

# Legal Issues for Aviation and Aerospace Distributors

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For  
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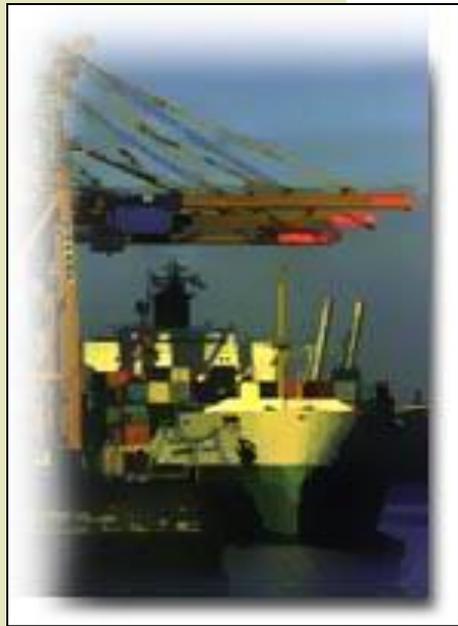
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# Agenda

- Export Controls
- Quality Control
- Distributors, Sales Reps, and the U.S. Foreign Corrupt Practices Act
- Allocating Risk Up Front

# I. U.S. Export Controls



- Everything leaving the U.S. is regulated – The only question is whether the U.S. Government must approve it....
- Commercial and Military Export Controls apply to small and large companies alike
- Do not allow sales imperative to unduly influence export, import, and other compliance analysis

## Question?

- When a distributor sells a military part or assembly to a foreign customer designed by a US OEM, the OEM is solely liable for regulatory compliance for that part or assembly.

➤ True or False?

# U.S. Export Controls

- Ensure that the Company processes and retains Critical Export Information:
  - What is the product, service or technology?
  - Where is it going?
  - Who will receive it?
    - Intermediate consignees
    - Ultimate consignee/recipient
  - Where is the ultimate destination?
  - What will be the end use?

# U.S. Export Controls

- U.S. Export Controls Screening Checklist – **(Not just for Manufacturers)**
  - Denied parties clearance
  - Does an embargo apply?
  - Commercial or military product?
    - New product development
    - Modification of commercial products
    - Agency jurisdiction?
  - Product classification
  - Do foreign policy restrictions apply?
  - License required?
  - Exceptions/Exemptions?
  - Reporting requirements? (pre or post export)

# U.S. Export Controls

- Recurring issues
  - Determining EAR/ITAR Jurisdiction
  - Deemed Export violations – ensuring that companies do not inadvertently commit an unauthorized export by disclosing technical data to foreigners while in the U.S.
  - DDTTC - To register or not to register?
  - Distributors seeking indemnification from Manufacturers?

# Foreign Brokers Still Regulated by U.S.

- December 19, 2011 – ITAR Part 129 Brokering Rules
  - Clarification, not a major narrowing of requirements
    - Still “any person” (US or foreign national) who engages in various activities, excluding strictly administrative....
  - Registration and reporting is simplified
  - But still covers “any action to facilitate the manufacture, export, reexport, import, transfer, or retransfer of a defense article or defense service... not limited to: (1) financing, insuring, transporting, or freight forwarding... or (2) soliciting, promoting, negotiating, contracting for, arranging, or otherwise assisting in the purchase, sale, transfer, loan, or lease...

# U.S. Export Control Reform?

- The U.S. export control regime is undergoing an unprecedented reform
  - 4 Singularities
    - Single licensing agency
    - Single IT system
    - Single enforcement agency
    - Single control list

# The ITAR Controls Review Process

- BIS rule focuses on review process:
  - What is inherently military?
    - 1) does it possess critical US military capabilities? and
    - 2) is it almost exclusively available from the US
    - Dropping original design intent
  - If item has both characteristics, it stays on USML
  - So, “specially designed” is narrower than current “specifically designed” standard

# Migration of USML to CCL

- Reduction of aircraft subject to Category VIII
  - Inertial navigation systems to be in Category XII or CCL
  - Certain gas turbine engines transferred to Category XIX (including turbofan and turbojet engines), whether in development, production, or inventory capable of 15,000lbs of thrust or greater
    - “Hot sections” to remain under ITAR
  - No generic aircraft parts, components, except those specially designed for certain specific aircraft (e.g., B-1B, B-2, F-15E, F/A-18E/F/G, F-22, F-35, F-117 etc.
  - Other parts, components transferred to new CCL 600-series in Category 9

## Migration of USML to CCL

- December 6, 2011 – proposed 600-series in Category 9 of CCL
  - End items identified in new ECCN 9A610
  - UAVs into 9A610.l –n
  - Parts, components, accessories, attachments specially designed for end items above – 9A610x
  - 25 specific types of commodities needing less control (only AT controls, not NS controls) – 9A610y
  - Other turbine engines to 9A619

# Satellite Controls

- November 2, 2011 (H.R.3288 proposed legislation) Safeguarding US Satellite Leadership and Security Act would end the statutory requirement since 1999 that satellite goods and technology be governed by ITAR and give the US President discretion to move items to the CCL
  - Retains bar against exports to China and usual embargoed countries
  - US share of satellite manufacturing has fallen from 75% (pre-1999) to 44% due to restrictions on licensing and foreign competition

# U.S. Export Controls

- Internal Controls - An effective Export Compliance Program
  - Employee training
    - Applicable regulations
    - Knowledge of company products/tech
    - Red flag transaction details
  - Employee empowerment without retribution
    - Empowered Official and company commitment from all levels of management
  - Internal recordkeeping and audit procedure
  - BUDGET?
  
- Come to EMCP Workshop in afternoon



# Export Controls Enforcement

- Penalties for ITAR Violations:
  - Criminal (Entities): Up to US\$1 Million
  - Criminal (Individuals):
    - Up to US\$1 Million/10 years prison
  - Civil Fines: Up to US\$500,000 and Forfeitures
  - Debarment from government contracts
  
- Penalties For EAR Violations:
  - Criminal (Entities): Up to US\$1 Million
  - Criminal (Individuals):
    - Up to US\$250,000/10 years prison
  - Civil Fines: US\$50,000
  - Denial of export privileges

## Enforcement Against Parts Resellers

- April 5, 2012 - Alpine Aerospace Corp. and TS Trade Tech, Inc. of Closter N.J. agreed to suspended civil penalties of \$30,000 and \$20,000 respectively to settle 9 ITAR violations for missile parts exports to Korean Air Force
  - Resellers of low-cost engine parts
  - 6 exports of flywheel, latch, release mechanism, loader link and other parts

# Enforcement Against Parts Resellers

- SED export number error claiming engine parts
- Failed to obtain a Non-transfer certificate
- Remedial compliance measures for 3 years, employee training, 2 external compliance audits of compliance program
- Without cooperation and remedial measures, fines could have been extreme



## Enforcement Against Individuals

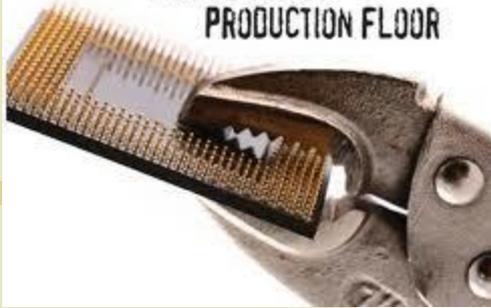
- Jason Liang, owner of Sanwave Int'l sentenced April 23, 2012 to 4 years in prison and 3 years supervised release for exporting thermal imaging cameras to China without an export license.
  - Liang argued no damage to US national security, but violations are more like strict liability, not affected by resulting effect on national security
  - Recent lessening of licenses to 36 countries did not affect China

## II. Quality Control, Standards, Counterfeiting



- Continuing issues
  - Counterfeit parts continue to increase
    - 2010 BIS report: 3,300 incidents in 2005 to 8,000 incidents in 2008
    - Other presentations on avoidance, detection, and mitigation of counterfeit parts in the supply and distribution chain

KEEPING COUNTERFEIT  
PARTS OFF THE  
PRODUCTION FLOOR



## Standards and Counterfeiting

- Quality Standards, e.g., AS 9100; 9120
- Increased contract requirement flowdowns for part quality requirements
- Increased use of QSLD
- Adoption of standards such as SAE AS5553 for electronic parts
- Private Defense contractors have teamed with the USDOJ to prosecute crimes involving sales to the US government
- MRO contractors may still have export control reporting obligations as well as parts authentication issues

# Aerospace Distributor prosecutions for counterfeiting

- Aljaff Case - Feb 15, 2012
  - Mr. Aljaff, MVP Micro in CA sentenced to 30 months prison for sales of 13,000+ counterfeit integrated circuits (design and trademark infringements) to 420 US and foreign buyers (US Navy, aerospace among others, including distributors and others in the aerospace supply chain)
  - Value of US\$140,835
  - 20 import transactions
- Stephanie McCloskey Case – Vision Tech Components Administrative Manager
  - 38 Months in prison

### III. Foreign Distributors, Sales Agents, and the FCPA



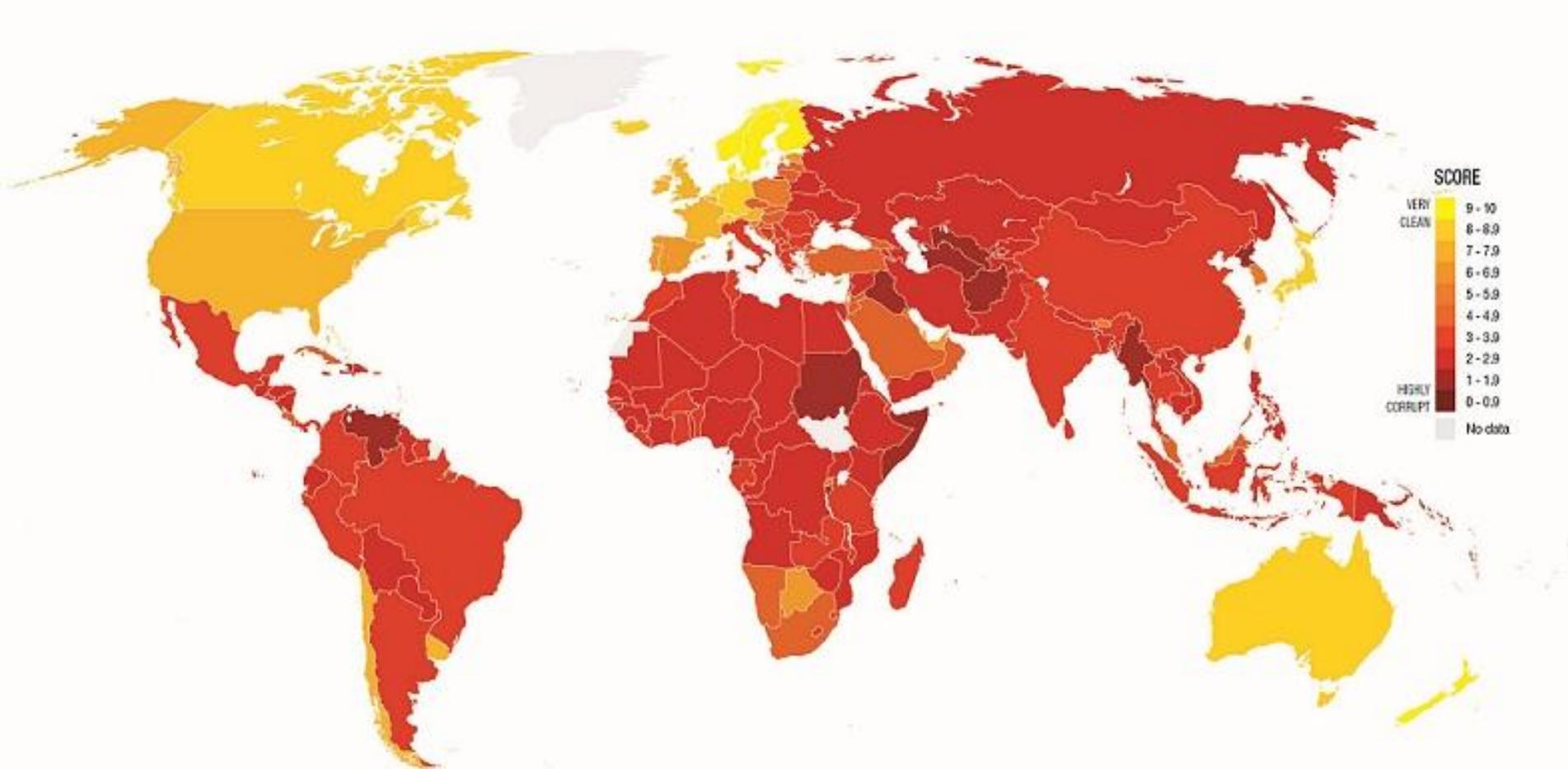
# The FCPA and Distributive Sales Model

- The US FCPA applies equally to domestic and foreign sales agents and distributors
- Monitoring, not just communication, is essential
- Compensation and expenses oversight
- Increased administrative burden
- Recordkeeping and documentation
- Corporate policy and procedure
- Need for FCPA Compliance Program

# FCPA Compliance

- To whom does the FCPA apply?
  - Any U.S. person, company or agents
  - Foreign persons committing acts in furtherance of a foreign bribe while in the U.S. **or using any means or instrumentality of interstate commerce....**
- Corrupt intent for improper purpose to influence action or inaction to obtain or retain business or gain an improper advantage
- Intermediaries
- Knowledge Standard
- Head in Sand Syndrome

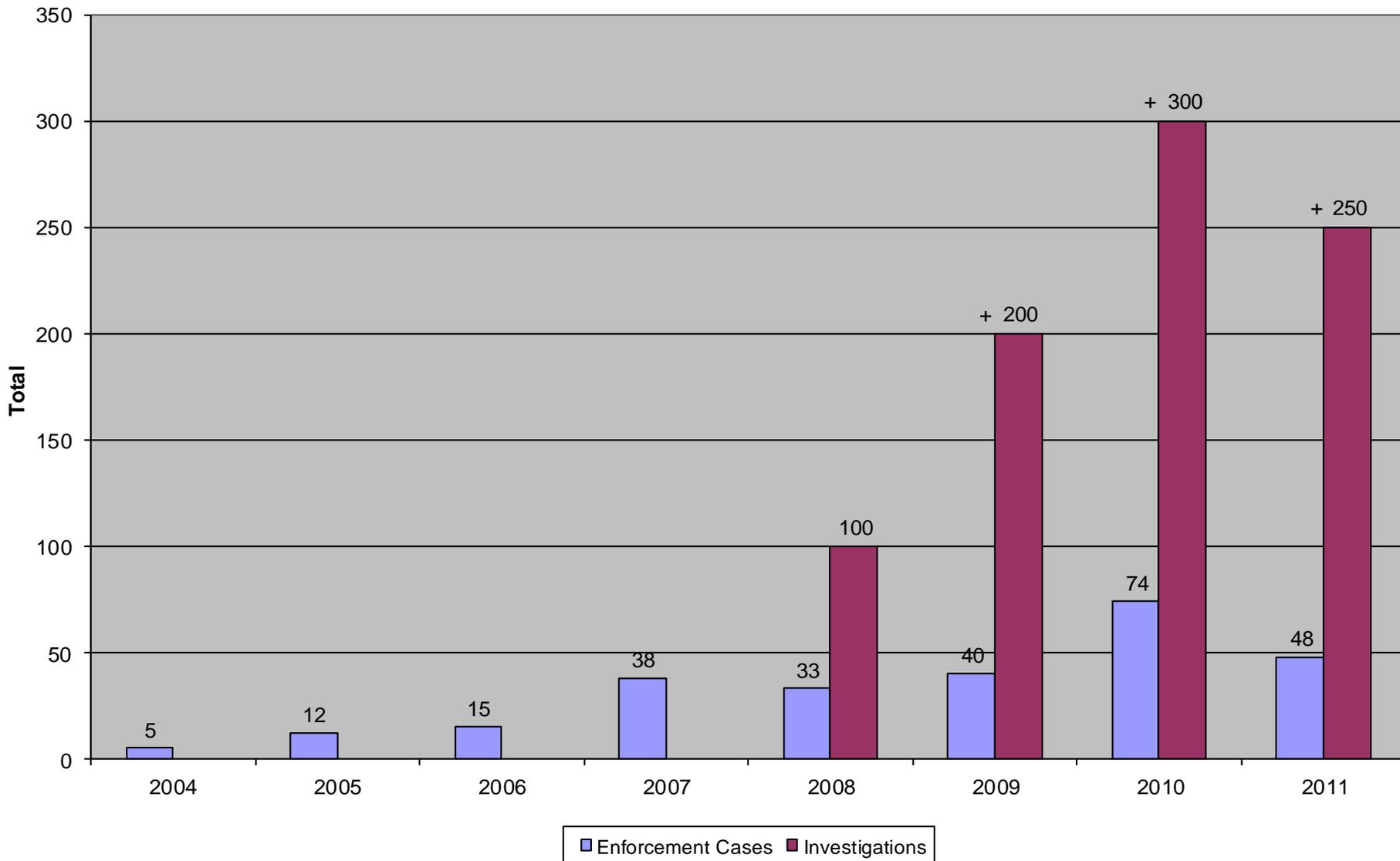
## Perceived Corruption Worldwide – Transparency International 2011



# FCPA Compliance

- FCPA enforcement trends:
  - Increased enforcement
  - Increased enforcement against foreign companies and foreign subsidiaries of U.S. companies (extraterritorial jurisdiction defined in the FCPA)
  - Increased prosecution and fines for individuals
  - Use of internal monitors (paid by the company)

## RECENT FCPA ENFORCEMENT ACTIONS



# FCPA Compliance – In-house Essentials

- Written and clearly defined corporate policies and procedures
- Implemented and repeated trainings
- Effectively disseminated to ALL domestic and foreign employees and agents
- Tailored to local risks and practices
- Gift guidelines – no cash; nominal value; legitimate business nexus
- Travel in connection with business events/demonstrations
- Donation and lobbying should be pre-approved by company compliance officer

# FCPA Compliance – In-house Essentials

- Documentation and approval procedures
  - Code of Conduct
  - Employee and Foreign Rep Due Diligence
  - Transactional Due Diligence
  - Transactional Investigation Procedures
- Compliance monitoring – Audits
- Support of top management – Consistency and genuineness
- Transparency
- Balance between pushing the edge and stepping over the line

# FCPA Compliance - Due Diligence of Foreign Reps

- Due Diligence reviews should be conducted on all 3<sup>rd</sup> party foreign reps and agents:
  - To confirm reputation, experience, and integrity
  - To determine conflicts of interest
  - To determine risk of corruption
  - For military products, to get them ITAR registered
  
- Dedicate adequate financial and personnel resources
- Apply a procedure consistently
- Use disinterested reviewers, if possible
- Routinely audit and recertify foreign reps

# FCPA Compliance – Due Diligence of Foreign Reps

- Control Components Inc. Case
- President and 5 other officers of CCI, a specialty control value seller in Cal. plead guilty to bribing officials in 36 countries
  - US\$18.2 million fine
  - “Friend-In-Camp” and “consultant” sales model
  - Sentencing scheduled for October 15, 2012
  - May 29, 2012 Dir. Worldwide Sales plead guilty; faces up to 15 months in prison
- Foreign rep, an Italian citizen residing outside the U.S., is prosecuted based on wire transfers alone

# FCPA Compliance - Penalties

- FINES ARE TYPICALLY MUCH LARGER THAN BRIBES
- Criminal Penalties
  - Up to \$2 million per violation for companies
  - Up to \$250,000 fine and 5 years in prison for individuals
  - Alternative fines equaling 2x total profit
  - Willful violations of the Books and Records provisions – up to \$25 million for a company, \$5 million and 20 years imprisonment for an individual
- Civil Penalties
  - \$11,000 per violation for individuals
  - \$11,000 per violation, plus reporting obligations for companies

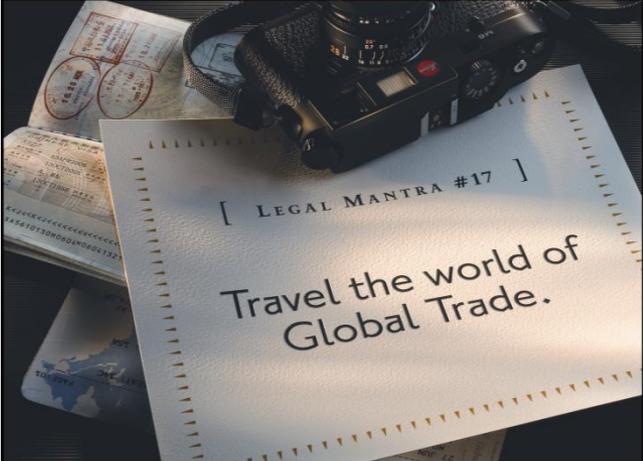
## IV. Allocating Risk Up Front

- Transaction Structure and Taxes
- A brief International Sales Checklist:
  - Who are the parties; located in what countries?
  - What are the relative tax rates in the affected jurisdictions?
  - What transaction structures facilitate the export?
    - Regional tax treaties
    - Local partnerships
    - Investing in a local branch
  - Allocate responsibilities with written sales terms

# Why Bother?

- “An ounce of prevention is worth a pound of cure....”
- It’s the law....

# Thank You.



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**Legal counsel from both sides of the brain.**

Contact Akana Ma or Ning Fu, 503-226-1191.

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