CLIENT ALERTS & INSIGHTS

Today's Compliance Risks for Global Logistics Intermediaries

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Global logistics service providers' role in international trade compliance has become increasingly critical to managing national security risk and maintaining compliance in international movements. Logistics service providers like all U.S. persons are responsible for compliance with economic sanctions and export controls, and mere participation in or facilitation of unlawful transactions - with or without knowledge - can be a violation of trade laws itself. However, logistics service providers face unique challenges. Logistics service providers do not own the materials shipped, do not select or diligence the customers, and in many cases do not have any direct contact with the goods.

Treasury Enforcement of OFAC Sanctions. The Treasury Department's Office of Foreign Asset Controls (OFAC) administers approximately 40 different sanctions programs against countries and persons. Those programs generally prohibit the transfer of property or funds, including participating in or facilitating such transfer, to restricted parties. All U.S. persons must comply, including any non-U.S. entities owned or controlled by a U.S. person as determined under the specific sanction program. A service provider's mere participation in a restricted transaction has been an area for exposure in recent years. Traffic involving Cuba and Iran have historically been a unique area of difficulty for industry due to the swift evolution of U.S. policy over the last decade.

In the last five years Russia has presented particular risk. In 2021 Russia invaded Ukraine, leading to war in Europe and swift U.S. countermeasures through numerous economic sanctions and export controls programs. In 2023 OFAC along with the US Department of Justice and the US Department of Commerce (Commerce) published a Tri-Seal Compliance Note titled "Cracking Down on Third-party Intermediaries Used to Evade Russia-Related Sanctions and Export Controls" (the Compliance Note). In 2023 and 2024 Houthi rebels began to attack ships bound for Israel leading to a new set of U.S. sanctions and export controls applicable to Iran. The Compliance Note establishes that sanctions and export control evasion occurs through US logistics service providers. Published enforcement actions in recent years include penalties against logistics service providers for amounts up to hundreds of thousands of dollars.

State Enforcement of ITAR. The Department of State's Defense Directorate of Trade Controls (DDTC) enforces the International Traffic in Arms Regulations (ITAR). Those export controls restrict the import, export, and temporary import or export, of defense articles, technical data, and defense services. The ITAR applies to any items designated on the United States Munitions List (USML) including firearms, ammunition, missiles, explosives, training equipment, military electronics, optics, and spacecraft systems. The DDTC requires registration of certain actors involved in the trade of arms, including, service providers, engaging in activities that may be considered brokering of defense articles and services. Unlawful brokering and participation with knowledge of violations

remain areas of risk exposure for logistics service providers in recent years. Published enforcement penalties range between tens of millions of dollars for knowing violations, and lesser penalties for unintentional violations.

Commerce Enforcement of the EAR. The Department of Commerce's Bureau of Industry and Security (BIS) enforces the Export Administration Regulations (EAR). Those export controls principally restrict the export and reexport of items and technology, including participating in or facilitating such export, based on item, country-specific embargoes, and end users. Items under control include any nonmilitary goods, software, or technology that are physically located in the U.S. or of U.S. origin, of foreign origin but containing more than de minimis U.S. content, or of foreign origin but a direct product of U.S. technology or software. The EAR applies to U.S. persons, but also foreign subsidiaries that are controlled, directly or indirectly, by a domestic entity. Importantly for transportation and logistics providers, one of the Ten General Prohibitions Ten of the EAR makes it unlawful to proceed with transactions with the knowledge that a violation has occurred or is about to occur. General Prohibition Ten has continued to be a specific area of enforcement against service providers in recent years.

In 2022 and 2023 President Biden began imposing stringent controls on tech exports to China, particularly in the chips and advanced computing space. BIS also prohibits shipments that will be ultimately received by a China Military End User, and publishes and regularly updates its list of prohibited China Military End Users. Recent published enforcement for BIS violations have resulted in penalties in amounts of millions of dollars with lesser penalties for unintentional violations.

Customs Enforcement. The Department of Homeland Security's Customs and Border Protection (CBP) enforces customs regulatory compliance as well as delegated enforcement functions from other government agencies. The import regulations generally allow CBP to facilitate the lawful importation of items in line with forced labor, anti-dumping (AD), countervailing (CV), and intellectual property laws. Additionally, Customs is increasingly involved in the enforcement of export controls and may seize shipments destined for international locations and destroy them. Customs laws apply to persons importing goods into the U.S. and requires that importers and their agents, such as customs brokers, use reasonable care to complete filings and documentation that CBP uses to value and collect duties. CBP collect CBP uses importer filing and documentation with import valuation to collect duties, including general duties, Section 301 duties, AD and CV duties, Section 232 duties, and any others that are implemented. While logistics service providers are not immediately responsible for many customs compliance obligations they can nonetheless bear risk to turning a blind eye. More importantly, the industry can add value to customer relationships by taking a consultative approach due to awareness of global supply chain best practices.

Compliance Best Practices and Red Flags. The penalties for violation of these and other U.S. regulatory regimes, including the Foreign Corrupt Practices Act (FCPA), anti-boycott restrictions, and even U.S. customs compliance, extend well beyond negative headlines that yield harm to commercial reputations. Significant civil penalties, criminal fines, and even jail time can follow misconduct and careless acts. There is neither a one-size-fits-all approach to international trade compliance nor any real benefit in adopting compliance programs and practices that will not be followed. Rather, the task for each transportation and logistics operator is to assess risk for the operation and tailor an appropriate program together with training and process controls. The tactical elements of a strong compliance program include: developing internal leadership and subject matter

expertise on trade controls; sticking to process fundamentals, such as denied parties screening; and watching for the gamesmanship among shippers that can cause liability for even the most well-meaning of operators.

Watching for gamesmanship is of course the front line of trade compliance risk mitigation for transportation and logistics providers. An awareness of weaknesses and "red flags" helps personnel to remain vigilant and to escalate issues where they arise. Perhaps the best example of this tactic is found in the "Know Your Customer Guidance" published by the Department of Commerce in Supplement No. 1 to Part 732 of the EAR. That guidance amounts to: (1) deciding whether "red flags" exist; (2) inquiring further if necessary; (3) avoiding self-blinding against bad facts; (4) training sales and operations staff; (5) reevaluating situations as new facts are learned; and (6) consulting with the respective agencies or counsel before proceeding if "red flags" or other risks cannot be resolved. A few important "red flags" for transportation and logistics providers to guard against as part of trade compliance programs include:

- The customer is reluctant to offer information about the end use of a product.
- The product's capabilities do not fit the buyer's line of business.
- The product ordered is incompatible with the technical level of the country to which the product is being shipped.
- The customer has little or no business background.
- Deliveries are planned for out-of-the-way destinations.
- A freight forwarder is listed as the product's final destination.
- The shipping route is abnormal for the product and destination.
- Packaging is inconsistent with the method of shipment or destination.

Remember, Voluntary Disclosures Are Available. Now more than ever international transportation and logistics moves fast and relies on technical facts, variable skills, flexibility, and visibility. Real or potential violations can arise for even the most well-meaning of operators. Agencies enforcing trade compliance violations used to have a 5 year statue of limitations. This was a relatively long period of exposure for logistics service providers moving high volumes of shipments around the world. In 2024, the lookback period of enforcement of economic sanctions was increased to a 10 years statute of limitation on nearly all programs. Companies can prepare for increased enforcement and changing programs. Now is the time to update compliance programs, train or retrain personnel, and implement meaningful corrective actions to mitigate present and forward-looking risk. When companies discover a violation they may also consider submitting a voluntary self-disclosure to the agency with jurisdiction over the matter. A voluntary self-disclosure is also not an "easy out" but it may result in meaningfully reduced penalties, or no penalties at all.

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