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U.S. Export Control Reform What It Means for Shipyards

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In August 2009, President Obama launched a broad inter-agency process for reviewing U.S. export controls, including both the dual-use and defense trade systems, with the stated objective of updating controls to address current threats to U.S. foreign policy and national and economic security by “building high walls around a smaller yard” and focusing enforcement efforts on the “crown jewels.” The reform process has as its goal transformation to a single control list, a single primary enforcement coordination agency, a single IT system and a single licensing agency. These goals were intended to be implemented in three phases. Although ambitious target dates for completion of the three phases have come and gone, considerable progress has been made, including on several previously stalled initiatives that have been placed on a faster track due to the reform initiative, and recently published proposed rules have laid the groundwork for detailed regulatory reform.

PHASES OF REFORM

As originally contemplated, the first phase involves reform that can be initiated immediately without legislation, such as policy and procedural changes and amendments to Regulations. Phase I also encompasses creation of the framework necessary for a new system, including preparation for any legislative proposals and implementation of specific reform actions already underway.

Phase II was billed as involving creation of a “fundamentally new U.S. export control system” based upon the current system by restructuring the existing two control lists (U.S. Munitions List (“USML”) and the Commerce Control List (“CCL”)) into identical tiered structures, as well as paring down the USML by transferring items from the USML to the CCL as appropriate. Congressional notification would be required to eliminate controls on USML items or to transfer USML items to the CCL. This phase also contemplates further consolidation of export licensing including the transition towards a single electronic licensing system and a revamp of export enforcement – both of which will require additional funding.

The final phase would complete the transition to the new U.S. export control system, provided that the necessary legislation is approved by Congress. Ultimately, the goal is to merge the two

control lists into a single list and to implement new processes and procedures to ensure the list remains current. Similarly, in the longer-term, the goal is to consolidate multiple agencies charged with licensing and enforcement into a single export licensing agency and a primary export enforcement coordination agency. Implementation of a single, enterprise-wide IT system which will be used both for export licensing and enforcement also is planned. While on paper the reform initiative was to have been a phased process, in practice the three phases have proceeded somewhat concurrently rather than consecutively, with the result that, while no phase is fully complete, significant progress has been made towards the goals of all three phases.

PROGRESS TO DATE

On November 9, 2010 the President issued an Executive Order establishing an Export Coordination Enforcement Center. The Center falls under the Department of Homeland Security for administrative purposes and will serve as a central point of contact for executive departments and agencies to coordinate and enhance their export control enforcement efforts. The Center also will serve as a primary point of contact between enforcement authorities and agencies engaged in export licensing and will coordinate public outreach activities related to export controls. Finally, the Center will serve as a conduit between Federal law enforcement agencies and the U.S. intelligence community for the exchange of information related to suspected violations of U.S. export controls.

Progress on another key reform proposal, creation of a single IT system to receive, process and screen new license applications and end-users, also is well underway. The agencies reportedly have decided on the single platform to be used and plans for migrating all agencies to the single platform are under discussion.

Likewise, at the direction of the President, in March of this year, the Office of Management and Budget began to plan for streamlining of the various agencies currently overseeing trade and export.

On the licensing front, several specific reforms have been implemented, including movement on several long pending regulatory reforms. Developments include:

- Elimination of duplicate USML licensing requirements for foreign employees (DSP-5 is now the sole licensing vehicle)

- Proposed rules designed to eliminate unnecessary obstacles to exporting products to companies with dual-national and third-country national employees

- Clarification of hand-carried USML technical data exemption

- Removal of requirement for prior approval for certain proposals to foreign persons for Significant Military Equipment (“SME”)

- Elimination of paper filing for agreements and commodity jurisdiction requests and proposed rule regarding electronic payment of registration fees

- Proposed rules updating FMS exemption, permitting temporary export of chemical agent protective gear for personal use, and eliminating license requirements for USML replacement parts and components previously authorized for export

- Senate ratification of long pending defense trade treaties with Australia and the United Kingdom

As can be seen from a review of progress to date, fundamental structural changes remain in the planning stages, while licensing reforms to date have consisted primarily of bringing various previously pending initiatives to fruition.

CHANGES ON THE HORIZON

Considerable work has, however, been done to lay the groundwork for more fundamental regulatory reforms, as can be seen from significant proposed rules issued in late 2010.

On December 9, 2010, the Department of Commerce published a proposed Strategic Trade Authorization (“STA”) License Exception, which, if implemented as planned, would authorize broad-based exports, re-exports and in-country transfers of many CCL items to destinations that are not a threat to U.S. foreign policy or foreign policy goals without an export license. Use of the STA license exception would be optional; exporters could still choose to apply for a license or rely on a different license exception as appropriate. However, the purpose of the planned exception is to further focus export controls on the most critical national security priorities, consistent with one of the primary goals of the reform initiative.

Also on December 9, the Department of Commerce sought public comments on how to make the CCL more clear and positive and “tiered” in a manner consistent with the control criteria developed as part of the reform effort. The Department of State published a similar request on

December 10 with respect to the USML. A three tiered control system is contemplated for both lists, depending upon whether the item controlled provides a critical (Tier I), substantial (Tier II) or significant (Tier III) military or intelligence advantage, and the extent to which the item is available outside of the United States or from its close allies and multilateral regime partners, with Tier I items (the “crown jewels”) being subject to the highest level of controls. The ultimate objective is to make the lists clearer and more positive thereby enabling exporters to easily identify where specific commodities fall based upon set criteria and to align the two lists so that they can later be combined into a single control list. Among other things, the notices signal an intention to revise the USML format to more closely mirror the CCL, in that each USML category would be subdivided into the same subcategories as the CCL (“A” for Equipment, Assemblies, and Components; “B” for Test, Inspection and Production Equipment; “C” for Materials; “D” for Software; and “E” for Technology), with additional subcategories “F” and “G” for Defense Services and Manufacturing and Production Authorizations respectively. The proposed revisions for Category VII of the USML, also issued for comment on December 10, illustrate the contemplated approach.

IMPACT ON EXPORT CONTROLS IN THE SHIPYARD

While few of the concrete reforms accomplished to date have had much impact on the burden of export compliance by U.S. shipyards and their contractors and subcontractors, the recent proposed rules foreshadow considerable progress toward substantial regulatory reform. Although culmination of the migration to a single list, single agency system is unlikely to be achieved in the short term, the current reform initiative appears to have gained sufficient traction to give cause for cautious optimism that the goal of fewer controls focused on the most critical items can in fact be realized.

**This article reflects developments through April 8, 2011. The views expressed herein are those of the authors, do not necessarily reflect the opinion of the firm or other members of the firm, and should not be construed as legal advice or opinion or a substitute for the advice of counsel.*

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