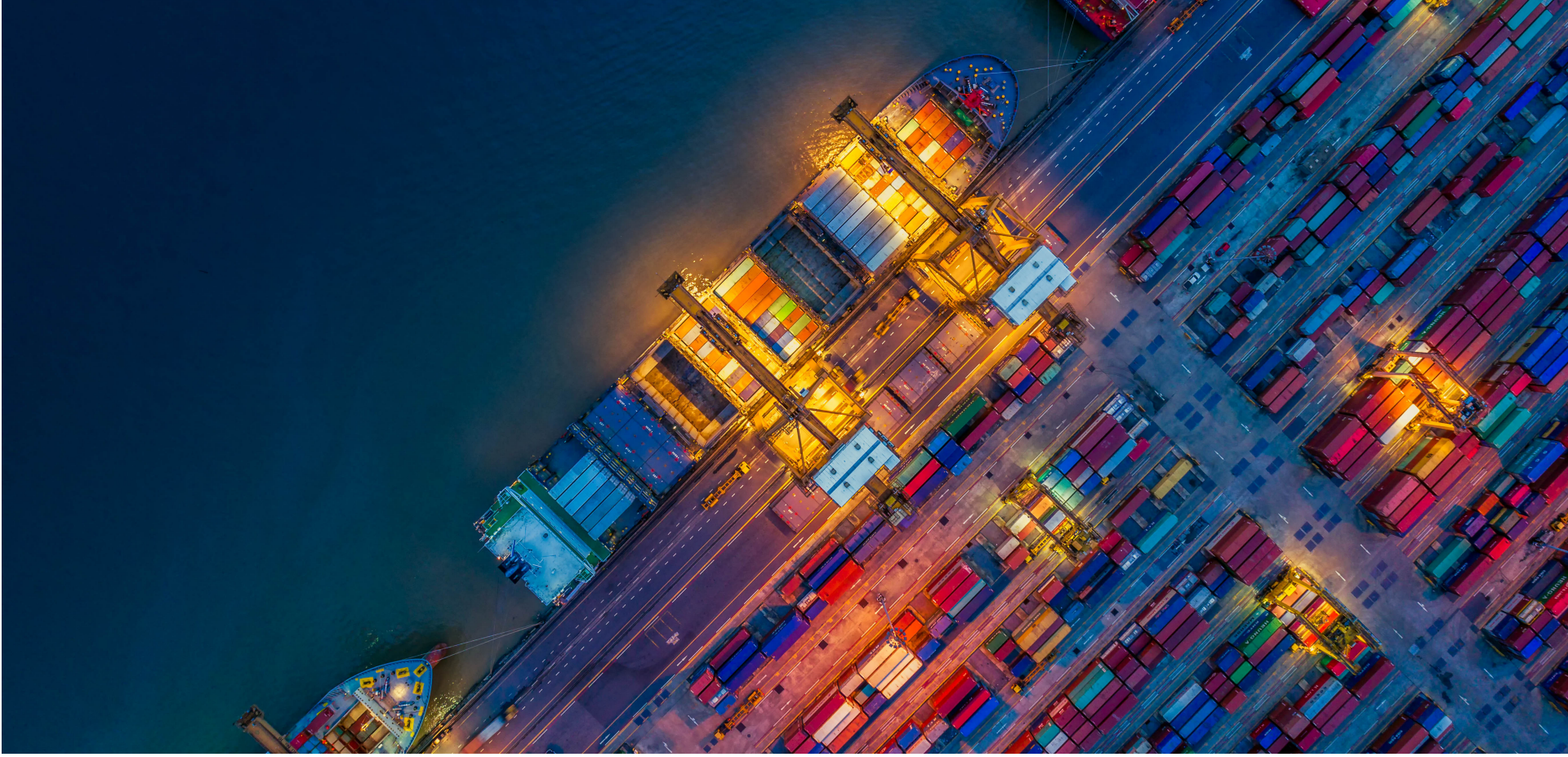

Trade Regulations Apply to All U.S. Businesses

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ACC Association of Corporate Counsel
NATIONAL CAPITAL REGION

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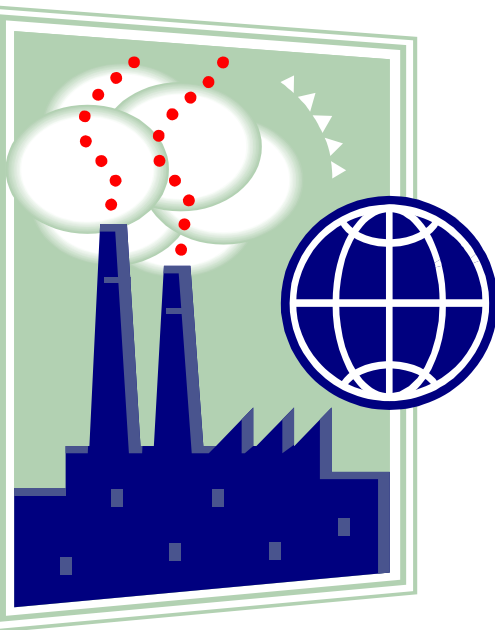
I. Export Law Implications

Export Law Basics – U.S. Agencies That Regulate Exports

U.S. Department of State, Directorate of Defense Trade Controls (DDTC)
Governs defense articles and services and technical data, including space and satellite related articles

U.S. Department of Commerce, Bureau of Industry and Security (BIS)
Governs commercial and dual-use items and technology, including software and encryption items

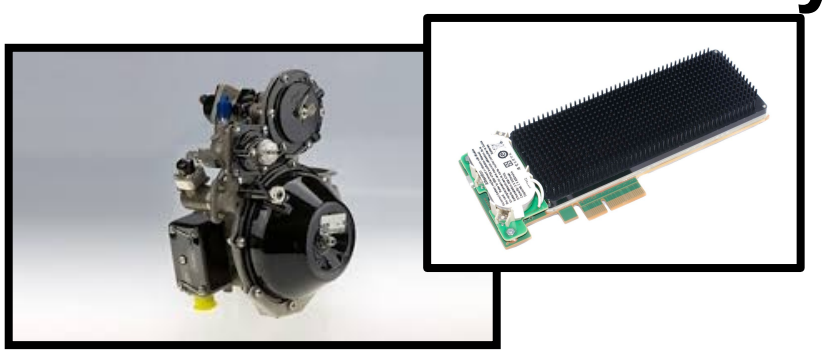
Export Law Basics – What is an Export?



- Send or Carry items/information out of the country
- Re-Export items/information from the original country of export to a third country
- Provide Defense Services outside of the country
- “Deemed Exports”; and
- Brokering

Export Law Basics - What can you “Export”?

- Goods



- Services

- Information (including software)

Controlled Information Under the ITAR and EAR

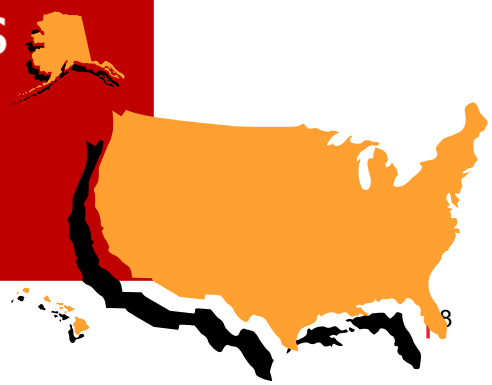
- **Commerce/EAR**
  - **Technology**: Information necessary for the development, production, use, operation, installation, maintenance, repair, overhaul, or refurbishing of an item.
- **State/ITAR**
  - **Technical Data**: Information required for the design, development, production, manufacture, assembly, operation, repair, testing, maintenance, or modification of defense articles.

What is a "Deemed Export"?

- The actual release or transfer of technology or technical data to a foreign person **IN** the same country

- It is **NOT** required for the data or technology to be exported outside of the country

Releasing controlled technology to a foreign person is DEEMED to be an export to the person's country or countries of nationality.



How do Export Control Laws Apply?

When You Are:

- Physically or electronically exporting product or Technology from the U.S. to other countries
  - **NOTE**: When a foreign item, software, or Technology enters the territory of the United States it becomes subject to U.S. export laws
- Employing foreign nationals in the U.S. office and the foreign national will have access to Technology (deemed export)
- Providing Technology to U.S. based customers that will:
  - Provide access to foreign national employees (deemed export), or
  - Export the item or Technology

Classification – How to classify?

There are three ways to classify:

1. Get it in writing from the manufacturer
2. Request a classification
3. Self-classify

Screenings

Once you classify, you are **NOT** done – in all cases, even when an item is EAR99, you have to screen.

Three screenings:

1. End-use Screening
2. End-user Screening
3. Destination Screening

Export Controls – Increased Controls on U.S. Technology Will Continue

- Export Control Reform Act of 2018 (signed in August 2018) included a process for evaluating and increasing controls on Emerging and Foundational Technology
- Expected to result in stricter controls on technology like:
  - AI
  - Biotechnology
  - Microprocessor technology
  - Additive manufacturing
  - Advanced materials
  - Advanced surveillance
  - Robotics
  - Logistics tech
- The Emerging and Foundational Technology review also impacts foreign direct investment rules – foreign investment in businesses with emerging and foundational technology may require a filing to CFIUS

Export Controls – Recent Changes

- Commerce has recently added many Chinese companies to the Entity List due to their involvement in human rights violations and abuses against Uyghurs and other ethnic minorities in the Xinjiang region, meaning that U.S.-origin items may not be sold to these entities
- Also recent additions to Entity List related to war in Ukraine
- Revocation of Hong Kong's special status – U.S. export controls no longer distinguish between Hong Kong and China
- Military-Intelligence -- effective March 16, 2021, no U.S. person may, without a license, "support" any Chinese, Cuban, Russian or Venezuelan "military-intelligence end use" or a "military-intelligence end user"
- On January 15, 2021, the Trump Administration notified Huawei suppliers that previously issued licenses allowing certain sales to Huawei were being revoked and that numerous outstanding license applications to supply Huawei would be rejected
- Prohibition on transactions for Chinese securities
- Prohibitions on transactions involving information and communications technology/services controlled by foreign adversaries

New Russia Export Controls

- The U.S. Department of Commerce, Bureau of Industry and Security (BIS), is scheduled to revise U.S. commercial export controls in the first week of March to:
  - Extend export controls to all U.S.-origin commercial items destined for a military end use or military end users in Russia (including those not normally requiring a license for export to Russia), with limited exceptions.
  - Increase licensing requirements for exports to Russia and designated Russian entities.
  - Restrict the use of license exceptions for exports, reexports, and transfers to Russia.
  - Further restrict the export to Russia and Russian military end users of foreign direct products of i) certain U.S.-origin software or technologies and ii) certain plants or major components thereof which are themselves the direct product of certain U.S.-origin software or technology.
  - Impose a policy of denial of export license applications related to the above restrictions, with limited exceptions (such as exports related to safety of flight, maritime safety, humanitarian needs, government space cooperation, civil telecommunications infrastructure, and government-to-government activities, and those supporting limited operations of partner country companies in Russia).
  - Add more Russian entities to the Entity List (which restricts the export of U.S. commercial goods to listed parties).

II. Sanctions

Department of Treasury

Office of Foreign Assets Control (OFAC)

- OFAC administers laws that impose economic sanctions against hostile targets to further U.S. foreign policy and national security objectives. These targets include:
  - foreign governments (e.g., Iran, Cuba),
  - individuals (i.e., terrorists and narcotics traffickers),
  - groups (i.e., drug front companies and charities linked to terrorist groups), and
  - practices (i.e., cyber crimes, trade in non-certified rough diamonds and proliferation of weapons of mass destruction)

Sanctions Basics - When do Sanctions Apply?

Top 5 Reasons why a company needs to worry about sanctions:

1. The company sends money overseas or receives money from overseas, including virtual and cryptocurrencies
2. The company works with foreign customers, partners, vendors, distributors, employees, third parties, or other entities
3. The company is under OFAC jurisdiction and provides services abroad
4. The company exports goods, technology or software from the U.S. or of U.S. origin - this includes downloading online products, technology, and software
5. The company purchases foreign items/technology, receives foreign services, or receives foreign funding

- Sanctions apply whether these actions are taken directly or indirectly

Jurisdiction - Who is subject to U.S. Sanctions?

- "U.S. Persons:"
  - U.S. citizens
  - U.S. permanent resident
  - A Person Granted Asylum
  - A Refugee
  - A Temporary Resident Granted Amnesty
  - Any other person **located** in the U.S.
- Entities that are:
  - Organized in or doing business in the U.S.
  - Foreign branches of U.S. entities
  - Owned or controlled by a U.S. Person
  - Trading in U.S. goods
  - Trading in U.S. dollars
  - Causing another entity to violate sanctions

❖ OFAC has recently been extending its jurisdiction

Why does it matter?

- Avoid new violations – Payoneer settlement
- Required licenses and filings for certain transactions
- Strict liability – criminal and civil penalties
- Reputational damage
- Loss of access to U.S. financial system
- Avoid frozen assets

Cryptocurrency – OFAC Guidance (Oct. 2021)

- OFAC issued Sanctions Compliance Guidance for the Virtual Currency Industry in October 2021
  - "[T]he virtual currency industry, including technology companies, exchangers, administrators, miners, wallet providers, and users, plays an increasingly critical role in preventing sanctioned persons from exploiting virtual currencies to evade sanctions and undermine U.S. foreign policy and national security interests"
- OFAC sanctions compliance obligations apply equally to transactions involving virtual currencies and those involving traditional fiat currencies
  - "Members of the virtual currency industry are responsible for ensuring that they do not engage, directly or indirectly, in transactions prohibited by OFAC sanctions, such as dealings with blocked persons or property, or engaging in prohibited trade- or investment-related transactions"
- If a U.S. person determines that they hold virtual currency required to be blocked, they must deny all parties access to that virtual currency and ensure that they comply with OFAC regulations related to the holding and reporting of blocked assets
- Risk of facilitating sanctioned ransomware transactions

Cryptocurrency

- Multiple cryptocurrency services have been the subject of OFAC enforcement
- Often OFAC finds that these entities fail to prevent persons apparently located in embargoed locations from using services, including transferring currency
- Considered a terrorist financing and money laundering risk
- Venezuela government-related cryptocurrency (Petro) sanctioned
- Strict liability, so it does not matter that the platform was not aware of sanctioned users
- Each transaction is considered a separate violation, so penalties based on the number of violations can escalate quickly
- Important to implement geolocation blocks

Screenings - OFAC Sanctioned & Embargoed Locations

- Balkans
- Belarus
- Burma
- Burundi
- Central African Rep.
- China/Hong Kong
- Cote d'Ivoire
- Crimea
- Cuba
- Donetsk
- Democratic Republic of the Congo
- Iran
- Iraq
- Lebanon
- Libya
- Luhansk
- Mali
- North Korea
- Nicaragua
- Russia
- Somalia
- Sudan
- South Sudan
- Syria
- Ukraine
- Venezuela
- Yemen
- Zimbabwe

* OFAC sanction programs are in constant flux; countries may be added or removed at any time.

OFAC and Russia

- New prohibition on the direct or indirect importation or exportation of goods, services, or technology from or to the Donetsk People's Republic (DNR) or Luhansk People's Republic (LNR) regions of Ukraine, as well as any new investment in these regions, subject to a wind-down period for existing activities ending on March 23, 2022
- Additionally, on Feb. 22, OFAC extended a prohibition against:
  - Participating in the primary market for ruble- or non-ruble-denominated bonds issued after June 14, 2021, by the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation
  - Lending ruble- or non-ruble-denominated funds to the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, or the Ministry of Finance of the Russian Federation after June 14, 2021
  - Dealing in Russian sovereign debt to the secondary market for bonds issued after March 1, 2022
- On Feb. 24, 2022, OFAC added more entities to the SDN, Non-SDN Menu-Based Sanction (NS-MBS), and Correspondent Account or Payable-Through Account (CAPTA) lists and issued two significant directives. Directive 2 restricts U.S. financial institutions from undertaking certain transactions with designated foreign financial institutions, including Public Joint Stock Company Sberbank of Russia and its 50 percent or more owned subsidiaries. This prohibition will go into effect on March 26, 2022, or, for any new institution designated under Directive 2, within 30 days of the designation. Directive 3 prohibits U.S. persons from transactions in, provision of financing for, or other dealings in new debt of longer than 14 days or new equity for designated entities
- OFAC sanctioned 24 Belarusian individuals and entities in response to Belarus' support for and facilitation of Russia's invasion of Ukraine
- Limited General Licenses i) authorizing prohibited activities ordinarily incident and necessary to overflight payments, emergency landings, and air ambulance services; ii) providing wind-down periods for certain transactions related to energy (June 24, 2022), debt or equity (May 25, 2022), derivative contracts (May 25, 2022), and certain blocked persons (March 26, 2022); and iii) authorizing the rejection of transactions with certain blocked persons through March 26, 2022
- On Feb. 25, 2022, OFAC designated Russian President Vladimir Putin, Foreign Minister Sergey Lavrov, and others as SDNs. Designations of a sitting president are extremely rare, indicating that the U.S. is committed to imposing maximum pressure on Russian leaders using its sanctions regime
- On Feb. 28, 2022, OFAC designated the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, and the Ministry of Finance of the Russian Federation. Transactions involving these entities, including any transfer of assets to or any foreign exchange transaction for or on behalf of these entities, are prohibited

Destination, Activity, and Restricted Party Screenings

- **Embargoed Country**
- **Restricted Parties List**
  - Specially Designated Nationals and Blocked Persons List or SDN List
    - **Now includes a cryptocurrency exchange and cryptocurrency wallets**
  - Foreign Sanctions Evaders List
  - Sectoral Sanctions Identifications List
  - 50% Rule
  - Blocking
- **Activity**
  - Ex. Rough Diamond Trade
  - Ex. Proliferation of WMDs
    Ex. Narcotics Trafficking

Facilitation

No one under OFAC jurisdiction can assist a third party with or "facilitate" <u>any activity</u> that they themselves would be prohibited from taking part in under OFAC sanctions.

- No brokering business
- No introductions
- No lending or moving money
- No assistance with logistics or any other business function
- No Selling to third party who will sell to sanctioned country or entity

- **Facilitation is interpreted very broadly. Don't take chances!**

Secondary Sanctions

- Non-U.S. companies must understand U.S. sanctions and how the sanctions affects their businesses
- OFAC secondary sanctions are designed to influence the actions of non-U.S. parties to prevent them from doing business with sanctioned entities and countries -- like Iran and N. Korea
- The sanctions put pressure on other countries to align with U.S. policies
- If non-U.S. parties do not comply with U.S. sanctions, the non-U.S. parties risk being listed on a sanctions list themselves and this risks access to the U.S. market and/or financial system
- Most companies are choosing the U.S. financial system over doing business in sanctioned places

Proactive Sanctions Reporting Requirement from OFAC

- Requirement for U.S. persons to file report when a transaction is rejected, blocked, or if allowing the transaction would result in an OFAC violation
- Actions:
  - Ensure companies are performing restricted parties screening
  - Limit access to anyone in embargoes countries
  - Review compliance policy/procedures

OFAC Recommended Compliance Framework

- Five essential components for compliance:
  - **Management commitment** to compliance
    - Review and endorse policies
    - Provide adequate resources
    - Delegate autonomy
    - Appoint dedicated compliance officer
  - **Risk assessment**
    - Evaluate exposure to sanctions, minimize risks
  - **Internal controls**
    - Conduct sufficient due diligence
    - Identify red flags
  - **Testing/auditing** of controls
  - **Training**
    - Provide knowledge
    - Communicate responsibility
    - Hold accountable

III. CFIUS

FIRRMA Changes

- 2018 law made several important changes in FDI reviews:
  - Mandatory filing requirements
    - Technology: does certain controlled technology require a license to the country of the foreign buyer
    - Substantial government investment: 49 percent or greater voting interest in a foreign person that would obtain a 25 percent or greater voting interest in the target TID U.S. business
  - Jurisdiction over certain non-control investments (TID U.S. business)
  - Expanded “review” period to 45 days
  - Filing fees
  - Declaration process available – no filing fee
  - Jurisdiction over certain real estate transaction
  - Excepted foreign investors and states

Foreign Direct Investment (CFIUS) Trends

- Expanding Enforcement
- Continuing use of “non-notified” process by CFIUS
- Focus on export classifications
- Guidance for private equity funds and treatment of limited partners

When Can U.S. Companies Take Foreign Investment without Triggering CFIUS?

- Foreign company has no control of the U.S. business
- If the foreign investor is limited partner with no control, no board seat, access to material nonpublic information, or involvement in substantive decision making of a TID U.S. business
- Majority of equity in “foreign entity” is owned by U.S. nationals

IV. Import and Supply Chain

Tariffs/Trade Agreements

- U.S. import restrictions on products from China's Xinjiang region and ongoing response from China and interested parties
- No plan to immediately remove China tariffs. Goal is to develop a strategy with allies that takes into account overall relationship with China
- Steel and aluminum tariffs likely to be tweaked to achieve policy objectives; exceptions could be granted more freely (change to tariff-rate quota)
- USMCA – new rules for trade in the North American region and potential considerations for use of expansive Mexican trade agreements
- Biden Administration may want to rejoin the Trans-Pacific Partnership and negotiate a trade agreement with the UK

Supply Chain Security

- Biden Administration plans to address supply chain vulnerabilities:
  - **Medical** supplies and equipment
  - Energy and **grid resilience technologies**
  - **Semiconductors**
  - Key **electronics and related technologies**
  - **Telecommunications infrastructure**, and
  - Key **raw materials**
- Biden will institute a comprehensive and permanent government-wide process to monitor supply chain vulnerabilities and national security risks
- Biden plans to use the Defense Production Act to rebuild domestic manufacturing capacity in critical supply chains – **Buy American Act**
- New FAR to prohibit federal agencies from contracting with companies that use certain telecommunications equipment produced by Huawei and ZTE or video surveillance and telecommunications equipment produced by Hytera, Hangzhou Hikvision, Dahua or their affiliates
- Biden Administration has declared that threats to the **information and communications technology and services (ICTS)** supply chain by foreign adversaries are a national emergency

New Government Contracting Requirements

(1) Build America, Buy America Act (BABA)

- Part of Infrastructure Investment and Jobs Act (IIJA), signed into law 11.15.21
- Starting in May 2022 applies to infrastructure projects including: surface transportation; broadband; resiliency; water infrastructure; and modernization.
- Bars the award of federal financial assistance for infrastructure unless all of the iron, steel, manufactured products, and construction materials used in the project are produced in the United States.

(2) Biden Administration has proposed new FAR rule increasing Buy American domestic content requirement: from the current 55% threshold, to 60% upon implementation of the rule, then gradually to 75% by 2029

V. Case Studies

Case Studies – Apple Inc.

- On its App Store, Apple hosted, sold, and facilitated the transfer of a sanctioned Slovenian software company's applications and associated content. The SDN had suspected ties to a steroid trafficking ring.
- Processed more than $1 million in payments to the company
  - Nearly 50 payments between 2015 and 2017
- Screening software didn't match the uppercase "D.O.O." portion of the sanctioned entity's name with the lowercase "d.o.o." shown on the SDN list D.O.O. is a Slovenian corporate suffix similar to LLC
- Apple had the SDN listed as an "account administrator" in its App Store, but was only screening people listed as "developers"
- Apple noticed the oversight after enhancing its compliance software
- Apple reported the lapse and cooperated with investigators, prompting the agency to reduce the settlement amount
- The statutory maximum penalty for the violations was more than $74 million. OFAC settled with Apple for $467,000 based on the voluntary disclosure

Case Studies – PatientsLikeMe

- PatientsLikeMe provides an online service for people to share information about health conditions
- The company sold a majority stake to Shenzhen-based iCarbonX and did not notify CFIUS
- Fairly small investment (<$100 million) but serious concern about personal health data
- CFIUS forced iCarbonX to sell its stake in the company

Case Studies – Honeywell International, Inc.

- The State Department fined U.S. Honeywell $13 million for illegally exporting **Technical Data** to several countries
- Honeywell sent **drawings of parts** for military-related items, including ITAR-controlled items like engines of military jets and bombers.
- Note the enforcement case only concerns the transfer of controlled information – no physical exports
- Honeywell discovered that some of the employees were not following its compliance plan
- Between 2011 and 2018 the company committed 34 violations
- Enforced procedures and compliance training are crucial

VI. Recommendations

Recommended Risk Assessments Topics

- Focus on China will grow. Consider an import assessment
- Complete and document export classifications for licensing and proactive CFIUS planning
- Commerce Department refines AI and emerging technology
- Government contracting focused on foreign ownership, control and influence as well as product country of origin
- Companies need to consider evolving international trade regulations:
  - in their sourcing plans;
  - when selling their products or sharing technology with non-U.S. persons; and
  - when engaging in mergers and acquisitions and in any transactions with third parties.
- Effective proactive compliance actions (procedure/spot check operations)
- Does the company perform restricted party and destination/location screenings?
- Does the company block online users from sanctions destinations, as necessary?
- Share the risk