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ISSUE 26. October 2013
www.WorldECR.com

Maersk Line to halt all Iran port stops

Shipping giant Maersk Line has stopped port calls to Iran in response to sanctions, Reuters has reported. The news agency reported a spokeswoman for Danish group A.P. Moller-Maersk as saying, 'This is a pragmatic decision based on an assessment of balancing the benefits of doing limited business in Iran against the risk of damaging business opportunities elsewhere particularly the U.S.'

'Maersk Line will maintain a dormant business entity in Iran and will look to resume business should the sanctions regime be eased.'

According to the spokeswoman, 'To date, Maersk Line's business in Iran has involved transporting foodstuffs and other goods, for example vehicles, for the benefit of the general civilian population. It is with regret that it is ceasing these activities.' But, she added, the company would not be cutting its ties with the country completely: 'Maersk Line will maintain a dormant business entity in Iran and will look to resume business should the sanctions regime be eased.'

Reuters notes that in 2011 the U.S. blacklisted major Iranian port operator Tidewater Middle East Co, which operates seven terminals in Iran, including the biggest container port Bandar Abbas. This is believed to have led Maersk Line to suspended operations at several ports, but it continued to call at the small northern Iranian container port of Bushehr. However, the spokeswoman said Maersk Line halted loading cargo bound for Bushehr on 30 September and stopped loading outbound cargo from Bushehr on 24 September. 'Maersk Line ceased its acceptance to all other ports than Bushehr in 2011. The discontinuation of services to and from Bushehr unfortunately reflects the difficulties servicing Iran as a whole,' she is reported as saying.

Cryptography controls suffocating UK exporters

Differences between the U.S. and UK licensing regimes governing export of encrypted products are impacting heavily on British exporters, a UK export control compliance advisor has told *WorldECR*.

Bernard O'Connor of Manchester-based Strong and Herd said: 'The issue we are seeing is the fact that the USA will export encrypted products under exceptions rather than needing a licence, yet in the UK they require SIELs as this category, 5a002, isn't on a lot of OGELs. We seem to be in a discriminatory situation with one client company being threatened with job losses and taking work to the USA as licence applications are slowing down the UK business's ability to meet deadlines.'

According to O'Connor, U.S. companies enjoy an advantage in that many encrypted products benefit from a 'half-way house' provision under which exporters are 'essentially left alone'. No such provision applies in the UK, he said, with the upshot that the threshold defining when a product is not exempted as a 'mass market' product is high. 'I have a client that supplies servers,' he said. 'The company didn't think that it was required to obtain a licence until his goods were seized in the warehouse by the UK Border Force.'

O'Connor said that despite the fact that the product was freely available in the consumer retail market, the UK Export Control Organisation took the view that it exceeded the conditions set out in the Cryptographic Note, which details the conditions for the de-control of products.

According to O'Connor this is not an isolated incident. He said that in his experience certain industries were being especially affected – the controls were 'seriously impacting on the competitiveness of the telecoms industry,' and he added that oil and gas companies operating in the North Sea were being similarly hit by the UK's stringent requirements.

Rwanda condemns military aid cut

The United States government is reported to have cut off 'some forms of military aid' to the African republic of Rwanda because of alleged links to the M23 rebel group operating in the Democratic Republic of Congo. M23 was designated earlier this year by OFAC, partly on account of its recruitment and use of child soldiers.

News service, Voice of America reports that Linda Thomas-Greenfield, assistant secretary in the State Department's Bureau of African Affairs, announced the sanctions in an online forum with African reporters, and that she said the U.S. State Department believes M23 'continues to actively recruit and abduct children in Rwandan territory'.

The U.S. government, said Voice of America, is acting under the 2008 Child Soldiers Prevention Act ('CSPA'), which denies certain forms of military aid to countries found to be using child soldiers or supporting armed groups that use them.

According to the BBC, a Rwandan military spokesman has said the decision was not based on evidence: 'It is surprising that Rwanda would be liable for matters that are neither on its territory nor in its practices,' army spokesman Joseph Nzabamwita told the BBC. 'As a long-term partner of the Rwanda Defence Force, the United States has ample evidence that our forces have never tolerated the use of children in combat,' he added.

China announces embargo list for dual-use items to North Korea

On 23 September 2013, the Ministry of Commerce ('MOC') announced that China will impose substantive sanctions on the Democratic People's Republic of Korea ('DPRK'), to comply with the requirements by the United Nations Security Council, *writes George Tan of Bryan Cave Consulting*. As such, the MOC issued an embargo list which will ban the export of certain high-technology dual-use items to DPRK. This is the first time China has undertaken such action against any particular country and is in response to DPRK's third nuclear test in February 2013.

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The 236-page embargo list is stipulated in accordance with UN Security Council Resolution No. 1718, 2087, 2094; INFCIRC/254/ Rev.11/Part 1, INFCIRC/ 254/Rev.8/Part 2 published by the International Atomic Energy Agency; S/2012/947, S/2006/853, S/2009/364 published by the UN Security Council; as well as appendix C of United Nations Security Council Resolution No. 2094.

The embargo list covers the ban on dual-use items and technologies in four major areas, including nuclear, missiles, chemicals and biological. The dual-use nuclear items list is similar to the Catalog for the Administration of Import and Export Permit for Dual-Use Items and Technologies which is currently adopted in China's export control system. The embargo list includes more items and technologies relating to missiles, chemicals and biological agents with more detailed technical specification.

This broader coverage of items is partially because the embargo list is not based on HS codes and it is anticipated that exporters may face difficulties accurately classifying products and may have to consult the relevant authorities if the exported products are subject to the embargo list. It is recommended that exporters should ascertain whether their products for export to DPRK are subject to control.

The details of the announcement can be accessed at:
http://exportcontrol.mofcom.gov.cn/article/t/z/201309/20130900319092.shtml

Turkish trading company hit with ITR fine

OFAC has assessed a penalty of $750,000 against Finans Kiymetli Madenler Turizm Otomotiv Gida Tekstil San. Ve Tic, a Turkey-based trading company, for violating the Iranian Transactions and Sanctions Regulations.

In a statement, OFAC said that 'from on or about February 21, 2012, to on or about May 29, 2012, Finans originated at least three electronic funds transfers, totaling $257,808, processed through financial institutions located in the United States for the benefit of the Government of Iran and/or persons in Iran. Two of those transactions were blocked by the U.S. financial institution. OFAC determined that Finans violated the prohibition against the exportation of services, directly or indirectly, from the United States to Iran or the Government of Iran set forth in § 560.204 of the Regulations.'

According to OFAC, it determined that Finans did not voluntarily self-disclose the violations to OFAC and that the violations constituted an egregious case. It added that the amount reflected the facts that:

- Finans acted recklessly by concealing and/or omitting material information in funds transfers originated by Finans for processing through the United States
- Finans' management, including senior management, had at least reason to know of the conduct that led to the violations
- Finans' conduct, including processing transactions on behalf of an oil and gas development company in Iran, resulted in harm, and potentially significant harm, to U.S. sanctions programme objectives with respect to Iran, and that,
- Finans does not appear to have an OFAC compliance programme and that Finans did not cooperate with OFAC during the course of its investigation.

http://www.treasury.gov/resource-center/sanctions/CivPen/Documents/09262013.pdf

EU-Indonesia import agreement aims to counter illegal logging

In a move designed to counter illegal logging, the European Union is to sign a voluntary partnership agreement with Indonesia concerning the import of forestry products. A 23 September 2013 Council decision to that effect was reported by the EU law journal *EUR LEX*.

EUR LEX notes that in May 2003 the European Commission adopted a Communication to the European Parliament and to the Council entitled 'Forest Law Enforcement, Governance and Trade (FLEGT): Proposal for an EU Action Plan' which called for measures to address illegal logging by developing voluntary partnership agreements with timber-producing countries. Council conclusions on the action plan were adopted in October 2003, and a European Parliament resolution on the subject was adopted on 11 July 2005.

Council Regulation (EC) No 2173/2005 established a FLEGT licensing scheme for imports of timber into the EU from countries with which the EU has concluded voluntary partnership agreements.

'A central element of the EU's strategy to combat illegal logging are trade accords with timber exporting countries.'

The negotiations with the Republic of Indonesia were completed and the voluntary partnership agreement between the EU and Indonesia on forest law enforcement, governance and trade in timber products to the European Union ('the Agreement') was initialled on 4 May 2011. On 23 September 2013, the Council received authorisation to sign the agreement.

A website dedicated to FLEGT explains: 'Illegal logging has a devastating impact on some of the world's most valuable forests. It can have not only serious environmental, but also economic and social consequences. Europe's response to the problem is reflected in the FLEGT (Forest Law Enforcement, Governance and Trade) Action Plan of the European Union. The EU FLEGT Action Plan provides a number of measures to exclude illegal timber from markets, to improve the supply of legal timber and to increase the demand for responsible wood products.

'A central element of the EU's strategy to combat illegal logging are trade accords with timber exporting countries, known as Voluntary Partnership Agreements, to ensure legal timber trade and support good forest governance in the partner countries. As a second element, the EU created legislation to ban illegally-produced wood products from the EU market, known as the EU Timber Regulation.'

The decision can be found at
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:265:0001:0002:EN:PDF

Russia and Belarus in potash spat

Agweb, the agricultural trade website, has reported an ongoing spat between Russia and Belarus regarding sanctions against Belarus arising from a dispute over potash.

According to the website, relations between the two FSU nations have declined since July when Russia's Uralkali, a potash fertiliser company, announced it would secede from a joint venture with Belarus's Belaruskali, following the arrest by Belarus of Uralkali CEO Vladislav Baumgertner on charges of abuse of power. According to Agweb: 'High ranking Belorussian officials had invited Baumgertner to Minsk and arrested Baumgertner shortly after his arrival in Belarus on charges of abuse of power. Russia has since pursued import sanctions against Belarus including limited sendouts to Belraus of Russian crude oil and limited tenders of Belorussian pork and dairy products into Russia. Between those three sanctions and reduced capacity to tender potash contracts, Putin has put a major crimp on Belarus' export revenues.'

It added that Belarus has 'also targeted other Uralkali executives and has asked Russia to extradite Suleiman Kerimov, who remains at large. [The President of Belarus, Alexander] Lukashenko told reporters that Baumgertner could be sent back to Russia, but only if Russia pursues a course of action to investigate Belaruskali's claims that Uralkali had broken the rules of the joint venture and tendered product outside the venture. But Uralkali leveled the same charge at Belaruskali, resulting in the July split of the two.'

Agweb predicts that as trade sanctions tighten between Russia and Belarus 'tempers are likely to build pressure. Neither of these nations wants to blink here and as Baumgertner waits in a Belorussian prison, it looks like Putin is in no hurry to come to the bargaining table with Lukashenko,' suggesting that if the spat is not resolved soon, Putin may decide to use the threat of turning off Russia's supply of natural gas to Belarus.

On the agenda: Impact of export controls on EU, Turkish, Israeli and Swiss business

We are pleased to announce the addition of further sessions to the *WorldECR* Export Controls and Sanctions Forum in London, November 14 and 15.

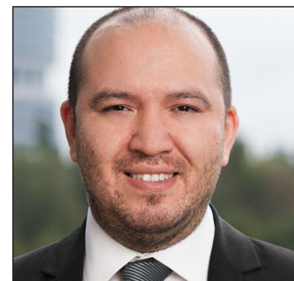
Impact on business

Two additional panel sessions, chaired by Iain MacVay, partner and head of the London Trade and Customs Practice of King & Spalding, will discuss the impact of U.S. and EU legislation on, firstly, EU businesses and, secondly, on non-EU businesses, with particular focus on key trading nations, Turkey, Switzerland and Israel. The two panels will draw on their particular expertise to offer valuable insight for EU companies and the subsidiaries of U.S. and Asian companies.

Panel members include Konstantinos Adamantopoulos, a partner in the Brussels office of Holman Fenwick & Willan, Sandra Strong, name partner at Strong and Herd in Manchester, Jikke Biermasz, head of the international trade team at Kneppelhout & Korthals in Rotterdam, Dr. Shuki Friedman of the Peres Academic Center, Rehovot, Israel, Orçun Çetinkaya, partner at Mehmet Gün and Partners, Istanbul, and Matthew Parish, a partner in the Geneva office of Holman Fenwick & Willan.

Counter proliferation

We are also pleased to announce that Ian Stewart, head of Project Alpha at King's College, London, will be joining us at the conference. Project Alpha is a UK government-sponsored initiative that was established to support the private sector in implementing export controls and countering the illicit trade that maintains the prohibited nuclear and missile programmes of countries such as Iran and North Korea. Ian, who writes in this issue of *WorldECR*, will discuss the important role that the private sector can play in countering proliferation, and examine some of the internal strategies businesses can adopt to meet the proliferation threat while protecting the bottom line. More information at **www.worldecr.com/conference**



New speakers/panel members joining the WorldECR Forum include, clockwise from top left: Jikke Biermasz, Orçun Çetinkaya, Ian Stewart, Iain Macvay and Matthew Parish.

Russia and U.S. consider Iranian participation in Syria conference

The U.S. is considering whether Iran should participate in the Geneva II talks aimed at working toward a peace in Syria, U.S. State Department spokeswoman Marie Harf told reporters on Monday this week. Asked whether Secretary of State John Kerry and Russia's Foreign Minister Sergei Lavrov had discussed the participation of Iran in Geneva II, she said: 'We've been clear multiple times about Iran's destructive role in the Syrian crisis and our expectation that any party that's included in Geneva II must accept and publicly support the Geneva communique. If, and this is an if, Iran were to endorse and embrace the Geneva communique publicly, we would view the possibility of their participation more openly.'

In May 2013, Iranian Ambassador to the UN, Mohammad Khaza'ie said that Iran supported Geneva II, saying, 'We believe that, apart from the Syrian sides, all relevant regional and international partners that wield some influence over the parties and could help the Syrians should move towards peace and they must participate in the conference and endeavor towards its success. Iran's participation in the conference will depend on the details that we will consider when we receive them.'

Observers say that the talks between Iran and the P5+1 which commence mid-October will prove a critical bellwether to ongoing relations between Iran and the West, and thus likely to influence the make-up of the Geneva II conference.

http://www.state.gov/r/pa/prs/dpb/2013/10/215183.htm#SYRIA

Swedish Group fined for EAR evasion

KMT Group, a Stockholm-based group of companies producing precision grinding and waterjet systems, has entered into a settlement with the U.S. Bureau of Industry and Security ('BIS') for an alleged violation of the Export Administration Regulations ('EAR').

The charge made against KMT was that it tried to evade the EAR with an unauthorised export to Iran of nine high-pressure water pumps destined for use in Iran's South Pars Industrial Complex. The items, subject to the Iranian Transactions Regulations ('ITR'), had a declared total value of $800,000.

BIS said that KMT GmbH (a German subsidiary of KMT Group) submitted an order to its U.S. sister company, KMT Aqua-Dyne in Houston, for the manufacture and export of the pumps, without including information as to their intended destination, falsely representing that the pumps were intended for a customer in the UAE. Transhipment, however, was halted 'by law enforcement' and the pumps were returned to the United States. BIS says that the action was a violation of section 764.2(h) of the EAR.

KMT is to pay a $125,000 penalty to BIS, and to complete an external audit of the export control compliance programmes of its operating entities worldwide.

Dr Baerbel Sachs, partner at the Berlin office of law firm Noerr, told *WorldECR*: 'This is a classic case of enforcement of U.S. re-export control under the Export Administration Regulations against non-U.S. companies. This is not one of the cases where U.S. authorities, and in particular OFAC, claim extraterritorial application of U.S. law in cases without any connection to the U.S. Rather, the – in our eyes still extraterritorial – scope of application of U.S. law stems from the fact that KMT GmbH tried to tranship goods of U.S. origin.'

Sachs added: 'The civil penalty is not surprisingly high. In 2011, another German company, Flowserve* Hamburg GmbH settled for identical penalties: civil penalties in the amount of $125.000, plus submission to an external audit of the export compliance program. This is yet another example of U.S. enforcement of U.S. re-export control and should be a motivation for European companies to get acquainted with the U.S. rules and design and implement compliance programmes.'

* Among the sessions at the WorldECR Export Controls and Sanctions Forum (14-15 November, London), Scott Sullivan Flowserve's Vice President of Ethics, Compliance & Legal, and Tony Marjoram, Director, Export Compliance EMA, will outline the steps Flowserve took to launch the post-disclosure compliance audit and enhance the company's compliance programme to address ongoing risks, describing some of the obstacles that they encountered on the way and how they cleared them.
Full details at www.worldecr.com/conference

Amber Road acquires Shanghai-based EasyCargo

Amber Road, a leading provider of global trade management ('GTM') solutions, has acquired EasyCargo, a Shanghai-based GTM solutions provider specialising in complex Chinese trade regulations. EasyCargo is a cloud-based solutions company with a specific focus on a subset of global trade management called China Trade Management, or CTM.

'Many of our existing North American and European-based customers do business with or in China, either as a source of supply, a manufacturing base, or as a market for exports,' said Jim Preuninger, CEO of Amber Road. 'Our acquisition of EasyCargo will enable us to offer deep China-specific trade capabilities to our existing customer base as well as access the growing Chinese market.'

U.S. offers sensitive technology to India

Indian news outlets have reported that the U.S. is softening its position on sharing defence technology with India. Zee News has reported that 'the Pentagon has submitted a list of 10 sensitive technologies for transfer from U.S. to India,' and that 'New Delhi is "reviewing" these offers and would get back to the United States soon, with its response.'

According to the news agency, U.S. authorities are reviewing, in consultation with its defence industry, which technologies could be shared and transferred to India. It says that 'the number of such defence technology transfers could cross 90.' It quotes Deputy Secretary of Defence Ashton Carter, who is leading the Trade and Technology Initiative, as saying that the U.S. has submitted a white paper explaining where India falls within the U.S. export control system. Mr Carter is reported as saying: 'The paper we sent them covered several key areas from export controls rules themselves to end use monitoring and the need to identify proposals for co-production and co-development.'

Mr Carter went on to add, 'We have demonstrated repeatedly that we can release sensitive technology to India. We've adapted our system in ways that will speed our release process for India, especially in the Department of Defense, recognising that for, of course, all partners, this process is subject to case-by-case review and there will always be some technologies that we will keep to ourselves.'

Change of mindset

Speaking at an event at a Washington think-tank, Carter said: 'We changed our mindset around technology transfer to India in the Department of Defence from a culture of presumptive no to one of presumptive yes.' Asserting that India has been brought at par with the closest of its allies, Carter said that the Obama Administration has now included India in a so-called 'Group of Eight' that 'receives the best of the technologies without export control'.

Regulatory changes to export control laws leave many important questions open

02 THE CHANGING TIMES

THE BEST 5

TIPS FOR EXPORTERS TO GET A HANDLE ON EXPORT CONTROL CHANGES BY THE

END OF 2013

ACT NOW!

1 EXPORT ISN'T ONLY EXPORT

... from the U.S point of view when EU member states ship to third countries. U.S. export controls also apply to shipments within the EU, if the goods are of U.S. origin, contain components of U.S. origin, or were produced using U.S. technology.

2 CONTROLLING TECHNOLOGY

U.S. export controls do not only apply to physical goods, but also to exports of technology. These include the transfer of technology or source code that can take place by e.g. talking to a foreign national in the U.S. (deemed export), or participating in an online demo.

3 HOW MINI CAN DE MINIMIS BE

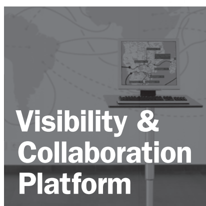
If the share of U.S. components in any traded product is above 10% of its value (embargo countries) or 25% (other countries), the goods must be classified and the transaction is subject to U.S. export controls. Country of origin counts, not country of last import.

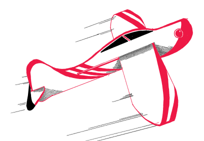
4 REGULATIONS AT A GLANCE

Which laws and regulations must be considered for international movements of goods? What are businesses required to do if a business partner appears on a sanction list? Excellent overview is provided by AEB's A1 poster detailing the required checks and following processes.

AEB's Export Controls US-EAR module lets businesses automatically check all their export transactions and screen goods based on the Commerce Control List (CCL) and Commerce Country Chart (CCC), against embargo countries based on the ISO codes, for applicability of license exceptions, and to conform with the U.S. Export Administration Regulations (EAR).

Too late. Someone beat you to it. Get your own copy on www.aeb.com/uk/posters





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AEB

CHINA

China (Shanghai) Pilot Free Trade Zone inaugurated

By Danian Zhang, Harvey Lau and Brendan Kelly
Baker & McKenzie
www.bakermckenzie.com

The China (Shanghai) Pilot Free Trade Zone ('SHPFTZ' or 'Zone') was formally inaugurated on Sunday 29 September 2013. The inauguration was augmented by the promulgation of a number of decrees over the weekend. We set out below a high-level review of these developments and their significance.

Overall Plan

The State Council published on Friday 27 September 2013 the China (Shanghai) Pilot Free Trade Zone Overall Plan.[1]

General policy themes

The Overall Plan sets out general policy objectives for the next two or three years, including:

- transforming government functions (from prior verification to more enforcement on activities);
- further opening of service industries, in particular financial services;
- reforming foreign investment administration;
- developing the 'headquarters economy' and new forms of trade;
- RMB convertibility on the capital account;
- creating a new model for customs supervision of goods;
- implementing a suitable tax policy; and
- creating a new support system for investment and these new policies.

Foreign investment administration: filing and registration as default

The basic requirements for setting up foreign-invested enterprises ('FIEs') whose industry is not on the 'negative list', and changing their corporate particulars, will closely approximate 'pre-entry national treatment' (i.e. the same treatment as domestic enterprises).[2] At the inauguration of the SHPFTZ, 25 new enterprises in the SHPFTZ, including FIEs, were granted business licences.

To set up in the Zone, FIEs no longer need verification or approval from the Shanghai Commission of Commerce or Ministry of Commerce. Rather, a foreign investor now files an application form and certification with the SHPFTZ Administrative Commission (the SHPFTZ's chief administrative authority) providing information on itself and the FIE. No additional supporting documents and no substantive examination are required.

After filing, FIEs can then register with the local Administration for Industry and Commerce ('AIC') and other agencies to obtain the required certificates and licences to operate. These registration requirements are generally the same as for FIEs elsewhere. However, we understand that the processing time will be greatly reduced, with our source suggesting that all certificates and licences may be obtained within four business days from filing the initial application.

This simplified treatment does not apply to industries on the 'negative list' (see below), which are either prohibited or restricted in various specified ways, and still need verification or approval.

Further opening measures

The Overall Plan's 'Appendix: China (Shanghai) Pilot Free Trade Zone Further Opening Measures' sets out 18 service industries in six areas of services (financial, shipping, commercial and trading, professional, cultural and social) for which relaxed approval requirements will apply.

With the exception of banking institutions and information and telecommunications services, approval requirements are generally relaxed for these industries by suspending or removing previous restrictions on (1) qualifications for foreign investors, (2) equity ratios, and (3) business scope.[3]

The industries are identified by categories defined in the Chinese government's National Economy Industry Classification[4] rather than those used in the Foreign Investment Industry Guidance Catalogue. Additional information on the Appendix with the Further Opening Measures is available upon request.

SHPFTZ regulations

Late Sunday 29 September, the Shanghai City Government published six basic SHPRTZ regulations pursuant to the Overall Plan and minutes of an explanatory conference. The regulations, summarised below, include the 'negative list', general administrative regulations and administrative measures for filing.

Negative list

The negative list sets out the industries where foreign investment is still restricted or prohibited, so foreign investors do not enjoy the new, simplified filing and registration treatment described above.

The negative list specifies legal restrictions which will still apply; in particular, State Council requirements for National Development and Reform Commission verification; prohibitions or restrictions in treaties between the investor's country and China; national security review; and general prohibition on activities harmful to 'social public interest'.

The negative list also uses the National Economy Industry Classification's division of economic activity, identifying 18 broad categories (labelled A to T). Two categories are not on the negative list at all (S, Public

Administration, and T, International Organisations). For the remaining categories (A to R), the negative list sets out, within each category, the specific industries excluded from the foreign investment administrative reform.

The negative list also specifies which 'special administrative measures' apply to the industries on the list. Some products or activities are specified as prohibited to foreign investment, for example:

- directly or indirectly engaging or participating in online games operation services (I649)
- investment and operation in domestic delivery of mail and courier services, or investment in postal services company (G601, G602)
- auction sales of cultural relics (F518)

For many industries on the negative list, the foreign investment restrictions in the Foreign Investment Industry Guidance Catalogue are carried over. In other cases, the negative list is less restrictive than the Catalogue.

Branches

We understand from sources that FIEs in the Zone will generally be able to set up branches outside the Zone (except where branches are specifically prohibited). Details on procedures for setting up branches are not yet available, but we understand that the Zone's requirements will be less restrictive than current requirements for FIEs generally. However, whether the location where the branch is to be set up could or would impose new requirements remains to be seen.

Filing administrative measures

The four filing administrative measures specify the application procedures and filing requirements for foreign investors setting up FIEs or participating in foreign investment projects, or for FIEs or domestic enterprises in the Zone investing overseas.

The procedures are quite straightforward, involving filling out a form online or in hard copy, and providing required documents. The application will then be filed within a specified time period.

Taxation

It is now clear from both the Overall Plan and the Explanatory Presentation that tax incentives (for certain types of investment-related capital gains, equity options and for trade-related levies such as customs duties, import VAT and consumption tax) are to be part of the SHFTPZ, although concrete details have not been provided in the regulations issued to date.

Financial reforms

It is clear from the Overall Plan that RMB convertibility on the capital account and other financial reforms remain a key aspect of the Zone's purpose. However the SHPFTZ regulations published on 29 September did not deal concretely with these issues. Further developments in this area are expected later this year or early next year.

Links and notes

1 http://www.gov.cn/zwgk/2013-09/27/content_2496147.htm The Overall Plan was dated 18 September 2013, but published on 27 September
2 Domestic enterprises need not file with MOFCOM, but state owned enterprises generally must file with their competent departments. So FIE treatment is very close to national treatment for state owned enterprises
3 Overall Plan 2 (2) 2
4 http://www.stats.gov.cn/tjbz/hyflbz/

EU

EU Court annuls sanctions against IRISL

By Patrick Murphy, Clyde & Co LLP
www.clydeco.com

The General Court of the European Union has, in a judgment dated 16 September 2013, annulled restrictive measures against Islamic Republic of Iran Shipping Lines ('IRISL') and 17 other applicants linked to IRISL, having determined that the Council of the EU could not justify the adoption and maintenance of restrictive measures against these entities.

IRISL is one of the most heavily sanctioned of all Iranian commercial entities, having been targeted by the U.S., EU and even the United Nations Security Council ('UNSC'). The dry bulk carrier, which at one stage operated the largest dry bulk fleet in the Middle East, had up to 150 vessels under its control prior to EU sanctions against it in 2010. However, successive EU and U.S. sanctions against it and its subsidiaries have severely affected its commercial operations.

EU Regulation 267/2012

EU Regulation 267/2012 (the 'Regulation') requires, at article 23 (2) (a), that all funds and economic resources of the persons and entities listed in annex IX of the Regulation are

frozen. The criteria for being listed in annex IX is that the persons within it have been identified in Council Decision 2012/413 CFSP (the 'Decision') as being engaged in or having supported Iran's proliferation sensitive nuclear activities. The Decision annuls annex IX insofar as it concerns IRISL and the 17 other applicants[1].

IRISL's application

IRISL (together with 17 of the 23 entities listed in annex IX) applied to annul the Decision and the Regulation, insofar as they related to the applicants, on various grounds. The Court addressed just two of the five grounds relied on by the applicants in its judgment.

The applicants' first argument was that the Council breached its obligation to state reasons for the designation of IRISL when deciding to subject it to restrictive measures. The second was that the Council relied upon mere presumptions that the applicants were involved in nuclear proliferation and did not identify any evidence to support that conclusion.

The applicants were unsuccessful on the first argument. The Court was persuaded that the Council had communicated sufficiently clearly to the applicants the basis for the designation; that basis being three incidents referred to in a 2009 annual report of the UNSC's Sanctions Committee, in which IRISL was involved in the shipment of military material from Iran (described by the Council as 'proliferation') and the UNSC's own position *vis à vis* IRISL.

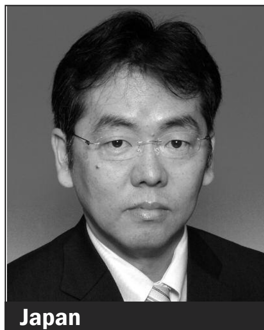
However, as to the second of the two arguments, the Court was not persuaded that the Council had sufficient evidence that the applicants had indeed supported nuclear proliferation. The wording of the Decision and the Regulation required the Council to establish that support for nuclear proliferation had actually been provided. It was not enough, said the Court, that the Council showed there was a mere risk that the person or entity concerned might in the future provide support for nuclear proliferation.

The Court noted that the three incidents in the 2009 report involving IRISL related only to the export of military material from Iran and were not linked to nuclear proliferation. There was no evidence to suggest that the export of this material funded nuclear proliferation. And whilst the UNSC's request to member states to inspect IRISL vessels in certain circumstances demonstrated that there was a risk that IRISL may provide support for nuclear proliferation, it did not establish that it had actually been provided as the Decision and Regulation required. Accordingly, the Court concluded that insofar as annex IX of the Regulation and the Decision apply to IRISL and the other applicants, the restrictive measures are annulled.

Effect of the judgment

Although the Court has annulled the designations as outlined above, the annulment will not take effect until after any appeal by the Council is determined or until the expiry of the period for bringing an appeal. The Council has two months within which to appeal the judgment and any appeal will take some time to be heard. For the time being, therefore, IRISL remains designated under article 23 (2) (a) of the Regulation.

The judgment only annuls the applicants' listing in annex IX; it does not affect any of the other restrictions upon IRISL and the other applicants that might apply under other articles of the Regulation. For example, it does not affect IRISL's status as an 'Iranian Person' and so EU insurers will still be unable to provide insurance/reinsurance to IRISL and EU-domiciled companies will still be unable to provide key naval equipment and technology to IRISL. Nor does it affect any entities listed in annex VIII of the Regulation, such as Irano Hind Shipping Company, IRISL Benelux NV, or South Shipping Line Iran, whose funds and economic resources must be frozen. Those entities are included in annex VIII by virtue of their designation under UNSC



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Resolution 1929/2010 as entities whose funds, financial assets and economic resources must be frozen and so the judgment will not affect their designation in annex VIII.

Neither will the judgment have any effect upon EU Member States' UN obligations to inspect cargoes on vessels operated by IRISL.

U.S. sanctions

Perhaps most significantly, it will have no effect upon the U.S. sanctions against IRISL. It will not affect IRISL's designation as a Specially Designated National under the U.S. Weapons of Mass Destruction Proliferators sanctions regulations, nor its designation as an entity involved in the Iranian shipping industry under the Iran Freedom and Counter-Proliferation Act. Those designations mean that non-U.S. persons who deal significantly with IRISL may be subject to a range of penalties which can include the freezing of such persons' assets or denial of their ability to engage in transactions in the U.S. Whilst there are administrative procedures through which IRISL could seek to have its SDN designations rescinded, there is no indication that they intend to do so.

Tide of annulments

However, the judgment is nonetheless the latest in a series of judgments by the General Court annulling the designation of persons under the Regulation. On 6 September 2013, the General Court annulled the designation of, amongst others, Bank Melli Iran, Persia International Bank plc, Export Development Bank of Iran, Iran Insurance Company, and Good Luck Shipping. Earlier this year, the General Court annulled the designation of Bank Mellat Iran. On each occasion the evidence that the Council relied upon in designating the parties was not sufficient to establish that they had supported nuclear proliferation. In the case of Good Luck Shipping, the Council had only relied upon proposals from two member states that Good Luck Shipping be designated and notes from a Council working group which did not contain any evidence relating to Good Luck Shipping.

With another designated entity successfully challenging their designation, it can reasonably be expected that other sanctioned entities may now seek to follow suit.

Links and notes

[1] Bushehr Shipping Co. Ltd (Malta); Hafize Darya Shipping Lines (HDSL) (Iran); Irano – Misr Shipping Co. (Iran); Irinvestship Ltd (UK); IRISL (Malta) Ltd (Malta); IRISL Club (Iran); IRISL Europe GmbH (Germany); IRISL Marine Services and Engineering Co. (Iran); ISI Maritime Ltd (Malta); Khazar Shipping Lines (Iran); Leadmarine (Singapore); Marble Shipping Ltd (Malta); Safiran Payam Darya Shipping Lines (SAPID) (Iran); Shipping Computer Services Co. (Iran); Soroush Saramin Asatir Ship Management (Iran); South Way Shipping Agency Co. Ltd (Iran); Valfajr 8th Shipping Line Co. (Iran).

JAPAN

Updated Japan control list for export control effective 15 October 2013

By Tatsuya Kanemitsu
Bryan Cave International Consulting (Asia Pacific) Pte. Ltd.
www.bryancaveconsulting.com

On 27 September 2013, the Ministry of Economy, Trade and Industry ('METI') announced that Japan will update its control list for dual-use items to reflect the latest changes of international non-proliferation regimes and conventions, such as the Wassenaar Arrangement, the Australia Group, the Missile Technology Control Regime, and the Nuclear Suppliers Group.

Japan's control list was last amended on 1 August 2012 and covers the revisions adopted by the regimes and convention in their respective control lists. The changes made this time (in 2013) reflect the ongoing relaxation of control on dual-use items which are mainly used for industrial purposes and applied to military uses at the same time, covering commonly traded dual-use items, such as electronics, computers, telecommunications and information security products.

On the other hand, there is a strengthening of control on more sensitive items, such as certain scroll-type compressors, or spray-drying equipment, etc. which may be used in the development, manufacturing and use of nuclear supply or chemical weapons.

Exporters and declaring agents should review classification results with the updated list. Although certain items remain unchanged, a broad range of categories have their technical specifications updated.

The updated control list of dual-use items will be effective on 15 October 2013.

A summary of the announcement can be accessed at:
http://www.meti.go.jp/press/2013/09/20130910004/20130910004.pdf

Full details at www.worldecr.com/conference

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Talking export controls with PHILIP GRIFFITHS

Philip Griffiths was appointed Head of the Wassenaar Arrangement Secretariat from June 2012. With a distinguished career as a New Zealand diplomat, including as Ambassador to Poland (2004-08) and Ambassador to Austria and the international organisations in Vienna (2010-12), Philip Griffiths brings a strong background in arms control and non-proliferation to the role.

Based in Vienna, the Wassenaar Arrangement contributes to regional and international security by promoting transparency and responsibility in transfers of conventional arms and sensitive dual-use goods and technologies, thus preventing destabilising accumulations. The Arrangement's 41 Participating States work closely together and with industry in developing and maintaining the export control lists for licensing decisions and in compiling best practice guidelines. With increased international attention being paid to regulating trade in conventional weapons as reflected in the UN Arms Trade Treaty agreed earlier this year, it is in all our interests to learn more about what is going on in the Wassenaar Arrangement.

WorldECR: What are the Wassenaar Arrangement's ('WA') plans regarding outreach to industry/private sector?

Philip Griffiths: The Wassenaar Arrangement's members recognise that cooperation with industry and academia is essential for the successful implementation of export controls. In addition to private sector outreach by Participating States at the national level, the Arrangement's Head of Secretariat makes presentations to industry-focused export control conferences and seminars. The 2011 WA plenary approved a document entitled *Best Practice Guidelines on Internal Compliance Programmes for Dual-Use Goods and Technologies*. This document, which provides guidance in the development and implementation of internal compliance programmes by industry and academia, recognises the importance of targeted outreach to help exporters understand and take full account of national export control legislation and its objectives. The aim is to reduce the risk of corporate involvement in exports that expose firms or institutions to penalties and wider reputational damage and also contravene the purposes of the Wassenaar Arrangement.

WorldECR: What is the status of the WA's information-sharing system? Are there developments in the pipeline, for example, real-time data sharing?

Philip Griffiths: The Wassenaar Arrangement Information System ('WAIS') is a dedicated and secure network used by Participating States to share both general and specific information, including notifications relating to the approval or denial of export licences, as appropriate. This system is also used for meeting preparations, presentations and reports, and for other intersessional communications. Data submitted by Participating States and the Secretariat are immediately accessible. That said, there are continuing efforts to make the system as efficient and user-friendly as possible.

WorldECR: Are there likely to be any new membership additions this year?

Philip Griffiths: The Wassenaar Arrangement is open on a global and non-discriminatory basis to prospective adherents who meet the agreed criteria. Since the establishment of the Arrangement in 1996, its membership has increased from 33 to 41 countries. Mexico was the latest to join, in 2012. Currently there are a number of membership applications under consideration. Admitting a new Participating State requires a consensus decision at the plenary level. While the 2013 plenary may decide to admit a new member or members, this depends on the readiness of applicants.

WorldECR: What are the WA's new/emerging technologies areas (e.g. nano-materials and 3-D printing)?

Philip Griffiths: The WA Experts Group is the body responsible for reviewing on a continuing basis the Arrangement's control lists for both conventional arms and dual-use goods and technologies. Updates are prepared and submitted for plenary approval annually. Taking account of new and emerging technologies from an export control perspective is a highly technical and collaborative task. Additive manufacturing machines ('3-D printing') and recent developments in information technology are only two of the new technologies under Experts Group consideration. Similarly, this group also considers de-controls on items that have become obsolete or are widely available commercially. The continuing effectiveness of the Wassenaar Arrangement depends upon its success in keeping its control lists up-to-date and relevant. A summary of the 2012 list changes is available on the WA website (www.wassenaar.org).

WorldECR: Any new plans for the Secretariat's scope of work?

Philip Griffiths: The Secretariat is dedicated to serving the objectives of the WA and the interests of its Participating States as effectively as possible. It provides the full range of assistance to the WA decision-making and working bodies and interacts closely with the Participating States. The Secretariat also supports an active outreach programme with non-member countries, including annual briefings. This amounts to a full agenda for a Secretariat of this size. Expanding the Secretariat's scope of work and resourcing a new mandate would be a decision for Participating States.

WorldECR: What plans are there for WA self-assessment? Will the metrics be available publicly?

Philip Griffiths: In recent years the WA has implemented a four-year assessment cycle. The most recent assessment year was 2011, when three new 'Best Practices' documents were adopted and a basic analytical guideline was updated. During this assessment process, Participating States examine all aspects of the Arrangement's functioning and contributions with a view towards implementing changes that would enhance the effectiveness and efficiency of the WA's work. The WA's assessment-related deliberations and results are internal to the Arrangement and its Participating States.

'National discretion with respect to the issuance or denial of export licences is a basic principle of the Wassenaar Arrangement.'

Philip Griffiths

WorldECR: Would you expect to see expansion of the dual-use controls list further into telecommunications and other forms of technology that can be used for surveillance?

Philip Griffiths: The dual-use list already has a number of categories in this area, including electronics, computers, telecommunications and information security. It is to be expected that the list will expand as new challenges are faced in the areas of telecommunications and other forms of technology relating to information security and surveillance. Items are regularly considered for possible addition to the dual-use list based on national proposals and a collective risk assessment of new technologies and international trends.

WorldECR: Is it possible that there would be changes in the Wassenaar Arrangement's operations in light of the UN Arms Trade Treaty ('ATT')?

Philip Griffiths: Many of the WA's Member States participated actively in the negotiations that led to the approval of the Arms Trade Treaty by the UN General Assembly. On 3 June 2013, the WA Participating States issued a public statement welcoming the adoption of the ATT and noting that its goals align with those of the Wassenaar Arrangement. They also said that they stand ready to share their experience and expertise with other states, as suggested in the ATT. I would expect there to be further discussion among members in coming months about the implications of the ATT for the Arrangement's work.

WorldECR: In light of pressure on countries to control access to dual-use products and technology, will there be pressure for enhanced national enforcement activity and coordination of enforcement among Wassenaar countries?

Philip Griffiths: National discretion with respect to the issuance or denial of export licences is a basic principle of the Wassenaar Arrangement. Similarly, enforcement of national export control laws and regulations is a national responsibility. Participating States regularly share experiences on all aspects of export controls, including licensing and enforcement. They stand ready to advise and assist one another on the effective implementation of controls.

WorldECR: Is it necessary to expand dual-use coordination and communication with key non-members, especially growing military and security markets such as India?

Philip Griffiths: The principal goal of the Wassenaar Arrangement's outreach programme to non-member countries is to help them to establish and implement robust national export control systems. Annual enhanced technical briefings provided to key non-member countries, including those that have adopted the WA control lists, are a response to their desire for more detailed information and advice regarding the list changes that have been agreed. The Arrangement has also undertaken comprehensive outreach visits at the invitation of a number of key non-members, including India.

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Into the mainstream

WorldECR started life as a journal with a very particular remit: to report on the world of sanctions and export controls – a subset of a tight area of law if ever there was one. We never envisioned our subject matter becoming as mainstream and topical as it subsequently has. The last few months have seen the topics of Iran sanctions, Syria's use of chemical weapons, Zimbabwean elections, cybercrime and surveillance (to name a few), dominating world affairs coverage by the international press. If nothing else, this demonstrates that many of those whose working lives are devoted to finding a way through the repercussions of these developments (many of whom are our readers and contributors) are at the coalface of global changes of geopolitical importance.

In November, we're looking forward to the collective experience of *WorldECR*'s constituents, amongst them regulators, lawyers, heads of compliance, being shared at our London Forum. There's a lot to discuss: will the apparent rapprochement between the West and Iran augur change in the way restrictions placed on both Iranian and non-Iranian businesses in their relations with each other?

How should regulators respond to developments in technology that pose new threats?

How should regulators respond to developments in technology that pose new threats, not only to commercial enterprises and governments, but to the privacy and security of the individual? What responsibility is owed by business to ensure it does not inadvertently facilitate the proliferation of weapons which can be used to devastating effect?

Many of our delegates will be looking to share technical know-how: on how best, for example, to respond to legislation which is complex and sometimes difficult to comply with, or that seems to contradict or conflict with domestic laws. Readers of this issue will see the news story about how some UK businesses fear that they may be pushed to the brink of bankruptcy by discrepancies between U.S. controls, which have relatively low thresholds pertaining to the export of certain kinds of cryptographic products, and UK laws, which raise the bar much higher for exporters of the same goods.

Other, perhaps all industries, directly or indirectly, are commercially impacted by laws whose intention is only laudable: to make the world safer, more just, and/or to strengthen national and collective security. The debate as to who should feel the squeeze in consequence, and how, is ongoing and raises questions that are more than merely legal or political, but strike at the very heart of the stories making the headlines. The *WorldECR* Forum will host the exchange of ideas between experts in these fields. Do join us there.

Tom Blass, October 2013
TNB@worldecr.com

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1040 Brussels, Belgium
P +32 2 742 70 00
F +32 2 742 71 00

Export controls contacts:

Laurent Ruessmann
P +32 2 742 70 61
E laurent.ruessmann@ffw.com

Jochen Beck
P +32 2 742 70 43
E jochen.beck@ffw.com

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The West and Iran: a window of opportunity?

Recent weeks have seen an apparent thaw in relations between Iran and the West, with the Islamic Republic's new president having launched a high-octane smile offensive in the United Nations. President Obama and western allies have declared themselves cautiously receptive to Iran's overtures. But do they represent a change of heart – or a shift in strategy? And if a genuine rapprochement were possible, what are the challenges facing those that would forge a 'solution'? By Tom Blass

Depending on your perspective, what a BBC journalist described as 'good atmospherics' between the Islamic Republic of Iran and the United States represents either a breakthrough in one of the most entrenched geopolitical conflicts of the decade, or a dangerous deception by which Tehran is adopting a new tactic in furthering its aim of bringing its nuclear weapons capability to completion under the subterfuge of a smile offensive.

Either way, hawks and doves on both sides of the rift will argue over each party's sincerity, and the concessions that should be made available. When President Rouhani landed at Imam Khomeini airport following his (guardedly) conciliatory speech to the United Nations General Assembly he was met with cheers from his supporters and jeers from hardliners opposed to his apparent overtures to 'the Great Satan'. Barack Obama returned to Washington to attempt to find a way out of the impasse over health funding, while Israeli prime minister Benjamin Netanyahu warned the world that Rouhani is a wolf in sheep's clothing, more dangerous than his wolf in wolf's clothing predecessor.

Tentative first steps

But assuming that there is a genuine political will to reach some ultimate grand bargain between the international community and Iran concerning the latter's use of nuclear power, the path toward a successful outcome remains fraught with difficulties; it may even be a tougher road to travel than maintaining the mutually belligerent growling that has stood for U.S.-Iranian relations for the past 33 years.

In the first place, both will need to stay committed despite the inevitable misunderstandings and slings and arrows – many hurled by their own domestic constituents. And secondly, what has been done is not easily undone. As Shashank Joshi, an Iran analyst at the Royal United Services Industry ('RUSI') points out, 'The biggest challenge is going to be sequencing. Everybody talks about "steps" but that suggests that there's some kind of grand deal to be had. Actually, there are processes not steps.'

For example, points out Joshi, if Iran wanted to shut down its enrichment capacity, this is a process that could happen quite quickly; but the process of giving the IAEA full transparency would take very much longer. 'There'd be huge technical challenges and amounts of information to hand over, and Rouhani would have to persuade the hardliners that it was in the national interest to give the IAEA access. All that could take years.' Joshi adds: 'It's all about "who goes first". The international community isn't going to start to lift sanctions unless it starts to see progress on Iran's part, and likewise Iran will want to see significant gestures before it moves.'

The current stranglehold on Iran is, as Rouhani has acknowledged, hurting the country badly. Sanctions imposed by the United Nations Security Council on account of Iran's failure to comply with IAEA safeguards agreements include an arms embargo, travel bans for individuals, freezing of the funds of the Iranian Revolutionary Guard and IRISL, and impose considerable pressure on Iran's financial system. But, says Sara Bazoobandi of London's Chatham House, 'Iran knows that the Chapter 7 sanctions imposed on Iraq have only been lifted this year – a decade after they were imposed. Rouhani is very conscious of the time lag between any successful negotiations with the West and actual implementation of a deal. The pressure is mounting on him.'

Bazoobandi adds that, by a long way, the most damaging sanctions are the U.S. measures that have blocked Iranian petrodollar transfers, which, in combination with embargoes on the import of Iranian oil, have seen the value of the rial crash and inflation soar. Both Iran and the U.S. have at

various junctures downplayed the impact of sanctions, the former out of pride, the latter, because it maintains that the sanctions are not intended to hurt ordinary Iranians, but to force a change of position by the Iranian leadership.

U.S. issues

If Rouhani's objective is to see a relaxation of U.S. measures, he's in for a long haul. Miller & Chevalier partner David Hardin points out that 'Many of the sanctions have been imposed by Congress and thus codified in a statute. This leaves very little flexibility for the Administration when it negotiates with Iran because Congressional approval would be required to rescind those sanctions. The President could seek to get many of the statutory sanctions removed should he extract a favourable deal from Iran, but would Congress ever agree? Given how things are going in DC, probably not. So that only leaves a few options for the President. He can roll back many of the non-statutory sanctions or exercise his discretion not to impose sanctions required under the statutory sanctions, but that may not be enough for Iran and may annoy Congress.'

Indeed, the U.S. President's powers for change are not without controls. As one political observer asked, 'A lot is said about whether Rouhani has real power to solve the nuclear issue. But does Obama? And given what we've seen with the current feud over government spending, you have to pose the question as to whether the Congressional position will be intransigent on Iran to spite the President of the United States, not Iran.'

In early October, Wendy Sherman, Under Secretary of State for political affairs, said during a Senate Foreign Relations Committee hearing, 'Let me assure you that we will continue to vigorously enforce the sanctions that are in place as we explore a negotiated resolution, and will be especially focused on sanctions evasion and efforts by the Iranians to relieve the pressure.'

Sherman also made a plea: in the light of Congress's current honing of a fresh round of sanctions she said, 'In terms of legislation that is currently being discussed here on the Hill, we do believe it would be helpful for you all to at least allow this meeting to happen on the 15th and 16th of October before moving forward to consider those new sanctions.'

Were Congress to take that request to heart, it might at least slow the sanctions machine. But it is a truism of conflict resolution that small gestures are critical to maintaining trust between parties, and that slow steps forward can be valuable. Recent licences issued by OFAC for sporting, cultural and humanitarian activities arguably represent such gestures – as does the exchange of notes between Rouhani and Obama.

Politics is also personal: The two presidents didn't shake hands, but meetings between Secretary of State John Kerry and Iranian Foreign Minister Javad Zarif could be critical in mutually demystifying each in the eyes of the other. French President Francois Hollande's meeting with Rouhani himself was similarly significant. If, as some have reported, back-channel negotiations between Iran and the West have been active since before Rouhani's electoral win, these are already the culmination of significant efforts – and, say optimists, a genuine change of tack from Tehran. As Sara Bazoobandi notes, 'Many international observers focus on the rift in Iran between the "hardliners" and the "reformists" but Rouhani is also under pressure from ordinary Iranians who want to see an improvement in their lives. He's popular, but he knows that he has to deliver quickly, and can't get it wrong. Clearly, he has been given the green light to negotiate with the Americans. Neither Khatami nor Ahmedinajad ever got permission to do that. It's evident that [the Supreme Leader of Iran, Ali Hosseini] Khamenei has changed his tune – and given his Prime Minister the authority to build bridges with the West.'

It may transpire that given the resistance of Congress in the U.S., it could be more likely that the overtures would come first from Europe. Rouhani has already talked about the desirability of resumption of the SWIFT network, by which most financial transactions are processed, for example – and technically, that could happen quite quickly. There is more appetite in Europe, commercially, for a resumption of trading relationships. France has already showed that it's started to change its mind on Iran, by suggesting that Iran should be invited to the Geneva II conference on Syria, while UK Foreign Minister William Hague is meeting Zarif. Nor can the fact that the European courts have had a recent run of overturning EU designations (Iranian shipping line IRISL, and banks Mellat and Saderat) have hurt.

But Iran's sanctions-related woes are much more on account of U.S. measures, and whether Congress can be convinced that now is the right time to soften the line is yet to be seen.

Iran's sanctions-related woes are much more on account of U.S. measures, and whether Congress can be convinced that now is the right time to soften the line is yet to be seen.

Israeli influence on Congress is a key factor. Says Joshi: 'What does Israel actually want? On the face of it, it seems as though it wants Iran to shut down all its nuclear capability. But simply demanding capitulation is a negation of negotiation. Is Israel simply playing bad cop in order to squeeze a better deal – i.e. maximum restraint on the Iranian nuclear programme – or does it have another objective? It's actually difficult to know.'

Speaking at the United Nations on 1 October, Israel's Prime Minister Benjamin Netanyahu urged the international community to keep the pressure on Iran, and not to relax sanctions until the Islamic Republic had fully dismantled its weapons programme. He asked why a country with vast natural energy reserves would invest billions in developing nuclear energy; or why a country intent on merely civilian nuclear programmes would continue to defy multiple UN Security Council resolutions and incur the tremendous cost of crippling sanctions on its economy.

'Why would they do all this? The

answer is simple. Iran is not building a peaceful nuclear programme; Iran is developing nuclear weapons,' he declared, warning that 'a nuclear-armed Iran' would have a choke-hold on the world's energy supplies, and would trigger nuclear proliferation throughout the Middle East. 'It would make the spectre of nuclear terrorism a clear and present danger.'

Sanctions, said Netanyahu, are the key: 'Iran faces one big problem, and that problem can be summed up in one word: sanctions.' For Netanyahu, the only way to peacefully prevent Iran from developing nuclear weapons is to combine tough sanctions with a credible military threat. 'Lift the sanctions only when Iran fully dismantles its nuclear weapons programme,' he said, noting that with the measures in place, Iran's oil revenues have fallen and its currency has plummeted. 'So as a result, the regime is under intense pressure from the Iranian people to get the sanctions relieved or removed... The international community has Iran on the ropes. If you want to knock out Iran's nuclear weapons programme peacefully, don't let up the pressure.'

Dr. Shuki Friedman, a lecturer on international law at the Peres Academic Centre, agrees: 'If sanctions are working, then increasing sanctions pressure increases the chances of a diplomatic solution.' But Dr. Nimrod Goren of the Israeli foreign affairs think tank MITVIM is not convinced that Netanyahu has quite read the mood right: 'There is a tendency in Israeli foreign policy to be sceptical. When the West gives a chance, Israel clings to the status-quo. Policy-wise, there is not a big difference, regarding the Iran nuclear issue, between what the West wants, and what Israel wants, but in terms of style of engagement, Israel faces being left behind, and becoming isolated.'

Goren points out that Netanyahu's is not the only voice in Israel. President Shimon Peres has recently said that Israel's response to the increased U.S.-Iranian engagement has been 'too scornful'. 'Peres would be willing to give talks a greater chance,' says Goren. 'But Netanyahu sees his ideological mission – and responsibility – as being to erase the existential threat that he sees Iran as posing to the state of Israel.' Unilateral Israeli military action, however, is, Goren believes, now a very much more distant prospect than it seemed last year.

Many observers believe that the deepest, if quietest rift in the Middle East is, indeed, that between Sunni, Arab Saudi Arabia and Shia, Persian Iran.

Oil change?

In the past week, it has been reported that western oil companies, both U.S. and EU, had been 'queuing up' to meet Iran's oil minister Bijan Zanganeh at the United Nations. But, says, Caspian energy analyst Paul Sampson, if they're looking at a return to Iran, they'll have to be prepared to play the long game game. U.S. companies have long been blocked from investing in Iran, although Conoco came close to a deal for the offshore Sirri oilfield in 1995 but was halted by the Clinton administration for national security reasons in 1995. Until the late 2000s, that gave a free run to EU oil companies including Shell and Total to invest in Iran.

Increasing U.S. sanctions pressure, in conjunction with EU sanctions, caused them to sever their ties to the country. 'They'd want to see a very clear statement, not only from the EU but especially from the U.S. if they wanted to return,' Sampson told *WorldECR*, adding that under the Ahmadinejad presidency, there had been 'a culling of personnel within the National Iranian Oil Company ('NIOC'). He took control and stamped his authority on it, appointing his own allies and bestowing patronage to cronies. It meant that for the most part, the international oil companies haven't actually had any channels into the NIOC for the last few years, because the guys they'd been dealing with had been forced out.'

Gradually, says Sampson, that is changing: 'The old people are being reinstated under the new presidency. Things will be back to where they were eight years ago.' Examples among the new guard include Zanganeh's deputy Mehdi Rosseini, typically described as West-friendly, and reported to be reviewing Iran's current buy-back regime, by which foreign investors are compensated with production rights.

No-one doubts that the NIOC faces an uphill struggle. Sampson says that the Iranians were probably disappointed that the world didn't feel their absence from the markets more deeply. 'The lack of Iranian oil didn't have great impact on prices. No-one has really felt it. The Iranians thought they could push up prices, but the world doesn't need it. It would be a struggle for the Iranians to get back in, because actually the market is adequately supplied. They'd really need to try and undercut the Saudis and other producers, which I think they would be reluctant to do.'

Indeed, since the world turned the taps off of Iranian oil, its rival Iraq has recovered from the U.S.-led invasion in 2003 to become OPEC's second-largest producer – which means Iran will have some catching up to do, if or when it returns to the oil markets. Many observers believe that the deepest, if quietest rift in the Middle East is, indeed, that between Sunni, Arab Saudi Arabia and Shia, Persian Iran. '[Subsequent to the election of Rouhani] the Iranians will be working hard to patch up relations with the Saudis. But a lot of damage has been done by Ahmadinejad. They'll embark on a charm offensive around the Gulf, but fundamentally deep issues remain, and the Gulf states – along with Israel – will still be warning the United States: "Beware of Iran,"' says Sampson.

The next move?

All these thoughts are largely conjectural. More will be revealed next week when the P5+1 recommence negotiations with Iran, its delegation led by a new team of supposedly more internationally-minded, and intent on reaching a solution. Hawks and doves will remain divided for the foreseeable future as to what is desirable, what is possible, and how to achieve either.

Afghan firms being blacklisted without due process

The de facto debarment process known as C2X threatens American values of due process, rule of law, transparency and plain dealing as well as the interests of Afghans who have served the U.S. and its allies well, say D.E. Wilson Jr. and Ward E. Scott II.

Afghan companies are being blacklisted from working for U.S. and allied forces in Afghanistan without notice and without being advised of the justification for the debarment. Moreover, there is no process for challenging these decisions. U.S. citizens are being swept up by this approach, since many Afghan companies are owned by Americans.

After more than 11 years, the U.S. is winding down its presence in Afghanistan. Troops are being withdrawn but, because of the high cost of transportation, we will leave behind substantial quantities of equipment. Hopefully, more is being left behind in Afghanistan than equipment. It should be a U.S. goal to leave Afghans with a new appreciation for the benefits of the rule of law and due process, and how these values can lead to a more prosperous Afghanistan.

Unfortunately, the U.S. has adopted de facto debarment practices in Afghanistan that obstruct this goal. These practices are in sharp contrast with standard debarment and suspension procedures, in which principles of fundamental fairness are required and followed. Under normal procedures, contractors are given notice specifying the reasons for the action, adequate time to respond and the right of appeal. This time-tested procedure, readily adaptable to an operational theatre, safeguards the U.S. government's interests in a manner that exemplifies American values of due process, rule of law, transparency and plain dealing.

C2X

In Afghanistan, one of the principal blacklisting mechanisms goes by the designation 'C2X Reject', or simply 'C2X'. The action is taken within U.S. Forces-Afghanistan, not through contracting commands or channels, based on information contained in classified reporting. No reason or recourse is given. Little is known about how these decisions are made or by whom. Nothing is known about quality assurance or reviews in a counter-insurgency environment in which misreporting to settle scores is endemic.

The effect of C2X frequently is economically fatal to Afghan firms, whether U.S.- or Afghan-owned, that have faithfully served the U.S. and the coalition.

The purposes of C2X are to safeguard U.S. and allied forces, and to prevent American taxpayer dollars from falling into the hands of bad actors — most often, corrupt host nation officials. However, the apparently summary manner in which the C2X designation is given ultimately does a disservice to these goals by rolling up the good with the bad, the well-performing with the nefarious, with no recourse.

Loyal and reliable contractors have gone bankrupt and others have given up operations in Afghanistan because of C2X blacklisting.

The simple addition of notification, an opportunity to be heard and to appeal, could readily be done in theatre. A well-prescribed, rules-based peer- and command-reviewed finding of 'imminent threat' to friendly forces and/or intelligence 'sources and methods', with the right of appeal through properly cleared legal counsel, would preserve the inherent authority and duty of commanders to protect their troops, as well as the government's national security interests.

C2X raises many disturbing questions, among them:

- What protections are in place to prevent this blacklisting from being manipulated by a contractor's competitors or others seeking to settle a personal, political or commercial score?
- Should the U.S. provide assistance to loyal contractors who are more interested than anyone in ridding their business activities of force-protection deficiencies?
- Should contractors be left in the dark about their supposed deficiencies, and left to live with these deficiencies against their interests?
- Are C2X and similar blacklisting practices harming the coalition's ability to distribute fuel, food and other supplies to operating bases and to secure those bases?
- Is this practice contributing to counterproductive and otherwise harmful animosity toward the U.S. and its allies in Afghanistan?

The situation warrants the urgent attention of U.S. officials interested in a successful outcome in Afghanistan. Loyal and reliable contractors have gone bankrupt and others have given up operations in Afghanistan because of C2X blacklisting. The U.S. is being blamed for summary debarment that prevents contractors from being able to pay their Afghan employees and encourages animosity against the U.S.

Finally, C2X runs counter to American values, interests and goals in Afghanistan. We can and must do better.

D.E. Wilson Jr., a former White House and Treasury Department official, is a partner with Venable LLP in Washington. Ward E. Scott II, a retired U.S. Marine, is managing partner of Scott Kakar Advocates LLP, a commercial law firm based in Kabul. Scott and Wilson represent a number of ISAF and U.S. contractors active in Afghanistan.

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Beyond compliance: preventing the diversion of sensitive equipment – The 'Controlled Delivery Model'

The logistical technique referred to by MKS as the 'Controlled Delivery Model' aims to reduce the systemic risk of sensitive dual-use technologies being diverted to WMD programmes of concern through illicit trade. This voluntary approach by MKS is an example of 'anti-proliferation' in practice write Ian J. Stewart and John McGovern.

Most countries lack the capability to manufacture all prerequisite technologies required for the production of fissile materials, nuclear weapons and their means of delivery. Those countries pursuing the acquisition of nuclear weapons are therefore reliant on goods imported from the international marketplace. While trade explicitly destined for proliferation would be blocked by export controls in almost every state, proliferators work actively to evade controls. As such, blocking proliferation-related trade often depends as much on the actions of companies that manufacture or control technology as on the laws adopted by governments and the international community.

The experience of MKS provides a prime example. As a leading manufacturer of capacitance manometers, an item used to measure near-vacuum pressures in semiconductor, pharmaceutical or advanced coating processes, MKS products are perhaps the best example of a dual-use 'chokepoint technology' – an item without which some forms of gaseous uranium enrichment could falter or even be set back. This article describes one logistical technique referred to by MKS as the 'Controlled Delivery' model (or Direct Factory Shipment Program, 'DFSP') for reducing the systemic risk of sensitive dual-use technologies being diverted to proliferation programmes of concern through illicit trade. The adoption of this voluntary approach by MKS is an example of 'Anti-proliferation' in practice – the concept of resilience to proliferation in companies' supply chains.

Blocking proliferation-related trade often depends as much on the actions of companies that manufacture or control technology as on the laws adopted by governments and the international community.

History

Capacitance manometers manufactured by MKS became sensitive in the 1960s when the items were specified for use by URENCO for use in uranium enrichment centrifuges. Several years later AQ Khan would steal the design for these very centrifuges, utilising them to jump start Pakistan's own nuclear weapons programme. In doing so, Khan sought components and materials from the supply chain established by URENCO. Khan used his network to sell centrifuge technology to at least three additional countries – Iran, North Korea and Libya.

While the Khan network has long since been disbanded, the proliferation risks associated with capacitance manometers have not lessened, with the Iranian nuclear programme and others continuing to seek such goods from a handful of existing international suppliers.

Products

Highly accurate, corrosion-resistant vacuum measurement equipment is perhaps the best example of a 'chokepoint technology' – a technology without which proliferation can be greatly constrained. Uranium enrichment – one of the two routes for producing fissile material for use in nuclear weapons — can be undertaken using a number of different processes. One commonality across most methods is that the enrichment process occurs under vacuum. This is true for enrichment using centrifuges as pursued in Iran and North Korea, in the gaseous diffusion plants pursued by many of the early nuclear weapons states, in electromagnetic separation pursued by the U.S. and Iraq, and also in the emerging field of laser isotope separation. In many of these processes the optimum form of uranium for enrichment is uranium hexafluoride (UF6). Hydrogen Fluoride – a common industrial but highly corrosive gas that most metals cannot withstand – is always present in the UF6 gas stream. Certain metals, alloys, and certain other materials are, however, resistant to these gases. Capacitance manometers and similar vacuum equipment made from such alloys are therefore sought by proliferators.

Understanding the importance of accurate vacuum measurement, the Nuclear Suppliers Group ('NSG') maintains controls on certain dual-use categories of vacuum pressure transducer made from materials resistant to UF6[1]. Specifically, these materials are defined as aluminium, aluminium alloys, nickel, and nickel alloys with 60%+ nickel content. But these controls are not comprehensive. First, it may be possible to utilise transducers with a lower corrosion

resistance for a limited period of time, thus potentially allowing the procurement of uncontrolled transducers.

Second, a competitor of MKS has introduced a product with parts made of aluminium oxide. Aluminium oxide is resistant to UF6 so dual-use products made from this material are also of proliferation concern. However, pressure transducers made from these materials have only recently been added to the NSG's control lists and, therefore, will not automatically be included in UN lists of goods prohibited by sanctions for export to Iran or North Korea. It is also likely that it will be some time before the updated NSG lists are incorporated into national export control regulations. On the positive side from a non-proliferation perspective, capacitance manometers have a finite lifespan which varies according to use. This means that the enrichment capability of any country will slowly degrade over time unless additional units can be procured.

MKS updates its approach: taking the profit out of proliferation

Trade compliance had been a high priority for MKS even before 2012. The control status of all products were recorded so that licences could be sought when exporting any controlled item to a destination requiring a licence. Customers and other parties to an export were screened against denied and designated entity lists. MKS management espoused a commitment to compliance and all staff were trained in compliance, red flag indicators and conducting due diligence. Local agents were also tasked with validating the credentials of potential customers.

Despite the operation of a trade compliance system, it became apparent to MKS in 2012 that some of the company's products were (allegedly) fraudulently being diverted to unauthorised end-users via the company's distributor in China[2]. Indeed, a China-based agent of MKS was arrested upon arrival in the U.S. and currently awaits trial on charges of conspiracy to violate the Export Administration Regulations and the International Emergency Economic Powers Act. The complaint associated with that arrest alleges that Mr Qiang Hu caused thousands of MKS pressure transducers to be exported to unauthorised end-users by falsifying details of the true customers.

In response, MKS rapidly implemented an approach to compliance based on supply-chain integrity herein referred to as 'Controlled Delivery' or the 'Direct Factory Shipment Program (DFSP)'. This new system has been implemented by MKS since 2012 and has multiple, adjustable layers of protection designed to ensure legal compliance and to minimise the risks that goods will be systematically diverted. This updated approach increases supply chain transparency and is based upon the principles of simplification and directness. The founding principle of the new approach is to align the commercial interests of each element of the supply chain with the non-proliferation and compliance objectives of MKS.

Customers

The new approach allows sensitive capacitance manometers to be shipped only to the ultimate end-user, or system manufacturers ('ultimate consignees'). The items are not shipped to resellers or distributors. Legally, shipment to intermediaries is permitted by most types of export authorisation or licence, provided that an undertaking is provided that the goods will not be supplied to WMD programmes. As such, the approach taken by MKS is an additional voluntary measure taken to prevent diversion to unauthorised end-users. MKS adopted this policy in recognition that in a market-based environment, an intermediary may be willing to bend the rules and could potentially seek profit from selling goods on the 'black market'. The decision to ship directly to authorised end-users, therefore, negates any financial incentive and opportunity to misappropriate the goods on unauthorised parties, as resellers are never part of the transaction. As middlemen do not handle MKS products, their reliability and integrity cannot be challenged by the prospect of financial gain for facilitating diversion.

Nevertheless, proliferation can also occur if the declared end-user itself poses an onward diversion risk. To counter this, MKS has implemented an approach to due diligence based around the principle of 'credible economic operators'. End-users with a legitimate need for MKS products are, by and large, well-established manufacturing companies which would stand to lose significantly from a reputational or economic process disruption if they became involved in the onward proliferation of MKS products. U.S.-based MKS representatives therefore conduct site visits for all but the smallest orders, taking photographs of the premises of end use and conducting other forms of due diligence to establish if the potential customer is a 'credible economic operator'. MKS takes additional steps to verify their credentials, including utilising independent translators to verify the bona fides of potential customers.

In the case of system integrators, they are considered the ultimate consignee of the capacitance manometer but must also go through an economic justification process similar to any other end-user. Even under such circumstances, however, this 'ultimate consignee' is required to provide a list of those ultimate customers to whom the finished product will be sold – a list that is then included in the export licence application submitted by MKS to U.S. regulators.

By focusing on customers that are 'credible economic operators' MKS realises other business benefits. As capacitance manometers have a limited useful life, this approach to customer validation strengthens the relationship between MKS and customers, facilitating future sales. MKS staff build up personal

The new approach allows sensitive capacitance manometers to be shipped only to the ultimate end-user, or system manufacturers ('ultimate consignees'). The items are not shipped to resellers or distributors.

connections with officials in the customer's organisation, thus gaining insights into customer needs. MKS recognises the opportunity cost associated with short-term business relationships, such as those that arise in proliferation-related trade. As such, the Controlled Delivery Model is seen as more sustainable business model for MKS in the long term.

Agents

To get goods to the market, MKS has traditionally used a network of agents or distributors. Utilising agents and distributors is often attractive from a business perspective. For example, local agents will understand local market conditions and compliance requirements. However, it was one such agent who allegedly became involved in the unauthorised onward transfer of capacitance manometers noted above. In response, MKS has opted to replace its network of distributors with a single global trusted delivery agent. The use of a single agent minimises the logistical burden on MKS because all of the company's products can be tracked and monitored through the agent's globalized tracking system.

In selecting an agent after the 2012 incident, MKS opted to utilise a firm with a strong reputational interest in maintaining compliance. As such, the firm selected was an agent which regularly serves consumer electronics and industrial product markets in the U.S. and elsewhere. In part, this action was taken in recognition that the cost of involvement in proliferation for such a firm could be disproportionally high. Designation by the U.S., for example, would seriously damage the agent's competitiveness by denying the agent access to the North American market. The agent was thus selected to ensure that compliance interests and economic motivations converged.

The intermediate market appears therefore to be substantially closed off by the MKS Controlled Delivery program. MKS summarises this approach as 'taking the profit out of proliferation'.

The impact of change

MKS implemented its revised approach to non-proliferation in mid-2012, with a global rollout occurring in January 2013. As such, the programme continues to evolve to meet the specific challenges presented by the risks and the marketplace, although the fundamentals remain constant.

The MKS system focuses on minimising complexity and assuring transparency with delivery custody over the controlled products. Export-controlled capacitance manometers are now delivered only to verified end-users in elevated risk countries. Profit-driven proliferators can no longer expect to gain financially from intermediate resale if they never have possession or control of the goods in the first place. Proliferators could still opt to resort to more basic criminal activity such as theft, but with the profit motive and local government revenue protection lined up against them, such unprofitable inventory losses would be obvious to all concerned. The intermediate market appears therefore to be substantially closed off by the MKS Controlled Delivery program. MKS summarises this approach as 'taking the profit out of proliferation'.

Effect on proliferation

There continues to be a demand for proliferation-sensitive technologies. As whenever there is an increase in demand there is a corresponding one in price, there are potentially lucrative profits to be made by any entity that succeeds in circumventing controls. Such market conditions can complement the personal 'world views' of those individuals involved in proliferation, thus providing both an incentive and a justification for them to facilitate the illicit procurement of proliferation-sensitive goods through whatever mechanism is deemed necessary, be it legitimate or otherwise, should the opportunity arise.

The targeting of supply chains by proliferators means that the implementation of an export control system which ensures legal compliance alone may be insufficient to prevent proliferation without a programme like Controlled Delivery. Even when a company complies with export controls, proliferation can still occur through at least two channels. First, as described above, unsupervised delivery to resellers could provide the opportunity for the reseller to sell the items to the highest bidder, potentially evading and circumventing the controls in the process. Second, uncontrolled foreign inventory resales and transfers can obscure the path of true end use, potentially allowing diversion in the supply chain.

Tackling these proliferation risks is a complex challenge even for the most committed firms. The challenge becomes how to manage the proliferation risks while also facilitating trade. The decision by MKS to use 'Controlled Delivery' to authorised and licensed end-users offsets substantial risks and their

Distribution channels: can free-trade zones be non-proliferation assets?

Free trade zones ('FTZs') are areas where some financial assessments and admissibility regulations are deferred by the parent territory. As such, FTZs have traditionally been viewed with suspicion by authorities working to counter proliferation. MKS believes, however, that FTZs can prove to be non-proliferation assets if appropriately utilised. Specifically, as the authorities of the FTZs are strictly constructed to protect and collect revenue when items enter the parent territory, it is in the interests of the recipient government to ensure that the trade is conducted transparently and legitimately. Goods can be temporarily held in FTZs close to high-profit markets – thus facilitating responsive delivery to customers. At the same time, MKS staff can utilise the agent's web-based inventory and delivery tracking tools to ensure that goods are not shipped to unauthorised end-users.

unpredictable costs, but simplicity and consolidation of logistics agents has allowed MKS to keep the costs manageable. It is a tailored solution which – because of the MKS commitment to protect the supply chain for legitimate customers – ensures both these customers and MKS profits are systematically protected from diversion risks.

Corruption, diversion and circumvention of legitimate users is always a risk, but leveraging the commercial interests of each part of the supply chain can produce an environment in which diversion is an unlikely exception rather than a likely outcome.

The MKS case demonstrates that the costs of deploying an effective proliferation-resistant supply chain model can be affordable provided that the system is well-tailored to the needs of the business.

Why should companies care?

The reforms MKS has undertaken in recent months originated in the diversion of items in 2012. Nonetheless, these reforms build upon a well-established compliance culture in the firm which had previously developed around the need to counter known proliferation risks. As a result, the company's leadership had a clear awareness of the risks involved. That diversion still occurred is as much down to the complexity of securing the supply-chain as it is to any specific legal failure by MKS. The internal bureaucratic and cost hurdles to implementing the Controlled Delivery approach described here were minimal and the drivers were clear: failure to respond could leave the company susceptible to legal, financial, reputational and market-based penalties. Proactive mitigation on the other hand could largely counter these risks while also leading to more sustainable business relationships.

When engaging commercial enterprises on non-proliferation grounds, national authorities cannot afford to rely upon initiating events such as that experienced by MKS in 2012. This is because firms often become aware of supply-chain risks only when it is too late. The focus should be on proactively engaging firms in implementing tailored and transparent trade compliance systems; simplification and transparency are an aid to compliance.

The concept of resilience to proliferation in the supply chain of firm's is termed 'Anti-proliferation' herein[3]. It is in firms' interests to be proactive in implementing anti-proliferation measures. The MKS case demonstrates that the costs of deploying an effective proliferation-resistant supply chain model can be affordable provided that the system is

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well-tailored to the needs of the business. Motivations for firms to be proactive include better management of risk and proactive demonstration of Corporate Social Responsibility credentials. These motives have real business benefits: for example, demonstrating a commitment to compliance can ease export licence decisions even when exporting the most sensitive of goods.

The first step that a firm should take to implement an effective trade compliance system is to recruit or train an employee to become a compliance specialist. Having an employee who understands the proliferation risks associated with a company's products, the controls that affect a company's products and the company's supply chain is vital to managing proliferation risks in the long term. Trade compliance does not necessarily require a full-time member of staff, but it is vital that the trade compliance function has the full support of senior management.

Governments must also do more to help firms. The Controlled Delivery system is well suited to the MKS business model and may well prevent future diversion of MKS products, but it is not a system that suits other firms.

Outlook

Firms are often prepared to go beyond compliance when there is a clear rationale for doing so. Firms may be driven by a number of factors, such as avoiding legal penalties, protecting reputations and 'doing the right thing'. Each of these drivers requires that senior management and those in a compliance role understand both how the firm's technology could be misused and what measures the firm should take in order to counter supply chain risks. Other staff in the organisation must see that senior management take compliance obligations and non-proliferation objectives seriously. They must also understand both the rationale for controls and their own responsibilities in the process.

In the case of MKS, the Controlled Delivery programme is well supported by the company's top management and it is well resourced. This model leverages the economic interest of all parties in the legitimate supply chain to prevent diversion.

There is nonetheless no immediate prospect of a reduction in the demand for proliferation-sensitive technology. There will also continue to be a financial incentive for middlemen to circumvent the MKS control system. Perhaps because of this, MKS has noticed a shift in the nature of suspicious enquiries since introducing the programme: enquiries from China and other traditional diversion hubs have reduced, whereas, suspicious enquiries from individuals in more developed countries, including the U.S. and Europe, appear to be rising. Continued vigilance is therefore vital if proliferation is to be stemmed.

This paper was prepared under Project Alpha at King's College London which is funded by the British Foreign and Commonwealth Office and by the Macarthur Foundation (Grant 100971). It was originally published by the Centre for Science and Security Studies, King's College London in August 2013.

Links and notes

[1] INFCIRC 254 Rev 8 Part 2, Control list of the Nuclear Suppliers Group, available online at http://www.nuclearsuppliersgroup.org/Leng/PDF/infcirc254r8p2.pdf accessed 30 March 2012

[2] US Department of Justice Press Release: Chinese National Charged With Illegal Export Of Sensitive Technology To China, 23 May 2012, available online at http://www.bis.doc.gov/news/2012/doj05232012.htm accessed 30 March 2013

[3] For more information on the concept of antiproliferation see Stewart, Ian J. 'Antiproliferation: Tackling Proliferation by Engaging the Private Sector'. Discussion Paper 2012-15, Project on Managing the Atom, Belfer Center for Science and International Affairs, Harvard Kennedy School, November 2012.

Ian J. Stewart is seconded to the Centre for Science and Security Studies at King's College London from the British Ministry of Defence to run Project Alpha, an initiative intended to engage the private sector in preventing proliferation-related trade. Ian holds masters degrees in both Nuclear Science & Technology and Electrical and Electronic Engineering. He has also studied various aspects of international relations and politics. Ian is also a visiting research fellow with the Managing the Atom and International Security Program of Harvard's Belfer Center.

John P. McGovern has been involved in global trade compliance for over 30 years, starting with the Hewlett Packard Company, Sun Microsystems Global Customs Compliance Manager, and currently Global Trade Compliance and Logistics Senior Manager at MKS Instruments Inc. He is a graduate of Williams College, Williamstown, Massachusetts, and Chairman of the Customs and Trade Facilitation Advisory Committee (ITAC14) to the U.S. Secretary of Commerce and the U.S. Trade Representative who he advises on foreign compliance issues for U.S. Companies. He is a licensed U.S. Customshouse Broker and has spoken widely on trade compliance management techniques.

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Contact the editor:
tom.blass@worldecr.com

What U.S. and Chinese companies need to know about U.S. export control laws applicable to China

The People's Republic of China is the United States' second-largest trading partner and third-largest export market, yet U.S. exports to the country are among the most strictly controlled. Joseph D. Gustavus details the regime that governs trade between the two countries.

According to a recently published report of the U.S. Congressional Research Service, the United States and the People's Republic of China ('China') expanded economic ties substantially over the past three decades. Total U.S.-China trade rose from $5 billion in 1981 to $503 billion in 2012.[1] China is currently the United States' second-largest trading partner and third-largest export market.[2] The mutually beneficial trade relationship between China and the United States is growing increasingly complex due to the rapid pace of economic integration.

At the same time, U.S. national security concerns are at a high-water mark. U.S. technology transfers to China under U.S. export control laws receive increasing scrutiny from enforcement authorities. Significant civil and criminal penalties result from violating the confusing patchwork of U.S. export control laws, which control the possession, trade, and export of controlled items and technology. U.S. export control compliance is particularly important for companies involved in the aerospace, automotive, defence, information technology, telecommunications, and software industries.

U.S. export control laws have an extraterritorial reach, leading to the prosecution of foreign persons located abroad. The sentencing on 20 December 2012 of Xun Wang, a former managing director of PPG Paints Trading (Shanghai) Co., Ltd., to one year in prison for violating U.S. export control laws illustrates this point.[3] Whether the U.S. exporter is a U.S. parent company of a Chinese subsidiary or an existing or recently acquired U.S. subsidiary of a Chinese parent company, the same concerns apply.

This article explores the purposeful tailoring of certain aspects of U.S. export control laws to regulate exports of controlled items to China.

U.S. International Traffic in Arms Regulations ('ITAR')

ITAR controls the export from the U.S. of controlled items classified as defence articles, defence services, or technical data covered by the ITAR's U.S. Munitions List ('USML').[4] U.S. export control laws under ITAR primarily affect the defence and aerospace industries.

Shipment of U.S. defence articles licensed for export on any vessel, aircraft or other transport that is owned, operated by, or leased from a Chinese location is prohibited.

Additionally, despite its name, the USML broadly covers many items other than munitions, such as rockets and associated technology, tanks and military vehicles, surface and submersible naval war vessels, special naval equipment, aircraft and associated technology, military electronics, optical and guidance equipment, chemical and biological agents, satellite, spacecraft systems, and associated technology. The Directorate of Defense Trade Controls ('DDTC') approves the export from the U.S. of defence articles and defence services, and technical data covered by the USML.

U.S. defence article exports to and from U.S. and China

It is the policy of the U.S. for national security reasons to deny licences and other approvals for ITAR-covered USML item exports to (and imports from) China of defence articles, defence services, and technical data.[5] Obtaining an export licence from the DDTC for the export of U.S. defence articles, defence services, or technical data to China is prohibited.

Chinese defence article imports to the U.S

There is a U.S. prohibition on imports of Chinese defence articles into the U.S. which will apply if the item is covered by the United States Munitions 'Import' List.[6] This list is a subset of the USML and applies to imports into the U.S. rather than exports. It should also be noted that China has its own system of export controls for weapons of mass destruction- ('WMD') related goods and technologies.

Shipment by Chinese vessels, aircraft, and other transport

Also of note is that shipment of U.S. defence articles licensed for export on any vessel, aircraft or other transport that is owned, operated by, or leased from a Chinese location is prohibited.[7] Each ITAR export control licence issued by the DDTC has end-user limitations, which limit use to specified end-users and limit further diversion or transhipment to other end-users. Since 1990, the DDTC has operated the 'Blue Lantern' end-use monitoring programme[8] which monitors the end use and transhipment of U.S. defence articles, defence services, and technical data subject to ITAR export controls.[9] DDTC enforcement personnel conduct

Blue Lantern checks abroad to identify and investigate transactions and controlled items that appear to be at risk of further diversion or transhipment to prohibited destinations. Specifically, the DDTC enforcement personnel check for the diversion or transhipment of ITAR-controlled items to China from the foreign destination originally licensed for export.

Chinese companies should be careful to note that Chinese operations, their foreign personnel, their development activities, and resultant defence articles produced may become subject to ITAR export controls through any use of (a) U.S. components, services, or technology controlled under ITAR, or (b) foreign personnel possessing or having access to these controlled items. Chinese companies with any U.S. operations or U.S. market presence should engage in careful planning and coordination to ensure that their Chinese operations, their foreign personnel and their transactions with the U.S. do not become subject to U.S. export controls under ITAR.

Export Administration Regulations ('EAR')

Because of their specific technical capabilities, certain commercial-based systems, equipment and components; test, inspection and production equipment; materials; software; and technologies may be covered by the U.S. Commerce Control List ('CCL') and subject to export controls under EAR. Unlike ITAR export controls, EAR-based export controls affect all industries, including aerospace, automotive, information technology, telecommunications, and software industries. The Bureau of Industry and Security ('BIS') is charged with controlling and approving the export of those items covered by the CCL.

Current EAR section 744.21(a)(2) requires a licence prior to shipment to China of items intended for 'military end-use'.[10] However, on 16 April 2013, the BIS published a Final Rule (effective 15 October 2013) amending the EAR to create a new '600' series of military items on the CCL (i.e., items tagged as military).[11] The 600 series identifies items of military significance to the U.S.[12] As before, an export control licence from the BIS will be required prior to shipment to China of items within the 600 series. It should be noted that the BIS has a strong presumption of denial of export control licences for items within the 600 series that make a direct and significant contribution to Chinese military capabilities.

Non-600 series items subject to EAR export controls are generally eligible for export to China upon procurement of an export control licence from the BIS or upon qualifying for a particular EAR licence exception. The availability of an export licence or licence exception depends upon the specific item covered by the CCL and the reasons for control. The reason for imposing export controls under EAR for controlled items exported to China include U.S. national security interests; non-proliferation of chemical and biological weapons; non-proliferation of missile technology; maintenance of regional stability; nuclear non-proliferation; and, to a lesser extent, for China, syndicated crime control.[13] Even some select EAR-controlled items

Recent export control prosecutions involving China

The following are some recent prosecutions of companies and individuals for exports of U.S. items and technology to China in violation of U.S. export control laws.[22]

- 30 May 2013: A Chinese citizen pled guilty in the Eastern District of New York for attempting to export weapons-grade carbon fibre from the United States to China. The carbon fibre is a high-tech material used frequently in military, defence and aerospace industries, and which is therefore closely regulated. The defendant will face up to 20 years in prison and a fine of up to $1 million.[23]
- 17 January 2013: A U.S. district court in the Eastern District of Pennsylvania sentenced a U.S. national to 42 months in prison, three years' supervised release and a $1,000 fine for exporting 57 microwave amplifiers from the U.S. to customers in India and China without an export control licence. This investigation was conducted by the BIS under suspected EAR export control violations.
- 6 December 2012: A U.S. national was arrested on an indictment for allegedly using his U.S. company, Dahua Electronics Corporation, to export rocket nozzle coatings and other goods controlled under the ITAR to China. He also exported microwave amplifiers controlled under the EAR to China by falsely stating that the goods were destined for an educational institution in New York, rather than military uses in China. This investigation was conducted by the BIS and FBI under suspected EAR export control violations.
- 18 December 2012: The Department of Justice ('DOJ') indicted two Chinese nationals for alleged export and money-laundering violations in connection with efforts to obtain dual-use programmable logic devices ('PLDs') having possible military applications from the United States for export to China. The FBI investigated the case in cooperation with the BIS.
- 5 December 2012: The BIS charged a U.S. national for EAR export control violations for causing the export of sensitive U.S. carbon fibre from the U.S. to Belgium and then causing the illegal transhipment of the sensitive carbon fibre to China.
- 3 December 2012: The BIS charged a Chinese company, China Nuclear Industry Huaxing Construction Co., Ltd., for export control violations under EAR for engaging in the transhipment of sensitive U.S. high-performance coatings from China to a nuclear reactor in Pakistan.
- 4 October 2012: The DDTC charged a Chinese national for export control violations under ITAR for illegal weapons trafficking and exporting multiple shipments of firearms from the U.S. to China.
- 26 September 2012: The DOJ convicted a Chinese national for export control violations under ITAR for taking export-controlled technical data on military technology from a U.S. employer to China on his laptop without a U.S. export control licence.
- 24 July 2012: The BIS charged a Singapore company, which then entered into a settlement agreement and agreed to pay a fine of $110,000 for export control violations under EAR, for engaging in the transhipment of sensitive U.S.-origin technologies to two Chinese nationals in China.
- 28 June 2012: The DDTC filed charges against United Technologies subsidiaries (Pratt & Whitney Canada and Hamilton Sundstrand), which pled guilty to criminal charges under ITAR and agreed to pay a fine of $75 million for helping China develop a new attack helicopter by providing electronic engine control software.
- 23 May 2012: The BIS charged a Chinese national who was a sales manager at MKS Instruments Shanghai, Ltd., a Chinese subsidiary of a U.S. company, for causing millions of dollars of sensitive pressure-measuring sensors to be exported from the U.S. and delivered to unauthorised end-users by using export licences fraudulently obtained from the BIS.

Links and notes

1 Wayne M. Morrison, Cong. Research Serv., RL 33536, China-U.S. Trade Issues 2 (2012).
2 Id.
3 Press release, Dep't of Justice: 'Former managing director of PPG Paints Trading (Shanghai) Co., Ltd., sentenced to a year in prison for conspiring to illegally export high-performance coatings to nuclear reactor in Pakistan' (20 December 2012).
4 22 C.F.R. § 121.
5 15 C.F.R. § 126.1(a).
6 27 C.F.R. § 447.21.
7 15 C.F.R. § 126.1(b).
8 Defense Trade Controls Compliance, *End-use monitoring of defense articles and defense services commercial exports* (2012).
9 Id.
10 15 C.F.R. §744.21(a)(2).
11 Amendment to the International Traffic in Arms Regulations: Initial Implementation of Export Control Reform, 78 Fed. Reg. 73, 22740 (16 April 2013) (to be codified 22 C.F.R. pts. 120, 121, and 123).
12 Id.
14 15 C.F.R. § 738.
14 15 C.F.R. § 748.15, § 748 Supplement No. 7.
15 15 C.F.R. § 744.21, § 744 Supplement No. 2.
16 Id.
17 15 C.F.R. § 748.10.
18 15 C.F.R. § 748.9(b)(2).
19 15 C.F.R. § 744.21
20 Id. § 744.21(a).
21 Id. § 744.21(e).
22 See: *Summary of major U.S. export enforcement, economic espionage, trade secret and embargo-related criminal cases*, Department of Justice (February 2013), www.pmddtc.state.gov/compliance/documents/OngoingExportCaseFactSheet022013.pdf
21 Press release: *Department of Justice, Cyber-sting nets Chinese national in attempt to export sensitive defense technology* (30 May 2013).

on the CCL are eligible for export to China without an export control licence or licence exception. A determination of whether an EAR export licence or licence exception for exports to China is required and is performed on a case-by-case basis.

It is important for Chinese companies to note that the BIS has developed a specific licensing policy for certain high-technology exports to China.

China-specific licence policy for EAR-controlled items

It is important for Chinese companies to note that the BIS has developed a specific licensing policy for certain high-technology exports to China. On the one hand, this China-specific licence policy facilitates exports to trusted companies in China; and on the other, it imposes additional licensing requirements for exports to China of items controlled by EAR.

a) *Validated end-user programme for exports to China*
The BIS has a validated end-user ('VEU') programme. This programme facilitates exports of items controlled by EAR to trusted companies in China. Pre-screened Chinese companies may qualify for, and receive, VEU designation from the BIS. Thereafter, the Chinese company may receive U.S. exports and certain EAR-controlled items without EAR export licences. The BIS publishes a list of approved Chinese validated end-users.[14] Requests for VEU designation are prepared and submitted to the BIS for consideration.

b) *Additional licensing requirements for exports to China*
The BIS imposes additional China-specific licensing requirements on a targeted list of items covered by the CCL ('target list items') that, though commercial, have the potential to contribute to China's military modernisation. This list of items, 30 in all, covers 20 product categories and associated technologies and software.[15] These China-specific licensing requirements impose stricter end-use controls on EAR-controlled technologies comprised of, or usable with, aircraft and aircraft engines, avionics and inertial navigation systems, lasers, depleted uranium, underwater cameras and propulsion systems, certain composite materials, and some telecommunications equipment.[16] Furthermore, Chinese companies receiving target list items must provide U.S. exporters with PRC end-user statements as specified under the EAR.[17] Exporters must obtain an end-user certificate from the PRC Ministry of Commerce ('MOFCOM') for any export that requires a licence to China that exceeds $50,000 in total value.[18] PRC end-user statements help facilitate the BIS's ability to conduct end-use checks on exports of controlled articles and technologies to China. Additionally, if the exporter knows that the export is destined for military end use in China, the exporter must obtain a licence.[19] There are 31 items, identified by their export classification control number ('ECCN'), that are subject to this military end-use requirement.[20] The BIS will deny any licence where the export will make a material contribution to the PRC's military capabilities contrary to U.S. national security concerns.[21]

BIS China office

The BIS issues EAR export control licences with end-user limitations, which limit use to specified end-users and limit further diversion or transhipment to other end-users. Like the DDTC Blue Lantern programme, the BIS staffs special agents overseas as export control officers ('ECOs') in Beijing and Hong Kong to ensure compliance with the end-use licence limitations in EAR export control licences issued by the BIS.

Joseph D. Gustavus is a partner in the Troy office of Miller Canfield where he advises clients primarily in the automotive, defence, aerospace, software and information technology sectors on corporate and export control matters.

gustavus@millercanfield.com

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U.S. export control reform: a summary of the major changes

On 15 October, U.S. export control reforms come on line. Lindsey N. Roskopf, Jamie A. Joiner and Michael L. Burton recap the key points issues and examine some of the main issues that exporters will need to be aware of.

By the end of this month, export controls as we know them will have changed. On 16 April 2013, the Department of Commerce, Bureau of Industry and Security ('BIS') and the Department of State, Directorate of Defense Trade Controls ('DDTC') issued the first pair of final rules implementing the Export Control Reform ('ECR') Initiative. On 15 October 2013, these rules will take effect.

These first rules implement the initial ECR changes by adding a structure and related provisions to control munitions items on the Commerce Control List ('CCL') that the President has determined no longer warrant control on the U.S. Munitions List ('USML'). The rules also move an initial group of items from the USML to the CCL, including aircraft and gas turbine engines, and related parts, components, software, and technology. In addition, the rules adopt a common definition of 'specially designed' for use under the Export Administration Regulations ('EAR') and the International Traffic in Arms Regulations ('ITAR'). Finally, the rules address implementation issues related to the transition of items from the USML to the CCL.

Since the initial rules were released on 16 April 2013, there have been subsequent final rules addressing the transition of vessels and ground vehicles from control under the ITAR to control under the EAR. This article discusses issues related to the migration of items from the USML to the CCL; key changes to the ITAR, USML, EAR, and CCL; and some of the myriad issues exporters will face as a result of ECR.

BIS and DDTC have adopted an effective date of 180 days after publication in the Federal Register for ECR final rules. As such, the first final rules issued on 16 April 2013 will become effective on 15 October 2013. The second set of final rules, issued on 8 July 2013, will become effective on 6 January 2014. Given the impending implementation dates, exporters should evaluate their items to determine if any have migrated from the USML to the CCL.

Below is a summary of proposed rules and final rules that have been published to date.

	Proposed rules		Final rule (effective date)*
USML category	Date*	CCL '600 Series' entry	
I. Firearms	Not yet published		
II. Guns	Not yet published		
III. Ammunition	Not yet published		
IV. Missiles	1/31/13	604	
V. Explosives	5/2/12	608	
VI. Vessels	12/23/11	609	7/8/13 (1/6/14)
VII. Vehicles	12/6/11	606	7/8/13 (1/6/14)
VIII. Aircraft	11/7/11	610	4/16/13 (10/15/13)
IX. Training equipment	6/13/12	614	
X. Protective equipment	6/7/12	613	
XI. Electronics	11/28/12 , 7/25/13	611	
XII. Sensors	Not yet published		
XIII. Aux. military equip.	5/18/12	617	7/8/13 (1/6/14)
XIV. Chem/Bio	Not yet published		
XV. Satellites	5/24/13	515	
XVI. Nuclear	1/30/13 (DDTC only)	N/A	
XVIII. Directed energy	Not yet published		
XIX. Gas Turbine engines	12/6/11	619	4/16/13 (10/15/13)
XX – Submersibles	12/23/11	620	7/8/13 (1/6/14)

Note: Only minor revisions were made to Categories XVII and XXI. These rules are included in the final rules published on 4/16/2013 and are effective on 10/15/2013.

** Dates are presented in the U.S. format – month/day/year*

Effect of existing licences during the transition period

For items that have moved to the CCL, exporters will need to examine their DDTC authorisations to determine how long they will remain valid and at what point they will need to apply for a licence from BIS. The chart on the following page illustrates the validity of DDTC authorisations existing prior to the effective date of transition for items moving from the USML to the CCL.

DDTC licence holders will have the option of applying for a new licence

from BIS or holding onto their existing licence as long as it is valid. If a licence holder chooses to obtain a new licence from BIS before a DDTC licence expires, it must return the licence to DDTC.

Dual licensing issues
The final rules have addressed the issue of dual licensing in situations where an export of an item on the USML contains parts and components on the CCL. To prevent exporters from having to obtain one licence from DDTC and another from BIS, the final rules give DDTC licensing authority over the export of items subject to the EAR when those items will be used in or with items subject to the ITAR. USML categories will have a new (x) paragraph that allows for ITAR licensing of items subject to the EAR. It is important to note, however, that transfers not covered by a DDTC approval will require BIS authorisation for items subject to the EAR.

Extended licence duration and transfers among end-users
One key benefit of ECR for exporters of items on the CCL is an extension of licence duration for BIS licences. BIS has extended the validity period of BIS licences from two years to four years to harmonise the EAR with the ITAR. BIS licences will also now allow direct export, re-export, and in-country transfer to and among approved end-users.

New '600 Series' items
To accommodate the migration of items from the USML to the CCL, BIS has created a new control series, the '600 Series', in each of the ten CCL categories. This series will control most items formerly on the USML that have moved to the CCL. These are the items for which it has been determined that the relatively stricter controls of the USML are not necessary. Each 600 Series ECCN will have three types of subparagraph:

- .a through .w includes specifically enumerated end items, parts, components, accessories, and attachments moving from the USML.
- .x includes 'specially designed' parts, components, accessories, and attachments that are not specifically enumerated.

	Licences/authorisations where all items are transitioning to CCL	Licences/authorisations containing both transitioning and non-transitioning items
DSP-5	DSP-5 Licence remains valid until the earlier of the expiration date, return by license holder, or two years from the effective date of final rule.	Licence remains valid until expired or returned by license holder.
DSP-61 DSP-73	Licence remains valid until expired or returned.	
TAA MLA WDA	Agreement remains valid for a period of two years from the effective date of the final rule.	Agreement remains valid until the earlier of expiration date, unless an amendment is required, or two years from the effective date of final rule. An agreement may remain valid beyond two years if an amendment is submitted.

- .y includes specifically enumerated parts, components, accessories, and attachments that are 'specially designed'. These are items that that have been deemed less sensitive (e.g., military aircraft tyres, military gas turbine engine oil tanks, and ground vehicle batteries) and therefore warrant no more than 'AT-only' controls. The implication of this approach is that one need not review subparagraph .x if a specially designed part, component, accessory, or attachment is enumerated in subparagraph .y.

In general, items in .a through .x are controlled to all countries except Canada, whereas .y items are only controlled under the AT reason for control and to China if for military end use.

New definition of 'specially designed'
The first final rules also adopt a common definition of 'specially designed' for use under both the EAR and the ITAR. The new definition of 'specially designed' employs a 'catch and release' approach. Paragraph (a) will 'catch' items as 'specially designed' and paragraph (b) will 'release' items if they meet any of the six exceptions set forth.

Under the 'catch', an item is specially designed if:

- As a result of development, an item has properties peculiarly responsible for achieving or exceeding the performance levels, characteristics, or functions described in the relevant ECCN or USML paragraph; or
- It is a part, component, accessory, attachment, or software for use in or with a commodity or defence article enumerated or otherwise described on the CCL or USML.

In the second part of the definition, a part, component, accessory, attachment, or software that has been caught by paragraph (a) may be released from treatment as specially designed if it meets one of the exclusions in paragraph (b) discussed further below.

(a) *Classification request exclusion:* The item was subject to either (1) a prior CJ determination by DDTC or (2) a DDTC-cleared CCATS request and was identified in an ECCN paragraph that does not contain a 'specially designed' control parameter or was identified as EAR99.

(b) *Minor component exclusion:* The item is a fastener (e.g., screw, bolt, nut, nut plate, stud, insert, clip, rivet, pin), washer, spacer, insulator, grommet, bushing, spring, wire, or solder, regardless of form or fit.

(c) *Production exclusion:* The item has the same function, performance capabilities, and the same or equivalent form and fit, as a commodity or software used in or with an item that is or was in production (i.e., not in development) and (i) is not on the USML or CCL or (ii) is controlled for AT reasons only.

(d) *Developed for multiple commodities exclusion:* The item was developed with knowledge that it would be used in or with commodities or software that are (i)

described in an ECCN and (ii) also commodities or software either not enumerated on the CCL or USML or that are described in an ECCN controlled for AT reasons only.

(e) *Developed for general purposes exclusion:* The item was developed as a general purpose commodity or software without knowledge of its use in or with a particular commodity or type of commodity.

(f) *Developed with knowledge of EAR99 or AT-only use exclusion:* The item was developed with knowledge that it would be for use in or with commodities or software described in an ECCN controlled for AT reasons only or for use in EAR99 commodities or software.

For additional reference, BIS has created a 'Specially Designed' decision tool on its website that can aid in determining whether an item is 'specially designed'.

Order of review in determining jurisdiction

To determine how an item is controlled, the exporter first must determine whether the item is on the USML or the CCL. Because the ITAR still effectively trumps the EAR, the USML should be reviewed first to determine whether the item is specifically enumerated on the USML or is included in a USML 'catch-all' paragraph. If the item appears on the USML or is included in one of its 'catch-all' paragraphs, the item is subject to the ITAR and there is no need to consult the CCL.

If the item is not ITAR controlled, it is likely subject to the EAR. BIS has added a CCL order of review document in a new supplement no. 4 to part 774 of the EAR in its first final rule that sets forth the steps that should be followed in classifying items that are 'subject to the EAR'. It provides guidance on how to classify items in light of the addition of the 600 Series to the CCL and the new definition of 'specially designed'. BIS has also created a 'CCL Order of Review' decision tool on its website to aid in this process.

The primary change to classifying items is that the 600 Series of each category must be consulted before considering the rest of the CCL. Just as the ITAR trumps the EAR, items described in the 600 Series trump other ECCNs on the CCL. Within the 600 Series, specifically enumerated items should be reviewed first followed by the catch-all controls (generally in the .x subparagraph). The review of the catch-all controls includes determining whether the item is 'specially designed'. If the item is not controlled by a 600 Series ECCN, then applicable non-600 Series ECCNs should be reviewed for classification. Once the 600 Series is ruled out, the rest of the classification analysis proceeds as it did under the EAR prior to ECR implementation.

Revisions to licence exceptions and application to 600 Series items

Licence exceptions LVS (shipments of limited value), TMP (temporary imports, exports, and re-exports), RPL (servicing and replacement of parts and equipment), TSU (technology and software unrestricted), GOV (governments, international organisations, international inspections under the Chemical Weapons Convention, and the international space state), and STA (strategic trade authorisation) are available for 600 Series items. These exceptions, however, are not available for 600 Series items destined for arms embargoed countries listed in a new country group D:5 (i.e., Afghanistan, Belarus, China, Congo, Cote d'Ivoire, Cuba, Cyprus, Eritrea, Fiji, Haiti, Iran, Iraq, Lebanon, Liberia, Libya, North Korea, Somalia, Sri Lanka, Sudan, Syria, Venezuela, Vietnam and Zimbabwe). Also note the other limitations set forth in parts 736 and 744, and in § 740.2; the licence exception itself; and in the ECCN for the item(s) shipped, if specified.

Just as the ITAR trumps the EAR, items described in the 600 Series trump other ECCNs on the CCL.

Licence exception TMP has been streamlined and also broadened to correspond to certain ITAR exemptions. TMP has been revised to provide that when authorisation to retain an item abroad beyond one year is requested, the term of the authorisation may be for a total of four years rather than just an additional six months. Additionally, exports to a U.S. person's foreign subsidiary, affiliate, or facility abroad are no longer limited to Country Group B countries.

Licence exception RPL adds 600 Series parts, components, accessories, and attachments to the authorisation.

Licence exception GOV has been streamlined and authorises items consigned to non-governmental end-users, such as U.S. government contractors, acting on behalf of the U.S. government in certain situations, subject to written authorisation from the appropriate agency and additional export clearance requirements.

Licence exception TSU adds authorisation for the release of software source code and technology in the U.S. by U.S. universities to their bona fide and full-time regular foreign national employees.

Licence exception STA places additional requirements on 600 Series items. STA may be used to export 600 Series items to nationals in a newly created country group A:5 if:

- The ultimate end-user is a Country Group A:5 government or the U.S. government;
- For development, production, or servicing of an item in a Country Group A:5 country or the U.S. that will ultimately be used by an A:5 government, the U.S. government, or a person in the United States; or
- The U.S. government has issued a licence that authorises the use of licence exception STA. STA may not be used to export aircraft in ECCN 9A610.a unless BIS has approved the export under STA.

The revisions to the licence exceptions should be carefully reviewed as the changes to several of the licence exceptions will affect items beyond the 600 Series. Further, all exporters currently relying on licence exceptions should review the changes to confirm that they meet the revised requirements.

***De minimis* calculation for 600 Series items**

600 Series items will generally follow the same *de minimis* provisions as other items subject to the EAR. As such, most foreign-made items that incorporate less than 25% of U.S.-origin 600 Series items are not subject to the EAR. Importantly, there is no *de minimis* level for foreign-made items

Changes to the USML and CCL

While a detailed explanation of all the changes is beyond the scope of this article, the final rules published to date make the following broad changes to the USML and CCL. All exporters and manufacturers with products potentially within these categories would be well advised to review the revised categories, as there have been numerous significant revisions.

Revision of USML category VIII (aircraft and related articles)
USML category VIII has been revised to move similar articles controlled in multiple categories into a single category, including moving gas turbine engines to a newly established category XIX. Additionally, the revised category VIII contains a positive list, with one exception, of specific types of items that warrant control on the USML. The one exception is for items that are 'specially designed' for certain enumerated stealth aircraft. All other 'specially designed' parts for military aircraft (not included in the new, 'positive' list contained in category VIII of the USML) are now subject to control in the new 600 Series in category 9 of the CCL. ECCNs 9A610, 9B610, 9C610, 9D610, and 9E610 have been added to the CCL to control these items. These revisions will be effective 15 October 2013.

Addition of USML category XIX (gas turbine engines and associated equipment)
USML category XIX has been established to cover gas turbine engines and associated equipment formerly covered in USML categories IV, VI, VII, and VIII. This category was previously 'reserved' on the USML. While final rules for categories IV, VI, and VII have not been published, the new category XIX supersedes the controls under these categories. ECCNs 9A619, 9B619, 9C619, 9D619, and 9E619 have been added to the CCL to control gas turbine engines and related items that do not warrant control under the new USML category XIX. These revisions will be effective 15 October 2013.

Revision of USML category VI (surface vessels of war and special naval equipment)
USML category VI is revised to remove from the USML harbour entrance detection devices formerly controlled under USML category VI(d); developmental vessels identified in the relevant defence contract as being both for civil and military applications; demilitarised surface vessels of war manufactured prior to 1950; and generic parts, components, accessories, and attachments specifically designed or modified for a defence article, regardless of their significance to maintaining a military advantage for the U.S. Category VI also no longer controls submarines – these are now controlled in USML category XX. Additionally, revised category VI(f) contains a positive list of specific items that continue to warrant control. All other items are subject to the new 600 Series of the CCL. ECCNs 8A609, 8B609, 8C609, 8D609, and 8E609 have been added to the CCL to control items that no longer warrant control on the USML. These revisions will take effect 6 January 2014.

Revision of USML category VII (ground vehicles)
USML category VII is revised to remove most unarmoured and unarmed military vehicles, trucks, trailers, and trains (unless specially designed as firing platforms for weapons above .50 calibre), and armoured vehicles manufactured before 1956 (either unarmed or with inoperable weapons). Additionally, engines formerly controlled in paragraph (f) are now covered in revised USML category XIX. Similar to the revision of category VI, revised category VII does not contain controls on all generic parts, components, accessories, and attachments that are specifically designed or modified for a defense article. There is now a positive list of parts, components, accessories, and attachments in paragraph (g) that warrant control on the USML. ECCNs 0A606, 0B606, 0C606, 0D606, 0E606 have been added to the CCL to control ground vehicles and related items that no longer warrant control on the USML. These revisions will take effect 6 January 2014.

Revision of USML category XIII (materials and miscellaneous articles)
USML category XIII is revised to move self-contained diving and underwater breathing apparatuses to ECCN 8A620.f; structural materials to ECCN 0C617 and amongst revised USML categories; and metal embrittling agents to ECCN 0A617.f. These revisions will take effect 6 January 2014.

Revision of USML category XX (submersible vessels and related articles)
USML category XX is revised to consolidate controls that apply to submersible vessels in a single category. This revised category controls only those parts, components, accessories, and attachments that are specially designed for defence articles controlled in category XX. All other parts, components, accessories, and attachments are subject to the new 600 Series controls. ECCNs 8A620, 8B620, 8D620, and 8E620 have been added to the CCL to control submersible vessels that no longer warrant control on the USML. These revisions will take effect 6 January 2014.

that incorporate U.S.-origin 600 Series items when destined for a U.S. arms embargoed country (i.e., new Country Group D:5). In other words, foreign-produced items containing any amount of 600 Series content are prohibited from export or re-export to any D:5 country. The 10% *de minimis* rule (and its exceptions) remains in effect for controlled U.S. content (other than the 600 Series content) incorporated into foreign-produced items destined for Cuba, Iran, North Korea, Sudan, or Syria.

Prior jurisdiction determinations
Commodity jurisdiction ('CJ') determinations by DDTC for items deemed to be subject to the EAR will remain valid. CJ determinations for items previously deemed to be on the USML, but subsequently transitioned

to the CCL, however, are superseded and would now become subject to the EAR.

AES filings for 600 Series items

AES filings are required regardless of value for all 600 Series items except for .y items. The AES filing requirement for .y items is the same as all other AT-only controlled items. Further, all exports under licence exception STA require an AES filing.

Furnishing of ECCNs to consignees

The new rules require that the ECCN for each 600 Series item in a shipment be entered on the invoice and on the bill of lading, air waybill, or other export control document (i.e., documents on which the destination control statement is required) that accompanies the shipment from the point of origin in the United States to the ultimate consignee or end-user abroad.

Looking ahead

Now that the framework for migration is in place, additional proposed and final rules will continue to be published over the next year for USML items that will transition to the CCL. As ECR becomes a reality, exporters should take the following steps to be prepared for implementation:

- Classify your products. Items may be transitioning from the USML to the CCL, within the CCL, or within the USML. Items should be reviewed to determine appropriate classification and agency jurisdiction.
- Review existing export authorisations. Exporters with items transitioning to the CCL need to develop a plan for determining if EAR licence exceptions apply or, if not, obtaining licences from BIS.
- Review licence exceptions. There are revisions to many of the licence exceptions beyond the 600 Series. These should be carefully reviewed before exporting under a licence exception.
- Update compliance manuals. All exporters will need to modify their export compliance procedures to account for changes to the ITAR and EAR resulting from the implementation of ECR.

While coping with the challenges these regulatory changes pose can seem a daunting task, it is far better to prepare for the imminent transition now rather than struggling to deal with it once the rules are final. The former can pave the way for a (relatively) smooth transition and increased efficiency, while the latter risks business delays and potential non-compliance.

Lindsey N. Roskopf is an associate, pending Texas Bar results, and Jamie A. Joiner and Michael L. Burton are members of the law firm Joiner Burton.

jjoiner@joinerburton.com

mburton@joinerburton.com

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A practical approach to dealing with Argentina's import restrictions

With the aim of protecting the country's trade balance, Argentina's government established controls which require an importer to export goods of equal value to those it brings into the country. Augusto Vechio describes the various solutions adopted by Argentina's exporters in complying with the restrictions.

As is widely known, since 2005 the Argentine government has been using different procedural tools to manage the 'Argentinean trade balance'. A key aim of the Argentine government is to protect the level of federal reserves of the Central Bank by preventing U.S. dollars from being taken out of the country. The stated rationale of these import restrictions is the protection of local industry and jobs.

This protectionist policy has hardened in the wake of Argentina's need to import energy, a need which is threatening the country's trade balance surplus and could affect the federal reserves. Accordingly, the government is trying to improve the country's trade balance by maintaining an excess of exports over imports of goods (i.e. an excess of inward flow of foreign currency over outflow). As a consequence of this policy, not only is the entry of merchandise that is capable of competing with local industry controlled, but also that of any imported merchandise which may be capable of distorting the trade balance.

Under this policy, since February 2012 the Secretariat of Domestic Trade has controlled imports through pre-import affidavits (in Spanish: *Declaración Jurada Anticipada de Importación*, 'DJAIs'). DJAIs came into force with the issuance of AFIP general resolutions nos. 3252 and 3255, in January 2012. By means of these resolutions, the tax authority established that as of 1 February 2012, all importers must comply with a non-tariff measure applied to imports for consumption. In other words, every importer must file a DJAI for each import and such DJAI can either be approved or released (allowing the importer to import), or objected to (not allowing the importer from importing).

Basically, the result is that importers are required to export one dollar for every dollar imported (and thus offset the company's trade balance through exports) as a *de facto* condition for obtaining the release of DJAIs. It is important to stress that there is no legal limitation on importing, just the factual one as set out by the above-mentioned exercise of control with the required affidavits.

Practical ad-hoc solutions to be able to import

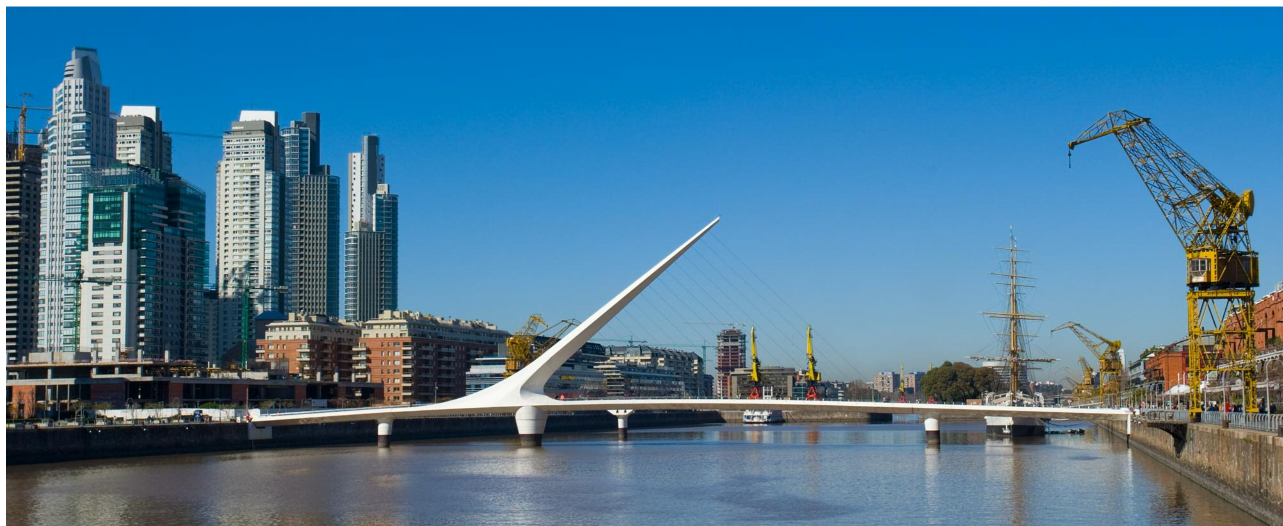
As a consequence of the scenario just described, and in order for importers that do not have any exports to be able to import their products, practical ad hoc solutions (not contemplated for expressly in any law) have been adopted by importers. These solutions involve the implementation of different import compensation strategies, such as:

(i) local purchase by the importer of merchandise to export;
(ii) execution of a 'cooperation agreement' with a local producer/exporter;
(iii) exports on behalf of a third-party;
(iv) exports promotion; and
(v) capital injections from abroad.

(i) Local purchase of merchandise to export

In order to compensate their trade balance, some importers have developed the capacity to export goods of the same value as their imports.

If importers lack the capacity to produce locally and then to export – in



order to achieve this goal – importers will purchase merchandise from a local producer/exporter and export such goods abroad. It is important to point out that such exports would be delivered to the producer/exporter's client/market abroad.

To put it simply, an importer that is not able to compensate its own trade balance would purchase goods from a local exporter and export said goods to the exporter's customers abroad. In exchange, importers pay the exporter – in addition to the merchandise's price – a compensation fee. Further, the importer would have to face other possible costs (i.e. applicable taxes, duties, etc.).

(ii) Cooperation agreements

As a *sui generis* alternative to the solution in (i) above, importers are also entering into 'cooperation agreements' with a local exporter, by means of which the parties agree that the exports of the exporter will compensate the importer's operations. This means that the exporter will assign an amount of its exports to the importer in order for the latter to show a compensated trade balance.

A 'market of export capability' has developed in which local exporters offer their export capability for a fee. Accordingly, local exporters are executing these so-called 'Cooperation Agreements' by means of which the importers pay a compensating fee (on average, 8-12% of the compensation amount) to the exporters in order to help them increase their exports and improve their margins. As a result, the imports of the importer are artificially matched with the exports of the local exporter.

In general, importers are choosing this alternative as it is cheaper and bears less operative risks than the one explained in (i) above. Typically, these agreements do not exceed a one-year term.

(iii) Exports on behalf of a third-party

This alternative is regulated by General Resolution AFIP N° 2000/2006. In this scenario, the importer – which is not and cannot be the owner of the products to be exported (they are owned by a local producer/exporter) – exports the products that belong to the local producer/exporter on its behalf: the value of such exports can be used to compensate the importer's trade balance.

This alternative is expressly regulated from a trade/customs and tax standpoint. In general, the fee to be paid to the local producer/exporter amounts on average to 6% of the value of the exports. However, there are other tax and customs obligations that the importer will need to bear.

(iv) Exports promotion

Another possible solution that can work for economic groups that have an international presence, is the so-called 'exports promotion'.

This alternative is viable when a parent company to an Argentine affiliate (or its foreign affiliates outside Argentina) is purchasing raw materials or components from an Argentine local producer that it is not linked to the multinational company.

In this scenario, those purchases (that are in fact exports of a local company) can be used to compensate the trade balance of the local entity of the multinational company.

An example to illustrate this approach might be: International economic group 'AA Corporation' has a local affiliate in Argentina named 'AA Argentina'. 'AA Argentina' acts only as an importer and does not export anything and thus it needs to compensate its trade balance in order to obtain the release of the DJAIs. Meanwhile, another linked entity from Brazil – 'AA Brazil' – is purchasing raw materials from an Argentine local producer that it is not linked to 'AA Corporation' or any of its controlled entities. The value of those exports made by this local producer to 'AA Brazil' can be used by 'AA Argentina' in order to compensate its own trade balance.

(v) Capital injections from abroad

Capital injections from abroad by a parent company to the local affiliate can be used to compensate the trade balance of a local company that has an importing profile.

It should be pointed out that this

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alternative will only work to offset the trade balance if the money from the capital injection is brought into Argentina. If the money is left in a bank account outside of Argentina, this alternative will not work.

By choosing to follow one of the alternatives mentioned, the importer will be deemed to have duly complied with the government's commercial policy because its imports are compensated.

Final comments
As indicated above, there are no legal restrictions to imports. The current restrictions or impediments to the import of products are imposed de facto by the Secretariat of Domestic Trade as a consequence of the government's policy aimed at protecting the country's trade balance.

Furthermore, there are no legal prohibitions on entering into the agreements outlined above (i.e.: there is no law that prohibits the execution of the agreements mentioned in (i), (ii) and (iii), and therefore they can be agreed upon by the parties). Consequently the execution of such agreements is legal and cannot be sanctioned. As a matter of fact, these import commitments are among the ad-hoc solutions currently accepted – without any formal resolution– by the Secretariat of Domestic Trade and hence, as it is publicly and openly known, many importers are making use of them.

By choosing to follow one of the alternatives mentioned, the importer will be deemed to have duly complied with the government's commercial policy because its imports are compensated.

Should the Secretariat of Domestic Trade consider that the importer has complied with said policy by means of any of the described alternatives, the Secretariat of Domestic Trade may approve the DJAIs filed by the importer and consequently the importer would be able to import.

However, it should be pointed out that none of the practical solutions mentioned does assure that the DJAIs would be released, given that the handling of the trade balance also depends on the level of foreign currency reserves of the Central Bank.

Augusto Vechio is a senior associate at Estudio Beccar Varela where he leads the International Trade department. He has a wide experience in antitrust (merger control and anticompetitive practices), domestic trade regulation and international trade (antidumping, safeguards, subsidies and countervailing measures, import licences, DJAI, MERCOSUR proceedings).

avechio@ebv.com.ar

Raphaël Barazza
Avocat à la Cour

33 rue Galilée, 75116 Paris, France
Phone + 33 (0) 1 44 43 54 63

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Contributors in this issue

D.E. Wilson Jr., Venable LLP, and Ward Scott, Kakar Advocates LLP
www.venable.com
www.scottadvocates.com

Ian J. Stewart, Project Alpha, and John P. McGovern, MKS Instruments Inc.
www.kcl.ac.uk/csss

Joseph D. Gustavus, Miller Canfield
www.millercanfield.com

Lindsey N. Roskop, Jamie A. Joiner and Michael L. Burton, Joiner Burton
www.joinerburton.com

Augusto Vechio, Estudio Beccar Varela
www.ebv.com.ar

WorldECR Editorial Board

Michael Burton, Joiner Burton, Washington, DC
mburton@joinerburton.com

Larry E. Christensen, Miller & Chevalier, Washington, DC
lchristensen@milchev.com

Iain Macvay, King & Spalding, London
imacvay@kslaw.com

Dr. Bärbel Sachs, Noerr, Berlin
bärbel.sachs@noerr.com

Edmund Sim, Appleton Luff, Singapore
sim@appletonluff.com

George Tan, Bryan Cave Consulting, Singapore
george.tan@bryancave.com

Stacey Winters, Deloitte, London
swinters@deloitte.com

General enquiries, advertising enquiries, press releases, subscriptions: info@worldecr.com

Contact the editor, Tom Blass: tnb@worldecr.com tel +44 (0)7930405003

Contact the publisher, Mark Cusick: mark.cusick@worldecr.com tel: +44 (0)7702289830

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ISSN 2046-4797. Refer to this issue as: WorldECR [0306]

Correspondence address: D.C. Houghton Ltd, Suite 17271, Lower Ground Floor, 145-157 St John Street, London EC1V 4PW England

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ISSUE 26. OCTOBER 2013
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