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Client Alert

International Trade & Litigation Practice Group

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Status of Key Aspects of Export Control Reform

On April 16, 2013, the State Department and the Commerce Department published the first set of final rules in the *Federal Register* to implement the Obama administration's Export Control Reform Initiative. The State Department described the publication of these final rules as a "major milestone" for U.S. export controls. Additional final rules will be published in the coming months. Also, on May 24, 2013, the State Department published a proposed revision to the definition of the term "defense service."

Background

Currently, most exports are subject to one of the following export control regulations: the International Traffic in Arms Regulations (ITAR), administered by the State Department, or the Export Administration Regulations (EAR), administered by the Commerce Department. The ITAR's U.S. Munitions List (USML) is a broad list that controls virtually anything specifically designed, developed, configured, adapted, or modified for a military application. The breadth of the USML means that certain items that may have been originally developed for a military application may continue to be controlled under the USML, even when used in commercial applications. The EAR's Commerce Control List (CCL) controls dual-use items, which include commercial items that may be useful in both commercial and military end-uses. Unlike the USML, the CCL is a "positive" list that specifically identifies controlled items based on technical parameters.

Under the ITAR, licenses are needed for virtually all exports of defense articles, with very few exemptions. In contrast, the EAR's export controls are more flexible, allowing controlled items to be exported to certain countries without licenses and containing many more license exceptions. The current efforts of the Export Control Reform Initiative revolve around restructuring the USML and CCL into positive lists that describe controlled items by using objective criteria. This relieves a great deal of uncertainty as to the status of items that may have military origins, but that have subsequently migrated into the commercial market. To that end, the Administration is working through the process of shifting jurisdiction over less sensitive items from the USML to the CCL. Congress must be formally notified of any changes being made to the USML, and has 30 days to review the proposed changes.

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The Final Rules

On March 7, 2013, the State Department submitted the first required formal notification to Congress regarding defense articles to be transferred from the USML to the CCL. The notification covered USML Categories VIII (aircraft) and XIX (gas turbine engines, a new category). Congress raised no objections to the proposed changes during the 30 day period, which led to the publication of the final rules on April 16. The new final rules take effect 180 days after their publication in the *Federal Register, i.e.*, October 15, 2013.

Under the final rules, certain aircraft and related parts and components will remain in USML Category VIII. These items will now be identified as part of a positive list. In addition, parts, components, accessories, and attachments "specially designed" for certain US aircraft that have "low observable features or characteristics" (B-1B, B2, F-15SE, F/A-18 E/F/G, F-22, F-35 (and variants), F-117 or US government technology demonstrators) remain ITAR-controlled. Finally, any part, component, accessory, attachment, equipment or system that is classified, contains classified software, or is being developed using classified information remains on the USML. USML Category XIX follows a similar positive list approach, with specific types of engines and their parts and components positively listed.

Items moved off the USML are not decontrolled, but rather are controlled under new categories in the CCL. The new CCL categories are known as the "600 Series" categories. For example, military aircraft and related commodities will fall under Export Control Classification Number (ECCN) 9A610, while military gas turbine engines and related commodities are now controlled under ECCN 9A619. License exceptions can be used for many of the items in the new 600 Series categories that will allow much greater international cooperation between subsidiaries of U.S. companies without the need for export licenses or other approvals.

Parts, components, accessories, and attachments "specially designed" for a military aircraft controlled under USML Category VIII or ECCN 9A610 fall into ECCN 9A610.x when the parts are not specified elsewhere on the USML or the CCL. Certain enumerated aircraft parts, components, accessories, and attachments fall under a less restrictive ECCN, 9A610.y, which is only subject to anti-terrorism controls, meaning that they can be exported to all countries except certain countries deemed to be state sponsors of terrorism without a license. A similar structure is followed for gas turbine engine parts classified under ECCNs 9A619.x and 9A619.y.

The final rules also add ITAR Section 120.41 and amend EAR Section 772.1 to provide a definition for the term "specially designed." The definition has a two-paragraph structure. The first paragraph identifies commodities and software that are "specially designed," including commodities and software that, "as a result of development, have properties peculiarly responsible for achieving or exceeding the controlled performance levels, characteristics, or functions described" in the relevant USML paragraph or ECCN. The second paragraph of the definition identifies certain types of parts, components, accessories, attachments, and software that are excluded from the definition of "specially designed." The definition is described in the final rules as a "catch and release approach" designed to describe what the term did not include rather than what it does include.

Executive Order 13637

In addition to the final rules described above, on March 8, 2013, President Obama issued Executive Order 13637 to address the administration of the reformed export controls. Among other administrative functions, Executive Order 13637 does the following:

- Delegates to the State Department the authority to license certain EAR items that have moved to the CCL and that are to be used in or with defense articles on the USML, to prevent the need to seek licenses from both the State Department and the Commerce Department for the same transaction;

- Consolidates all licensing and registration requirements for brokering activities and delegates them to the State Department; and

- Establishes procedures for notifying Congress about export licenses for certain items that have moved from the USML to the CCL. Although such items are no longer subject to statutory notification requirements, to promote transparency, the Executive Order makes clear that the Administration intends to continue to provide notifications to Congress.

New Definition Of "Defense Services"

On May 24, 2013, the State Department published a proposed rule revising USML Category XV (Spacecraft Systems and Related Articles) and the definition of "defense service" in ITAR Section 120.9. The proposed definition of "defense service" incorporates public comments from earlier proposed rules and has a similar structure to the definition of "specially designed." Paragraph (a) lists activities that constitute a defense service, such as:

- the furnishing of assistance (including training) using other than public domain information to a foreign person in the design, development, engineering, manufacture, production, assembly, testing, intermediate- or depot-level maintenance, modification, demilitarization, destruction, or processing of defense articles;

- the furnishing of assistance to a foreign person for the integration of any item controlled on the USML or items subject to the EAR into an end item or component that is controlled as a defense article on the USML, regardless of origin;

- the furnishing of assistance (including training) to a foreign person, including formal or informal instruction by any means, in the tactical employment of a defense article, regardless of whether technical data is transferred.

Paragraph (b) enumerates activities excluded from the definition, such as training in organizational-level maintenance of a defense article, mere employment of a natural U.S. person by a foreign person, and servicing of an item subject to the EAR that has been integrated or installed into a defense article. The examples provided in paragraph (b) are not intended to be exhaustive, but rather are intended to highlight services about which the State Department has received inquiries.

In the proposed rule, the State Department addresses the question of "whether companies will be required to amend approved agreements for activities that may no longer be considered defense services" by stating that these companies should contact the State Department or the Commerce Department for clarification on an individual basis as needed. The State Department also clarifies that instances where USML articles are incorporated or installed into a CCL item will be addressed in a later rule.

Next Steps

The changes to the USML and CCL in the final rule will go into effect on October 15, 2013. During the 180 day waiting period, export license applications for items moving from the USML to the CCL will be accepted by both the State Department and the Commerce Department, but the Commerce Department will not issue approved licenses until the effective date. Existing licenses for items that will be moved from the USML to the CCL will remain valid until the license expires, the license is amended, or two years from the effective date of the transition (October 15, 2015). Companies may continue to request licenses from the State Department for items moving off the USML, but the licenses will be approved for no more than two years.

According to officials, the Commerce Department is currently preparing congressional notifications for the final rules for USML Categories VI (warships and naval equipment), VII (tanks and military vehicles), XIII (auxiliary equipment, which includes composite materials) and XX (submarines). The formal notifications should be provided to Congress in the coming months.

The State Department is accepting **comments** on the proposed rule for USML Category XV and the definition of "defense service" until July 8, 2013. The State Department also indicated in the proposed rule that it plans to revise the definitions for "technical data" and "public domain information" in future proposed rules.

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