Portfolio Media, Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Export Controls Developments In 2011

Law360, New York (January 27, 2011) -- 2010 ended with a bang for the export controls community, as long-anticipated changes to the export controls system began to take concrete shape for implementation in 2011. At the same time, new enforcement cases in December and January illustrate that no matter how much things change, continuing strict enforcement of the export controls laws will continue to require that exporters take their compliance responsibilities seriously.

Export controls are not a topic that usually receives public presidential attention, but President Barack Obama has adopted export controls reform as a key part of the administration's initiative to double exports over the next five years. On Dec. 9, 2010, President Obama held a meeting of the President's Export Council and publicly announced the administration's first steps towards the implementation of a new export controls system. Simultaneously, the U.S. Department of State and the U.S. Department of Commerce released draft rules that represent meaningful steps towards export control reform.

For years, the export controls system, which is divided between multiple agencies (primarily the departments of State and Commerce, but with potential coverage by several others), has been criticized as cumbersome and slow, with jurisdiction of the various agencies uncertain.

Jurisdictional disputes between the State Department, which regulates munitions with military applications through the International Traffic in Arms Regulations (ITAR), and the Commerce Department, which regulates commercial exports through the Export Administration Regulations (EAR), have been common. Exporters complained that they often were unable to determine with reliability which technologies and goods were controlled under the ITAR and the EAR, or sometimes even which set of regulations would apply.

Cumbersome licensing procedures, which often took a long time, delayed the ability to export products, and some foreign competitors had taken to advertising that their goods were "ITAR free" or "EAR free," as a means of showing that their products were free of the export controls baggage that accompanied being tagged as a product that contained U.S.-origin products or technology. Since many of the technologies controlled by the EAR and even the ITAR are available worldwide, many questioned whether the export controls were, in many cases, advancing U.S. national security in any meaningful way.

Avoiding these types of export constraints, all while still preserving controls essential to preserving U.S. national security, accordingly has become a high-profile initiative. The goal, as stated by Defense Secretary Robert Gates, is to implement what generally is described as a system in which there are "higher fences around fewer items" — in other words, a system in which the only restrictions are on items that involve goods and technology that could truly be dangerous in the wrong hands, and where the technology is not available worldwide.

The initiatives announced in December, and under current consideration as draft proposals, make meaningful moves toward this goal. The initiatives announced by the departments of Commerce and State propose the following:

- Rebuilding the lists of controlled technologies and goods contained in the ITAR and the EAR, which currently have completely different structures and take different approaches to defining controlled products — into complementary lists and policies.
- Revising the controlled items into tiered lists to distinguish items that should be subject to stricter and more permissive levels of controls for different destinations, end-uses and end-users.
- Creating a system in which there are sharper dividing lines between the coverage of the control lists in the ITAR and the EAR to allow users more easily to determine which agency has jurisdiction.
- Restructuring the U.S. Munitions List in the ITAR and the Commerce Control List in the EAR so that they are "positive lists" that describe controlled items using objective criteria (such as horsepower or descriptions of physical capabilities), rather than the more subjective, largely design/intent-based criteria that characterize the current lists (especially the ITAR), such as whether an article was designed for a military application.

These proposals, when finalized, will result in control lists that will provide for three tiers:

- *Top Tier:* Items in the top tier will be articles that either: 1) provide critical military or intelligence advantages to the U.S., based upon technology almost exclusively found in the U.S.; or that 2) pertain to weapons of mass destruction.
- *Middle Tier:* Items in the middle tier are those that provide substantial military or intelligence advantage, based upon technology almost exclusively available from multilateral partners and allies of the U.S.
- *Bottom Tier:* Items in the bottom tier will be those that provide substantial military or intelligence advantage to the U.S., based upon technology that is available broadly through the world.

In addition to publishing these overall goals, the departments of State and Commerce brought the proposals to life by publishing concrete implementation proposals. The State Department published a proposed regulation that would rewrite Category VII (tanks and military vehicles) based upon "positive list" attributes that an interagency technical working group determined provided a significant military or intelligence advantage to the U.S., based upon what is intended to be a clear and concise criteria.

Estimates are that the rules, if implemented, would transfer approximately 74 percent of the current

Category VII items to the EAR. The intent was not only to accomplish a rewrite of Category VII, but also to provide a model for rewriting the other categories. The State Department released an accompanying notice that requested input on describing currently controlled defense articles in a positive manner, the recommended tier of control for each defense article and identifying any current defense articles that should be moved out of the ITAR altogether.

The Commerce Department also released a proposed regulation that offers a new set of licensing policies. The proposal would create a new license exception that would allow exports of controlled items to countries that are members of certain export control regimes or NATO countries without need to seek a prior license. It also would ease rules on exports to countries that have not historically represented a significant diversion or proliferation risk. The proposed exception also would include certain requirements intended to provide safeguards against re-exports to other countries, including notification requirements, destination control statements and other requirements.

The proposals are only the start of the export controls process. The agencies have announced that they are planning to publish proposed revisions of such key items as what it means to be "specially designed" for certain uses, what it means to be "publicly available" and what it means to be engaged in "fundamental research," among other items, with the goal of adopting uniform definitions of these phrases as they appear in the EAR and the ITAR.

In addition, hashing out the movement towards positive lists in the ITAR (and the EAR, to the extent necessary) will take considerable agency work, based on what is likely to be extensive industry comment.

Although economic motives certainly undergird much of these efforts, the other reason for this movement is to focus U.S. government attention on more manageable licensing regimes that can receive significant enforcement attention. There may be fewer technologies controlled, but the enforcement activities by both the departments of State and Commerce are not going away, as underscored by two recently announced enforcement actions.

In the first, a foreign subsidiary of PPG Industries Inc. pled guilty to illegally exporting high-performance coatings to a nuclear reactor in Pakistan on Dec. 21, 2010. According to the plea agreement, after the Commerce Department denied a license for the export of its product to Pakistan, PPG conspired to export high-performance coatings to Pakistan through a third-party Chinese distributor, as a means of circumventing its license denial. The settlement called for PPG to pay $3.75 million in fines and to forfeit received gross proceeds of $32,319.

In the second enforcement action, on Jan. 10, 2011, a former NASA employee was charged with illegally exporting ITAR-controlled infrared military technology to South Korea. According to the criminal information, Kue Sang Chun knowingly exported and caused the export from the U.S. to South Korea of infrared focal plane array detectors and infrared camera engines that are found on the U.S. Munitions List, without first obtaining the required license from the State Department.

Further compounding the woes of Kue Sang Chun, he also was charged with failing to report the

$83,399.08 in income that he made from these sales on his individual tax return. Although the case still needs to proceed to potential trial or settlement, recent convictions in analogous cases, such as the 37-month sentence handed down on Jan. 3, 2011, to Emenike Charles Nwankwoala for exporting arms without a license, and the 2008 case of former University of Tennessee professor Dr. J. Reece Roth, who was sentenced to four years in prison for the illegal export of military technical information related to plasma technology, show the potential for significant prison time for Kue Sang Chun.

It is not clear whether the technologies involved in these cases would still be controlled under the new approach of the departments of Commerce and State. Regardless, these cases represent the continuing escalation of fines and penalties, as well as the willingness of the U.S. government to vigorously prosecute individuals for violations of the nation's export controls laws and regulations.

It is probable that these trends will continue under the new proposals. As the export regulations move to a clearer and more understandable form, it is likely that there will be less room for defendants to argue that their actions did not involve controlled technologies or goods, since fuzzy terms such as whether an item truly was "designed for" a military application, are likely to be replaced with less nebulous and more objective criteria.

The likely impact will be a greater willingness of the departments of State, Commerce and Justice to be more aggressive regarding clearer violations of the law, and for prospects of a successful defense based upon the ambiguity of the regulations to decline.

Further, the agencies have taken concrete steps to enforce their export capabilities as part of the movement towards a new system. In a recent speech, Eric Hirschhorn, the undersecretary for industry and security at the Commerce Department, noted that the Commerce Department has taken multiple steps to enhance enforcement of U.S. export controls, including relying on new electronic validations in U.S. Customs and Border Protection's Automated Export System to identify problematic exports, as well as working with the Federal Bureau of Immigration, Immigration and Customs Enforcement, and the intelligence community to identify leads regarding export controls violations.

It is worth noting that one of the first actions taken when beginning the process of rewriting the export control regulations was the establishment of the Export Enforcement Coordination Center, which was established by executive order on Nov. 9 to better coordinate the expected increase in enforcement activity of the country's export controls laws. Pursuant to this initiative, enforcement agents even are being placed abroad, in countries such as China and Singapore, to expand the enforcement reach of the U.S. government.

For all these reasons, it is likely that enforcement activity under the new system will be greater than under the current one, even if export controls simplification occurs. This underscores that all exporters of controlled goods, information, technology and information need to pay close attention to the proposed changes. It appears that there will be a series of opportunities to comment on proposed new regulations, which could be of intense concern to affected entities.

For other companies, particularly defense contractors, a host of issues require close monitoring,

including the status of any controlled goods or technologies they use, the impact on any licenses issued by the departments of Commerce and State, the procedures for classifying goods and technologies, and the operation of their compliance programs. Great care will need to be taken to ensure that companies and individuals affected not suffer the fate of PPG or Kue Sang Chun in the tumult of the switchover to what is likely to be an extensive rewrite of the export controls regulations over the coming year.

--By Gregory Husisian, Foley & Lardner LLP

Greg Husisian (ghusisian@foley.com) is of counsel in Foley's Washington, D.C., office. He currently is finishing a treatise entitled "U.S. Regulation of Exports and International Conduct," which will be published in the spring of 2011.