AKIN GUMP STRAUSS HAUER & FELD LLP
Attorneys at Law

March 31, 2005

INTERNATIONAL TRADE ALERT

U.S. BUREAU OF INDUSTRY AND SECURITY'S PROPOSED REVISIONS TO DEEMED EXPORT RULE MAY EXPAND SCOPE OF RULE

OVERVIEW

On March 28, 2005, the Bureau of Industry and Security (BIS) at the U.S. Department of Commerce (Commerce) issued an "Advance Notice of Proposed Rulemaking" (Notice) involving provisions in the U.S. Export Administration Regulations (EAR) governing the transfer of controlled technology to foreign nationals in the United States or abroad, commonly known as the deemed export rule (the Rule). The Notice was drafted in response to a report issued in March 2004 by the Commerce Office of the Inspector General (OIG) that identified potential gaps in the control of such technology transfers.

The proposed changes would institute a new requirement to analyze the country of birth of a foreign national in assessing EAR deemed export licensing requirements. In addition, if implemented, the revisions could expand the circumstances in which an export license is required from the U.S. government to provide foreign nationals access to technology related to the "use" of items that are controlled under the EAR. As this suggests, the proposed changes could have a significant impact on business operations for many companies and require companies that deal with deemed export issues to review and revise, as applicable, export compliance procedures.

BACKGROUND – THE DEEMED EXPORT RULE

Under the EAR, an export includes the "release" of technology and source code to foreign nationals as an export. Depending on the technology involved and the nationality of the recipient, deemed exports may require authorization, in the form of a license issued by BIS, prior to release. The Rule, however, does not apply to persons lawfully admitted to the United States for permanent residence or to persons otherwise subject to residential protections under the U.S. Immigration and Naturalization Act.

The definition of "release" gives the Rule a very broad scope of application. Under this definition, technology or source code can be "released," and thereby exported, through any of the following methods:

- the visual inspection by a foreign national of U.S.-origin equipment or facilities
- the oral exchange of information in the United States or abroad
- the application of personal knowledge or technical experience acquired in the United States.

These provisions make it possible for U.S. companies to violate U.S. export controls simply by granting foreign nationals, including employees, access to controlled technology or source codes.

PROPOSED CHANGES TO THE RULE

As required by the FY 2000 National Defense Authorization Act, the OIG conducted an interagency review to assess whether current deemed export control laws and regulations adequately protect against the release of controlled U.S. technology to countries of concern. The OIG also analyzed compliance with the Rule by U.S. industry, academic institutions and federal research facilities. In March 2004, the OIG issued a report that identified certain concerns with current U.S. technology control and provided recommendations to address those concerns.

In response to the OIG report, BIS issued the March 28, 2005, Notice describing certain proposed changes and soliciting public comment on these changes prior to the initiation of formal rulemaking. The March 28 Notice covered the following proposed changes to the EAR involving the Rule.

Recognizing Country of Origin of Foreign Nationals

Currently, in applying the Rule, BIS examines a foreign national's most recent citizenship or permanent residence to assess whether licensing requirements apply. In its report, the OIG claimed that this policy allows foreign nationals who are born in countries of concern to "bypass" the screening process and access controlled dual-use technology by becoming permanent residents or citizens of other countries. In order to address this concern, the OIG has proposed that the current policy be amended to require an export license when a foreign national was ***born*** in a country for which the technology in question is EAR-controlled.

The Notice contains two ambiguities that could have an important impact on corporate compliance. First, the Notice does not state that naturalized U.S. citizens or permanent U.S. residents will be exempt from the proposed requirement, as suggested in the OIG report. Second, the Notice does not clearly explain whether both the country of birth and the country of citizenship/permanent residence should be analyzed under the proposed changes to determine licensing requirements (as the OIG report implies) or whether the analysis of applicable licensing requirements will be limited to country of birth.

Modifying the Definition of "Use"

The release of controlled technology to a foreign national can include the provision of information related to the "use" of an item controlled under the EAR. Currently, "use" is defined in the EAR as the following: "operation, installation (including on-site installation), maintenance (checking), repair, overhaul ***and*** refurbishing." (Emphasis added.) The OIG expressed concern that BIS practice has been to require licensing of deemed exports only if the information to be released meets all six criteria. Thus, for example, a foreign employee that receives only the operating instructions related to a controlled centrifuge is not subject to the Rule because he is not accessing information related to the repair, refurbishment, etc. of the item, i.e., the other "use" criteria. The OIG asserted that this approach has made the objective of technology control associated with EAR-controlled equipment "almost unobtainable."

To address this perceived gap in the regulations and practice, the OIG has proposed amending the definition of "use" to make it disjunctive, i.e., the definition of use should cover "operation, installation (including on-site installation), maintenance (checking), repair, overhaul ***or*** refurbishing." (Emphasis added.) Under the proposed revision, the same employee in the example above would be subject to the Rule merely by receiving instructions to operate the controlled centrifuge. In other words, the revised definition could require an export license if the transfer of information relates to only one – as opposed to all six – of the criteria.

Revising Interpretive Guidance Regarding Government-sponsored and University Research

The OIG has also recommended clarifications to two interpretations of the Rule that are included in Supplement 1 to Part 734 of the EAR. Essentially, the OIG suggested that the answers contained in the Supplement be revised in order to ensure that it is consistent with the proposed definition of "use" and current BIS policy. These changes are limited, however, to circumstances involving government-sponsored and university research.

IMPLICATIONS FOR BUSINESSES

The OIG's recommended changes could significantly expand the activities and/or persons subject to export licensing requirements under the Rule. As an initial matter, if the changes are implemented, companies with controlled technology will need to review and, as appropriate, revise their export compliance programs to adjust to the revised regulations and/or new policy. The proposed revisions suggest that specific areas of concern for initial review will include screening of foreign employees, business partners and independent contractors (e.g., outsourcing) to ascertain their country of birth. Moreover, technology control plans and any associated systems (e.g., company intranets) will need to be analyzed to ensure that access is restricted for foreign nationals who may perform discrete functions related to controlled equipment maintained by the company (e.g., repairs and maintenance).

Ultimately, the practical impact on individual companies will depend on a number of factors specific to each company, including: (1) the nature and extent of controlled technology maintained by the company – particularly technology that is required for the "use" of controlled equipment under the EAR, (2) the involvement of foreign nationals in company operations associated with controlled technology and (3) the structure of the current export compliance program, including screening procedures and the company technology control plan. Depending on the language of the final rule and conclusions reached during a preliminary assessment of impact of the rule on the company export compliance pro-

gram, additional areas may require examination. With these considerations in mind, the changes to corporate internal controls required as a result of the final rule may range from minor to highly burdensome.

CONCLUSION

Comments on how the recommendations could affect industry, academic institutions, U.S. government agencies and holders of export-controlled technology are due to BIS by **May 27, 2005**. In this regard, BIS has stated that it is particularly interested in the following:

- views on the impact the proposals will have on technology developers and manufacturers, academic institutions, and U.S. government research facilities
- data on the number of foreign nationals in the United States who will face licensing requirements if the OIG's recommendations are adopted and impact on compliance, e.g., cost, resources, procedures
- any alternative suggestions regarding the concerns raised by the OIG.

The comment procedure provides industry with an opportunity to assess preliminarily the impact of the proposed changes and participate in shaping the language of any revisions to regulations or policy at an early stage. Accordingly, if the proposed changes raise significant concerns, we recommend prompt action to provide comments to BIS.

CONTACT INFORMATION

If you have any questions or would like to learn more about this topic, please contact the partner who normally represents you, or:

Ed Rubinoff . . . . . .202.887.4026 . . . . . .erubinoff@akingump.com . . . . . .Washington
Wynn Segall . . . . . .202.887.4573 . . . . . .wsegall@akingump.com . . . . . .Washington
Tom McCarthy . . . . . .202.887.4047 . . . . . .tmccarthy@akingump.com . . . . . .Washington
Suresh Maniam . . . . . .202.887.4021 . . . . . .smaniam@akingump.com . . . . . .Washington