

## **Screening Customers: The First Step For A Compliant Global Export Program**

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When a business finds “going global” is the most profitable next step, before doing so, some of the first few questions in-house counsel responsible for international trade issues should ask, and get clear answers to, are: Who are the potential customers? Where are the sales territories? Will the U.S. export control regulations prohibit such sales, thereby making any global sales efforts unprofitable or worse?

For years, in-house counsel counseled internal global sales clients to pay special attention to whom they are targeting their sales and where their targeted customer base may be located. Indeed, screening parties for export transactions in order to avoid doing business with “sanctioned” or “restricted parties” has been a fundamental activity at the heart of any adequate export compliance program. Thankfully, former labor intensive “manual search” processes of such published lists have all but been replaced by free, published, and consolidated U.S. government restricted party lists. Even a number of automated service offerings by restricted party screening vendors have made it their business to make it easier for companies to avoid such “sanctioned” debarred or otherwise “prohibited” parties. While such “end-user” (and “end-use”) due diligence corporate programs have been around for some time, the tightened U.S. trade policies for countries like the People’s Republic of China, Russia, Burma, and other countries, have presented a massive challenge to U.S. exporters. And while the U.S. government agencies with the authority to impose restrictive export and sanction policies, like the U.S. Department of Defense, the U.S. Department of the Treasury’s Office of Foreign Assets Controls, the U.S. Department of State’s Bureau of Political-Military Affairs, Directorate of Defense Trade Controls and the U.S. Department of Commerce’s Bureau of Industry and Security, have continued to evaluate “prohibited” parties, and basing such an evaluation on how or if such entities pose a threat to U.S. national security, foreign policy and human rights policies, and other important national interest issues, ensuring that businesses don’t run afoul of such prohibitions is a key factor for in-house counsel who support internal global sales clients.

But, let’s step back to the larger question: Do your global sales internal clients know with whom they are doing business?

1. **Integrate export compliance into your pre-existing customer due diligence.** In-house counsel understands the importance of implementing customer due diligence programs, e.g., identifying and verifying the identity of customers, the beneficial owners of companies opening accounts, and understanding the nature and purpose of customer relationships by developing customer risk profiles and ongoing monitoring to identify and report suspicious transactions, so for

those in house counsel's clients engaged in global sales and therefore export, re-export or transfer commodities subject to U.S. jurisdiction, integrating additional restricted party screening and sanctions due diligence for such transactions is equally important. Indeed, when it comes to the basic exercise of "reasonable care" in global sales, U.S. export control regulations are clear, "as an exporter, you are responsible for knowing your customers and for ensuring that your exports do not go to prohibited end-users....[exporters must address] risk factors commensurate with different types of customer relationships", therefore, in-house counsel should start with senior management in international sales. Integrating the following "red flags" considerations into customer due diligence programs are key to avoiding issues. Oft-used examples of "Red Flags" below provide an initial guide:

- Is the buyer's/customer's business related to products they are procuring?
- Is the buyer's/customer familiar with the products they are attempting to procure?
- Is the buyer/customer reluctant to offer information about the end use (or end-user) of a product?
- Is the buyer/customer an end-user, or is it a broker, re-seller?
- Is the buyer/customer willing to pay cash?
- Do you know all of the parties to the transaction?
- When questioned, the buyer is evasive or unclear about whether the purchased product is for domestic use, export, or re-export?
- Does the buyer/customer use only a "P.O. Box" address or has facilities that appear inappropriate for the items ordered?
- Is the buyer/customer known to have, or is suspected of having, unauthorized dealings with embargoed countries?
- Is the customer a foreign military contractor of a country where the U.S. government has issued target export restrictions?
- Is product ordered compatible with the technical level of the country to which the product is being shipped? An example often used is, is the order for semiconductor manufacturing equipment for a country without an electronics industry?
- Is the buyer's/customer's order for parts known to be inappropriate, for which the customer appears to have no legitimate need (e.g., there is no indication of prior authorized shipment of system for which the parts are sought)?
- Are the shipping routes abnormal for the product and destination?
- Is the buyer's/customer's packaging guidelines/demands consistent with the stated method of shipment or destination?
- Are the delivery dates vague or are deliveries planned for unusual destinations?

If internal clients have a concern with answers to these questions, they need to know how to handle the answers. And ultimately, if there is a reason for concern, refrain from the transaction or consult the U.S. government agency with jurisdiction over the export of that commodity.

2. **You've checked the "Red Flags," now what? Am I good to go?** If there are no "red flags," you do not have a duty to inquire and delve further into the transaction, but companies should supplement their 'red flag' analyses by screening all customers, against U.S. government lists. According to the U.S. Department of Commerce's Bureau of Industry & Security, conducting such checks "helps to identify parties prohibited or restricted from participating in U.S. export transactions, to include parties whose bona fides the U.S. government has been unable to determine

in end-use checks.” But, for the U.S. government lists, which are published, it is important to screen such customers, on a daily basis, against the following U.S. government lists, to make sure that they don’t appear on these non-exhaustive published lists, e.g., Denied Persons; Entity List; Unverified List; Specially Designated Nationals List; Embargoed/Sanctioned Countries List; Specially Designated Nationals List; Foreign Sanction Evaders List; Sectoral Sanctions Identifications (SSI) List; Palestinian Legislative Council (PLC) List; The List of Foreign Financial Institutions Subject to Part 561 (the Part 561 List); Non-Specially Designated Nationals Iranian Sanctions Act List (NS-ISA); Nonproliferation Sanctions, and the Arms Export Control Act Debarred List.

The process of “screening” customers against the above-referenced lists can easily be integrated into the company’s customer relationship management enterprise resource planning system or other existing or new automated or manual sales process.

3. **Is your targeted customer sales base located in Hong Kong, the People’s Republic of China, Russia, Venezuela or Burma?** Businesses which primarily involve doing business in China, Hong Kong, Russia, Venezuela and Burma should go the extra mile when it comes to screening its customers. Many businesses are aware of the significant uptick in trade relations conflict between the United States and the People’s Republic of China over the last few years. And the ongoing and problematic trade relations with Russia, Venezuela and changes in leadership in Burma have been absorbed into that chasm of U.S. foreign policy challenges. The U.S. government has had a pre-existing prohibition on exports of military commodities to China, but based on a number of trade relations concerns of late, to include human rights concerns, China’s attempts to seek global civilian and military leadership in advanced and emerging technologies (e.g. the *Made In China 2025* campaign strategy) and in particular, a growing concern over cyber espionage and cyber-threats from China and Russia in particular, the U.S. government, took action to prohibit purchasing various communications technology products and services from certain Chinese entities, “Communist Chinese Military Companies” and “Chinese Military Industrial Complex Companies,” and that overall policy has had a ripple effect on U.S. government contractors and U.S. businesses in general. For companies in the advanced manufacturing, artificial intelligence, information technology, new materials, robotics and semiconductors industries, intent on marketing to customers in what is termed the People’s Republic of China Special Administrative Region of Hong Kong (which U.S. government export policy now classifies as a part of China) and the People’s Republic of China in particular as a sales territory, in-house counsel must be proactive and advise them to heavily scrutinize such a sales and marketing vision. Indeed, the U.S. government has greatly expanded how some of the most benign commodities (computers, operating software, electronic devices, commercial aircraft parts) may fall within what the U.S. government has deemed the “Military End-User/End-Use Rule” and “Military Intelligence End-User/End-Use Rule” likely requiring prior U.S. government approval or even may be prohibited for export to such entities in Hong Kong, China, Russia, Venezuela, Burma, and/or to any person or **“entity whose actions or functions are intended to support military end-use.”** And under the military intelligence end-users, the export restrictions are even greater. Don’t think your internal clients are affected? Well, the Rules include a **non-exhaustive list** of entities; even related parties to such “military end-users” located outside of Hong Kong or China may fall within the Rules.

Clearing the way for headache-free global sales is not an easy task, but the ultimate goal is always to “know your customer”, which includes understanding and addressing end-user and end-use implications prior to engaging in such sales. Integrating these screening steps into existing

customer due diligence programs builds a more seamless process and compliant export program, with fewer headaches.

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