Editor's note

It's out of control!

Is the management of export controls becoming uncontrollable?

Although modern-day export controls are said to date back to the US's Trading with the Enemy Act of 1917, for most of us in charge of managing the regulatory aspects of cross-border trade, "export controls" (or "strategic goods controls", as they are often referred to in many Asian nations) still feels new and unfamiliar. It does not help that the term "export controls" can apply to a wide range of regulatory restrictions, often with very different objectives. Many of our readers probably think 'weapons of mass destruction' when they hear the term export controls. The more experienced will know that many more products are subject to such controls.

The reason why the export of certain products is controlled varies significantly. It could be for general public safety (such as the aforementioned controls on weapons). It could be to maintain a competitive advantage (such as – to some extent - the recent US semiconductor controls). It could be to prevent a shortage of certain goods in the country of export (such as the recent Indian rice export restrictions). It could be for environmental reasons (for example to fight illegal logging). Or perhaps some other geopolitical reason (such as – allegedly – the recently lifted Indonesian restrictions on exports of sea-sand).

Although often the US springs to mind when the term export controls comes up, it is clear that such controls are widely used in many territories. Keeping track of these controls can be a tough task, especially the ones that are extra-territorial. Although it is usually the customs authorities that are tasked with policing, they may not always have a full understanding of which controls apply to which shipments. It is easy to look for an export licence if it is linked to the declared tariff classification of a product. But many controls apply to product characteristics, not tariff codes. Hence even companies that have a good handle on their tariff codes may well struggle to correlate such codes (even through use of technologies) to the appropriate export control codes and related licensing requirements. In addition, the product characteristics that determine export controls are harder for a port official to know about. Not to mention that accidental or deliberate misclassification of products makes even the "easy" controls harder to police.

For a long time, dealing with export controls was something that was added to the list of a customs manager or customs broker to take care of. For many companies, it still is. Yet the proliferation of "trade compliance managers", often with a very distinct scope from a more traditional customs manager, suggests that many companies see a need to take these regulations more seriously, or at least dedicate more manpower to them. To some extent this is a result of regulatory requirements. Often obtaining bulk export licences necessitates not only detailed Internal Compliance Programmes to be developed, but also the appointment of a dedicated trade compliance manager. The "Strategic Goods Compliance Officer" is borne.

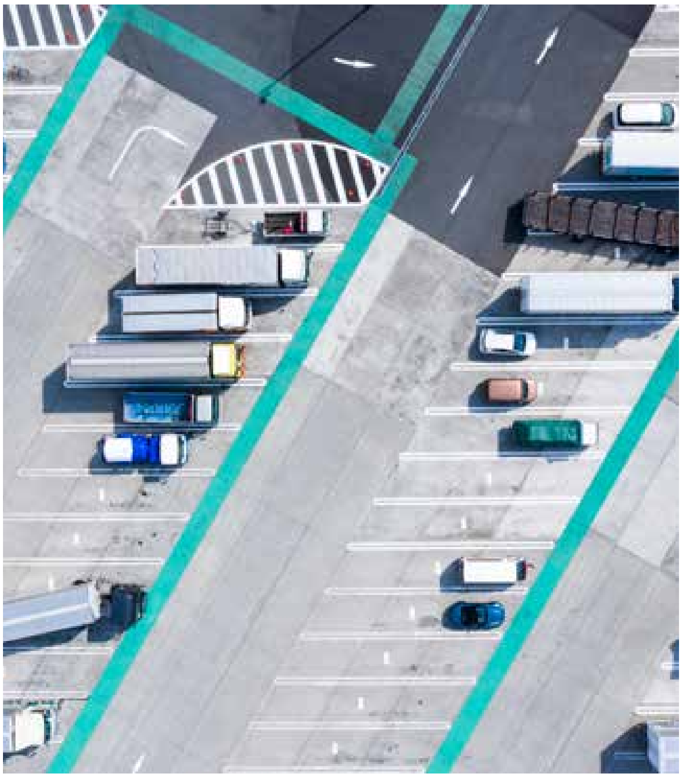
Despite all this, it is also abundantly clear that many companies look to get by without such a dedicated resource. The sheer volume of trade and the resource constraints on the customs authorities mean - in practice at least - that unless there is a good reason for the authorities to believe that a company is in breach of applicable export control rules, no questions are asked. Are you exporting an X-ray machine? Red flags abound. Are you exporting dried milk powder? Probably less so. Yet both can cause quite a bit of damage in the wrong hands. Consequently, it is likely that many products leave many countries every day that should have an export licence, but don't. The exporters don't know they need a licence, or can't be bothered to get one. The border authorities don't have the resources and knowledge to know which shipments to stop and challenge. At the same time, it is equally likely that for the vast majority of those products a licence could be easily obtained, if only it was applied for.

The advances of modern technologies make both the analysis of large volumes of data and the scanning of physical shipments a much more manageable exercise. Hence from a regulator's perspective, things may be looking up when it comes to policing the export of controlled goods. From an exporter's perspective, maybe less so. In our recent work we have come across a great many companies, even large multinationals in clearly affected industries, that display a worrying lack of knowledge and / or care.

With that in mind, here's some thoughts on what should be the basics of proper export controls management.

- Clearly **allocate responsibility and accountability** for managing all export controls. This should be the case no matter how small or large your organisation. Small companies may not necessarily have (m)any resources to spare, but someone needs to be spending some of their time to make sure their company is at least aware of what matters. Knowing the landscape is not limited to companies that export controlled products. Both companies that supply their customers in-territory, as well as those that purchase goods, may have export control responsibilities. The former may need to attest to the sourcing of their inputs and the relevant characteristics of products, while the latter may need to explain their intended use for them. Fortunately, there are plenty of resources available, many for free and some at a cost, that should be sufficient for any company to do this. As a bonus, it shows to the regulators that you take export controls seriously.

- Establish a system for **monitoring regulatory requirements** on exports. This should start with cataloguing any existing regulations, an exercise that can be time-consuming. Care should be taken to check all regulations that may apply, especially those from other jurisdictions (such as US re-export controls). Once an appropriate catalogue is made, continued monitoring should be easier to conduct. Many off-the shelf tools exist to help in that. Do remember though that they are just tools, so make sure you read and understand the small print on comprehensiveness and up-to-date-ness.



- **Determining which** of those **requirements apply** to you. This may be the hardest task. It may require you to know the tariff classification of your products (regardless of whether you actually export them). Even if not, you may need to know the characteristics of inputs into your products, which only your suppliers may know, and may – for commercial reasons – not be so willing to share. Even relevant knowledge of your own products may be harder to come by than you would at first think. Engineers, researchers, procurement, HR, are but some of the departments that have a role in determining the proper application of export controls. They will typically not be aware of this, and often not want to know. You will likely also need to ask your customers what they plan to do with the products (finished or intermediate) you supply to them – again something they may not be so willing to share (which you may want to treat as a red flag). Moreover, the Incoterms under which you trade will have a bearing on who has the immediate legal responsibility for export control compliance. Some Incoterms may put that onus on you even if you do not have the necessary knowledge about the products you export (this is a common challenge for trading companies). Hence your relationships with your suppliers and customers are going to be key.

- **Establish processes** for managing the export controls requirements that apply. In a way, this ought to be a relatively easy step. Most companies are quite familiar with process implementation in many parts of their business. Hence as long as someone knows which requirements apply, it should not be an unsurmountable task to create a clear process outlining all the steps to take: obtaining information, documenting analyses, apply for a licence (if applicable), instructing shippers, escalating issues and so on and so forth. Most importantly, such processes, and whomever is responsible for them, need to have the power to stop potentially non-compliant shipments, regardless of how much it upsets their sales and supply chain people, or how much their customers complain. Once again, there are many systems and tools that can help you with this step, but also once again, they are limited in what they can do. The biggest risk we see is that companies expect such tools to do everything, leave it all to the tool, and "switch off" their common sense and human safeguards.

- **Escalation and disclosure processes** for if/when things go wrong. Even the best make mistakes. It is therefore also necessary to be ready for dealing with such mistakes. Correcting incorrect information supplied to a customer. Disclosing the shipment of a controlled product without a licence to the authorities. Eliminating suppliers or customers that are unable or unwilling to comply. All of this and more should form part of a comprehensive error management programme. It may not entirely prevent another mistake occurring. But it will certainly minimise the risk, and mitigate any penalties the authorities would look to impose.

Following the above guidelines to the best of your ability will get you a long way on the road to full export control compliance. A remaining challenge, and one that perhaps warrants a special word, are the latest US re-export controls affecting predominantly the semiconductor industry, but with ramifications far beyond. Recent penalties imposed on companies breaching these rules have been eye-watering (up to US$ 300 million and 5 year denial of export). In many cases they are imposed on the US affiliates of companies that violated US rules in other territories. If such companies have no US affiliates (or another so-called "nexus" in the US), they may lose access to US dollars, severely impeding their ability to engage in international trade.

On 13th October 2022, the US Department of Commerce's Bureau of Industry and Security ("BIS") announced an interim final rule (it is still interim today) on additional export control measures to advanced computing, supercomputer and semiconductor manufacturing. Industries most affected by this rule are semiconductor manufacturers and distributors, suppliers of semiconductor manufacturers (e.g., semiconductor production or testing equipment supplier), and all their customers.

Products, technologies, software and services developed, manufactured, and / or provided outside the US may be subject to US export control if there is sufficient linkage to the US. This does not only cover inclusion of US originating physical materials, but also the inclusion of US related technologies or software, the use of US related production equipment, and the involvement of US persons in product development, production or shipment. Determination of US export control implications also requires knowledge of the end-use / end user of your products and services. "End use" is the ultimate intended use of the product, while "end user" is the last consumer in the product's supply chain. Neither of these may relate to your immediate customer and its use of the product. It is up to you, as the seller, to take reasonable actions for end use / end user identification for US export control purposes.

In short, under the US's Foreign Direct Product Rules, products made entirely outside of the US may still be subject to US export controls and require a licence from the BIS. Our experience is that most companies that make products in – say – a facility in Malaysia and sell them to – say – India are not aware that US re-export controls may apply to them. Consequently they have no processes in place to check which of their products are captured, even if they knew how to, let alone obtain the necessary licences for export.

Confused? Concerned? Good. That could be the first step to compliance. Remember that export control compliance relies on good controls, good controls rely on good processes, good processes rely on good knowledge, and good knowledge relies on awareness and concern.