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Preparing For Export Control Reform

Law360, New York (July 09, 2010) -- On April 20, 2010, the Obama administration announced an ambitious plan to fundamentally restructure the U.S. export control system. The reform plan broadly focuses on building “higher walls” around fewer, high-priority items — the so-called crown jewels of American military technology. This would be accomplished by creating a single, streamlined control list, a single licensing agency, a single enforcement coordination agency, and a single, unified IT infrastructure to support the export control system.

The reform plan has high-level support in the administration, with Secretary of Defense Robert Gates first announcing the details of the plan and leading efforts to implement the plan. In President Barack Obama’s January 2010 State of the Union address, the president specifically discussed export control reform as one means of achieving his goal of doubling U.S. exports over the next five years.

For U.S. industry, which has been advocating reform for decades, the administration’s commitment to fundamental reform of the export control system is a welcome development. However, many veterans of previous export control reform efforts remain cautious, having seen similarly ambitious efforts flounder in the face of congressional opposition.

Despite various reform efforts over the years, the export control system has continued to become more complex, operating with insufficient resources and marked by interagency disputes over jurisdictional and other issues. Therefore, the Obama administration must be careful to avoid the pitfalls of past efforts and implement reforms that deliver on the

administration's promises to create a more transparent, streamlined and effective export control system.

This article summarizes the administration's reform proposals and identifies challenges to implementing the reforms that must be addressed by the administration. We conclude by discussing how companies can begin to prepare for potential export control reforms.

Obama Administration's Export Control Reform Proposals

On April 20, 2010, Secretary Gates laid out the administration's reform proposals in detail at an event for business executives. Gates stated that the current regime controlled a large number of items without prioritizing which were most important and without distinguishing between critical and noncritical technologies. Although the U.S. has one of the most stringent export regimes in the world, Gates stressed that stringency did not mean the system was effective. Finally, Gates noted that the maze of different bureaucracies and agencies governing the system resulted in confusion as well as interagency conflicts over authority. Concerns that U.S. exporters are at a competitive disadvantage because of U.S. export control requirements also have motivated the export reform initiative.

The administration's reform plan, as originally articulated by Gates, would consolidate the export control process into what he called "four singles." First, a single export-control list would be created so that exporters need only review one list to determine whether an export license is required. This single list would be tiered so that controlled items would be prioritized based on their sensitivity or importance to U.S. national security or foreign policy interests. The reform plan also would streamline the control list, and items or technologies that do not have substantial military application (e.g., screws and bolts) could be subject to less control or removed from the control list altogether.

Second, a single licensing agency would be created. This single agency would have jurisdiction over munitions items, currently licensed by the U.S. Department of State's Directorate of Defense Trade Controls, and dual-use or commercial items, currently licensed by the Commerce Department's Bureau of Industry and Security. The administration will likely propose that the single licensing authority take the form of a new, independent agency that would be governed by a board of directors comprised of Cabinet officials from the relevant agencies.

Third, a unitary office referred to as an "enforcement coordination agency" or "export enforcement unit" would be responsible for coordinating enforcement of the export control system. Currently, administrative and criminal enforcement responsibilities are spread among several agencies, including the Department of Homeland Security's Immigration and Customs Enforcement, DDTC, BIS, the Census Bureau and the FBI.

Finally, the export control system would have a unified IT infrastructure. Currently, BIS operates under an IT system that was established in 1987, while DDTC only recently moved away from a paper-based system to an online licensing system. Under the reform plan, multiple computer systems and databases would be merged into one system that would process both munitions and dual-use license applications.

The administration intends to implement the reform plan over three phases, as summarized below:

Phase One — The first phase will lay the groundwork for substantive reform and will consolidate the export control regime's existing structure. The executive branch will harmonize and refine the two primary control lists — the U.S. Munitions List and the Commerce Control List — in preparation for creation of the unitary list. The executive

branch will establish criteria for the tiered priority system, with items moving down the tiers of priority as their technology or product life cycle matures.

Phase One will also streamline licensing procedures to increase efficiency and prepare for a single licensing regime. Officials will attempt to synchronize efforts among the various enforcement agencies to eliminate redundancies and conflicts. Finally, in Phase One government officials will assess the current state of the control system's IT infrastructure.

Phase Two — In this phase, the executive branch will finalize the consolidation of the munitions and dual-use control lists. This likely will involve transferring certain items from one control list to another or removing items altogether from the control lists and establishing a new list. Removing items from the munitions list or transferring items between lists will require congressional notification.

Phase Two also will involve restructuring of the control lists, creating tiers of items depending on their sensitivity or importance. The tiered structure serves the reform effort's objectives by protecting the truly critical "crown jewels" while easing controls on less important technologies.

In addition to harmonizing the control lists, Phase Two will attempt to fully harmonize the State and Commerce department licensing policies and practices, taking steps toward the transition to a single licensing system. Finally, Phase Two will continue the transition to a single IT architecture across the export control system.

Phase Three — This phase will require congressional legislation, and will involve merging the two control lists, implementing a single licensing agency, and completing the transition toward a single IT system. Phase Three will also likely involve consolidation of administrative enforcement within an enforcement coordination agency.

Although the administration has not publicized specific dates for the start or completion of the phases, National Security Advisor James L. Jones stated in June 2010 that the administration planned to complete Phases One and Two in 2010. Jones also stated that the administration hoped to initiate the legislative process required for Phase Three in 2010.

The administration is already taking actions under phases One and Two. In his June 2010 speech, Jones noted that the administration had been developing tier criteria for the control lists for several months. In the enforcement area, Jones discussed the administration's ongoing work with Congress on harmonizing export control criminal penalties and exploring the option of a mandatory minimum sentence for criminal violations.

Also, Jones discussed the ongoing development of an Export Enforcement Fusion Center, a standing office composed of employees from all export enforcement entities and intelligence agencies that will help coordinate investigations and eventually screen license applications. With regard to IT infrastructure, IT experts are currently building a single interface for exporters rather than the separate electronic systems currently in place.

Finally, on June 25, 2010, BIS, which administers regulations regarding dual-use items, published an interim final rule streamlining review and reporting requirements for commercial encryption products. The changes will allow exporters to self-classify certain encryption products and export them without a review or license after registration of the company with BIS. The administration also has announced a plan to simplify the treatment of dual and third-country nationals for export licensing.

Challenges to Export Control Reform

The Obama administration's ambitious efforts to reform the export control system will likely face a number of significant challenges. For instance, the administration's phased approach implements an initial set of reforms through its executive authority without the need for

congressional approval. However, critics concerned about national security have in the past stopped export control reform efforts, and if they succeed in stopping legislation to create a single agency and a merged control list, the result may be an even more complex system with partially implemented reforms.

Second, the administration has provided few details on how the control lists would be streamlined. While administration officials have indicated that certain less sensitive military items would be subject to less control in the new tiered system, they have not clarified whether and which controls on dual-use items also would be eased.

For instance, the administration has not indicated whether only dual-use items subject to unilateral controls would be reviewed or whether attempts would be made to remove items from control at the multilateral level. In addition, there has been little discussion of how the deemed export rule, which governs the release of technology to foreign persons in the United States, would be addressed.

Third, if licensing authority is consolidated into a single agency, the administration must take measures to ensure that licensing policy does not become more restrictive for dual-use and commercial items as policies and practices from the munitions licensing system are harmonized with the dual-use licensing system. In addition, it is important that the administration and Congress determine carefully which agency or agencies are given authority over the single licensing system.

For instance, placing this authority within an agency that does not have adequate experience working with nonmilitary businesses could result in new restrictions on U.S. commercial exports. We understand that the administration favors creating a new independent agency that would be governed by a board of directors comprised of Cabinet

officials from the relevant agencies. This could be a workable approach assuming that gridlock does not result from the structure of the board.

Preparing for Export Control Reform

Given the breadth of the administration's export control reform efforts and the uncertain environment in Congress, it remains to be seen whether the proposals summarized above will result in a more efficient, transparent and effective export control system. U.S. companies and foreign companies subject to U.S. export controls must closely monitor developments regarding export control reform and assess how the various reform measures will impact their businesses. While some reform proposals may create new business opportunities and reduce administrative burdens, others could create new requirements.

Indeed, in addition to streamlining some requirements, the recent encryption amendments will create new registration and annual reporting requirements for exporters of encryption items. Companies should carefully review each proposal as details are released and consider providing input to the government as appropriate. The administration is actively seeking feedback from industry, which should give companies opportunities to shape upcoming regulations and policies.

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