

**Before the Committee on Foreign Affairs
U.S. House of Representatives**

Hearing on

Advancing Export Control Reform: The Agenda Ahead

**Statement of
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Chairman Royce, Ranking Member Engel, and Members of the Committee, I am pleased to be here today to discuss the President's Export Control Reform (ECR) initiative. The Obama Administration is in the midst of the most comprehensive reform of our nation's export control system in history, which will significantly enhance the national security, foreign policy, and economic interests of the United States. It has taken unprecedented interagency cooperation, extensive consultations with the Congress, and voluminous inputs from the public to improve our Cold War-era system so it can address the threats and opportunities of today through secure export facilitation measures coupled with stronger compliance and enforcement safeguards to protect members of our armed forces and citizens from harm.

The Role of Export Control Reform in Safeguarding U.S. Interests

From the beginning, this Administration's ECR effort has been about national security. Such reform would serve to focus our controls and U.S. Government resources on those items and destinations of greatest concern. All of us on this panel know that there are countries and non-state actors that seek unauthorized access to our most sensitive military and dual-use items. Properly calibrated export controls and enforcement play a critical role in safeguarding U.S. national security interests while facilitating secure trade to legitimate end users.

The Commerce Department's Bureau of Industry and Security (BIS) plays a unique role in this process. We are the only U.S. Government agency with trained staff focused on both the administration and enforcement of U.S. export laws, including: educating the public about export

controls, performing engineering and regulatory analyses of controlled items for licensing purposes, and conducting enforcement analysis and investigations to bring violators to justice. These technical skills combine with the judgment of the Departments of Defense, Energy, and State to render decisions on licensing policy and applications for dual-use items -- and up until now, a handful of less sensitive munitions items. In addition, BIS's law enforcement assets augment those of the Department of Homeland Security and the Department of Justice to investigate and prosecute violators criminally and administratively, as well as further inform the Intelligence Community (IC) on both policy and enforcement activities.

ECR represents a paradigm shift in how the U.S. Government implements export controls. In the near term, that shift entails the transfer of tens of thousands of less sensitive munitions items to the Commerce Control List (CCL) to facilitate military interoperability with allies and partners as well as strengthen the competitiveness of the U.S. defense and space industrial base while taking advantage of interagency compliance and enforcement assets. The President's initiative will result in a more secure and innovative America.

Safeguarding U.S. Munitions List Items Moving to the Commerce Control List

The Department of Defense established the national security rationale that resulted in the identification of U.S. Munitions List (USML) defense articles that continue to warrant control on the International Traffic in Arms Regulations (ITAR). The majority of these items will be identified on a new "positive" USML, which establishes controls based on objective performance parameters that provide clarity to exporters, enforcement agents, and prosecutors to determine the proper jurisdiction of an item. Munitions and satellite-related items not meeting these USML control requirements will be transferred to the CCL, where they will be subject to tailored controls. These tailored controls will maintain ITAR-like restrictions on countries, like China, subject to U.S. arms embargoes, while providing export flexibility to facilitate interoperability among our allies and partners.

Transparent Regulations to Increase Compliance

Transparent regulations are fundamental to the President's secure trade facilitation and strengthened compliance and enforcement paradigm. Exporters need clarity, reliability, and predictability with regard to export control rules, all of which are improved through this reform effort. These reforms will create a clearer, more reliable and more predictable export control system by creating bright lines between agencies' jurisdictions thus ensuring that industry is able to easily self-classify their items; that the U.S. Government can more easily make jurisdictional determinations on items; and that prosecutors will have greater confidence in bringing forward cases based upon the clearer rules. In other words, secure trade will be facilitated, and malicious actors will be thwarted.

In addition to positive lists, our new definition of “specially designed” plays a significant role in enhancing predictability. Currently neither the ITAR nor the Export Administration Regulations (EAR) have objective, comprehensive definitions of the catch-all terms of art that are meant to control many defense articles or dual-use items. In the ITAR, the undefined term is “specifically designed.” In the EAR, the term is “specially designed” and is defined as *exclusive use* in one context and not defined in any other. The lack of a clear, common definition also undermines predictability. Engineers with the best of intentions can disagree over the meaning of these terms. This has led to many exporters either making their own decisions about what should be controlled, which can result in under-control, or U.S. Government officials disagreeing over whether something is controlled on one list or another, which can either result in the over-control of certain items, or worse, undermine enforceability.

The new, complementary definitions of “specially designed” in the ITAR and EAR address this flaw and provide objective criteria for exporters, licensing officers, and enforcement officials to determine whether an item is subject to control or eligible for decontrol (e.g., it is a specified item (screw, bolt, etc.), determined by State or Commerce not to be controlled, incorporated into an uncontrolled item in serial production). Such decisions require exporters to document their findings, thereby creating a paper trail for subsequent compliance and enforcement actions, if necessary. For example, in the case of development of an item, documentation about intended end use must be contemporaneously created, thereby eliminating the opportunity to make retroactive classifications after production to avoid control. This will make company and government decisions more predictable and government regulations more enforceable.

A “positive” list with defined terms also will assist U.S. Customs and Border Protection (CBP) in deciding whether to detain shipments. This will expedite legitimate exports and help prevent illegitimate ones.

Leveraging Interagency Resources to Enhance Monitoring and Enforcement

Leveraging interagency resources is critical to building higher fences. Commerce and State are working together on a joint outreach program, including web-based tools, to educate exporters on USML-CCL changes. To streamline licensing and avoid exporters having to receive authorization from two different agencies for transactions involving CCL items used in or with defense articles, the President signed Executive Order 13637 on March 8, 2013 delegating to the Secretary of State authority to license such CCL items. For those CCL items licensed by State pursuant to this Executive Order, the Department of Commerce will retain enforcement authority, which requires State and Commerce to coordinate on licensing and compliance issues. The new information technology system (i.e., USXPORTS) we are

developing with the Department of Defense, along with information sharing protocols Commerce and State are establishing, will increase U.S. Government efficiencies in this regard.

Commerce has hired 22 licensing and compliance officers dedicated to processing and monitoring munitions transactions subject to the CCL on its new “600 series” (items transferred from the USML). In addition, Commerce, working directly with the Intelligence Community, administers the Information Triage Unit, which compiles, coordinates and reports intelligence and other information about foreign transaction parties to license applications. This interagency center combines the analytical resources of Commerce, Defense, Energy, and the IC to produce products for all agencies involved in the review of, *inter alia*, EAR export licenses.

The leveraging of interagency resources is particularly important with regard to enforcement of 600 series and satellite-related exports. Dedicated Commerce criminal investigators and enforcement analysts will be added to the existing pool of resources investigating transactions suspected of violating and monitoring compliance with the EAR.

Commerce enforcement officials bring unique capabilities and authorities to investigate and monitor export activities. Our Export Enforcement Special Agents conduct criminal investigations and the Bureau of Industry and Security (BIS) can bring to bear unique administrative authorities – such as civil penalties, temporary and long-term denial orders, and Entity List and Unverified List designations – that can be more powerful than criminal sanctions by taking away a company’s ability to export or a foreign company’s ability to obtain U.S.-origin items. We have seen time after time that our Entity List drives front companies out of business and legitimate businesses to change their behavior to become responsible stewards of international trade. For example, in October 2012, BIS added to the Entity List the names of 165 companies and individuals involved in an illicit procurement network for Russian military and intelligence end users and end uses. We have received multiple requests for appeal, one of which has been granted to date, where the foreign intermediaries have agreed to change their business practices to comply with U.S. export control rules.

Additionally, we have seven Export Control Officers (ECOs) stationed in five embassies and one consulate abroad (China, Hong Kong, India, Russia, Singapore, and the United Arab Emirates (UAE)), with operational responsibility for 29 countries, dedicated to conducting on-site end-use checks. The President’s FY 2014 budget requests three additional ECOs. These assets are augmented by Special Agent-led Sentinel Teams and Foreign Commercial Service officials that conduct end-use checks worldwide. We will leverage these assets in coordination with those of the Blue Lantern program at the Department of State to increase the U.S. Government’s footprint of end-use checks where USML defense articles are co-located with CCL items. And where U.S.-origin satellite exports are concerned, Department of Defense

officials will continue to perform launch monitoring in the same manner as they do today, regardless of whether the satellite is subject to the ITAR or EAR.

The combined strength of Commerce, Homeland Security, and Justice forms the senior management team of the Export Enforcement Coordination Center, a multiagency organization housed in Homeland Security per Executive Order 13558 that includes eight departments and 15 agencies and the Intelligence Community. This organization coordinates the sharing of enforcement information and deconflicts enforcement activities to create investigative efficiencies. It also serves as a key conduit between the U.S. Intelligence community and Federal export enforcement agencies for the exchange of information related to potential U.S. export control violations. To date, 60% of E2C2 deconfliction requests identified another agency that may have relevant information related to the targets of the investigation.

We have had numerous recent successful criminal prosecutions, administrative sanctions, and extraditions under the International Emergency Economic Powers Act, or IEEPA, in enforcing the EAR. One example involves the export of microwave amplifiers to China. Fu-Tain Lu, owner and operator of Fushine Technology in Cupertino, California, facilitated the export of a microwave amplifier to Everjet Science and Technology Corporation in China, after being notified that the item required a license for export. The amplifier was restricted for export to China for national security reasons. On November 17, 2011, Lu pleaded guilty to violating IEEPA and on October 29, 2012, was sentenced to 15 months in federal prison, three years of supervised release, and a fine of \$5,000, as well as ordered to forfeit a seizure valued at \$136,000.

Another recent criminal conviction involves Jeng Shih, a U.S. citizen and owner of Sunrise Technologies and Trading Company of Queens, New York. From 2007 through 2010, Shih conspired with a company operating in the UAE to illegally export U.S.-origin computer equipment through the UAE to Iran. Shih and Sunrise caused the illegal export of over 700 units of computer-related goods to Iran via the UAE. On October 7, 2011, Shih and Sunrise pleaded guilty to conspiracy to violate the IEEPA and to defraud the United States. On February 17, 2012, Jeng Shih was sentenced to 18 months in prison, two years of supervised release, a shared forfeiture with Sunrise Technologies of \$1.25 million, and a \$200 special assessment. Sunrise Technologies was sentenced to two years of corporate probation, the shared forfeiture, and a \$200 special assessment. On October 11, 2011, pursuant to the global settlement, BIS issued Final Orders against Shih and Sunrise for a 10-year denial of export privileges (suspended) for their role in the illegal export of commodities to Iran.

In December 2012, as the result of a BIS investigation, the Chinese firm China Nuclear Industry Huaxing Construction Limited pled guilty to conspiracy to violate IEEPA and the EAR related to the illegal export of high-performance coatings through China to a nuclear reactor

under construction in Pakistan. This is believed to be the first time a Chinese corporate entity has pled guilty to export control violations in a U.S. court. On December 3, 2012, Huaxing was sentenced to the maximum criminal fine of \$2 million, \$1 million of which will be stayed pending successful completion of five years of corporate probation. In a related administrative settlement with BIS, Huaxing has agreed to pay another \$1 million and be subject to multiple third-party audits over the next five years to monitor its compliance with U.S. export laws.

In the case of Hing Shing Lau, the U.S. was able to successfully extradite a defendant from Canada on charges related to the export of thermal imaging cameras to China. Lau, a Hong Kong national, attempted to export twelve thermal imaging cameras from the United States to Hong Kong without first obtaining the required export licenses from the Department of Commerce. When Lau arrived in Canada to complete the transaction on June 3, 2009, he was apprehended by Canadian law enforcement authorities pursuant to a U.S. arrest warrant. Lau was extradited to the United States in October 2010. Lau entered a plea agreement and was sentenced to 10 months' imprisonment in May 2012.

These actions demonstrate the effectiveness of Export Enforcement at BIS in aggressively pursuing investigations under IEEPA and the EAR to prevent unauthorized export transactions, and are a harbinger for the enforcement posture that the Administration will apply with regard to 600 series and satellite-related items that move from the USML to the CCL as part of the President's ECR initiative.

Complementary Controls between the ITAR and EAR

The Administration is ensuring that the United States maintains fidelity with its commitments under the international export control regimes. No munitions or satellite-related items transitioning to the CCL will be decontrolled unless explicitly determined by the Departments of Defense and State, consistent with such commitments and national security.

CCL controls on munitions and satellite-related items transitioned from the USML will complement ITAR controls with regard to most exports and reexports. Unless these items are destined for one of 36 allied and partner governments as authorized under License Exception Strategic Trade Authorization (STA) or have been expressly identified as less significant, all such exports will require a license and be subject to an ITAR-like licensing policy. All munitions and satellite-related exports destined for countries subject to a U.S. arms embargo, including China, will be subject to a licensing policy of denial and a zero percent *de minimis* rule. Other munitions and satellite-related exports will be subject to a 25 percent *de minimis* rule to avoid the "design-out" of U.S.-origin products, which is an unintended consequence of the ITAR. Enforcement to prevent the unauthorized reexport of these CCL items will remain the

same as it is today under the ITAR with the added benefit that Commerce enforcement resources will be available to monitor and investigate possible violations.

As noted above, a significant difference between the ITAR and EAR will be the application of License Exception STA to and among allied and partner destinations for certain 600 series and satellite-related exports and reexports. Prior to export and all subsequent reexports of any STA-eligible transaction, the exporter must notify its customer of the CCL classification of an item and receive a written certification that the customer will comply with the EAR and maintain associated records. For 600 series items, new strengthened safeguards will limit the availability of STA to ultimate government end use in one of the 36 countries, require all foreign parties to have been previously approved on a Commerce or State license, and require all foreign parties to agree to an end-use check. As has always been the case for items subject to the EAR, government end users of 600 series items, including STA members, will be subject to Commerce's end-use check program.

There is no requirement that exporters avail themselves of STA. We believe its impact will be measurable, though, in terms of facilitating interoperability with allies and strengthening the U.S. defense and space industrial base by reducing current incentives for foreign manufacturers to "design out" controlled U.S.-origin parts. In fact, we conservatively estimate that 50 percent of the 40,000 ITAR licenses associated with items moving to the CCL could be eliminated under STA, with no diminution of national security due to the strengthened safeguards discussed above.

Even the least significant munitions items on the CCL will continue to be controlled to China, Cuba, Iran, North Korea, Sudan, and Syria. And new Automated Export System validations will enable, *inter alia*, Commerce and DHS officials to target these exports, as well as those subject to STA.

Entry-into-Force of Changes

Notwithstanding the positive impact that these changes will have for exporters and the U.S. Government, the Administration recognized early on that changes of this proportion require a phase-in period for companies to adjust their internal compliance and information technology systems. Accordingly, changes of jurisdiction are taking place 180 days after the publication of State and Commerce final rules covering a specific USML category of items; the first two of which, involving military aircraft and gas turbine engines, were published on April 16. While companies are free to submit license applications to Commerce during this interim period, EAR authorizations will not take effect until the 180 days has elapsed.

Even after this 180-day period expires, generally, persons holding a valid ITAR license may export under that license for up to two years. This is in addition to exporters being able to take advantage of the State Department's delegation of authority for licensing CCL items used in or with a USML item. Subsequent categories, or groups of categories, will be published in final form on a rolling basis in the same manner. These rules provide exporters with sufficient time and flexibility to adjust to the changes and take advantage of the most advantageous export authorization permitted under the ITAR or EAR.

The Role of the Congress in Export Controls

The President's ECR initiative creates regulatory transparency and clarity, facilitates exports to our allies and partners, strengthens the U.S. defense and space industrial base, and enhances the enforcement posture of the U.S. Government to ensure strengthened safeguards for the items that matter most. While all of these changes can be made in accordance with the consultation provisions of Section 38(f) of the Arms Export Control Act, there are a number of authorizations that Congress could enact in the short-term to enhance the effectiveness of the U.S. export control system. Of course, when we move beyond rewriting the lists to merging them into one, legislation will be necessary to establish a single list as well as a single licensing agency and a primary enforcement coordination agency, the three final pieces of the fundamental reform envisioned by this initiative. We are committed to working closely with Congress when we approach this phase of the initiative.

In 2010, Congress granted BIS with permanent law enforcement authorities as part of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA). However, BIS's authorization for non-enforcement-related EAR activities under section 109(d) of CISADA expires in 2013. We believe this authorization, in addition to the confidentiality protections of Section 12(c) of the Export Administration Act, should be made permanent.

Commerce has made clear that additional resources would increase operational efficiencies and activities. The President's Fiscal Year 2014 budget requests \$8.291 million for additional resources to augment BIS enforcement capabilities. These include additional analysts, Special Agents, and three new Export Control Officers, two of which would be dedicated to conducting end-use checks in STA-eligible countries, with the third expanding our regional footprint in the Middle East.

Thank you for the opportunity to testify on this important topic. I would be pleased to answer any questions you may have.

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