

COURSE 12, TUTORIAL 2

COMMODITY JURISDICTION REQUESTS AND EXPORT VIOLATIONS



Another very important piece of the puzzle is called **Commodity Jurisdiction Requests**. Sometimes when you review your product you're not sure if it's on the Munitions List. Perhaps the list is unclear, or you have a unique twist to your product, and you're not sure if it's covered - and you don't want to get this wrong. Well, the State Department has a procedure where if you submit a request to them and describe your product, they'll tell you if it's on the Munitions List or not. And, they'll tell you in writing – and it's legally binding. So this is a very valuable process if you're trying to sort out if your product is on the list or not, because now you have legal evidence of whether it's controlled.

HOW TO SUBMIT A COMMODITY JURISDICTION REQUEST

But let me give you a warning. When someone submits a Commodity Jurisdiction Request to the State Department, I recommend that you don't just describe your product and ask, "Is my product on the Munitions List?" You've got to go beyond this – you've got to present your case of why your product is not on the list. There's a number of legal standards that apply in determining if an item is on the munitions list or not. I recommend that you not only describe the product, but also provide the legal reasons as to why it should not be on the list. Also, you should provide evidence to support your assertion as to why this is outside of the legal standard on the Munitions List.

What you don't want to do is simply say, "Here's my product. This is what it does. Is it on the list?" – because some reviewers may simply say: "When in doubt, put it on the list." If there are legal reasons to support your case, you want to put that in your Commodity Jurisdiction Request. For companies that are

commercializing a Defense-related product, this is actually a very important step in the commercialization process.



DO YOUR HOMEWORK!!!

Let's say you develop a product, and now you're starting to sell it commercially. One of the first things your customers are going to ask is, "What is the export classification of the item?" That simply

means - *Is it ITAR-controlled or not – or, is it controlled under the Export Administration Regulations?* Potential customers are going to want to know what the export classification is.

If you say to them, “Well, I think it's not ITAR-controlled,” the customer will say “Well how do you know that?” If you say, “Well, I'm not quite sure, I kind of looked at the list...,” they'll get a little nervous. They'll back away, because they don't want to have to start addressing ITAR controls.

If on the other hand you say “No, this is not ITAR-controlled,” and they say, “Well how do you know that?”, and you say, “Here – here's the Commodity Jurisdiction Determination that we received from the State Department, showing that it's not ITAR-controlled.” Then they'll say, “Great, that's what we needed, now we can move ahead.” So, Commodity Jurisdiction Requests can be very valuable in the commercialization process.

REQUIREMENTS FOR PRODUCTS ON THE USML

So, what happens if your product is on the list? Up to now, we've been talking about whether the item is on the Munitions List or not. What are the requirements that apply if it's on the list? Let me start with some of the most important requirements. Number one, if your product is on the list, you are not allowed to export the product unless you obtain an export license from the State Department. This is for physical products – you can't export the product without obtaining an export license from State.

For software and technology that is on the list, you can't send or take that out of the United States without an export license, and

you can't disclose that to foreign nationals in the U.S. without an export license. Remember I said ITAR applies even in purely domestic activities – so companies are prohibited from disclosing ITAR-controlled technical data to foreign nationals even in purely domestic activities. And for taking it out of the U.S. – it is not necessary to take it out and disclose it to a foreign person. Simply carrying it with you overseas, such as in your laptop or your briefcase, is the export of the technical data, even if you don't show it to anyone.

For services, if you perform a service for a foreign party overseas related to a USML item, you need an export license. The export license for services is called the **Technical Assistance Agreement, or a TAA**. You may hear people say, “Do we need a TAA for this, or for that?” and that's the code word for a license for services. So if you're performing Defense services for parties overseas it requires a TAA. Also, performing services for foreign parties in the U.S. requires a TAA. If you perform that service for a foreign party in the U.S., that's regulated and requires a TAA.

An export license for a service is called a Technical Assistance Agreement or TAA

DEFENSE SERVICES FOR FOREIGN PARTIES IN THE U.S.

How do you perform a Defense service for a foreign party in the U.S.? Well, a phone call. Let's say you have a customer overseas, they just bought a very complex defense item from another U.S. firm. They're trying to integrate that item into their system and they call up your company and they want to hire your firm to consult with them on how to do this integration.



Methods of performing a defense service for a foreign party in the U.S.



You're sitting there, talking to them on the phone, you're Skyping to them, you're sitting in your office in Herndon, Virginia or Jacksonville, Florida, and they're over in Europe - that's the performance of a defense service.

Another example of performing Defense services in the U.S.: when a foreign naval vessel comes into a U.S. port such as Norfolk, Virginia - we have a big office in Norfolk, Virginia. Say the Taiwanese Navy, the Indian Navy - and those vessels get retrofitted and the U.S. ship contractors are working on those foreign naval vessels for the foreign naval organizations - that's a defense service regulated under ITAR, even though all of the work is performed in the United States. So, the controls on defense services are very broad.

Another important item is imports. If you're importing defense items in temporary import transactions this will require an import license under ITAR.

There's a number of other requirements that will apply - that are also very important. Probably the most important of these is **registration**. Companies that manufacture or export items on the Munitions List are required to register with the State Department. You may have heard of other companies that have registered - also your firm may be registered with State as well. Now, it's important to note here, registration is required not just for exporters. The regulations provide that companies that either manufacture or export, or perform defense services, are required to register. Registration is also required for importers and brokers. So if you are simply manufacturing ITAR-controlled items in the U.S., a purely domestic activity, you are still required to register. There's about 10,000 companies registered with the State Department under ITAR - under their last numbers that I've heard - and about two-thirds of these are registered as manufacturers and don't do any exporting at all. In many cases prime contractors on defense projects are requiring that their subcontractors and suppliers register under ITAR - to protect themselves from liability.

OTHER IMPORTANT REQUIREMENTS

Alright, there's a number of other requirements out there under ITAR. I'm not going to have time to go through all of these, but I want you to know a few of the most important ones.

Recordkeeping - this sounds sort of mundane but, if you're regulated under ITAR you're required to maintain records of your ITAR-related activity for a five year period. If you obtain an export

license under ITAR, the recordkeeping period is extended for the term of the license - so the recordkeeping period may be up to 9 years or longer in certain instances.

Also brokering - if you facilitate another company selling defense articles - and you are not the principal in the transaction, this is regulated under ITAR as well - including registration, obtaining authorizations, reporting and recordkeeping.

So the take-away here is: if you are involved in almost any part of the defense industry, you will most likely be subject to ITAR - manufacturing products, performing services as a Prime, or subcontractor, as a second or third tier supplier... and ITAR may apply even in some non-defense industries - energy, technology, technical services, etc. - So these should all be on your radar screen.

WHAT HAPPENS IF SOMETHING GOES WRONG

So - Important issue - What happens if something goes wrong? Let's say you have an ITAR violation. So, as we've heard, up to now, there are civil and criminal penalties for violations. Penalties can be up to \$1,000,000 financial fine, and 20 years imprisonment, per violation. Prosecutors and the State Department can go after the corporations, as well as after the officers and directors, and employees in their individual capacities.

Other penalties available to the government include debarment - you could lose the right to perform contracts for the government - the denial of export privileges and seizure and forfeiture of goods. These are often the most severe penalties, more severe than the financial penalties.

The largest export compliance penalty was the recent case involving ZTE - the Chinese company - \$1.1 billion combined civil and criminal penalties. So these are big numbers.

Another remedy available to the government is that they prepare a press release and put it on their website. The release provides details about the company and the violation. This can be very harmful to the company because now, anytime someone Googles your company's name, this press release comes up, and they learn about the violation. So now your employees will know, your shareholders will know, your competitors will know, your customers will know. It's another thing you don't want to have to deal with.

About a third of the export enforcement cases that are brought

There are stiff penalties for violations:

- » **Fines up to \$1,000,000 per violation**
- » **20 years imprisonment per violation**
- » **Directors, officers and employees may be liable**
- » **Debarment**
- » **Press releases so everyone will know**



by State, Commerce and the Justice are against large companies, about two thirds are mid-size or smaller companies. Why go after smaller companies? What's the big deal? Doesn't the government have enough to do to go after the big companies?

WHY BOTHER WITH SMALL BUSINESSES?

Well, they're interested in enforcement against mid-size and small companies for two reasons. Number one, some of the most valuable, sophisticated technologies for the defense sector are developed by smaller companies. The SBIR program is a good example of this. You are developing the next generation of sophisticated defense, technology and energy products - products that will be used for the next decade - so the government is very interested in protecting this information, even at the incipient development stage. So small companies are not overlooked. They're a high priority for protecting this information. The government also doesn't want small companies to think that they get a free pass. Everybody is subject to the rules. But if you're careful, and if you comply, then things will be under control. That's the key for dealing with this - be on top of the regulations, comply with them, and you will be OK.

The voluntary disclosure process can sometimes be very valuable

There's one other point about penalties. There's something called a voluntary disclosure - and this is very important to know about. Under a voluntary disclosure there's a procedure in ITAR that if a company thinks it has a violation and it reports that violation to the State Department on its own, the State Department has the right to reduce the penalty or impose no penalty at all.

This can sometimes be a very valuable process. If you discover a problem and self-report it to State, if the State Department is not already aware of the violation, they have the option of reducing the penalty or imposing no penalty. Usually when we submit voluntary disclosures for clients we explain why the violation occurred, the process that the company will put in place to remedy the problem and why the problem will never happen again. That's probably the most important part of the voluntary disclosure process - showing how you corrected the weakness in your procedures so the problem won't reoccur in the future. So, this can often be an excellent way of cleaning up past problems and moving forward.

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