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presents

Export Control Compliance: Technology Transfers and Deemed Exports

Crafting a Comprehensive Compliance Program to Mitigate Penalties for Inadvertent Violations

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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Thursday, December 3, 2009

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1 pm Eastern
12 pm Central
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O'MELVENY & MYERS LLP

Greta L.H. Lichtenbaum, Esq.
December 3, 2009

Introduction to the EAR and ITAR Technology Controls

U.S. Export Control Laws

- Relevant U.S. Government Agencies with Oversight Responsibility Relating to Export Activities Involving Technology:
  - Department of Commerce, Bureau of Industry and Security ("BIS")
    - administers the Export Administration Regulations ("EAR")
      - The EAR regulates commercial and "dual use" items
  - Directorate of Trade Controls, U.S. State Department ("DDTC")
    - administers the International Traffic in Arms Regulations ("ITAR")
    - broad controls of U.S. munitions items
  - Department of Treasury, Office of Foreign Assets Control ("OFAC")
    - administers economic sanctions against certain countries, entities, individuals, and organizations
      - These include export restrictions and broad restrictions on U.S. persons doing business with restricted or "sanctioned" countries/entities
  - Department of Justice ("DOJ")
    - criminal enforcement of export control laws

Key U.S. Export Control Principles

- The EAR and the ITAR apply to goods, software and technology
- U.S. and non-U.S. persons alike are subject to the EAR and the ITAR, although in different ways
- The EAR and the ITAR apply to exports, re-exports and transshipments
- Licenses may be required for exports/re-exports – it depends on **what** is being exported, and to **whom**, to **where, and for what purpose** the item is being exported or re-exported
- There are significant penalties for non-compliance

I. The Export Administration Regulations

What is Subject to the EAR?

- **The first step in complying with the EAR is determining whether a given export or re-export is "subject" to the EAR**
  - Most items (goods, software, or technology) in the United States (regardless of level of technical sophistication), even if of foreign origin (unless they are subject to the ITAR);
  - U.S.-origin items (goods, software, and technology), wherever located;
  - Certain foreign-produced products produced from U.S. technology;
  - Foreign-produced items "incorporating" more than *"de minimis"* U.S.-origin content. This rule also applies to foreign technology

What is Not Subject to the EAR?

- Any item, including technology, that is wholly non-U.S.-origin (or has *de minimis* U.S. content) and that is outside the United States
- certain publicly available information, educational information, and fundamental research

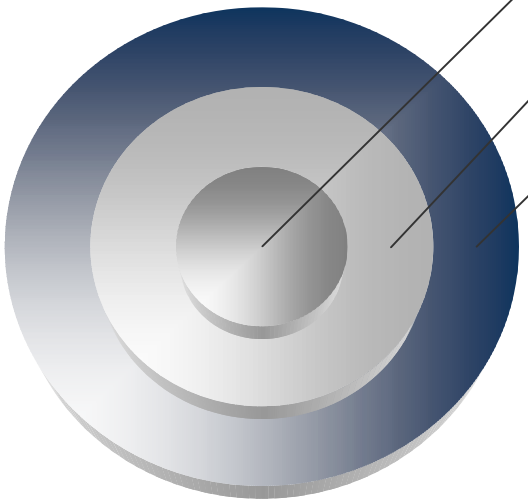
What is “Controlled” Under the EAR?

– Most items in the United States and all items of U.S.-origin located abroad are subject to the EAR

However . . .

- Not all such items are controlled for export or re-export
- If an item is controlled for export or re-export, then a BIS or OFAC license for that particular transaction is required
- Whether an item requires a license depends on the item, the end user, the end use, and the destination

What is "Controlled" Under the EAR?



Controlled Item = needs license to be exported

Controlled but subject to license exception

All items subject to EAR: Must follow EAR procedures for export documentation and recordkeeping.

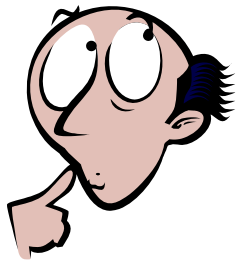
Items Not

Subject to EAR

- publicly available
- foreign origin with *de minimis* U.S. content

How Do I Know if My Technology is Controlled by the EAR?

- The first step is classification on the Commerce Control List ("CCL") which includes a number of different categories of "dual use" items, including technology.
- Technology used to create, design or manufacture a particular item is classified under the same CCL product category as the item itself.
- So, proper classification of the actual product is required to correctly classify the technology for that product.



What if I Am Not Sure of the Proper Classification of My Product?

- Exporters can request an official commodity classification from BIS
- BIS will review the product and determine the appropriate classification
- If BIS misclassifies the product, the exporter is not liable for any related export violations

End-user Controls/End-use Control

- U.S. economic sanctions and export control laws restrict or prohibit exports and re-exports to certain persons and entities based on one of two main reasons:
  - the activities of that person or entity (for example, chemical and biological weapons proliferation), or
  - that person or entity is subject to administrative or economic sanctions (for example, a person considered to be a terrorist organization)
- It is critical that exporters screen against the various lists of prohibited or restricted end users prior to exporting any goods, services or technology

Denied and Debarred Parties

- BIS maintains the Denied Persons List. These persons and entities are subject to Denial Orders, meaning that these parties are denied export privileges and may not receive or ship items subject to the EAR.
- DDTC maintains a similar list called the Debarred Parties List, which is a list of persons denied export privileges for items subject to the ITAR.

Penalties and Enforcement

Recently increased penalties for violations of the U.S. export control regulations:

- Maximum civil penalties raised from $50,000 to up to $250,000 per violation, or twice the amount of the violative transaction
- For each willful violation by a company or individual, a criminal fine of up to $1,000,000
- In addition, for each willful violation by an individual, imprisonment up to 20 years
- It shall be unlawful for a person to violate, attempt to violate, conspire to violate, or cause a violation of any license, order, regulation, or prohibition issued under the statute

II. The International Traffic in Arms Regulations

ITAR

- Covers Defense Articles, Defense Services and related Technical Data
- Defense Articles: "specifically designed, developed, configured, adapted or modified for a military application." These items are on the U.S. Munitions List ("USML")

USML

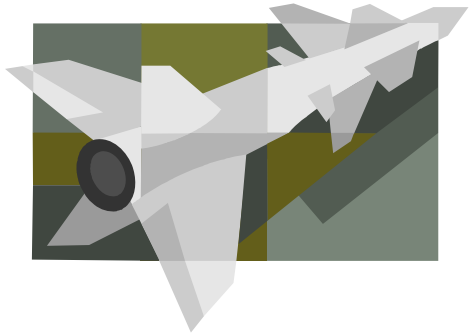
- 20 categories (from firearms and ammunition to tanks and stealth bombers)
  - includes parts, components, accessories, etc.
  - “specially designed or modified for military application”
- Significant Military Equipment
- Generally similar to other countries’ control lists, with the exception of civilian communications satellites
- Each category includes Technical Data that is used in connection with Defense Articles

Defense Articles (ITAR § 120.3)

- Article designated a defense article if it:
  - Is specifically designed, developed, configured, adapted or modified for a military application, and
    - does not have predominant civil applications, and
    - does not have performance equivalent (defined by form, fit and function) to those of an article used for civil applications; or
  - Is specifically designed, developed, configured, adapted or modified for a military application, and has significant military or intelligence applicability such that control under the ITAR is necessary

ITAR

- Potential Traps for Commercial Operations:
  - Adaptation/modification of a product for a defense end use
  - A U.S. person assisting defense end user to adapt/modify can provide a defense service
  - Use of a defense article for civilian purposes



Defense Articles: Some Key Points

- Intended use of the article after export is not relevant in determining whether an article is a defense article. The focus is on **design intent**, not **actual use**
- Foreign-made articles are defense articles if on the USML (although they are not necessarily subject to the ITAR)
- Modification of a catalog part could make an item ITAR controlled
- "**See through" rule: ITAR parts in non-ITAR item make non-ITAR item into ITAR-controlled item; also, if an item is made from ITAR- controlled technology abroad, it is subject to the ITAR**
- Commodity jurisdiction determinations are available to confirm if article is a defense article

Defense Services (ITAR § 120.9)

- Furnishing of assistance, including training, to foreign persons in the design, development, engineering, manufacture, production, assembly, testing, repair, maintenance, modification, operation, demilitarization, destruction, processing or use of defense articles
- Military training and advice
- ITAR-controlled technical data need not be transferred or exported for a service to be a defense service

Defense Services: Key Points

- Defense services covered by ITAR are those involving a U.S. person providing services to foreign person
- A defense service may be performed regardless of whether the underlying defense article is of U.S. or foreign origin, and may include assisting a foreign person to convert a commercial item into a defense article
- A defense service may be performed even when no technical data is involved (*e.g.*, all the information relied upon in furnishing defense services to a foreign government/person is in the public domain)

Potential Penalties for Violation of ITAR

- Civil penalties up to $500,000 per violation
- Debarment from ITAR activities, usually for up to three years
- Huge potential criminal penalties of $1 million and 10 years imprisonment for corporations and individuals if the DOJ pursues criminal charges
- Generally, DDTC will bring charges in cases where there is a very serious compromise to national security or pattern of no corporate commitment to compliance
- When DDTC brings charges, fines are typically in the millions and post-charging monitoring requirements are imposed

Technology Controls in the EAR and the ITAR

- In assessing the applicability of the EAR or the ITAR to technology-related activity, there are five questions to ask:
  - Technology: Does it fit the definition of "Technology" or "technical data"?
  - U.S.-origin: Is it U.S. technology or otherwise subject to the EAR or the ITAR?
  - "Exports" and "re-exports": Is an export, transshipment or re-export going to occur?
  - Is it controlled for export under the EAR or the ITAR to the destination, entity, person or end-use in question?
  - If controlled, what kinds of license/authorization is available/required?

1. Is it Technology?

- **The EAR definition is very broad: "Specific information necessary for the 'development,' 'production' or 'use' of a product."**
  - Development = "all stages prior to serial production, such as: design, design research, design analysis, design concepts, assembly and testing of prototypes, pilot production schemes, design data, process of transforming design data into a product, configuration design, integration design, layouts."
  - Production = "all production stages, such as: product engineering, manufacture, integration, assembly (mounting), inspection, testing, quality assurance."
  - Use = "operation, installation (including on-site installation), maintenance (checking), repair, overhaul and refurbishing."

1. Is it Technology?

- Under the EAR, technology may take the form of either technical assistance or technical data:
  - Technical assistance = “instruction, skills training, working knowledge, consulting services.”
  - Technical data = “blueprints, plans, diagrams, models, formulae, tables, engineering designs and specifications, manuals and instructions written or recorded on other media or devices such as disk, tape read-only memories.”
  - Technology includes not only information in a tangible form, but also “know-how” that is developed or acquired in the United States and applied through research and development, servicing, production and other activities.

1. Is it Technical Data Under the ITAR?

- Information which is required for the design, development, production, manufacture, assembly, operation, repair, testing, maintenance or modification of defense articles
- Includes information in the form of blueprints, drawings, photographs, plans, instructions and documentation
  - May include emails, faxes, and other documents that may appear less technical than specifications
  - Intangible information (verbally conveyed) can be technical data
- Does not include general scientific principles, information in the public domain (including fundamental research), or "basic marketing information on function or purpose or general system descriptions of defense articles."

2. Is it U.S.-Origin Technology?

- **U.S.-Origin technology is technology that is generated or developed in the United States, even if such activities are undertaken by non-U.S. persons**.
- Examples of how U.S.-origin technology can be created include:
  - any research and development activities in the United States
  - collaborative activities in the United States between U.S. persons and non-U.S. persons relating to technical issues
  - Technology that is generated or developed outside the United States is not U.S.-origin technology.
    - However, foreign-produced technology or items that contain or are commingled with U.S.-origin content are often subject to U.S. re-export controls
    - Commingled is a broad term that includes any mixing of U.S.-origin technology with non-U.S. origin technology
  - For example: Technology relating to production of chemicals that is developed in the United States is U.S.-origin, even if non-U.S. persons such as employees of a foreign company develop it
- **The U.S.-origin nature of technology is not affected by who owns the intellectual property rights.** If the technology is developed in the United States, then it is U.S.- origin technology, even if a non-U.S. company holds the IP rights.

3. Is an Export, Transshipment or Re-export Occurring?

- **Technology and technical data can be exported in several different ways under the EAR and the ITAR:**
  - Taking, sending or transmitting technology abroad from the United States
    - Transmitting via fax, mail, courier, or email to a foreign destination
    - Sending proprietary product or process information to a subsidiary in Argentina involves an export
    - Downloading abroad proprietary technical data located on server in the United States
  - Disclosing or releasing U.S.-origin technology to persons outside the United States
    - Disclosing or releasing includes verbal exchanges, visual inspection, meetings, and presentations
    - Meetings with a subsidiary or licensor outside of the United States may result in exports

3. Is an Export, Transshipment or Re-export Occurring?

- Applying knowledge gained in the United States (by a U.S. person or by a non-U.S. person) to situations abroad. For example:
  - Knowledge gained in the United States being applied abroad by a U.S. person to repair a facility located abroad
  - If a foreign person is trained in the United States, it can export U.S. technology by applying its training abroad
- Under the ITAR, performing a defense service on behalf of or for the benefit of a foreign person, whether in the United States or abroad, is an export

3. Is an Export, Transshipment or Re-export Occurring?

- **Technology can also be exported via a "Deemed Export"**
  - If technology (and source code) is disclosed or released in the United States to a person who is not a U.S. citizen or permanent resident (also called a "green card holder") then such an act is considered a "deemed" export to the home country of that person
- Technology and technical data are also "deemed" to be exported if released in the United States with the intent or reason to know it will be exported to a foreign country.
- DDTC is also of the view that merely providing access to a foreign person, without actual disclosure, is an export

3. Is an Export or re-export taking place?

- Deemed exports occur when they are made to a "Foreign Person" under the ITAR or a "Foreign National" under the EAR. These are:
  - An individual who is neither a U.S. citizen nor a permanent U.S. resident
    - Green card holder = U.S. person
    - H1B Visa = foreign person
  - Special rules apply to "dual nationals" and BIS and DDTC have different approaches

3. Is an Export, Transshipment or Re-export Occurring?

- **Examples of Deemed Exports:**
  - If a Chinese citizen is given a tour of a plant, visible technology or technical data will be deemed exported to China
  - Training of Indian nationals in Texas
  - If an employee provides a report containing U.S.-origin technology to a French citizen for review in the United States, the U.S.-origin technology in that report is deemed to be exported to France
- **Examples of Deemed Re-exports:**
  - A "re-export" is the transmission, release, or disclosure of U.S.-origin or commingled-U.S. and non-U.S. technology to, by, or from a non-U.S. person or location to a third-country person or destination. The same means of "exporting" technology described above apply to "re-exporting." For example, if a French national were to disclose U.S.-origin technology to an Iranian national during a meeting in France, a deemed re-export would occur.

4. Is the Export or Re-export of the Technology Controlled?

- **EAR Categories of Controls – Licenses may be required for several reasons:**
  - controls based on the classification of the item to be exported
    - If the item is listed on the EAR's CCL then it is a "dual-use" item and may require a license depending on the destination
  - controls based on end-use or end-user of the item
    - If an item is being exported to a problematic end-user (for example, chemical weapons factory, terrorist) or for a problematic end-use (for example, incorporation into a missile), it may require a license, even if it is not on the CCL
  - controls based on the destination of the item
    - Some countries are subject to strict controls or trade embargoes (Cuba, Iran, Sudan, or Syria)

4. Is the Export or Re-export of the Technology Controlled?

- Types of EAR authorizations:
  - License Exceptions
    - An item may be controlled, but a “license exception” may apply. These permit exports without a license in certain circumstances to certain types of end users or certain destinations.
  - Export or Re-export license
    - An authorization to export specific technology to specific end users abroad, subject to conditions and expiration
  - Deemed Export License
    - an authorization to disclose certain technology to U.S.-based foreign national employees
  - Site License
    - Permits the export of technology, including technical exchanges to occur on an on-going basis at one or more sites abroad.

For ITAR, Four Categories of Activities Requiring License or Approval

- Defense Articles (USML) (export and temporary import)
- Technical Data (export and temporary import)
- Defense Services
- Brokering Activities

★ Licenses are required for these activities for all destinations (Canada excepted in some circumstances), unless there is an applicable exemption

★ Licenses are denied for embargoed destinations (including China and Iran, among others)

ITAR Authorizations

- Export Exemptions – very limited
- DSP-5 – License for permanent export of defense articles. This is also used for Deemed exports to U.S. employees
- Technical Assistance Agreement – an agreement for the performance of a defense service or the disclosure of technical data. These can cover the assembly of defense articles also, as long as production rights or manufacturing know-how are not provided. If they are, they need a Manufacturing License Agreement
- DSP-73 – Temporary Export License
- DSP-61 – Temporary Import License

Enforcement Under the EAR and ITAR Related to Technology Exports

- A few trends
  - Higher penalties at BIS likely to lead to higher fines
  - At DDTC, likely to be high costs in terms of remedial compliance measures, monitors, and audits, sometimes even if no penalty is imposed
  - More active criminal enforcement at DOJ pursuant to Export Enforcement Initiative launched in 2007

Examples of Enforcement Under ITAR Related to Technology Exports

- **ITT Corporation, March 2007:** ITT agreed to pay a criminal fine of $100 million in connection with numerous violations of the ITAR, including unauthorized deemed exports of night vision technology to foreign national employees, some of whom were from proscribed countries.
- **General Motors Corporation/General Dynamics Corporation, November 2004**: $10 million civil settlement for unauthorized exports of technical data and defense services to foreign national employees from proscribed countries.

Examples of Enforcement Under the EAR Related to Technology Exports

- **Lattice Semiconductor Corp., April 2004**: Civil penalty of $560,000 to settle charges of unauthorized transfers of technology, including to Chinese national employees.
- **Suntek Microwave, January 2005**: Criminal and civil penalties totaling $614,000, including violations related to deemed exports to Chinese national employees. Included denial of export privileges and sentence for president

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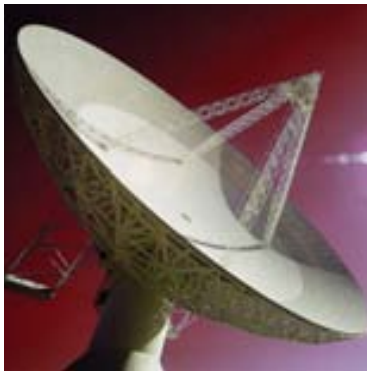
EXPORT CONTROL COMPLIANCE: TECHNOLOGY TRANSFERS AND DEEMED EXPORTS

Strategies for an Effective Global Compliance Program





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December 3, 2009

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Developing Controls

I. Requires a baseline understanding of your business and how it is conducted

II. Involves all operations, not only those who “export” or “reexport”

III. Requires multi-layered compliance efforts across the company

IV. Compliance programs should be constructed around the company’s “pressure points” -- both ingoing and outgoing

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Preliminary Issues

I. When identifying how you conduct business, the focus should include not only the activities conducted, but the technology used to conduct those activities, wherever located

II. Utilize existing resources and processes to build the export program:

a. Information Technology
b. Intellectual Property attorneys
c. Human Resources
d. Finance
e. General Counsel or Law Department personnel
f. Security
g. Program Management
h. Research & Development or Engineering

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Preliminary Issues

III. Retrieve the last 5 years of patent and other intellectual property developed, protected and/or used by the company

IV. Determine the way technology or technical data is used by the company:

a. Discussions
b. Collaborative efforts
c. University subcontracts or licensing
d. Meetings
e. Electronic Mail
f. Closed conferences
g. Facsimiles
h. Outsourced computer storage
i. Outsourced computer maintenance
j. Server locations

Preliminary Issues

V. Coordinate with R&D, Engineering or Product Development regarding technology and technical data used by the groups

VI. Collect all nondisclosure agreements executed by the company and/or its personnel (wherever located) concerning any technology or technical data developed, used or otherwise incorporated into company activities or products

VII. Conduct comprehensive classification analyses for technical data and/or technology:

a. self-classify
b. obtain Commodity Jurisdiction determinations from the Department of State
c. obtain Commerce classifications from the Department of Commerce

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Most Critical Issues When Developing a Program

I. Lengthy, complicated and process-oriented procedures are not the same as a workable compliance program

II. The key to successful compliance is simplicity, focus and details, where needed

III. Apart from standard compliance program elements (*i.e.,* compliance policy, management commitment as demonstrated through the allocation of resources and assignment of compliance personnel, and the establishment of written procedures governing the area for which compliance is sought), export compliance programs need to address high risk areas most comprehensively

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High Risk Compliance Areas

I. Misclassification

a. Biggest area of risk
b. Most difficult to address in a fast-moving development environment
c. Works like a “domino effect” – if the baseline classification is incorrect, every subsequent classification runs a greater risk if not certainty of being equally incorrect
d. Affects not only the technology or technical data itself, but the product to which it relates

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High Risk Compliance Areas

e. Creates corporate and individual liability:

i. Department of State cases:
   - A. Northrop Grumman Consent Agreement (2009)
   - B. Analytical Methods Consent Agreement (2009)
   - C. Boeing Company Consent Agreement (2008)
   - D. L-3/Goodrich Consent Agreement (2006)

ii. Department of Commerce cases:
   - A. In re Carol Wilkins Settlement Agreement (2009)
   - B. In re Falmouth Scientific, Inc. Settlement Agreement (2009)
   - C. In re MTS Settlement Agreement (2008)

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High Risk Compliance Areas

II. Areas to include in a compliance program when addressing export classifications

a. definitions of technical data
b. definitions of technology
c. definitions of “derivative” data
d. scope of intellectual property limits
e. jurisdiction where technology or data is developed
f. method in which data or technology is exchanged

III. Depending upon how development and product design, manufacture and assembly occurs, classification may be difficult to determine because of the variety of resources that “created” the technology or technical data

IV. Determine whether *de minimis* issues exist

V. Define where intellectual property protections will be first obtained and remain consistent, if possible

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Compliance Program Elements

I. Top-down policies with “teeth”

II. Effective, knowledgeable and competent resources who understand the company’s business

III. Processes or procedures:

a. Registration (if applicable)
b. Jurisdiction and/or classification
c. Licensing
d. Recordkeeping (with a cross-reference to the company’s standard policies)

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Compliance Program Elements

III. Processes or procedures:

e. Electronic Mail (with a cross-reference to the company's standard policies)

f. Servers (identify designated information resident on the servers and location)

g. Access authorizations and who may grant access (sign-off and justification processes, with limited or no exceptions)

h. Nondisclosure and/or confidentiality agreement processes, training and renewals

i. Media (portable media requires special policies to address licensing, limitations and identification of items permitted or not permitted on portable media)

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Compliance Program Elements

III. Processes or procedures

j. Handling Government contacts (*i.e.,* administrative visits by OEE/BIS; search warrants; subpoenas; seizures at airports by CBP under August 2009 Homeland Security Directive related to computer searches; directed disclosure inquiries)

k. Audits (*i.e.*, specific processes to audit not only technology licenses in the US, but those from overseas; should always require compliance audits, not just policies/procedures audits; should include external auditors who are competent in the substance and not the process)

l. Disclosures (when, how, by whom and to which agency under what circumstances)

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Tools

I. Effective Policies

II. Adequate and accurate classification

III. Robust NDA/Confidentiality agreements which include liability allocations and certifications

IV. Enforceable limits on outsourcing (*i.e.,* "it is considered a breach of contract subject to termination and related penalties should any aspect of the information provided as part of this agreement be forwarded to any foreign person, whether in the United States or abroad, without prior written approval of COMPANY and appropriate export authorization from the relevant US Government agency…")

V. Annual compliance certifications regarding individual/entity's standing under the export laws (US and/or foreign)

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QUESTIONS?