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Export Control Reform: Opportunities And Risks For The UAV Industry

Many UAV system, component, and part manufacturers are looking forward to the liberalization of export controls proposed under the President's Export Reform Initiative. Under the proposed changes, many items currently controlled under the U.S. Munitions List (USML) and International Trade in Arms Regulations (ITAR) will be transferred to the Commerce Control List (CCL) and Export Administration Regulations (EAR). The transition promises to release many items, particularly certain parts and components, from restrictive export controls under the ITAR to generally more liberal controls under the EAR. These changes will likely bring new export opportunities to the UAV industry, but they will also present challenges in the form of increased complexity and enhanced enforcement.

The Benefits of Reform

Under current ITAR controls, most items designed, modified, or prepared for military use require an export license prior to export to any destination, including U.S. allies. These controls apply to virtually all military UAV systems, components, and parts, to most commercial items that are modified to meet military specifications, and to most commercial items that were adapted from military designs. The transition of many of these items to the CCL could significantly reduce the licensing requirements for many parts and components producers, particularly when shipping to certain qualifying U.S. allies. ITAR registration will no longer be required for manufacturers who produce items subject only to the new CCL controls and restrictions on sharing associated data and providing related services will be liberalized.

Perhaps more importantly, "ITAR taint" will no longer be as difficult an issue for commercial or foreign-made systems that only incorporate components and parts that are transitioned to control under the CCL. Under the current regime, most systems that incorporate an ITAR-controlled part or component become "tainted" and subject to control under the ITAR (known informally as the "see through rule"). The "tainted" new system often cannot be exported to any destination without a license from the State Department. This regulatory restriction has been a significant barrier to the commercialization and export of many parts and components designed for the UAV industry that have non-military applications. It has also led many foreign producers to seek non-U.S. suppliers.

Under proposed reforms, parts and components transitioned to the CCL are less likely to "taint" foreign made UAV systems. Instead, the U.S. will only assert licensing control over the foreign made system if it incorporates more than a small amount of U.S. content by value (generally 10 percent). UAV systems that remain subject to the ITAR will also face relaxed incorporation rules under current proposals, lessening the impact of "ITAR taint." As indicated, these are proposed rules and are still being developed by the agencies.

The Risks: New Complexity and Enhanced Enforcement

While these benefits will be significant for many in the unmanned vehicle industry, the transition will not be a panacea. One of the primary drawbacks of the transition is the complexity of the transition process and the proposed new regime. Unlike the ITAR, the CCL subjects different items to varying levels of licensing requirements. CCL licensing exceptions, including license exception STA (Strategic Trade Authorization), will be available for certain items, but reporting and other requirements may well be triggered.

Moreover, complete UAVs and significant systems are subject to the international Missile Technology Control Regime (MTCR) and Wassenaar Agreement, which requires the U.S. and other governments to maintain restrictive controls on exports of those items. Therefore, even if UAV systems are transferred to the CCL, they will remain subject to a high level of control. For example, significant UAV systems, such as handling, control, activation, launching, radar, and flight control systems are proposed to be transferred to the EAR, but will still require a license prior to export to nearly any destination, including to U.S. allies in Europe. Complete military UAVs and significant systems will remain subject to the ITAR under the new regime.

The EAR will also expose certain exporters to enhanced enforcement. BIS has indicated that items transitioned to the CCL, including UAV items, will be subject to enhanced enforcement scrutiny by enforcement agents. At an advisory committee meeting in Washington, DC, Commerce Department Assistant Secretary for Export Enforcement David Mills told industry leaders that Commerce is "going to apply all of our enforcement resources to policing" exports of the transitioned items. Mills promised that Commerce would be closely monitoring the Automated Export System (AES) for exports of these items and predicted that the agency "would be finding on its own quite a lot of these violations." The Commerce Director of Export Enforcement reiterated that message at a BIS conference in mid-July this year.

Counter-intuitively, Commerce will likely penalize certain exporters who violate the rules more severely than the State Department, even in voluntary self-disclosure situations. For example, DDTC has often been willing to issue warning letters without a monetary fine for properly disclosed unlicensed exports of ITAR-controlled parts and components where U.S. national security was not severely threatened by the improper export or the violation was unintentional and compliance improvements were implemented. In contrast, BIS is much more likely to conduct investigations and apply monetary penalties to companies that make even accidental exports of controlled items without a license – even if the exporter volunteers information on those errors to the agency. Voluntary disclosures to BIS earn significant penalty mitigation, but disclosures can take years to resolve and many disclosures involving actual violations result in a monetary fine.

Note that under the Commerce rules inadvertent violations are treated under a strict liability approach (you don't have to intend to violate the rules to have a violation). The criminal penalties are comparable to State's (20 years in jail plus $1 million per violation in some cases) and civil penalties are typically subject to a $250,000 penalty cap (or two times the value of the shipment) per violating export shipment or technology release.

What You Can Do

Companies should monitor the proposed reforms and begin considering the opportunities presented for increasing exports, expanding cooperation abroad, and moving into the commercial space. Of course, exporters should also be aware of the pitfalls in the new licensing regime. Producers should be very cautious about commercializing ITAR items, as it is a very complex process that can lead to difficult classification issues and unintentional violations.

As the proposed reforms are incorporated into formal rules, exporters should consider updates to their compliance programs. Such updates should include a product classification review, training for employees, and updates to processes and procedures. Exporters should also take this opportunity to ensure that their compliance systems adequately address risks from sanctions laws, end-use restrictions, denied party screening, and anti-boycott provisions that will continue to apply.

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