

Proposed Rule Details Major Changes to U.S. Export Controls

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In a significant step in the reform of U.S. export controls, the Department of Commerce issued a proposed rule on Friday, July 15, 2011, that would fundamentally affect the overlap between, and operation of, the International Traffic in Arms Regulations (“ITAR”) administered by the U.S. Department of State, Directorate of Defense Trade Controls, and the Export Administration Regulations (“EAR”) administered by the Department of Commerce, Bureau of Industry and Security. See Proposed Revisions to the Export Administration Regulations (EAR): Control of Items the President Determines No Longer Warrant Control Under the United States Munitions List, 76 Fed. Reg. 41,958 (July 15, 2011) (amending 15 C.F.R. Pts. 730, 732, 734, 738, 740, 742, 743, 744, 746, 748, 756, 762, 770, 772 and 774). The changes, which are based on the interagency review of the U.S. export control system that was initiated by President Obama in August 2009, would create a regulatory construct for harmonizing the United States Munitions List (“USML”) of the ITAR and the Commerce Control List (“CCL”) of the EAR, as well as standardizing certain key definitions between the two regulatory systems.

A summary of the key provisions follows.

Structural Changes to Regulatory Framework

Under the proposed rule, the regulatory structure would be altered to allow for large numbers of parts and components currently covered by the ITAR to migrate to the EAR. The steps contemplated in the rule would serve as an intermediate step towards the ultimate aim of creating a single “dual-use” and munitions control list. 76 Fed. Reg. at 41,960. The USML would eventually be changed to make its categories more positive (i.e. using objective criteria to describe controlled items) and aligned with the CCL. *Id.* at 41958. The changes will also shrink the number of items subject to the ITAR, perhaps considerably, as some current catch-all ITAR categories of items now subject to control are replaced with specifically enumerated lists. For example, the catch-all ITAR categories of parts and components would be replaced with specifically enumerated lists of parts and components. Other specific items would be moved from the USML altogether and relegated to EAR control. *Id.* at 41,959 (mentioning tow trucks as an example of the latter).

To accomplish the initial migration, Commerce has proposed the creation of a new set of controls in the CCL, comprising what is functionally a “Commerce Munitions List” that would assign items moved from the ITAR and not otherwise fitting an existing Export Control Classification Number (“ECCN”) to “600 Series” control numbers. 76 Fed. Reg. at 41,960. The 600 Series would be subject to significant control (National Security Column 1), and would require an export license to all countries other than Canada unless a license exception is available. *Id.* Further, under the proposed rule foreign “600 Series” items would be subject to a 10% *de minimis* rule for U.S. origin content. *Id.* at 41,966.

The proposed rule would also create a mechanism for exporters to apply for application of the recently created Strategic Trade Authorization (“STA”) license exception to “600 Series” items. If approved, the STA license exception would allow exports of such items for ultimate end use by certain government bodies of the countries that qualify for the STA exception. *Id.* at 41,963. The proposed rule indicates that the STA exception will be made available when the item “does not

provide a critical military or intelligence advantage to the United States or is otherwise available in countries that are not regime partners or close allies,” unless the Departments of Commerce, Defense, and State articulate an “overarching foreign policy rationale” for restricting the availability of the STA license exception. *Id.* at 41,975.

The proposed rule would also create a new temporary “holding category” on the CCL, analogous to the USML’s Category XXI (Miscellaneous Articles), for which the U.S. Government is determining an appropriate control on the CCL. *Id.* at 41,966. Classification under this holding category would be available in one year increments for up to a total of three years. *Id.* at 41,967.

Migration of Items to the EAR

The proposed rule includes specific transfer of an initial group of military use vehicles from USML Category VII to new ECCNs in Category 0 of the CCL. Vehicles being transferred would include those designed or modified for “non-combat military use.” *Id.* at 41,979. Thus, military modifications for vehicles including pneumatic tire casings, tire pressure inflation control systems, armored protection of vital parts, special mounting for weapons, and black-out lighting would not necessarily subject vehicles to control under the USML. *Id.* at 41,979, 41,982 (proposed ECCN classifications and descriptions for ground vehicles).

On the CCL, some “600 Series” items would be placed in a “y” category that is subject to only antiterrorism controls. Others would be in an “x” category for which few license exceptions would be available. It is significant, however, that General Interpretation No. 2 in EAR part 770.2, which provides that parts physically incorporated into a machine or equipment do not require a license, would continue to apply in the usual manner to end items subject to the EAR. This means U.S. industry could incorporate “600 Series” “x” category components in civilian end products and proceed with export in accordance with the ECCN governing the end product, even if the component had been developed earlier on a military program.

Changed Definitions

One of the most important features of the proposed rule is a new definition of “Specially Designed” that would apply to the new “600 Series” category, existing ECCNs, and revised USML categories using the Term. *Id.* at 41,960. The rule was formulated with the aim of formulating a clear and objective definition that would rely less on subjective intent. *Id.* at 41,967.

The new definition of “specially designed” would apply where an item has properties that are responsible for achieving or exceeding performance levels referenced in the CCL, or for “parts or components” of items that are controlled either on the USML or on the CCL for reasons other than Anti-Terrorism. *Id.* at 41,980. In a change to a much-maligned aspect of the current definition of “specially designed,” the proposed rule would remove application of that term to common hardware and unassembled parts such as screws and bolts that are used in civil items. *Id.*

Although in many cases the new definition of “specially designed” will liberalize current controls to remove items from the ITAR, it is possible that the more objective criteria in the new definition, particularly the requirement for an item to be in “serial production” in the civilian sector in order to qualify under paragraph (d)(3), will cause some items that would have been subjectively “intended” for civilian as well as military markets, and thus outside of ITAR previously, to come within ITAR under the new definition.

Definitions for other terms such as “parts,” “components,” and “end items” would also change under the proposed rule. In a largely semantic change, the terminology attaching to “dual use” items would change to “items for export,” to more clearly express the scope of the CCL as covering a broad range of U.S.-origin items. *Id.* at 41,966.

Conclusion

Although it represents a considerable step in the reform of U.S. export controls, the new rule has not yet taken effect. The Department of Commerce will accept comments on the draft rule up to and including September 13, 2011. Given the considerable scope of the rule and import of many of its changes, businesses affected by the changes may wish to submit comments on the proposed rule. Further, businesses involved in exports would be wise to revisit their export control compliance programs now to determine what effect, if any, the regulations in the proposed rule would have on their business, and to begin planning accordingly for forthcoming changes.

For further information concerning the proposed rule and how it may affect your company's exports, please feel free to contact a member of the Sheppard Mullin export control team:

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Sheppard Mullin partner [Curt Dombek](#) serves as an industry member of the President's Export Council Subcommittee on Export Administration, which is working on changes to the export control regulatory framework. The views expressed here are those of Sheppard Mullin's export control attorneys and do not represent the views of the Subcommittee.