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Export Control Reform: Key Insights and Status Update

As many of our clients and friends know, Alston & Bird LLP hosted an expert panel discussion on the Obama Administration's export control reform effort on March 18, 2011. The event brought together leading voices and stakeholders on export control reform efforts from the Administration and Capitol Hill for an interactive and engaging discussion moderated by Bill Reinsch, President of the National Foreign Trade Council ("NFTC").

The discussion panel featured the following speakers:

- **Kevin Wolf**, Assistant Secretary of Commerce for Export Administration
- **Robert Kovac**, Managing Director, Directorate of Defense Trade Controls
- **Brian Nilsson**, Director, Non-Proliferation, Export Controls, National Security Council
- **Anthony Aldwell**, Deputy Director, Defense Technology Security Administration
- **Jason Waite**, Partner, Alston & Bird LLP
- **Ed Rice**, Senior Professional Staff Member, House Committee on Foreign Affairs
- **Tom Moore**, Professional Staff Member, Senate Committee on Foreign Relations

This discussion focused on the Administration's plan to review and reform the U.S. export control system, which has not undergone substantial reform for decades despite significant changes in the technology and foreign policy and national security imperatives that should be the drivers of any export control policy.

The panelists shared their thoughts on the Administration's progress toward its ultimate goal of a (1) single, "positive" control list, (2) administered by a single licensing agency, (3) running on a single information technology platform and (4) enforced by a single primary export enforcement coordination agency. While these "four singularities" are no doubt a familiar concept to all those tracking the reform effort, the panel shared their insights on the status of key elements of the reform efforts to date, including feedback received through comments on the recently published series of proposed regulations. The panelists also provided forward-looking analysis of the prospects for completing the Administration's ambitious goals for reform, including major next steps and the remaining obstacles likely to impact the pace and overall progress of reform.

Key Insights from the Alston & Bird Panel on Export Control Reform

- **Industry input:** Industry comments have been generally positive and very helpful to reform efforts, and the Administration urges continued industry participation through comments to proposed rules or direct engagement with the agencies involved.
- **Department of State:** Review and revisions to all categories of the U.S. Munitions List has been started with each Category assigned to an interagency team of expert reviewers; the goal is to complete internal work by June 2011.
- **Department of Commerce:** The STA License Exception is not the last license exception we will see under the revised EARs, and BIS will continue to emphasize the development of revised policy through license exemptions instead of control list reforms.
- **Capitol Hill:** Expect hearings in both the House (Foreign Affairs) and Senate (Banking and/or Foreign Relations), while the extent of further congressional involvement remains overall unclear.
- **Prospects for Legislation to Complete the Reform Effort:** The Administration has a draft bill in progress and Congressman Howard Berman (D-CA) will continue work on his draft bill, while some continue to focus on revisions and reauthorization of the Export Administration Act.

Up Next:

- Proposed revisions for USML Categories I, II and/or V (likely published within the next month)
- Final Rule on Category VII
- Final Rule on STA (will reflect comments and was submitted to OMB for approval on April 11, 2011)
- Single license application and harmonized definitions will be worked together and draft proposed rules are in process

The following summary of the status of export control reform efforts incorporates and expands upon many of the topics discussed at Alston & Bird's offices on March 18, 2011, including expectations for future reforms and, more generally, the government's efforts to date.



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Background

In August 2009, President Obama called for a broad interagency review of the United States export control regime in an attempt to ensure that the country's export laws and regulations effectively address the security threats of today's world in a way that makes sense to the exporting business community. Throughout the review, the Administration's goal has been to find ways to strengthen both national security and the U.S. manufacturing and technology sectors by adapting the existing export control system to current threats and the changing economic and technological landscape.

Built around the framework of the "four singularities", the government commenced its interagency review in August 2010, at which point the President announced that "we need fundamental reform in all four areas of our current system — in what we control, how we control it, how we enforce those controls, and how we manage our controls." Specifically, President Obama has called for a single, tiered, positive list of export controls as well as the establishment of a single set of licensing policies that would apply to each tier of control, the conversion to a single IT system for the management of licensing processes and other export data, and the creation of an Export Enforcement Coordination Center to coordinate efforts across all the relevant departments and agencies.

Before creating a single tiered and positive control list, the Administration recognizes it likely needs to revise the existing Commerce Control List ("CCL") and U.S. Munitions List ("USML") in an effort to create conformity in structure and base existing controls on objective criteria. The Departments of State and Commerce took a step towards aligning the USML and CCL by issuing a series of proposed regulations and requests for comment in December 2010. The aim of the proposed rules is to eliminate overlap between the two lists and to apply objective, technical criteria for classifying items. The Department of State published a revised Category VII: Tanks and Military Vehicles of the USML to serve as an example of how the Administration plans to proceed in revising the remaining categories in the list. The Department of State also published a notice providing details on the process for creating the revised Category VII and requesting public comments on the process. The notice made clear that the revision of Category VII would serve as a model for future revisions. Meanwhile, the Department of Commerce published a proposed rule creating a new, broad license exception called Strategic Trade Authorization ("STA") and requested input from industry and affected parties with respect to the Administration's plans to categorize export items into tiers of controls and focus the highest-tier, tightest controls on more sensitive items while relaxing restrictions on less sensitive, more widely available technologies under the lower two tiers. These proposed rules together provide the framework for further reform and additional revisions to the existing control lists.

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A snapshot of accomplishments in the reform effort, including some less drastic policy changes that have been implemented or proposed, is summarized in the following table:

Export Control Reform: Progress to Date

- Final Rule issued by BIS easing license and review requirements for many types of encryption technology
- Revisions to the EAR and CCL to liberalize license requirements and end-use restrictions for exports to India
- Proposed Rule creating license exception STA
- Proposed Rule issued by DDTC to remove licensing requirements for dual--or third--country nationals employed by foreign parties to ITAR licenses
- Proposed Rule issued by DDTC easing licensing requirements for replacement parts/components for U.S. origin defense items
- Proposed Rule issued by DDTC revising Category VII of the USML
- Proposed Rule issued by DDTC revising the definition of Defense Services covered by the ITAR and adding additional definitions and clarifications long sought by industry
- Executive Order creating the Export Enforcement Coordination Center (a primordial step toward the “single enforcement agency”)

Export Control Reform: Coming Soon

- Final Rules on replacement parts/components, Category VII, and STA
- Harmonized definitions
- Single license application for DDTC, BIS and OFAC
- Proposed Rules revising remaining categories of USML (Categories I, II and V likely to be next)

A Single Control List: Positive and Objective Criteria

As described above, the Administration’s goals with respect to export control reform envision an end state based on a single, tiered positive control list. In order to achieve this result, the Administration plans to first harmonize the two existing lists of controls, including revising the USML to track the structure of the CCL and include the same Subsections, as described in further detail below. The Administration hopes that the revisions will ensure both lists are based on clear, objective criteria and that the revised lists will allow for a transition to a single, positive control list.

The U.S. Munitions List and the Control of Defense Articles

The revision of Category VII of the USML (the category for Tanks and Military Vehicles) uses objective criteria and technical parameters to define the defense articles that are controlled under the category. The proposal tracks the structure of the CCL and creates seven Groups for Category VII — Subsection “A” for End Items, Systems, Accessories, Attachments, Equipment, Parts, and Components; “B” for Test, Inspection, and Production Equipment; “C” for Materials; “D” for Software; “E” for Technology; “F” for Defense Services; and “G” for Manufacturing and Production. The revision additionally assigns each defense article one of the three control tiers (Tier 1, Tier 2, or Tier 3) developed by the Administration. The Administration hopes that the revised Category VII, as proposed, would clarify the jurisdiction of the ITAR and focus on the most sensitive items. Specifically, after revision, the category would include only items determined by the Administration to provide at least a significant military or intelligence advantage to the United States.

Further USML Revisions: What to Expect Next

The Administration hopes to finish all category reviews this year and has a schedule in place for each of the remaining categories. The goal is to have all internal work finished by June, and key officials have confirmed that work has begun on each of the USML categories. Some of the categories are simply more difficult to revise than others. Categories VIII and XV, for example, were among the first categories to be reviewed and the interagency task force is still working to revise those categories. However, industry can expect to see proposed revisions of Categories I, II and/or V next. All three categories have been drafted and are currently in the final stages of the interagency review process.

The Commerce Control List and Restrictions on Dual-Use Items

Divided into ten categories and using mostly objective criteria in its descriptions, the CCL is already a positive list for the most part. However, certain ECCNs could be revised to reflect clearer, more positive criteria. The Bureau of Industry and Security (“BIS”) therefore sought public comments from trade groups, industry, and other interested parties regarding proposed steps to clarify descriptions of items controlled on the CCL and make the controls more positive and tiered pursuant to the criteria developed by the Administration. In the same advance notice of proposed rulemaking published in the Federal Register on December 9, 2010, BIS also requested comments on the availability of controlled items outside certain countries and the degree to which controlled items provide critical, substantial, or significant military or intelligence advantages to the United States. We therefore anticipate further revisions to the Export Administration Regulations (“EAR”), and potentially the CCL, based on those comments as to foreign availability.

List Harmonization: A Shifting Battleground

If both the USML and CCL are harmonized to reflect clear, objective criteria and the same control policy and structure, then the two lists can, in theory, be easily merged into a single list once the Administration has the necessary authorization and is ready to do so. Until the reform effort reaches that final stage, the harmonized lists will serve as the basis for the export control regime.

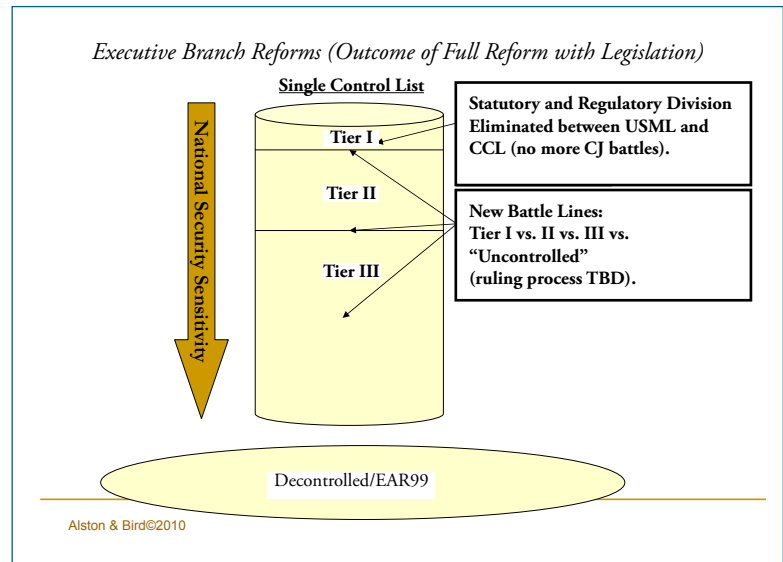
Whether as part of a single list or as part of the interim export control regime, it is important to note that clearer, more objective criteria will not necessarily end the debate over the appropriate level of control for a particular item. While the reform efforts may clarify jurisdictional questions regarding the appropriate list for controlling a particular item, the battleground in the new export control regime will likely shift to the appropriate level of control in the tiered system. Commodity jurisdiction determinations will give way to decisions over whether an item should be controlled as Tier 1 or Tier 2, for example. It is not yet clear whether affected parties will have an opportunity to challenge tier classifications, nor is it clear what the process for doing so would entail. Even if the new export control regime does not provide a mechanism for challenging the Administration’s original tier determinations, it seems only likely that certain items or technology will, as time passes, be more appropriately controlled in a lower tier. Industry will likely want a process for adjusting the level of control to reflect the passage of time and its effect on the sensitivity of items or technology.

A Single Control Policy: Focusing Controls on the Most Sensitive Items

Under the approach outlined by the Administration, the tiered system of export controls will apply a different level of control and licensing requirements to each of three tiers. The Administration’s goal is to increase and strengthen controls over the most sensitive items while loosening restrictions on those less sensitive items that are available outside the United States. The tiers will be defined primarily by the availability of items outside the United States and certain other countries and the degree to which an item provides the United States with a military or intelligence advantage. The Administration plans to couple the new tiered control system with newly available license exceptions to ease the licensing burden on less sensitive items.

The Three-Tiered System of Controls

Generally, the most sensitive items will be classified in the highest tier of control and will be subject to the most comprehensive controls and licensing requirements. Specifically, Tier 1 will include (a) weapons of mass destruction (“WMD”), (b) WMD-capable unmanned delivery systems, (c) plants, facilities or other items specially designed for producing, processing, or using WMDs, and (d) items almost exclusively available from the United States and which provide a critical military or intelligence advantage to the United States. Tier 2 items, on the other hand, will include items that are almost exclusively available from multilateral regime partners and that provide a substantial military or intelligence advantage to the United States or make a substantial contribution to the indigenous development, production, use, or enhancement of a Tier 1 or Tier 2 item. More broadly available items that nonetheless provide a significant military or intelligence advantage to the United States or make a significant contribution to the indigenous development, production, use, or enhancement of another tiered item will be considered Tier 3 items. Tier 3 will also include any items controlled for national security, foreign policy, or human rights reasons.



Any item determined to be outside the scope of each of the three tiers will be removed from all control lists, unless the particular item(s) must be controlled as a result of a separate foreign policy, statutory or multilateral obligation, in which case Tier 3 controls would apply.

Proposed License Exception: Strategic Trade Authorization

BIS published a proposed regulation that would provide a new Strategic Trade Authorization (“STA”) license exception to allow exports, re-exports and in-country transfers of controlled items to countries that are members of all four multilateral export control regimes or other regime members that are also members of NATO. The intent behind the exception is to facilitate shipments to countries that provide little risk of unauthorized use of controlled items.

The proposed exception provides three different authorizations to export items without a license; each type of authorization is based on the underlying reason for the license requirement, the destination country, the sensitivity of the item, and its end-use. Items subject to any of the seven reasons for control can be exported to a list of 37 specific countries. Less sensitive items subject to only national security reasons for control will be authorized to go to two additional countries for any permissible end-use or to 125 additional destinations if intended for civil end-uses only. Certain items controlled for national security reasons will be ineligible for the exception and will be identified by a new “STA exclusion paragraph” in the “License Exceptions” sections of ECCN entries on the CCL.

To ensure that the items are not diverted to unauthorized destinations, anyone exporting, re-exporting or otherwise transferring items under this proposed license exception would be subject to certain notification, destination control statement, and consignee statement requirements. There have been some indications that these requirements could be streamlined in the final rule.

The license exception will apply only to licensing requirements based on the CCL, but the exception will not apply to every item listed on the CCL and the Administration is currently reviewing individual ECCNs to determine whether the exception will apply. In particular, the license exception will not apply to items ultimately determined by the Administration to be Tier 1 items or to items that are subject to controls as a result of statutes, treaties, implementation of international commitments or human rights concerns.

What to Expect Next: Final Rule for STA and Additional License Exceptions

The final rule for the STA exception is expected in April, and the Administration has indicated that the final language will reflect the input received from industry through the comment process. Specifically, the number of ECCNs to be excluded will be much lower than the full scope of the 29 ECCNs listed in the proposed rule.

Additional proposed license exceptions are likely, although leading government officials have indicated that the intra-company transfer (“ICT”) license exception is currently not a priority. Instead, industry should expect a proposal for an exception to further ease restrictions on Tier 3 items. Meanwhile, the Department of State has published a proposed rule easing licensing requirements under the ITAR for replacement parts and components. The Department of the Treasury, however, has issued no proposals related to license exceptions or other mechanisms to ease requirements under the Office of Foreign Assets Control regulations.

A Single Agency and Other Structural Changes

The Administration has called for a single licensing agency running on a single information technology platform and enforced by a single primary export enforcement coordination agency. The structural changes require a varying level of work to enact. A single licensing agency, for example, will likely require congressional authorization and will present a significant challenge to the Administration. A single IT system, on the other hand, is a relatively simple step in the reform process, and leading government officials have indicated that it will be completed soon. Similarly, on November 9, 2010, President Obama issued an Executive Order establishing the Export Enforcement Coordination Center within the Department of Homeland Security.

Further structural reforms are expected in the near future. The Administration is currently working on a draft of a single licensing application in conjunction with a draft of harmonized definitions. Proposals for each can be expected later this year.

Prospects for Legislative Action

Although the President has broad statutory authority to implement many reforms to the system, certain aspects of the reform process will require congressional action, and it remains to be seen whether this Congress will act. Congressional authorization would likely be required, for example, before the Administration can create a single agency with jurisdiction over export controls and licensing. The Administration is working on draft legislation for the final stages of the reform process, but whether the Administration presents its draft to Congress may depend on whether Congress takes any action on its own.

Hearings and Legislation to Reauthorize the Export Administration Act

The House Committee on Foreign Affairs has indicated that it intends to hold hearings on a broad range of export-related issues, including oversight of the reform process. In fact, the Committee recently scheduled hearings for April 6, 2011 but was forced to postpone the hearings indefinitely due to scheduling conflicts with witnesses. Congresswoman Ileana Ros-Lehtinen (R-FL), the new Chairman of the Committee on Foreign Affairs, is considered by many in the industry to be reluctant to support the Administration’s efforts. Hearings before the House Committee on Foreign Affairs would present an opportunity for the Chairman to express her views to the Administration.

The Senate Committee on Banking, Housing & Urban Affairs is also likely to hold hearings this year, but it is otherwise difficult to predict the role Congress will play in export control reform. The reauthorization of the Export Administration Act remains a priority for Congressman Howard Berman (D-CA), Ranking Member of the House Committee on Foreign Affairs, and Congressman Berman is likely to introduce a new version of his 2010 draft legislation that was circulated among key industry stakeholders for comments despite never being introduced.

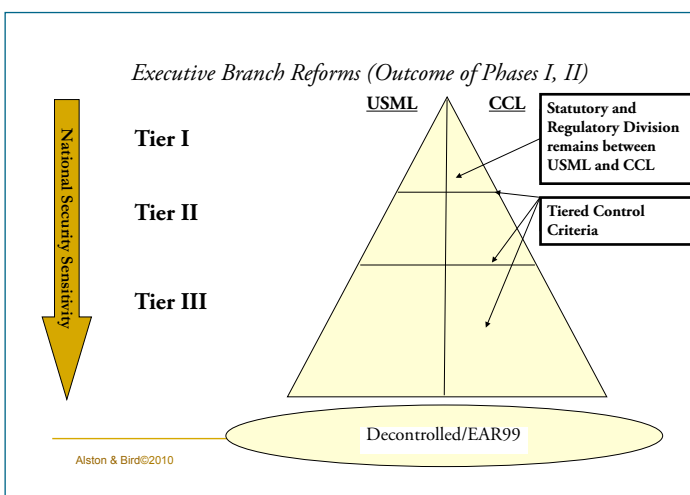
Congressional Notification and Review

The extent to which, and the manner in which, Congress will play a role in the Administration's efforts to rewrite USML categories remains unclear. The narrower and more precise scope of the revised Category VII allows the Department of State to identify those items that may be more appropriately controlled under the EAR. In fact, the Administration has indicated that it expects approximately 74 percent of the items formerly controlled under Category VII will eventually be transferred to the jurisdiction of the EAR. Whether Congress will act as an impediment to the transfers could depend on the status of the reform effort and the Administration's level of communication with Congress. There may be some on Capitol Hill who would prefer to have a better sense for where the reform effort is headed and to have licensing policies in place before removing items from the USML. Moreover, the sheer volume of items to be removed, and the technical nature of the items controlled, could cause significant delays should Congress decide to be proactive in its review and oversight. If every USML Category follows the model of Category VII and results in nearly 75 percent of the items being moved to the EAR, the volume of work may present a significant challenge. The relevant congressional committees are not staffed with engineers or the appropriate level of technical expertise, and the determinations are likely to include foreign policy considerations for the relevant committees.

Preparing for an Incomplete Reform Effort

It is important to note that a significant amount of reform can be achieved without Congressional action, although it seems that the Administration and some in the Legislative Branch may not agree on precisely how much can be achieved without new legislation from Congress.

Moreover, as described in greater detail above, the Administration hopes that its revisions of the USML and CCL will ensure that both lists reflect a single control policy and are based on more objective criteria, regardless of whether the Administration receives Congressional authorization to merge the lists. Therefore, partial reform that goes as far as possible, without the legislation necessary to fully implement the Administration's goals, may not be all that different from the Administration's desired end-state.



Specifically, it is increasingly likely that industry can expect the following reforms regardless of whether Congress acts to pass legislation:

- A single IT system;
- A single license application with harmonized definitions and key terms;
- A single Export Enforcement Coordination Center (albeit one that attempts to coordinate the activities of all the existing enforcement agencies);
- A single, tiered control policy;
- The existing USML and CCL framework, revised with the goal of incorporating clear and objective criteria throughout both lists; and
- A lessening of controls on less sensitive items through license exception STA, and possibly other similar exceptions.

Even without legislation to complete the reform effort, industry can expect the Administration to accomplish a significant amount of reform. The creation of a single agency charged with licensing and controls likely cannot be accomplished without legislation, but many of the other goals of the Administration can be achieved through regulatory action or executive order. Industry will need to familiarize itself with these efforts and adapt to a new, reformed system of export controls.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any one of the following members of the International Trade & Regulatory and Legislative & Public Policy Groups.

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