

US Government Announces Reforms to Space and Satellite Systems Export Controls

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On May 13, 2014, the U.S. State Department's Directorate of Defense Trade Controls (DDTC) and the U.S. Commerce Department's Bureau of Industry and Security (BIS) issued interim final rules amending the U.S. export controls on satellites, spacecraft systems and related parts, components, technology, software and services. Companies making satellites and spacecraft systems, as well as those that produce and sell microelectronics and any of the hundreds of thousands of other items encompassed by the new rules, will want to update their compliance procedures, licenses and business planning to account for this significant change in the U.S. export control regime. Investors in the U.S. electronics, aerospace and defense sectors also will want to factor these changes into their due diligence efforts to identify and avoid the potential for successor liability.

The new rules move a wide range of items from the more restrictive U.S. Munitions List (USML) (subject to DDTC jurisdiction under the International Traffic in Arms Regulations (ITAR)) to a new "500 series" category within the Commerce Control List (CCL) maintained by BIS under the Export Administration Regulations (EAR). Such items will become subject to the end-user, end-use and country-based controls of the EAR, and licensing and enforcement jurisdiction will shift from DDTC to BIS. Items with various space-related military functions, sophisticated sensors, certain satellite integration and launch services, and most types of manned spacecraft will remain subject to the ITAR under Category XV of the USML.

Items that will transition from the USML to the CCL under the new rules include certain commercial communications satellites and remote sensing satellites and probes and rovers for planetary and interplanetary science and exploration. In part, this transition reverses the move in the late 1990s that put licensing jurisdiction over commercial satellites in the hands of DDTC in response to concerns over improper release of U.S. satellite technology to China. Many in the industry have blamed that move for reducing U.S. competitiveness, as foreign buyers increasingly turned to "ITAR-free" alternatives to U.S. satellite technology. Importantly, however, items that transition from the USML to the CCL under the new rules will remain subject to stringent end use controls, including prohibitions on their export, re-export and transfer to China and embargoed countries such as Iran and North Korea (even when the U.S.-origin items constitute only a small fraction of the overall finished product or system).

With one exception, the new rules will become effective on November 10, 2014, following a 180-day transition and comment period. The single exception applies to certain radiation-hardened microelectronic circuits and other microelectronic circuits (as well as directly-related technology and software) "specifically designed or modified" for spacecraft and satellite use. The new rules that apply to these items will become effective on June 27, 2014. According to BIS and DDTC, this faster implementation period is in recognition of the fact that "[m]icroelectronic circuit development has advanced to a stage where manufacturers are concerned that the next generation of purely commercial microelectronic circuits may meet or exceed" the current limits under the USML, resulting in new controls on these commercial items. In light of the significance of the new rules and the many potential unanticipated issues that could arise following their implementation,

both DDTC and BIS have stated that they anticipate additional changes in the months ahead and welcome formal comments on the interim final rules as well as feedback and questions submitted through the advisory opinion and licensing processes of each agency.

Failure to account for these new rules can result in significant civil and criminal penalties and loss of business. Under the ITAR, DDTC may impose civil penalties of up to \$500,000 per violation and may prohibit exports and participation in government contracting for a period of three years or more. Since each individual export, re-export or transfer may be charged as a separate violation, civil penalties under the ITAR can quickly add up to the many millions of dollars for transactions involving multiple items or shipments. In addition, willful violations of the ITAR can result in criminal fines of up to \$1 million per violation, imprisonment of up to 20 years, or both. Violations of the EAR also can result in both criminal penalties of \$1 million per violation and up to 20 years' imprisonment and civil penalties of the greater of \$250,000 or twice the amount of the transaction involved in the violation. It is common for BIS to charge each export or other transaction as a separate violation, leading to civil penalties in the millions of dollars. Like DDTC, BIS may prohibit violators from participating in export transactions for periods of several years or more.

Given the scope of U.S. export controls on satellite and space systems, the compliance risks involved and the numerous changes that have resulted from the latest rules, U.S. exporters, their overseas partners and investors in the electronics, aerospace and defense industries will need to continue to be vigilant to avoid potential liabilities. We encourage you to contact any of the attorneys listed here or your regular Skadden contact with any questions specific to your situation or business.