

## International Trade

April 19, 2013

### **Export Control Reform Is Here: Aerospace Industry is First, Others to Follow**

On April 16, 2013, the Obama Administration, through the departments of State and Commerce, issued important new rules as part of its Export Control Reform (ECR) initiative. These rules, which are the first in a series of new State and Commerce regulations expected in the coming months, become effective on October 15, 2013 and will have a major impact on the aerospace industry, which is heavily regulated under U.S. export control laws. Specifically, the rules will transition control over a number of items manufactured for the aerospace industry from the International Traffic in Arms Regulations (ITAR) to the Export Administration Regulations (EAR), requiring aerospace companies around the world that manufacture, export or re-export ITAR-controlled items to evaluate and amend their current authorizations and restructure compliance activities in order to meet tight regulatory deadlines and avoid violations of the new laws. As further ECR final rules are published, companies in other regulated industries will also need to account for additional changes within this evolving framework.

#### **Summary of U.S. Export Control Laws**

U.S. export controls are primarily comprised of two major regulatory regimes: (i) the ITAR, administered by the U.S. Department of State (“State”); and (ii) the EAR, administered by the U.S. Department of Commerce (“Commerce”). The ITAR regulates the export of military commodities, technical data and services (i.e., defense articles and services) and requires authorization (either a license or an exemption) from the agency for all exports. The EAR regulates the export of commodities, software and technologies that have a commercial and some other strategic application (e.g., military, terrorism, etc.)—often referred to as “dual-use”—and requires licensing based on the classification of the item under the EAR, its destination, end use and end user. The broad reach of these laws can affect activities all over the world that have a U.S. nexus, including mergers and acquisitions, the structure of supply chains, types of permissible customers and end-users, employment decisions and information technology networks, among others.

#### **Major Reforms**

The ITAR includes a list of covered items, known as the U.S. Munitions List (USML). Similarly, the EAR contains a list of items that are covered, known as the Commerce Control List (CCL). The new rules make substantial changes to the structure of the USML and CCL, transfer certain items from the USML to the CCL, provide more precise guidance on making decisions regarding whether an item is subject to the ITAR or EAR and update how items may be exported under export licenses and exemptions. As noted above, the new rules become effective on October 15, 2013.

***Restructuring the ITAR and EAR***

One of the goals of the reforms is to provide more precision in the description of items in the laws to allow affected parties to understand whether their items are covered by the laws and, if so, under what “category” (in the case of the ITAR) or “classification” (in the case of the EAR). To accomplish this, the ITAR rule has added more detail on the types of items covered under the current military aircraft category—what the agencies call a “positive list”—that attempts to identify controlled items based on more detailed performance criteria rather than general descriptions. In addition, the ITAR has added a new Category XIX covering gas turbine engines and associated equipment, including items that were formerly within Category VIII (military aircraft).

Within the EAR, Commerce has significantly expanded Category 9 to include, among other things, a detailed list of military aircraft and related commodities in Export Classification Control Number (ECCN) 9A610. Category 9 will also now include military gas turbine engines and related commodities in ECCN 9A619. This new “600 Series” of classifications refers to ECCNs that have “6” as the third digit (e.g., 9A619) and covers military items formerly under the ITAR, and is intended to be the format for changes to other non-aerospace CCL categories as additional rules are published.

***Transferring Certain Aerospace Items from the ITAR to EAR***

Under the new rules, ITAR Categories VIII (Aircraft and Related Articles) and XIX (Gas Turbine Engines and Associated Equipment) will now list aerospace items that are subject to those categories in detail, including naming certain aircraft, and parts thereof, that remain subject to the ITAR. For example, revised Category VIII lists thirteen types of aircraft (e.g., bombers, fighter bombers, attack helicopters) that are covered. Similarly, new Category XIX describes certain types of turbofan and turbojet engines covered based on thrust capacity and other characteristics, but also identifies certain engines by name that remain subject to the ITAR (i.e., GE38, AGT1500, CTS800, TF40B, T55, TF60 and T700).

The State rule also creates certain “catch-all” provisions that control items that are “specially designed” (a concept discussed in more detail below) for military aircraft. For instance, revised USML Category VIII(h) controls parts “specially designed” for the B-1B, B-2, F-15SE, F/A-18 E/F/G, F-22, F-35 and F-117. Similarly, parts “specially designed” for the AE1107C, F101, F107, F112, F118, F119, F120, F135, F136, F414, F415, J402, GE38, TF40B and TF60 engines are now controlled under new Category XIX(f). Items that fall outside these more specific USML categories are transferred to the CCL.

As noted above, the Commerce rule captures these military items in the 600 Series of the CCL. For instance, ECCN 9A619 controls gas turbine engines “specially designed” for military use. The majority of items identified in this ECCN, and others in the 600 Series, are subject to licensing requirements when exported to most locations because they are associated with restrictive reasons for control (e.g., National Security (NS1) controls). Certain 600-Series items (e.g., ECCN 9A619.y), however, are only subject to Anti-Terrorism (AT) controls that generally do not require export licensing to most destinations. Furthermore, as discussed below, most items in the 600 Series are eligible for license exceptions.

***Determining Whether an Item is Subject to the ITAR or EAR***

A vexing question for many exporters in the aerospace industry, and other industries heavily regulated under the ITAR and EAR, has been determining whether an item is subject to the ITAR or EAR. That determination drives conclusions about which federal agency oversees activities related to exporting, but the law has been remarkably vague on how to reach such conclusions, giving rise to significant uncertainty and a sense of heightened regulatory risk. One of the goals of ECR is to provide more detailed guidance on this question. As noted above, one way that the State rule attempts to clarify ITAR jurisdiction by creating a “positive list” of items in USML categories.

When a “catch-all” provision applies, however, the State rule attempts to clarify whether an item is subject to ITAR through the revised definition of “specially designed.” This definition operates through a so-called “catch and release” process. The first section of the definition “catches” any items that (i) as a result of development, has properties peculiarly responsible for achieving or exceeding the controlled performance levels, characteristics or functions described in the relevant USML paragraph, and (ii) is a part, component, accessory, attachment or software for use in or with a defense article. It then “releases” items from the definition if it (i) is subject to the EAR according to a commodity jurisdiction (CJ) ruling; (ii) is a fastener, washer, spacer, insulator, grommet, bushing, spring, wire or solder; (iii) has the same function, performance capabilities and the same or “equivalent” form and fit as a production item that is not on the USML; (iv) was or is being developed with “knowledge” that it will be used for both USML and non-USML items; or (v) was or is being developed for general purposes, and not for a specific application. As a result of these exclusions, various items can be excluded from the catch-all provisions in the USML and consequently transferred to the CCL.

On a related point, the EAR also contains an updated definition of “specially designed” that generally aligns with the new ITAR definition of this term. This definition is primarily used to determine whether an item is properly classified within the 600 Series. In response to public comments, the Commerce rule establishes a new process for submitting Commodity Classification Automated Tracking System (CCATS) requests to Commerce to confirm that certain items (i.e., parts, components, accessories, attachments and software) do not meet the definition of “specially designed.” This request would result in an interagency review involving State and the Department of Defense, and is thus modeled to replicate the current CJ request process under the ITAR.

***State Licensing of CCL Items***

Given the transfer of many military-related items from the ITAR to CCL, many in the aerospace industry worried that this transition would result in companies being required to more frequently apply for both the ITAR and EAR licenses to support a single military program. To address these concerns, State now has authority to issue licenses and authorization for certain items that are subject to the EAR. USML categories will now include a “paragraph (x),” which will control commodities, software and technical data subject to the EAR that are used in or with defense articles controlled in the relevant USML category. State may issue authorization for the export of these category (x) items so long as they are (i) for end use in or with a USML defense article proposed for export, (ii) described in the purchase documentation submitted with the export application and (iii) separately enumerated within the license application.

***EAR License Exceptions***

These new rules also attempt to make EAR licenses available and beneficial for use in exporting 600 Series items. In particular, Commerce modified the Strategic Trade Authorization (STA) license exception to facilitate its use for almost all 600 Series items. As background, STA authorizes the export, re-export or in-country transfer of certain eligible items to certain eligible countries in lieu of a license if certain requirements (e.g., certifications) are met. Under the new rule, STA is eligible for most 600 Series items, but can generally only be used if the ultimate end user is an approved government or, in some cases, a person in the United States. In addition, all parties to the STA authorization (e.g., purchaser, intermediate consignee, foreign consignee, etc.) must have previously been approved on an export license issued by Commerce or State. This requirement is to ensure that all parties have, at some point, been properly vetted by one of the agencies.

In addition, because items subject to the 600 Series have less military significance than those subject to the ITAR, Commerce determined that they should not be subject to EAR exceptions that are more restrictive than comparable ITAR exemptions. As such, revisions were made to a number of EAR exceptions (e.g., TMP, RPL, GOV, TSU and STA) in order to harmonize those exceptions with relevant ITAR exemptions. Because the 600 Series items remain military items or items designed for military application, however, Commerce has also placed restrictions on the use of EAR exceptions for exports or re-exports of 600 Series items to countries with a U.S. arms embargo.

**Implementation and Transition Plan**

The twin State and Commerce rules become effective on October 15, 2013, giving manufacturers, exporters and other affected parties just 180 days to accomplish some enormous tasks. To assist U.S. companies in dealing with the period leading up to and after the effective date, State and Commerce have outlined a detailed transition plan. The transition plan presents a number of issues, including the use of authorizations currently in place for items transitioning to the CCL and the process for seeking export authorization during and after the 180-day transition period.

During the 180-day transition period, license applications will be accepted by both the Directorate of Defense Trade Controls (DDTC) and the Bureau of Industry and Security (BIS) for items moving from the USML to the CCL. However, BIS will not issue approved licenses for those items until on or after October 15, 2013. After that date, DDTC will no longer accept license applications for any items that have moved from the USML to the CCL, unless those items are identified in a paragraph (x) entry.

Authorizations issued by State prior to and during the transition period remain valid for a certain period of time after October 15, 2013, depending on the items authorized. Attachment A to this article contains a chart identifying the validity of various State licenses and agreements authorizing the export of items transitioning to the CCL.

**Implications**

These reforms will have a major impact on regulated companies, particularly in the aerospace industry. In the short- to medium-term, the impact will likely involve a significant burden on companies that must

adjust their compliance programs to account for the new export jurisdiction, classification and licensing requirements. Specifically, implementing these changes will be particularly difficult for companies that export items that are subject to both the EAR and ITAR. Among other things, companies will be required to undertake the following:

- a. re-evaluate all ITAR-controlled items to confirm that they are properly classified
- b. re-assess their licensing structure to ensure that proper authorization exists that is consistent with the transition plan
- c. review existing policies and procedures to ensure that they properly reflect these updated procedures
- d. re-train employees regarding these changes
- e. coordinate with business partners regarding these changes
- f. update markings and control statements.

In light of the above, many aerospace companies will be challenged to address all of these issues within the next 180 days.

In the long term, however, these new rules may offer the possibility to reduce licensing burdens, although it may increase compliance resources needed to properly manage the complexity associated with license exceptions. For some companies, the result of these changes may be a transition to more Commerce licensing for companies that export ITAR-controlled items, but an overall reduction in export licensing requirements. To enjoy the benefits of these changes, however, companies must invest resources to update their compliance program to align with these new requirements and avoid missteps and violations in their exports and licensing under the ITAR and EAR.

## Attachment A – Validity of State Department Export Authorizations

State Authorization	Validity
ITAR Agreements — all items transitioning to CCL	Two years from effective date of revised USML category (i.e., for Category VIII and Category XIX, October 15, 2015) or date of expiration, whichever comes first, unless revoked, suspended or terminated.
ITAR Agreements — some items transitioning to CCL	Two years from effective date of revised USML category (i.e., for Category VIII and Category XIX, October 15, 2015) or date of expiration, whichever comes first, unless revoked, suspended or terminated. To remain valid beyond two years after the effective date of the revised USML category, they must be amended to authorize the CCL items using the new (x) paragraph.
DSP-5 Licenses — all items transitioning to CCL	Two years from effective date of revised USML category (i.e., for Category VIII and Category XIX, October 15, 2015), until returned by license holder, or expired, whichever comes first, unless revoked, suspended or terminated.
DSP-5 Licenses — some items transitioning to CCL	Until expired or returned by license holder, unless otherwise revoked, suspended or terminated.
DSP-61 and DSP-73 Licenses	Valid until expired or returned by the license holder, unless otherwise revoked, suspended or terminated.

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