TED MACVEAGH

Ted MacVeagh is an associate at Bromberg & Sunstein and specializes in business law. Ted devotes a significant portion of his practice advising start-up and pre-IPO technology companies. His work for start-ups includes advising on issues relating to the formation, structure and financing as well as setting up contractual relationships with key employees, customers and vendors. Ted also performs export control work for technology companies.

Ted has aided numerous early-stage companies in meeting their funding needs. He worked closely with the founders of a high-profile web-strategy consulting company in its formation and in closing a first-round of venture capital financing. He has also represented a rapidly-growing software company in conducting a private placement which raised over a million dollars. And he has represented a medical information software firm in closing on its third round of venture capital financing, a round that involved a group of over thirty investors.

Ted has also represented both buyers and sellers in significant M&A transactions. Representative clients include a major physician management organization for which he organized the acquisition of several physician practices; a Massachusetts-based company which purchased a controlling interest in a corporation that specialized in wafer polishing; and an international services company participating in a national roll-up of similar companies.

Ted has helped a number of companies develop licensing programs and forms. His clients in this area have included the U.S. subsidiary of a global IT consulting company, for which he acted as the main legal resource for a national sales force; a company with significant business-method patents on investment risk management techniques; and a not-for-profit company that has developed ground-breaking education and testing materials for grammar and high schools.

Ted's export work includes developing an export compliance program for a publicly-traded software company and advising start-up companies regarding technology used for military training purposes.

Ted graduated from Wesleyan University with a degree in Philosophy. He received a masters degree in Philosophy from University of Pennsylvania. He received his law degree from the University of Michigan where he was summa cum laude and a member of the Michigan Law Review. Prior to joining Bromberg & Sunstein, he practiced law for Cleary, Gottlieb, Steen & Hamilton in New York. He is licensed to practice in New York and Massachusetts.

Export Control Law

July 17, 2003

Presentation to
Franklin Pierce Law Center
Twelfth Annual
Advanced Licensing Institute

by
Theodore E. MacVeagh

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What is Export Control Law

Export control law is the body of law that controls the transfer of goods which may have military uses to certain non-U.S. persons and entities. These controls are based on shifting national security and foreign policy interests

Export control laws also control:

- Certain activities of U.S. persons and entities outside of the United States (e.g. activities relating to proliferation)
- Certain activities of foreign persons within the United States
- Certain transfers within the United States to foreign nationals
- Certain transfers within the United States to U.S. persons (!)

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Relation of Export Control Law to Licensing

- Export controls are imposed on technology (and raw materials used with the technology)
- Export control law is (potentially) relevant to every technology transfer
- Patent and software licenses generally contain a clause such as:
  - The Licensee shall not export, re-export or use the Materials or any copy thereof in violation of the export control laws of the United States of America
- The clause becomes more than boilerplate if the technology is exported or intended for use outside the United States
- The items controlled by the Department of Commerce include an array of items which are not obviously military in nature as well as objects that are used broadly in civilian contexts
- Every technology company should be aware of controls relating to high performance computers, encryption software and deemed exports

Convincing Clients to Care

The cost of compliance with U.S. export laws can by high and clients may not perceive the value

It is very important for your clients to buy-in to any compliance efforts

Consider these points:

- Important transactions can be held up if export status of technology is not clear
- Penalties for failure to comply can be severe, including fines, loss of export rights, blacklisting, and criminal penalties
- More aggressive enforcement is likely in the current climate
- Headlines regarding a violation of U.S. Export law are a public relations nightmare
- Patriotism: certain exports may cause material damage to U.S. interests

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Current Status of Export Control Law

- Pre 9/11 Conventional Wisdom: Outdated cold war laws prohibiting efficient global commerce, and desperately in need of reform
- Post 9/11 Conventional Wisdom: Vital first line in the protection of our national security interests, and desperately in need of reform

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Some Historical Perspective

1775 - Continental Congress outlaws export of goods to Great Britain, establishing first American export controls

1949 - U.S. and 6 Western European nations create the Coordinating Committee for Multinational Export Controls (CoCOM) to prevent the transfer of militarily useful technology to communist countries - NOTE MULTILATERAL ORIGINS

1949 - U.S. passes the Export Control Act (ECA) giving the Dept of Commerce primary responsibility for enforcing controls on "dual-use" items

1970 - The ECA lapses and the Export Administration Act (EAA) took effect

1994 - The EAA lapses; Dept. of Commerce continues to act under Executive Orders (invoking authority under International Emergency Powers Act)

1995 - U.S. and 27 nations (including former communist block countries) establish the Wassenar Arrangement as a successor to CoCOM to control the spread of dangerous military technology - CURRENT MULTILATERAL FRAMEWORK

1996 - Interim rule published in the Federal register simplifies the Export Administration Regulations (EAR), the first comprehensive rewrite in 40 years

2002 - The EAA is in the process of being rewritten

Some Policy Issues

1. Despite recent efforts to change, policies are still shaped by a cold war that is not relevant to today's foreign policy concerns
2. Distinctions between military and civilian technology have been blurred
   - Recent engagements (Iraq, Kosovo, Afghanistan) show value of technologies for sensors, geo-spatial location, signal processing and telecommunications over conventional military power
3. Value of export controls to national security v. drag on U.S. economic interests
   - If products are available outside U.S., U.S. loses market share with no appreciable gain in security
   - If regulations fail to keep up with technology, U.S. loses market share with no appreciable gain in security
4. Rationalization of controls is necessary. Divided regime makes compliance difficult
5. Value of the multilateral structure of controls

Divided Authority of Current Export Control Regime

1. Department of Treasury - Office of Foreign Assets Control (OFAC)
2. Department of State - Office of Defense Trade Controls (ODTC)
3. Department of Commerce - Bureau of Industry and Security (BIS) (previously known as the Bureau of Export Administration (BXA))
4. Other relevant agencies: Defense Department; Intelligence Agencies; Energy Department; NRC; DEA; FDA; PTO; Department of the Interior

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OFAC Responsibilities

There is no single authorizing statute for OFAC. Much of its work is authorized under the International Emergency Economic Powers Act § 1701-1706

There is no single set of OFAC regulations. Rather they are contained in several parts in Title 31 of the C.F.R. (starting with Part 500)

OFAC administers and enforces economic sanctions programs against countries persons and entities subject to U.S. and U.N. embargoes. These include:

- financial sanctions, including investment bans and asset freezes
- export and import embargoes (sometimes including travel and transportation bans and bans on other commercial activity)

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OFAC Responsibilities

Sanctions are administered against the following countries, entities and individuals:

- Balkans, Burma, Cuba, Iran, Iraq, Liberia, Libya, North Korea, Sierra Leone, Sudan, Yugoslavia
- Taliban, UNITA and its nationals (embargo against Syria is administered by BIS)
- Specially Designated Nationals (SDNs) which act as fronts for sanctioned governments
- Specially Designated Terrorists
- Specially Designated Narcotic Traffickers

OFAC Responsibilities

- OFAC's regulations are complex and ever-changing
- Since September 11, there have been multiple changes to the list of Blocked Persons and a huge increase in the pressure to comply with regulations
- OFAC penalties are high, up to $1,000,000 fines and 12 year jail terms
- Banks in particular are under pressure and have been struggling to comply with OFAC regulations designed to stop the flow of funds from or to Blocked Persons
- It is vital banks have a compliance in place to identify and stop transactions with Blocked Persons or using assets that have been frozen pursuant to OFAC regulations

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ODTC Responsibilities

- The ODTC has jurisdiction over the export of "Defense Articles" and "Defense Services"
- Controls are contained in the International Traffic in Arms Regulations (ITAR) - 22 C.F.R. § 120 - 130
- ITAR is promulgated under the Arms Export Control Act § 2778 - 2994
- "Defense Articles" are those products included on the U.S. Munitions List (USML) - 22 C.F.R. § 122
- "Defense Services" are military training services or services relating to the design, development, production, maintenance, processing of use of defense articles

ODTC Responsibilities

In addition to overseeing exports of items off the USML, the ODTC has responsibility for the following:

- Maintaining the USML (adding and subtracting items)
- The registration of persons engaged in manufacturing or exporting defense articles
- Licensing temporary imports of defense articles (permanent imports of such articles are under the jurisdiction of the Treasury Department's Bureau of Alcohol, Tobacco and Firearms)
- Regulating the brokering of transactions involving defense articles or services, whatever the location or origin by a U.S. person
- Governing "deemed exports" of defense articles and services

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Defense Articles

Unlike the CCL (discussed below), the USML does not include detailed technical parameters

An article may be designated on the USML if the article:

- (a) is specifically designed, developed, configured, adapted, or modified for a military application (ii) does not have predominant civil applications and (iii) does not have equivalent performance to an item or service used for civil applications; or
- (b) is specifically designed, developed, configured, adapted, or modified for a military application, and has a significant military or intelligence applicability such that control by the State Department is necessary. 22 C.F.R. 120.3

ITAR defines "defense article" to include "technical data" which includes software "directly related to" defense articles (unlike the BIS regulations, which treat technology and software differently)

Commodity Jurisdiction Requests

Because of the broad categorizations used by the USML, it is not always possible to tell whether a particular product would qualify as on the USML or not. One entry reads:

> (a) military training equipment including but not limited to . . . operational flight trainers . . . and simulation devices related to defense articles.
>
> (b) Components, parts, accessories, attachments, and associated equipment specifically designed or modified for the articles in paragraph (a) of this category.
>
> (c) Technical Data . . . directly related to the defense articles enumerated [above].

If you are selling electronics or software to the military for use in military flight schools, your products may fall on the USML

In order to determine whether an item or service is on the USML you can file a Commodity Jurisdiction (CJ) Request with the ODTC. If you file a Classification Request with BIS for an item predominantly sold to the military, the BIS may require that you file a CJ Request before they will rule on its classification

In reviewing CJ Requests, the ODTC pays particular attention to the origin of an item (military or not), its current use (whether it also has civilian applications) and any characteristics specially related to the use of the item by the military

BIS (BXA) Responsibilities

BIS has jurisdiction over the export and reexport of "dual use" items - items that may have both military and non-military uses

Controls are contained in the Export Administration Regulations (EAR) - 15 C.F.R. § 730-774

BIS is authorized to promulgate and administer the EAR under Executive Order; a successor to the EAA is in the process of being drafted

BIS also regulates:

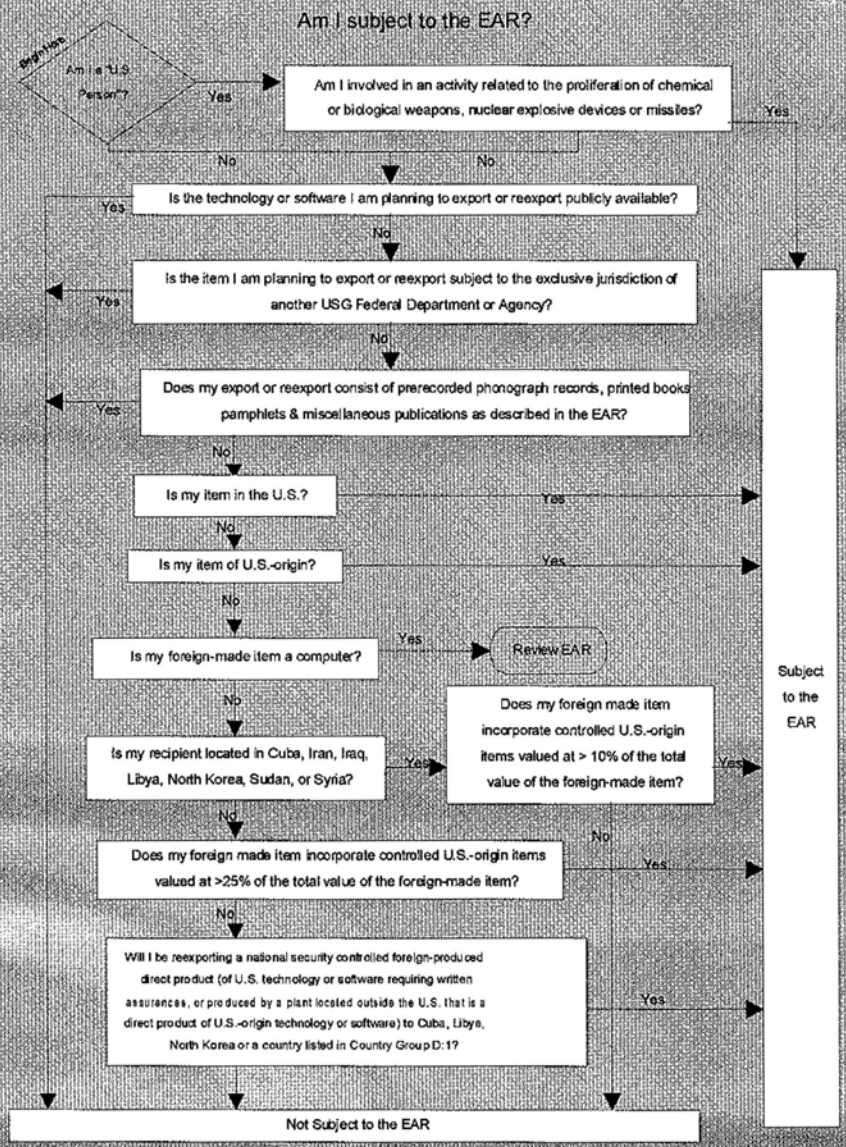
- activities of U.S. persons relating to spread of ABC weapons or missile technology
- release of certain items of technology to foreign nationals within the United States (deemed exports)
- sales of certain foreign-made items made with or incorporating U.S. technology
- transmission of data and software electronically (e.g., via posting on web site without restrictions on access)

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Using the EAR - "Subject to the EAR"

KEY CONCEPT: Is an export or activity "subject to the EAR"? See chart at 15 C.F.R. § 732 (Supplement 2)

- Is the export or activity related to the proliferation of ABC weapons or missile tech?
- Is the item publicly available?
- Does another agency have jurisdiction?
- Is the item in the U.S.?
- Is the item of U.S. origin?
- Does item have certain U.S. content or is it the direct product of certain U.S. technology?



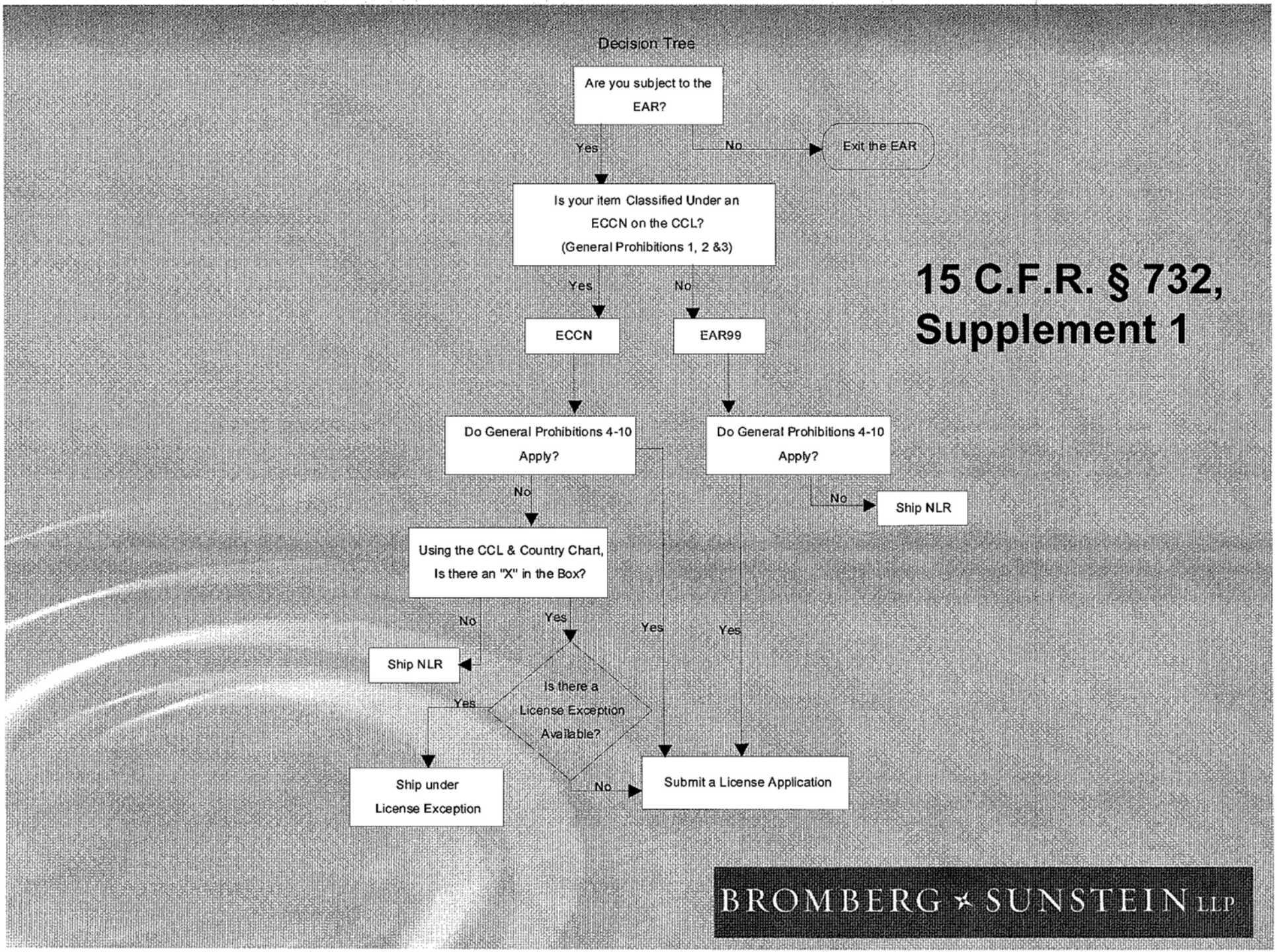
15 C.F.R. § 732, Supplement 2

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Using the EAR - Is a License Required?

If an export is subject to the EAR, is a license required?

- Is the item classified under an ECCN on the CCL?
- Does a General Prohibition apply?
- Is there an "X" across from the proposed destination of the export in the Country Chart?
- Does a license exception apply?
- Use the EAR Decision Tree at 15 C.F.R. § 732 (Supplement 1)


Decision Tree
Are you subject to the EAR?
Yes
No
Exit the EAR
Is your item Classified Under an ECCN on the CCL? (General Prohibitions 1, 2 &3)
Yes
No
ECCN
EAR99
Do General Prohibitions 4-10 Apply?
Do General Prohibitions 4-10 Apply?
No
No
Ship NLR
Using the CCL & Country Chart, Is there an "X" in the Box?
No
Yes
Yes
Yes
Ship NLR
Is there a License Exception Available?
Yes
Ship under License Exception
No
Submit a License Application
15 C.F.R. § 732, Supplement 1
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Using the EAR - General Prohibitions

15 C.F.R. § 736 lists 10 General Prohibitions relating to the export of goods

General Prohibitions 1-3 relate to the Commerce Control List and depend upon the nature of the product being transferred

General Prohibitions 4-10 focus on preventing proliferation of missile technology and nuclear, chemical and biological weapons and apply to the transfer to end-users or end-uses related to proliferation without regard to the nature of the products

- Prohibition 4 prohibits transfers to persons on BIS's "Denied Person List"
- Prohibition 5 prohibits transfers where the exporter "knows" of a specific link to proliferation activity. "Knowledge" includes a conscious disregard of the likelihood of a violation as well as positive knowledge
- Obligations require companies to use and follow BIS's "Know Your Customer" guidance and be alert for "Red Flags" (Appendix A)

Using the EAR - CCL and ECCNs

If an export is subject to EAR, you must determine whether the item to be exported classified on the Commerce Control List (CCL) - 15 C.F.R. § 774

- If not, a license is required only if one of the General Prohibitions apply
- CCL is "parametric" - a millimeter can make a difference

The Export Control Classification Number (ECCN) of the item will depend on its classification. The CCL will indicate the reasons for controls on a particular ECCN. These reasons include:

- Chemical/Biological Weapons
- Nuclear Nonproliferation 1/2
- National Security 1/2
- Missile Technology 1
- XP (for High Performance Computers)
- Regional Stability 1/2
- Firearms Convention 1
- Crime Control 1/2/3
- Anti-terrorism 1/2

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Using the EAR - Commerce Control List

The CCL has ten broad categories:

- 0. Nuclear Materials, Facilities & Equipment
- 1. Materials, Chemicals, Microorganisms & Toxins
- 2 Materials Processing
- 3. Electronics Design, Development and Production
- 4. Computers
- 5. Telecommunications Systems, Equipment and Components
- 6. Sensors and Lasers
- 7. Navigation and Avionics
- 8. Marine
- 9. Propulsion Systems, Space Vehicles and Related Equipment

Each category is divided into 5 subcategories:

- A. Systems, Equipment and Components
- B. Test, Inspection and Production Equipment
- C. Materials
- D. Software
- E. Technology

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Using the EAR - ECCN 4A002

4A002 "Hybrid computers" and "electronic assemblies" and specially designed components therefor.
License Requirements

Reason for Control: NS, MT, AT, NP, XP

Control(s)	*Country Chart*
NS applies to entire entry	NS Column 2
MT applies to hybrid computers combined with specially designed "software", for modeling, simulation, or design integration of complete rocket systems and unmanned air vehicle systems that are usable in systems controlled for MT reasons	MT Column 1
AT applies to entire entry	AT Column 1

NP applies, unless a License Exception is available. See §742.3(b) of the EAR for information on applicable licensing review policies.

XP applies to hybrid computers with a CTP greater than 28,000 MTOPS, unless a License Exception is available. XP controls vary according to destination and end-user and end-use; however, XP does not apply to Canada. See §742.12 of the EAR for additional information.

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Using the EAR - ECCN 4A002

License Exceptions

LVS: $5000; N/A for MT
GBS: N/A
CIV: N/A

List of Items Controlled

Unit: Equipment in number; parts and accessories in $ value
Related Controls: See also 4A102 and 4A994
Related Definitions: N/A
Items:

a. Containing "digital computers" controlled by 4A003;
b. Containing analog-to-digital converters having all of the following characteristics:
   b.1. 32 channels or more; *and*
   b.2. A resolution of 14 bits (plus sign bit) or more with a conversion rate of 200,000 conversions/s or more.

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Using the EAR - Commodity Classification Requests

If there is any doubt about how a product should be classified, you should submit a Commodity Classification Request to the BIS.

Why is this necessary:

- CCL may be difficult to interpret; often the standards it uses are not familiar to engineers
- BIS may interpret CCL differently than is apparent from the written text based upon policy decisions
- Classification Requests are fairly easy to prepare and submit

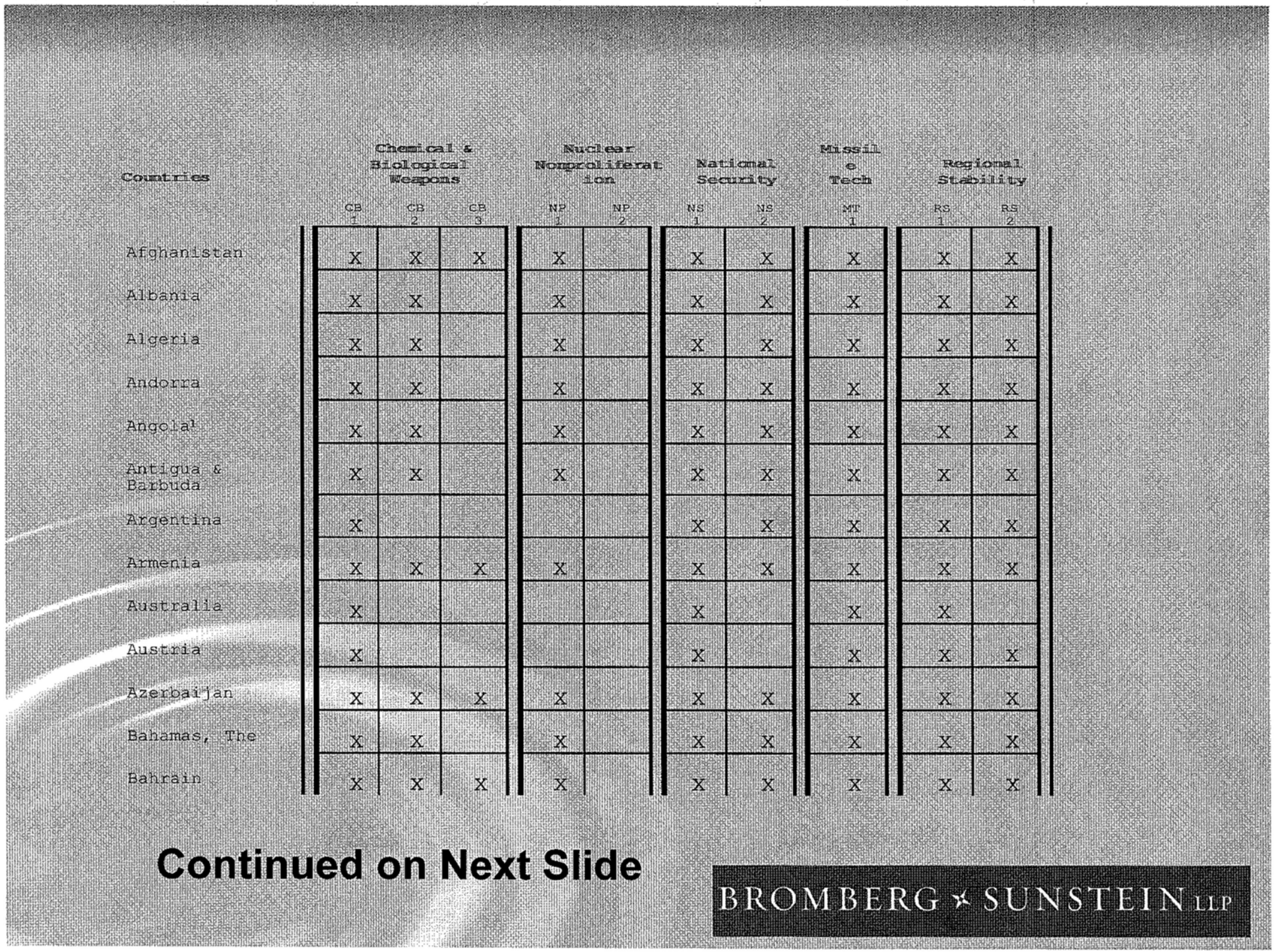
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Using the EAR - Country Chart

Is the item's ECCN controlled to the particular country to which you are proposing to export it?

- Review the Country Chart at 15 C.F.R. § 738
- Is there an X across from the country to which you want to export under the reason for control identified under the ECCN under which your product falls?
- If not, no license is required
- If so, a license is required

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Countries
Chemical & Biological Weapons
Nuclear Nonproliferation
National Security
Missile Tech
Regional Stability
CB 1
CB 2
CB 3
NP 1
NP 2
NS 1
NS 2
MT 1
RS 1
RS 2
Afghanistan
Albania
Algeria
Andorra
Angola[1]
Antigua & Barbuda
Argentina
Armenia
Australia
Austria
Azerbaijan
Bahamas, The
Bahrain
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Guyana	X	X		X		X	X	X	X	X
Haiti	X	X		X		X	X	X	X	X
Honduras	X	X		X		X	X	X	X	X
! Hong Kong	X	X		X		X		X	X	X
! Hungary	X					X	X	X	X	
Iceland	X			X		X	X	X	X	
India	X	X	X	X	X	X	X	X	X	X
Indonesia	X	X		X		X	X	X	X	X
Iran	See part 746 of the EAR to determine whether a license is required in order to export or reexport to this destination.									
Iraq[1]	See part 746 of the EAR to determine whether a license is required in order to export or reexport to this destination.									
Ireland	X					X		X	X	X
Israel	X	X	X	X	X	X	X	X	X	X
Italy	X					X		X	X	

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Using the EAR - License Exceptions

License exceptions are detailed at 15 C.F.R. § 740. In order to qualify for an exception, an export must meet the specific criteria required therefor. Important exceptions include:

- LSV - Shipments of Limited Value
- CIV - Civil End-Users
- TSR - Technology and Software Under Restriction
- CTP - Computers
- TMP - Temporary Imports, Exports, and Reexports
- TSU - Technology and Software - Unrestricted
- ENC - License Exceptions

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Using the EAR - License Exceptions

Consider the TSR License Exception. This exception permits "exports and reexports of technology and software controlled to the ultimate destination for national security reasons and identified by 'TSR - Yes' in entries on the CCL" provided:

- that the software or technology is destined for countries in Group B;
- a written assurance is received from the consignee that neither the technology/software or products of the technology or software will be delivered to certain countries in Group D1 and Group E; and
- certain reporting requirements are met

Exports of Non-Encryption Software

Exports of software are governed like any other product by the CCL

However, there is an important exception for "mass market" software (other than encryption software)

Software qualifies as "mass market" if it is generally available to the public by being:

- sold from stock at retail selling points, without restriction, by means of: (1) over the counter transactions; (2) mail order transactions; or (3) telephone call transactions; AND
- designed for installation by the user without further substantial support by the supplier

Non-Encryption mass market software can be exported without a license under license exception TSU to any destination except the T-7 (Cuba, Iran, Iraq, Libya, North Korea, the Sudan, Syria)

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Exports of High Performance Computers (HPCs) - CTP License Exception

For a long time the issue of the export of HPCs was a source of tension between regulators and industry

- Regulations were always outmoded; lagged behind industry
- In 1992, 1/3 of computer industry's overseas sales were subject to license review; in 1993, a computer with a performance of 12.5 million theoretical operations per second (MTOPS), equivalent of an Intel 486 chip, needed a license; manufacturers were preparing to mass produce computers with performance at 200 MTOPS (using Intel Pentium chips and DEC's Alpha AXP chip)
- Mass-produced HPC technology was uncontrollable
- U.S. industry was being harmed; losing market share and encouraging the development of a non-U.S.-based competitors
- U.S. defense requires HPCs and would be harmed if the U.S. HPC industry ceased to be a world leader
- Control of HPCs used to be justified because of use of HPCs in nuclear weapon design. If computer speed is no longer a critical choke point for nuclear weapon design, what is the justification for control?
- Issues resolved by the creation of License Exception CTP and a commitment to revisit the policy on a regular basis

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CTP License Exception Chart from BIS Web Page - http://www.bxa.doc.gov/HPCs/ctpchart.htm

Computer Tier	End-User	CTP greater than	CTP less than or equal to
1[4]	All[2]	28,000[1]	No Limit
2	Reserved		
3[5]	All[2]	28,000[1]	190,000[3]
4[6]	License Exception CTP not available		

1. No license required under 28,000 MTOPS except for AT reasons
2. License Exception CTP not available for nuclear, chemical, biological or missile end users
3. Increased from 85,000 effective March 6, 2002
4. Tier 1 Countries: List of about 136 countries including major industrial nations
5. Tier 3 Countries: List of about 48 countries (including China, India, Pakistan, Russia and the Middle East (including Israel))
6. Tier 4 Countries: Cuba, Iran, Iraq, Libya, North Korea, Sudan, Syria

NOTE: Wassenar reporting required for exports to non-Wassenar members over 65,000 MTOPS

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Exports of Encryption Software

- Until 1996 most encryption technology was still listed on the Munitions List, meaning that it could not be exported without a license from the ODTC
- Similar story as with HPCs
  - Rigorous controls were a source of tension between industry and regulators
  - Wide industrial use of encryption and international availability made overbroad export control impracticable (Microsoft Office 2000 could not be exported without a license under 1999 rules)
  - Compromise reached through a far-reaching license exception ENC which lifts most controls on technology
- Encryption Software is still treated differently than other software (and other technology)
- However, new rules issued in January, 2000, substantially loosened the controls

Exports of Encryption Software

START YOUR ANALYSIS WITH EAR § 742.15. Most exports require review or notice by BIS

Under License Exception TSU:

- Free, publicly available source code can be exported without a license (upon notification of BIS)

Under License Exception ENC:

- Any encryption products may be exported to foreign subsidiaries of U.S. corporations without review and classification by BIS
- Any encryption products of any key length may be exported to any user in the EU+8 or any non-government user in other countries (other than the T7) after review and classification by BIS
- Products designated as "retail" may be exported to any end user (other than in the T7) after review and classification
- Be careful of cryptanalytic products or cryptographic products with open cryptographic interfaces

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Deemed Export Rule

EAR § 734.2(b)(2)(ii) defines export to include: "Any release of technology or source code subject to the EAR to a foreign national. Such release is deemed to be an export to the home country or home countries of the foreign national."

EAR § 734.2(b)(3) provides that the "release" of technology includes: "(i) Visual inspection by foreign nationals of U.S.-origin equipment and facilities; (ii) Oral exchanges of information in the U.S. or abroad; and (iii) The application to situations abroad of personal knowledge or technical experience acquired in the U.S."

Foreign national includes anyone in the U.S. on nonimmigrant visa categories (B, E, F, H, J or L), but does not include permanent residents (green card holders) and "protected individuals" as defined in the Immigration and Naturalization Act (e.g. asylees)

BEWARE: ITAR has a similar rule for deemed exports of defense articles and there are almost no applicable license exceptions (see ITAR § 120(17)(a)(4)

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Deemed Export Rule

- Encryption "software" (source code and objet code) is not subject to "deemed export" rule (possibly a reaction to Bernstein v. Department of State, 922 F. Supp. 1426 (1996)). See § 734.2(b)(9)
- The deemed export rule would apply to encryption "technology" except that license exception ENC permits transfers of encryption technology to foreign nationals within the U.S. for internal company use (exception nationals of the T7)
- Result of Deemed Export Rule:
  - Companies must classify all technology, not just technology included in exports
  - Companies have an obligation to determine the nationality or immigration status of all of its employees who may have access to controlled data

Exporting with Confidence

1. You have checked your licensor/purchaser against the most recent OFAC list of SDNs
2. You have submitted a Commodity Jurisdiction Request and received confirmation that your product is not a "defense article" under the jurisdiction of OTDC
3. You have submitted a Classification Request with respect to your product to the BIS and received an ECCN Number
4. You have checked the controls on the ECCN against the Country Chart and determined that there is no control for the country to which you are exporting
5. You have confirmed that you are not exporting your product in violation of any of the General Prohibitions, paying attention to the BXA "Know Your Customer" Guidelines
6. You have a process in place that will catch any Red Flags

NOW . . . EXPORT AWAY!

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THANK YOU

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