

## E-ALERT | Foreign Trade Controls

December 16, 2010

### U.S. EXPORT CONTROL REFORM DEVELOPMENTS

The Obama Administration last week took a number of significant steps toward achieving the goals set out earlier this year in its Export Control Reform Initiative. On December 9 and 10, respectively, the Department of Commerce, Bureau of Industry and Security (“BIS”) and the Department of State, Directorate of Defense Trade Controls (“DDTC”) issued proposed rules and requests for public comment concerning revisions to the two export control lists they administer – the Commerce Control List (“CCL”) of the Export Administration Regulations (“EAR”) and the U.S. Munitions List (“USML”) of the International Traffic in Arms Regulations (“ITAR”). Revising the control lists, which the Administration hopes to complete by the end of 2011, is central to the Administration’s reforms and would have a sweeping impact on exporters.

The *Federal Register* notices issued last week and analyzed below seek comment on:

- **Plans to revise the USML** to make it a “positive” list based on objective criteria, similar to the CCL, and also to divide it according to the Administration’s proposed three-tier control framework;
- **A proposed overhaul and streamlining of USML Category VII** (Tanks and Military Vehicles) as the first application of the new tiering approach; and
- **Plans to revise the CCL** to make the list clearer, more “positive,” and “tiered” according to the same three-tier framework.

Comments on the proposed CCL revisions are due February 7, 2011, and comments on the proposed USML revisions are due February 8, 2011. Clients may want to take this opportunity to comment on the Administration’s reform efforts to date and to contribute their technical expertise to the control-list revision process. As discussed below, the nature of the comments requested could pose certain challenges, but we are well-positioned to assist clients and groups of clients within particular industries in formulating strategies and comments in response to the agencies’ notices.

The proposals come in the midst of two other noteworthy trade control developments, which will be the subject of a future E-Alert from our Firm:

- The publication by BIS of a **proposed rule** to establish a new license exception, Strategic Trade Authorization (“STA”), that would allow license-free transfers of certain dual-use items to many destinations; and
- The launch of a government-wide, consolidated electronic list for screening entities that are sanctioned or are subject to special export requirements, which is available on a new Export Control Reform Initiative webpage at <http://www.export.gov/ecr/>.

## OVERVIEW AND ANALYSIS OF REFORM PROPOSALS

The Administration's four-part effort to implement a new U.S. export control system involves: (1) the creation of a single control list; (2) administered by a single agency; (3) using a single information technology platform; that (4) is enforced by a single export enforcement agency. The proposed rules analyzed and described in this alert are important preliminary steps to the eventual creation of a single control list that would combine the CCL and USML.

The proposed amendments to the USML are intended to streamline the list to protect a smaller number of more important, highly-sensitive military items; items that do not meet the USML standard will be notified to Congress and then transferred to the Department of Commerce for consideration of the appropriate level of EAR controls to be applied, if any. Guidelines governing how items moved to the jurisdiction of the EAR would be controlled will be addressed in a future Department of Commerce notice. However, the Administration has indicated that it anticipates that many items that will be removed from the USML will be deemed to be non-sensitive EAR99 items or will be only lightly controlled and exportable to many destinations without a license.

Until a single list can be created, State and Commerce will continue to administer and enforce separate lists. These separate lists will be revised and realigned, and will be distinguished by a "bright line" that is drawn between the two lists "based on national security concerns." Jurisdiction of items – whether USML or CCL – will be determined by whether they meet specific technical or objective criteria in one list or the other.

Significantly, as further discussed below, the notices make clear that the "bright line" will no longer be drawn based on design intent, which is a key criterion for determining export control jurisdiction under current regulations. Today, items that are specifically designed, developed, configured, adapted, or modified for a military application are controlled by the ITAR, and dual-use commercial items are controlled by the EAR.

Under the new approach of making both the USML and CCL "positive" lists, technical characteristics and performance would govern control status, with the result that some items specially designed or modified for military use might nevertheless fall off the USML because they do not meet the performance criteria. At the same time, as DDTC's notice regarding revisions to the USML also confirms, items that meet or exceed the established technical parameters of the revised USML categories could be ITAR-controlled even if they were designed for purely commercial purposes. This outcome may follow naturally from a "positive list" approach, but it also has the potential to subject to ITAR control for the first time certain items that were not designed, developed, configured, adapted, or modified for a military application and end-items into which those newly-ITAR-controlled items are integrated. In addition, the move to a detailed, highly-technical positive list raises questions about how State will stay abreast of changing technology so as to ensure appropriate levels of control while also protecting U.S. national security from new and emerging threats.

The notices outline the framework for the three-tier system that would be applied to each of the lists. The primary criteria for determining the appropriate tier for an item are (a) the degree to which the item provides the United States with a military or intelligence advantage and (b) the availability of the item outside of the United States, its close allies, and multilateral export control regime partners. The public is invited to provide the agencies with information about each of these factors.

Applying the new criteria, the CCL and USML will each be split into three tiers:

- **Tier 1** - Items that provide a “critical” military or intelligence advantage to and are available almost exclusively from the United States, as well as weapons of mass destruction (“WMD”); WMD-capable unmanned delivery systems; and plants, facilities, or items specially designed for producing, processing, or using WMDs, special nuclear materials, or WMD-capable unmanned delivery systems. Release of such “crown jewels” would cause a “grave threat” to national security.
- **Tier 2** - Items that provide a “substantial” military or intelligence advantage to the United States and are available almost exclusively from our multilateral export control regime partners or adherents, or items that make a substantial contribution to the indigenous development, production, use, or enhancement of a Tier 1 or Tier 2 item.
- **Tier 3** – Items that provide a “significant” military or intelligence advantage to the United States and are more broadly available, or that make a significant contribution to the indigenous development, production, use or enhancement of a Tier 1, 2, or 3 item, or that are controlled for national security, foreign policy, or human rights reasons.

## ADVANCE NOTICE OF PROPOSED RULEMAKING - REVISIONS TO THE USML

The broader of the two DDTC notices provides details on the U.S. government’s methodology for revising USML Category VII (as discussed below) and also solicits public comment on the remaining categories of the USML (excluding Categories XVII (Classified) and XXI (Miscellaneous)). DDTC requests that comments focus on (1) describing defense articles in specific and technical ways; (2) determining what tier of control should be applied to each defense article; and (3) stating and explaining what defense articles do not fall within the scope of any of the tiers.

Public comments should follow the steps and guidelines listed below and use the revised Category VII as a guide for the level and type of detail the U.S. Government is seeking:

**Step 1:** Provide comments on a category-by-category basis. Due to the scope and complexity of the control lists, 18 separate interagency technical teams will be working to revise the lists of defense articles and, to the extent necessary, dual-use items that are controlled for export.

**Step 2:** Provide input following the new proposed structure of the USML. The Administration proposes to revise the structure of the USML to track the A through E structure of the CCL along with additional F and G groups to address ITAR-specific defense service and manufacturing controls. Each USML category therefore will be divided into seven groups: (A) Equipment, Assemblies, and Components; (B) Test, Inspection, and Production Equipment; (C) Materials; (D) Software; (E) Technology; (F) Defense Services; and (G) Manufacturing and Production Authorizations. Comments are not requested on groups F and G at this time.

**Step 3:** Describe defense articles in a “positive” way. DDTC has provided the following guidelines for submitting comments that will make the revised USML a “positive list”:

1. Use objective criteria and thresholds, including technical descriptions and parameters. Subjective or discretionary terms such as “design-intent” or “ultimate end-use” should be avoided.
2. Specifically identify items and avoid descriptions that refer to general “parts” or “accessories.” Similarly, do not use generic standards such as “capable for use with” a defense article, has a “military purpose,” or is “predominantly used” in military applications.

3. Items will not be on both the CCL and the USML unless specific technical or objective criteria distinguish between when an item should be USML-controlled or CCL-controlled.
4. Because the current review efforts pertain only to unclassified information, where technical characteristics are classified, the objective descriptions of products should be set at an unclassified level.
5. Use the term “specially designed” only when required by multilateral obligations such as the Wassenaar Arrangement or when no other reasonable option exists.

**Step 4:** Provide recommended tier of control for defense articles identified in step 3. While the U.S. government retains full discretion in deciding how any particular type of defense article will be tiered, public input is requested regarding the appropriate tier for specific defense articles.

### REVISION OF USML CATEGORY VII (TANKS AND MILITARY VEHICLES)

As noted above, the Administration began the process of revising the control lists by proposing [revisions to USML Category VII](#), which was expected to be the least controversial category to revise. DDTC’s proposed revision is significantly more detailed and technical than the existing USML category and is intended both to categorize military vehicles for export purposes and to inform the public of the level of specificity to be expected in revisions to other USML categories. Accordingly, this notice is likely to be of broad interest beyond those companies that manufacture or export military vehicles.

The revision of Category VII tracks the current A through E structure of the CCL, and items in each group have been assigned a Tier 1, 2, or 3 designation that will determine, in part, the level of export control to be applied. For example, among the equipment designated under Group A of Category VII are vehicles “specially designed” for deploying weapons of mass destruction (which are Tier 1) and tanks manufactured after 1955, with their capabilities determining the tier into which they are placed.

Clients that manufacture or export USML Category VII-controlled items should consider providing comments on the proposed revision of Category VII if certain criteria are over-inclusive and could capture broad categories of vehicles that are limited to civilian use. In particular, clients may wish to propose changes to the objective criteria to more directly capture actual military use. Comments might also explain how the technology at issue would be unlikely to advance indigenous development (although that could prove difficult to assess) and whether the technology is generally available outside of the United States and its regime partners.

The Administration stated in a [December 9 fact sheet](#) that Category VII as proposed for revision would include only about 26 percent of the Category VII items DDTC licensed for export in 2009. The Administration expects that three-quarters of the items formerly controlled under Category VII will, once Congressional notification obligations are satisfied, be transferred to the EAR and that ultimately a large percentage of the items transferred off the USML would be permitted to be exported without a license to destinations other than sanctioned countries. (Because the tiers of the CCL and USML are proposed to be structured in the same way, if an item does not fit within the USML tiers, it logically should not fit within the CCL tiers. Clarification on how items moved to the jurisdiction of the EAR would be controlled is needed, and apparently will be provided in a future Department of Commerce notice.)

## ADVANCE NOTICE OF PROPOSED RULEMAKING - REVISING DESCRIPTIONS AND FOREIGN AVAILABILITY OF ITEMS ON THE CCL

As part of the effort to develop descriptions of items controlled on the CCL that are clearer, more positive, and “tiered,” [BIS has requested comments](#) suggesting proposed revisions to the text of Export Control Classification Numbers (“ECCNs”) – the specific alpha-numeric control entries on the CCL – or proposed Technical Notes to ECCNs. Proposed revisions could include edits that reorganize the text of the ECCN or changes to technical parameters to make an entry clearer. Comments should refer to internationally accepted standards and use industry-standard terms and references. Where objective criteria are missing, BIS is seeking specific suggestions on technical parameters, characteristics, thresholds, and capabilities. All proposed revisions should include an explanation, with supporting materials if available, of why the change is needed and how it would make the ECCN clearer and more positive.

Comments also could address the degree to which an item provides a military or intelligence advantage to the United States and the item’s availability outside of the United States and 37 identified countries that are members of all four multilateral export control regimes or other regime members that also are members of NATO.

Comments should specify whether items on the CCL controlled for reasons other than Anti-Terrorism or Crime Control provide a “critical,” “substantial,” or “significant” military or intelligence advantage to the United States. This includes comments on how existing ECCNs, down to the subparagraph level, could be further divided so that their descriptions are organized by technical or other objective characteristics consistent with the Administration’s tiering criteria.

Comments also may discuss whether items with the capabilities and characteristics described on the CCL, and controlled for other than solely Anti-Terrorism or Crime Control reasons, are indigenously developed, produced, or enhanced almost exclusively within the United States or in destinations outside of the 37 countries identified in the notice. These comments should offer specific, objectively verifiable information regarding the item’s availability such as foreign manufacturer(s), relevant company catalogues or descriptions of the item’s technical capabilities and parameters, and a detailed, documented explanation of why these parameters equal or exceed those contained in the relevant ECCN entry.

## KEY ISSUES AND CONSIDERATIONS REGARDING THE CONTROL LIST REFORMS

While the publication of the *Federal Register* notices described above marks a significant and welcome milestone in the Administration’s progress toward implementation of a new U.S. export control system, the notices reveal a number of important issues that industry representatives should consider and about which clients may wish to comment:

- **Move away from design intent for ITAR controls:** As noted above, DDTC’s advance notice of proposed rulemaking regarding revisions to the USML makes clear that if items exceed the established technical characteristics, they could be ITAR-controlled even if not specifically designed for military use. Clients should determine if there are potential additions to the USML among the products they manufacture and export and consider whether to suggest criteria that would avoid inappropriate USML controls. However, it may be challenging to do that in light of the lack of guidance from DDTC about what items/capabilities it is trying to protect through the tighter controls of the USML. DDTC has not identified the characteristics that drive “national security concerns” for various items, such as the characteristics that are peculiarly responsible for achieving critical military capabilities. Thus, commenters will be providing granular input on

USML and CCL entries without having guidance from the government regarding the purpose of the USML controls for a given category.

- Separately, clients may want to consider establishing internal processes to ensure that commercial items do not inadvertently become ITAR-controlled as a result of ongoing technology development.
- Licensing consequences of tier placement: There is no information in the State Department notices regarding the specific export licensing policies that will apply to each of the tiers. As a result, industry is being asked to recommend whether an item belongs in a given tier without any information about the consequences of its placement in that tier (*i.e.*, without knowing to which countries the item will require a license for export and reexport and what license exceptions or exemptions might be available). Clients thus may want to request a follow-on opportunity to comment on tier placement once guidelines regarding the licensing consequences of tier placement become available.
- Request for national security judgments: Proposing items for particular tiers (regardless of whether those items are on the USML or CCL) requires industry to make national security judgments, *e.g.*, whether an item results in a “military advantage” that is “critical,” “significant,” or “substantial.” In many cases it may be difficult for industry to make these judgments, especially in light of the vague definitions of those terms, and some companies may not feel comfortable doing so. Thus, although the Administration is not actively seeking comments on the definitions of these tiers or the operative terms that inform tier placement (*i.e.*, “critical,” “substantial,” and “significant”), clients may nonetheless wish to comment on them. Similarly, it is unclear how to measure the contribution of items to indigenous development, and clients may suggest that the government provide greater clarity here as well.
- Foreign availability information required: The use of foreign availability criteria may be a viable way for industry to provide input into the “tiering” effort. However, clients should act quickly to gather the detailed information BIS and DDTC have requested before the 60-day deadline, especially in light of the holidays.

## CONCLUSION

Due to the sweeping nature of the changes being proposed, clients are well advised to take this opportunity to comment on and help shape the scope and content of the control lists. We would be happy to assist individual clients or groups of clients with common interests in preparing such comments. In addition, clients should stay tuned for further developments, since a substantial number of definitions and guidelines are expected to be the subject of future *Federal Register* notices.

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If you have any questions concerning the material discussed in this client alert, or would like to discuss the potential submission of comments on these proposals, please contact the following members of our foreign trade controls practice group:

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