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EXPORT CONTROL ENFORCEMENT: WHAT TO EXPECT (AND WHAT NOT TO EXPECT) DURING THE OBAMA ADMINISTRATION

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For the government, calibrating export controls means maintaining comprehensive, strategic national security restrictions without unduly impeding innovation, international collaboration, and global competitiveness in some of the most dynamic areas of the American economy. For businesses engaged in international trade, export controls too often mean complexity and regulatory uncertainty. For them, the prospect of harsh enforcement frequently raises the stakes of their many compliance choices to levels that exceed any security justification the government could legitimately advance.

How, if at all, has the change in presidential administrations affected the way the government will strike the balance between rigorous export regulation on the one hand, and encouraging exports on the other? How will this balance affect the enforcement decisions export control agencies make? Given the ideological differences between the last administration and the current one, as well as President Obama's explicit emphasis on breaking with the past, businesses understandably want to know what to expect.

The Obama administration recently unveiled a blueprint for reforming important parts of the U.S. export control system. The blueprint calls for ambitious changes over the next 12 months to focus and streamline the rules and processes—and the agencies themselves—that govern export control. If successfully implemented, the reform plan promises major improvements in export regulation and administration, which, in turn, could affect export enforcement in a number of ways. Nevertheless, even with major systemic reform underway, businesses will likely see changes to export enforcement over the next few years that are less rapid and pronounced than might be expected in other areas of federal regulation.

A number of factors make export control policy resistant to change. Agencies tend to step carefully where national security is concerned, and they are reluctant to make untested changes that can introduce security risks or upset international expectations. In addition, civil and criminal cases can take years to build and prosecute, and the role of career employees in investigatory and charging decisions ensures the stability of offices with enforcement responsibilities. Export controls are also heavily influenced by geopolitical developments and foreign threats that exist beyond the control of regulators. The responses to these influences frequently transcend party differences. For these and other reasons, the trajectory of change in U.S. export controls historically has been gauged in years, not months.

With these considerations as a backdrop, this White Paper proceeds in four parts. Part I provides a short introduction to the several programs that constitute the bulk of the U.S. export control system, with a focus on each program's enforcement functions. In Part II, we focus on trends in export enforcement over the last few years. In Part III, we look at background forces that appear to have produced these trends. Finally, in Part IV, we consider what businesses can (and cannot) anticipate regarding the future of export control enforcement.

I. BACKGROUND

The primary responsibility for export control falls to three agencies: the Department of State, which is charged with regulating the export of defense articles and services; the Department of Commerce, which regulates commodities, software, and technology that, while generally subject to commercial use, may also have dual, military applications; and the Department of the Treasury, which administers economic and trade sanctions. Under regulations administered by the State Department and Commerce Department, an export occurs not only when covered U.S. technical information, goods, or services are transferred or accessed outside the United States, but also when technical information is accessed by or made available to foreign nationals within the United States. 22 C.F.R. §120.17; 15 C.F.R. §734.2(b)(2)(ii). The Department of Justice investigates and prosecutes criminal export violations under each of the three agencies' authority.

A. THE DIRECTORATE OF DEFENSE TRADE CONTROLS AT THE STATE DEPARTMENT

The Directorate of Defense Trade Controls ("DDTC") regulates "munitions" under the International Traffic in Arms Regulations ("ITAR"). 22 C.F.R. §§120-130. ITAR is promulgated under the State Department's authority pursuant to the Arms Export Control Act ("AECA"), 22 U.S.C. §§2778-2780, and generally requires a license to export defense goods and services, which are identified in broadly defined categories on the U.S. Munitions List ("USML"). In addition, any person or company in the United States that manufactures, exports, or imports items on the USML must register with the DDTC. 22 C.F.R. §122.

DDTC implements and enforces ITAR through three primary offices: Licensing, which reviews license applications and provides advisory opinions; Policy, which conducts training and outreach; and Compliance, which maintains company registrations and investigates ITAR violations. Each violation of ITAR is subject to civil fines of up to $500,000, and each criminal violation may be sanctioned by up to $1 million, 10 years' imprisonment, or both. 22 U.S.C. §§2780(j), (k). Moreover, in bringing administrative enforcement actions, the DDTC has available a particularly potent sanction in the form of debarment—the prohibition of a firm from participating directly or indirectly in the export of defense articles or services. 22 C.F.R. §127.7.

B. THE BUREAU OF INDUSTRY AND SECURITY AT THE COMMERCE DEPARTMENT

The Bureau of Industry and Security ("BIS") regulates the export of dual-use items and information primarily through implementation of the Export Administration Regulations ("EAR"). 15 C.F.R. §§730-774. The authority for the EAR originally derived from the Export Administration Act of 1979 ("EAA"), Pub. L. No. 96-72. The EAA has expired and been renewed several times since its original enactment; at each lapse, the President has relied on his authority under the International Emergency Economic Powers Act ("IEEPA"), 50 U.S.C. §1701 *et seq.*, to maintain the EAR. The EAR has operated under this substitute authority since 2001. *See* Executive Order No. 13222 (Aug. 17, 2001).

The EAR contains a set of detailed lists that determine the licensing requirements for dual-use exports. Central to the EAR is the Commerce Control List ("CCL"), 15 C.F.R. §774 supp. I. The CCL covers a wide range of items ranging from "actively cooled mirrors" to "zirconium metal particulate," and denotes whether the exporter is or is not required to obtain a license prior to export. *Id.* The EAR also relies on a Country Chart, 15 C.F.R. §738 Supp. I, and Entity List, 15 C.F.R. §744 Supp. IV, to restrict exports to specific countries, organizations, and individuals based on the risk the exports pose to national security or other foreign policy interests. As a result, the EAR restrictions vary from country to country; for example, pursuant to the embargo of Cuba, nearly every item that is subject to the EAR requires a license for export. 15 C.F.R. §746.2.

BIS operates through two main branches: Export Administration and Export Enforcement. Administration is responsible for processing export license applications and outreach. Enforcement investigates alleged dual-use export violations and also works with the Department of the Treasury on embargo-related issues. Consistent with its national security mission, BIS Export Enforcement gives enforcement priority to violations involving weapons of mass destruction ("WMD") proliferation, terrorism, and unauthorized military end uses. *See* U.S. Department of Commerce, Bureau of Industry and Security, *Annual Report to Congress for Fiscal Year 2008* (2009). When BIS Enforcement discovers an EAR violation, it may work with the BIS Office of Chief Counsel to impose civil fines and denials of export privileges, or it may refer the matter to the Department of Justice ("DOJ") for criminal prosecution. EAR violations are currently subject to civil fines of up to the greater of $250,000 or twice the amount of the transaction at issue. Criminal penalties may be imposed up to $1 million per violation and imprisonment of up to 20 years. *See* 71 Fed. Reg. 44189.

C. THE OFFICE OF FOREIGN ASSETS CONTROL AT THE TREASURY DEPARTMENT

The Office of Foreign Assets Control ("OFAC") administers and enforces almost 30 economic and trade sanctions programs against foreign countries and individuals, including embargoed countries and regimes, terrorists, international narcotics traffickers, and entities involved in the proliferation

of WMDs. 31 C.F.R. §500 *et seq*. In addition to specific sanctions laws, OFAC derives its authority from the Trading With the Enemy Act ("TWEA"), 50 U.S.C. app. §5(b)(1), which authorizes the President to restrict foreign trade during wartime, and IEEPA, which allows the President to impose many of the same restrictions based on "any unusual and extraordinary threat" that creates a national emergency. 50 U.S.C. §1701.

While individual sanctions programs administered and enforced by OFAC vary in their specifics, the regulations generally list prohibited transactions, *i.e.*, trade or financial transactions in which U.S. persons may not engage unless authorized by OFAC or expressly exempted by statute. OFAC has the authority to grant exemptions for prohibited transactions by issuing a general license for certain categories of transactions or by granting specific licenses on a case-by-case basis. OFAC also maintains a list of restricted individuals—the Specially Designated Nationals and Blocked Persons ("SDN") list—which is in some ways similar to BIS's Entity List; however, because the SDN list is a product of various sanctions laws, it has a broader impact, barring financial dealings as well as exports.

A relatively small agency, OFAC operates through approximately 10 main divisions, including two divisions primarily devoted to narcotics and terrorism programs; a Licensing Division that grants exceptions to the broad prohibitions of the sanctions programs; a Compliance Division that conducts outreach and training for financial institutions and the public; a Civil Penalties Division that brings administrative enforcement actions for violations; and an Enforcement Division that helps to pursue criminal cases. Violations of regulations administered by OFAC carry similar penalties to violations of EAR: civil fines up to the greater of $250,000 or twice the amount of the transaction at issue and criminal penalties up to $1 million per violation and 20 years' imprisonment. 15 U.S.C. §1705.

D. INVESTIGATIVE AGENCIES AND THE DEPARTMENT OF JUSTICE

While the DDTC, BIS, and OFAC may impose civil fines, each of these agencies also works with other investigative agencies and the Department of Justice to pursue criminal charges. Depending on the nature of a particular investigation, agencies such as the FBI, Immigrations and Customs Enforcement ("ICE"), Customs and Border Protection ("CBP"), and the Defense Criminal Investigative Service ("DCIS") may be involved. Not surprisingly, the FBI is particularly involved in counterintelligence and terrorism-related cases, ICE and CBP focus on trade-related violations, and DCIS targets defense-related exports.

Once a case is referred for criminal prosecution, DOJ acts as the lead agency. As part of a 2007 initiative to prioritize export control enforcement, DOJ created a National Export Coordinator in the National Security Division. The National Export Coordinator serves as an interface with the primary export control agencies, trains Assistant U.S. Attorneys, and monitors export control prosecutions. DOJ also targets export control violations through Counter Proliferation Task Forces in certain U.S. Attorney offices.

II. RECENT ENFORCEMENT ACTIVITY

The last several years have not necessarily seen a dramatic increase in the total number of enforcement actions brought by export control agencies, the size of the median penalty, or a substantial shift in the type of cases being brought. However, the size of the largest administrative penalties, particularly those imposed by OFAC, has increased dramatically. Thus, while export controls enforcement may present a fairly consistent narrative over the last several years, the peaks appear to be growing higher.

A. DDTC ENFORCEMENT

Because a large number of DDTC investigations are resolved through private remediation agreements, only a handful of cases result in public administrative orders. When a case warrants a formal consent agreement, however, the penalties are typically substantial. DDTC entered into five public consent agreements in 2006 resulting in $26.5 million in civil penalties, one consent agreement in 2007 carrying a $28 million penalty, four consent agreements in 2008 resulting in $47 million in civil penalties, and two consent agreements in 2009 resulting in $600,000 in penalties. In 2010, DDTC has to date entered into one consent agreement carrying $1 million in penalties.

While the ebb in DDTC civil penalties might seem to suggest less ITAR enforcement during the current administration, such a conclusion may be misleading, as significant ITAR cases have recently been referred to the DOJ for criminal prosecution. Earlier this year, for example, the Justice Department entered into a $400 million settlement with BAE Systems based on allegations that the defense contractor violated the Foreign Corrupt Practices Act and made false statements in an application for an ITAR license. Last year, University of Tennessee Professor Emeritus John Reece Roth was sentenced to four years in prison after being convicted of unlawfully exporting 15 defense articles—restricted technical data associated with an Air Force project to research and develop advanced plasma technology for unmanned air vehicles—to a Chinese national.

B. BIS ENFORCEMENT

In contrast to DDTC actions, BIS cases generally reflect a wide variance in penalties, with fines typically in the range of several thousand dollars and rarely in the millions. In the last year, however, BIS has imposed several multimillion dollar penalties. In FY2006, BIS closed 108 administrative enforcement actions resulting in $10.4 million in fines, with the heaviest fine reaching just under $2 million. *See* U.S. Department of Commerce, Bureau of Industry and Security, *Annual Report to the Congress for Fiscal Year 2006*, 41-60 (2007). Enforcement penalties dropped off somewhat in FY2007, during which BIS closed 88 administrative cases resulting in $4.6 million in penalties. *See* U.S. Department of Commerce, Bureau of Industry and Security, *Annual Report to the Congress for Fiscal Year 2007*, 52-69 (2008). And in FY2008, BIS closed 57 administrative enforcement cases resulting in $3.6 million in administrative penalties. *See* U.S. Department of Commerce, Bureau of Industry and Security, *Annual Report to the Congress for Fiscal Year 2008*, 29-46 (2009). Moreover, the largest penalty in either year was $1.1 million. In 2009, however, while BIS closed only 54 administrative cases, those cases resulted in $14 million in civil penalties, including a $9.4 million settlement with DPWN Holdings (USA), Inc. and DHL Express (USA), Inc. DHL agreed to pay the $9.4 million penalty to settle allegations by BIS and OFAC of having made more than 300 unlicensed shipments to Iran, Sudan, and Syria, and having failed to maintain required records with respect to other shipments to Syria and Iran. OFAC and BIS have characterized the settlement as one of the largest joint settlements in the agencies' history, and one that represents greater enforcement cooperation between the agencies.

In that regard, BIS, working together with OFAC, has already entered into significant settlements in 2010. On February 6, 2010, London-based Balli Group PLC and its subsidiary, Balli Aviation Ltd. (collectively, "Balli"), pleaded guilty in the United States District Court for the District of Columbia to a two-count criminal information for illegal exportation of commercial aircraft from the United States to Iran. Balli was also to be charged with related civil violations of the EAR and the Iranian Transactions Regulations for its conduct. Balli was alleged to have accepted financing from Mahan Air of Iran to purchase three U.S.-origin Boeing 747 aircraft, and to have entered into a lease agreement to permit Mahan to operate the planes on flights in and out of Iran. Balli was also alleged to have violated a Temporary Denial Order, which barred both Balli and Mahan Air from engaging in export transactions subject to the EAR, by engaging in financing and sales negotiations with Mahan with respect to three additional U.S.-origin aircraft.

Under the plea agreement, Balli agreed to pay the Justice Department a criminal fine of $2 million and be placed on probation for five years. To settle the civil allegations, Balli agreed to pay BIS and OFAC a $15 million penalty, of which $2 million will be suspended if Balli commits no further export control violations. The civil fine represents one of the largest in BIS history and by itself makes 2010 a record year for EAR enforcement. The DHL and Balli cases are fitting examples of BIS enforcement actions in another respect: they both arose from export activity involving Iran. Perhaps not surprisingly given the current threat Iran poses to U.S. national security, 30 percent of open BIS cases involve potential exports to Iran.

C. OFAC ENFORCEMENT

Like penalties under the EAR, penalties issued by OFAC vary widely but have reached record heights recently. In 2005, OFAC tried or settled 85 administrative cases producing a total of $1.2 million in penalties. In 2006, 32 cases produced $10.8 million in fines. In 2007, 56 cases led to $4.3 million in penalties. And in 2008, the number of cases or settlements

rose to 99, with $3.5 million in resulting fines. In 2009, however, OFAC tried or settled 27 cases leading to a record-shattering $772 million in penalties.

The bulk of these penalties are the result of several enormous settlements with foreign banks that deleted or manipulated information to evade U.S. banks' electronic filters. Zurich-based Credit Suisse AG, London-based Lloyds TSB Bank plc, and, reportedly, eight other foreign banks were investigated for altering or deleting information about U.S.-sanctioned parties in payment instructions executed in or through the United States on behalf of bank and non-bank customers. In December 2009, the government announced that Credit Suisse and Lloyds had each entered multimillion dollar settlements of civil and criminal allegations relating to this practice, known as "stripping."

Credit Suisse agreed to pay $536 million to the Justice Department, the New York County District Attorney's Office, and OFAC to settle criminal and civil allegations of various sanctions programs administered by OFAC. Credit Suisse allegedly had established procedures for using cover payments to avoid referencing parties subject to U.S. sanctions and manipulating information in payment messages to conceal the identities of sanctions targets in electronic funds transfers and securities transactions executed through or in the United States. These procedures allowed payment messages and securities transactions to evade automated OFAC filters at third-party U.S. clearing banks, which would have halted the transactions.

Lloyds agreed to pay $175 million to the Justice Department, $175 million to the New York County District Attorney's Office, and $217 million to OFAC (which OFAC agreed would be satisfied by the other two payments) to settle alleged violations of several sanctions programs. Like Credit Suisse, Lloyds was alleged to have established policies for manipulating messages in electronic funds transfer instructions to strip information regarding sanctioned entities, enabling the transactions to be processed through U.S. banks.

OFAC has continued to announce major settlements in 2010. For example, on March 17, 2010, Innospec, Inc., a Delaware chemical and fuel specialties company, agreed to pay $2.2 million to settle civil allegations that it violated the Cuban Assets Control Regulations. *See* Part IV(A)(2), *infra.* On May 10, 2010, the DOJ announced that the former ABN AMRO Bank N.V., now named the Royal Bank of Scotland N.V. since being acquired in 2007, has agreed to forfeit $500 million to settle charges that it had violated U.S. sanctions regulations by engaging in stripping.

D. CRIMINAL ENFORCEMENT

While OFAC, DDTC, and the DOJ do not publish comprehensive reports of criminal convictions for export control violations, substantial evidence suggests that criminal prosecutions have been more aggressively pursued since 2007. BIS reports 16 criminal convictions for EAR violations in 2007, 39 criminal convictions in 2008, and 40 convictions in 2009. Moreover, DOJ has substantially increased charges for export violations; the agency reports charges in 110 cases in 2007 and 145 cases in 2008, with no indication that charges abated in 2009.

As with civil penalties, criminal enforcement tends to focus on Iran and China, with roughly 43 percent of the defendants charged in 2008 charged in export control or embargo cases involving those countries. In total, Iran ranked as the leading destination for illegal exports of restricted U.S. technology in the prosecutions brought in both 2007 and 2008.

III. FACTORS AFFECTING ENFORCEMENT

While the above analysis suggests a recent increase in total penalties for export control violations, a study of individual cases provides only a partial picture of the enforcement landscape. Ultimately, the total number of export control cases is relatively small; the total penalties assessed in a single year by a single agency can therefore be distorted dramatically by one or two outlying cases such as the mega-settlements with Credit Suisse and Lloyds. Moreover, export control enforcement, like any investigative enterprise, is dependent on factual discoveries that are often outside the control of the investigating agencies. Variations in penalties may therefore reflect statistical drift as much as agency policy. For these reasons, it is also helpful to look at some of the underlying policy changes that may have contributed to recent enforcement results and indicate future enforcement trends.

A. INCREASE IN IEEPA PENALTIES

One of the factors that could support a continued rise in export control penalties is the recent increases in allowable penalties under IEEPA. With the expiration of the EAA, the punishment for EAR and OFAC violations has been based on, and limited by, the punishment provisions of IEEPA. *See* Revision and Clarification of Civil Monetary Penalty Provisions, 71 Fed. Reg. 44189 (Aug 4, 2006). Since 2001, the maximum penalty under IEEPA had been approximately $11,000 per violation. However, in 2006, Congress amended IEEPA to raise the maximum monetary penalty to $50,000 per violation. *See* USA PATRIOT ACT Improvement and Reauthorization Act of 2005, Pub. L. No. 109-177 (Mar. 9, 2006). Then, on October 16, 2007, President Bush signed the International Emergency Economic Powers Enhancement Act, Pub. L. No. 110-96, which substantially increased the maximum penalties for most export control violations. Under the Act, maximum civil fines increased from $50,000 to the greater of $250,000 or twice the amount of the transaction at issue. Maximum criminal penalties increased from $50,000 to $1 million per violation (the maximum term of imprisonment of 20 years remained unchanged).

BIS and OFAC have indicated that they will not attempt to apply the increased fines retroactively to certain types of administrative cases, such as those in which voluntary self-disclosures, proposed or filed charging letters, prepenalty notices, memorialized settlement offers, or limitations waivers were made or issued prior to October 16, 2007. *See* U.S. Department of Commerce, Bureau of Industry and Security, Fact Sheet–*BIS's Charging and Penalty Practices*, 1 (Nov. 1, 2007); U.S. Department of the Treasury, Office of Foreign Assets Control, *Civil Penalties–Interim Policy*, 1 (Nov. 27, 2007). However, the agencies will, in most circumstances, apply the increased penalties in cases commenced after October 16, 2007, even if based on conduct that occurred before October 16, 2007. BIS officials have noted that the few cases they have already brought based on a $250,000 maximum have settled at far lower percentages of the maximum penalty than under the earlier penalty practice. Nonetheless, as BIS and OFAC increasingly turn to investigations that will be governed by the new penalties, the nearly 25-fold increase in maximum fines could certainly increase the motivation of exporters to settle cases for substantial sums.

B. DOJ EXPORT ENFORCEMENT INITIATIVE

In October of 2007, the Justice Department announced that it was working with the U.S. Attorneys' Offices, BIS, DDTC, and OFAC to prioritize the enforcement of export controls through an Export Enforcement Initiative. As part of the initiative, DOJ appointed a National Export Control Coordinator, assigned to the Counter-Espionage Section of the National Security Division, who works to improve coordination of agencies, train AUSAs, and monitor prosecutions. The initiative also established Counter-Proliferation Task Forces in key U.S. Attorneys' Offices in districts with high-technology businesses and research facilities. The initiative appears to have had an impact; criminal prosecutions for export control violations rose by about 30 percent in the year following the initiative. And although DOJ has not yet tabulated its export control cases for 2009, there has been no indication that DOJ's enforcement zeal has diminished.

C. REVISED ENFORCEMENT GUIDELINES

Both BIS and OFAC have recently issued enforcement guidelines that memorialize their charging and penalty-calculation practices. BIS's guidance, issued in July of 2007, codifies an intuitive set of aggravating and mitigating factors, including the degree to which a defendant willfully committed a violation, the seriousness of the violation, and whether the defendant fully and voluntary disclosed the violation. 15 C.F.R. §766 Supp. I & II. OFAC's guidelines similarly rely on common-sense factors, but they also standardize factors in a Penalty Matrix reminiscent of the U.S. Sentencing Guidelines. 74 Fed. Reg. 57593. In particular, the OFAC guidelines explicitly emphasize the presence of a risk-based compliance program as a substantial mitigating factor. An appendix to the Enforcement Guidelines provides a risk matrix designed to help firms evaluate their compliance programs. *Id.* at 57607. While the enforcement guidelines certainly do not represent a sea change in enforcement policy, they emphasize a more formal focus on issues such as voluntary disclosures and compliance efforts.

IV. TRENDS AND PREDICTIONS

The government's finite enforcement resources have been, and will continue to be, directed primarily at the most

serious national security threats—illegal procurement networks and exports of sensitive items (1) for proliferation of weapons of mass destruction; (2) for international terrorism and to state sponsors of terrorism; and (3) to unauthorized military end-users.

In line with this observation, the DOJ has given no indication that it intends to step back from the priorities it established as part of its 2007 Export Enforcement Initiative. Indeed, in its FY2011 Performance Budget Congressional Submission, the National Security Division counted the Initiative (and, presumably, the resulting increase in export enforcement) as among its notable achievements. Similarly, there are no signs that the export control agencies intend to change the basic enforcement and penalty practices they have pursued for the last several years.

Some continuity can also be expected with regard to foreign policy priorities. For example, following the controversy surrounding Iran's 2009 presidential elections and the country's nuclear ambitions, the current administration has broken from the previous one in matters of diplomatic engagement, but not in the judgment that Iran continues to present a profound national security threat.

That said, the President has indicated on multiple occasions his commitment to increasing American exports and to reducing export controls on items and to areas that have little bearing on national security. This commitment should translate, even if not in a publicly discernable way, into some refinements in the types of civil and criminal proceedings that the agencies will initiate.

A. FOREIGN POLICY DEVELOPMENTS

Export control enforcement priorities are often shaped by U.S. foreign policy toward nations and entities that represent specific threats to national security. Since the start of the Obama administration, much attention has been focused on the special and escalating concerns presented by Iran. As noted previously, a large proportion of investigations and actions that the export agencies have pursued in the last several years pertain to Iran (with China—a major investor in and a supplier of key nuclear components to Iran—close behind). In contrast, some commentators have predicted a relaxation in sanctions against Cuba during the Obama administration.

Iran. Of mounting concern in the West is the ability to contain Iran's weapons capabilities and political influence. Iran's nuclear program and its military assistance to armed groups such as Hamas, Hezbollah, and other groups in Iraq and Afghanistan, as well as its repression of protesters following its 2009 presidential election, are all directly relevant to shaping U.S. export control priorities, which in turn animate enforcement activities.

Iran is currently subject to comprehensive U.S. sanctions and export controls, including a ban on almost all U.S. imports and exports with Iran, U.S. dealing in Iranian-origin goods, and investment in Iran, with narrow exceptions for food, medical equipment, carpets, and caviar. *See* 31 C.F.R. Part 560 (Iranian Transaction Regulations); 15 C.F.R. Part 746 (BIS embargo controls). Other sanctions include: those incident to the State Department's 1984 designation of Iran as a "state sponsor of terrorism" (*e.g.*, foreign aid restrictions, a ban on arms exports, and a presumption of denial of BIS licenses); those imposed by statutes that authorize sanctions on foreign entities deemed to have provided conventional weapons to Iran or assisted Iran's weapons of mass destruction programs, *see* Iran-Iraq Arms Nonproliferation Act, Pub. L. No. 102–484, 50 U.S.C. §1701 note; Iran, North Korea, and Syria Nonproliferation Act, Pub. L. No. 106–178, 50 U.S.C. §1701 note; OFAC designations of Iranian entities under Executive Orders targeting international terrorism and proliferation, *see* Executive Orders 13324 and 13382; and a variety of potential sanctions available under the Iran Sanctions Act, Pub. L. No. 104-172, 50 U.S.C. §1701 note.

Rather than impose greater unilateral sanctions, the Obama administration has chosen diplomatic engagement and the pursuit of multilateral sanctions to impede Iran's nuclear progress. It has left open to Iran the option of accepting an arrangement negotiated in October 2009 that would help resolve its nuclear file. Iran has since rejected the details of this arrangement and ignored the year-end deadline set for its acceptance. Meanwhile, Congress has shown increased impatience with the administration's approach to Iran, as evidenced by bills passed by each chamber to expand and make mandatory the United States' unilateral sanctions

on Iran. *See* Iran Refined Petroleum Sanctions Act (H.R. 2194); Comprehensive Iran Sanctions Accountability and Divestment Act (S. 2799). Notwithstanding their impatience, House and Senate leaders opted to temporarily delay pushing forward to allow the United Nations time to consider a new round of sanctions and to see what transpires at the upcoming mid-June meeting of the E.U.'s European Council.

On June 9, the United Nations approved additional financial and commercial sanctions on Iran's military establishment, although many doubt that these sanctions will actually affect Iran's production of nuclear fuel. House Foreign Affairs Chairman Howard Berman immediately called for other countries to follow by imposing tougher national measures against Iran, promising, "The U.S. Congress will do its part by passing sanctions legislation later this month."

The Obama administration has also encountered increasing Congressional criticism for its failure to begin enforcing unilateral sanctions available under the Iran Sanctions Act ("ISA"), Pub. L. No. 104-172, 50 U.S.C. §1701 note. The ISA authorizes the President to impose two sanctions (from a menu of six possible sanctions) on any entity—foreign or U.S.—that the U.S. deems to have made an "investment" of $20 million or more "that directly and significantly contributed to the enhancement of Iran's ability to develop petroleum resources of Iran." The ISA allows, but does not require, the President to investigate violations when the U.S. receives credible information that an entity has engaged in prohibited investment activity in Iran. In addition, the statute allows the President to waive the application of sanctions by certifying that doing so is in the interest of national security. Sanctions under the ISA include being: (1) barred from U.S. government contracts; (2) ineligible for Export-Import Bank loans; (3) denied U.S. export licenses for military or militarily useful technology; (4) restricted from importing into the U.S.; (5) prevented from receiving loans and credits exceeding $10 million per year from U.S. financial institutions; and (6) precluded from serving as a primary dealer in U.S. government bonds or as a repository for government funds.

While a number of Iranian investments have been placed under State Department review since the 1996 enactment of the ISA, no violations have been found and no entities have been sanctioned. In 1997, the United States and the European Union entered a nonbinding agreement that ISA sanctions would be waived as to European entities in exchange for EU cooperation on nonproliferation and counterterrorism, as well as the EU's agreement to withhold filing a WTO action based on the ISA's allegedly extraterritorial applicability.

On October 20, 2009, however, 50 Congressional members signed a letter to the President identifying more than 20 major international corporations that have "likely violated" the ISA. These members requested that the President "consider full implementation of the ISA." On October 28, 2009, the administration's Assistant Secretary of State for Near Eastern Affairs testified before the House Foreign Affairs Committee that the State Department was reviewing those investments for possible ISA violations. State Department officials told the Congressional Research Service in November 2009 that the agency planned to make a determination on those investments within the time period contemplated by the ISA, but no findings or enforcement proceedings have been announced. At this time, it is unknown whether the administration will undertake the challenge to initiate enforcement under the ISA, but it is clear that the administration faces domestic political pressure as well as national security pressure to apply greater sanctions to Iran.

If the current diplomatic impasse, reluctance by the international community, and Congressional urgency for stronger measures continues, the administration may well find an outlet for this pressure through more aggressive enforcement of existing unilateral sanctions. This could take a number of forms, including additional OFAC designations, and increased dedication of intelligence, investigative, and prosecutorial resources in developing and bringing cases related to transactions with Iran.

Cuba. On April 13, 2009, the President issued a Memorandum to the Secretaries of State, Treasury, and Commerce on the subject of "Promoting Democracy and Human Rights in Cuba." In that memorandum, the President identified as "a key component of this Nation's foreign policy in the Americas" the promotion of "measures

that decrease dependency of the Cuban people on the Castro regime and that promote contacts between Cuban-Americans and their relatives in Cuba as a means to encourage positive change in Cuba." To that end, the President directed the three Secretaries to take actions that would lift certain restrictions on family travel and remittances to Cuba, and would promote telecommunications networks and services, satellite television and radio, and donated personal communications devices for Cubans who are not members of the Cuban government.

On September 3, 2009, OFAC and BIS amended their regulations to implement the President's memorandum. While some have interpreted these actions as signaling a general abatement in the Cuba sanctions program, these changes with respect to Cuba more likely reflect the administration's specific view that the free flow of information is helpful rather than harmful to U.S. foreign policy objectives in sanctioned countries. *See* 75 Fed. Reg. 10997-11000 (March 10, 2010) (amending OFAC's Iran, Sudan, and Cuba regulations to authorize exportation of certain software and services incident to online communications and social networking such as text messaging, email, and web browsing); 74 Fed. Reg. 45985 (amending BIS regulations to expand the allowance for exporting gift parcels and consumer telecommunications to Cuba).

Indeed, those who would assume that OFAC has relaxed its enforcement attitude toward Cuba violations would likely be wrong. For example, on March 17, 2010, OFAC entered into a settlement with Innospec, Inc., a Delaware chemical and fuel specialties company, for $2.2 million to resolve civil allegations that Innospec violated the Cuban Assets Control Regulations. Innospec is alleged to have acquired a Swedish corporation with a sales office in Cuba, maintained the sales office, conducted Cuban business through that sales office and through another subsidiary, employed Cuban nationals, entered contracts with Cuban power companies, and held Cuban bank accounts. The base penalty amount for these violations was $4.4 million, but Innospec received mitigation because it voluntarily disclosed its violations and cooperated with the investigation, and OFAC did not consider the case to be egregious.

B. FOCUS ON END-USERS RATHER THAN COUNTRIES

In January of 2008, President Bush issued National Security Presidential Directive 55 ("NSPD55"), which called for export controls to be tailored more to end-users rather than implemented as broad bans on entire export categories or country-wide embargoes.

Consistent with this policy goal, BIS has increased the number of factors that will cause individuals to be added to (or removed from) the Entity List. 73 Fed. Reg. 163. This allows BIS to address threats from low-level technologies without adding broad controls that will impose significant, but inefficient, burdens on industry. For example, a number of parties have been added to the Entity List because they trade in the same types of mass-market electronic components used in improvised explosive devices. As a result, the Entity List has grown substantially.

BIS also issued a proposed rule on October 3, 2008, that would grant an exemption to licensing requirements for inter-company transfers ("ICT") of goods or technology that would otherwise be considered a controlled export. 73 Fed. Reg. 57554. While the Entity List imposes heightened restrictions on individual bad actors, the ICT exemption would operate by singling out individual companies with a strong record of export control compliance for eased restrictions. BIS officials at one time indicated that the final rule would be released in mid-April; however, the rule received many industry comments suggesting that the process for accessing the exception was too burdensome, and it is now unclear if and when any final rule will be issued.

Although the Obama administration has introduced its own plans for export control reform, *see* Part C *infra*, its reforms appear to be consistent with NSPD55's goal of more targeted export controls. Given this uniform policy vision and the efforts already made by BIS to develop more targeted export controls, exporters should not be surprised if the importance of knowing their products' end-users continues to increase.

C. EXPORT CONTROL REFORM

The Obama administration has made reform of the export control system an explicit policy priority. In August 2009, the White House issued a statement that the President had launched "a broad-based interagency process for reviewing the overall U.S. export control system, including both the dual-use and defense trade processes." The President charged the National Economic Council and the National Security Council with leading the review. Soon after this announcement, House Foreign Affairs Committee Chairman Howard Berman launched a Congressional review of the dual-use export control system to run parallel to the President's broad-based review, as a prelude to introducing a renewal of the Export Administration Act, which has been in lapse since 2001.

In his first State of the Union Address, the President announced the launch of a National Export Initiative, a goal of which is to "double [U.S.] exports over the next five years, an increase that will support two million jobs in America." In remarks at the Export-Import Bank's Annual Conference in March 2010, President Obama again highlighted his "single, comprehensive strategy to promote American exports … called the National Export Initiative." As part of this initiative, the President identified his desire "to reform our Export Control System" in ways that would include "streamlin[ing] the process certain companies need to go through to get their products to market," and "eliminat[ing] unnecessary obstacles for exporting products to companies with dual-national and third-country national employees."

On April 20, 2010, Secretary of Defense Robert Gates outlined the administration's export control reform blueprint based on the President's broad-based review. In remarks to Business Executives for National Security, Secretary Gates pointed out that the "current system—which has not been significantly altered since the end of the Cold War" has "rules, organizations, and processes [that] are not set up to deal effectively with those situations that could do us the most harm in the 21st Century" and "fails at the critical task of preventing harmful exports while facilitating useful ones." Gates specifically identified as problems: (1) "an overly broad definition of what should be subject to export classification and control … mak[ing] it more difficult to focus on those items and technologies that truly need to stay in this country"; and (2) "the bureaucratic apparatus that has grown up around export control—a byzantine amalgam of authorities, roles and missions scattered around different parts of the federal government" that "creates more opportunities for mistakes [and] enforcement lapses," creates resource-squandering "fights between agencies over jurisdiction," "discourage[s] exporters from approaching the system" and encourages them to "move production offshore."

Accordingly, Gates described the administration's ambitious plan as consisting of "four key reforms: a single export-control list, a single licensing agency, a single enforcement-coordination agency, and a single information-technology system." The plan is slated to unfold in a three-phased process over the next year. The first phase includes "begin[ning] the transition towards the single list and single licensing agency … by establishing criteria for a tiered control list and standing up an integrated enforcement center." The second phase "completes the transition to a single IT structure [and] implements the tiered control list." The third phase, which, unlike the first two phases, would require Congressional action, creates by legislation "the single licensing agency and single enforcement coordination agency." The Under Secretary of Commerce for Industry and Security recently announced that BIS has set an internal deadline of August 13, 2010, to establish criteria for a tiered control list as part of the first phase.

While the near-term effects of the President's reform plan on export enforcement is uncertain—export control cases run through a long pipeline and certainly will not be suspended pending the President's reforms—the administration has made clear its views that regulating the export of commercially available items and technologies is a waste of resources that actually undercuts the government's national security mission. This policy statement may affect the types of investigations and cases that are pursued by the export control agencies and the Justice Department in the coming year. Similarly, the administration's criticism of infighting between agencies and its emphasis on increased

coordination will likely have an effect on how the export control agencies interact with each other on licensing as well as enforcement. Finally, the portion of the reform plan that calls for the creation of a single, tiered control list and a new integrated enforcement center will likely require a significant investment of time from enforcement staff at BIS, DDTC, other investigative agencies, and DOJ (but possibly not OFAC, which is not mentioned in connection with the review or the reform blueprint) to complete the transition.

When the first phases of the plan are complete, there may be major changes in the types of conduct that are subject to enforcement, as well as the procedures enforcement offices will follow for investigations and initiating cases. While it is too early to speculate what those changes will be, the next year promises a period of intense scrutiny for the current export control system with the potential for groundbreaking reform.

V. LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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