



# **Legal Restrictions on the Government Contractor Global Market**

## ***Navigating Risk While Protecting Your Cross-Border Competitive Strategy***

April 19, 2023

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and DFARS

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# Panelists

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# 01 Overview of Legal Landscape

# Overview of Legal Landscape

In this webinar, we will address:

- a. Primary legal risks US government contractors face when doing business globally.
  - i. Sanctions is "the new FCPA"
  - ii. Compliance risks under the FAR and DFARS
  - iii. Shifting policy concerns
- b. Failure to comply can lead to suspension, debarment, reputational risks, and harm to future government contracting business.



## 02 Sanctions Risks

# Russia

## Complex web of sanctions and export controls

- Many designated parties (**US SDNs**) subject to comprehensive restrictions.
- **Sectoral sanctions** – more targeted measures targeting specific sectors (e.g., financial energy, defense, railways).
- **Services prohibitions** (accounting; trust and corporate formation; management consulting, quantum computing).
- **New investment** prohibitions.
- **Broad export controls** – especially for "dual-use" goods, software, and technology; industrial equipment; and luxury goods – and arms embargo.
- **Comprehensive embargoes** – Crimea, Donetsk People's Republic, and Luhansk People's Republic.
- **Import bans** on certain Russian-origin products (e.g., energy products, non-industrial diamonds, etc.) entering US.

# 10 Recent Sanctions Lessons

- Globalization of sanctions – not just a US and EU issue.
- Lack of uniformity across G7 and even within the EU.
- Extra-territoriality of controls.
- Conflicts, counter-measures and blocking laws.
- Terminated contracts and litigation risks.
- Counter-party DD getting more complex.
- Product controls a common sanctions feature.
- Manage dealings with banks and auditors with care.
- Regulatory queries will flow.
- Geo-political crises are increasingly the “new normal” - future proofing your supply chain and operations.



# Key US Measures Targeting China



## Export controls

- Entity List, Unverified List, SDN List (sometimes), military end-user controls (incl. MEU List), item-based controls.



## Sanctions

- SDN List, CMIC sanctions (investments).



## Restrictions on US inbound transactions

- ICTS Supply Chain measures, US federal gov't procurement, Customs and Border Protection Withhold Release Orders.



## Intersections with related risks

- Human rights, ESG.

# China's Retaliatory Sanctions and Current Status

Restricted Party List	Description	Current Status
Export Control Law's blacklist	The sanctions element of the ECL, similar to the concept of " <b>entity list</b> " under EAR	No designation made
Unreliable Entity List	Targeting those that acted against "normal market principles" to suspend normal transactions with or take "discriminatory measures" against Chinese entities or individuals, or <b>threatened China's sovereignty or national security</b>	Two US defence contractors designated for arms sales to Taiwan
Sanctioned parties designated by the Ministry of Foreign Affairs or Taiwan Affairs Office of the State Council	The MFA and TAO have designated dozens of foreign and Taiwanese entities and individuals as "sanctioned parties"	Designations made through the MFA or TAO press conferences, more recent designations inc. primarily advocates for " <b>Taiwan independence</b> " and their sponsors
Targets of the "retaliatory" sanctions under the Anti-Foreign Sanctions Law ("AFSL")	Targets are subject to restricted measures including asset freeze (similar to the " <b>asset freeze</b> " enforced by OFAC), transaction bans and travel bans	Sanctioned entities include primarily US/EU/UK politicians and NGOs, and two US defense contractors

# Overview of China's Countersanctions / Countermeasures

- Retaliatory sanctions targeting parties that:
  - form or implement “discriminatory” sanctions against China, or
  - threaten China’s sovereignty or national security
- Blocking Rules that block the “discriminatory” foreign sanctions



- New export controls and the “catch-all” provision
- Cybersecurity review
- Trade barrier investigation
- Trade remedies
- Non-tariff barriers to trade – e.g., labelling rules, *ad hoc* import bans
- Cross-border data transfer

- **Current enforcement**

- **National security** is prioritized over other considerations
  - **Balanced approach** to limit impacts on MNCs doing business in China



# Practical Considerations

## Transacting with China's "rival" jurisdictions

Export of China-made products to foreign government or military customers involved in military "rivalry" with China – question over whether there is a known "national security" or WMD concern

## Conducting trade due diligence in China

Proactive sanitization required to prevent unauthorized cross-border transfer of sensitive data caught under China's data protection regime – e.g., certain personal information or "important data" concerning national security

## Terminated agreement and litigation risks

Potentially expanded scope of damage claim in the event the Chinese party allegedly infringed by the compliance with "discriminatory" foreign sanctions files a civil lawsuit in a Chinese court

## Unidentified market access barriers

New market access barriers arising due to enforcement discretion exercised by the regulators – e.g., restrictions on IT products supplied to Chinese power grids, banks, telecom customers or other critical infrastructures

# Sanctions Contingency Planning Buckets

Business Activity	Type of Sanction	Impact - Examples
R&D	Entity list restrictions	<ul style="list-style-type: none"> <li>Restrictions on R&amp;D partners</li> </ul>
	Expanded export controls	<ul style="list-style-type: none"> <li>Restrictions on transfers of technology, software, tools, materials</li> </ul>
	New investment and financing restrictions	<ul style="list-style-type: none"> <li>Financing of R&amp;D</li> </ul>
Manufacturing	Expanded foreign direct product rules (jurisdictional)	<ul style="list-style-type: none"> <li>Access to manufacturing tools</li> <li>Access to critical US/commingled manufacturing/production technology</li> <li>Access to critical components (e.g., semiconductors), maintenance services</li> </ul>
	Expanded export controls	<ul style="list-style-type: none"> <li>Restrictions on exports of key components (e.g., key ICs), materials, technology, etc.</li> <li>Restrictions on export of application/operating software</li> <li>Restrictions on export of key proprietary technology for hardware</li> <li>Industry sector-specific restrictions on manufacturing tools/materials inputs</li> </ul>
	SDN Designations	<ul style="list-style-type: none"> <li>Targeting contract manufacturers, upstream vendors or their banks</li> </ul>
	New investment ban	<ul style="list-style-type: none"> <li>Capital contributions/loans for manufacturing</li> <li>Joint venture investments</li> </ul>
Procurement	Export ban/restrictions	<ul style="list-style-type: none"> <li>Inability to procure critical materials, parts</li> </ul>
	Expanded forced labor/similar restrictions	<ul style="list-style-type: none"> <li>Sourcing from certain regions</li> <li>Sourcing of additional sensitive minerals, critical materials, etc.</li> </ul>
	SDN designations	<ul style="list-style-type: none"> <li>Targeting key suppliers/technology partners</li> </ul>
Marketing	Services ban	<ul style="list-style-type: none"> <li>Restrictions on advertising/marketing/brand services into/in sanctioned jurisdiction</li> </ul>
	SDN designations	<ul style="list-style-type: none"> <li>Of third-party marketing/ad providers</li> </ul>

# Sanctions Contingency Planning Buckets

Business Activity	Type of Sanction	Impact - Examples
Sales	SDN designations	<ul style="list-style-type: none"> <li>Cut off from distributors, resellers</li> </ul>
	Entity listings	<ul style="list-style-type: none"> <li>Cut off from distributors, resellers in sanctioned jurisdictions or elsewhere</li> </ul>
	Luxury goods ban	<ul style="list-style-type: none"> <li>Restricting export, sale, supply of "luxury products"</li> </ul>
	Import ban into US	<ul style="list-style-type: none"> <li>Restrictions on imports of product (finished goods, spares, accessories, etc.)</li> </ul>
Key Partners	SDN Designations	<ul style="list-style-type: none"> <li>High risk partners, esp. SOEs, government-funded, sensitive competitive industries</li> </ul>
Financial / Funds Flows	SDN designations	<ul style="list-style-type: none"> <li>Own banks - operating accounts, financing, cross-border remittances (dividends, royalties, service fees, intercompany loans, etc.)</li> <li>Banks of vendors</li> <li>Banks of key distributors, resellers, retail stores, payment processors, etc.</li> <li>Retail payments</li> <li>Online payments/platform payments</li> <li>License fees/royalties from third parties/to third parties</li> </ul>
	Central Bank restrictions	<ul style="list-style-type: none"> <li>Payment of taxes, fees, permits, etc.</li> <li>Approvals for payment of dividends out</li> </ul>
	Bank risk tolerance	<ul style="list-style-type: none"> <li>Contractual/risk tolerance issue impacting accounts</li> </ul>
	Broad financial services ban	<ul style="list-style-type: none"> <li>Restrictions on payments in/out for all purposes (internal/external flows)</li> </ul>
	New investment ban	<ul style="list-style-type: none"> <li>Restrictions on capital contributions, licensing for royalties</li> </ul>



# Sanctions Contingency Planning Buckets

Business Activity	Type of Sanction	Impact - Examples
<b>Government Interactions</b>	Blocking of local government	<ul style="list-style-type: none"> <li>Broad impact on taxes, licensing, fees, employee social security, etc.</li> <li>Inability to get permits, licenses</li> <li>Audits and investigations risk</li> </ul>
	Select SDN designations	<ul style="list-style-type: none"> <li>SOEs, key government agencies, regulators, etc.</li> </ul>
<b>IP and Royalties</b>	Blocking of local government	<ul style="list-style-type: none"> <li>Blocking of US-owned IP (patents, trademarks) – brand protection generally permissible vs. assignment/licensing</li> <li>Inability to license for commercialization by others through manufacture, sale, etc.</li> <li>Royalty and license fee flows</li> </ul>
	New investment ban	<ul style="list-style-type: none"> <li>Impact on participation in royalties derived from revenues/profits</li> </ul>
<b>Brand Support</b>	Services ban	<ul style="list-style-type: none"> <li>E.g., "management consulting" includes brand management, marketing, etc.</li> </ul>
<b>Operations – IT</b>	Export controls on hardware, software	<ul style="list-style-type: none"> <li>Inability to procure new user licenses/downloads or new user hardware, network infrastructure, etc. leading to segregation of systems</li> <li>Data hosting issues with third party vendors</li> <li>Follow the sun technical support</li> </ul>
<b>Operations – HR/People</b>	SDN designations of banks	<ul style="list-style-type: none"> <li>Company banks/beneficiary banks of employees</li> </ul>
	Services ban	<ul style="list-style-type: none"> <li>Inc. human resource management services</li> </ul>
	Restrictions on US, EU, etc. persons	<ul style="list-style-type: none"> <li>Limitations on key local management/regional management roles e.g., under services ban</li> </ul>
	Import/export bans	<ul style="list-style-type: none"> <li>Impact on downloads, employee apps, etc.</li> </ul>

# **03 Compliance Risks Under the FAR and DFARS**

# Overview NDAA Section 889

- Prohibits the federal government from purchasing certain blacklisted products—i.e., “covered” telecommunications equipment and services—and from contracting with entities that use these products. (FAR § 52.204-25 || DFARS § 252.204-7018).  
the EU.
- Intended to protect the United States from national security and cyber security threats.
- “Covered” telecommunications equipment and services prohibited under Section 889 include those produced by:





# Part A Prohibition - Section 889(a)(1)(A)

- In broad terms, Part A (also known as the “Sale Prohibition”) prohibits the government from purchasing prohibited equipment or services that are covered by Section 889.
- More specifically, Part A prohibits the government from procuring or obtaining, or extending or renewing a contract to procure or obtain, any product that uses “covered” equipment or services as a “substantial or essential component of any system, or as critical technology as part of any system.”
- This restriction flows down to subcontractors; prime contractors with the government cannot get around this restriction by using subcontractors as intermediaries.

# Part B Prohibition- Section 889(a)(1)(B)

- Part B (also known as the “**Use Prohibition**”) prohibits the government from entering into a contract, or extending or renewing a contract, with an entity that **itself uses** any of the “covered” equipment or services as a “substantial or essential component of any system, or as critical technology as part of any system.”
- This prohibition applies regardless of whether that use is in performance of work under a federal contract.
- Unlike Part A, the Part B prohibition **does not flow down to subcontractors**—it only applies to entities that the government agency enters into a contract with.

# What Does Section 889 Mean for You?

- Contractors cannot provide prohibited equipment or services covered by Section 889 to the government, either directly or through the use of subcontractors (Part A).
- Contractors looking to do business with the government cannot themselves use any of the “covered” equipment or services that are prohibited under Section 889 (Part B).
- Part B also requires contractors to provide a representation, after conducting a “reasonable inquiry,” regarding their use or non-use of “covered” equipment and services when submitting an offer to the government.



# Consequences of Violating the FAR & DFARS

- Suspension
- Debarment
- Loss of security clearances, licenses, and permits
- Contract ineligibility with state and local governments, foreign governments, and international organizations
- Reputational damage (suspension or debarment status published on SAM.gov)

# **04 What These Risks Mean for Our Compliance Programs**



# Compliance Best Practices

- Adopt a **holistic approach** to compliance that considers:
  - Sanctions and export controls
  - Anti-bribery and corruption
  - FAR and DFARS compliance
  - False Claims Act compliance
  - Supply chain management

# Compliance Best Practices

- Tailor your internal controls to applicable risks
  - Conduct periodic audits and reviews
  - Conduct third party due diligence
  - Consider highest risk touchpoints from a sanctions enforcement perspective
  - Implement controls aimed at ensuring any and all representations made to the government are accurate and supported by a reasonable inquiry/investigation/review
  - Implement mechanisms to ensure mandatory FAR and DFARS provisions are flowed down to subcontractors

# Sanctions Compliance Framework

- Essential components of a sanctions compliance program



**Management Commitment**



**Internal Controls**



**Training**



**Risk Assessment**



**Testing and Auditing**

# Questions

# Panelist Bios



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Kerry Contini is a partner in the Firm's international trade practice in Washington, DC. She advises companies on export controls, sanctions, and related human rights and supply chain compliance issues. She has been with Baker McKenzie since she was a summer associate in 2005 and started as an associate in 2006.



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Frank has over 15 years of experience working in a broad range of trade actions, including advising clients on trade law compliance, export control, trade remedy, and other PRC regulatory and customs issues related to supply chain planning and managing disputes with PRC regulators.

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