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First-of-its-Kind E5 Joint Guidance Prioritizes Industry Compliance to Prevent Diversion of Items Critical to Russian Weapons Systems

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On September 26, 2023, the "Export Enforcement Five" or "E5" partnership among the governments of Australia, Canada, New Zealand, the United Kingdom, and the United States issued joint guidance focused on preventing Russian diversion and foreign procurement of items critical to Russian weapons systems. The E5 partnership was created on June 28, 2023 in an effort by its member nations and the Global Export Control Coalition ("GECC")[1] to coordinate on export control enforcement issues and to address sanctions and export controls circumvention concerns. The E5's joint guidance is the first of its kind under the new partnership and signals prioritized enforcement efforts regarding the diversion of sensitive items critical to Russian weapons technology, solidifying the role of the E5 as an important compliance guidepost for exporters that operate in the defense, electronics, and technology sectors. The joint guidance also serves as a useful practical tool for companies and financial institutions in third countries – especially those outside the GECC – that will help them identify potentially risky transactions and payment flows, against which they can then take remedial action.

The E5 Joint Guidance

The joint guidance identifies 45 Harmonized System ("HS") codes for controlled items that are critical for the operation and development of Russian weapons systems and that industry should prioritize as part of diversion-prevention and related efforts. Specifically, the guidance categorizes those 45 HS codes into four tiers that include electronic components such as integrated circuits and radio frequency transceiver modules, as well as other items that are essential for the manufacturing and testing of electronic components and circuits. Of those 45 HS codes, the E5's guidance isolates nine specific HS codes that exporters should view as top priority in preventing unlawful diversion. Those nine high-priority HS codes correspond to items such as integrated circuits, microelectronics, and other electronics related to wireless communication, satellite-based radio navigation, and passive electronic components.

The joint guidance encourages exporters to conduct heightened due diligence when dealing with any of the 45 flagged HS codes in order to mitigate attempts to evade E5 export controls or sanctions regulations. In particular, the guidance enumerates several transactional patterns and attributes, which are associated with importers in non-GECC countries that the E5 have identified as signaling diversion concerns:

- The company never received exports prior to February 24, 2022;

- The company received exports that did not include any of the nine priority HS codes prior to February 24, 2022; or
- The company received exports involving the nine priority HS codes prior to February 24, 2022, but also saw a significant spike in exports associated with those HS codes thereafter.

The joint guidance recommends exporters dealing in any of the 45 sensitive HS codes identified by the E5 guidance should conduct customer and transactional due diligence prior to export. As part of that due diligence, exporters should be highly attuned to identifying and scrutinizing any of the above patterns identified by the E5. For existing customers, the guidance encourages exporters to identify and evaluate information about end users and end-uses, "red flags" including any atypical increases in the volume or value of orders, as well as any inconsistencies between the items ordered and the customer's line of business. For new customers, the E5's guidance specifically urges exporters to complete the following due diligence checks when opening accounts for new customers located in non-GECC countries:

- Evaluate the customer's date of incorporation, with incorporation after February 24, 2022 reflecting a red flag;
- Evaluate the end user and end-use of the item, including whether the customer's line of business is consistent with the ordered items; and
- Evaluate whether the customer's physical location and public-facing website raise any red flags, such as whether available addresses correspond to business or residential facilities or if no public website is available.

The E5's guidance also provides industry with a list of potential red flag indicators of export control and/or sanctions evasion that exporters should consider in tandem with conducting customer and transactional due diligence. Those new transactional and behavioral red flag indicators of export control and/or sanctions evasion include the following:

1. Transactions related to payments for defense or dual-use products from a company incorporated after February 24, 2022 and based in a non-GECC country.
2. A new customer whose line of business is in trade of products associated with the nine high-priority HS codes, is based in a non-GECC country, and was incorporated after February 24, 2022.
3. An existing customer who did not receive exports associated with the nine high-priority HS codes prior to February 24, 2022 and is now exporting or re-exporting such items to known transshipment points.
4. An existing customer, based outside the E5, received exports associated with one or more of the nine high-priority HS codes prior to February 24, 2022 and requested or received a significant increase in exports with those same codes thereafter.
5. A customer who lacks or refuses to provide details on banks, shippers, or third parties, including about end users, intended end-use, or company ownership.
6. Transactions involving smaller-volume payments, all from the same end user's foreign bank account, to multiple, similar suppliers of dual-use products.

7. Parties to transactions listed as ultimate consignees or listed in the "consign to" field who do not typically engage in business consistent with consuming or otherwise using the subject commodities (e.g., other financial institutions, mail centers, or logistics companies).

8. A customer that significantly overpays for a commodity, as determined by known market prices.

9. A customer or address thereof that is similar to one of the parties on a proscribed party or sanctions list of one or all of the E5.

As emphasized by the E5 guidance, exporters are responsible for ensuring compliance with all applicable export control and sanctions regulations, and these potential red flag indicators are critical to ensuring compliance with such regulations that cut across all five of the E5 member countries. Indeed, the E5 guidance explicitly notes that failure to comply with these compliance recommendations can result in reputational harm, challenges to doing future business, financial penalties, and/or civil and criminal enforcement actions that vary among the different enforcement regimes of the E5. We note that these risks apply not only to companies, institutions, and individuals in E5 countries, but also around the world, and in particular to those entities located in third countries which are known transshipment points for trade with Russia.

Practical Takeaways

The joint guidance explicitly sets out practical transaction attributes that companies and institutions can search for and use to mitigate the risk of unlawful diversion of the specified goods and technologies. In addition to the risk factors enumerated, companies and institutions exporting other goods subject to diversion risk may also consider using those factors in connection with a proactive risk or controls gap assessment to help identify whether existing compliance controls are adequate to catch these obvious risk factors. Companies and institutions can also use the guidance as a basis for a proactive look-back at historical transactions in the event that they perceive some risks in their historical trade since February 2022; companies with such a profile would likely be well-served to do so, as the joint guidance also clearly indicates expected enforcement activity by E5 countries around trade and financial flows with the red flag attributes identified and enforcement agencies are proactively reaching out to the business community to identify other companies involved in potential diversion of goods to Russia. Indeed, the U.S. Bureau of Industry and Security ("BIS") has put out form certifications and best practice guides reflecting the joint guidance for exporters to employ.

Conclusion

As demonstrated by the E5's joint guidance, private companies and financial institutions play a critical role in supporting their mission to prevent Russian diversion and evasion of export control and sanctions regulations. While companies can take solace in understanding that the E5's joint guidance seeks to provide unified recommendations for companies to mitigate diversion and evasion risks as that "first line of defense," companies and financial institutions will be well-served to continue to ensure individualized compliance with applicable local trade controls regulations. Failure to do so risks investigation and potential penalties, or in third-country companies' and institutions' cases, possible secondary sanctions. Nonetheless, the E5's joint guidance is a promising start to more harmonized policies regarding trade controls compliance among the member countries, particularly as the E5 continues to increase their coordinated enforcement efforts to detect, prevent, and penalize Russian diversion and evasion of export control and sanctions regulations.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

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[1] The GECC is comprised of 39 members including Iceland, Liechtenstein, Norway, Switzerland, the 27 member states of the European Union, the five members of the E5, Japan, the Republic of Korea, and Taiwan.