	\$100,000	10 years	§ 515.701(a)(1)
Iranian Assets		\$50,000	10 years	§ 535.701(a)(1)
Iranian Transactions		\$50,000	10 years	§ 560.701(a)(1)
Libyan		\$50,000	10 years	§ 550.701(a)(1)
Iraqi	\$1,000,000	\$1,000,000	12 years	§ 575.701(a)(1)

### 3. *Statutory Scheme and Proposed Legislation*

The legislation that authorized the Department of Commerce to enforce export controls expired on August 20, 1994,<sup>27</sup> “and replacement legislation has been languishing for six years.”<sup>28</sup> EAA 1979, as reflected in the EAR, provided for fines of five times the value of the exports, or \$50,000, and up to five years in prison for “knowing” violations.<sup>29</sup> “Willful” criminal violations could result in a fine equal to the greater of five times the value of the exports or \$1,000,000 for companies, and up to a \$250,000 fine and ten years imprisonment for individuals.<sup>30</sup>

After the EAA 1979 expired, Congress continued to authorize penalties for export violations under provisions of the International Economic Emergency Powers Act<sup>31</sup> (“IEEPA”). The penalties under the statute were considerably less severe, with civil violations capped at \$10,000, willful violations capped at \$50,000, and a possible ten year imprisonment for individuals.<sup>32</sup> However, under the IEEPA<sup>33</sup> and Executive Order 12,924,<sup>34</sup> the

<sup>27</sup> 50 U.S.C. app. § 2419 (1991).

<sup>28</sup> David Biederman, *Export Penalties Going Up*, J. COM. WK., June 19–25, 2000, at 46.

<sup>29</sup> 50 U.S.C. app. § 2410(a).

<sup>30</sup> 50 U.S.C. app. § 2410(b).

<sup>31</sup> See 50 U.S.C. §§1701-1706 (Supp. 2000); see also Biederman, *supra* note 28 (noting the penalties for violations have been authorized under the IEEPA since the expiration of the EEA 1979).

<sup>32</sup> 50 U.S.C. § 1705.

<sup>33</sup> See 50 U.S.C. § 1702 (granting the President regulatory power under the IEEPA).

<sup>34</sup> See Exec. Order No. 12,924, 59 Fed. Reg. 43,437 (Aug. 19,1994), *reprinted in* 50

EAR remained in full effect.<sup>35</sup>

A thorough revision of the EAA 1979, the Export Administration Act of 1999 ("EAA 1999"), is currently before the Senate, and would increase civil penalties for violations of commercial export regulations from \$10,000 to \$1,000,000 per violation.<sup>36</sup> Criminal penalties for individuals would increase to a fine of ten times the value of the exports or \$1,000,000, whichever is greater, and a possible prison term of up to ten years.<sup>37</sup> Companies could face a fine of ten times the value of the exports or \$10,000,000, whichever is greater.<sup>38</sup>

The "conventional wisdom" is that EAA 1999 will not pass.<sup>39</sup> An alternative bill, the Security Assistance Act of 1999 ("SAA 1999"), made its way through Congress and became law on October 6, 2000.<sup>40</sup> SAA 1999 modifies the International Emergency Economic Powers Act to increase the penalties for export violations. Civil penalties increase to \$50,000 per violation.<sup>41</sup> Criminal penalties also increase for both companies and individuals.<sup>42</sup>

As an interim measure, on October 30, 2000, Congress passed the Export Administration Modification and Clarification Act of 2000 (House Bill 5239), which extends the terms of the EAA 1979 through August 20, 2001, and reinstates the more severe EAA 1979 penalties.<sup>43</sup> Although the earlier version of the

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U.S.C.A. § 1701 (West Supp. 2000) (exercising power under the IEEPA to continue enforcement of the EAR).

<sup>35</sup> See Cecil Hunt, *U.S. Export Controls*, in *COPING WITH U.S. EXPORT CONTROLS* 21-22 (Evan R. Berlack & Cecil Hunt eds., 1998) (explaining that the EAR have been maintained by executive order under the IEEPA).

<sup>36</sup> S. 1712, 106th Cong. § 603(c)(1) (1999).

<sup>37</sup> *Id.* § 603(a)(1).

<sup>38</sup> *Id.* § 603(a)(2).

<sup>39</sup> See Biederman, *supra* note 28 (noting the legislation was "yanked due to numerous disagreements"). The Export Administration Act 2001 is currently before the Senate. S. 149, 107th Cong. available at <http://thomas.loc.gov/>.

<sup>40</sup> H.R. 973, 106th Cong. § 708 (1999).

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> See *House Approves Extension of Export Administration Act*, CONGRESS DAILY AM, Oct. 30, 2000; see also Bill Summary & Status for the 106<sup>th</sup> Congress, available at <http://www.thomas.loc.gov> (last visited Nov. 14, 2000) (indicating that the House agreed to the Senate version of the bill, which was signed by former President Clinton on

House Bill had called for increased penalties, leaders in the Senate pushed for simply extending the EAA 1979 and leaving full-scale reform of the Act for a later day.<sup>44</sup> The President signed the bill on November 13, 2000.<sup>45</sup>

## II. WHAT IS AN EXPORT?

The U.S. government defines exports broadly in most instances. For example, under the EAR exports include:

- An actual shipment or transmission of items out of the United States;<sup>46</sup>
- Release of software or technology in a foreign country;<sup>47</sup>
- Release of technology or source code to a foreign national wherever located.<sup>48</sup> This includes visual inspection by a foreign national of U.S.-origin equipment or facilities.<sup>49</sup> It also includes oral exchanges of information;<sup>50</sup>
- Items produced abroad using U.S.-origin technology;<sup>51</sup> and
- Re-export of previously exported items.<sup>52</sup>

By using the word “transmission” the government clearly intends that the use of electronic mail (“e-mail”) or the Internet

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Nov. 13, 2000). Congress and the Administration may have been at least partially motivated to revive expired confidentiality rules under EAA 1979, “partly to stymie a federal law suit by the Wisconsin Project [on Nuclear Arms Control] that seeks to win release of license records since 1995 for dual-use exports to China, India, Israel, Pakistan and Russia.” Marc Selinger, *House Eyes Vote on Senate Export Control Bill*, AEROSPACE DAILY, Oct. 25, 2000, at 141.

44 See Brian Krebs, *Senate Passes Substitute To House Export Bill*, NEWSBYTES NEWS NETWORK, Oct. 12, 2000, available at 2000 WL 27301384.

45 See Clinton Signs New Curbs on High-Tech Exports, WASH. POST, Nov 14, 2000, at A07; Export Administration Modification and Clarification Act of 2000, Pub. L. No. 106-508, 114 Stat. 2360 (2000).

46 Export Administration Regulations, 15 C.F.R. § 734.2(b)(1) (2000).

47 15 C.F.R. § 734.2(b)(2)(i).

48 15 C.F.R. § 734.2(b)(2)(ii).

49 15 C.F.R. § 734.2(b)(3)(i).

50 15 C.F.R. § 734.2(b)(3)(ii).

51 15 C.F.R. § 734.3(a)(4).

52 Export Administration Regulations, 15 C.F.R. § 734.2(b)(4).

to send items be subject to the EAR. As such, controlled software or data could be included.<sup>53</sup> As specified in the EAR's discussion of the export of encryption source and object code, transmission includes:

downloading, or causing the downloading of, such software to locations (including electronic bulletin boards, Internet file transfer protocol, and World Wide Web sites) outside the U.S., or making such software available for transfer outside the United States, over wire, cable, radio, electromagnetic, photo optical, photoelectric or other comparable communications facilities accessible to persons outside the United States, including transfers from electronic bulletin boards, Internet file transfer protocol and World Wide Web sites, unless the person making the software available takes precautions adequate to prevent unauthorized transfer of such code.<sup>54</sup>

The EAR even specify that U.S. exporters should take certain precautions with regard to Internet transfers of encryption products.<sup>55</sup> The precautions include verifying that the address of each party outside the U.S. who is initiating such transfers does not have a domain name or URL of a foreign government end-user, such as ".gov," ".gouv," ".mil," etc.<sup>56</sup> Presumably, these same requirements would apply to the electronic transfer of other types of software and technical data that are subject to the EAR.

### III. WHAT ARE "ITEMS SUBJECT TO THE EAR"?

Subject to the EAR include items of U.S. and foreign origin items exceeding de minimis U.S. content.<sup>57</sup> Some examples of product categories that may be subject to the EAR are (1) tangible things such as commodities, products, etc.; (2) software;

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<sup>53</sup> See 15 C.F.R. § 730.5(c).

<sup>54</sup> 15 C.F.R. § 734.2(b)(9)(ii). It should be noted that these guidelines do not apply to transmissions with Canada.

<sup>55</sup> 15 C.F.R. § 734.2(b)(9)(iii).

<sup>56</sup> 15 C.F.R. § 734.2(b)(9)(iii)(A).

<sup>57</sup> 15 C.F.R. § 734.3.

(3) technology; (4) technical data; and (5) technical know-how.<sup>58</sup> With some exceptions, “[a]ll U.S. origin items wherever located” are subject to the EAR.<sup>59</sup> However, not all items subject to the EAR require a license for export.<sup>60</sup> The EAR are supposedly designed to require licenses only for exports of items that must be controlled for reasons such as nuclear, chemical, and biological warfare non-proliferation controls, missile technology, regional stability, national security, firearms conventions, crime control, and anti-terrorism concerns.<sup>61</sup>

The following are some examples of items that may require an export license:

- Oilfield equipment such as perforator cartridges, certain hydrophones and hydrophone arrays, and equipment made with Titanium-stabilized duplex stainless steel (Ti-DSS) (17-23% chromium content);
- Software such as machine tool controls, CAD for integrated circuits, and encryption;
- General purpose electronic equipment, masks; and
- Telecommunications equipment such as routers, modems, multiplexers, and transceivers.<sup>62</sup>

#### IV. WHO LICENSES EXPORTS?

##### A. *The Big List*

In the United States, several different government entities may be involved in export licensing, depending on the nature of the item:

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<sup>58</sup> *Id.*; 15 C.F.R. § 732.2.

<sup>59</sup> 15 C.F.R. § 734.3(a)(2). The Exceptions are listed in paragraph (b) of the section. See § 732, Supp. 2 for a flowchart to help determine if an export is subject to the EAR.

<sup>60</sup> See 15 C.F.R. § 734.2(a)(3) (clarifying that “subject to the EAR” does not equate to a license requirement); Cecil Hunt, *Department of Commerce Export Controls*, in Berlack & Hunt, *supra* note 35, at 55 (noting that despite the apparent breadth of the EAR, only about 4% of U.S. exports by value require a BXA license because most exports fall outside the Commerce Control List or fall within a licensing exception).

<sup>61</sup> 15 C.F.R. § 738.2(d)(2)(i)(A) (listing the “reasons for control” of the Commerce Country Chart, which gives rise to licensing requirements).

<sup>62</sup> See The Commerce Control List, 15 C.F.R. § 774, Supp. 1 (2000).

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- Bureau of Export Administration — Controls licensing for most commercial products.
- Office of Defense Trade Controls — Controls exports of U.S. Munitions List items.
- Office of Foreign Assets Control — Controls exports related to U.S. embargo programs.
- Nuclear Regulatory Commission — Controls the export of nuclear material and equipment.
- Department of Energy — Controls the export of nuclear technology, technical data for nuclear weapons/special nuclear materials, and natural gas and electric power.
- Department of the Interior — Controls exports related to fish and wildlife.
- Drug Enforcement Administration — Controls export of controlled substances.
- Food and Drug Administration — Controls export of drugs, biologics, and medical devices.
- Patent and Trademark Office — Controls patent filing data sent abroad.
- Department of Agriculture — Controls export of plants.

In addition to the aforementioned licensing agencies, other agencies are consulted as needed and may include: the Defense Technology Security Administration, the Arms Control and Disarmament Agency, and the National Security Administration.<sup>63</sup>

*B. The Big Three*

Of all the various agencies, the three that are most involved in export control are the Bureau of Export Administration, the Office of Defense Trade Controls, and the Office of Foreign Assets Control.

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<sup>63</sup> 15 C.F.R. § 730, Supp. 3 (listing other government agencies with export control responsibilities); Hunt, *supra* note 60, at 46-50 (briefly describing the structure of the export control system).

### 1. Bureau of Export Administration ("BXA")

The BXA is part of the Department of Commerce.<sup>64</sup> When seeking answers to export questions, it is probably the best source of information, as it often cross-references the resources of the multiple agencies involved in the export licensing process.<sup>65</sup> The BXA publishes the EAR and maintains the Commerce Control List<sup>66</sup> ("CCL"). The CCL is the list of commercial products that are most likely to require an export license.<sup>67</sup> The CCL identifies items with specific Export Control Classification Numbers ("ECCN"), which are then used to determine if a license is needed to export a particular item to a specific country, a specific end use, or a specific end user.<sup>68</sup>

The BXA is also charged with enforcing the EAR.<sup>69</sup> As part of these duties it maintains the Denied Persons List, which is a list of parties who have been denied export privileges.<sup>70</sup> Exporters use this list to ensure that they are not violating the EAR by entering into an export transaction with persons who have been denied export privileges.<sup>71</sup>

The BXA also maintains the Proliferation Entities List.<sup>72</sup> This is a list of foreign organizations and entities that the BXA has determined may be involved in the development or production of weapons of mass destruction.<sup>73</sup>

Finally, the BXA also plays a part in the government's anti-

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64 See Hunt, *supra* note 60, at 50 (outlining the basic structure of the Commerce Department controls). BXA's Internet home page is available at <http://www.bxa.doc.gov/>.

65 See, e.g., 15 C.F.R. § 730, Supp. 3 (2000).

66 See Hunt, *supra* note 60, at 50–53; The Commerce Control List, 15 C.F.R. § 774 (2000).

67 See The Commerce Control List, 15 C.F.R. § 774 (2000) (noting that the CCL "includes items . . . subject to the authority of BXA," but does not include "items exclusively controlled for export by another U.S. department or agency.").

68 Refer to discussion *infra* § V for specific steps involved in using the CCL in compliance with the EAR.

69 See generally, Hunt, *supra* note 60, at 80–98 (discussing the BXA's role in enforcement of the EAR).

70 Denied Persons List, 15 C.F.R. pt. 764, Supp. 2 (2001).

71 See *infra* § V(B)(3)(c) (discussing persons denied export privileges).

72 See Control Policy: End-User and End-Use Based, 15 C.F.R. § 744.1 (2001).

73 See *infra* §§ V(B)(3)(d)– V(B)(3)(e) (discussing Proliferation Entities and End User/End Use restrictions).

boycott efforts.<sup>74</sup> For example, the BXA enforces requirements that U.S. companies not participate in the Arab League embargo against Israel.<sup>75</sup>

## 2. Office of Defense Trade Controls (“ODTC”)

The ODTC is part of the Department of State.<sup>76</sup> It is in charge of maintaining the International Traffic in Arms Regulations<sup>77</sup> (“ITAR”), which includes the United States Munitions List.<sup>78</sup> Essentially, the ODTC handles the registration of all arms manufacturers, exporters, and brokers, and the export licensing of arms under the Arms Export Control Act<sup>79</sup> (“AECA”).

Because many commercially available items have both a civilian and military uses, the ODTC is in charge of determining which licensing regime applies to such dual use items.<sup>80</sup> For example, the wiring harness for a military fighting vehicle could also be used on commercial trucks.

The ODTC maintains the list of countries subject to a U.S. arms embargo.<sup>81</sup> It also maintains a list of persons who have been debarred from participating in the export of defense articles.<sup>82</sup>

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<sup>74</sup> See Restrictive Trade Practices or Boycotts, 15 C.F.R. § 760.5 (2000); *infra* § 5.1.5.

<sup>75</sup> See Office of Antiboycott Compliance *available at* <http://www.bxa.doc.gov/AntiboycottCompliance/OACRequirements.html> (last visited Feb. 13, 2001).

<sup>76</sup> See Office of Defense Trade Controls *available at* <http://www.pmdtc.org> (last visited Feb. 11, 2001).

<sup>77</sup> 22 C.F.R. pt. 120 (2000); Peter D. Trooboff, *A Brief Primer on the International Traffic in Arms Regulations (“ITAR”)*, in Berlack & Hunt, *supra* note 35, at 305.

<sup>78</sup> See 22 C.F.R. § 121.1.

<sup>79</sup> See Arms Export Control Act, 22 U.S.C. § 2778 (2000).

<sup>80</sup> See *infra* § V(C)(2) (discussing commodity jurisdiction determinations for dual use items).

<sup>81</sup> See Country Embargo Reference Chart, *available at* <http://www.pmdtc.org/country.htm> (last visited Nov. 14, 2000).

<sup>82</sup> See List of Debarred Parties, *available at* <http://www.pmdtc.org/debar059.htm> (last updated May 1999); Debarment, 22 C.F.R. § 127.7(a) (2001) (authorizing the Assistant Secretary of State to prohibit persons from exporting defense articles).

### 3. Office of Foreign Assets Control (“OFAC”)

The OFAC is part of the Treasury Department.<sup>83</sup> It “enforces economic and trade sanctions against targeted foreign countries, terrorism sponsoring organizations and international narcotics traffickers based on U.S. foreign policy and national security goals.”<sup>84</sup> It also administers the Foreign Assets Control Regulations.<sup>85</sup>

The OFAC maintains the Specially Designated Nationals and Blocked Persons List (“SDN List”), a list of individuals and companies that U.S. persons are prohibited from conducting business with without a license.<sup>86</sup>

## V. EXPORT COMPLIANCE - THE THREE P’S

The BXA identifies twenty-nine steps involved in determining whether an export is subject to the EAR.<sup>87</sup> “Step 7” through “Step 19” identify ten general prohibitions that may impact export activities.<sup>88</sup> It is very important that exporters and their staffs understand the impact of the steps and the prohibitions.

In first coming to grips with the structure of the EAR and of export regulations in general, it may be useful to view the primary factors of export regulations as “the three P’s of export compliance:”

- Pariahs: Country Controls
- People Controls
- Product Controls

These controls can be thought of as the main factors used in determining whether an exporter will need a license before

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<sup>83</sup> See R. Richard Newcomb, *Office of Foreign Assets Control*, in Berlack & Hunt, *supra* note 35, at 119.

<sup>84</sup> See Office of Foreign Assets Control, available at <http://www.ustreas.gov/ofac> (last visited Jan. 31, 2001).

<sup>85</sup> See Foreign Assets Control Regulations, 31 C.F.R. pt. 500 (2001).

<sup>86</sup> Office of Foreign Assets Control, *supra* note 84; see also *infra* § 5.1.2 (discussing the OFAC’s role in embargoes).

<sup>87</sup> Steps for Using the EAR, 15 C.F.R. §§ 732.2–732.5(2001).

<sup>88</sup> *Id.* at § 732.3; General Prohibitions, 15 C.F.R. § 736.2 (2001).

participating in a particular transaction. First, the controls look to the country and the nationals of such country that will receive the technology.<sup>89</sup> Next, they identify specific people who are prohibited from participating in export transactions.<sup>90</sup> Finally, they look to the specific product involved in the transaction.<sup>91</sup>

Many compliance programs suggest that you start with an understanding of your product as the basis of your company's export compliance program. This is a valid approach as long as the exporter understands that, because of the extraterritorial reach of the U.S. sanction programs<sup>92</sup> and the nature of e-commerce, a company can participate in a prohibited transaction without ever "exporting" a product.<sup>93</sup> In fact, a company's sales staff or technical support staff can violate the regulations merely by entering into discussions with proscribed countries or individuals.<sup>94</sup> Product level controls are, of course, an integral part of any export and trade compliance program; but when your product consists of electronic bits and bytes that do not require a license for export, your greatest risk is in choosing your customers.

#### A. *Pariahs: Country Controls*

Numerous U.S. sanctions treat certain countries and their citizens as pariahs, or social outcasts. Other sanctions ostracize specific individuals and entities. The following lists some of the major embargo and sanction programs.

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<sup>89</sup> See *infra* § V(A) (explaining the country controls of the ODTC, the OFAC, and the BXA).

<sup>90</sup> *Infra* § V(B) (discussing restrictions on doing business with particular individuals).

<sup>91</sup> See *infra* § V(C) (examining the complexities of product controls).

<sup>92</sup> See, e.g., Cuban Liberty & Democratic Solidarity (LIBERTAD) Act of 1996, 22 U.S.C. § 6091 (2000) (providing for "[e]xclusion from the United States of aliens who have confiscated property of United States nationals or who traffic in such property"). See *infra* § 6.4 (discussing the international reaction to this legislation).

<sup>93</sup> See *supra* § I(A) (pointing out that statistics on traditional product exports do not include all the transactions that could be considered "exports" by the export regulations).

<sup>94</sup> See, e.g., Prohibited Exports and Sales to Certain Countries, 22 C.F.R. § 126.1(e) (2001) (prohibiting even *proposed* sales or transfers of any defense articles, defense services or technical data subject to the ITAR to prohibited countries).

### 1. *State Department Arms Embargoes*

The U.S. State Department through the ODTTC maintains arms embargoes against a number of countries.<sup>95</sup>

The State Department publishes updates in the Federal Register, which are in turn referenced on the ODTTC web page.<sup>96</sup>

For a company dealing in defense articles, including dual use defense articles or defense services, it is very important to understand the impact and reach of these embargoes. The regulations prohibit U.S. persons located anywhere from entering into export, sales, or brokering activities with these countries, their citizens, or agents.<sup>97</sup>

### 2. *OFAC Embargoes*

The OFAC maintains a list of current economic sanctions pursuant to a variety of laws, regulations, United Nations Security Council Resolutions, and executive orders.<sup>98</sup> The OFAC's web site is an excellent resource for exporters. One may download summaries of each of the different sanction programs as well as summaries for various industry groups.<sup>99</sup>

### 3. *BXA Country Controls*

The BXA maintains controls on exports to embargoed

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95 *Id.* § 126.1(a). The current list of countries is: Afghanistan, Angola, Armenia, Azerbaijan, Burma, Belarus, China (PR), Cuba, Cyprus, Haiti, India, Indonesia, Iran, Iraq, Liberia, Libya, North Korea, Pakistan, Rwanda, Somalia, Sudan, Syria, Tajikistan, Ukraine, Vietnam, Yemen, FR. Of Yugoslavia (Serbia and Montenegro), and Zaire.

96 *Id.*; Country Embargo Chart, available at <http://www.pmdtc.org/country.htm> (last visited Jan. 30, 2001).

97 *See* 22 C.F.R. § 126.1(c), (e).

98 Office of Foreign Assets Control available at <http://www.ustreas.gov/ofac/> (last visited Nov. 16, 2000) (listing relevant orders, law, resolutions, and statutes). Currently subject to U.S. unilateral or other multilateral trade sanctions are: Burma (Myanmar), Cuba, Iran, Iraq, Libya, Narcotics Traffickers, Non-Proliferation Entities, Sudan, Taliban (Afghanistan), Terrorists (Syria), UNITA (Angola), Yugoslavia, and Sierra Leone. *Id.* The export controls applicable to North Korea were eased at the direction of President Clinton. Repeal of Traffic Restrictions to North Korea, 65 Fed. Reg. 38,164 (Jun. 19, 2000) (noting President Clinton's direction in Sept. 1999 to ease sanctions against North Korea).

99 <http://www.ustreas.gov/ofac/> (last visited Nov. 16, 2000).

countries.<sup>100</sup> The BXA controls essentially serve to require export licenses before exporting or re-exporting U.S. origin goods to any of the countries covered under an ODTC or OFAC embargo.<sup>101</sup>

In addition, the BXA maintains a Commerce Country Chart that exporters use to determine if an export requires a license for a certain country.<sup>102</sup> For example, software for the development of certain types of telecommunications transmission equipment and systems is controlled for reasons of national security and antiterrorism.<sup>103</sup> Looking at the sample Commerce Country Chart, below, one can see that a license would be required to export such software to all countries except Canada, because an "X" does not appear in the NS1 column of the Country Chart for Canada.<sup>104</sup> However, it should be noted that a special license exception would allow the export to many other countries once the exporter receives a written assurance that the recipient will not re-export the software to others without a license from the BXA.<sup>105</sup>

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100 Embargoes and Other Special Controls, 15 C.F.R. § 746.1 (2000).

101 *See id.*

102 Commerce Country Chart, 15 C.F.R. pt. 738, Supp. 1 (2000).

103 *See* Commerce Control List (CCL) Structure, 15 C.F.R. § 738.2 (2000); The Commerce Control List, 15 C.F.R. pt. 774, Supp. 1, 5D002, 5D992 (2000); Commerce Country Chart, 15 C.F.R. pt. 738, Supp. 1 (2000).

104 Commerce Country Chart, *supra* note 102; *see also* Commerce Country Chart Structure, 15 C.F.R. § 738.3(d) (2000) (reprinted below).

105 15 C.F.R. § 740.6 (2000); *see also* License Exceptions, 15 C.F.R. § 740.1 (2000); *infra* § VI(B) (for an example of determining if a license exception is available for a specific product being exported to a specific country).

Commerce Country Chart																
Countries	Reason for Control															
	Chemical & Biological Weapons			Nuclear Non-Proliferation		National Security		Missile Tech	Regional Stability		Firearms Conv.	Crime Control			Anti-Terrorism	
	1	2	3	1	2	1	2	1	1	2	1	1	2	3	1	2
Belize	X	X		X		X	X	X	X	X	X		X		X	
Benin	X	X		X		X	X	X	X	X		X		X		
Bhutan	X	X		X		X	X	X	X	X		X		X		
Bolivia	X	X		X		X	X	X	X	X	X		X		X	
Bosnia & Herzegovina	X	X		X		X	X	X	X	X		X		X		
Botswana	X	X		X		X	X	X	X	X		X		X		
Brazil	X	X				X	X	X	X	X	X		X		X	
Brunei	X	X		X		X	X	X	X	X		X		X		
Bulgaria	X	X	X			X	X	X	X	X		X	X			
Burkina Faso	X	X		X		X	X	X	X	X		X		X		
Burma	X	X	X	X		X	X	X	X	X		X		X		
Burundi	X	X		X		X	X	X	X	X		X		X		
Cambodia	X	X		X		X	X	X	X	X		X	X			
Cameroon	X	X		X		X	X	X	X	X		X		X		
Canada											X					
Cape Verde	X	X		X		X	X	X	X	X		X		X		

#### 4. *E-commerce Example*

U.S. trade sanctions have the potential of severely impacting American companies' international e-commerce efforts. Consider the following hypothetical and its implications on Business-to-Business ("B2B") exchanges. In a B2B exchange, it is possible for a non-U.S. buyer, from the United Kingdom for example, to use a U.S.-based electronic exchange to order a foreign-origin product for export to a third country.

If the third country were Iran, for example, unless the U.S.-based exchange had an export license from OFAC, OFAC could claim that the exchange had facilitated a prohibited transaction under 31 C.F.R. § 560.204 (even more so if the exchange harvested the transaction data and stored it in its database).<sup>106</sup> In other words, by transmitting an electronic purchase order that contains a proscribed destination in the "Ship To" field, the exchange has placed itself at risk. The mere storing of a "Ship To" address in its database significantly increases its risk because its own database shows that it "knew" of the transaction.

<sup>106</sup> Iranian Transactions Regulations, 31 C.F.R. § 560.204 (2000); Office of Foreign Assets Control, An Overview of the Foreign Assets Control Regulations relating to Iran, available at <http://www.treas.gov/ofac/> (last visited Feb. 13, 2001).

### 5. *BXA Antiboycott Regulations*

The BXA is also responsible for helping enforce the U.S. antiboycott regulations.<sup>107</sup> U.S. persons are prohibited from:

- Agreeing to refuse to do business with or furnishing information about its relationships with a company in a “blacklisted” country, such as Israel;<sup>108</sup>
- Agreeing to discriminate or furnish information concerning race, religion, sex, national origin, or nationality of any officer, owner, director, or employee of a U.S. corporation or other organization;<sup>109</sup>
- Implementing letters of credit that contain prohibited boycott terms or conditions.<sup>110</sup>

In addition, the statute creates a duty to report receiving a “request to take any action which has the effect of furthering or supporting a restrictive trade practice or boycott fostered or imposed by a foreign country against a country friendly to the United States or against any United States person . . . .”<sup>111</sup>

### *B. People Controls*

The BXA, OFAC, and ODTC all restrict specific individuals and entities with whom you, as an exporter, can conduct business.<sup>112</sup> The following are the main ways these agencies prohibit transactions with specific people.

#### 1. *Technical Data - Deemed Exports*

Under the EAR’s “deemed export” doctrine, an export occurs when you allow a foreign national to have access to technology or source code, even if the release occurs while that person is in the United States.<sup>113</sup> The BXA considers a release of technology or source code to occur when a foreign national sees it or talks

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Enforcement and Protective Measures, 15 C.F.R. § 764.1 (2001).

108 § 760.2(a)(4).

109 § 760.2(b)–(c).

110 § 760.2(f).

111 § 760.5(a)(1).

112 *See supra* § IV (discussing the various entities involved in export licensing).

113 Scope of the Export Administration Regulations, 15 C.F.R. § 734.2(b)(1), (b)(2)(ii) (2000).

about it.<sup>114</sup> When this occurs, it is deemed to be a release to the foreign national's home country.<sup>115</sup> This rule does not apply to permanent resident aliens.<sup>116</sup> For example, if you leave a listing of a program that contains code that would require a license to export it on your desk when you are visited by a foreign national, the BXA considers it a violation of the EAR.<sup>117</sup>

The "deemed export" rule was modified on January 14, 2000 for encryption source and object code.<sup>118</sup> The rule clarifies that the EAR are not violated unless the source or object code is actually transmitted outside the United States.<sup>119</sup>

The "deemed export rule" was criticized as inconsistent with First Amendment rights, which may have led to the new regulation.<sup>120</sup> At least two federal courts have held that encryption source code is expression protected by the First Amendment,<sup>121</sup> even though the court did not actually reverse the rule.<sup>122</sup> If the courts continue this trend, it may go a long way toward eliminating the deemed export rule for non-encryption exports as well.

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114 § 734.2(b)(3)(i)-(ii).

115 § 734.2(b)(2)(ii).

116 *Id.*

117 *See generally* § 734.2(b)(2)(ii)-(3)(i) (prohibiting release, which includes visual inspection, to any party with knowledge that a violation is about to occur).

118 *See* Revisions to Encryption Items, 65 Fed. Reg. 2492 (Jan. 14, 2000).

119 15 C.F.R. § 734.2 (b)(9)(i)(A)-(B) (transferring of source or object code in the U.S. to a foreign embassy or affiliate of a foreign country is also considered to be an export of such code); *See* Revisions to Encryption Items, *supra* note 117.

120 *See* James W. Butler, III, *Safe and Legal E-Commerce: Legal and Regulatory Issues Raised by the Use and Export of Encryption Technology*, in PRAC. LAW INST., PATENTS, COPYRIGHTS, TRADEMARKS, & LITERARY PROP. COURSE HANDBOOK SERIES 935, 940 (June 2000); Peter K. Hoffmann, Note, *Cracking the Department of Commerce's Encryption Export Regulations*, 6 B.U. J. SCI. & TECH. L. 15, 15 (2000).

121 *Junger v. Daley*, 209 F.3d 481, 485 (6th Cir. 2000) (holding source code protected by the First Amendment); *Bernstein v. United States Dep't of Justice*, 176 F.3d 1132, 1147 (9th Cir. 1999) (concluding that the export regulations regarding encryption were an unconstitutional prior restraint on free speech). *But see* *Karn v. United States Dep't of State*, 925 F. Supp. 1, 9 n.19 (D.D.C. 1996) (viewing source code as instructions not protected by the First Amendment).

122 *See Junger*, 209 F.3d at 485 (remanding the case to allow for interpretation under revised regulations rather than declaring the regulation unconstitutional).

## 2. *Questionable Transactions*

The BXA has published two documents that describe situations that should trigger additional diligence by the exporter.<sup>123</sup> These documents are published in the EAR.<sup>124</sup>

### a. *“Know Your Customer” Guidance*

The “Know Your Customer” Guidance supplement lists six things that exporters should consider when dealing with their customers.<sup>125</sup> These encourage the exporter to determine whether the product matches the customer. Does the situation or do the comments of the customer seem abnormal considering the product being exported? If something seems abnormal, the exporter has a duty to investigate further and inquire about the end-use, end-user, or ultimate destination of the export.<sup>126</sup> Exporters are encouraged not to “bury their heads in the sand,” a practice the regulations refer to as “self-blinding.”<sup>127</sup> For example, a company’s sales force should not preface its conversation with customers with statements akin to the “no tell” policy. Exporters should implement clear policies and procedures for dealing with situations in which a transaction appears abnormal.<sup>128</sup> If after further inquiry an exporter still feels that something about the transaction is incorrect, the BXA encourages the exporter to either refrain from the transaction or seek a license.<sup>129</sup>

### b. *BXA Red Flag Transactions*

The BXA’s Red Flags are instructive and should be shared both with the company’s sales force and shipping department. For example, an exporter should re-evaluate the export if “a

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<sup>123</sup> See BXA’s “Know your Customer” Guidance & Red Flags, 15 C.F.R. pt. 732, Supp. 3 (1999).

<sup>124</sup> 15 C.F.R. pt. 732, Supp. 3.

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> See *id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

small bakery places an order for several sophisticated lasers.”<sup>130</sup> Other flags you should consider are the sophistication of the intended purchaser, whether the purchaser is evasive, whether the shipping route is odd, or whether the purchaser is willing to pay cash for expensive products.<sup>131</sup>

### 3. *Specific Parties - The Lists*

Besides general guidance about customers, the three main export and trade regulators (BXA, OFAC, and ODTC) all maintain lists of specific persons and entities with whom U.S. persons may not engage in export transactions without a license.<sup>132</sup> The lists are described below.

#### a. *Specially Designated Nationals (“SDN”)*

The Specially Designated Nationals List is published by the OFAC.<sup>133</sup> The list is composed of persons, ships, and entities that the OFAC has determined are agents of the governments of embargoed countries, terrorists, narcotics traffickers, or organizations involved in the proliferation of weapons of mass destruction.<sup>134</sup>

#### b. *Debarred Parties*

The ODTC maintains a list of persons who are debarred from participating in the export of defense articles or services or the temporary import of defense articles.<sup>135</sup> U.S. persons who export defense articles are prohibited from entering into export transactions with these people.<sup>136</sup> Though the regulations do not

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<sup>130</sup> 15 C.F.R. pt. 732, Supp. 3.

<sup>131</sup> *Id.*

<sup>132</sup> See *supra* § IV(B) (discussing the BXA, ODTC, and OFAC).

<sup>133</sup> 31 C.F.R. ch. V, app. A. The list is available for download in a variety of formats, including a delimited ASCII format, on the OFAC web site, *available at* <http://www.ustreas.gov/ofac> (last updated on Jan. 19, 2001) (on file with the *Houston Journal of International Law*).

<sup>134</sup> See 31 C.F.R. ch. V, app. A.

<sup>135</sup> ODTC publishes its list of debarred parties on its website *at* <http://www.pmdtc.org/debar059.htm> (last visited Jan. 31, 2001) (on file with the *Houston Journal of International Law*). Note, however, that this list is not updated regularly.

<sup>136</sup> Denial, revocation, suspension or amendment of licenses and other approvals,

require it, it might be prudent for exporters of commercial products to screen their customers against this list. BXA enforcers might argue that entering into export transactions with someone who has been debarred by the ODTC could be considered a red flag.

*c. Denied Parties*

The BXA publishes a list of persons who have been denied export privileges.<sup>137</sup> U.S. persons are prohibited from taking any action involving an item subject to the EAR in a way “that is contrary to the terms of a denial order.”<sup>138</sup> The standard denial order prohibits U.S. persons from exporting to or for a denied party, facilitating the acquisition by a denied party of an item exported from the U.S., acquiring from a denied party items subject to the EAR that have been exported from the United States, or engaging in any transaction involving an item subject to the EAR that is owned or controlled by a denied party with knowledge that it will be or has been exported from the United States.<sup>139</sup>

*d. Proliferation Entities*

The BXA also maintains a list of entities that the U.S. government has determined are involved in the research into or the production of weapons of mass destruction.<sup>140</sup> This list is published in the EAR.<sup>141</sup>

*e. End User/End Use Restrictions*

The EAR lists a number of prohibitions that are based on

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22 C.F.R. § 126.7(a)(6)(2001).

<sup>137</sup> Denied Persons List, 15 C.F.R. § 764, Supp. 2 (2001). The Denied Persons list is available at BXA’s Internet web site at [http://www.bxa.doc.gov/DPL/2\\_denial.htm](http://www.bxa.doc.gov/DPL/2_denial.htm) (last revised Jan. 23, 2001) (on file with the Houston Journal of International Law).

<sup>138</sup> 15 C.F.R. § 764, Supp. 2 at (a)(3).

<sup>139</sup> Standard Terms of Orders Denying Export Privileges, 15 C.F.R. § 764, Supp. 1 (2001).

<sup>140</sup> <http://www.bxa.doc.gov/Entities/Default.html> (last visited Jan. 31, 2001) (on file with the Houston Journal of International Law).

<sup>141</sup> Entity List, 15 C.F.R. § 744, Supp. 4 (2001). The list is also available on BXA’s website, *supra* note 64.

the identity of the end user and/or end uses.<sup>142</sup> An exporter should refrain from exporting any product without a license to any party if he or she knows that the product will be directly or indirectly used in the research or production of nuclear, chemical, or biological weapons.<sup>143</sup> For example, shipping laboratory equipment-control software, which in and of itself might not require an export license, would require a license if it were shipped to a biological weapons laboratory, even if the laboratory were located in the territory of a U.S. ally.<sup>144</sup>

Until recently, exporting encryption software to a government entity was prohibited in many situations, while exporting the same item to a non-government entity was not.<sup>145</sup> However, the new encryption export rules have lifted the distinction between government and non-government end users for exports to the European Union member states, Australia, Czech Republic, Hungary, Japan, New Zealand, Norway, Poland and Switzerland.<sup>146</sup>

#### 4. *Interdiction Software*

Faced with the prospect of searching through a series of long, complex lists in different formats, many companies use interdiction software to help them screen customers and transactions.<sup>147</sup> Interdiction software compares the customer's name, address, and officers' names against the SDN, Debarred Parties, Denied Parties, and Entities lists. These software packages come in a wide variety of formats and capabilities.<sup>148</sup>

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142 See Control Policy: End-User and End-Use Based, 15 C.F.R. § 744 (2000).

143 *Id.* § 744.6.

144 See *id.*

145 Revisions to Encryption Items, 65 Fed. Reg. 62,600 (Oct. 19, 2000) (to be codified at 15 C.F.R. parts 732, 734, 740, 742, 744, 748, 770, and 774).

146 Revisions to Encryption Items, 65 Fed. Reg. 2492 (Jan 14, 2000) (to be codified at 15 C.F.R. Parts 734, 740, 742, 770, 772, and 774).

147 James M. Bedsole, *OFAC-A Hot Topic!*, available at <http://www.ofacompliance.com/OFAC hottopic.htm> (revised 1999) (recommending companies conduct a risk assessment and suggesting that the use of interdiction software and established controls, while not foolproof, will probably result in some mitigation of punishment for the company in the case of an inadvertent violation) (on file with the Houston Journal of International Law).

148 This list of a few of the companies that provide screening software is provided

### C. Product Controls

When most people think of export compliance, they think of product specific controls. The uninitiated imagine a list of commodities that are clearly identified, categorized, and searchable using UPC or similar codes. They soon learn, however, that the U.S. Munitions List and the Commerce Control List only hint at such organization and ease of use. The following three sections discuss the three main types of products controls.

#### 1. Defense Articles

Defense articles and services are listed in the ITAR in the United States Munitions List.<sup>149</sup> The U.S. Munitions List is described in terms of the following categories:<sup>150</sup>

CATEGORY	DESCRIPTION
I	Firearms
II	Artillery Projectors
III	Ammunition
IV	Launch Vehicles, Guided Missiles, Ballistic Missiles, Rockets, Torpedoes, Bombs, and Mines
V	Explosives, Propellants, Incendiary Agents, and their Constituents
VI	Vessels of War and Special Naval Equipment
VII	Tanks and Military Vehicles

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for your convenience, with the understanding that the inclusion of a package on this list is not an endorsement by the author.

Capstan at <http://www.capstan.com/>

ClearCross at <http://www.syntra.com>

MK Technology at <http://www.mktechnology.com/>

NextLinx Corporation at <http://www.nextlinx.com/>

OCR Services, Inc. at <http://www.ocr-inc.com/default.htm>

Vastera, Inc. at <http://www.vastera.com>

*Id.*

<sup>149</sup> United States Munitions List, 22 C.F.R. § 121 (2000).

<sup>150</sup> *Id.*

VIII	Aircraft and Associated Equipment
IX	Military Training Equipment
X	Protective Personnel Equipment
XI	Military Electronics
XII	Fire Control, Range Finder, Optical and Guidance and Control Equipment
XIII	Auxiliary Military Equipment
XIV	Toxicological Agents and Equipment and Radiological Equipment
XV	Spacecraft Systems and Associated Equipment
XVI	Nuclear Weapons Design and Test Equipment
XVII	Classified Articles, Technical Data, and Defense Services Not Otherwise Enumerated
XX	Submersible Vessels, Oceanographic and Associated Equipment
XXI	Miscellaneous Articles

Although these are good, descriptive categories, where is the category for military software? Software is covered under the definition of “Technical Data.”<sup>151</sup> Technical Data under the U.S. Munitions List is defined to include, but not be limited to, “the system functional design, logic flow, algorithms, application programs, operating systems, and support software for design, implementation, test, operation, diagnosis, and repair.”<sup>152</sup> “System” is defined as “a combination of end-items, components, parts, accessories, attachments, firmware or software, specifically designed, modified, or adapted to operate together to perform a specialized military function.”<sup>153</sup>

In other words, software is included within each category where the U.S. Munitions List refers to “Technical Data” or “Systems.” Most of the categories include a catchall clause for

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151 Technical Data, 22 C.F.R. § 120.10 (2001).

152 22 C.F.R. § 121.8(f) (2001).

153 22 C.F.R. § 121.8(g) (2001).

Technical Data “directly related to the defense articles enumerated” within the category.<sup>154</sup> There is no list that will clearly identify certain software packages as being defense articles subject to the ITAR. Each company must analyze its software inventory to determine whether its software is a Munitions List item.

When investigating your software, the following facts should alert you to the possibility that the software is subject to the ITAR.<sup>155</sup>

- Your company is a defense contractor. Stated another way, the Department of Defense or one of the branches of the military is a customer.
- Your company is a defense subcontractor; i.e. a company that makes military equipment or systems is your customer.
- Your company maintains a government security classification.
- Your products are manufactured to military specifications.
- Your software is written to military specifications.

If any of the above are true, investigate further. If your company is involved in the manufacture, exporting, or brokering of U.S. Munitions List items, the company must (1) register with the ODTIC, and (2) receive a license from the ODTIC prior to exporting the product.<sup>156</sup> If the Munitions List item qualifies as Significant Military Equipment<sup>157</sup> (“SME”), the company’s contracts and proposals to foreigners must be submitted to the ODTIC prior to entering into the contracts.<sup>158</sup>

## 2. *Dual Use Items*

Dual Use Items are those that have both “military and other

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<sup>154</sup> See, e.g., 22 C.F.R. § 121, Cats. I(e), II(d), VI(g).

<sup>155</sup> See generally Philip S. Rhoads, *Compliance and Enforcement Under the International Traffic in Arms Regulations*, in Berlack & Hunt, *supra* note 35, at 771 (stressing that there is no minimum threshold of activity that an exporter must meet before his defense-related exports are subject to the ITAR).

<sup>156</sup> 22 C.F.R. §§ 122.1, 123.1, 124.1 (2001).

<sup>157</sup> 22 C.F.R. § 120.7 (2001) (explaining that special controls are warranted for significant military equipment due to its “substantial military utility of capability,” and noting that these items are indicated by an asterisk on the Munitions List).

<sup>158</sup> 22 C.F.R. § 124.9(b) (2000).

strategic uses (e.g., nuclear)” and “civil[ian] applications.”<sup>159</sup> In many situations, it is unclear whether such products should be governed by the ITAR or the EAR. Because of this, the ODTC has a commodity jurisdiction procedure for determining which regime governs the export of the item.<sup>160</sup> Exporters who want to export an item that has both military and civilian application can request a commodity jurisdiction determination from the ODTC by submitting certain specified information about the item and its uses.<sup>161</sup>

If your company sells particular items to both the defense industry and to civilian users, get a commodity jurisdiction determination before exporting the product.

### 3. *Export Control Classification Numbers*

The basic tool for determining whether an item requires an export license under the EAR is the Commerce Control List (“CCL”), located in the EAR.<sup>162</sup> As with the U.S. Munitions List, this list is divided into categories, although the BXA has limited its list to only ten categories.<sup>163</sup> Each category is subdivided into five groups,<sup>164</sup> and within each group are individual Export Control Classification Numbers (each an “ECCN”) that describe

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159 15 C.F.R. § 730.3 (2001).

160 22 C.F.R. § 120.4 (2001).

161 *Id.* Numerous legends exist about companies that ran afoul of the ODTC for exporting dual use items without securing a commodity jurisdiction. For example, there is the story of a company that made wiring harnesses for trucks that are also used in military vehicles. Another is about a company that made replacement kits for spotlights. They had both a military and a civilian version, but other than the part number, the kit was the same.

162 Fact Sheet, Bureau of Export Administration, available at <http://www.bxa.doc.gov/factsheets/facts1.htm> (last visited Feb. 27, 2001). See 15 C.F.R. § 774, Supp. 1 (2001).

163 15 C.F.R. § 738.2 (2001) (describing the structure of the CCL and listing the categories as: (0) Nuclear Materials, Facilities and Equipment, and Miscellaneous; (1) Materials, Chemicals, Microorganisms, and Toxins; (2) Materials Processing; (3) Electronics; (4) Computers; (5) Telecommunications and Information Security; (6) Lasers and Sensors; (7) Navigation and Avionics; (8) Marine; and (9) Propulsion Systems, Space Vehicles, and Related Equipment).

164 *Id.* (listing the five groups as: (A) Equipment, Assemblies, and Components; (B) Test, Inspection, and Production Equipment; (C) Materials; (D) Software; and (E) Technology).

the characteristics and functions of items within the CCL.<sup>165</sup> The ECCN of an item is the basis for determining if the item requires a license prior to export.<sup>166</sup>

The CCL has a relatively good index, but as discussed above, there is no list where you can quickly identify a particular software product. For example, you will not find a listing for 3-D Seismic Interpretation software. Identifying the proper ECCN for your product requires interpretation.

The following is an example of how this interpretation process might work for a 3-D Seismic Interpretation system. There is no specific ECCN that clearly identifies such a system. The first step therefore, is to look through the categories and try to determine which ones might apply. For example, Category 1, Materials, could apply because the system is used to find crude petroleum, which is covered by ECCN 1C981.<sup>167</sup> Category 4, Computers, could apply because the software is for a computer.<sup>168</sup> But if you make certain logical leaps, you might find that Category 6, Lasers and Sensors, could apply because the software is used to interpret data derived from sensors, hydrophones, and geophones.<sup>169</sup> On closer examination of Category 6, you would find that hydrophones themselves are covered under ECCN 6A001a.2.a.<sup>170</sup> These are sophisticated hydrophones.<sup>171</sup> Less sophisticated hydrophones would fall under ECCN 6A991, which is described as “[m]arine or terrestrial acoustic equipment, n.e.s., capable of detecting or locating underwater objects or features or positioning surface vessels or underwater vehicles; and specially designed components,

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<sup>165</sup> *Id.* (explaining the significance of the first few digits and letters of the ECCN as the category, group, and reason for control).

<sup>166</sup> *Id.*

<sup>167</sup> 15 C.F.R. pt. 774, Supp. 1 (2001).

<sup>168</sup> 15 C.F.R. § 738.2(a) (2001).

<sup>169</sup> *E.g.*, 15 C.F.R. pt. 774, Supp. 1, 6D003 (2000) (stating that ECCN 6D003 controls “other” software, including programs for processing acoustic data from hydrophones).

<sup>170</sup> *See* 15 C.F.R. pt. 774, Supp. 1, 6A001a.2.a (2000) (describing hydrophones having characteristics such as optical fibers, piezoelectric polymers, and flexible piezoelectric ceramic materials).

<sup>171</sup> *Id.*

n.e.s.”<sup>172</sup>

Upon looking at the software group for Category 6, you will find the main problem with using the CCL with software. For the most part, software entries are defined by referencing the type of equipment or data with which they are associated.<sup>173</sup> In this instance, none of the software entries apply to the hydrophones in ECCN 6A001a.2.a. On closer inspection, if your software provides for the real time processing of acoustic data using hydrophone arrays, it will fall within ECCN 6D003a.<sup>174</sup> In that case, National Security controls affect the entry (as indicated by the “NS” in “Reason for Control”) and will impact your ability to export the software without a license.

Most seismic interpretation systems do not allow for real time processing, so ECCN 6D003a would not apply. If the software actually controlled the use of the hydrophone, ECCN 6D991 would apply.<sup>175</sup> But, again, most seismic interpretation systems do not control the use of the hydrophones, they simply process the data. Because none of the other entries in Categories 1, 4, or 6 are directly applicable to this hypothetical seismic interpretation system, it would fall into the software not elsewhere specified classification and be designated by the ECCN EAR99.<sup>176</sup>

The exporter is responsible for classifying the items it exports.<sup>177</sup> Exporters have the right to request a classification from the BXA, and the BXA has a duty to provide one.<sup>178</sup>

Once the exporter knows the ECCN number, it can determine whether a license is needed by comparing the Reason

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172 15 C.F.R. pt. 774, Supp. 1, 6A991 (2000).

173 *E.g., id.* 6D001 (covering software designed for development or production of equipment, including equipment controlled by ECCN 6A004 (optics) and ECCN 6A005 (lasers)).

174 15 C.F.R. pt. 774, Supp. 1, 6D003 (2000).

175 15 C.F.R. pt. 774, Supp. 1, 6D991 (covering software specially designed for the use of equipment controlled by ECCN 6A991 (marine acoustic equipment)).

176 *Id.*, EAR99. Even if its export is designated “EAR99,” an exporter must still determine if General Prohibitions 4-10 apply. If not, no license will be required. The “EAR99” ECCN essentially lets the exporter skip the “Country Chart” step for that item. *See Decision Tree*, 15 C.F.R. pt. 732, Supp. 1 (2000).

177 15 C.F.R. § 732.3(b)(1) (2001).

178 15 C.F.R. §§ 732.3(b)(2) and 748.3(a).

for Control against the Country Chart. The Reason for Control is listed in the ECCN entry.<sup>179</sup> For example, the sophisticated hydrophone software discussed above as having an ECCN of 6D003a is controlled for national security and antiterrorism reasons under columns NS1 and AT1 on the Commerce Country Chart.<sup>180</sup> Next, you would find the appropriate country on the Country Chart and look in the NS1 and AT1 columns. If an “X” appears, the item requires a license unless an exception applies.<sup>181</sup> If the item has an ECCN of EAR99, you do not have to compare the reason for control against the Country Chart.<sup>182</sup>

The ECCN entry also identifies which license exceptions apply. For example, for software covered by 6D003a, the TSR exemption applies.<sup>183</sup> The TSR (Technology and Software under Restriction) exemption allows exporters to export software to certain countries once the exporter has received a written assurance from the importer that the importer will not export or re-export the software or its direct product to specific countries.<sup>184</sup>

Note that the country and people controls described above apply even if the software has an ECCN of EAR99.<sup>185</sup> Even if no license is required for the export of the item due to product controls, the export may nonetheless be prohibited because of the country of destination or the identity of the importer.<sup>186</sup>

## VI. SPECIFIC STEPS

### A. *Products: Know Your Software/Products/Tech Data*

As discussed above, an important part of any export

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<sup>179</sup> See, e.g., 15 C.F.R. pt. 774, Supp. 1, 6D003 (citing national security and antiterrorism as reasons for control of various types of software).

<sup>180</sup> *Id.*, 6D003a; Commerce Country Chart, 15 C.F.R. pt. 738, Supp. 1 (2000). See *supra* § V(A)(3) (discussing the Commerce Country Chart).

<sup>181</sup> Commerce Country Chart Structure, 15 C.F.R. § 738.3(d) (2000).

<sup>182</sup> 15 C.F.R. § 732.3(d)(5).

<sup>183</sup> 15 C.F.R. pt. 774, Supp. 1, 6D003.

<sup>184</sup> 15 C.F.R. § 740.6(a)(1).

<sup>185</sup> See *supra* note 176 (indicating an EAR99 item must still be checked against the other Prohibitions).

<sup>186</sup> *Id.*

program is understanding the licensing requirements for your products. Developing this understanding generally requires a team effort, in that it needs someone who understands the technical composition of the product as well as someone who understands the legal requirements of the various export regulations. For those companies whose export compliance program has suffered a lapse, a good place to start is to use the company's shipping or accounting records to identify the products that have been exported during the previous five years. Start with the top five products and prepare written ECCN classifications. If you are uncomfortable with your classifications or if you are exporting to Country Groups D or E, consider submitting a classification request to the BXA.<sup>187</sup>

If your item is a defense article or a dual use item subject to the ITAR, you may have to request a commodity jurisdiction determination, register as an arms manufacturer, and request export licenses from the ODTC.<sup>188</sup>

#### *B. Developing A Country & Exception Matrix for Exports*

As you work through the classification process, develop a country matrix that can be used by your sales and shipping departments. The method you use to capture this information should be dynamic enough to allow changes as the various agencies modify their regulations. Of course, a matrix for all countries is not necessary at the beginning. Start with one that identifies the requirements for exporting your products to your principal trading partners. Following is a form that might be useful for recording this information:

PART #	PRODUCT NAME	ECCN	DESTINATION	LICENSE REQUIRED	EXCEPTIONS	VALUE	PURCHASER	WRITTEN ASSURANCE
0010A0	Hydrophone Source Code	6D003a2	UK	Yes	TSR		XYZ Co.	Yes
			Australia	Yes	No		ABC Co.	

<sup>187</sup> Country Groups, 15 C.F.R. pt. 740, Supp. 1 (2000) (listing Country Groups).

<sup>188</sup> See 22 U.S.C. § 2778(a)(1), (b)(1)(A)(i) (2000); *supra* §§ V(C)(1)–V(C)(2) (discussing ITAR controls and dual use items).

In this example, the source code could be exported to XYZ Co. in the United Kingdom. This is because the TSR license exception is available and XYZ Co. has delivered a written assurance that it will not export or re-export the item or its direct product. Based on the above data, if another company in the United Kingdom wanted to receive the code, they could—once they provide the appropriate written assurance. At that point the chart could be updated. No exception is available for exports to Australia.<sup>189</sup> Exporting the item to Australia would require that the company get an export license from the BXA prior to shipping the product.<sup>190</sup> Once the license is issued, the matrix could be expanded to include the license number and duration.

Note that this process determines whether the product requires a license prior to export. It does not determine whether the exporter can enter into the transaction with the customer.

### C. Implement Customer Screening Procedures

Customer screening is important at both ends of a transaction. At the beginning, it saves your sales and marketing staff time by quickly identifying parties with whom you are prohibited from entering into export transactions without a license. At the end, just prior to export, it confirms that the customer's status has not changed during the process of preparing for the export.

In the online environment, the time between placing the order and exporting the product can be almost instantaneous. Because of this, some type of interdiction software is critical to avoid facilitating prohibited transactions with specially designated nationals, denied parties, proliferation entities, and debarred parties.<sup>191</sup> Software and technology that require

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<sup>189</sup> See 15 C.F.R. pt. 774, Supp. 1, 6D003 (2000) (noting under the "License Exceptions" that "TSR" is limited to exports and re-exports to a limited number of countries, not including Australia).

<sup>190</sup> See 15 C.F.R. § 730.8(a)(4).

<sup>191</sup> Bedsole, *supra* note 147 (discussing interdiction software and suggesting that companies ask their "correspondent banks" how they screen their transactions, since the majority of OFAC violations are discovered through banking transactions).

licenses to most destinations should not be made available for immediate download. The exporter should implement procedures to verify the identity and location of the customer before accepting the transfer.

For internet-based companies that allow software or technical data to be downloaded from their websites or enter into or process electronic-order-entry transactions, use of interdiction software is a must.<sup>192</sup> The software can be used by various departments within the exporter's company. For example, the sales force can use it to pre-screen customers, and the shipping department can use it to screen the customers and destinations prior to shipment of the product. For internet-based sales, the software can reject prohibited transactions, or it can block the transfer when required by the regulations.

#### *D. Put Export/Trade Regulation Clauses in Agreements*

Many companies that are exporting software or technology include export and trade regulation clauses in their agreements with customers. These clauses generally require customers to acknowledge that they are not in embargoed countries, do not appear on any of the lists, and will otherwise abide by U.S. trade, export, and re-export regulations. The clause below is the standard clause used by NASA.<sup>193</sup>

(a) The Contractor shall comply with all U.S. export control laws and regulations, including the International Traffic in Arms Regulations (ITAR), 22 CFR Parts 120-130, and the Export Administration Regulations (EAR), 15 CFR Parts 730-799, in the performance of this contract. In the absence of available license exemptions/exceptions, the Contractor shall be responsible for obtaining the appropriate licenses or other approvals, if required, for exports of hardware, technical data, and software, or for the provision of technical assistance.

(b) The Contractor shall be responsible for obtaining

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<sup>192</sup> See *supra* note 148 and accompanying text (discussing and listing providers of interdiction software).

<sup>193</sup> Standard Clause for Export Controlled Technology, 64 Fed. Reg. 58,031, 58,032 (Oct. 28, 1999) (to be codified at 48 C.F.R. pts. 1825, 1852).

export licenses, if required, before utilizing foreign persons in the performance of this contract, including instances where the work is to be performed on-site at [insert name of NASA installation], where the foreign person will have access to export-controlled technical data or software.

(c) The Contractor shall be responsible for all regulatory record keeping requirements associated with the use of licenses and license exemptions/exceptions.

(d) The Contractor shall be responsible for ensuring that the provisions of this clause apply to its subcontractors.

The following is another approach for an internet-based service. It attempts to address the facilitation problem that internet-based companies have even after they have confirmed that the customer is not on one of the lists.

*Trade Regulations.* Customer acknowledges that Exporter is subject to the trade and export regulations and laws of the United States (collectively, the "Trade Laws"). Customer represents that it is not located within or otherwise subject to the laws of any country subject to a sanction program pursuant to the Trade Laws (each an "Embargoed Country"). Customer represents that it is not listed on the Specially Designated Nationals List, the Denied Parties List, the Debarred Parties List, or the Entities List published from time to time by agencies of the government of the United States (collectively the "Lists"), as amended from time to time. Customer agrees that it will not use or attempt to use the website to enter into transactions or otherwise engage in prohibited activities with the governments of, or persons subject to, the laws of an Embargoed Country or persons listed on any of the Lists. Customer expressly agrees that Exporter may reject any transaction or other transmission that it determines, in its sole and absolute discretion, may be a prohibited activity under the Trade Laws, whether or not such transaction or other transmission is ultimately determined to violate such Trade Laws, and that Exporter may employ software or other electronic means to analyze proposed transactions for violation of

this provision. Customer agrees that it will not export or re-export any products in violation of the Trade Laws. Customer agrees that it is responsible for satisfying any specific licensing requirements that may be applicable to the Products under the Trade Laws, including, without limitation, the Export Administration Regulations of the U.S. Department of Commerce and/or the International Traffic in Arms Regulations of the U.S. Department of State. Customer agrees that it has and will maintain during the Term an internal export compliance program to screen for transactions that require U.S. export licenses and to apply for such licenses as needed.

If your bargaining position allows it, you could also seek indemnification from the customer for damages caused by the customer's failure to abide by U.S. export and trade laws, as in the example below.

LICENSEE shall release, defend, indemnify and hold harmless LICENSOR and its Affiliates from any claims, liabilities, damages, judgments, and expenses (including reasonable attorney's fees) resulting to LICENSOR or its Affiliates from LICENSEE'S breach of this section or of any violation by LICENSEE of the Trade Laws of the United States Government.

Below is a clause intended to provide the exporter with written assurances suitable for use with software that can be exported using the TSR exception.

LICENSEE hereby assures LICENSOR that LICENSEE will not (1) release, export, or re-export, directly or indirectly (including via remote access or as a deemed export), any part of the Licensed Software to a national of a country in Country Groups D:1 or E:2; nor (2) export to Country Groups D:1 or E:2 the direct product of the Licensed Software, if such foreign-produced direct product is subject to national security controls as identified on the CCL. The terms of this Section \_\_ shall survive any expiration or termination of this Agreement.

Note, however, that a number of our allies have laws that prohibit them from participating in or otherwise agreeing to

submit to U.S. unilateral sanction programs.<sup>194</sup> For example, the European Union brought a WTO case against the United States shortly after the passage of the LIBERTAD (“Helms-Burton”) Act in October 1996.<sup>195</sup> Currently the parties have an “understanding” regarding both the LIBERTAD Act and the Iran Libya Sanctions Act (“ILSA”), in which the EU suspended its WTO case as long as the U.S. president agrees not to enforce the right to file private lawsuits under the Helms-Burton Act and to work with the EU to grant EU companies waivers with regard to enforcement of Iranian and Libyan sanctions.<sup>196</sup>

## VII. CONCLUSION

Global distributions in the electronic marketplace call for global solutions. Economic sanctions in the form of embargoes and boycotts present special challenges for companies operating on the Internet. It will require the development and implementation of special tools and technologies to solve the problems posed by conducting business over the anonymous Web. As long as unilateral sanctions are imposed by a country, they will hinder the ability of that country’s citizens to compete in the global marketplace, as the encryption and Cuban debates have so clearly demonstrated.<sup>197</sup> As long as countries single out individual products for special exporting procedures, businesses will struggle to understand the arcane art of export compliance.

In a digital marketplace where billions of dollars worth of intangible assets can cross continents at the speed of light and where such intangible assets increasingly impact and control not

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194 *E.g.*, Council Regulation 2271/96 of 22 November 1996 Protecting Against the Effects of the Extra-Territorial Application of Legislation Adopted by a Third Country, and Actions Based Thereon or Resulting Therefrom, 1996 O.J. (L 309) 1. *See also* Foreign Extraterritorial Measures Act, ch. 49, 1984 S.C. 1863-64 (Can.) (refusing to recognize or enforce any judgement under foreign antitrust laws that would “adversely affect significant Canadian interests,” such as the Cuban Liberty and Solidarity (LIBERTAD) Act of 1996, and empowering the Attorney General of Canada to prohibit compliance by Canadians with foreign measures that would have the same adverse effect).

195 *Bilateral Trade Relations* Dec. 15, 1997, available at <http://europa.eu.int/comm/trade/bilateral/usa/brief4.htm> (last visited Jan. 25, 2001) (discussing European Union/U.S. trade relations).

196 *Id.*

197 *See supra* §§ V(B)(1), VI(D).

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just the electronic infrastructure, but the brick and mortar infrastructure of countries, all types of businesses are beginning to understand that the Export Control Regulations are not just for “Exporters” anymore.