

Export Control Reform Initiative: The Obama Administration Proposes New Transition Rules For Companies Affected By Recently-Proposed Changes to the Current Export Control System

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First launched in August 2009, President Obama's Export Control Reform Initiative has proposed a number of changes designed to streamline and reduce the burdens imposed by the current U.S. export control system, which is administered by multiple federal government agencies through complex export control regulations and licensing regimes. Ultimately, the Export Control Reform Initiative seeks to create a single, unified list — the "Single Control List" — that will identify, classify and govern all items subject to U.S. export controls.

In the latest chapter of these on-going efforts, the Directorate of Defense Trade Controls (DDTC) of the U.S. Department of State and the Bureau of Industry and Security (BIS) of the U.S. Department of Commerce have now proposed transition plans to handle various issues that will arise from the proposed transfer of certain items with military applications from the U.S. Munitions List (USML) to the Commerce Control List (CCL).¹ The agencies have also jointly proposed a single definition of the term "specially designed" which will apply to the classification of certain items under both the USML and the CCL.²

All companies involved in the design, manufacture, sale, export, and re-export of items covered by the USML and CCL should be aware of these changes and begin to prepare now to ensure that the transition to the new export control regime is as smooth as possible. Waiting for the proposed rules to be finalized before assessing their impact on business operations and export compliance procedures may have significant negative legal and commercial consequences.

I. Export Control Reform Initiative

Currently, under the International Traffic in Arms Regulations (ITAR), DDTC has primary responsibility for controlling exports of items with military applications that are identified on the USML. Pursuant to the Export Administration Regulations (EAR), BIS administers the CCL, which identifies and classifies numerous commercial and dual-use items that are also subject to export controls. Since the announcement of the Export Control Reform Initiative, DDTC and BIS, in conjunction with the U.S. Department of Defense, have been working to revise the USML and CCL so that they can be merged into a single "positive" list. The first step in this process has involved an evaluation of all items on the current USML and CCL according to objective, technical parameters. As this review continues, the agencies have been gradually issuing proposals to move certain items that do not perform an inherently military function or otherwise provide a critical military or intelligence advantage from the USML to a newly created "Commerce Munitions List" within the CCL.³

- 1 See *Export Control Reform Transition Plan*, 77 Fed. Reg. 37346 (Dep't State June 21, 2012) (proposed policy statement); *Proposed Revisions to the Export Administration Regulations: Implementation of Export Control Reform; Revisions to License Exceptions After Retrospective Regulatory Review*, 77 Fed. Reg. 37524 (Dep't Commerce June 21, 2012) (proposed rule).
- 2 See *Amendment to the International Traffic in Arms Regulations: Definition for "Specially Designed"*, 77 Fed. Reg. 36428 (Dep't State June 19, 2012) (proposed rule); *"Specially Designed" Definition*, 77 Fed. Reg. 36409 (Dep't State June 19, 2012) (proposed rule).
- 3 To date, the agencies have issued USML to CCL proposals relating to items in Categories V, VI, VII, VIII, IX, X, XIII, XIX and XX of the current USML.

According to these proposals, items moved to the Commerce Munitions List on the CCL will be designated with a new “600 series” export control classification number (ECCN). With certain exceptions, a license would be required to export or re-export the “600 series” items to all countries except Canada. The proposals would also create a new paragraph “y” for certain “600 series” items that will require a license for export to the People’s Republic of China (PRC) for certain military end uses. In addition, a general policy of denial of export licenses will apply to all “600 series” items that are destined for export to a country subject to a U.S. arms embargo.

The proposed rules have further detailed how parts, components, and accessories and attachments will be handled. Specifically-identified parts, components, and accessories and attachments will be listed in the “600 series” next to the end item to which they are most directly related. Generic parts, components, and accessories and attachments will be classified under a new paragraph “x” of an item description if, for example, they were “specially designed” for the relevant item.

II. Single Control List: Transition Plans

Classification changes proposed under the Export Control Reform Initiative present challenges for companies from a business and compliance perspective. The latest transition plans issued by DDTC and BIS are designed to address these challenges and provide for an orderly transition to the new classification system. Specifically, these transition plans seek to minimize disruptions to existing export licenses (including agreements) by establishing a number of ground rules.

A. Transition Rules for ITAR Licenses, License Applications and License Amendments

Once each proposed transfer of an item from the USML to the CCL becomes final, the affected item will be subject to the EAR. Under the transition plan announced by DDTC, licenses issued and agreements (*i.e.*, Technical Assistance Agreements, Manufacturing License Agreements and Distribution Agreements) previously approved by DDTC will remain valid until they expire or are returned or amended, or for a period of two years from the effective date, whichever occurs first. Any limitation, proviso or other requirement imposed on such DDTC licenses and agreements will remain in effect until such time. License applications for items transitioning to the CCL that DDTC receives prior to the effective date of a proposed change to an applicable part of the USML will be adjudicated up until the effective date of the proposed change, unless the applicant requests that the application be Returned Without Action. License applications and amendment requests that DDTC receives within 45 days after the final rule’s publication but before the effective date will be adjudicated when the applicant provides a written statement certifying that the export or temporary import will be completed within 45 days after the effective date. The validity period for such licenses and amended licenses will be limited to 45 days after the effective date. Agreements and amendments to agreements that DDTC receives after the final rule’s publication, but before the effective date, will be Returned Without Action if they contain both USML and CCL items. Further, such agreements must be terminated if all items subject to the agreement are transitioning to the CCL.

Non-U.S. consignees or end users with items that have transitioned from DDTC to BIS jurisdiction must comply with the EAR for subsequent re-exports or transfers. During the transition periods, non-U.S. persons or U.S. persons abroad that have USML items in their inventory should continuously review both the USML and the CCL to determine the proper jurisdiction.

B. ITAR Registration

Under the ITAR, manufacturers, exporters and brokers are required to register with DDTC if their activities involve USML defense articles or defense services. In its proposed transition plan, DDTC reminds registered manufacturers, exporters, temporary importers, defense service providers and brokers (registrants) that they are required to notify DDTC in writing whenever they are no longer in the business of manufacturing, exporting or brokering USML defense articles or defense services, including as a result of their products being transferred from the USML to the CCL. Registrants who determine that all of their activities will be subject to BIS jurisdiction must nevertheless maintain registration with DDTC until the applicable transition date. Registrants who determine they will no longer be required to register with DDTC as a result of a transfer of their product to the CCL, and who have registration renewal dates that occur after publication of the final rule implementing the transfer but before its effective date, may request to have their registration expiration date extended to the effective date of transition. Such registrants will not be charged a registration fee. Registrants that avail themselves of the opportunity to continue using previously issued DDTC authorizations and agreements for items that have transitioned to the CCL must maintain current registration with DDTC, which includes payment of registration fees.

C. Broadening of EAR License Exceptions Consistent With ITAR Exemptions

In the course of its analysis of the proposed changes to the USML and CCL, BIS discovered that exemptions under the ITAR for some items were broader than license exceptions under the EAR. Accordingly, BIS's proposed transition rule seeks to harmonize the provisions of several EAR license exceptions with several ITAR exemptions (but does not apply to the scope of license exceptions available for items controlled for Missile Technology). The proposed EAR license exception changes are detailed and complex. Below are a few sample highlights:

- **License Exception TMP** would allow the temporary export of a specified item to a U.S. subsidiary, affiliate or facility abroad in any country (except a terrorism supporting country) without an export license. It would also allow a shipment originating in Canada or Mexico that incidentally transits the United States en route to a delivery point in the same country without an export license;
- **License Exception RPL** would allow the export of replacement parts for defense articles on the Commerce Munitions List, which were lawfully exported, without an export license;
- **License Exception GOV** would allow, in specified circumstances, the export, re-export and transfer without an export license of "600 series" items consigned to non-governmental end users (e.g., U.S. government contractors) acting on behalf of the U.S. government;
- **License Exception TSU** would allow training information related to a defense article on the Commerce Munitions List, which was lawfully exported, to be exported to the same recipient without an export license; and
- **License Exception STA** would specify that the use of this exception for "600 series" items is available only when all non-U.S. parties to the transaction (e.g., the purchaser, intermediate consignees, ultimate consignees, and end users) have previously received U.S. items under a license issued by DDTC or BIS. For purchasers, intermediate consignees, ultimate consignees and end users that have not been so vetted, a license would be required even for STA-eligible items.

D. Lengthening BIS License Validity Period

In its transition plan, BIS proposes to extend the validity period of its export licenses from two years to four years (consistent with the validity period of DDTC export licenses). Exporters may also request an extended validity period beyond four years. Grounds for requesting an extension include having agreements previously approved by DDTC for a longer period of time.

E. Notifications

Under BIS's proposed transition plan, the EAR will now include provisions requiring BIS to provide a certification to Congress prior to the approval of exports of major defense equipment (*i.e.*, any item of significant military equipment having a nonrecurring research and development cost of more than \$50 million or a total production cost of more than \$200 million). Exporters of major defense equipment that meet this dollar threshold will need to notify BIS of such transactions for all exports except those made under License Exception GOV.

F. De Minimis Rule for "600 Series" Content Items

This aspect of BIS's proposed transition plan has particular significance for companies that manufacture items overseas which incorporate U.S. origin items. For "600 series" content items, BIS has proposed a *de minimis* level of 0 percent for countries subject to U.S. arms embargoes, which reflects the ITAR's "see through rule," and 25 percent for all other countries. In addition, foreign-produced items that (i) meet any of the "600 series" ECCN classifications and (ii) are direct products of either U.S.-origin "600 series" technology or a plant that is a direct product of U.S.-origin "600 series" technology would be subject to the EAR when re-exported to certain countries of concern or to countries subject to a U.S. arms embargo.

G. PRC Military End Use

BIS's proposed transition plan confirms an earlier proposal whereby "600 series" items, including "y" items described in a "600 series" ECCN, may not be exported, re-exported, or transferred to the PRC without a BIS license.

H. Automated Export System Threshold Changes

Currently, exporters enter information for both ITAR- and BIS-controlled transactions into the Automated Export System (AES). Many exports worth less than \$2,500 are exempted from the requirement to enter information on the transaction into AES. The proposed transition plans remove the low-value exemption for "600 series" items for all destinations, including Canada, and requires AES filings for all "600 series" items, regardless of value. In addition, the proposed rule requires AES filings for all exports under License Exception STA, regardless of value.

III. Single Control List: Definition of "Specially Designed"

Concurrently with the transition plans discussed above, DDTC and BIS have also proposed a single definition of the term "specially designed" that will apply to the USML, the proposed "600 series" and the rest of the CCL. Comments on the proposed definition are due by August 3, 2012.

As discussed above, an overarching goal of the Export Control Reform Initiative is to simplify the export control system. To that end, DDTC and BIS have been looking into creating a "positive" list that would control items according to objective technical parameters instead of the current "design-intent"

approach. But as DDTC and BIS have acknowledged, completely eliminating design-intent based controls as part of a transition to a positive list is simply not feasible. For instance, the term “specially designed” is used widely throughout the CCL, as well as in the control lists of multilateral regimes to which the United States is a signatory. Consequently, through the new rules, DDTC and BIS have proposed a new, single definition of “specially designed” to apply throughout the EAR and the ITAR.

DDTC and BIS have coordinated their efforts to arrive at a unified definition through a so-called “catch and release” methodology. That is, the definition first attempts to “catch” a fairly broad swath of items that, as a result of “development,”⁴ (i) have properties peculiarly responsible for achieving or exceeding the performance levels, characteristics, or functions described in the relevant USML or CCL category, (ii) are required for a USML or CCL listed item to function as designed or (iii) are used with a USML or CCL listed item to enhance its usefulness or effectiveness. It then exempts or “releases” certain items if they, for example, (i) are enumerated elsewhere in the USML or CCL, (ii) are parts that are commonly used in multiple types of commodities not enumerated in the USML or CCL (*e.g.*, screws) or (iii) were or are developed for civil applications.

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In short, the Export Control Reform Initiative seeks to simplify the export control regime and minimize the compliance burden on companies by, among other things, simplifying and coordinating existing controls and creating “positive” lists of items subject to U.S. export controls. The latest transition plans proposed by DDTC and BIS seek to minimize the uncertainties caused by these changes for both the agencies and affected companies. Given the complexity of the reforms (as evidenced in the proposed transition plans) and the potential compliance risks involved, companies should not wait until they are finalized to assess their impact and should start preparing for the adjustments that may be necessary.

4 According to the proposed rules, the term “development” is related to all stages prior to serial production, such as: design, design research, design analyses, design concepts, assembly and testing of prototypes, pilot production schemes, design data, process of transforming design data into a product, configuration design, integration design, layouts.”