DEPARTMENT OF COMMERCE CONTROLS ON REEXPORTS AND OTHER ACTIVITY ABROAD

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TABLE OF CONTENTS

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Introduction

United States legislation and the practice of regulatory agencies of the U.S. Government are notorious for the aggressive assertion of jurisdiction to impose rules governing conduct that takes place outside of the United States. The Export Administration Regulations of the Department of Commerce (EAR), [1] contain many examples of so-called '"extraterritoriality." A prime example is the assertion in the EAR that the reexport of U.S.-origin items from one foreign country to another requires authorization from the Bureau of Industry and Security (BIS). This paper will look at steps that importers must take in order to acquire export controlled U.S. items, will present several aspects of reexport control and will also address provisions in the EAR that can affect the use and disposition within a country of items that have been acquired from the United States. Finally, the paper notes provisions in the EAR that regulate the conduct abroad of "U.S. persons."

These features have given the EAR an expansive jurisdictional reach for many years. They have been controversial in legal and political terms. Business has decried the complexity and burden of having to know and apply to a given transaction both the

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[1] 15 C.F.R. parts 730-774 (2002).

law of the country where the goods are located and the rules in the EAR. For the most part, business has "coped" with these features of the EAR, but there have been occasional flare-ups over conflicting governmental policies and requirements or over United States efforts to take enforcement action against violations based upon activity outside the United States.

More recent United States sanctions legislation has gone beyond the conventional extension of control based upon the U.S.-origin of an item or the U.S. nationality of the person involved. Such sanctions legislation can be broadly characterized as being designed to affect the conduct abroad of foreign persons without regard to the absence of transactional links to the United States in terms of, *e.g.*, the source of goods or of financing. In such sanctions legislation, compulsion takes the form of the threat of loss of economic benefits, not the threat of imposition of criminal or civil liability for a "violation" of law. Such economic benefits include eligibility for U.S.-government procurement, financing, or assistance and access to U.S. markets. When the sanction is ineligibility to receive exports from the United States, the sanction will normally be implemented through the EAR or other export control regulations.

The purpose of this paper is to give an organized presentation of the various features of the EAR that affect activity outside the United States. An indicator of the recognition by the Department of Commerce of the impact of the rules on businesses abroad is the inclusion in the Bureau of Industry and Security website of reexportation guidelines translated into Arabic, Japanese, Chinese, and Spanish. (www.bis.doc.gov). The reader will find in the journals and in the press a massive amount of analysis and criticism relating to the political and legal issues posed by the extraterritorial aspects of United States export controls and by economic sanctions measures directed at foreign activity?[2]

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[2] For opposing views on some fairly recent sanctions measures, see Andreas Lowenfeld, Agora: The Cuban Liberty and Democratic Solidarity (Libertad)

1 Importing from the United States -- Paperwork

Before the importer of U.S.-origin items need be concerned with U.S. restrictions on the use or reexport of such items, that importer has to qualify to receive the items. The EAR do not contain a part that presents “all that the customer needs to know”, nor is there any BIS brochure to guide the customer on responsibilities prior to and after the acquisition of export controlled items from the United States.

For many transactions, the customer will be required to execute either a "Statement by Ultimate Consignee and Purchaser” or some form of import certificate.

If the former is required, the customer will either receive from the supplier (or have on hand) Form BIS-711 or will provide the statement on the customer's letterhead, following the instructions in the EAR. If the statement is not given in the English language it must be accompanied by an English translation, prepared by a translation service or certified by the submitter to be correct. The statement includes the intended use, such as use or consumption by the customer, incorporation into products for domestic or foreign distribution, or reexport in the form received. Acceptance by BIS of a statement that indicates a customer's intention to reexport is not to be construed as authorization for such reexport, but the supplier can obtain advance authorization by specific request in the license application. In addition to certifying the representations, the documentation includes undertakings by the customer to notify the

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Act – Congress and Cuba: The Helms-Burton Act, 90 Am. Jul. Int’l L 419 (1996), and Brice Clagett, A Reply to Professor Lowenfeld, 90 Am. Jul Int'l L. 641 (1996). With respect to the international legality of U.S. export controls, see A.V. Lowe, Public International Law and Conflicts of Law and European Response to U.S. FAA Regulations, 33 Int'l & Comp. L. Q. 615 (1984) (an extensive critique) and Cecil Hunt, The Jurisdictional Reach of Export Controls, 26 Colurn. J. Transnat'l L. 19 (1987) (a brief defense).

supplier of any material change of fact or intention and not to reexport, resell or otherwise dispose of the imported items contrary to the representations or contrary to the EAR.

Unlike the Statement by Ultimate Consignee and Purchaser, an import certificate involves the governmental authorities in the customer's country. Depending upon the country of destination, the EAR may prescribe the submission of an International Import Certificate (IC) a standard document that was developed by the Western governments that participated in the Coordinating Committee (CoCom) during the Cold War. The customer fills out the certificate describing the proposed import, has it signed by the customer's government agency, and gives it to the supplier to retain or to submit to the export licensing authority in the supplier's country. In the IC, the importer undertakes not to reexport contrary to the laws of the importer's country, not, as in the statement of consignee referred to above, the rules of the supplier's government. There are currently eight countries, including India and the People's Republic of China, for which a national import certificate, in lieu of the International Import Certificate, is available and is prescribed by the EAR.[3] For firearms going to a member state of the Organization of American States, a special import certificate or equivalent official document must be obtained.[4]

Consult the EAR, particularly sections 748.9 through 748.12, to determine which type of documentation, if any, the customer must supply for a given transaction. Broadly speaking, an import certificate is likely to be required for an item controlled for national security reasons that is going to one of the countries that cooperates in the issuance of ICs. If no IC is required, the Statement by Ultimate Consignee and Purchaser will be required unless one of the exceptions applies. Except for firearms, no such documentation

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[3] 15 C.F.R. § 748.11(a)(1).

[4] 15 C.F.R. § 748.14(a).

is required for exports to Western Hemisphere countries other than Cuba. Other exceptions include low value transactions and some shipments to foreign government agencies.

Not all of the paperwork demands on customers are directly prescribed by the EAR. Customers can expect to be asked by suppliers to contribute to a "paper trail" that some exporters may believe will provide them with some protection. The EAR urge suppliers to "know your customer", and this may prompt general inquiries about a customer and its business. The ability of a supplier to export without a license will depend upon the exporter's being able to establish that the conditions set in the EAR for the availability of a license exception are met. The customer may therefore be asked to confirm, for example, that the items are not for a military end-use or end-user, so as to provide a record for one of the eligibility criteria for License Exceptions CIV and CTP. Even if the transaction involves relatively non-sensitive items that are not on the control list and that would not ordinarily require an export license, customers may occasionally be asked to declare the end-use, as some suppliers may consider pervasive documentation to be useful to reduce exposure under the "catch-all" provisions of the EAR which require a license when the exporter knows the export is going to a use or user of proliferation concern.

Three other types of paperwork that may be encountered by the importers of export controlled items from the United States should be mentioned, although only a small percentage of customers will encounter them. One is the signed statement as to use and disposition that is required for certain computers.[5] Another is the written assurance from the consignee of certain controlled technology that it will not, without authorization from BIS, export the

[5] 15 C.F.R. part 748 Supplement No. 2, paragraph (c)(2).

direct product of that technology to a proscribed destination.[6] Government-to-government assurances are the third type. These are frequently required by the Department of State under the International Traffic in Arms Regulations (ITAR). For the export of "significant military equipment" the ITAR require execution of a Form DSP-83 non-transfer and end-use certificate by the importing government, or its co-execution if the importer is a non-governmental entity.[7] The EAR contain no comparable provisions for governmental assurances from the destination country, but *ad hoc* license conditions can be imposed to require governmental assurances with respect to use, monitoring, access, or disposition of especially sensitive items.

If an importer of export controlled U.S.-origin items is an "approved consignee" under a Special Comprehensive License (SCL), that firm will initially have to cope with a lot of paperwork based on the EAR, but gaining approved status can spare it paperwork with respect to subsequent imports and reexports. The SCL is designed to facilitate the export of controlled items to manufacturers, distributors, or users whose reliability has been established and who set up acceptable internal control programs and observe record keeping and other requirements. (See 15 C.F.R. part 752.)

The importer of goods from the United States, whether or not the goods are export controlled, may find itself affected by the rules that relate to the filing of export declarations with U.S. customs authorities. If the sale is *ex works*, whereby the buyer assumes responsibility for export clearance (referred to in the U.S. regulations as a "routed transaction"), the freight forwarder or other agent engaged by the buyer will be looking to the buyer to provide a

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[6] 15 C.F.R. § 740.6(a)(1); 15 C.F.R. part 748, Supplement No. 2, paragraph (o)(3).

[7] 22 C.F.R. §§ 123.1(c)(5), 123.10, 125.3, and 125.7.

power of attorney or other authorization to submit the export declaration. If the routed transaction involves goods that require application for a Department of Commerce export license, the seller will be seeking a special written undertaking that the buyer assumes export licensing and export clearance responsibility. Absent such a document (and the mere use of *ex works* in the documentation may not suffice), the regulations place full export licensing and clearance responsibility on the seller, notwithstanding the trade terms.

2 Reexport Control Basics

2(a) Assertion of Jurisdiction

The EAR contain broadly stated requirements that authorization be obtained from BIS prior to reexportation of export controlled U.S.-origin Items. Of the ten "General Prohibitions" of unlicensed or otherwise proscribed activity, seven apply expressly to reexports as well as exports and the others (Numbers 4, 7 and 9) can apply indirectly to reexports.

As with controls on exports, the scope of transactions for which it is necessary to apply to BIS for authorization to reexport is greatly narrowed by various provisions of the EAR. These are, principally, the Commerce Control List/Country Chart matrix that will put the reexport of certain items to certain destination countries into the "no license required" category, and the availability for reexports, as well as for exports, of the many license exceptions set forth in part 740 of the EAR. As will be explained below, other provisions in the EAR exclude some reexports from licensing, even if export form the United States to the new destination would require a license.

2(b) "Reexport"

The EAR define "reexport" as “actual shipment or transmission of items subject to the EAR from one foreign country to another foreign country” or "release of technology or software subject to the EAR to a foreign national [of another country] outside the United States.[8] The EAR define “items subject to the EAR” to include “all U.S.-origin Items.”[9] This, of course, begs the question: What does “U.S.-origin” mean? Unfortunately, the EAR do not include a definition of that term.

Some aspects of the term "U.S.-origin" are implicit, however. The definition of "items subject to the EAR" also includes "[a]ll items in the United States, including in a U.S. Foreign Trade Zone or moving in transit through the United States from one foreign country to another."[10] The BIS interpretation of the predecessor EAR had been that a piece of foreign-made equipment that, for example, comes to the United States for demonstration, is subject to the applicable controls when it is leaving to return to its country of origin or to go to another foreign country, but, once abroad, it would not be treated as subject to reexport control by reason of its having been in the United States. The new EAR were designed to achieve this result by using "in" the United States in a context that included items without regard to origin, followed by use of the narrower term "U.S.-origin" in the context of items outside the United States.

2(c) Technology and Software

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[8] 15 C.F.R. 732.4(b)(4). The language inserted in brackets is found in subparagraph 732.4(b)(4) (5) that follows. Part 772 of the EAR, Definitions, has a definition of “reexport” that differs from that in § 734.2(b)(4), adding language on transit and transshipment that is found in § 734.2(b)(6), making a transfer of registration or operational control of a satellite a reexport, but lacking reference to the release of technology or software in a foreign country to a third country national.

[9] 15 C.F.R. § 734.3(a)(2).

[10] 15 C.F.R. § 734.3(a)(1).

As noted above, the release of technology or software in a foreign country to a national of another foreign country, or its shipment or transmission from one foreign country to another is a "reexport" under the EAR. One challenge for firms abroad in understanding and complying with restrictions on the use of U.S.-origin technology is the breadth of the definition of "release" in the EAR, which includes transfers in intangible form the visual inspection of equipment by foreigners, oral exchanges of information, and the application abroad of technical experience acquired in the United States.[11] Although multilateral regimes such as the Missile Technology Control Regime define "technology" to include "technical assistance" that may not be in tangible form, such as instruction, the export control laws of some countries do not clearly extend to intangible transfers of technology, and the concept of such transfers as "exports" (to say nothing of the concept of the domestic release of technology to a foreigner being a "deemed" export) may not come easily to some abroad who are receiving controlled, U.S.-origin technology.

2(d) License Exceptions

Each of the first fifteen license exceptions in part 740 of the EAR expressly and equally applies to both exports and reexports, except for one aspect of License Exception Aircraft and Vessels (AVS) that is applicable only to aircraft departing the United States. The broad availability of license exceptions greatly reduces the number of reexports that require application to BIS for a license. The impact of the broadly asserted jurisdiction over reexports is further reduced by License Exception Additional Permissive Reexports (APR).[12] This license exception currently contains ten distinct permissive reexport provisions that are applicable to a

[11] 15 C.F.R. § 734.2(b)(3).
[12] 15 C.F.R. § 740.16.

variety of circumstances. Some reflect a policy that, where several governments are cooperating in controlling the export of certain items, trade among them in such items need not and should not require an export license. Permissive reexport is also provided for certain shipments that will be authorized by a government that cooperates with the United States in export control, even if going to a country that is the object of controls. This is designed to credit the cooperative control and to eliminate some duplicative export licensing activity. In part, this permissive reexport provision continues a policy that was based on CoCom procedures that ended with the termination of this Cold War mechanism for controlling East-West strategic trade.

Another permissive reexport feature of the EAR should be noted, as it was adopted to limit the extraterritorial reach of certain controls that were put in place on foreign policy grounds. These controls, imposed in the 1980's, exclude from reexport control items covered by twelve control list entries that do require a license for export form the United States to the target country.[13]

2(e) "Catch-all"

It is important to note that the EAR make the "catch-all" controls in part 744 apply to reexport as well as to export. These are the provisions that were added pursuant to the 1990 'Enhanced Proliferation Control Initiative (EPCI) designed to stem the spread of weapons of mass destruction and of missile delivery systems. Under the catch-all controls, a reexporter is required to apply to BIS for a license if the reexporter knows that the item is to go to a proliferation-related end-user or end-user specified in part 744 or if the reexporter has been “informed” by BIS pursuant to part 744 that a License is required due to unacceptable risk of use in or diversion to such activities, anywhere in the world. The catch-all applies even

[13] 15 C.F.R. §§ 742.8((a)(2), 742.10(a)(2), and 746.7(a)(2)(ii)).

if the control list/country chart matrix (parts 738 and 774 of the EAR) indicates that no license is required in order to send the item to the destination country. The catch-all applies to any item that is subject to the EAR, even if it is not on the control list. This includes a wide range of commercial items that would not ordinarily be regarded as sensitive in an export control context. Furthermore, no license exceptions are available if the license requirement is based on the missile technology or chemical/biological weapons catch-all provisions and there is only limited license exception availability if the nuclear catch-all applies.[14]

In addition to being mindful that these catch-all provisions require that the intending reexporter be sensitive to indications of proliferation related use of ordinary items, note that the proliferation-based listing of certain entitles in the EAR triggers a license requirement even if the intended use is known to be benign. The main listing is the "Entity List" that is published as Supplement No. 4 to part 744 of the EAR. In addition, there is a listing of missile technology projects, and the catch-all covers any reexport destined for a listed project.[15]

The practice of many companies, within and outside to United States, is to establish automated screening of all export transactions against these and other lists of problem names (some companies extend screening to domestic transactions).

2(f) Obtaining Reexport Authorization

A firm outside the United States that wants to obtain authorization from BIS to reexport will find that, for the most part, the EAR call for it to use the same forms, supply the same

[14] 15 C.F.R. §§ 744.2(c), and 774.4(c)

[15] 15 C.F.R. § 744.3(a)(1), referring to projects listed in the footnote to Country Group 4 in Supp. No. 1 to part 740.

transaction information, and follow the same process as would a U.S. firm when sending the same items to that destination. The rules on the submission and processing of license applications will be found in parts 748 and 750 of the EAR.

For a foreign firm seeking a license to export from the United States, the EAR require that it authorize an agent that is subject to the jurisdiction of the United States to make the application. This requirement does not apply to applications from abroad for reexport authorizations.[16] This would not preclude use of an agent for convenience, but the foreign reexporter would be the responsible principal in the transaction.

Form BIS-748P, Multipurpose Application, is used for license applications for export or reexport. Copies or facsimiles of the form are not acceptable, so the reexporter should anticipate its needs and obtain an adequate supply of the forms from BIS. Alternatively, a firm that expects to seek reexport licenses frequently should look into the possibility of qualifying to apply electronically.[17] Electronic filing could speed the process, even if some supporting documentation had to be sent by air courier.

3 U.S.-Origin Content in Foreign Products

3(a) Basics

Part of the definition of the scope of the EAR includes the following:

> U.S. origin parts, components, materials or other commodities incorporated abroad into foreign-made

[16] 15 C.F.R. § 748.4(a).

[17] See the authorization procedure in 15 C.F.R. § 748.7.

> products, U.S. origin software commingled with foreign software, and U.S.-origin technology commingled with foreign technology, in quantities exceeding *de minimis* levels as described in § 734.4 and Supplement No. 2 of this part.[18]

The definitions part of the EAR does not include a definition of "incorporated", but Supplement No. 2 to part 734 states that peripheral or accessory devices that are merely rack mounted are not deemed to be incorporated.[19] Neither do the EAR define the term "commingled" as it relates to U.S. and foreign origin software and technology. However, some guidance can be found in the "interpretations" part of the EAR where it is stated that technology does not lose its U.S.-origin when it is "redrawn, used, consulted, or otherwise commingled abroad" with technology of any other origin.[20] Additional guidance is in section 734.4(e) of the EAR which states that technology and source code used to design or produce foreign made commodities or software are not considered to be incorporated into such foreign-made commodities or software.

It may be worth noting that the assertion in the EAR of control over U.S.-origin content represents an approach different from that taken for purposes of classifying equipment for export. For purposes of such classification, the EAR state that physically incorporated components in a piece of equipment do not require a license, but that the license or general exception under which the piece of equipment is exported will also cover its component parts if they are normal and usual and not incorporated as a device to evade licensing requirements.[21] It thus appears that the EAR "look inside" a piece of equipment to control the reexport of components on the

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[18] 15 C.F.R. § 734.3(a)(3).

[19] 15 C.F.R. part 734, Supp. No. 2, note to para. (a).

[20] 15 C.F.R. § 770.3(c)(1).

[21] 15 C.F.R. § 770.2(b)(1).

basis of their origin, but do not, for example, "look inside" to impose a license requirement on the export from the United States of a refrigerator that uses sensors or electronic switches that by themselves would require a license to certain destinations.

3(b) De Minimis -- Commodities

The EAR assert jurisdiction over the reexport of U.S.-origin content that is incorporated into or commingled with foreign produced items, but only if the U.S.-origin content exceeds specified minimum levels, which the EAR call *"de minimis"* levels.

For foreign produced items that are being sent to most countries, the *de minimis* level is twenty-five percent, by value. The *de minimis* calculations are made "like to like" -- software in software, technology in technology, and "parts, components, or materials" in a piece of equipment or other commodity. The level is ten percent if the foreign items is destined for one of a small group of countries specified in the EAR as being subject to a broad embargo (under United Nations sanctions or U.S. initative) or to special export restrictions based upon a determination by the United States that the government of the country has repeatedly provided support for acts of international terrorism.

The EAR exclude from the *de minimis* exceptions:

(1) Computers exceeding 190,000 MTOPS and containing certain U.S.-origin semiconductors or high speed interconnect devices, if going to a Tier 3 country, which currently covers almost fifty countries, including Russia and the People's Republic of China,[22] or exceeding 28,000 MTOPS, if going to a Tier 4 country.

[22] 15 C.F.R. §§ 734.4(a), as amended, 67 Fed. Reg. 10608, March 8, 2002.

(2) Certain items relating to information security or encryption.[23]

Two features of the rules on the reexport of U.S.-origin content in foreign-produced items are particularly important:

(1) Only "controlled" U.S. content is counted toward the *de minimis* content[24]. Supplement 2 to EAR Part 734 states that, in calculating U.S. content value, "[D]o not include parts, components, or materials that could be exported from the United States to the new country of destination without a license (designated as 'NLR') or under License Exception GBS…or under NLR for items classified as EAR99." The Supplement 2 guidelines are clear in one respect – items that are EAR99 (that is, not on the CCL) are excluded. Further, it seems clear that items that are on the CCL are to be excluded if there is no "X" for the new country of destination under the applicable columns of the EAR Part 738 matrix. The exclusion of items that could go to the new country of destination under License Exception GBS (a"what is going where" exception) seems to mean that no other license exception (including LVS for low value shipments) will exclude U.S. content from *de minimis* calculations. An anomaly in the guidelines is that paragraph (a) (1) refers to items that could be "exported" from the United States, whereas paragraph (a) (3) refers to items "reexported." For most destinations, license requirements for exports and reexports will be the same, but careful attention must be given to some distinctions in EAR part 746 for certain destinations, such as Iran.

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[23] 15 C.F.R. §§ 734.4(b), and 734.4(h).

[24] 15 C.F.R. § 734.4(c).

(2) Even if the controlled U.S. content exceeds the applicable *de minimis* level, the export of the foreign-produced items will not necessarily require a license from BIS. This is because the determination that the item is "subject to the EAR" just means that the rules in the EAR apply, so if the control list and country chart matrix don't show a license requirement to the new destination, or if the transaction qualifies for a license exception, no application need be made to BIS.

3(c) Technology and Software De Minimis

For the most part, the rules described in section 3(b) apply also to U.S.-origin technology or software that is commingled abroad with foreign-produced technology or software. Some important features that are specially applicable to technology and software *de minimis* are noted below.

One-time report. Supplement No. 2 to part 734 of the EAR states that one must file a one-time report with BIS before one "may rely upon" the *de minimis* exclusion for commingled software and technology. The report is to present the data and methodologies underlying the submitter's claimed entitlement. The EAR must be consulted for the details regarding calculations and report content. Note that there is a "report and wait" provision, whereby one may rely upon the exclusion claim from thirty days after submission of the report until such time as BIS makes further inquiry regarding it or indicates non-acceptance. The report approach stems from the complexity of assigning value to technology or software content. Such content is hard to "cost account" and hard to "amortize", as it is not "consumed" through commingling, but may be used again and again to add value to an unpredictable run of foreign-produced commingled software or technology. These factors, plus the fact that firms in different countries would be applying different accounting

standards, deterred BIS from prescribing in the EAR exclusive and detailed valuation provisions. Instead, Supplement No. 2 to part 734 refers to three criteria important to BIS, and states that calculations are not required to be based upon any one accounting system or U.S. accounting standards. The three so called "criteria" are the export price of the U.S. content, the assumption regarding future sales of software, and the choice of the scope of foreign technology. The Federal Register notice that promulgated the rewritten EAR describes the public comment on the one-time report proposal (generally negative) and it should be referred to for further understanding of BIS's dilemma in deciding how to define and enforce a *de minimis* rule for technology and software.[25] BIS should consider a change in approach, but the "how" and "when" are uncertain. BIS has been considering replacing the "like-to-like" accounting for *de minimis* content and aggregating the value of controlled U.S.- origin components, software, and technology in a foreign product, but has yet to reach a decision.

4 Products of U.S.-Origin Technology or Software

In specifying "items subject to the EAR", section 734.3(a) includes "[c]ertain foreign-made direct products of U.S., origin technology or software and" "[c]ertain commodities produced by any plant or major component of a plant located outside the United States that is a direct product of the U.S.-origin technology or software." These provisions both include the reference "as described in § 736.2(b)(3)." This refers to General Prohibition Three which prohibits export of such items to listed embargoed countries or to those countries, including Russia and China, that remain on the list of countries that had once included all of the Communist countries that were the object of the East-West strategic

[25] 61 Fed. Reg. 12717-12718, March 25, 1996.

trade controls of CoCom. [26] The scope of such "direct product" controls is defined by two criteria: (1) the product or plant must be the direct product of technology or software that requires a "written assurance" for its export from the United States, and (2) the product of the technology or software or the plant must be items that would be classified under a Commerce Control List entry that controls on national security grounds.

What are the "written assurances"? License Exception TSR (Technology and Software under Restriction) is subject to a requirement that an exporter or reexporter first obtain a statement from the importer that it will not reexport or release the technology to a national of one of the restricted countries. Such written assurance may also be required as a condition for the issuance of a license.

What is a "direct" product? Section 734.3(a)(4) says it means "the immediate product (including processes and services) produced directly by the use of technology or software." The use of the term "immediate" suggests that, if the technology were used to design a machine tool, the export of that equipment would be covered, but not the export of items produced with that machine tool. One the other hand, might a large, key, machine tool be a "major component of a plant," thereby making the items that it produces covered direct products? The EAR do not elaborate on the "plant" provision. The number of situations in which these "direct product" controls would apply is limited by the fact that the rule applies only when the U.S.-origin technology or software is controlled to the ultimate destination solely for national security reasons.[27]

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[26] General Prohibition Three, by its terms, is a complete prohibition, lacking the qualifying phrase "you may not, without a license or license exception," but the author believes this to have been a drafting error.

[27] 15 C.F.R. § 740.6(a).

5 Disposition without Reexport

5(a) Introduction

As shown above, the EAR extend broadly to exports and reexports of items within the scope of the regulations. Firms that acquire controlled items need to understand that the EAR can also apply to a variety of actions within a country – that is, that involve no transfer to a third country. Some of these restrictions on in-country disposition or use are found in provisions of general applicability in the EAR. Other restrictions are based upon license conditions, undertakings, or representations that relate to the importation or other acquisition of the specific U.S.-origin items.

5(b) Regulatory Provisions

Destination control statement. In many instances the importer of controlled items from the United States will find an EAR-based "destination control statement" on the commercial invoice that includes the sentence "Diversion contrary to U.S. law prohibited."[28] The EAR do not define "diversion". There is some basis for concluding that the term is intended to cover more than just diversion of a shipment from a declared and approved country of destination to a different country. For instance, EAR provisions that make the availability of items under a license exception depend upon the items not being for military end-users and/or end-uses reflect a regulatory concern that goes beyond just the country to which the items are destined.[29] Such provisions suggest that the application of the items to an ineligible use, with or without transfer of ownership, should be regarded as a "diversion."

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[28] 15 C.F.R. § 758.6(b).

[29] See, for example, 15 C.F.R. §§ 740.5 and 740.7(d)(3).

Representations, undertakings, and conditions. Whereas the destination control statement is only a notification to the recipient of the controlled items, other aspects of export control documentation can engage the responsibility of the recipient more directly. The key example is the Statement by Ultimate Consignee and Purchaser, which that person subscribes and which contains that person's representation as to the end-use and a certification that the recipient will not "reexport, resell, or otherwise dispose of" the items contrary to the representations or contrary to the EAR. In some transactions, special conditions will be attached to the export license. For example, for some exports of digital computers, the EAR require a statement signed by the importer or end-user that includes the statement that the computers will be used only for civil applications.[30]

Release of technology or software. Another way in which the use of U.S.-origin controlled material within a country is restricted by the EAR is their definition of "reexport" as including the release of technology or software to a national of another country, with "release" including visual inspection by and oral exchanges with the foreign national that take place within the first country.[31]

5(c) Denial Orders

The extraterritorial reach of "denial orders" under the EAR is so extensive that it can affect the activity abroad of persons who do not think of themselves as being involved with U.S.-origin items that are of concern from an export control standpoint. Denial orders are issued administratively by BIS.[32] Denial order can be imposed on

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[30] See 15 C.F.R. §§ 764.3, 764.6, and 766.1.

[31] Supplement No. 2 to 15 C.F.R., part 748, paragraph (c)(2)(i).

[32] See 15 C.F.R.§§ 764.3, 764.6, and 766.1

persons, wherever located, as a sanction for violation of the EAR or of other export control laws or as a "protective administrative measure" when determined to be necessary to prevent an imminent violation. The purpose of this order is not only to stop the denied person from exporting or reexporting, but also to keep that person from acquiring abroad goods, technology, or software that is subject to the EAR.

One feature of the standard denial order that greatly broadens its potential impact on firms abroad is that it applies not only to items that would normally require an export or reexport license, but also to "any item subject to the EAR.[33] This means that such denial orders usually extend to ordinary commercial and consumer items. For firms abroad, important exclusions from the scope of the orders are those items that were referred to above as not being subject to the EAR, namely, foreign-produced items with minimal amounts of controlled U.S.-content. Moreover, expressly excluded from the standard denial order are the foreign-produced direct products of U.S.-origin technology.

The key features of denial orders that bring them within this section on "disposition without reexport" are that they prohibit (1) any action that facilitates the acquisition by the denied person of ownership, possession, or control of any item abroad that is subject to the EAR, (2) the servicing of a denied person's U.S.-origin item, and (3) the use of any item subject to the EAR to service an item of whatever origin for a denied person.

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[33] The standard form of denial order is found in Supp. No. 1 to 15 C.F.R. part 764.

BIS maintains an up-to-date "Denied Person's List" that is available electronically.[34] The list is in two parts, one alphabetized by name of denied person, one organized geographically.

6 "U.S. Persons" Abroad

There is a further aspect of the EAR that can affect firms abroad even if they are not dealing with U.S.-origin commodities, technology, or software. The EAR impose restrictions on certain activities of U.S. persons, worldwide. The term "U.S. person" is defined to include individuals and firms organized under U.S. law, but not firms controlled by U.S. persons that are organized under the laws of another country. These restrictions are part of the controls designed to stem the proliferation of weapons of mass destruction. If the U.S. person knows that a specified proliferation-related use or recipient is involved, that person may not, without a license:

(1) Export, reexport or transfer any item, whatever its origin;

(2) Support (by transporting, financing, etc.) any transaction that does not have a license that is required by the EAR;

(3) Perform any "contract, service or employment" that will directly assist in specified activity; or

(4) Provide technical assistance with the intent to aid a foreign person in the development or manufacture of certain encryption items outside the United States.[35]

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[34] Access information can be obtained from the BIS home page on the World Wide Web, http://www.bis.doc.gov.

[35] 15 C.F.R. §§ 744.6 and 744.9.

How might these provisions affect a firm abroad? To cite just two examples:

(1) an individual U.S. national employee of a foreign firm may need to be protected by the employer from exposure to liability under the EAR by excusing that employee from involvement with a transaction that is legal for the employer, both under the EAR and under local law. This need not be a situation (hopefully, never to occur) in which the employer is knowingly supporting proliferation. For example, the employer could be satisfied that a sale to a company named by BIS to the "Entity List"[36] due to proliferation concern poses no risk of contributing to weapons development, but the U.S. national employee could not engage in the prohibited activity. The EAR do not express an exception for merely ministerial, as distinct from substantial, employee involvement.

(2) Firms abroad may find U.S. carriers refusing to handle cargo going to a consignee on the Entity List or may find that a U.S. financial institution is seeking extraordinary assurance that requested financing for an export to a country of proliferation concern is for benign use.

7 State and Treasury Department Controls

The objective of this section is to call attention to the fact that trade controls in addition to those administered by the Department of Commerce may be of concern to firms abroad. This section will not present fully the extraterritorial reach of controls on

[36] Supplement No. 4 to 15 C.F.R. part 744.

munitions list items that are administered by State's Directorate of Defense Trade Controls (DDTC) nor of the financial transactions and trade controls directed against embargoed and sanctioned countries that are administered by Treasury's Office of Foreign Assets Controls (OFAC).[37]

It will be worthwhile to note here some of the ways in which ODTC and OFAC controls differ from those under the EAR.

There are three significant considerations for firms abroad that acquire Munitions List items subject to DDTC controls. One is that they will routinely be required to execute a document in which they agree not to reexport or transfer the item without authorization from DDTC. Second, some transactions will be covered by assurances as to use and disposition of the items given by the government of the country of importation to the United States Government. Further, exporters of Munitions List items must be registered with ODTC, and only persons subject to the jurisdiction of the United States may be registered.

For many years, OFAC regulations did not apply to reexport from abroad of U.S.-origin items. The OFAC regulations have been directed at exports <u>from</u> the United States to the proscribed destination, to exports to a third country with knowledge that they are intended for transshipment to the embargoed country without coming to rest in a third country and without being substantially transformed or incorporated into a product there, and to exports by "U.S.-persons".[38] Some more recent OFAC

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[37] See the International Traffic in Arms Regulations, 22 C.F.R. parts 120-130, and various Office of Foreign Assets Control regulations in 31 C.F.R. parts 500 et seq.

[38] See, for example, the Libyan Sanctions Regulations, 31 C.F.R. § 550.202 and 550.409

regulations have covered reexports.[39] More recent OFAC regulations give the term "person subject to the jurisdiction of the United States" the same definition as the EAR definition of "U.S. person" referred to above. Older remaining OFAC regulations, however, contain a definition that includes an entity that is organized under the laws of a foreign state, if that entity is owned or controlled by U.S. individuals or entities.[40]

Some OFAC sanctions regulations go beyond reexportation of U.S. origin items and cover the sale to a proscribed country or person of foreign origin items if made or "facilitated" by a U.S. person. For example, if a French company were planning to sell an item produced in France to a customer in Iran, a U.S. national employee of the French company would violate the OFAC regulations if he or she participated in the transaction.[41] Further, for example, the French subsidiary of a U.S. company would not itself be barred from selling French products to Iran, but the parent company could violate the OFAC regulations if it facilitates such a sale. Facilitation can entail not only active involvement in the transaction, such as financing, but also steps to shift to the foreign subsidiary sales that the parent is barred from by the sanctions.[42]

8 Cooperation between Suppliers and Customers

Despite recent attempts at simplification and clarification, the rules on exports from the United States remain dauntingly complex. Mastering them is a challenge for those in the United States. It is, clearly, an even greater challenge for individuals outside the United States. Many of these people will have a language barrier to

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[39] See, for example, the Iranian Transactions Regulations, 31 C.F.R § 560.204.

[40] See, for example, the Foreign Assets Control Regulations, 31 C.F.R. § 500.329, and the Cuban Assets Control Regulations, 31 C.F.R. § 515, 329.

[41] See the Iranian Transactions Regulations, 31 C.F.R.§ 560.204.

[42] See the Iranian Transaction Regulations, 31 C.F.R. §§ 560.208 and 560.417.

contend with. Many will be used to dealing with a domestic regulatory environment in which there are fewer details spelled out in the law and there is more reliance on informal administrative guidance.

Government executives and legislators need to assess the costs and benefits of such complex and expansive controls, to consider ways to advance the multilateral harmonization of controls, and to deal with the legal and political tensions that arise when the jurisdictional reach of controls subjects business to conflicting requirements from two governments.

For business, however, the immediate concern is how best to cope with the existing situation. Business success is built upon "knowing the territory." Companies outside the United States that want to facilitate their ability to acquire advanced, dual-use items from the United States make it a point to have people in their organization who are trained in the EAR, as well as in the export control rules of the local jurisdiction, for this is all part of the "territory" -- the regulatory environment.

The author has had the opportunity to observe some sophisticated and efficient export control compliance systems that have been established by firms in Europe and Asia. They have successfully integrated the requirements of the applicable sets of regulations into a system that focuses on the pertinent products and on the actual sales or operations territories. These systems have guidance materials, check-lists, control points, and referral procedures that provide the personnel that handle exports with understandable and useful compliance information and that bring the expertise of a well-trained export control cadre to bear as needed.

The U.S. supplier that wants to sell controlled items abroad will welcome the convenience of dealing with a customer that is experienced and competent in meeting home country and U.S.

export control requirements. All too often, however, the supplier will run into the customer with little such experience or with limited resources to devote to mastering the complexities. Occasionally, the supplier will need to overcome a great deal of resistance to procuring from the United States, resistance that stems from not surprising concern over the impact of the myriad rules and documentation requirements that have been surveyed in this chapter. It is not unheard of that such concern has been fed and intensified by purposeful “horror stories” told by companies in other countries who are in competition with U.S. suppliers.

So, how should U.S. companies pursue opportunities abroad in the face of export control-related challenge? The chapter will close with a few of the many suggestions that could be drawn from the author's experience.

Do not retreat. Do not give up on attempts to market especially sensitive items abroad or to market more ordinary products in new countries. Assess your product's global competitiveness, assess the potential for profit, and then invest in neutralizing the export control factor by improving the export control know-how of your people and by resolving to work with your customers abroad.

Do not be lulled by license exceptions. Post-Cold War decontrols and the growth in the availability of license exceptions in the EAR result in only an tiny fraction of exports of industrial products from the United States being subject to the need to acquire a license, in this “sell today, ship tomorrow” environment, it is tempting for a firm to deemphasize the role of its export control compliance activities. The special expertise may be viewed as being needed only "at home” to deal with documentation and export clearance formalities. The people who are in contact with customers abroad may lose sight of the concerns that customers have regarding U.S. restrictions on the use and disposition of items from the U.S. If

these people on the front lines are not alert and competent in spotting and dealing with such concerns, potential business will be lost.

Serve the customer. The author has often heard firms abroad complain about the lack of advice and assistance from their U.S. suppliers regarding export controls. The most common complaint is the failure to respond to requests for the Export Control Classification Numbers of items exported under license exception, where the customer does not see documentation that shows the ECCNs. Anticipate the customer's export control needs. This can range from keeping repeat customers supplied with forms that they will need to complete, to ascertaining the customer's planned disposition of the items so that, if a license is required for export from the United States, that license can be designed to cover any anticipated reexport and make it unnecessary for the customer to apply later to BIS for authorization.

Invest in continuing relationships. A U.S. company that has a subsidiary abroad will have the opportunity and incentive to keep that subsidiary "on the right side of the law" regarding export controls. The same will be true for the company that must work with a firm abroad to qualify it to receive and reexport controlled items freely as an "approved consignee" under a Special Comprehensive License. Suppliers should recognize that there are other business relationships, such as with joint venture partners or with major long-term customers, which warrant special investment in educating them in U.S. export control requirements. One benefit will be to facilitate and speed the marketing of controlled goods. Another consideration is to avoid the embarrassment (or worse) of association with a diversion problem. The mode of education will be shaped by the business context. The education could range from planned training sessions to *ad hoc* troubleshooting by your people abroad who either know the answers or know where to get help. Consider inviting a customer executive to an export control seminar at which they can acquire an important sense of the export control compliance

culture of the U.S. business community, even if they do not leave with a full grasp of the specifics of the rules.