

Source: **American Shipper** Date Posted: **5/26/2010 1:31:58 PM**

## Control problems

*Obama makes pitch for export reform.*

By Chris Gillis

In Washington, many changes are proposed, but few actually occur. This could easily apply to the numerous attempts made by the White House and Capitol Hill lawmakers during the past 20 years to reform the country's Cold War-era export control regulations. However, a major push is underway by a determined Obama administration, a largely receptive Congress, and supportive industry to finally change the way federal regulators oversee export licensing procedures and policies.

"This is possibly the biggest change that many of us will have to deal with in our careers," said Brian Amero, global trade compliance manager for North Reading, Mass.-based electronics firm Teradyne. "It's an opportunity for us to step up to the plate and influence change. It's not a time to be passive."



Amero

"It's huge," added Dennis Farrell, global export compliance officer for Analog Devices, an electronics firm also located in Massachusetts. "It's something that I believe U.S. exporters should get behind and support.

"I get so frustrated about how much time it takes to get a license approved through today's interagency process and by the lack of response from licensing officers," Farrell said. "The current process puts U.S. companies at a revenue risk by waiting for licenses."

The Obama administration outlined its plan in late April for a significant export control reform, which it says will make the licensing process more efficient for legitimate shipments while keeping the most sensitive U.S.-made technologies out of the hands of terrorist organizations and militaries of rogue nations.

The current export control regime hasn't been updated since the demise of the Soviet Union in the late 1980s, resulting in a tangle of rules and processes overseen by a handful of federal agencies, namely:

- The State Department's Directorate of Defense Trade Controls.
- The Bureau of Industry and Security at the Commerce Department.
- The Defense Department's Defense Technology Security Administration.

"Much of the confusion today is the result of patching together small fixes, which have resulted in imprecise definitions and jurisdictions, and processes and systems that are unique to each agency," said Larry Disenhof, group director of export compliance and government relations at Cadence Design Systems. "The administration's plan acknowledges that it's time for a full review and streamlining of the system to ensure that we're focusing our resources on protecting our most valuable technologies, while clearly communicating the regulations and restrictions."

**Gates' Frustration.** The Obama administration picked Defense Secretary Robert Gates to kick off its export reform agenda in a highly anticipated speech before the Business Executives for National Security forum in Washington on April 20.

Within the interagency-based export licensing approval process, the Defense Department is often viewed by the industry as the most conservative and cautious when it comes to approving licenses for U.S.-made dual-use technologies, or items with both commercial and military applications.

"The United States is thought to have one of the most stringent export regimes in the world. But stringent is not the same as effective," Gates said in his speech.

Gates said the ineffectiveness of these export controls has been demonstrated in recent years by several illicit exports of highly sensitive materials and delays with implementing important homeland security capabilities.

"Several factors contribute to these kinds of scenarios, which at worst could lead to the wrong technology falling into the wrong hands," he said. "One major culprit is an overly broad definition of what should be subject to export classification and control. The real-world effect is to make it more difficult to focus on those items and technologies that truly need to stay in this country."

The defense secretary noted that the United States reviews "tens of thousands" of license applications for exports to the European Union and NATO countries and in 95 percent of cases approves them. In addition, many individual parts for military equipment require their own licenses.

"It makes little sense to use the same lengthy process to control the export of every latch, wire, and lug nut for a piece of equipment like the F-16, when we have already approved the export of the whole aircraft," Gates said.

"We need a system that dispenses with the 95 percent of 'easy' cases and lets us concentrate our resources on the remaining 5 percent," he said. "By doing so, we will be better able to monitor and enforce controls on technology transfers with real security implications while helping to speed the provision of equipment to allies and partners who fight alongside us in coalition operations."

Gates criticized the myriad of agencies, rules and procedures



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Robert Gates  
secretary,  
U.S. Department of  
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**"The United States is thought to have one of the most stringent export regimes in the world. But stringent is not the same as effective."**

that have evolved around the nation's export controls.

"In theory, this provides checks and balances — the idea being that security concerns, customarily represented by DOD, would check economic interests represented by the Commerce Department, and balance out diplomatic and relationship-building equities represented by State," he said. "In reality, this diffusion of authority — where separate export-control lists are maintained by different agencies — results in confusion about jurisdiction and approval, on the part of companies and government officials alike.

"It creates more opportunities for mistakes, enforcement lapses, and circumvention strategies such as 'forum shopping,' where exporters with problematic license applications try different agencies looking for the best result," he added.

"The system has the effect of discouraging exporters from approaching the process as intended," Gates warned. "Multinational companies can move production offshore, eroding our defense industrial base, undermining our control regimes in the process, not to mention losing American jobs."

On military relations, Gates said current U.S. export controls have been the source of much friction with allies. For example, a British military C-17 plane spent hours disabled on the ground in Australia because U.S. law required the Australians to seek U.S. permission before doing the repair. Similarly, the South Korean military, which purchases U.S. planes, has difficulty obtaining spare parts. Gates said that "weakens our bilateral relationships, our credibility, and ultimately American security."

**Action Plan.** To improve the process, the defense secretary said the administration will first develop a single export control list to make clearer to U.S. companies which items require licenses for export and which do not.

"Items that have no significant military impact, or that use widely available technology, could be approved for export quickly," Gates said. "We envision a more dynamic, tiered control system where an item or technology would be 'cascaded' from a higher to a lower level of control as its sensitivity decreases."

The administration's second objective is to develop a single licensing agency, which will have jurisdiction over munitions and dual-use items and technologies and streamline the review process and ensure that export decisions are consistent and made based on the real capabilities of the technology.

"This agency would also reduce exporters' current confusion over where and how to submit export-license applications, as well as which technologies and items are likely to be approved," Gates said. "The administration is currently preparing options for the agency's location, and I anticipate a presidential decision later this spring."

The process will be supported by a single, unified information technology to "reduce the redundancies, incompatibilities, and waste of taxpayer money that our current system of multiple databases produces," Gates said. "A single online location and database would receive, process, and help screen new license applications and end users."

Currently, there are three separate systems that govern U.S. export controls:

- The Commerce Department's IT system for export controls was set up in 1987 and is in need of significant overhaul.
- The State Department has only recently started to automate its paper-based licensing system.
- The Defense Department's system is considered the most modern of the three.

Gates said it's important to determine which end users are eligible to receive U.S.-made technologies.

"In order to facilitate compliance and tracking, we propose to consolidate current lists of banned end users into one single frequently updated list that will be easy for those performing transfers to consult," he said. "Entities can be added at any time if there is reasonable cause to believe they are involved in activities contrary to U.S. national security interests."

Gates emphasized that "the new system will be in full compliance with all of our existing multilateral treaties and obligations."

The Obama administration indicated that it's prepared to counter opposition to its export control reform plan. "No system — above all, the current one — is fool proof. But by consolidating most export licensing functions in one agency and creating an enforcement coordination agency, we can focus our energies and scrutiny on technologies that truly threaten American security, making it far less likely that these critical items will fall into the wrong hands," Gates said.

The administration plans to roll out the reforms this year and next. While some actions can be made by executive order, the single licensing and enforcement coordination agencies will require congressional action, Gates said.

**Initial Applause.** House Armed Services Committee Chairman Ike Skelton, D-Mo., and Ranking Member Howard P. "Buck" McKeon, R-Calif., both voiced their support for the Obama administration's export control reform plan.

"While controlling the export of sensitive technologies is fundamental to keeping our nation safe, it cannot be truly effective if the system is muddled and wrought with gaps and inconsistencies across agencies," Skelton said in a statement.

The United States is the only industrial nation with export controls split among several agencies rather than having this activity concentrated within one agency.

Steve Brotherton, managing partner of the Export Controls Practice at law firm Fragomen, Del Rey, Bernsen & Loewy in San Francisco, said other major trading countries have "become much more sophisticated and we've gotten left behind. We've become so archaic."

Overall, the industry backs the administration's export control reform after many years of lobbying for changes. Several trade associations, such as the National Association of Manufacturers, National Foreign Trade Council, TechAmerica, and Coalition for Security and Competitiveness, have offered their own recommendations in the past year for reform.

"We support the administration's sequencing plan, which begins with the most difficult issues and then moves on to agency reorganization," said the Coalition for Security and Competitiveness, in a statement. "CSC looks forward to hearing more from the administration on implementing many of the near and medium-term reforms we proposed earlier this year."

"The international trade community is very interested in the efficiencies that would be truly realized with the administration's reforms," said Marianne Rowden, president and chief executive officer of the American Association of Exporters and Importers. "We think streamlining the system is critical to help small-medium size enterprises export goods and technology."

"With Gates' leadership and Eric Hirschhorn's (undersecretary of Commerce for export administration and head of the Bureau of Industry and Security) combination of industry and government experience, the time is right" for reform, said Beth Peterson, president of BPE Global, a San Francisco-based industry consulting firm.

**Reform Anxiety.** For many exporters and trade associations, the realities of export reform are already

setting in with concerns about timetables and what's included in the Obama administration's agenda.

The National Association of Manufacturers (NAM) had hoped the phases of the administration's proposals included more details on near-term priorities, such as implementation of the intra-company transfer, a renewed focus on small and medium-sized manufacturers, and a streamlined approach for licensing to support U.S. government programs involving allies. Penalties for export violations will also need to be worked out in the reform.

"We will continue to urge implementation of near- and medium-term reforms while also working toward a fundamental makeover of the system," said Frank Vargo, NAM's vice president for international economic affairs. "Both are needed to enhance U.S. national security, support the industrial base and reach the president's goal of doubling exports within five years."

"The proposal for establishing one licensing agency, a single primary enforcement agency, a single control list and a single IT is extremely progressive and makes a great deal of sense," said Paul DiVecchio, president of export regulations consultancy DiVecchio & Associates, based in Northboro, Mass. "However, if not implemented with a great deal of commitment by the Congress, sufficient funding in the budget and a diligent oversight by the industry associations, this could be ugly."

DiVecchio warned that the integration of veteran licensing and enforcement staff from three different departments will be a challenge. "Resource allocation of qualified personnel will be very difficult since many current licensing and enforcement officials are close to retirement or won't take the risk of ending up low on the totem pole with the newly formed agency," he said.

Industry officials also remain concerned about where the new agency could end up, preferring it to reside in the Commerce Department. "This could become bad if the decision is made to place the single licensing agency under the State Department with its very restrictive policies," DiVecchio said. "The different mindset of State and DoD would result in micro-managing the licensing process which will ultimately inhibit legitimate trade opportunities."

Some industry officials believe the administration may concentrate the new export licensing and enforcement activities in the Department of Homeland Security, while others recommend the formation of a standalone body within the federal government.

"I would love to see a new agency, as the existing agencies have too much 'skin in the game' in how they approach the export controls for their areas of jurisdiction," said Dirk Petersen, vice president of contracts and export compliance for AMETEK Aerospace & Defense. "If the administration is truly interested in changing the protocol, a new agency is the only way to go."

The reform may suffer its biggest bumps among lawmakers on Capitol Hill. "Unfortunately, there are still people in Congress who believe that our current controls are acceptable, when they actually cast too wide a net and aren't focused on the key risk areas," BPE's Peterson said.

"I'm a little skeptical because I've been down this road to reform before, but this is the biggest overhaul plan that I've ever seen," said Farrell of Analog Devices. "This initiative is so important to the economy and for the United States to maintain itself as a key trading nation. I urge that we don't let it die on the vine."

"I think we're trying to assimilate this. Is it real? What's the impact?" Teradyne's Amero said. "There's some degree of optimism and that it should be supported. But there's concern that the government could really mess it up."

**Getting Ready.** Export compliance officers, many of whom are the sole individual for this activity in their companies, are taking this reform seriously and dedicating the time to understand and follow it.

"I'll be studying each clause to determine when I'll need to modify in-house to meet the new guidelines," Disenhof of Cadence said. "And as I become more familiar with the upcoming changes, I'll be creating in-house training modules to ensure that the message gets out to our employees who are involved — from sales to finance to R&D and support."

"I will be relying on external counsel and industry forums to keep myself up to date on the discussions and timelines regarding this issue," Petersen said.

"Industry is very mixed in terms of compliance programs and those that have heavily invested in technology will not be able to change over that quickly," he added. "We have a good mix of automated controls and manual checks and balances so the biggest issue for me would be any reclassification that would occur, as every SKU (stock keeping unit) in our system would have to be updated before any international shipments could occur."

Freight forwarders are expected to play an important role in guiding small to medium-sized exporters through these reforms.

"I definitely see ourselves helping companies understand what they need to do," said Michael Ford, vice president of compliance and quality for BDP International in Philadelphia. "We definitely don't want to see companies stepping away from exporting."

Brotherton said that no matter how the reforms shake out forwarders should anticipate the same amount of liability and government focus, if not more so, on their export operations.

Trade associations and coalitions are already lining up resources to track and respond to export reforms as they're proposed by the administration and generated through legislation in Congress.

"Feedback is important," said Disenhof, who also serves as East Coast chairman of TradeAmerica's Export Committee. "I believe we do share common goals that include protecting national security while protecting our ability to be the leaders in innovation and job creation."

"It will become critical for the industry to stay on top of this reform and to be very assertive in providing



DiVecchio

#### Shipper takeaways for U.S. export control reform

- Routinely monitor Commerce, State and Defense department Web sites for updates, and check the *Federal Register* for proposed rulemaking notices.
- Engage trade associations and offer input for position papers that will help shape export control reform's direction in Congress and the Obama administration.
- Start now to prepare your internal export compliance operations for these changes by contacting qualified and experienced consultants or attorneys for guidance.
- Be prepared to explain to your senior management about the need for making changes to information systems and organizing seminars to educate employees, especially those involved in logistics and transportation management and sales and marketing, about the changes to U.S. export controls.



Ford

constructive critique to their legislative representatives and key agency personnel," DiVecchio said.  
"Complacency will be the death knell for a progressive approach to export controls."



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