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Export Control Reform Roundup – Overview of Recent Developments

In this Issue:

Exporters saw a flurry of new developments on the U.S. export front this past May and June with the publication of several proposed rules by the Commerce Department's Bureau of Industry and Security (BIS) and State Department's Directorate of Defense Trade Controls (DDTC) as part of the Export Control Reform (ECR) initiative.

In an effort to keep manufacturers, retailers, exporters and importers updated on the ECR initiative as changes occur—as we previously reported in June on the proposed rules for fire control, range finder, optical equipment and guidance and control equipment—the following provides a detailed summary of each of the newest key developments.

I. BIS and DDTC Publish Their Respective Proposed "Bookend" Controls on Toxicological Agents and Directed Energy Weapons

On June 17, 2015, the BIS and DDTC published in the Federal Register their proposed rules for U.S. export controls on toxicological agents and associated equipment, as well as directed energy weapons that are currently designated in U.S. Munitions List (USML) Categories XIV and XVIII, respectively. *See* 80 Fed. Reg. 34562; and, 80 Fed. Reg. 34572. The BIS and DDTC are requesting that public comments weighing in on the proposed rules be submitted by August 17, 2015. **The DDTC's proposed revisions to USML Categories XIV and XVIII are summarized as follows—**

- Riot control agents, test facilities, equipment for the destruction of chemical and biological agents, and production tooling would be transferred from the ITAR to the EAR;
- Chemical warfare agents adapted for use in war would be covered in Category XIV(a)(5);
- Equipment for sample collection, decontamination and remediation of chemical and biological agents would be transferred from the ITAR to the EAR;

- Antibodies, recombinant protective antigents, polynucleotides, biopolymers or biocatalysts exclusively funded by a Department of Defense (DoD) contract for the detection of certain biological agents would be covered by Category XIV(g)—***except where*** the DoD is acting on behalf of another US government agency or provides initial funding but another agency funds further development or adaptation of the item;

- Certain vaccines funded exclusively by the DoD or specially designed for the sole purpose of protecting against certain biological agents and biologically derived substances would be covered by Category XIV(h);

- Modeling or simulation tools (including software) used by the DoD to assess the potential effects of chemical or biological weapons strikes and incidents for purposes of mitigation would be covered by Category XIV(i);

- Category XVIII(a) would only cover items that meet the specific definition of *directed energy weapons*;

- Tooling and production equipment specifically designed or modified for Category XVIII items, as well as test equipment and test models (e.g., diagnostic instrumentation and physical test models), would be transferred from the ITAR to the EAR; and,

- New paragraphs (x) would be added to Category XIV and XVIII to permit ITAR licensing of items that are subject to the EAR.

With respect to the BIS' proposed rule—

Five (5) new 600-series Export Control Classification Numbers (ECCNs) in CCL Category 1 would be created to cover—

- Riot control agent dissemination equipment, military detection and protection equipment, and related items transferred from the ITAR;

- Equipment specially designed to interface with detectors, shelters, vehicles, vessels or aircraft controlled under the ITAR or a 600-series ECCN, or to collect and process samples of articles controlled in USML Category XIV;

- Medical countermeasures specially designed for military use to counter chemical agents controlled by USML Category XIV;

- Military test, inspection and production equipment (and related commodities) specially designed for 1A607 items, ECCN 1C607 items or USML Category XIV items (e.g., incinerators, test facilities for military certification/qualification/testing, tooling and production equipment);

- Certain specially designed parts, components, accessories, attachments;

- Tear gases, riot control agents and materials for the detection and decontamination of chemical warfare agents;

- Software specially designed for items controlled in ECCN 1A607 or USML Category XIV; and,

- Technology required for items in 1x607.

In addition, three (3) new ECCNs in CCL Category 6 would be created for—

- Certain tooling and equipment, such as tooling, templates, jigs, mandrels, molds, dies, fixtures, alignment mechanisms and test equipment, used to produce DEWs (including non-lethal DEWs such as active denial systems)

- Certain specially designed parts, components, accessories and attachments for DEWs;

- Software specially designed for the development, production, operation or maintenance of the above-described tooling and production equipment; and,

- Technology required for the development, production, operation, installation, maintenance, repair, overhaul or refurbishing of the above-described tooling and production equipment.

II. BIS and DDTC Publish Their Respective Proposed "Bookend" Definitions Rules

On June 3, 2015, the BIS and the DDTC released their respective "bookend" rules revising and harmonizing the definitions of certain terms found in the EAR and the ITAR. See 80 Fed. Reg. 31505; and, 80 Fed. Reg. 31525. The objectives of these proposed changes are threefold: (1) improve national security because it will be easier for exporters to know how to comply with the regulations; (2) enhance economic security as it will reduce unnecessary burdens on exporters striving to ascertain the meaning of key words and phrases across similar sets of regulations; and, (3) take another step toward the creation of a common export control list and common set of export control regulations. **The key terms that would either be revised or adopted anew under the proposed rules include—**

- Technology
- Technical data
- Fundamental, basic and applied research
- Development
- Production
- Required
- Characteristics and functions of an item
- Peculiarly responsible
- Export
- Reexport
- Release
- Transfer (in-country)
- Retransfer
- End-to-end encryption

In addition, the proposed rules would specify the items that are either not subject to the EAR (including certain patent information) or are not defense articles under the ITAR. **The rules would also describe activities that do not constitute exports, reexports, releases, transfers, or retransfers under the EAR and ITAR, such as—**

- Launching a spacecraft, launch vehicle, payload or other item into space;
- Releasing technical data or EAR technology or software to a U.S. person in the United States;
- Moving items between the U.S., the District of Columbia, and the various U.S. territories and possessions; and,
- Sending, taking or storing technical data, technology or software that is: (i) unclassified; (ii) secured using end-to-end encryption, FIPS 140-2 compliance cryptographic modules, supplemented by software implementation of key management and other controls pursuant to NIST publications or other similar cryptographic means; and, (iii) not stored in Russia, a country listed in EAR Country Group D:5 or a proscribed country in Section 126.1 of the ITAR.

The proposed rules further clarify that licenses or other authorizations are issued to cover only the specific items, end-uses and parties identified in the associated license applications and any letters of explanation and other documents submitted by the applicants. The BIS rule also would require license applicants to inform the other parties identified on the license of its scope and the specific conditions that are applicable to them.

Both the BIS and DDTC proposed rules would allow technology or technical data (regardless of its media or format) to be exported by or to U.S. persons or foreign national employees of U.S. companies traveling or on temporary work assignment abroad where—

- The foreign nationals export or receive only the technology or technical data they are authorized to access through a license or applicable exception/ exemption;

- The technology or technical data would only be possessed or used by a U.S. person or authorized foreign person, and sufficient security measures would be taken to prevent unauthorized releases of that information;
- The U.S. person would be an employee of the U.S. government or directly employed by a U.S. company (i.e., not a foreign subsidiary of a U.S. company);
- The technology or technical data would not be used for foreign production, technical assistance or defense services unless separately authorized through a license, exception or other approval; and,
- The U.S. company must document the use of this exception/exemption in writing along and specify the reasons why the information is needed for the temporary business activities abroad.

The DDTC proposed rule also stipulates, with regard to exports of controlled information to U.S. persons abroad, that any exports or transfers of classified information must also comply with the Defense Department's National Industrial Security Program Operating Manual (NISPOM).

Both rules also emphasize that the release or transfer of information, such as decryption keys, network access codes or passwords that would allow access to other technology or technical in clear text or software ***with knowledge*** that such release will result in an unauthorized export, reexport or transfer is a violation of the EAR and the ITAR. Such releases would be treated as violations in the same manner as unauthorized transfers of the protected technology or technical data itself.

Finally, the DDTC proposed rule adds a new prohibition to Part 127.1(a) of the ITAR wherein persons would be prohibited from exporting, reexporting or retransferring ITAR technical data or software ***where they have knowledge*** that such information was previously made publicly available without the required ITAR authorizations.

III. DDTC's Proposed Rule Relation to ITAE Registration and Licensing of US Persons Providing Defense Services

As part of the Export Control Reform effort, the DDTC is requesting comments on its proposed rule published on May 26, 2015, clarifying requirements for the licensing and registration of U.S. persons providing defense services that are employed by foreign persons. *See* 80 Fed. Reg. 30001. Comments should be submitted to the DDTC on or before July 27, 2015. The DDTC provided examples of situations that will be impacted by the proposed rule:

- U.S. persons who are regular employees of a U.S. company working at a foreign branch;
- U.S. persons who are regular employees of a U.S. company's foreign subsidiary or affiliate where the U.S. company is actively providing services to the foreign subsidiary or affiliate;
- U.S. persons who are regular employees of a U.S. company's foreign subsidiary or affiliate where the U.S. company is not actively participating in the provision of services to the foreign subsidiary or affiliate;
- U.S. persons employed outside the United States who are independent contractors and do not meet the definition of a regular employee; and
- U.S. persons employed as regular employees of a foreign company with no U.S. affiliation.

The proposed rule first seeks to clarify the existing requirement that U.S. persons performing defense services abroad are generally required to be registered with the DDTC per Section 122.2 of the ITAR, and that only one occasion of furnishing a defense service is required to trigger that requirement. However, any natural person who is directly employed by a registered entity (or by an entity listed on the registration as a subsidiary or affiliate) is already deemed to be registered with the DDTC.

The proposed rule also provides that "natural U.S. persons" must generally be authorized under a DSP-5 license to provide defense services. The term ***natural person*** refers to an individual human being—not a corporation, business association, partnership, society, trust, or any other entity, organization or group. In addition, natural U.S. persons who are regular employees of a foreign subsidiary or affiliate that is already listed on the DDTC registration of a U.S. company may also be authorized to provide defense services under a Manufacturing License Agreement or Technical Assistance Agreement—however, the registered U.S. company must accept responsibility for and demonstrate its ability to ensure the natural U.S. person's compliance with the ITAR. Further, Section 124.17 of the ITAR would allow natural U.S. persons to provide defense services to and on behalf of their foreign employers without a license if ***all*** of the following conditions are met:

- The foreign employer must be located within a NATO or EU country, Australia, Japan, New Zealand, and/or Switzerland;
- The end users of the defense articles must also be located within NATO, EU, Australia, Japan, New Zealand, and/or Switzerland;
- No U.S.-origin defense articles (including technical data) may be transferred from the U.S. persons to the foreign employer without a separate authorization from the DDTC;
- No classified significant military equipment (SME) or missile technology (MT) technical data may be transferred—even if separately authorized—in connection with the furnishing of defense services; and,
- The U.S. person furnishing the defense services must maintain records of his/her activities and comply with the DDTC registration requirements outlined in Part 122 of the ITAR.

The term ***regular employees*** would be defined in Section 120.39 as individuals in a long term (i.e., 1 year or longer) contractual relationship with the companies, where they work at the companies' facilities, work under their companies' direction and control, work full time and exclusively for their companies, execute nondisclosure agreements for their companies, and any staffing agencies that seconded the individuals have no role in the work that they perform nor any access to controlled technology.

Further, the proposed rule would provide an exemption for natural U.S. persons employed by foreign companies engaged in Foreign Military Sales-related (FMS-related) activities. Specifically, proposed Section 126.6(c)(7) of the ITAR would allow such natural U.S. persons to provide defense services to and on behalf of their foreign employers without a license if: (i) the defense services must be provided in support of an active FMS contract and are identified in an executed Letter of Offer and Acceptance (LOA); (ii) no U.S.-origin defense articles may be transferred from the U.S. person to the employer, without separate authorization from the DDTC; (iii) the provision of defense services must not be made to an ITAR proscribed country in Section 126.1 of the ITAR; (iv) no classified or SME technical data may be disclosed (even if separately authorized) in connection with the furnishing of defense services; and (v) the U.S. person furnishing the defense services must maintain records of his/her activities and comply with DDTC registration requirements in Part 122 of the ITAR.

IV. BIS and DDTC Proposed Rules to Revise Destination Control Statement and Other Export Clearance Requirements

On May 22, 2015, the BIS and the DDTC published in the Federal Register several proposed rules impacting U.S. export clearance requirements, and are requesting public comments as to how these requirements may be improved as part of the overall Export Control Reform Initiative. *See* 80 Fed. Reg. 29554; 80 Fed. Reg. 29551; and, 80 Fed. Reg. 29565. Public comments were submitted to the BIS and the DDTC until July 6, 2015.

The BIS is considering the following revisions to the EAR:

- Revising Section 758.6 to harmonize the EAR's destination control statement language with that of the ITAR's Proposed Rule for Section 123.9(b)(1), which would read as follows:

  These items are controlled and authorized by the U.S. Government for export only to the specified country of ultimate destination for use by the end-user herein identified. They may not be resold, transferred, or otherwise disposed of, to any other country or to any person other than the authorized end-user or consignee(s), either in their original form or after being incorporated into other items, without first obtaining approval from the U.S. government or as otherwise authorized by U.S. law and regulations.

- Requiring the destination control statement on the commercial invoice and contractual documentation (if such contractual documentation exists)—it would no longer be required to be added to the air waybill, bill of lading or other export control documents.

- Requiring the ECCN of an item to be listed on export and shipping documentation, which is currently the requirement for 600-series items—this requirement would not apply to EAR99 items;

- Requiring the license number, license exception code, or no license required (NLR) designation to be entered on the export control documents.

The DDTC's proposed rule would include the following proposed revisions to the ITAR—

- Items subject to the EAR may be authorized for export under the U.S. Munitions List paragraph (x) provisions, by ITAR license or exemption, provided that the items are: (i) for use in or with defense articles authorized under an ITAR license or other approval; and, (ii) are described in the associated purchase documentation.

- When exporting items subject to the EAR under an ITAR license or approval, the U.S. exporter must also provide the end-user and consignees with the appropriate EAR classification information for each item exported, and a letter of General Correspondence is required for subsequent retransfers of EAR-controlled items that were previously authorized for export under the ITAR.

- Exporter would be required to insert the following information and destination control statement language on the bill of lading, air waybill, or other shipping document, and the purchase documentation or invoice whenever defense articles are to be exported, retransferred, or reexported pursuant to an ITAR license or other approval—

  (a) The country of ultimate destination;

  (b) The end-user;

  (c) The license or other approval number or exemption citation; and

  (d) "*These items are controlled and authorized by the U.S. government for export only to the country of ultimate destination for use by the end-user herein identified. They may not be resold, transferred, or otherwise be disposed of, to any other country or to any person other than the authorized end-user or consignee(s), either in their original form or after being incorporated into other items, without first obtaining approval from the U.S. government or as otherwise authorized by U.S. law and regulations.*"

For More Information

For more information about these proposed rules or other questions involving international trade, exports or imports, please contact the author, a member of Polsinelli's International Trade practice, or your Polsinelli attorney.

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