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What are friends for? The supply of restricted items to Chashma via China

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On November 15, 2011, Xun Wang, a former Managing Director of the Shanghai-based PPG Paints Trading Co. Ltd. (fully-owned subsidiary of the American PPG Industries based in Pennsylvania) pleaded guilty to the charges levelled against her before the federal judge at the US District Court at Washington DC. Ms. Wang has been charged with conspiring to export and re-export specially designed high-performance epoxy coatings to the Chashma-II Nuclear Power Plant (CNUPP-II) in Pakistan without requisite export licenses.[1] [1] Ms. Wang - a Chinese citizen and a permanent US resident - has been charged with one count of conspiracy and three counts of violating export laws under the International Emergency Economic Powers Act (IEEPA) and the Export Administration Regulation (EAR).

Ms. Wang was arrested on June 16, 2011 at the Atlanta airport and made her first appearance before the US District Court in Washington DC on July 7, 2011. While pleading guilty on November 15, Ms. Wang has reportedly reached a $200,000 settlement with the Department of Commerce and agreed to cooperate with investigators. Ms. Wang's arrest and guilty plea is intrinsically linked to the December 21, 2010 guilty plea made by PPG Paints Trading, Shanghai, to one count of conspiracy and three counts of acting with knowledge of a violation under various sections of the EAR and the IEEPA. PPG Industries Inc which is based in Pennsylvania and its fully owned Chinese subsidiary PPG Paints Trading which is based in Shanghai, paid a total sum of US $ 3.75 million in criminal and administrative fines and over US $ 32,000 in restitution. The amount of these fines represents one of the largest penalties imposed in the history of the Bureau of Industry and Security, US Department of Commerce for export violations.

Background

The current proceedings against Ms. Wang trace their origins to the January 2006 agreement signed between the PPG Paints Trading and the Chinese government-owned company China Nuclear Engineering Huaxing Construction Co. Ltd. to supply material to the Chinese companies working at the Chashma nuclear power plant in Pakistan. Huaxing Construction had been sub-contracted by the Chinese government owned Zhongyuan Engineering Corporation which is one of the Chinese companies involved in the construction of the Chashma Nuclear Power Plant.

However, a licence from the US Department of Commerce to export the item was necessary. This was due to two reasons. Firstly, epoxy paint and thinner was designated as EAR 99. This meant that it was not on the US Department of Commerce Control List but, was subject to regulations. Secondly, the Chashma reactor - where the item was to be used - is owned and operated by the Pakistani Atomic Energy Commission (PAEC) which is an entity on the Department of Commerce Entity list. Therefore, PPG Industries or any other organisation would require a licence from the Department of Commerce's Bureau of Industry and Security (BIS) to export any material destined to be used at Chashma.

Following the inking of the above mentioned agreement, PPG Industries submitted an application to the US Department of Commerce for a license to export the epoxy paint coatings to Chashma in January 2006. Given that the PAEC was on the Entity List, the license was denied by the BIS. Subsequently, PPG Paints Trading, Shanghai and Ms. Xun Wang (who had joined PPG Paints Trading in May 2006) were informed of this development by PPG Industries.

It is interesting to note that prior to the January 2006 agreement with the PPG Industries, the Huaxing Construction had unilaterally applied for an export license to export the epoxy paint to Chashma on five separate occasions previously. Each time its application had been rejected. The rejection of the PPG Industries application thus constituted its sixth attempt at procuring a license – either directly or indirectly – to export the paint to be used at the Chashma nuclear power plant.

Modus Operandi

Following the sixth rejection of the export license application, in June 2006, Xun Wang allegedly conspired with the Chinese government-owned Zhongyuan Engineering and Huaxing Construction to tranship the paint coatings to Pakistan via China. Ms. Wang, PPG Industries and the Chinese construction firms allegedly conspired to list Dalian Shi Zi Kou nuclear power station as the end-user.[2] [2] Given that the US conducts civil nuclear trade with China, an export license from the Department of Commerce would not be required if the epoxy paint was to be used in the Dalian nuclear power plant as opposed to the case where the paint was to be exported to Chashma.[3] [3]

Therefore, by stating the end-user as the Dalian Nuclear Plant and not Chashma-II where the paint and thinner was being used, PPG Industries between June 2006 and March 2007 exported a total of 385 gallons of epoxy paint and thinner in three separate shipments. The first two shipments amounting to a total of 360 gallons (shipped between June 2006 and December 2006) successfully reached the Chashma reactor. However, the third shipment of 265 gallons was stopped in January 2007 by PPG Industries while being stored at the PPG Paints Trading warehouse at Shanghai for onward re-shipment to Chashma.

Conclusion

As the Department of Commerce investigations have brought out, apart from the conspiracy to fudge the end-user, PPG Industries ignored several export control regulations and procedures which begin with the very signing of the January 2006 contract with the Huaxing Engineering to supply epoxy paint and thinner to the Chinese government-owned Zhongyuan Engineering Corporation working at the Chashma nuclear plant. This agreement itself went against existing US export control laws and regulations. Though it is not clearly established as to whether PPG Industries was directly involved with its Chinese subsidiary PPG Paints Trading to supply the regulated items to Chashma; some sort of tacit acceptance to turn a blind eye to the Chinese subsidiary's activities given that its future economic interests in China were at stake or at the least, weakness of the company's export control mechanisms is established beyond doubt.

There are several red flags which point to some level of complicity on the part of PPG Industries in tagging along with the supply of epoxy paints to Chashma via China. Firstly, when PPG

Industries submitted an application in July 2006, to ship epoxy paint and thinner to the Dalian nuclear power plant, it was fully aware that the paint and thinner had not received requisite clearances from the Chinese government departments and thus could not be used in any nuclear power plant in China. Secondly, the company overlooked export control regulations and procedures during the time of shipping of the product. PPG Industries instead of following the laid-down procedure of directly shipping the consignment to the Dalian nuclear power plant - which was the end user - shipped the consignment to its Chinese subsidiary PPG Paints Trading. The third incident of oversight or turning a blind eye by PPG Industries - depending on which end of the spectrum one is viewing the issue from - is regarding the timing of the order of the epoxy paint and thinner for use at the Dalian nuclear power plant. It is fairly common knowledge that as of June 2006, construction had just begun at the Dalian nuclear power plant. Pouring of concrete was to begin more than a year later around September 2007. Given that the epoxy paint and thinner have a shelf life of around a year, this should have *prima facie* been enough to raise red flags at PPG Industries regarding the end use of the shipment, thereby resulting in stopping of the shipment. However, nothing of that sort happened.

Though the role of the Chinese subsidiary, PPG Paints Trading is fairly clear and straight forward, the above indicates some degree of possible complicity on the part of PPG Industries to ship the restricted items to Chashma via China. At the very least, PPG Industries did not follow the rules and procedures laid down in the case of exporting such items. However, the worst case scenario points to possible complicity between the American company and its Chinese subsidiary to honour an agreement with an important Chinese company - Huaxing - given its connections with the Chinese government owned Zhongyuan Engineering. As brought out by a PPG employee in June 2006, failing to follow through with the agreement with Huaxing would make the chances of PPG Industries securing any future contracts in Chinese nuclear plants fairly bleak. It is therefore very much in the realm of the possible that the entire conspiracy to conceal the true end user of the consignment and tranship the products to Chashma via China was hatched by the American company and its Chinese subsidiary due to the pressure - whether direct or implied - to honour its commitment to supply the items to Chashma, the failure of which would hamper the company's prospects to do business in the lucrative Chinese nuclear construction market.

Coming close on the heels of the Chinese decision to build two nuclear power plants at Karachi as well as the continued assistance to the construction of nuclear reactors at Chashma, Xun Wang's case raises the worrying spectre of spotty Chinese implementation of and compliance with international export control regulations. The case of such blatant violation of export control laws also highlights the ever strengthening 'all-weather' friendship between China and Pakistan which continues to take new shape and forms. The Xun Wang episode also raises a much larger question; about the Chinese commitment to institutions and mechanisms like the Nuclear Suppliers Group (NSG) and the Missile Technology Control Regime (MTCR) which it is a party to.

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3. [4] Epoxy paint and thinner are categorised as 'Level – I nuclear coatings' and are tested and certified

as such by the American National Standards Institute (ANSI) and the American Society for Testing and Materials (ASTM). The Level I Nuclear Coating means that they are able to withstand the harsh environment with respect to the high temperatures and corrosion they have to withstand inside the containment area of a reactor, especially during loss of coolant during an accident like the one which recently occurred at the Fukushima Daiichi Nuclear Power Plant, Japan.

[5] The 'end-user' is a critical aspect of export control regulations as it is used to determine the controls that have to be placed on the exports. An end user can be broadly defined as the 'final recipient' of the exported goods. The term 'final recipient' is very important especially in cases where the goods are re-shipped from the consignee (first recipient).

[6] A small fraction of items which are to be exported from the US require a license from the BIS, Department of Commerce. This is based upon the item's technical characteristics, the destination, the end-user, and the end-use. Every item which has to be exported and requires a license has a specific Export Control Classification Number (ECCN) and is listed on the Commerce Control List (CCL). The CCL is further subdivided into ten broad categories (ranging from nuclear materials to propulsion systems), and each category is further subdivided into five product groups (ranging from equipment, software to technology). Some low-technology goods which are not listed in the CCL, but are still restricted, are designated as EAR 99. In many cases, EAR 99 items do not require a license to export. However, in case the end user is of concern, or for a prohibited end-use or to an embargoed country, a license from the BIS becomes mandatory. To this end, the Commerce Country List becomes important. The Country List outlines several broad "reasons of concerns" (like national security, anti-terrorism, nuclear non-proliferation etc.) based on which it can be determined whether a license is required for the export of a particular item to the country in question. For more details refer to Bureau of Industry and Standards, US Department of Commerce, "Introduction to Commerce Department Export Controls," August 2010, available at http://www.bis.doc.gov/licensing/exportingbasics.htm [7], accessed on November 23, 2011.

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