

EXPORT COMPLIANCE UPDATE

June/July 2006

Volume 9 Issue 5



FD ASSOCIATES, INC.
7926 Jones Branch Drive, Suite 260
McLean, VA 22102
TEL (703) 847-5801 FAX (703) 847-1523

Repair>Returns of ITAR Equipment

The exemption at Sec.123.4 (a) (1) of the International Traffic in Arms Regulations (“ITAR”), also known as the “repair exemption”, allows for the temporary import (and subsequent export) of unclassified U.S. origin defense items without a license. Use of this exemption is permitted if the purpose is for servicing (e.g. repair, one-for-one-replacement of defective articles, but no upgrade) and return to the country from which the goods were shipped. While the repair exemption is a useful tool to avoid the time/cost associated with obtaining a license, care must be taken when entering the goods into the United States. Failure to cite the ITAR reference (22 CFR 123.4(a) (1)) on the Customs Entry documents at time of import is a violation of the ITAR.

A common occurrence when returning goods to the US for repair is for a foreign customer to send parts directly to the manufacturer/repair facility without first notifying them of the incoming shipment. Oftentimes this is done via a courier service such as UPS or FedEx and the goods are not cleared through the Bureau of Customs Border Protection (“Customs”). While the parts may be received at the manufacturer’s facility without incident, the company will need to apply for a DSP-5 license to return the goods to the foreign customer upon completion of repair. The license application will not

(Continued on page 2)

Submission of DSP-5's Via D-Trade

In our April 2006 edition of Export Compliance Update, we identified that the Directorate of Defense Trade Controls (DDTC) is getting closer to implementing “mandatory D-Trade” licensing. Readers will be aware that D-Trade is a fully electronic licensing system that allows users to submit license applications and supporting documentation and retrieve completed licenses over the Internet using specialized Public Key Infrastructure security access controls.

In a recent announcement on its website, the DDTC identified that they are working to phase out the old ELLIE and ROBB licensing systems. Beginning October 12, 2006, these systems will no longer accept DSP-5 forms (for permanent export of defense articles). The notice identifies that industry users will be required to submit all DSP-5 forms through D-Trade. We have also learned that the DDTC is currently out of forms and that they are on backorder.

Clearly D-Trade is upon us, and we strongly urge readers to investigate the requirements to become a D-Trade User. The DDTC will be conducting free D-Trade training in several locations around the country. Please check the DDTC website (www.pmdtcc.state.gov), for the one nearest to you. You can also contact FD Associates for guidance and assistance in becoming a D-Trade user.

Compliance Corner— Debarment and Its Effects on Your Business

Debarment pursuant to section 127.7(c) of the International Traffic in Arms Regulations (ITAR), simply put, means that an individual or a company or both, is prohibited from participating directly, or indirectly in the export of any equipment, technical data or services related to articles on the US Munitions List (22 CFR § 121). A company may be debarred from exporting, if the company is convicted of violating the Arms Export Control Act (AECA) or conspiring to violate the AECA. This type of debarment is known as “statutory” debarment, however companies can be also be administratively debarred. The basis for administrative debarment is any violation of the AECA or ITAR where the violation is of such a nature, that the Directorate of Defense Trade Controls believes the company cannot be relied upon to comply in the future. The standard period for debarment is three years.

The effect of debarment on a company can be significant and potentially shut the company down. If a company is debarred, all export sales or transactions must be terminated. This will include all exports of hardware and technical data, as well as the provision of services. Existing programs will need to be shut down if they involve foreign person, or consignee. In addition, no other company will be able to export your products, data or services. Debarment will also mean the company may not hire any foreign person where a license would be required for the employment of the individual. The company will also not be eligible to use any regulatory exemptions, therefore precluding the return-for- repair of items on the US Munitions List.

A secondary result of debarment is that domestic companies will be precluded from doing business with the company or will make a business decision to not do business with the company. Not only may another firm not export any products produced by a debarred company, they also may not export any product or system containing components produced by a debarred company. Therefore a diligent company will screen its suppliers and vendors to ensure that the products it uses in its systems are not from any denied party.

Fortunately, debarment is not a common occurrence and a company with a good compliance program that includes top-down policy statements, clearly documented procedures and processes that are regularly audited for compliance and regular training of employees is unlikely to be debarred. *As always, compliance is good for business!*

This newsletter is provided as a service to our clients and is not intended to replace the ITAR or EAR as a reference source. If you have questions concerning the correct interpretation of the regulations please call us at (703) 847-5801.

(Continued from page 1)

have any of the required support documents (Purchase Order, end-use statement, etc) and therefore must identify that it is for return of articles not properly cleared through Customs. We are aware that in such circumstances, the State Department's Office of Defense Trade Controls Compliance has recently started issuing letters to companies, identifying that the company has responsibility to ensure that the repair/return of defense articles is in compliance with the requirements of 22 CFR § 123.4(d) including proper clearance through Customs at time of import.

In order to avoid possible ITAR violations related to improper use of the repair exemption and also to avoid having to apply for DSP-5 licenses unnecessarily, the company should have a detailed RMA (repair material authorization) procedure in place. Such a procedure should include a clear instruction to foreign customers and US customs brokers of the requirements of the ITAR for marking documents and clearing goods into the United States. Care should also be taken to ensure that the export of repaired articles meets all of the requirements of the ITAR § 123.4(d), including identifying the ITAR exemption reference and the Customs Entry # the goods were imported against on the AES record. Company personnel involved in the import or export of repair/returns of ITAR controlled equipment should also be briefed, particularly on what to do when they receive an article that has not been imported correctly.

The repair exemption can be a very useful tool in a company's import/export program however, careful coordination of the process to ensure compliance with the ITAR is a must.

REGULATORY UPDATES

The President

June 27, 2006 – 71 Fed. Reg. 36478: President Bush issued a finding that the furnishing of defense articles and defense services to the Kingdom of Swaziland will strengthen the security of the United States and promote world peace. This finding makes Swaziland eligible to receive U.S. defense articles and defense services.

Department of Commerce

May 22, 2006 – 71 Fed. Reg. 29301: The Bureau of Industry and Security (BIS) announced the creation of the Deemed Export Advisory Committee (DEAC); announced that it will not implement suggested changes to the regulations related to country of birth, the definition of "use" in the Export Administration Regulations (EAR), and the scope of fundamental research as they relate to deemed exports, and that it will leave these regulatory provisions intact; BIS also noted that it has increased its enforcement focus on deemed exports; and that it has received funding in the FY2006 budget to implement an "Enhanced Deemed Export Control Initiative" that will enable BIS to process an increased volume of deemed export license applications in a timely manner and to expand outreach and enforcement efforts regarding deemed exports.

May 31, 2006 – 71 Fed. Reg. 30840: BIS withdrew its Advance Notice of Proposed Rulemaking (ANPR) regarding deemed exports and related regulatory requirements (Published March

ITAR ANSWER

A NO. It is general policy of the Department of State to return without action (RWA) license application in furtherance of agreements, when the agreement is still in review. This policy also extends to approved agreements, where the agreement has not yet been signed by all of the parties.

There may be instances where companies have had their licenses approved under these circumstances, i.e. the agreement has been staffed to DOD and is back in final processing at State Department, but it is the exception rather than the rule. Companies submitting their license application in advance of a TAA/MLA approval or signing, run the risk of getting an "RWA".

REGULATORY UPDATES

28, 2005—70 Fed. Reg. 15607) and discussed the public comments on the ANPR.

June 12, 2006 – 71 Fed. Reg. 33614: BIS amended the EAR and Commerce Control List (CCL) to 1) expand controls on several biological agents and toxins that have been determined to have the potential to pose a severe threat to human, animal and plant life and to sectors of the U.S. economy; 2) clarify that Investigational New Drugs (IND) are included in any license requirements; 3) remove St. Kitts and Nevis from the list of countries of concern for chemical and biological weapons proliferation; and 4) update the list of countries that currently are members of the Chemical Weapons Convention.

June 13, 2006 – 71 Fed. Reg. 34008: BIS amended the EAR Sec. 756.2 to permit the Under Secretary for Industry and Security to designate any Commerce Department official to assist in the review and processing of administrative appeals of export control enforcement decisions. Formerly, only BIS officials could serve as appeals coordinators. The authority to decide appeals will remain with the Under Secretary or a BIS official designated by him.

July 6, 2006 – 71 Fed. Reg. 38313: BIS seeks comments for a proposed revision of Export Administration Regulations' (EAR) export and reexport controls for the People's Republic of China (PRC). BIS proposes to amend the EAR by revising and clarifying licensing requirements and licensing policy on exports and reexports of goods and technology to the PRC. The proposed amendments include a revision to the licensing review policy for items controlled on the Commerce Control List (CCL) for reasons of national security, including a new control based on knowledge of a military end-use on exports to the PRC of certain CCL items that otherwise do not require a license to the PRC. Items subject to this license requirement will be listed in a new supplement No 2. to Part 744 of the EAR. The proposed rule also seeks to revise the licensing review policy for items controlled for reasons of chemical and biological proliferation, nuclear nonproliferation, and missile technology for export to the PRC, requiring that applications involving such items be

REGULATORY UPDATES

be reviewed in conjunction with the revised national security licensing policy. The rule also proposes the creation of a new authorization for validated end-users in certain destinations, including the PRC, to whom certain, specified items may be exported or reexported. Such validated end-users would be placed on a list in the EAR after review and approval by the United States Government. Finally, this rule proposes to require exporters to obtain an End-User Certificate, issued by the PRC Ministry of Commerce, for all items that both require a license to the PRC for any reason and exceed a total value of \$5,000.

Sanctions & Denials

Department of Commerce

May 23, 2006 – *71 Fed. Reg. 29613*: BIS issued a 6-month temporary denial order (TDO) against Data Physics Corporation of San Jose, CA; Data Physics China in Shanghai, PRC; Data Physics China in Beijing, PRC; Sri Welranta of San Jose, CA; and Bill Chen of Beijing, PRC upon a showing that they had sold and shipped spherical couplings subject to the EAR (although not listed on the Commerce Control List) from the U.S. to a prohibited end user, a PRC technology academy involved in the development of cruise missiles. The evidence also indicated that Data Physics had separated the items into smaller shipments to avoid raising suspicion; had reassembled and installed the equipment in the PRC; and had concealed the identity of the end user by using a false customer name “27th Locomotive Factory.” BIS brought this case under the “catch-all” provisions of the EAR (Part 744).

June 5, 2006 – *71 Fed. Reg. 32272*: BIS issued a general order imposing a license requirement for all EAR-covered items where the transaction involves Mayrow General Trading of Dubai, United Arab Emirates, or any of the following entities related to Mayrow: Micatic General Trading, Majidco Micro Electronics; Atlinx Electronics; Micro Middle East Electronics; Narinco; F.N. Yahgmaei; and H. Ghasir. The order was based on information that Mayrow and its related entities have acquired electronic components and

devices capable of being used to construct Improvised Explosive Devices (IEDs) that have been and may continue to be used against Coalition forces in Afghanistan and Iraq.

June 7, 2006 – *71 Fed. Reg. 32920*: BIS issued a 10-year denial order against Swiss Telecom of Toronto, Ontario, Canada after ST failed to respond to a charging letter alleging nine violations of the EAR involving the unlicensed export of telecommunications devices to Iran via the UAE. The alleged violations included conspiracy to send the devices to Iran; causing a U.S. company to export the devices to Iran via the UAE; ordering the devices for a project in Iran with knowledge that they would be exported to Iran without proper authorization; and causing a U.S. company to provide controlled technical information and customer support for equipment in Iran without the required license.

June 12, 2006 – *71 Fed. Reg. 33724 and 33725*: BIS issued a 10-year denial order against Edsons Worldwide Services, Inc. and Eduard Mendelevich Yamnik, both of Edina, MN, for exporting fingerprint powers classified under ECCN 1A985 to Belarus after being notified that its application for a license for this export had been denied. Edsons agreed to the denial order to settle BIS charges of exporting without a required license and transferring an item with knowledge that a violation would subsequently occur.

June 15, 2006 – *71 Fed. Reg. 34593*: BIS issued a 6-year denial order against Kailash Muttreja of Amsterdam, Netherlands, in connection with allegations that Muttreja had conspired to obtain controlled toxins including Aflatoxin (M1, P1, and Q1) and Staphylococcal Enterotoxin (A and B) for export to North Korea and had solicited a violation of the EAR by ordering the toxins from a U.S. company and agreeing to complete the shipment of the toxins from Netherlands to North Korea.

June 15, 2006 – *71 Fed. Reg. 34596*: BIS issued a 10-year denial order against Teepad Electronic General Trading of Dubai, UAE after finding that Teepad had conspired to obtain controlled U.S.-made telecommunications devices and export them to Iran

via the UAE; had aided and/or abetted an act prohibited by the EAR by forwarding the devices from the UAE to Iran without the required authorization from the Office of Foreign Assets Control (OFAC); and had transferred these items with knowledge, or reason to know, that a violation of the EAR would occur.

Fines & Penalties

June 6, 2006: Arif Ali Durrani, was sentenced to 12-1/2 years in federal prison for coordinating exports of parts for the F-5 fighter jet and Chinook helicopter to Iran via Belgium, Malaysia, and the UAE. Durrani, a Pakistani, had earlier served 5 years in federal prison for illegally supplying Iran with Hawk anti-aircraft missile guidance systems. Durrani was deported after his earlier prison sentence and coordinated the recent exports from his home in Mexico. Durrani claimed during the trial that he had made the shipments at the direction of National Security Council aide Oliver North.

June 7, 2006: The Treasury Department Office of Foreign Assets Control (OFAC) disclosed that Exel Global Logistics, Inc., of Hayward, CA had paid \$6,226.50 to settle allegations of violations involving coordination of shipments to Iran. Exel voluntarily disclosed the violations to OFAC. Exel also represented to OFAC that it has subsequently upgraded its OFAC compliance program.

June 15, 2006: State Metal Industries, Inc. of Camden, NJ and its vice president, Michael Dorfman, pleaded guilty in U.S. District Court in Newark to violating the Arms Export Control Act and admitted attempting to illegally sell scrapped missile parts to China instead of melting them into ingots as they had agreed when bidding on the scrap. Custom agents discovered the parts in a shipping container at a NJ port. Under a pleas agreement, the company will pay a \$250,000 criminal fine and will be under probation for 3 years. Dorfman will be sentenced in September.

EXPORT COMPLIANCE UPDATE

FD Associates, Inc.
7926 Jones Branch Drive, Ste. 260
McLean, VA 22102

June/July 2006 Export Compliance Update



Published by
FD Associates, Inc.
7926 Jones Branch Drive
Suite 260
McLean, VA 22102

Tel: (703) 847-5801
www.fdassociates.net

ITAR QUIZ

Q

I have recently submitted a Technical Assistance Agreement (TAA) to the Department of State for the design and development of my company's Almighty Defense System ("ADS") for end-use by the German Government.

My company has advised me that we urgently need to export prototypes of our ADS to the customer in Germany for fit check. We have described these prototypes in the TAA, and will need a DSP-73 license to temporarily export them to Germany.

Can I submit my DSP-73 license application for approval, even though the TAA is still being processed?

FD ASSOCIATES 2006 EXPORT SEMINARS

14 September 2006: Tech Data & Defense Services
26 October 2006: Compliance Programs

Please visit www.fdassociates.net for additional information.