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Defense Trade Advisory Group (DTAG) Export Control Reform Working Group

DTAG Working Group Members:

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Purpose

This DTAG Working Group was tasked to: "Research industry's views of the munitions/dual-use split pipeline State has adopted as a result of ECR. Analyze whether there is greater flexibility for exporters resulting from the transfer of certain items to the jurisdiction of the Export Administration Regulations, including the availability of the Strategic Trade Authorization license exception. Review and identify potential unintended consequences as a result of the publishing of new U.S. Munitions List and Commerce Control List categories. Identify areas of improvement and/or consideration." Tasking for this DTAG Working Group was contained within a Department of State letter dated June 30, 2015.

Working Group Methodology

As part of the assigned tasking, the Working Group conducted a review of the DTAG ECR Working Group White Paper work product dated January 16, 2014. The DTAG Working Group which authored the 2014 White Paper was specifically tasked to "Identify potential negative impacts and unintended consequences of the Export Control Reform (ECR) initiatives on industry and provide recommendation on how to overcome/minimize such impacts." Several of the unintended consequences of ECR initiatives identified in the 2014 White Paper were validated as continuing issues. As part of this assessment, the Working Group validated several of the previously identified unintended consequences of the ECR initiative as well as identified several new consequences both of which are included in the following assessment summary. The newly identified consequences and examples were identified internally within the DTAG membership as well as obtained from industry members external to the DTAG.

Discussion Points:

ECR Observation #1 Analysis of Munitions/Dual Use Split Pipeline

The DTAG was asked to provide feedback on the processing by State of "600 Series" license requests. Unfortunately, the DTAG membership was unable to provide such feedback as they do not have access to the staffing practices of "600 series" license submissions.

ECR Observation # 2 – Establishment of a Single Agency, Single Policy, and Single Coordination Office for U.S. Export Management Has Not Been Achieved

Several U.S. agencies and offices are involved in the ECR initiative with no apparent single position of control for final decision making purposes. Involvement of these many disparate government entities are a "piece meal" result of the entities becoming involved as a result of:

- Human Rights legislation
- Anti-boycott legislation
- Embargos
- Arms Export Control Act
- Export Administration Act
- International Conventions and Agreements
- Tracking Drug and Terrorist Money and Arms Movement

ECR Observation # 3 – Inconsistent Interagency Acceptance of USML/CCL Classifications Remains a Concern

Industry continues to experience instances where DoD disagrees with the revisions to the USML and the CCL and the classifications industry cites on its license submissions. Examples were reviewed where DoD have recommended a Return Without Action (RWA) position for "600 Series" submissions indicating that the item should have remained on the USML even though the item is clearly cited on the CCL. DDTC acceptance of DoD determinations in essence equates to DoD making export policy. In general, industry perceives that DoD is asking for a large scale reversal of the items moved to the CCL and their return to the USML with the expectation that following the Order of Review as the correct way to classify an item is not consistent with reality. Additionally, when conflicting decisions on product jurisdiction and classification arise, no method exists to address ECR concerns as they occur. Essentially, industry is left with a long road of RWAs to overcome and each instance is handled as a one-off company specific issue, rather than a technology concern. Interim guidance to U.S. companies remains an important element of the ECR Initiative. A method is required to highlight areas of controversy as these controversies arise, then have DDTC provide interim guidance based on the analysis conducted at the time the controversy arose. This interim guidance would then become binding until a formal policy or regulatory change is issued. If no formal policy or regulatory change is issued, the interim guidance would stand. This is an approach that DHS undertakes with a degree of regularity. Following the conclusion of an initial issued license, a company can conduct a CJ and a CCATS on the controversial item or the part 748.3 procedure with BIS, whichever makes more sense depending on the nature of the controversy. DDTC could publish a WebNotice or an FAQ about the item and

the jurisdictional question and how they resolved it, without being too specific as to the involved company or the item. Currently, in many cases the independent judgment industry could rely on prior to the change in the regulations no longer remains. The approach being affected by the U.S. offices charged with compliance are making it too difficult to find a Safe Harbor even in those cases involving no intent, just an error.

ECR Observation #4 – Differing Interpretations of Key Definitions

The DTAG recognizes the various U.S. Government attempts at clarifying the meaning of the terms found in both the ITAR and EAR. In reality, many of the clarification attempts have generated more inconsistencies in interpretations amongst industry themselves as well as with the government licensing authorities. An example of differing and confusing terms is "tooling". Generally, tooling was moved to the EAR under ECR however, some USML categories continue to identify general buckets of tooling and test equipment related to platforms. The confusion is created by having items generally captured under the USML by generalized buckets but then also have those items enumerated on the CCL. The most important definition of ECR is specially designed. That too has come under scrutiny as not being clear. The adage that 10 people given the same pieces of information will yield the same jurisdiction and classification in using specially designed simply is not reality. To mitigate this concern, Federal Register Proposed Notices should continue to be used as a barometer of potential impact of the terminology and definitions. Additionally, the DTAG should be considered as a reviewing entity to provide feedback.

ECR Observation # 5 – Positive Results of ECR

It was assessed that positive effects of the changes have been achieved under ECR. Many in industry were able to relinquish Technical Assistance Agreements for the use of license exceptions under the EAR or simpler licenses (BIS-748P). Additionally, the license exceptions available under the EAR such as GOV and STA provide more options for exporters than were previously available to them under the ITAR. To date, the ongoing ECR initiative to overhaul the nation's export control system as a means to enhance U.S. national security has achieved several significant milestones. Among these milestones are included:

- Creation of a more positive USML
- Publishing of final rules on 15 of 21 USML Categories
- Amending the EAR and the CCL to control former USML items through establishment of "600 series" ECCNs
- Revised definition of "specially designed" based on a catch-and-release construct

Additionally, changing the jurisdiction of military items, mostly parts and components, that do not provide a critical military or intelligence capability has significantly benefitted U.S. defense companies. As an example, one Tier One OEM of an U.S. inventoried military aircraft stated that after completing the re-classification of the in excess of 48,000 unique parts (the aircraft engine being one unique part) comprising the aircraft, approximately 95% of the parts reclassified moved to the CCL with the remainder of the aircraft's parts remaining on the USML.

ECR Observation # 6 – License Exception Strategic Trade Authorization (STA) for "600 Series" is often interpreted as requiring the Foreign End-User Government to sign a Prior Consignee Statement. 740.20(d)(2) states in pertinent part "…Prior Consignee Statement. The requirements in

this paragraph (d)(2) apply to each party using License Exception STA to export, reexport or transfer (in-country), including reexporters and transferors of items previously received under License Exception STA. The exporter, reexporter, or transferor must obtain the following statement in writing from its consignee prior to shipping the item and must retain the statement in accordance with part 762 of the EAR…In addition, paragraph (d)(2)(vii) is required for all transactions in "600 series" items and paragraph (viii) of this section is required for transactions in "600 series" items if the consignee is not the government of a country listed in Country Group A:5." Little to no use of STA for "600 series" items was noted largely due to the thought that even if the exporter were to assume the End-User Government is exempt from this Prior Consignee Statement, because they are the *end user*, the definitions do not entirely support that interpretation when read with 740.20(d)(2). End-user as defined by BIS is the person abroad that receives and ultimately uses the exported or reexported items and may be the purchaser or Ultimate Consignee. The Ultimate Consignee, is defined as the principal party in interest located abroad who receives the exported or reexported items and may be the end-user. As stated in 740.20(d)(2) if paragraph (viii) is required when the *consignee* is not the government of a country listed in Country Group A:5, then the end user government for purposes of STA must be a consignee for the requirement of the Prior Consignee Statement. No Country Group A:5 government is willing to sign this statement. Accordingly, 740.20(d)(2) should be annotated to state that the government of a country listed in Country Group A:5 is not required to sign a Prior Consignee Statement.

ECR Observation # 7– Reclassification of Hardware and Data Continues to be Problematic for Industry

As noted during the 2014 DTAG, significant expenditures of time, money, and company resources continue to tax industry in reclassifying products to fully implement ECR. The expenditure of substantial company costs negates lower unit cost and adversely impacts U.S. industry's competitive edge in the international marketplace. The ECR objective of establishing a positive list (i.e., a "look up table") for export controlled items has not come to fruition. Foreign recipients of U.S. technical data and or hardware continue to experience difficulty in classifying the items they already have in their inventories which in turn increases the level of difficulty for tracking de minimis application. As a result, the see-through rule applicability to ECR appears flawed when dealing with positive control lists. USG regulators must remain sensitive to the effects of regulatory changes and industry's global competitiveness. USG regulators must be open and agile to industry comments and simplification as industry implements changes.

ECR Observation # 8- Product Classification

Exporters appear to be using different classifications for the same product which is resulting in significant inconsistencies. As an example, a supplier provided ABC Company with a .y classification for one of its parts. ABC Company's review could not conclude .y (reading the coverage differently) electing instead to treat the part as .x. When ABC contacted the supplier to advise its classification on the part, the supplier advised that it, possibly at the direction of DOD, had submitted a CJ (instead of a CCATS). The CJ has been in process for 8 months. The part is not positively identified on the USML and a search of the CJ determinations listing on DTC's website shows that only one part of similar capability is captured on the ITAR, the rest being "600 series" or even EAR99. Neither ABC Company nor the supplier has any indication as to why the CJ is taking so long. As a result, it appears that both Commerce and DOD are managing exports of "600 series" items.

A company confidently self-classified a product and submitted a license for test equipment under 3B611.a. DoD recommended to RWA the case based on their internal review, advising the company to submit a license to DDTC under USML Category XI(a)(6) which is currently a "RESERVED" section of the USML. Upon receipt of the re-submission, DDTC RWA'd the submission due to XI(a)(6) not being a valid USML Category. The company then submitted a new license submission to DDTC citing the test equipment under a USML category that 'closely' fit the item's description but the USML description did not 'positively' identify the item. Following review, DDTC and DoD approved the license which resulted in the approval of an item under the wrong jurisdiction and inappropriate USML Category. During all of the above processing, the exporting company contacted the product manufacturer which, in writing, provided it the classification as ECCN 3B611.a.

ECR Observation # 9 – Appearance That License Provisos Are Being Used To Set Policy

Industry is facing challenges through the proviso language applied in a one-off manner with no consistency with current regulations. For example, a recent proviso was issued that established interpretative guidance on the definition of a defense service. The details in the proviso appear counter to the current interpretation and is inconsistent with DDTC's published proposed definition changes. Another example was observed where a company reported that a "600 Series" Department of Commerce license submission was RWA based on DoD review. The technology requested for export is related to component-level hardware classified under the CCL as 3A611.x as part of a potential offset offering. This technology was previously classified as USML XI(d) for XI (C), however the technology transitioned to the CCL at the end of 2014. The license request classified the technology under ECCN 3E611.a for 3A611.x. The radar remains controlled under the ITAR, USML Category XI(a)((3). Of note, the submission contained "600 Series" data that met the criteria for use of the STA exception. Rather than utilizing the STA exception, the applicant elected to submit a license request. Upon receipt of the "600 Series" license submission, Dept of Commerce routed the submission to DoD (DTSA) for review. DTSA in turn routed the submission to the Tri Service Committee for review. The TSC review position was returned to DTSA with a review position recommending RWA due to the release of the information being prohibited for release in accordance with an issued LO/CLO EXCOM memorandum. This DoD action is viewed as being in conflict with the intent of ECR and the movement of the technology from jurisdiction under the ITAR to control jurisdiction under the EAR.

ECR Observation # 10 – Industry Requires Flexibility During the Period of ECR Transition

Product classification remains a significant undertaking, especially for distributors and foreign governments who are not the original manufacturer of the parts and which in some cases, the original equipment manufacturer either no longer exists or it takes time to locate a representative of the manufacturer to have the part classified. In the case of aircraft parts, some exporters have found it to be easier to cite all parts under 9A610.x as a safeguard. As an example, when a foreign government needs to temporarily import 500 lines of items to support joint activities with US troops (UAV, flight training, etc.) each of those items is to be classified under the Order of Review and in most cases using the Specially Designed definition. To save time for the export, the exporter may arbitrarily assign all items to 9A610.x. Other examples that require flexibility during the ECR transition is the classification of parts and components for old land vehicles and aircraft. In many instances, the original manufacturer is no longer in business or available to assist in the product's classification. Having a part properly classified only to have it seized by Customs under the assessment that the item should have remained on the ITAR and requires a DSP-5

license remains problematic. Of note, one company noted that they had previously obtained licenses to sell civil aircraft internationally with little to no issues. After ECR was implemented, the license submission split no longer existed and they now put the value of the entire aircraft, including the mission system, on the license instead of only the mission system that's controlled. This larger value triggers Congressional Notification where previously it was not required.

One improvement for ECR that can be considered is related to industry participation in list updates. Industry desires to participate and be able to talk ITAR and EAR at the same time. Industry also desires to have a process where industry can suggest changes without necessarily having to wait to be asked. The bright line was never supposed to be a terms or definitions thing—it was supposed to be a list which has not occurred. It is becoming the norm for instances of ITAR and EAR regulated commodities and technical data coming into contact more frequently than before and it appears that DoD is reverting back to the belief that crown jewels equate to any item in the U.S. military inventory. In reality, DoD appears to applying discretion and analysis to what was supposed to be a positive list. Terms are very important and industry requires formal guidance on the terms.