

BOSTON
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www.mintz.com

*One Financial Center
Boston, Massachusetts 02111
617 542 6000
617 542 2241 fax*

*666 Third Avenue
New York, New York 10017
212 935 3000
212 983 3115 fax*

*701 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
202 434 7300
202 434 7400 fax*

*11911 Freedom Drive
Reston, Virginia 20190
703 464 4800
703 464 4895 fax*

*157 Church Street
New Haven, Connecticut 06510
203 777 8200
203 777 7111 fax*

Client Alert

August 2001

BUSINESS AND FINANCE

How to Avoid Export Compliance Traps in E-Commerce

by Cynthia J. Larose, Esq.

By its very nature, the Internet is global and offers web-based businesses an easy way to reach international customers without ever leaving the U.S. of A. If your web-based business can be accessed by purchasers outside the United States, you should be thinking about export compliance issues, because, by definition, you are offering an "export." Most goods shipped outside the United States may be exported to most destinations, subject to certain limitations, without an export license. Online sellers must comply with basic export regulations to ensure that goods are not exported to unauthorized parties. The evidence on the Internet, however, demonstrates that many e-commerce sites have not considered these issues.

The E-Commerce Export Faux Pas

You don't need to be an export compliance guru to spot violations on the Internet. Many e-commerce sites use "shopping cart" functionality that permits buyers to fill in shipping and billing information on a secure site, often using drop-down menus for items such as State, Province and Country information. The next time you visit one of these sites, take a moment to look at the Country drop-down menu. If the user has the ability to choose Iran, for example, and order goods to be shipped to an address in Iran, the site may be in violation of U.S. export laws. Due to a long-standing trade embargo, any U.S.-based site should not take payment from, ship goods to, or ship goods through Iran. In the case of software downloads, you will see later in this article that eliminating the prohibited countries from such drop-down menus may not be a sufficient screen to prevent inadvertent export violations.

A random check of U.S.-based e-commerce sites reveals a startling number of sites that accept orders from Afghanistan, Cuba, Iran, Iraq, Libya, Syria, Sudan and other countries with which the U.S. has either total or partial trade embargoes or other trade restrictions. Some sites are inconsistent: the shopping cart functionality will accept payment from an embargoed country, but will not accept a shipping address in such a country. U.S. companies are prohibited from "doing business" or "engaging in trade" with embargoed countries, and that would include accepting payment from a national of one of those countries for goods to be shipped elsewhere.

It is likely that any shipment would be stopped at Customs, or that the site's fulfillment house would catch the violation and refuse to ship. Operators of the sites, however, are still in violation of the export regulations by facilitating the shipment to prohibited destinations. Over the past year, the Justice Department has been sending out letters to e-commerce sites notifying operators of the existence of export violations through their shopping cart functionality. Despite the notices, one can find any number of sites still ignorant of the regulations and existing violations.

The bottom line: U.S.-based e-commerce sites should not permit orders to be taken from prohibited countries. But, as you will find out below, the screening process must go further.

The Hidden Export Violations: Both Physical Shipment and Online Downloads of Software

We have already noted that most goods may be shipped out of the United States without an export license. There are limitations, however, and export compliance procedures in the offline world are designed to allow most exports to take place as long as the exporter has certain procedures in place to ensure that goods are not exported to unauthorized parties. Most software can be exported without restrictions under certain license exceptions.¹ These license exceptions are not unlimited; there are numerous restrictions in the export regulations.

The shipment of physical software outside the United States is a bit more obvious than the download of software from a web site. Sites should not accept orders or payment from individuals with addresses in prohibited countries and goods should not be shipped to, or transshipped through those countries. If site operators consider the consequences and take the time to audit their web sites, the functionality is readily available to prevent export violations when shipping goods.

With regard to software available through download over the Internet, Intranet sites, or subscriber or customer-only sites, the Bureau of Export Administration (BXA) has taken the position that if the seller (or web site operator) knows that anyone that may access such sites is outside the United States, then the "exporter" must treat the download of software, or mere posting of software on the site as an export.² Thus, export compliance procedures must be in place for both e-commerce software sites and restricted access sites that would permit the download of posted software by registered individuals or subscribers.

Sellers are responsible for all information received regarding buyers, including name, address, shipping addresses, billing addresses, etc., even if this information is never reviewed by a human being and is only stored on a server or routed from one computer to another without human intervention.

We have discussed the country prohibitions. Potential purchasers (or downloaders) should be asked to fill out online forms requiring information such as name, address, Internet address and other shipping and billing information. Once provided, the back-end system should incorporate a screening functionality to determine whether any of the information indicates that the potential purchaser may be in a prohibited country and the download cancelled. In the case of software downloads, once a party in a prohibited country has been denied access, the site operator (exporter) should consider steps to prevent that party from backing up and entering a false country address to obtain access to the software. Such steps could include, for example, automated back-end procedures to permanently block particular names and credit card numbers. Also, software is commercially available to enable a web site to screen IP addresses or DNS addresses originating in prohibited countries and deny access to a site. **For this reason, software providers should be particularly careful about the use of drop-down menus. It is all-too-easy for a determined downloader in a prohibited country to enter a false address from a drop-down box when no shipping address is necessary. The IP address screen is a second line of defense against such actions.**

In addition to the embargoed countries, exports may not be made to so-called "prohibited parties." The BXA has a Denied Parties List and a Denied Entities List; the Treasury Department has a Specially Designated Nationals List, and a Terrorists and Narcotics Traffickers List. All names and addresses received from a potential purchaser or downloader of software should be screened against these lists before completing the transaction. These lists are updated regularly by the responsible agencies. Commercial services and software are available to assist exporters with screening against these various lists.

¹ Encryption functionality creates entirely different export issues and compliance with the regulations applicable to the export of encryption products should not be treated lightly.

² The export rules apply whether the download is free, or at a price.

Current BXA Initiatives

Officials at the BXA will admit that exporters are not “officially” required to screen incoming orders against various governmental lists of prohibited overseas customers and they publicly acknowledge the difficulties faced by e-commerce. But, in the same breath, they will be sure to point out that there are sanctions for shipping to such end users—civil fines, criminal penalties, and a possible spot on one of those very lists with a denial of export privileges.

BXA’s export enforcement unit is reportedly working on an outreach program to assist companies with the challenges of e-commerce and export compliance. It is also reported that the Bush Administration’s BXA plans to make e-commerce export compliance “a priority.”

The Commerce Department is working with industry through its Information Systems Technical Advisory Committee (ISTAC). Bob Rarog, representing Sun Microsystems, made a presentation on export compliance challenges in the e-commerce environment to a recent ISTAC meeting. To meet the new challenges raised by e-commerce, Rarog recommended practical steps to help vendors comply with the regulations, such as standard formats for country codes and flexibility in implementing user screening. These take time and industry-wide cooperation, however, and a “quick fix” is not seen on the horizon.

Conclusion

The possibility for export violations looms large in the e-commerce environment. Young companies are ignorant of the export regulations and the applicability of those regulations to Internet sales. The lack of human intervention in e-commerce makes possible repeat violations of all export control regulations. If the first transaction with a denied party or to an embargoed country does not draw heightened scrutiny through the order process on the back-end of an e-commerce site, the chances are great that companies will not catch subsequent violations. Given the severe potential penalties for export violations and the step-up in enforcement, companies are well advised to engage in e-commerce compliance audits and implement prudent procedures to ensure compliance with export controls for their global sales.