Illegal Diversion Emerging As Top Export Control Issue

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According to U.S. export officials, one of the most significant export control issues facing U.S. companies today is illegal diversion risk. Simply defined, illegal diversion is when your company sells a product to a foreign customer (say in the U.A.E.) and that customer resells the product without your knowledge in a prohibited country (such as Iran or Syria), to a prohibited party or for a prohibited end-use. Illegal diversion can occur most commonly in the high risk transshipment hubs such as Dubai (for diversion to Iran and Syria), China (for diversion to N. Korea), Russia (for diversion to multiple locations) and Central American countries (for diversion to Cuba), however diversion can occur in any foreign country. Illegal diversion can create significant problems for U.S. exporters, ranging from reputational damage (news story about your product showing up in markets in Iran) to enforcement actions.

The following are a number of steps that we advise for our clients to reduce potential liability from illegal diversion. This list is not complete and other steps are often added based upon the company, product and countries in question:

- Include a clause in your contract with the foreign purchaser that provides that the customer will not reexport the product from the purchaser?s country without obtaining the consent of the exporter.
- Require the purchaser to provide an end-use statement in the export contract or otherwise as part of the transaction documentation.
- Conduct a careful due diligence review of the purchaser as well as all other parties to the transaction; maintain copies of the results of this review to establish the exporter?s good faith attempts to comply with the law (this can be valuable if there is any subsequent investigation of the transaction).
- Use only freight forwarders and other intermediaries who have sophisticated export compliance processes.
- Avoid ?routed? transactions unless they are with a trusted purchaser.
- Conduct screening for: (i) prohibited parties (for all parties to the transaction); (ii) prohibited country

destinations; and (iii) prohibited end-uses.

- Communicate ECCN/EAR99 classifications and destination information to end-users, consignees, freight forwarders and other parties to the transaction.
- Use information technology to enhance your due diligence review.
- Conduct training for foreign distributors, resellers and other intermediaries regarding the legal risks from unauthorized diversion.
- Include a clause in your contact with the foreign purchaser that provides that the purchaser will indemnify the exporter from liability (including defense costs) arising from unauthorized diversion.

The Bureau of Industry and Security (?BIS?) has previously published a set of industry ?best practices? for U.S. companies to combat illegal diversion and the Directorate of Defense Trade Controls (?DDTC?) has also promulgated a list of ten ?best practices? for diversion risk for ITAR compliance. We strongly advise every exporter to adopt these practices and comply with them scrupulously. The BIS and DDTC best practices can be found at: http://www.bis.doc.gov/news/2011/bis_press08312011.htm.

This article contains general, condensed summaries of actual legal matters, statutes and opinions for information purposes. It is not meant to be and should not be construed as legal advice. Readers with particular needs on specific issues should retain the services of competent counsel. Retired partner Tom McVey was the original author of these materials. Please contact Chris Skinner for more information at 202.293.8129 or cskinner@williamsmullen.com.

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