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What Every Contract Manufacturer Needs to Know About Export Compliance

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Contents

Background	2
What Regulations?	2
CM Requirements Under ITAR	3
Responsibilities Summarized	5
About the Author	5

Background

Contract manufacturers (CM's) have become the de facto production division for many U.S. companies. The reasons for this continued trend include outsourcing non-core competencies (i.e. manufacturing), reducing supply chain costs, reducing capital expenditures, and building flexibility into production operations.

Relationships with CM's vary from distant and transactional (discreet PO-based) to more intimate extensions of a company's own operations (long-term relationship contracts). Regardless of the relationship with their customer, CM's need to know what their customers are doing with the products or assemblies that they manufacture.

The CM's customer who exports is required to comply with the U.S. Department of Commerce Export Administration Regulations (EAR) and the U.S. Department of State International Traffic in Arms Regulations (ITAR). The EAR has jurisdiction over 'dual use' items, that is, those items with both commercial and military applications, while ITAR has jurisdiction over defense articles. But what about the CM's export compliance requirements?

What Regulations?

CM's must first establish whether or not the assemblies or products they produce are under the jurisdiction of the ITAR or EAR. For this reason it is important that the CM have a good understanding of their customer's business. Receiving drawings stamped "ITAR Controlled" area sure bet that the products fall under ITAR jurisdiction. Are the assemblies used in defense, satellite or aerospace applications?

Are the items used in telecommunications or commercial applications? If so, what are the end articles produced and what are their end-uses. CM's will likely already know the answers to these questions which will help to determine the commodity jurisdiction.

ITAR Jurisdiction

Items under ITAR jurisdiction are defined on the U.S. Munitions List (USML) which can be found in CFR 22, Part 121. In addition to ammunition, missiles and explosives, this list includes military vessels, vehicles, aircraft, training equipment, protective personnel equipment, military electronics, optical and guidance control equipment.

It is imperative that the CM knows that the USML includes components, parts, accessories, attachments, and associated equipment specifically designed or modified for use with the equipment in each of the USML categories. Furthermore, ITAR Part 120.10 controls technical data which is required for the design, development, production, manufacture, assembly, operation, repair, testing, maintenance or modification of defense articles. This includes information in the form of blueprints, drawings, photographs, plans, instructions and documentation.

EAR Jurisdiction

Items under EAR jurisdiction can be found on the Commerce Control List (CCL) in CFR 15, Part 774. The CCL includes items (commodities,

software, and technology) subject to the authority of the U.S. Department of Commerce, Bureau of Industry and Security (BIS) and include 'dual use' items as well as purely commercial items. The CCL does not include those items exclusively controlled for export by another department or agency of the U.S. Government. In instances where other agencies administer controls over related items, entries in the CCL will contain a reference to these controls.

Jurisdiction Requests

If you are unsure of the export jurisdiction of an item or service, you should request a commodity jurisdiction (CJ) determination from the U.S. Department of State, Directorate of Defense Trade Controls (DDTC). A CJ request should be submitted to DDTC in the form of a letter and supporting documents.

Once the commodity jurisdiction is known, the CM can determine what their requirements are as a manufacturer and an exporter.

CM Requirements Under ITAR

ITAR 121.1 states that any person who engages in the U.S. in the business of either manufacturing or exporting defense articles is required to register with the DDTC. Registration is a means to provide the U.S. Government with necessary information on who is involved in certain manufacturing and exporting activities. Registration does not confer any export rights or privileges. It is generally a precondition to the issuance of any license or other approval. A person who is required to register may do so for a period up to 2 years upon submission of a completed Form DS-2032, transmittal letter, and payment of \$1,750 to the Department of State.

Registration with the DDTC confers additional responsibilities upon the CM including notifications of violations of U.S. criminal statutes, changes in senior management, foreign ownership and mergers or acquisitions. In addition, a person who is required to register must maintain records concerning the manufacture, acquisition and disposition of defense articles and technical data.

Exporting Under the ITAR

Part 120.17 defines an export as sending or taking a defense article out of the U.S. in any manner. It also includes disclosing (including oral or visual disclosure) or transferring technical data to a foreign person, whether in the United States or abroad. Foreign persons are defined as any natural person who is not a lawful permanent resident or who is not a protected individual as defined by 8 U.S.C. 1324b(a)(3). Foreign persons also include any foreign corporation, business association, partnership, trust or any other entity or group that is not incorporated or organized to do business in the United States. This means that technology transfers to a CM's employees on H1B Visas constitute an export and may require an export license from the Department of State.

The CM is required to obtain Department of State approval of license applications for the export of defense articles on the USML. The license application review process clarifies the ultimate end-use and end-user of the defense export, as

well as facts related to intermediate handling for the purpose of preventing and eliminating diversions to unauthorized parties. Companies must certify eligibility to export and understand the laws governing licensed exports. In addition, they must meet certain conditions in terms of documentation (electronic reporting of export information using the Automated Export System (AES)).

Once ITAR-controlled items have been exported, companies are required to perform end-use/end-user monitoring checks to prevent illegal technology transfers.

Exporting Under the EAR

Part 734.2 similarly defines an export as an actual shipment or transmission of items subject to the EAR out of the United States, or release of technology or software subject to the EAR to a foreign national in the U.S. As under the ITAR, the EAR may require a CM to obtain an export license for technology transfers to its employees on H1B Visas.

License requirements are dependent upon an item's technical characteristics, the destination, the end-user, and the end-use. The CM, as the exporter, must determine whether the export requires a license. When making that determination the CM must consider the item's Export Control Classification Number (ECCN) from the CCL list and cross reference it with the Commerce Country Chart (Supplement 1 to Part 738). The ECCNs and the Commerce Country Chart, taken together, define the items subject to export controls based solely on the technical parameters of the item and the country of ultimate destination.

Exports under the EAR also require the CM to understand who will receive the product

and what the intended end-use will be. Exports to embargoed or terrorist-supporting countries will almost always require a license. In addition, it is prohibited to export to certain individuals and organizations while others may require a license for export. Exporters should check the following lists prior to export: Entity List, Specially Designated Nationals and Blocked Persons List, Unverified List, and the Denied Persons List. These lists are available on the BIS website at: <http://www.bis.doc.gov/complianceand/enforcement/liststocheck.htm>. Lastly, export licenses are required for certain end uses and exports may be prohibited for entities involved in proliferation of weapons of mass destruction. As such, CM's are required to know their customers and their intended end uses.

Responsibilities Summarized

It is clear from the preceding information that CM's need to know a great deal about export compliance. To summarize:

Under ITAR Jurisdiction

- Registration with the Dept. of State, DDTC. This is required even if the CM does not export the controlled items.
- Notification of the DDTC of violations of criminal statutes, changes in senior management, changes in foreign ownership and mergers and acquisitions.
- Maintenance of records concerning the manufacture, acquisition and disposition of defense articles and technical data.

- Apply for licenses (or use appropriate exemption) for exports of items on the USML.
- Apply for licenses (or use appropriate exemption) for technology transfers of items on the USML to foreign persons or entities.

Under EAR Jurisdiction

- Apply for licenses (or use appropriate exemption) for exports of items on the CCL and Commerce Country Chart as required.
- Apply for licenses (or use appropriate exemption) for technology transfers to foreign persons or entities of items on the CCL and Commerce Country Chart as required.
- Check end-user against the government lists of prohibited parties / entities.
- Ensure that items are not intended for prohibited end-uses (i.e. WMD).

Failure to comply with these federal regulations can result in significant criminal penalties (possible prison sentences and fines) and civil action (e.g., fines and denial of export privileges).

About the Author

James Anzalone is the president of Compliance Assurance LLC, a firm specializing in global trade compliance solutions.

Mr. Anzalone has over 15 years of international management experience and holds a Master's Degree in International Business Administration from Nova Southeastern University and a B.S. Degree in Business Logistics from the Pennsylvania State University.