CLIENT ALERT

This Month in International Trade - January 2014

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THIS MONTH'S TOP TRADE DEVELOPMENTS

1) Limited Sanctions Relief for Iran Remains Rife with Risk for U.S. and Non-U.S. Entities

On January 20, 2014, the U.S. Departments of State and Treasury published guidance relating to the roll-out of limited secondary sanctions relief for the Government of Iran resulting from the International Atomic Energy Agency's Report on the status of Iran's nuclear program published that same day. Pursuant to the Joint Plan of Action (JPOA) agreed upon by Iran and the P5+1 (the United States, United Kingdom, Germany, France, Russia, and China), U.S. sanctions targeting certain activities not involving U.S. persons (with limited exceptions) will be rolled back for six months, ending on July 20, 2014.

Based on informal State and Treasury Department guidance, companies are advised that (1) any activities now permissible must commence on or after January 20, 2014 and terminate before July 20, 2014; (2) there is no guarantee that the relief will be extended past July 20, 2014; and (3) remaining sanctions will continue to be vigorously enforced.

Practical Implications

For U.S. persons and U.S.-owned or -controlled foreign entities – The implementation of the JPOA has changed the sanctions landscape in only two very limited circumstances: (1) the Department of Treasury Office of Foreign Assets Control (OFAC) has published a favorable licensing policy for certain transactions intended to ensure the safe operation of Iranian commercial passenger aircraft; and (2) OFAC and other members of the P5+1 are establishing means to facilitate payments for the already licensed exports of goods pursuant to the Trade Sanctions and Export Enhancement Act of 2001.

For non-U.S. persons – Sanctions relief, while broader than for U.S. persons, is also limited and will expire (unless extended) on July 20, 2014. This limited scope will be especially problematic for companies providing services that are typically for terms longer than six months. In particular, non-U.S. insurers and reinsurers may have difficulty issuing coverage limited to the six-month period—the U.S. agencies have counseled that all claims and payments must be made within the six month window to fall within the limited relief.

Suspension of Certain U.S. Sanctions Against Iran

On January 20, 2014, pursuant to the JPOA, OFAC released: (1) a Guidance detailing the Iran sanctions that have been temporarily suspended, (2) a Statement of Licensing Policy that establishes a mechanism through which persons can request authorization to engage in transactions to ensure the safe operation of Iranian passenger aircraft, and (3) a Frequently Asked Questions designed to address certain questions companies may have.

The vast majority of sanctions targeting the Government of Iran remain in place; U.S. persons and U.S.-owned or -controlled foreign entities are still prohibited from virtually all transactions with Iran and many secondary sanctions targeting the activities of non-U.S. persons who do business with Iran remain in place. The limited, targeted, and reversible relief involves the relaxation of only a small number of secondary sanctions.

Sanctions relief will cover only activities and services (including related payments) initiated and completed during the six-month period beginning on January 20, 2014 and ending July 20, 2014. Transactions cannot involve persons that are named on OFAC's Specially Designated Nationals (SDNs) List except for those SDNs explicitly authorized in the guidance.

The following is a summary of the guidance's key provisions:

- Petrochemical Products – Secondary sanctions on the export of petrochemical products from Iran and associated services defined as any necessary service such as insurance, transportation, or financial services have been suspended.
- Auto Industry – Secondary sanctions on "the sale, supply, or transfer to Iran of significant goods or services used in connection with the automotive sector of Iran" and associated services have been suspended.
- Gold and Other Precious Metals – Secondary sanctions on the purchase or acquisition of precious metals to or from Iran and associated services have been suspended.
- Crude Oil – Secondary sanctions on exports of "petroleum and petroleum products" from Iran to the six countries currently receiving a "waiver" permitting them to import Iranian crude oil (at current levels) – China, India, Japan, the Republic of Korea, Taiwan and Turkey—and associated insurance and transportation services have been suspended.
- Civil Aviation Industry – OFAC has established a favorable specific licensing regime for applications to engage in transactions intended to ensure the safe operation of Iranian commercial passenger aircraft. OFAC has committed to reviewing these applications as quickly as possible because all licenses will expire on July 20, 2014; all licensed activity, including export, shipment, and payment, must therefore also be completed by July 20, 2014. Licensable activities include safety related inspections and repairs of Iranian commercial passenger aircraft, the exportation or re-exportation of safety related U.S.–origin spare parts, and all associated services.
- Humanitarian Relief – The United States and the other P5+1 members are working with Iran to establish a mechanism to further facilitate the payment for humanitarian goods including agricultural commodities, medicine and medical devices; tuition payments for Iranian students; and payments of dues and other obligations owed by Iran to the United Nations. OFAC has emphasized that the mechanism will not be exclusive and humanitarian transactions may continue to be processed pursuant to pre-existing exceptions and mechanisms. OFAC is informally requesting that U.S. exporters seek banking channels in the six countries that have received crude oil waivers.

For more information, contact: Cari Stinebower, Lindsay Denault, Dj Wolff

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2) Trade Legislation: TPA Update

The "Bipartisan Congressional Trade Priorities Act of 2014," which would renew trade promotion authority (TPA) for four years, was introduced in the House and Senate on January 9, 2014. Pro-trade Members of Congress and the Obama administration face an uphill battle in achieving passage of TPA—the authority to negotiate trade agreements and have the legislation implementing said agreements approved by Congress under an expedited process. The previous version of TPA expired in 2007.

The bill establishes Congress' guidance on negotiating objectives to be pursued by the U.S. Trade Representative, and also sets out consultation and access to information requirements prior to, during, and after negotiating a trade agreement. Provided that the administration meets these requirements, Congress would take an up or down vote on legislation implementing the trade agreement, with no amendments to the actual provisions of the agreement. Experts believe enactment of TPA will be crucial in enabling the U.S. to finalize current trade negotiations, notably the Trans-Pacific Partnership involving 12 Asia-Pacific countries and the Transatlantic Trade and Investment Partnership under negotiation between the U.S. and the European Union.

Looking ahead, it appears certain that Congress will see a vigorous debate over both the substantive negotiating objectives outlined in the bill and the procedural provisions defining the interaction between the Congress and the Administration during trade negotiations. New negotiating objectives in areas like currency policy have already generated controversy, and serious tussles can also be expected over intellectual property rights, agriculture, and other sensitive trade subjects. While President Obama has welcomed introduction of the TPA bill, some Congressional leaders assert that stronger leadership from the Administration will be essential to ensuring its passage.

For more information, contact: Josh Kallmer, Chris Wilson, Nancy Cruz

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3) End of First Sale for Export in the EU?

On January 13, 2014, the European Commission (EC) released a draft of the Implementing Act of the Union Customs Code (UCC) with a provision that could eliminate the use of "first sale for export" in the EU. The draft provision (Title II, Chapter 3, Value of goods for customs purposes, Transaction value) states:

> "For the purposes of Article 70(1) of the Code, the value of the goods shall be determined at the time of acceptance of the customs declaration *on the basis of the transaction occurring immediately* before the goods are declared for free circulation."

The provision would not affect importers determining the customs value of the goods based on the invoice price paid relating to the most recent (or "last") sale in the commercial chain prior to import into the EU. However, under previous interpretations of Article 1 of the Agreement on Implementation of Article VII of the 1994 GATT (commonly referred to as the World Trade Organization valuation code), importers could base transaction value on an earlier or "first" sale in the supply chain when the importer demonstrated that the earlier sale met the criteria for transaction value; that it, the first sale was a bona fide sale, conducted at arm's length and was destined for export to the importing jurisdiction. Using the first sale price as the basis of transaction value resulted in a lower declared customs value and therefore lower assessment of ad valorem duties. Most notably, the EU and the United States permitted first sale valuation. For importers utilizing first sale valuation, the EU elimination of first sale will lead to a dramatic increase in tariff spend as well as an increase in VAT expenses as VAT is also assessed as a percentage of customs value.

The proposed change to first sale in the EU is not expected to come into force prior to May 1, 2016 as the EC and EU Member States continue negotiating changes to the UCC. Importers utilizing first sale valuation should discuss alternative valuation strategies to minimize the impact of the proposed UCC changes with their trade counsel.

For more information, contact: John Brew, Dan Cannistra, Brian Gatta, Jini Koh

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4) BIS Releases Advisory Opinion Interpreting "Specially Designed" for Certain Semiconductor Items

The Bureau of Industry and Security (BIS), at the request of the Semiconductor Industry Association (SIA), posted an advisory opinion to its website interpreting the term "specially designed" as defined by the Export Administration Regulations (EAR) for multipurpose die, standard packages, and integrated circuits comprised thereof. In its opinion, BIS agreed with SIA that these items are not "specially designed" under either of two conditions. The first is knowledge that the items were being designed for use in a wide range of applications. The second is the items have the same function, performance capabilities, and the same or 'equivalent' form and fit of items already in production and in use with a wide range of applications.

In these two cases, the multipurpose die, standard packages, and integrated circuits comprised thereof are "released" from being "specially designed" as they do not meet the criteria set forth on page 35 and 36 of §772.1 of the EAR. The opinion goes on to state that if an integrated circuit comprised of multipurpose die encased in standard packages is subject to additional development activities, a separate analysis of the new "specially designed" definition in §772.1 would be required.

Because BIS is the issuing agency, this opinion applies solely to the EAR. Furthermore, BIS' opinion is fact specific and any deviation from the facts regarding these multipurpose dies, standard packages, and integrated circuits could change BIS' analysis and conclusions.

For more information, contact: Chris Monahan, Brian Gatta, Edward Goetz

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5) CITT Upholds Border Agency's Decision to Include R&D in Import Price

On January 8, 2014, the Canadian International Trade Tribunal (CITT) made public its opinion to uphold decisions made by the Canada Border Services Agency (CBSA) requiring Skechers USA Canada Inc. to include all research and development (R&D) costs within the dutiable value of goods purchased from its U.S. parent. After launching a verification audit in 2006 of Skechers Canada's 2005 imports, the CBSA concluded in March 2008 that a portion of R&D payments should be included in the price of the imported goods. In March 2013, Skechers Canada had appealed seven CBSA decisions issued in December 2012 requiring that Skechers Canada must include all R&D costs in the duty value of footwear it imported from its U.S. parent between 2005 and 2011. Skechers Canada filed proposed corrections to the Detailed Adjustment Statements issued by the CBSA in addition to requests for redetermination of these findings. The CBSA responded by requiring that the full value of the R&D payments should be incorporated into the cost of the imported goods.

According to the CITT ruling, Skechers Canada purchases all of its footwear from its sole shareholder, Skechers USA, who sets the transfer price for the sales. This price includes the factory invoice price paid by Skechers USA to third-party manufacturers, transportation costs to the United States, warehousing in Skechers USA's distribution center, and an arm's-length profit. Based on the verification audit, the CBSA believed that the duty value for the footwear imports should also include R&D payments made under the Amended and Restated Research and Development and Advertising and Marketing Cost-Sharing Agreement. This agreement distributes the costs of research, development, design, advertising and marketing activities needed to develop and maintain the brand.

The ruling also states that of the 40,000-50,000 prototype samples produced each year, about 5,000 become successful footwear styles available for sale. While Skechers Canada usually markets about 1,700 of the 5,000 styles available in a year, it is generally not involved in the footwear design process. The transfer price paid by Skechers Canada covers the costs of molds and samples when developing successful styles. However, it does not cover costs associated with overall research and design costs or unsuccessful prototype costs of Skechers USA.

Furthermore, the CITT rejected Skechers Canada's argument that R&D payments to its U.S. parent were only related to the Skechers brand, which it argued is not physically incorporated into the products and is therefore not necessary for footwear production. However, evidence revealed that the entire R&D process is necessary to design, develop and produce Skechers footwear. The CITT also rejected Skechers Canada's argument that the footwear can be sourced elsewhere than from Skechers USA.

Skechers Canada also proposed to further apportion the R&D payments so that design costs attributable to goods never imported into Canada are not added to the duty value of the imported goods. It further proposed to deduct 60 percent of the total R&D payments covering aspects such as research and conceptualization since they are not directly related to the goods. However, CITT rejected these proposals because the entire R&D process is necessary to create the successful models. The CITT also rejected Skechers Canada's proposal to divide the total R&D payments due by the entire yearly production of Skechers USA to obtain a "cost per pair" of the subsidiary's contribution. This amount could then be multiplied by the number of pairs imported annually. However, an apportionment has already been made by tying the amount of R&D payments to Skechers Canada's profits, which vary according to its imports. The primary purpose of the cost-sharing agreement is therefore to apportion the share of R&D and design process costs to each party.

For more information, contact: John Brew, Dan Cannistra, Jini Koh, Carolyn Esko

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THIS MONTH IN TRADE – OTHER NEWS

Agency Enforcement Actions

Bureau of Industry and Security (BIS)

- Pennsylvania Company Settles for $500,000 for Violations of Export Controls. Amplifier Research Corp. (Amplifier), a Pennsylvania electronics manufacturer, allegedly engaged in the unauthorized export of $3 million in amplifiers to China, India, Russia, Hong Kong, Singapore, Malaysia, Taiwan, Korea, and Thailand. BIS determined that Amplifier failed to maintain adequate oversight over its export coordinator, who regularly approved items for export without first receiving necessary licenses. Amplifier agreed to pay $500,000 to settle the charges.

- Former Connecticut Resident Indicted Attempting to Ship Military Documents to Iran. Mozaffar Khazaee, formerly of Manchester, Connecticut, allegedly attempted to ship to Iran proprietary material relating to the U.S. F35 Joint Strike Fighter program. Mr. Khazaee allegedly stole the documents from his employers, who were defense contractors. Mr. Khazaee is charged with two counts of transporting, transmitting and transferring in interstate commerce goods obtained by theft, and each charge carries a maximum prison term of 10 years and maximum fines of $250,000.

U.S. Customs and Border Protection (CBP)

- Default Judgment of $324,000 Entered Against Importer for Negligent Misclassification. Lafidale, Inc., a California company, allegedly was grossly negligent in misclassifying 46 entries of wallets and handbags. CBP calculated the duty loss to be $81,171 and sought a penalty of $324,687. Lafidale failed to respond to the action at the Court of International Trade, and the Court entered a default judgment in favor of CBP.

Securities and Exchange Commission (SEC) – FCPA

- Alcoa Resolves FCPA Allegations for $384 Million. On January 9, 2014, Alcoa Inc. and its subsidiary agreed to pay a total of $384 million to resolve DOJ and SEC allegations that a London-based consultant for the subsidiary paid $110 million in bribes to Bahraini officials to influence contract negotiations with a government-operated aluminum plant. The SEC determined that Alcoa Inc. lacked sufficient internal controls to detect or prevent the bribes.

For more information, contact: John Brew, Richard Massony, Dj Wolff

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CBP Updates Tariff Schedule Note Regarding Eligibility of Certain Imports for MPF Exemption

On January 3, 2014, U.S. Customs and Border Protection (CBP) issued a notice stating that General Statistical Note 3(c) has been updated in the 2014 U.S. Harmonized Tariff Schedule. This update indicates that goods imported under the Civil Aircraft Agreement, the Pharmaceutical Agreement or the Intermediate Chemicals for Dyes Agreement (special program indicators (SPI) "C," "K" and "L," respectively) that are the product of a country with which the United States has a free trade agreement (FTA) that provides the merchandise processing fee (MPF) exemption can be imported free of the MPF using SPI C#, K# and L#. This exemption applies even if the FTA's origination rules and imported directly rules are not met. CBP states that this change applies to all FTAs that provide the MPF exemption, which include NAFTA, CAFTA and the U.S. FTAs with Chile, Singapore, Australia, Israel, Bahrain, Oman, Peru, Korea, Colombia and Panama.

For more information, contact: John Brew, Jini Koh, Carolyn Esko

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BIS and DDTC Publish Third Set of Export Control Reform Changes

On January 2, 2014, the Department of State's Directorate of Defense Trade Controls (DDTC) and the Department of Commerce's Bureau of Industry and Security (BIS) concurrently published the third in a series of final rules amending the International Traffic in Arms Regulations (ITAR) and the Export Administration Regulations (EAR) (see 79 FR 276). These final rules become effective July 1, 2014.

This set of rules revises U.S. Munitions List (USML) Categories IV (Launch Vehicles, Guided Missiles, Ballistic Missiles, Rockets, Torpedoes, Bombs, and Mines), V (Explosives and Energetic Materials, Propellants, Incendiary Agents, and Their Constituents), IX (Military Training Equipment), X (Personal Protective Equipment), and XVI (Nuclear Weapons Related Articles).

As is the case with each set of changes, this revision also creates new 600 series Export Control Classification Numbers in the Commerce Control List for items in the categories above determined to no longer warrant USML control.

In addition to changing the categories identified above, a previously undefined term, "equipment," has been added to §121.8. This section of the ITAR currently defines end-items, components, accessories, attachments, parts, firmware, software, and systems.

For more information, contact: Jeffrey Snyder, Chris Monahan, Brian Gatta, Edward Goetz

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Investors Facing More Challenges with New Price Control Law in Venezuela

On January 23, a new "Law of Fair Prices" came into force in Venezuela. This new price control law sets a maximum profit of 30 percent and creates a price enforcement agency, which will be responsible for issuing "fair price certificates" required to access dollars through the country's currency control mechanism. It also compiles a series of measures that the Venezuelan government has been implementing in recent months to overcome last year's 56 percent inflation rate, among the highest in the world.

At first glance, the new price control law is a more rigorous and bureaucratic version of the "Law of Fair Costs and Prices" of 2011. Among other aspects, the new law creates the Superintendence for Defense of Socioeconomic Rights, replacing two consumer protection agencies that were carrying similar functions under the previous law (*Indepabis* and *Sundecop*). However, while the law of 2011 only regulated food and household items, the law of 2014 applies to all sectors of the economy. Moreover, it establishes higher penalties for crimes of hoarding or over-charging, including prison terms of up to 14 years.

Since last November, the government has been sending state officials to hundreds of businesses, forcing them to lower their prices. Recently, state inspectors visited McDonald's subsidiary offices, and the company agreed to cut the price of its Big Mac Combo in 7.5 percent. The government also inspected GM's subsidiary assembly plants in Carabobo, Venezuela, and as a result, the company was fined 535.000 *bolívares* (almost 85.000 dollars at the official exchange rate) for allegedly selling spare parts at "up to 500 percent more than cost." Days after this episode, the government signed a decree to control new and second-hand car prices.

The reason behind these measures comes from the government's strategy aimed at reducing the wide gap that currently exists between the official and parallel exchange rates in Venezuela. Under the currency control framework established since 2003, the current official values are 6.3 and 11.3 *bolívares* per dollar, while the parallel market rates are between 60 and 75 *bolívares* per dollar, *i.e.* almost ten times more. Furthermore, the lack of foreign exchange availability since 2003 has been the greatest obstacle for importers due to the government's complex and bureaucratic exchange control mechanism. As a result, importers' failure to access dollars at the official exchange rate forces them to turn to the parallel market, significantly increasing production costs.

In an attempt to eliminate the current exchange disparity, the government decided to decree the "Law of Fair Prices," putting the private sector up against the wall. Importers needing dollars access will now face an additional barrier by trying to obtain a "fair price certificate" from the new Superintendence, and the parallel market will no longer be a secondary resort. As long as the exchange control system continues to be as complex as it has been, those unable to obtain dollars at the official rate would be forced to either close their businesses or sell their products at a higher price, facing the risk of being fined for overcharging or even spending some prison time.

Nevertheless, despite Venezuela's current environment with respect to investment, the country still offers export opportunities for U.S. suppliers in certain sectors such as food processing ingredients. According to a recent report by the USDA's Foreign Agricultural Service, U.S. suppliers are seen by importers as "reliable sources in terms of volume, food, safety standards and quality," and the U.S. can provide both local and U.S. food products that are currently unavailable or insufficient in Venezuela.

For more information, contact: Eduardo J. Mathison

NYS Department of Financial Services Holds Hearing on the Potential Regulation of Virtual Currencies

On January 28 and 29, 2014, the Superintendent of the New York Department of Financial Services (NYDFS) held a public hearing on the potential State regulation of virtual currencies, including "crypto-currencies" such as Bitcoin and Litecoin. The hearings, which came fresh on the heels of a highly-publicized arrest of the founder of a Bitcoin exchange company, accused of using the crypto-currency to aid in the laundering of money for narcotics traffickers, were held in connection with the NYDFS' August launch of an inquiry into the appropriate regulatory guidelines for virtual currencies.

The hearing featured witnesses with backgrounds ranging from capital managers whose portfolios include more traditional assets, investors in virtual currency trading platforms, academics, the creator of the "Litecoin" crypto-currency as well as State and Federal prosecutors. Some of the witnesses, in particular those on the prosecution side, highlighted the particular risks posed by virtual currencies as an efficient means to launder money and process illicit transactions in a relatively anonymous manner. Apart from money laundering, some witnesses also expressed concerns relating to consumer protection with respect to the particular combination of a decentralized financial system and what has been, to this point and in particular in the case of Bitcoins, an extremely volatile asset. On the other side, witnesses highlighted the benefits of digital currencies both as a store of value free from government interference and as an efficient alternative to more established payment systems, such as traditional banks and credit card companies.

Although NYDFS Superintendent Benjamin Lawsky did not make clear what if any specific decisions the NYDFS has made concerning the future of regulation of virtual currencies, consistent with the Financial Crimes Enforcement Network (FinCEN) Director's approach, he has made it clear that there is a desire within the Department to bring the currencies into the "mainstream" though regulations aimed at stability and transparency, rather than to stamp them out or otherwise discourage their use altogether. Lawsky intimated that it remains to be seen whether the Department will seek to use existing anti-money laundering and consumer protection regulations or whether some entirely new regulatory framework would need to be created.

Whatever the decisions may be, they look to be made relatively soon as Mr. Lawsky noted that the "expectation that the information we've gathered in this fact-finding effort will allow us to put forward, during the course of 2014, a proposed regulatory framework for virtual currency firms operating in New York".

For more information, contact: Cari Stinebower, Brian Gatta, Dj Wolff

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CROWELL & MORING SPEAKS

John Brew will be speaking at the International Compliance Professionals (ICPA) Association Annual Conference on March 24, 2014 for the Bootcamp session on Customs Valuation and Assists. Crowell & Moring will be hosting a dinner on Monday, March 24, which is open to Crowell & Moring clients and friends. Please contact John Brew at jbrew@crowell.com - (202) 624-2760 if you would like to attend.

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