

With new EU 'dual use' Export Control legislation due to take force from August 27, 2009, **John O'Loughlin**, Consultant, Customs & International Trade at PwC, reviews existing Irish and relevant US legislation in this area and highlights the new EU provisions.



# Are you **Export Control** compliant?

**F**ollowing the events on 9/11 and the subsequent attacks on Madrid and London, administrations throughout the world have tightened up on the implementation and enforcement of Export Control legislation. The EU and Ireland are no exception.

Export Control legislation controls the export of specific 'dual-use' items by means of licences issued by national authorities. Dual-use items are items that may be used for civilian or military purposes. They cover a wide range of

products and services such as certain 'high-tech' equipment, software, aviation and aerospace systems, chemicals and pharmaceuticals as well as some support services including research and development (R&D) outputs.

Traditionally, we think of an export as a tangible or physical transaction. However, for export control purposes, an export also includes intangible exports (e.g. those by electronic means such as faxes, e-mails, web downloads and in certain cases, telephone conversations).

The advanced nature of some R&D projects can result in technologies with possible applications in military systems as well as civilian usages. Therefore, colleges and companies involved in 'state of the art' R&D should be aware of the control status of their work and also be aware that the sharing of their work with colleagues abroad may need to be licensed by the relevant authorities. The onus is on organisations to be fully compliant in all applicable export control obligations and also to maintain records to support their controlled activities.

Products that may need a licence or may be subject to authorisations include software containing high-levels of encryption; high specification computers and other electronic equipment or components; chemicals and pathogens and an extensive range of military specific items. Not only can the finished 'end-product' be controlled under legislation, but also systems equipment and components, test inspection and production equipment, the materials used in the manufacture process, the software and technology for the manufacture or use of the controlled finished 'end-products'.

In addition to products specifically listed as controlled, other items may be controlled under EU Export Control legislation because of what is known as the 'catch all' clause. Broadly speaking, this is where the exporter is aware that the items are or may be intended for use in the arena of weapons of mass destruction. Accordingly, there is an onus on exporters to have knowledge of their customers' business and the intended use of the product by the consignee or ultimate end-user.

#### EXISTING EXPORT CONTROL

**REQUIREMENTS** Companies based in Ireland are required to comply with both the provisions set out in Irish legislation and also with EU Export Control legislation. Furthermore, there may be a requirement to comply with US re-export controls.

US Export Control Legislation is 'extra-territorial' as the rules extend well beyond US borders. For example, US export controls can apply to US-made items that are re-exported from Ireland to another country or to technology that is used in the manufacturing process in Ireland. In addition, foreign affiliates of US companies must also comply with applicable US re-export restrictions and licence requirements when exporting products that use US technology or software or technology. Many companies do not realise the broad applicability of the

requirements and restrictions on exports and that potentially, they are required to comply with multi-jurisdiction Export Control legislation.

**IMPACT ON BUSINESS** Export Controls are compliance-based and do not result in any obvious 'bottom-line' savings. However, legislation introduced by the Irish Government, which came into force in April 2008, means that the Irish Customs authorities now have increased powers to carry out audits and to enforce Export Control legislation for items exported from Ireland.

The legislation has also increased the penalties for non-compliance; increasing the existing fine from €12,500 to €10 million or three times the value of the shipment and/or up to five years imprisonment on indictment. Breaches of Export Control legislation can also lead to significant reputational damage and can result in business interruptions, whereby the offending company is prohibited from exporting certain products and from exporting to certain destinations.

**In order for traders to determine if an exported item (tangible or intangible) is subject to Export Control legislative requirements (Irish, EU, US Re-export), they will need to assess the following:**

- What is my product?
- Where is it being exported to?
- Who is the end-user?
- What is the end-use?
- Are there any other risks or considerations which need to be taken into account ('red-flags')?

#### RECENT CHANGES AND UPCOMING

**DEVELOPMENTS** As mentioned above, in April 2008, the Irish Government introduced the 'Control of Export' Act 2008. The main provisions of the 2008 Act include:

- Clarity on controls applicable to exports of technology
- Extension of powers of audit and enforcement to Irish Customs
- Increased penalties for non-compliance
  - A fine not exceeding €5,000 and/or six months imprisonment on summary conviction
  - A fine not exceeding €10 million or three times the value of the shipment and/or up to five years imprisonment on indictment

Non-compliance can also result in reputational damage to a company.

We also expect the introduction of secondary legislation that will:

- Require an exporter to document an internal compliance programme
- Specify information and documentation to support licence applications
- Provide reports on usage of licences
- Provide for a legislative basis for an appeal process

**NEW EU LEGISLATION** As recently as May 2009, the EU published new Export Control legislation that amends current legislation. This new legislation will apply from August 27, 2009, with the current legislation being repealed from the same date. The new Export Control legislation will introduce the following changes at EU level, which will automatically apply in Ireland:

- Provision of controls on certain goods in transit (goods in transit affected by export controls are not the same as those affected for customs purposes)
- Introduction of controls on brokering of certain activities involving dual use goods.
- Consideration of a trader's internal compliance procedures as part of the authorities' criteria in assessing a global licence application. This effectively requires companies to document procedures in order to benefit from using global licences.
- Introduction of additional customs controls on certain transactions including compliance with end use/end destination.
- Introduction of an EU-wide time limit for Member States to reply to exporters registering their use of the CGEA (Community General Export Authorisation) and for exporters to declare their use of the CGEA in their customs export declarations.
- Enhanced communications and consultations between Member States before licences are issued.

**BEST PRACTICE FOR EXPORTERS** US companies have, in most cases, taken the lead when it comes to implementing practices and procedures to monitor and control their export control compliance obligations.

Best practice suggests that traders should implement a comprehensive 'Export Management System' (EMS) or 'Internal

Compliance Programme' (ICP), which documents export compliance processes and procedures. Such systems or programmes provide companies with a documented road-map as well as an assignment of responsibilities and ownership for Export Control activities.

The content and structure of an EMS or ICP will differ from company to company, depending on the size of the company, industry, volume of exports, size of product portfolio and geographical location. The nature of an EMS or ICP can either be a manual or an automated system. The automated system will generally be either part of the company's ERP systems or will be an external software system purchased specifically for export control purposes. It should be noted that where this is automated, it is important that there is detailed knowledge behind the data maintained in the system. The automated system will also require a set of documented processes and procedures in place to support its operations.

The documented procedures included in an EMS or ICP will generally include:

- Management policy
- Export control classification
- Licence determination
- Licence application
- Embargo and country sanctions
- Internal reviews
- Recordkeeping
- Training

Such procedures will generally apply to both EU/Irish exports and US re-exports. However, the following are US specific procedures which should be included in a comprehensive EMS or ICP if the exporter, the product or the technology being exported is subject to US re-export controls:

- Denied parties/entities screening
- Anti-boycott screening
- End-Use screening (nuclear proliferation, missile technology, chemical biological weapons)
- Diversion risk 'red flag' controls

Frequently, we see the implementation of an EMS or ICP as US-focused with companies omitting the procedures needed under EU Export Control. Adopting such an approach can lead to gaps in a company's EMS or ICP.

As indicated above, following on from the introduction of the Control of Export Act 2008, we also anticipate the introduction of secondary legislation that will provide for the mandatory documentation of a company's processes and procedures relating to its Irish and EU export control obligations.

However, the new Export Control legislation, which will apply from August 27, 2009, already includes a provision whereby the licensing authorities in each of the EU Member States will be required to take into account a trader's internal compliance procedures as part of the criteria when assessing licence applications. In effect, this new EU Export Control legislation now requires traders to document Export Control procedures.

**RECOMMENDED ACTION** In light of these new rules, there are a number of points that Irish exporters should consider:

1. Are the products we are exporting subject to Irish Export Control Legislation?
2. As an exporter, are we complying with EU Export Control Legislation?
3. Do we export US origin products or technology or are our suppliers a foreign affiliate or subsidiary of a US company? If yes, are we complying with US re-export control legislation?
4. Have we documented our internal processes and procedures required to manage our company's Export Control requirements?
5. Can we afford the risk of prosecution for breaching Irish or EU Export Control or US re-export control legislation and face the risk of penalties and potential damages to business reputation?

**EXAMPLES OF NON-COMPLIANCE** In May 2008, a UK businessman was jailed for 18 months for illegally exporting 'gyrocompass' navigation devices to Iran. He admitted shipping hi-tech navigation equipment, adaptable for missile guidance systems, to the Iranian Ministry of Defence. The gyrocompasses, designed as standalone shipping navigation systems, contain accelerometers and gyros, which are classified as 'Dual-Use items' as they can be used



Best practice suggests that traders should implement a comprehensive 'Export Management System' (EMS) or 'Internal Compliance Programme' (ICP), which documents export compliance processes and procedures.

for both civil and military applications. The businessman was also ordered to pay £432,970 and the goods were made subject to a confiscation order under the Proceeds of Crime Act 2002. He was required to pay the sum within six months or face a three-year prison sentence in default.

As recently as February 2009, a UK mining company was fined for attempting to export military vehicles to use in mining activities, and, in June 2009, two individuals were jailed for 10 years for conspiracy to export oxygen cylinders from the UK to Iran.

To date there have been no similar high-risk-profile cases in Ireland, where companies were prosecuted for breaches of export controls. However, with the introduction of the increased penalties under the Control of Exports Act 2008, this may change.