

International Business Updates – Best Practices to Keep you “In the Black” and Out of Orange (Jumpsuits)

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Are “international” business issues relevant to me?

- The prevalence of international trade:
 - It is difficult to find a company today that is not involved in international business either directly or indirectly, whether that be on the supply side or sales side or both.
 - Approximately 25% of world production is sold outside of its country of origin.
 - More than 300,000 U.S. companies export goods or services.
- It’s not just the “big” guys:
 - Nearly 98 percent of companies that export are small or medium-sized companies (SMEs) with fewer than 500 employees.
 - SMEs were responsible for 33 percent of goods exports in 2011.
- The consequences of trade violations are significant:
 - Denial Orders preventing future exports or imports – up to 10 years.
 - Administrative Penalties up to \$11,000 PER COUNT for administrative cases, \$120,000 PER COUNT for certain administrative cases involving national security and \$250,000 PER COUNT for certain defense-item violations.
 - Criminal Penalties of up to a \$1 million fine and 20 years in prison PER COUNT.
 - For example, in 2013, Houston-based Weatherford International and its subsidiaries agreed to pay a total penalty of \$100 million.
 - Debarment – Denial of right to sell to the U.S. government or its agencies.
 - Seizure, forfeiture and sale of goods.
- Companies often rely on their CPAs as “control” points.

One Lawyer's Case for Dumping International Trade Compliance Responsibility in the CPA's Lap

- The CPA has the “big picture” view of the company's profitability, as opposed to the competing motives of different departments or units (e.g., sales' “sales at any cost” mentality”).
- Duties of objectivity, integrity and independence.
- Many companies see “control” as a significant CPA function.

Section I

A Review of U.S. Import and Export Law

Ten Steps of Export Controls Compliance

- 1. Military and Paramilitary Items/Defense Articles and Services
- 2. Dual Use Items
- 3. Country Controls (Embargos)
- 4. End User and Intermediary Controls
- 5. End Use or Application Controls
- 6. Deemed Exports
- 7. Record Keeping Requirements
- 8. Anti-boycott Compliance
- 9. The Foreign Corrupt Practices Act
- 10. Export Compliance Programs

#1 - Military and Paramilitary Controls

- The export and temporary import of “defense articles” and “defense services” are controlled
- Legal Authority:
 - Arms Export Control Act
 - Executive Order 11958
 - The International Traffic in Arms Regulations (ITAR)
- A license is required to export “defense articles” and “defense services”

- ITAR's United States Munitions List (22 C.F.R. part 121) designates/defines "defense articles" and "defense services"
- The United States Munitions List is divided into categories, ranging from items clearly having military applications (e.g., Category II - Guns and Armament) to those that may include apparent civilian applications (Category XV - Spacecraft Systems and Associated Equipment)
- Note the inclusion of components, attachments, accessories and parts within the definition of "defense articles"
- ITAR contain a "commodity jurisdiction" process. 22 CFR §120.4. This can be used by a business either to resolve doubt as to whether an article or service is covered by the USML or to seek removal from the list.

What is required under ITAR?

- All manufacturers, exporters, and brokers of controlled defense articles, defense services, or related technical data, as defined on the USML, are required to register with the U.S. Department of State's Directorate of Defense Trade Controls (DDTC). Note that even non-exporting manufacturers of defense articles are required to register with DDTC.
- Registered persons and companies must notify DDTC of any prospective change of ownership, sale or transfer to a foreign person of ownership or control of the registered company or its subsidiary.
- Licensing - Generally, any person or company intending to export or to temporarily import a defense article or service must obtain the approval of DDTC (i.e., obtain a license) prior to the export or temporary import.
 - Foreign persons, debarred persons, and persons convicted or indicted for certain criminal offenses are not eligible for a license.
 - For certain exemptions from the licensing requirements, see 22 CFR§123.16, et seq.
- U.S. companies and persons transacting in defense services or controlled technical data with foreign persons (whether in or outside of the U.S.) must submit "MLAs" (manufacturing license agreements), "TAAs" (technical assistance agreements), distribution agreements, and/or off-shore procurement agreements to DDTC prior to such agreements' effective date, and must have such agreements approved by DDTC. 22 CFR Part 124. Signed agreements must be timely filed with DDTC.
- A Non-transfer and Use Certificate (Form DSP-83) must be executed by any foreign consignee, foreign end-user, or applicant and submitted to DDTC in connection with any license, MLA or TAA relating to "significant" military equipment, classified articles, or classified technical data. 22 CFR§123.10 and 1424.10.
- The licensed export of "defense articles" must be accompanied (as an "integral part of the bill of lading and the invoice) by the following statement (22 C.F.R. §123.9): "These commodities are authorized by the U.S. Government for export only to [country of ultimate destination] for use by [end-user]. They may not be transferred, transshipped on a non-continuous voyage, or otherwise be disposed of in any other country, either in their original form or after being incorporated into other end-items, without the prior written approval of the U.S. Department of State."
- There is an extensive list of countries to which defense items and services are not to be shipped.
- Note additional requirements exist.

#2 - “Dual Use” Items

- Items designed for civil use but having possible military application
- Analysis of item and destination country utilizing:
 - The Commerce Control List
15 C.F.R. Part 774, Supplement No. 1 or
www.access.gpo.gov/bis/ear/ear_data.html#ccl
 - The Commerce Country Chart
15 C.F.R. Part 738, Supplement No. 1 or
www.access.gpo.gov/bis/ear/ear_data.html#ccl
 - Note license exceptions (Low Value Shipments to certain countries, inventory items, de minimis, etc.)

DUAL USE GOODS

COMMERCE CONTROL LIST EXAMPLE

9A002 - Marine gas turbine engines with an ISO standard continuous power rating of 24,245 kW or more and a specific fuel consumption not exceeding 0.219 kg/kWh in the power range from 35 to 100%, and specially designed assemblies and components therefore.

License Requirements:

Reason for Control: NS (National Security), AT (Anti-terrorism)

<u>Control(s)</u>	<u>Country Chart</u>
NS applies to entire entry	NS Column 2
AT applies to entire entry	AT Column 1

License Exceptions LVS: \$5000 GBS: N/A CIV: N/A

List of Items Controlled:

Unit: Number

Related Controls: N/A

Related Definition: The term "marine gas turbine engines" includes those industrial, or aero-derivative, gas turbine engines adapted for a ship's electric power generation or propulsion.

Items: The list of items controlled is contained in the ECCN heading.

Note: The Commerce Control List may be found at 15 C.F.R. Part 774, Supplement No. 1, while the Commerce Country Chart may be found 15 C.F.R. Part 738, Supplement No. 1. Both may be found on the web at www.access.gpo.gov/bis/ear/ear_data.html#ccl.

Commerce Country Chart

Reason for Control

Countries	Chemical & Biological Weapons			Nuclear Nonproliferation		National Security		Missile Tech	Regional Stability		Firearms Convention	Crime Control			Anti-Terrorism	
	CB 1	CB 2	CB 3	NP 1	NP 2	NS 1	NS 2	MT 1	RS 1	RS 2	FC 1	CC 1	CC 2	CC 3	AT 1	AT 2
	Afghanistan	X	X	X	X		X	X	X	X	X		X		X	
Albania	X	X		X		X	X	X	X	X		X	X			
Algeria	X	X		X		X	X	X	X	X		X		X		
Andorra	X	X		X		X	X	X	X	X		X		X		
Angola	X	X		X		X	X	X	X	X		X		X		
Antigua & Barbuda	X	X		X		X	X	X	X	X	X	X		X		
Argentina	X					X	X	X	X	X	X	X		X		
Armenia	X	X	X	X		X	X	X	X	X		X	X			
Aruba	X	X		X		X	X	X	X	X		X		X		
Australia	X					X		X	X							
Austria	X					X		X	X	X		X		X		
Azerbaijan	X	X	X	X		X	X	X	X	X		X	X			
Bahamas, The	X	X		X		X	X	X	X	X	X	X		X		
Bahrain	X	X	X	X		X	X	X	X	X		X		X		

#3 - Country Controls - Embargoes

- Sanctions can take the form of restrictions against military-related exports, dual-use exports, economic assistance and financial restrictions.
- Military items embargoes are extensive. Refer back to the “ITAR” controls.
- Cuba – Various exceptions exist, but commercial transactions are subject to extensive sanctions
- Iran – General ban
- Sudan – Do not confuse these sanctions with the new country of “The Republic of South Sudan” which is generally not subject to sanctions
- Note various “Country” sanctions are actually not country-wide sanctions. Rather, they are trade restrictions directed at specific persons and/or companies within that country. For example, one should be especially diligent when dealing with persons or companies in Russia, the Ivory Coast or Yemen.
- One must stay current regarding embargoes, as they change over time.

IT'S NOT JUST IN THE U.S.

- These comprehensive embargoes, administered by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"), prohibit commercial or financial dealings between embargoed countries and their nationals on the one hand and "persons subject to the jurisdiction of the United States" on the other. Persons subject to the jurisdiction of the United States generally include anyone located in the United States, *a U.S. national wherever located*, any firm incorporated in the United States, *its foreign offices and branches, or subsidiaries that are controlled or 100% owned by U.S. firms.*

#4 - End User and Intermediary Controls

- Specially Designated Nationals
- Specially Designated Terrorists
- Denied Persons List (Export Denial by U.S. Commerce Department)
- Entity List (Weapons of Mass Destruction)
- Specially Designated Narcotics Traffickers

HOW AND WHEN SHOULD I SCREEN?

- One-time screening of entire customer database against the prohibited parties lists.
- When prohibited parties lists are amended: (1) screen additions to lists against customer database and (2) add to approved customer database, parties that are no longer prohibited.
- Screen new customers.
- Visit the agencies' websites and/or utilize a subscription service that notifies of updates.

#5 - End Use/Application Controls

- Nuclear Weapons and Related Processes
- Chemical Weapons
- Biological Weapons
- Missiles

#6 - THE DEEMED EXPORT RULE

- Do not release “controlled” technology to a foreign national by permitting access within the U.S. by such means as personal visits to the U.S., permitting plant tours and discussing controlled technology, permitting Internet access of your U.S. database, etc.
- For this purpose, a “foreign national” is any non-U.S. person except one who is:
 - Granted permanent residence, as demonstrated by the issuance of a permanent resident visa (i.e., "Green Card");
 - Is granted U.S. citizenship; or
 - Is granted status as a "protected person" under 8 U.S.C. 1324b(a)(3) (i.e., political refugees and political asylum holders).

#7 - RECORD KEEPING

- Keep records of your export transactions
- Keep the records for five (5) years

#8 - Anti-boycott Compliance

Under these regulations, a **U.S. person may not**:

- Refuse, knowingly agree to refuse, require any other person to refuse, or knowingly agree to require any other person to refuse, to do business with or in Israel;
- Furnish or knowingly agree to furnish information concerning his or any other person's past, present or proposed business relationships with or in Israel, or with any other person who is known or believed to be restricted from having any business relationship with or in a boycotting country (a blacklisted person);
- Refuse to employ or otherwise discriminate against any individual (or corporation) who is a United States person on the basis of race, religion, sex, or national origin;
- Furnish information about the race, religion, sex, or national origin of any United States person;
- Furnish or knowingly agree to furnish information about whether any person is a member of, has made contributions to, or is otherwise associated with or involved in the activities of any charitable or fraternal organization which supports a boycotted country; or
- Honor, confirm, or otherwise implement a letter of credit which contains a condition or requirement, compliance with which is prohibited by Part 760 of the EAR. Similarly, a U.S. person shall not be obligated to pay, honor or otherwise implement such a letter of credit.

Anti-boycott Reporting Requirements

- In general, and with many exceptions, a U.S. person who receives a request to take any action that has the effect of furthering or supporting a restrictive trade practice or boycott must report that request to BIS. Required reporting must be done quarterly, whether or not the U.S. person intends to comply with the request. See the Department of Commerce's Bureau of Industry and Security form BIS 621-P for single transactions or BIS 6051P for multiple transactions received in the same calendar quarter.
- Complying with the boycott request may result in the loss of certain tax benefits (e.g., IC-DISC benefits, deferral of tax on foreign subsidiary earnings, etc.). Additionally, one may receive an administrative fine of up to \$11,000 per violation or a criminal penalty of up to \$50,000 or five times the value of the exports involved, whichever is greater, plus imprisonment of up to five years.
- On the Form 5713 (International Boycott Report), U.S. taxpayers (for themselves and for members of a U.S. corporation's "controlled group") must report, with their annual tax filings, operations in, with, or related to countries participating in boycotts not sanctioned by the U.S. government. As per the Form 5713 Instructions, this includes Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates, and the Republic of Yemen.

#9 - Foreign Corrupt Practices Act

- Bottom Line = Don't be involved in any payment to a foreign government official to influence that official.
- Specifically, one may not make:
 - a payment, offer, authorization, or promise to pay money or anything of value
 - to a foreign government official (including a party official or manager of a state-owned concern), or to any other person, knowing that the payment or promise will be passed on to a foreign official
 - with a corrupt motive
 - for the purpose of (a) influencing any act or decision of that person, (b) inducing such person to do or omit any action in violation of his lawful duty, (c) securing an improper advantage, or (d) inducing such person to use his influence to affect an official act or decision
 - in order to assist in obtaining or retaining business for or with, or directing any business to, any person.
- While there is a “bona fide expenditures” exception (e.g., reasonable travel and lodging expenses directly related to a demonstration of the goods), it is narrow.

#10 – EXPORT COMPLIANCE DOCUMENTATION

- Licensing:
 - Licensing is done electronically through the Commerce Department's SNAP-R licensing system, which enables exporters to submit export license applications, re-export applications, commodity classification requests, and associated supporting documents to the Bureau of Industry and Security via the Internet.
 - Go to: www.bis.doc.gov/snap/index.htm
 - Through this system, one may also:
 - Receive a license number, electronic facsimile of the license, conditions and riders (if any) to the license, etc.
 - Obtain online validations (e.g. electronic facsimile of export license) from BIS.
 - Receive same day acknowledgment of your submission.
 - Electronically attach documentation supporting license applications, commodity classification requests, etc.
 - Receive the Export Control Classification Number (ECCN) for item classifications.
 - Receive and respond to BIS requests for additional information.
- “Shippers Export Declaration” or “Electronic Export Information”:
 - Must be submitted electronically through the Automated Export System
 - Required for shipments (a) with a value in excess of \$2,500 or (b) that require an export license
 - Is used by the Bureau of the Census to collect trade statistics and by the Bureau of Industry and Security for export control purposes.
- Include a destination control statement on your documentation such as an invoice, bill of lading or air waybill, and other export documents (15 C.F.R. §758.6 for EAR items and 22 C.F.R. §123.9 for ITAR items)
- Keep a record of your compliance efforts. For example make a record of product screening compliance, destination screening, customer and intermediary screening, and end use screening. The latter three presumably will be recorded in the order entry process.
- Keep a record of your denials of improper export requests (e.g., embargoed country requests).
- Have a written system (if applicable) for protecting controlled data from improper deemed exports.
- Keep records of your anti-boycott compliance.
- Maintain an export compliance policy.
- Maintain written standard procedures for those in export-related jobs.
- Ensure quotations, acknowledgments, and invoices contain export compliance terms.
- Ensure distributor, representative, joint venture, etc. agreements contain export compliance terms.

Export Compliance Programs

- An export compliance program should have a “process” based design.
- A good export compliance program should include:
 - A company policy, promulgated and adopted by senior management, that requires strict compliance with U.S. export laws, rules and regulations.
 - Persons within the organization responsible for export compliance.
 - A screening program, as referenced above. Ensure it catches potential problems not only when the products are ready to ship, but in the sales field, at the bid stage, and especially at the order entry stage.
 - Require independent sales representatives, distributors, joint venture partners, etc. to comply with U.S. law, rules and regulations.
 - Conduct periodic training/continuing education.
 - Conduct periodic, internal audits.
 - Have written standard procedures for persons involved in the export process.
 - Retain only reputable freight forwarders and customs brokers.
 - Keep records as required.
 - Follow up any red flags. Ask more questions. If in doubt, walk away from the transaction.
 - Make export compliance part of any acquisition due diligence review.
 - Note - For companies and persons subject to ITAR regulations, see:
http://pmdrtc.state.gov/compliance/documents/compliance_programs.pdf

Section II

International Trade Best Practices and Updates

Strategic Planning: Which international trade model is appropriate?

- Foreign direct investment vs. international trade vs. international licensing of technology and/or other intellectual property – A Two-track decision process:
 - Track #1 - Five Practical questions:
 - Step #1 – What mechanism is the minimum necessary to effectively reach my target customer base in the foreign country?
 - Step #2 – Do we have overriding objectives that would compel us to utilize one mechanism over another (e.g., protection of intellectual property - > direct distribution or ensuring manufacturing of controlled technology in U.S. - controlling market pricing – direct distribution, etc.)?
 - Step #3 – Various cost vs. benefit analyses:
 - Example: Cost of extending the distribution channel vs. the benefits gained by that extension - Greater distribution expenditures = may mean higher gross margin but also higher indirect costs, while lower distribution expenditures = lower gross margin – In other words, offloading distribution functions to other entities generally means giving up gross margin to those entities.
 - Step #4 – Considering internal limitations: Available personnel, capital, management time, etc. More limited internal resources = outsource more distribution functions
 - Step #5 – Considering external limitations:
 - Legal or practical restrictions (e.g., Saudi Arabia, Malaysia, etc.)
 - Product marking or “code” limitations, etc.

Track #2 – Guide Me, Oh Wise CPA - Tax Consequences and Potential Legal Liability

- Branch - A branch has no separate legal identity, and its activities may be attributable directly to the manufacturer. It may subject the manufacturer itself to the jurisdiction of the foreign country for tax and other purposes.
- Form or purchase a foreign legal entity (foreign direct investment) - A separate entity (e.g., corporation, limited company, etc.) on the other hand, is legally distinct from its parent, and its activities in a country will not normally subject its parent company to local taxation (other than repatriation issues) or legal jurisdiction.
- Representative office - Permissible to utilize to in many countries to undertake only promotional and liaison activities on behalf of the parent company, as long as it sends sale contracts back to the home country to be executed. The representative office is not considered as being conducting business in the foreign country and, in some countries, does not trigger taxation in the foreign country.
- Joint venture with foreign company.

International Trade

Foreign Representation

Advantages of Foreign Representation:

- Effectively identify and communicate with potential customers
- Familiarity with local language, customs, and culture
- Foreign representative can obtain necessary import licenses or other approvals, clearing the goods through local customs, arranging for delivery, assisting in installation and testing, providing or arranging for service and warranty repairs, and performing other necessary follow-up services.

Risks of Foreign Representation:

- Potentially high termination costs
- If utilize distributor form, limited contact with end customers

Distributor Model vs. Representative Model vs. Agent Model

Finding Foreign Agents, Distributors or Representatives

- U.S. government sources (e.g., U.S. Dept. of Commerce's U.S. Commercial Services' Gold Key Package)
- Foreign government agencies and quasi-government agencies
- Chambers of Commerce
- Banks
- Trade publications
- Foreign trade fairs – Good place to analyze (a) presentation to customers (b) sales ability (c) English proficiency, etc.
- Inquire of existing customers and potential customers in foreign country
- Personal visits whether in U.S. or foreign country
- Caveat: Avoid competitor's intermediaries – Relationship analogy - Also, consider potential litigation from competitor.

Foreign Representation

- Contractual Legal Issues:

- Contract Products and/or Services
- Contract Territory and Contract Customers
- Exclusive or Non-exclusive Appointment – Avoid exclusivity if possible and practical
- No Competitive Activities and Activities Outside the Contract Territory (note competition law restrictions and “actively pursue” customers strategy)
- Use of Subagents and Sub-distributors
- Independent Relationship of the Parties
- Which Sales Subject to Commission - Accrual of Commissions - Commission Splitting – Timing of Payment of Commissions
- Terms and Conditions of Sale
- Choice of Law
- Choice of Forum (and possibly alternative dispute resolution)
- Duties of Agent, Representative or Distributor
- Securing Governmental Licenses and Approvals
- Compliance with U.S. and Local Foreign Laws
- Indemnification
- Intellectual Property Matters (trademarks and licenses)
- Duty Not to Disclose Confidential Information
- Term and Termination
 - Term and Renewal – Avoid Automatic Renewals
 - Avoid Indefinite Term Agreements
 - Termination Prior to Expiration and Consequences of Termination or Expiration
 - Option for Post-Termination Non-Compete Term
- Objective Performance Standards – Failing to Meet Standards are “Material” Breaches as Bases for Termination

International Sale Contract

Important Terms

- Dispute Resolution, Choice of Law and Jurisdiction
 - Litigation vs. Alternative Dispute Resolution
 - Applicable substantive law - If the parties to a contract fail to designate applicable law, the United Nations Convention on Contracts for the International Sale of Goods may be applicable.
 - Applicable jurisdiction (country) in which disputes will be heard
- Express Warranties and Warranty Disclaimers
- INCOTERMS 2010
 - Must use INCOTERMS for international trade, as they differ from U.S. UCC terms, e.g., FOB.
 - 2010 version has a reduction in the number of terms to 11 from 13. The DAF, DES, DEQ, and DDU designations have been eliminated, while two new terms, Delivered at Terminal (DAT) and Delivered at Place (DAP), have been added.
- Default Provisions
 - What constitutes default
 - What are remedies in case of default
- Basis for Termination/Cancellation
- Price, Description of Goods, Payment Terms, Duty to Pay Taxes, Delivery, Etc.
- Force Majeure
- Export Compliance

Risk Management

- Payment Security:
 - Spectrum ranging from open account to prepayment (including documentary draft, letters of credit, prepayment, government insurance programs, etc.)
- Letters of credit
 - See Uniform Customs and Practice for Documentary Credits (UCP 600)
 - Letters of credit are independent of the underlying transaction
 - Subject to the issuing bank's approval, the terms of the letter of credit are negotiable
- Insurance Through Point of Passage of Risk
- Currency Hedging and Insuring Against Nationalization and Expropriation

ABOUT THE PRESENTER

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- His areas of expertise include:
 - Agency and Distribution – Offering strategic advice regarding supply and distribution channels; distributor, representative and agency agreements; and international distributor, representative and agency termination proceedings/litigation
 - Appellate Practice - Research and drafting of appellate briefs - Admitted to the United States Supreme Court
 - Commercial Law and Contracts – Review, advisement and negotiation pertaining to commercial contracts, strategic alliances, etc.
 - Corporate Law – Coordination of business entity formation, strategic planning and continued compliance with ongoing corporate formalities requirements
 - Industrial Projects – "Cradle to grave" oversight and advice pertaining to complex commercial projects including bidding procedures, contract placement, sub-contracting, financing, government financing programs, securitization, export issues, hedging decisions, etc.
 - Intellectual Property – Offering advice and oversight pertaining to patent, trademark and licensing portfolios, as well as intellectual property lawsuits
 - International law – Extensive experience with the range of legal issues arising from worldwide business operations
 - International Trade – Offering oversight and advice pertaining to international trade policies, procedures and compliance with relevant export and import laws, rules and regulations