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Export Controls & Economic Sanctions Committee

This issue of the e-Newsletter is devoted to key regulatory developments from January to March 2011, including news and comment. The articles are provided by Committee members. Please follow the links below to read the full text materials.

Broad US and UN Sanctions Freeze Libyan Assets and Restrict Dealings with the Qadhafi Regime, Client Alert, Latham & Watkins LLP

Corporations Must Focus on Deemed Exports, Article, Baker, Donelson, Bearman, Caldwell & Berkowitz, PC

Commerce Revises EAR Provisions for India, Article, Navistar, Inc.

DDTC Publishes Clarification Regarding Scope of ITAR-Controlled Defense Services, Advisory, Steptoe & Johnson LLP

Encryption Alert: New Permit for Exports and Technology Transfers to EU Plus 5 Countries, Article, McCarthy Tétrault LLP

EU Libyan Sanctions Council Decision and Regulations Published, Bulletin, Bryan Cave LLP

How Best to Respond to an OFAC Administrative Subpoena, Article, Becker & Poliakoff, P.A.

New Libyan Sanctions, Bulletin, Bryan Cave LLP

New Sanctions Measures Prohibit Dealings with Corrupt Foreign Officials, Article, McCarthy Tétrault LLP

Proposed Amendment to ITAR Clarifies Definition of "Defense Services", Alert, Greenberg Traurig, LLP

Recent Unrest in Libya - Sanctions and other Legal Issues, Briefing, Freshfields Bruckhaus Deringer LLP

UN Sanctions on Libya adopted by EU and UK, Client Alert, Latham & Watkins LLP

UPCOMING EVENTS

Insights on DDTC's Proposed Rule on Defense Services - with Charles B. Shotwell, Director of the Office of Defense Trade Controls Policy

June 1, 2011
12:30 p.m. - 2:00 p.m.
Location: Arent Fox, LLP
Washington, D.C.
Format: In-Person/Teleconference

Libya Sanctions Roundtable: Dealing with US, EU, and Canadian Measures

June 8, 2011
12:30 p.m. - 1:30 p.m.
Location: TBD
Format: In-Person/Teleconference

We are seeking submissions for the next issue of the e-Newsletter!

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Remarks of Eric L. Hirschhorn, Under Secretary for Industry and Security, U.S. Department of Commerce

Delivered at Export Control Forum, Irvine, California, February 28, 2011

Good morning and welcome to BIS' Export Control Forum. Let me first thank Mike Hoffman, his staff, and the many other BIS and U.S. government colleagues who have contributed to this conference.

In President Obama, we have as forceful a top-level advocate for export control reform (ECR) as I have seen in my 30 years working in the export control field. At the President's request, Defense Secretary Gates, Secretary of State Clinton, and my boss, Secretary Locke, have directed the effort to create an export control system that is responsive to the national security, technology and commercial imperatives of the 21st Century. The Bureau of Industry and Security's (BIS) day-to-day administration of the Export Administration Regulations (EAR) needs to be considered against the backdrop of President Obama's export control reform initiative.

Last spring, Defense Secretary Gates set out the Administration's conclusion that fundamental reform is needed. "If the application of controls on key items and technologies is to have any meaning," he said, "we need a system that dispenses with 95 percent of 'easy' cases and lets us concentrate our resources on the remaining 5 percent. By doing so, we will be better able to monitor and enforce controls on technology transfers with real security implications while helping to speed the provision of equipment to allies and partners who fight alongside us in coalition operations." Moreover, he added, the current system encourages multinational companies to move research, development, and production offshore, "eroding our defense industrial base" as well as "undermining our control regimes."

This past August, the President, Secretary Locke and others discussed how the end result of addressing these critical questions would be a *single* control list administered by a *single* licensing agency operating on a *single* information technology platform and enforced by a *single* primary export enforcement coordination agency. The structural reforms require congressional action. Today, I'd like to discuss our work towards a *single* control list and a *single* IT system.

This past December, the Departments of State and Commerce issued proposed regulations to achieve two fundamental reform objectives:

- controlling items based on transparent technical parameters, which translates in export control parlance to "positive lists" that do not overlap; and
- separating items by tier, to focus controls on the most sensitive items while allowing for more flexible authorizations for relatively mature technologies that are more widely available.

The U.S. Munitions List

The most important aspect of control list reform may be making the USML a "positive" list. Currently, the USML controls many defense articles based on "design intent," in part because at one time, the majority of items used by the military were produced specifically for the military. Today, however, many – if not most technologies used by the military are developed and manufactured by the commercial sector.

Moreover, the design-intent nature of the USML is inconsistent with a predictable and transparent regulatory process-one where industry and government alike readily and objectively can determine what is controlled. The existing setup has fueled an increase in commodity jurisdiction disputes. This has resulted in many commercial systems being ruled subject to ITAR control or jurisdictional decisions being delayed, thereby impeding the competitiveness of U.S. items or, even worse, resulting in their being "designed out" of foreign end products.

Under the leadership of the Defense and State Departments, the Administration is addressing this problem by converting the USML to a positive list. On December 10, the Department of State issued a proposed regulation that would revise Category VII of the USML-Tanks and Military Vehicles into a positive list. This would focus the category's controls on truly significant military items, while moving less significant items – particularly parts and components that do not serve an inherently military function – to the Commerce Control List. The process for such moves, and for control on the Commerce Control List, will be described in detail early next year.

Last August, at the "other" Update, Secretary Locke displayed two functionally equivalent pivot blocks that hold wheel axle assemblies together. One is for use in the axle of a fire truck and can be exported to China without a license. The other is

designed for a military vehicle and almost imperceptibly different, but export that one to China and you'll end up in jail. Control for minor items whose function isn't inherently military results in needless burdens, particularly for small- and medium-sized businesses. Ameliorating such burdens, which divert the time, energy, and resources of the Government as well as of exporters, is an important aspect of the reform effort.

Concurrently with the proposed Category VII rewrite, State requested public comment on converting the remaining USML categories into positive lists. The Department of Defense has an ambitious plan for completing its work on this review in 2011. State and Defense are working diligently on this project, and the President's vision of a reformed export control system cannot be accomplished without it.

For many of the low level, widely available items that will be transferred from the USML to the CCL, Commerce jurisdiction will provide greater flexibility and a simpler structure of controls. First, ITAR registration would be eliminated for many small and medium-sized exporters if their sole ITAR items are minor elements of defense products. Second, the change in jurisdiction should eliminate many problems associated with the "see through" rule, which make certain items manufactured offshore subject to U.S. re-export control requirements if they incorporate U.S.-origin ITAR parts and components, regardless of value or importance. Third, there would be far fewer transactions requiring United States exporters to enter into and obtain complex Manufacturing Licensing Agreements or Technical Assistance Agreement to share data and services. Finally, there could be a significant reduction in the time required to determine the jurisdiction of parts and components.

The Commerce Control List

The USML is not the only focus of the Administration's attention. The existing CCL is largely a "positive" list that describes items using objective criteria but it's not wholly so. We seek to make it sufficiently "positive," clear, and precise, so that someone who isn't an expert on U.S. export controls but understands the technical characteristics and capabilities of an item can accurately determine its jurisdictional status and classification.

Public input to establish clear and objective control lists is important. The U.S. Government lacks perfect knowledge on a number of the items likely to be affected by the ECR exercise. To this end, in December BIS sought public comment on CCL entries for the purpose of ensuring that such entries are clear and based on objective facts, parameters, characteristics, and technical thresholds that are recognized and employed worldwide. This work, including public input, is needed to achieve clarity, and to avoid items from being subject to both lists unless there are specific parameters that distinguish USML or CCL control. The notice also sought information on the foreign availability of CCL items to assist the U.S. Government in further differentiation of controls by tier.

The Parallel-Tiered Control Lists

The second element of the reform exercise involves converting the USML and CCL into parallel constructed, three-tiered lists that allow the U.S. Government to focus control on the most sensitive items while establishing cascading controls on more mature and widely available items.

To implement this tiered construct, the U.S. Government has developed control list criteria:

1) Tier I items are weapons of mass destruction or are almost exclusively available from the United States that provide a critical military or intelligence advantage. These are what Secretary Gates has termed our "crown jewels."

2) Tier 2 items are almost exclusively available from regime partners or adherents and provide a substantial military or intelligence advantage, or make a substantial contribution to the indigenous development, production, use, or enhancement of a Tier 1 or Tier 2 item. These are what the U.S. Government has termed "precious metals."

3) Tier 3 items are more broadly available and provide a significant military or intelligence advantage or make a significant contribution to the indigenous development, production, use, or enhancement of a Tier 1, 2, or 3 item, or are other items controlled for national security, foreign policy, or human rights reasons.

The Government would then apply licensing policies associated with the tiers.

Licensing Policy

On December 9, BIS published the proposed rule for License Exception Strategic Trade Authorization, or STA. STA would

allow the export, reexport, and in-country transfer of specified items. It could be used only where Commerce Control List-specified license requirements would apply. There are two key elements of the proposal:

- For exports of most items on the Commerce Control List that do not require a license for statutory reasons, exports would be authorized to a group of 37 countries under the proposed license exception.
- For certain other countries, Wassenaar Arrangement "Basic List" items would be eligible for export under this exception.

The STA proposal represents the first step in implementing the President's goal of eliminating easy cases so that we can focus the Government's limited resources on items and on end users requiring greater scrutiny.

STA's reduced license requirements would be accompanied by safeguards in the form of higher walls to ensure that items are not re-exported outside eligible countries without U.S. authorization. As proposed, the safeguards would include requiring that exporters and re-exporters notify the purchaser of the safeguard requirement applicable to the license exception. Additionally, the foreign end user would have to certify its understanding and willingness to comply with such conditions. These conditions would establish a knowledge standard that is necessary to prevent potential misuse of the license exception. To ensure an understanding of STA, the Bureau has started reaching out to U.S. companies that may benefit from the license exception.

It is estimated that the proposed license exception STA has the potential to eliminate approximately 3000 individual licenses.

Related Export Control Issues

An important part of the higher wall is the new consolidated end-user screening list. The new list reduces drastically the time and cost burdens associated with having to review up to ten separate lists to screen transaction parties. The new consolidated electronic screening list includes more than 24,000 entities. Most important, exporters now can screen parties in a cost efficient manner from an up-to-date list. This should help prevent inadvertently exporting to an ITAR-debarred party, a specially designated national, a denied person, or an entity on our Entity List. The consolidated file can be downloaded from the Export Control Reform website at www.export.gov/ecr.

We are working on several other initiatives to produce a more streamlined, user-friendly system. This includes developing a single license application form that the Departments of Commerce, State, and Treasury will use and harmonizing definitions of key terms such as "technology" across the spectrum of export control and sanctions regulations.

As part of the ECR initiative, the U.S. Government hopes to clarify the meaning of the term "specially designed" as used in the CCL and the USML. We are working on harmonizing a number of definitions but "specially designed" is a priority given the frequency with which the term is used in the two control lists and the importance of adequately defining the term in order to develop two "positive" lists. The regulatory initiative to clarify the meaning of the term "specially designed" is progressing. We intend to publish a proposed rule on this subject as one of the next regulatory initiatives to come out of the ECR.

Compliance and Enforcement

License efficiencies and outreach efforts are not the entire story. Enforcement activities have a high priority in the reform program in at least three important respects. First, in November, the President signed an executive order to enhance coordination among export control enforcement agencies. The order mandates an Export Enforcement Coordination Center comprising representatives from BIS, the Federal Bureau of Investigation, Immigration and Customs Enforcement, the Intelligence Community, and military security agencies. Agencies will share information and leverage their resources to enhance compliance with export control laws and regulations.

Second, BIS will continue to make use of specific compliance tools to prevent the unauthorized export of technologies to end users of concern. We use the Entity List to target specific compliance concerns rather than apply a broader, less sharply focused set of tools. This allows BIS to use temporary denial orders, as well as additions to the Entity List, to focus attention on those who may violate our laws. The use of the Entity List has been particularly successful because the business impact of being singled out on this list will result in companies modifying their behavior or going out of business.

Third, BIS is adjusting how we penalize those who violate U.S. export controls. In the past, BIS typically has imposed penalties on *companies* involved in export violations. Going forward, where a violation is the deliberate action of an *individual,* we will consider seeking penalties against that individual – including heavy fines, imprisonment, and the denial of export privileges – as *well as* against the company. The same will be true for supervisors who are complicit in deliberate violations by their subordinates.

At the same time, we recognize that even companies that have good intentions can make mistakes. We promote the submission of voluntary self-disclosures (VSDs) in these and other instances. We view VSDs, along with robust internal compliance programs, as important mitigating factors. Given the volume of exports and re-exports that are subject to the EAR – BIS processed more than 20,000 license applications during 2010 – we rely on industry for the bulk of compliance. Your knowledge of your products, their end uses, and your customers makes you the front line troops in this important effort.

Information Technology System

We have a plan in place to upgrade our IT systems to make them more user-friendly for exporters and to leverage the resources and information of agencies across the U.S. Government.

One of the first steps we have taken to improve customer service through expansion of IT capabilities is to establish online registration for the SNAP-R licensing system. This allows an exporter to go on line to file and quickly obtain a personal or corporate information number that allows the exporter to file licenses and other requests. This approach also transfers to the exporter the responsibility to manage its account and add or remove persons authorized to have access to the system. This move will eliminate the manual and sometimes untimely processing of more than 6500 annual requests for access to our system. Amanda Simpson, my senior technical and IT adviser, and Ken Whaley will be speaking with you tomorrow about IT developments including online registration.

Conclusion

When we have implemented these actions, the Administration will have achieved what I term the three “Es”:

- Greater *efficiencies* in terms of focusing controls and investigations on those items that are the most significant in terms of providing the United States with a military or intelligence advantage, while facilitating exports to coalition partners in order to improve our interoperability.
- Increased *education* to ensure that everyone subject to our regulations knows of their existence and requirements. The effort also will help exporters understand how the changes will affect their compliance responsibilities. We are also emphasizing the adoption of internal export management and compliance programs.
- The final “E” is enhanced *enforcement,* to ensure that exporters, re-exporters, and end users comply with our regulations and use U.S.-origin items responsibly. BIS compliance personnel evaluate exports made under license or license exception to ensure they comply with the EAR. We review EAR99 transactions as well. Our enforcement agents are increasing their presence domestically and abroad. We have new export control officers in China and Singapore, and will leverage the resources of the FBI and ICE as participants in the Export Enforcement Coordination Center. Finally, we will continue to use all the law enforcement tools at our disposal, including the Entity List and temporary denial orders, to inhibit illicit trade in controlled items.

My remarks today underscore the unprecedented commitment of the Obama Administration to export control reform. Thank you again and I look forward to hearing your feedback and ideas.