

# U.S. Export Controls and Economic Sanctions Compliance in a Globalized World

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United States Industry Coalition as a service to our members.



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# White Paper



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*It goes without saying that we live in a globalized world. An electronic device purchased at your local retail store is designed in Japan, with components manufactured in China and quality testing performed in India. U.S. companies enter into joint ventures with their British counterparts to bid on infrastructure projects in the Gulf with Russian scientists on the project team. A German company hired as a subcontractor to a U.S. manufacturer is a subsidiary of a Brazilian conglomerate and is headed up by a dual German-Iranian citizen. Cross-border and cross-continent combinations are endless and potential business opportunities are continually expanding. However, our globalized world is also a world framed by national security, economic and foreign policy interests. To protect these interests, countries like the United States impose strict controls on the export of certain commodities and data. And just as these national interests change, so do the systems of controls.*

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Today, more than ever, export controls present a significant compliance challenge to U.S. companies participating in the global marketplace and can even affect foreign company partners utilizing U.S. technology. This white paper attempts to shed some light on the complex web of export control laws and regulations and their applicability to every day commercial transactions. We also highlight some areas of focus, such as nuclear exports to India and controls on encryption technology. Finally, we discuss some best practices for compliance.

## What Is an Export?

First, it is important to understand what constitutes an export because it is broader than it may seem. An export can be a shipment of a commodity – the most common understanding of the term. However, an export can also be a disclosure, transfer or transmission – oral, written, electronic or visual – of information, data, assistance or software source code. An export is any transfer outside of the United States, even if the recipient is a U.S. national.

Some examples of exports include:

- Loans of equipment and technology
- Downloads of software from a server
- Publications of scientific findings
- Participation in exchange programs
- Conversations with foreign nationals

In addition to exports, many U.S. agencies also regulate “reexports.” A reexport is the shipment or transmission of a U.S. controlled item from one foreign country to another foreign country.

## Deemed Exports

In the recent decade, U.S. federal agencies have focused on a concept known as the “deemed export” rule. A “deemed export” is the transfer of technology to a foreign national within the United States. For purposes of the deemed export rule, a transfer of technology to a foreign national within the United States is equivalent to a transfer of such technology to that national’s home country.

This is particularly complicated because determining for export control purposes what constitutes someone’s citizenship or nationality – particularly in the case of non-U.S. dual-nationals – varies by agency. For example, both agencies recognize that an individual qualifies as a U.S. person if he or she is a U.S. citizen or U.S. lawful permanent resident, regardless of country of birth. However, in determining nationality for third-country nationals, while the U.S. Department of Commerce recognizes the last country of citizenship or permanent residence obtained, the U.S. Department of State always takes into account country of origin or birth in addition to country of citizenship or permanent residence that is subsequently obtained. The U.S. Department of Energy does not have a formal deemed export rule, but subscribes to the deemed export principle.

Finally, each agency allows deemed exports to take place subject to exceptions and general authorizations, usually based on the foreign person’s countr(ies) of nationality. These exceptions and generally authorizations also vary by agency. Therefore, a U.K. permanent resident who is a citizen of India and is employed on an H-1B visa at a U.S. company will be treated differently by each U.S. Government agency that controls exports to this individual.

## Which U.S. Agencies Control Exports?

The United States has established a comprehensive system of controls over the export of commodities, technology and software. There are several agencies that have export control jurisdiction. Shipments of

most U.S. products and technical data are controlled by either the U.S. Department of Commerce or the U.S. Department of State under two separate sets of regulations:

- The U.S. Department of Commerce (DOC) through its Bureau of Industry and Security (BIS) is responsible for implementing and enforcing the Export Administration Regulations (EAR). The EAR regulates the export and reexport of commercial items that it views as having “dual-use,” i.e, both commercial and military or proliferation applications.
- The U.S. Department of State controls the export of defense articles and services under the International Traffic in Arms Regulations (ITAR). These are items and services that, at the time of export, are considered inherently intended for military use. ITAR-controlled defense articles, services and technology are set out on the U.S. Munitions List.

In addition, two agencies – the U.S. Nuclear Regulatory Commission and the U.S. Department of Energy – regulate the transfers and retransfers of nuclear equipment, components and technology:

- The U.S. Nuclear Regulatory Commission (NRC) controls the export of certain nuclear equipment, components and materials under the Atomic Energy Act and the Non-Proliferation Act via its regulations at 10 C.F.R. Part 110.
- The U.S. Department of Energy (DOE) controls the export of certain nuclear commercial technologies and specific nuclear reactor and nuclear weapons technologies under the Atomic Energy Act of 1954 and various nonproliferation mandates. The DOE controls are set out at 10 CFR Part 810.

The U.S. Government has also imposed economic sanctions against certain foreign countries and entities, which can take the form of either limited or comprehensive embargoes. These sanctions, which include asset freezes; prohibitions on imports, exports or financial transactions; and restrictions on travel, are administered by the Office of Foreign Assets Control (“OFAC”) within the U.S. Department of the Treasury. OFAC administers and enforces economic and trade sanctions against targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction.

Finally, the U.S. Patent and Trademark controls the export to foreign countries of unclassified technology in the form of a patent application or amendments, supplements, modifications, etc. to such applications.

It is important to note that most U.S. exports take place under expressly defined exceptions or waivers and do not require a specific export license or other special authorization. However, the export control system is ever changing and to simply understand where the controls apply often takes significant analysis and thorough understanding of each agency’s jurisdiction and applicable regulations. Furthermore, violations of export control laws administered by all of the agencies cited above carry both civil and criminal penalties, which have risen exponentially just in the last few years underscoring that exports are an increased focus of enforcement. As U.S. Government officials often say: “exporting is a privilege, not a right.”

### **Department of Commerce Controls**

The DOC controls the export of all commodities, technologies, and software not regulated by another federal agency through the Department’s Bureau of Industry and Security (BIS), which administers the Export Administration Regulations (EAR).

For purposes of identifying whether and how your product or technology is subject to DOC's export licensing requirements, the most important part of the EAR is the Commerce Control List. The Commerce Control List identifies commodities, software, and technology subject to BIS' export licensing authority and, for items exclusively controlled by another agency, provides helpful references to that controlling agency. BIS also maintains the Commerce Country Chart which contains licensing requirements based on destination and reason for control. In combination with the Commerce Control List, the Commerce Country Chart allows you to determine whether a license is required for items on the Commerce Control List to any country in the world.

Before an item or activity is regulated by the EAR, it must be subject to the EAR. Those items subject to the EAR include but are not limited to:

- all items in the United States
- all U.S. origin items wherever located
- U.S. origin parts, materials or other commodities incorporated abroad into foreign-made products
- U.S. origin software/technology commingled with foreign software/technology in quantities exceeding a de minimis level,
- certain foreign-made direct products of U.S. origin technology or software, and
- certain commodities produced by any plant or major component of a plant located outside the United States that is a direct product of U.S. origin technology

Even though an item or activity may be subject to the EAR, it does not necessarily require an export license. License requirements are dependent upon an item's technical characteristics, the destination, the end-user, and the end-use.

If the item is subject to the EAR but is not specifically identified on the Commerce Control List, it is designated as EAR99. Although the proposed export of an EAR99 item generally does not trigger a license requirement based on the technical characteristics of the item, it still can if the transaction is to an embargoed country, to an end-user of concern, or in support of a prohibited end-use.

### **Department of State Controls**

Analogous to DOC's Commerce Control List is the Department of State's U.S. Munitions list (USML). The USML within the the International Traffic in Arms Regulations (ITAR) controls exports of "defense articles" and "defense services" and the U.S. Munitions List includes such obviously military items as firearms, ammunition, explosives and military vehicles (land, air, and sea). However, the list also includes items like:

- spacecraft (including nonmilitary)
- military and space electronics
- protective personnel equipment; guidance and control equipment; and
- components, auxiliary equipment, and miscellaneous articles related to military equipment

Any item that is considered specially designed or modified for a military/defense application is considered to be on the U.S. Munitions List. This can include items that are today used solely for civilian applications. Therefore, an item that is today used only in commercial products, but was once specifically designed, developed, configured, adapted or modified in any way for a military application, or a commercial satellite, spacecraft or launch application, could very well be controlled by ITAR. Furthermore, when it is unclear whether the item was designed for a military or civilian application, it is presumed to be on the U.S. Munitions List and must be confirmed otherwise.

ITAR controls are very strict and export of any item or technology on the U.S. Munitions List requires specific authorization. Some exemptions are, however, available.

### **Nuclear Regulatory Commission and Department of Energy Controls**

The NRC and DOE control nuclear-related commodities, technology and software. Each agency's jurisdiction is exclusive of the other and can be divided as follows: the NRC controls tangibles – certain nuclear components, equipment and material, while the DOE controls intangibles – certain nuclear information, data, assistance, software codes, etc.

The NRC has export control authority over any equipment especially designed or made for use in a nuclear reactor. For illustrative purposes, the NRC states that a nuclear reactor basically includes the items within or attached directly to the reactor vessel, the equipment which controls the level in the core, and the components which normally contain or come in direct contact with or control the primary coolant of the reactor core. Although the NRC does not maintain an equivalent of the Commerce Control List or U.S. Munitions List, the agency does provide an illustrative list of nuclear components subject to its controls (Appendix A to 10 C.F.R. 110).

Certain exports – depending on the identity of the commodity exported and its destination – may be exported under an NRC general license (i.e. no license application required). Other NRC controlled items require an NRC specific export license.

The DOE controls are less detailed than those of its agency counterparts. For commercial transactions, DOE under its regulations at 10 C.F.R. Part 810 controls any activities that can be deemed to constitute engaging “directly or indirectly in the production of special nuclear material.” DOE interprets this language to apply to activities related to commercial reactor nuclear technology as well as nuclear fuel cycle activities. By this broad interpretation, most U.S. companies involved in the quickly globalizing nuclear industry, will in one way or another find themselves subject to DOE's export control regulations.

DOE provides no illustrative list of the types of information, technology and software that may be subject to its regulations. However, it maintains a restricted country list at 10 C.F.R. 810.8(a). Any DOE controlled activities in a 810.8(a) country require specific authorization (license) from the DOE. Other activities – such as commercial nuclear activities in non-810.8(a) countries and exports of public information – can occur pursuant to a DOE general authorization.

### **Office of Foreign Assets Control Sanctions**

The Department of Treasury's OFAC regulations administer and enforce economic and trade sanctions against targeted foreign countries and listed entities, such as terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. As applied to exports, and in many cases reexports of U.S. origin products, the restrictions administered by OFAC are in large part related to financial transactions with or involving “designated foreign countries” or their nationals.

The United States currently maintains comprehensive embargoes on Cuba, Iran, and Sudan, well as more limited sanctions programs for Syria, Myanmar (Burma), Liberia, North Korea, Republic of Congo, Ivory Coast, Belarus, Zimbabwe and other countries. For the countries that are subject to the comprehensive embargoes, the prohibitions encompass exporting goods, technology or services; importing goods or services; “dealing” in goods, technology or services from a country subject to sanctions, or in which that country has, or has previously had, any interest; approving, financing or “facilitating” a prohibited transaction by a foreign entity; and avoiding, or attempting to avoid, sanctions. This serves as a bar to U.S. companies and can also pose complicated compliance challenges for U.S. subsidiaries abroad, as well as U.S. nationals wherever located.

The United States also prohibits dealings with Specially Designated Nationals (SDNs), which are persons and entities that are controlled by or acting on behalf of governments of embargoed countries, terrorists, drug traffickers, and weapons of mass destruction proliferators. OFAC publishes the SDN List, which lists the names and addresses of all SDNs.

### **Patent and Trademark Office Controls**

BIS has delegated authority under the Export Administration Act to the PTO to approve exports and reexports of unclassified technology in the form of patent filings which is subject to the EAR. Exports and reexports of such technology not approved under PTO regulations must comply with the EAR.

PTO regulations mainly concern applications filed in patent offices or agencies outside of the United States and patent application classified for national security purposes. PTO regulations require applicants to obtain a foreign filing license before filing any application for patent (including modifications, amendments, supplements, etc.), in any patent office or agency other than the U.S. PTO. A foreign filing license is only required if the invention was made in the United States and (1) an application on the invention has been on file in the United States less than 6 months prior to the date on which the application is to be filed, or (2) no application on the invention has been filed in the United States.

A foreign filing license can be obtained from the PTO either as part of the filing receipt for a U.S. patent application or as a separate document.

## **Focus Areas**

### **Exports of Publicly Available Information**

Under most U.S. export control regulations, exports of publicly available information are either generally authorized or exempt from licensing requirements, depending on the terminology used by the particular agency. Each agency, however, has a distinct definition, of what is “public information,” “publicly available,” or in the “public domain.”

The DOC’s EAR, for example, devote an entire regulatory supplement to one of its sections to an FAQ regarding what is considered publicly available with respect to different types of export activities – publications, conferences, educational instruction, research, commercial activities, software, etc.

The DOS’s ITAR provides a simple definition of “public domain” as information generally accessible or available at newsstands, bookstores, public library, through unrestricted subscriptions, and through mailing privileges granted by the U.S. Government.

The DOE's Part 810 rules provide a detailed definition of "public information" which, like its DOC and DOS counterparts, includes information available at public libraries, domains, etc. One interesting aspect of the DOE's definition, however, is that it explicitly provides that any technical embellishment or enhancement to "public information" has to be in itself "public information" to qualify for the general authorization for export of such information, as provided by Part 810.

One interesting issue related to exports of publicly available information is that of "fundamental research." In 1985, in response to fears over the transfer of defense-related information by universities to Eastern Bloc countries, the Reagan Administration issued a directive providing that "fundamental research" – basic and applied research in science and engineering the results of which ordinarily are published and shared broadly within the scientific community – was to remain unrestricted. Otherwise, the only way to restrict such information was for a federal agency to issue a national security classification. The EAR and ITAR continue to recognize this "fundamental research" exception, though the ITAR exception is more limited.

### **Nuclear Exports to India**

On October 11, 2008, the United States and India signed a landmark agreement on civilian nuclear cooperation, commonly known as a "123 Agreement." It lifted a three decade-long U.S. moratorium on nuclear-related trade with India that was imposed when India conducted a nuclear test in 1974. It laid the foundation for U.S. companies to supply nuclear components and technology to construct new reactors in the fast-expanding Indian market, as well as provide nuclear fuel to the Indian reactor fleet. However, before the doors to the Indian nuclear market can fully open, the two governments have to complete two important actions:

- India and the US have to finalize a spent fuel reprocessing agreement which will allow India to reprocess US-origin spent fuel for its civilian program.
- India has to enact nuclear liability legislation that provides protection for companies in the event of a nuclear incident.

Even when these actions are completed, further steps remain to be taken to obtain the requisite licenses and authorizations for exports of nuclear-related commodities, technology and software to India. The Hyde Act, which implemented the 123 Agreement under U.S. law, placed additional conditions on nuclear exports to India. These conditions include additional approval requirements, limitations on the scope of licenses, IP protection requirements and enhanced reporting. For example, the Act requires that India provide assurances that U.S. technology transferred to India will not be re-transferred without prior U.S. consent, even in the case of domestic transactions within India..

### **Encryption Technology**

Another complicated area is that of controls on encryption, which are subject to special rules in the EAR. Today, encryption is ubiquitous, present in just about all the devices we regularly use, such as smart phones, and part of transactions we engage in every day, such as sending e-mails or doing online banking. However, encryption is also subject to comprehensive export controls because in the wrong hands, it can be used to encode or decode communications concerning activities that might jeopardize U.S. national security.

Although certain use of encryption can be exempted, such as that exclusively for password protection, items with encryption strength exceeding 56 bits generally are subject to a government filing requirement before they can be authorized for export. Specifically, to export such encryption generally requires



submission to BIS of a technical questionnaire response concerning the product and its encryption functionality and then abiding by a country-specific export waiting period.

This requirement can be triggered even if the encryption used is not proprietary but rather coming from a third party source (including an open source) and even if the incorporation is not actually physically incorporated into the product, but rather implemented indirectly such as through an automatic call. These rules make determining whether a product has encryption a challenging but necessary exercise.

The wide use of encryption in today's globalized and digitalized world means that encryption export compliance issues can seep into virtually every aspect of a company's business. For example, it affects what markets you can sell your products into; what precautions you have to take if you co-develop products or outsource certain functions to offshore partners; and even how and with what your employees can travel outside the United States. Also, because a server can instantly transmit a product or technology an exponential number of times, it is essential to have command over a company's use of encryption to avoid a multitude of export violations from instantly being created.

### Best Practices

As evident in this paper, the U.S. export control system is complex and ever changing. Failure to comply with the applicable controls can put your company and its management at risk of severe penalties. Thus, any U.S. company participating in the global marketplace – whether through trade in commodities, contractual relationships with foreign companies or simply by employing foreign nationals – needs to have an export control compliance plan that accounts for all possible areas of its business. Key components of an effective export control compliance plan include:

- A company policy to comply with export controls that is implemented and communicated company-wide
- A designated company official that serves as a point of contact and is responsible for the company's export control compliance
- A current and comprehensive understanding of the export control regulations and how they relate to one another
- Procedures for classifying items and for identifying and determining licensing requirements for potential exports
- Record keeping procedures
- Procedures for hiring foreign nationals
- Procedures for facility security and for controlling access to company technology, such as on its server
- An export control training program for employees
- A mechanism for auditing the compliance program, both internally and externally.

Of course, plans will vary by company and industry. It is important to integrate your export control compliance function with your other business practices, so that compliance is aware of what products you are developing, what markets you are selling into and who are your customers and business partners and can take the necessary steps before exports occur that may violate the regulations. The more that export control compliance becomes integrated into the overall operations of a company, the stronger the likelihood of avoiding potential pitfalls and violations and the more efficient the company will be in securing appropriate licenses for its global activities.

## About the Authors

### **Elina Teplinsky**

Ms. Teplinsky is an Associate in Pillsbury's energy group. Her practice includes a wide variety of nuclear energy federal regulatory issues and focuses on international nuclear energy matters.

Ms. Teplinsky has extensive experience in issues related to compliance with U.S. export controls for the transfers of nuclear technology, components and equipment. She has assisted a number of nuclear utilities, suppliers and consultants in developing nuclear export control compliance policies and procedures; obtaining U.S. Government DOE Part 810 advisory opinions specific authorizations for the transfer of nuclear technology outside of the United States; and conducting export control training programs for employees. Ms. Teplinsky frequently coordinates briefings with U.S. Government export control officials for her clients and assists them with preparation for such briefings. She also assists clients with addressing violations of export control regulations and preparing corrective action programs for future compliance. She has given a number of talks and presentations on DOE and NRC export controls.

### **Sanjay Mullick**

Sanjay Mullick is Counsel in Pillsbury's International Trade group and concentrates his practice in export controls, economic sanctions, international dispute resolution and international trade regulation.

Mr. Mullick has a broad range of experience providing counsel to companies on export control matters administered by the Bureau of Industry and Security (BIS) under the Export Administration Regulations (EAR) as well as economic sanctions administered by the Office of Foreign Assets Control (OFAC). He assists companies in preparing export license applications and classification requests for encryption software and technology, as well as in conducting voluntary self-disclosure internal investigations and designing and implementing export control compliance programs, including employee training. He also advises companies on the export control aspects of offshore outsourcing master services agreements. In addition, Mr. Mullick counsels companies on compliance with economic sanctions, including assisting international banks with implementing global payments screening policies and procedures.

## About the USIC

The United States Industry Coalition (USIC) is a non-profit corporate membership association of high tech businesses, associations, and research institutions who are actively engaged in technology commercialization in the service of global security, peace and prosperity. A USIC corporate membership grants companies access to a wide range of valuable technology commercialization expertise and resources.

## About Pillsbury

Pillsbury Winthrop Shaw Pittman LLP is a full-service law firm with market-leading strengths in the energy, financial services, real estate and technology sectors. Based in the world's major financial and technology centers, Pillsbury counsels clients on global corporate, regulatory and litigation matters. We work in multidisciplinary teams that allow us to anticipate trends and bring a 360-degree perspective to complex business and legal issues—helping clients to take greater advantage of new opportunities and better mitigate risk. This collaborative work style helps produce the results our clients seek.

If you have any questions about the content of this white paper, please contact the Pillsbury attorney with whom you regularly work, or the authors.

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**An Export Controls Teleconference** is scheduled for April 15, 4 p.m. EDT (1 p.m. PDT). It will include a brief review of the material and a Question and Answer session with authors Elina Teplinsky and Sanjay Mullick. The session will give readers an opportunity to delve deeper into the topics presented here and gain insights from the writers. Call in number is 800-791-2345. Conference code is 69447.

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