

Vol. 30, No. 3

January 18, 2010

Industry Sees “Stars Aligned” for Export Control Reform

Industry representatives in Washington are more optimistic about the chances for export control reform this year than they have been in decades. “I think the stars are aligned now thanks to the president to make a significant effort and substantial reforms,” National Foreign Trade Council (NFTC) President Bill Reinsch said Jan. 12 at a press conference unveiling an export community wish list of 64 reforms its wants to see adopted as part of the White House export control review (see **WTTL**, Jan. 11, page 1). His optimism was echoed by Frank Vargo, vice president of the National Association of Manufacturers (NAM). “What’s new is the attitude of this administration is totally different from any I have ever seen,” Vargo said.

The reform proposals offered by the multi-association Coalition for Security and Competitiveness (CSC) were sent to President Obama Jan. 11. Most of the proposed changes could be adopted without new legislation. Industry representatives say many of these ideas are already being studied by the interagency team conducting the staff-level review for the administration.

This team is expected to begin briefing senior administration officials by the end of January on the options for export control reform. Those senior officials will be giving their staffs guidance on which options to expand into actual proposals to go to President Obama.

One of the factors giving industry representatives optimism is the role Defense Secretary Robert Gates has played in pushing for the review and his support for reform. In the past, reform efforts have often been short circuited by Pentagon staffers who have gone around the back of their leaders to stir opposition to change in Congress. This time, staff at the Defense Technology Security Administration (DTSA) are supporting the review. Vargo reported that he saw the change during a recent visit to the agency. “They made it very clear that they have definite directions from the top, and they are moving,” he said.

SEC Offers Better Deals under Enforcement Cooperation Initiative

The Securities and Exchange Commission (SEC), which shares responsibility with the Justice Department to enforce the Foreign Corrupt Practices Act (FCPA), has joined other agencies in offering firms ways to reduce or avoid potential penalties by cooperating with the commission in investigations. The SEC Jan. 13 unveiled a new Enforcement Cooperation Initiative (ECI) that is similar to the penalty mitigation guidelines issued by other departments. Cooperation, including voluntary self-disclosures, could lead to cooperation agreements with the SEC,



deferred prosecutions or non-prosecution agreements. The SEC has revised its Enforcement Manual to add a new section entitled, "Fostering Cooperation." It has also streamlined the process for submitting witness immunity requests to Justice for witnesses "who have the capacity to assist in its investigations and related enforcement actions."

The Commission "has set out, for the first time, the way in which it will evaluate whether, how much, and in what manner to credit cooperation by individuals to ensure that potential cooperation arrangements maximize the commission's law enforcement interests," it said. The revised manual provides guidance that is intended to provide an incentive for cooperation. This guidance is similar to the so-called "Seaboard Report" the SEC issued 2001 to explain how it evaluates cooperation by companies. [Editor's Note: Copy of revised Enforcement Manual will be sent to WTTL subscribers on request.]

Among the factors that will be weighed are: (i) whether the individual's cooperation was voluntary or required by an agreement with another law enforcement or regulatory organization; (ii) the types of assistance the individual provided to the SEC; (iii) whether the individual provided non-privileged information, which was not requested by the staff or otherwise might not have been discovered; (iv) whether the individual encouraged or authorized others to assist the SEC when they might not have otherwise participated; and (v) any unique circumstances in which the individual provided the cooperation.

Google's Complaint Puts Focus on Chinese Hacking

Google's revelation Jan. 12 that its Gmail system in China has been the target of computer hacking and its threat to pull out of China if the intrusions don't stop brought public attention to a problem that has been the subject of previous warnings and reports from both government agencies and the private sector. Because of Google's size and visibility, the issue has now garnered publicity it has never gotten before and forced the Obama administration to put cybersecurity higher on its negotiating agenda with Beijing.

U.S. counterintelligence officials have been warning about Chinese cyber attacks and hacking for some time, including during the Beijing Olympics. A report produced for the U.S.-China Economic and Security Review Commission in October provided a detailed analysis of how China's Peoples Liberation Army (PLA) is supporting private Chinese hackers as part of its effort to develop a cyber warfare capability (see **WTTL**, Oct. 26, page 1).

Secretary of State Hillary Clinton is scheduled to give a major policy speech Jan. 21 on Internet freedom, a State official told a House hearing Jan. 12. "She has been very engaged on the issue of Internet freedom and the need to stake out clear policy ground on the subject," said Deputy Assistant Secretary of State for East Asia David Shear. He said Clinton had dinner with 10 executives the week of Jan. 4 to discuss the issue and also has been in touch with Google CEO Eric Schmidt. Clinton also issued a statement saying, "We have been briefed by Google on these allegations, which raise very serious concerns and questions. We look to the Chinese government for an explanation."

Google reported that its Gmail system was the subject of a "sophisticated and targeted attack" in December aimed primarily at accessing accounts of Chinese human rights activists, although only two accounts appear to have been accessed. It said it also discovered that at least twenty other large companies from a wide range of businesses – including the Internet, finance, technology, media and chemical sectors – have been similarly targeted. "These attacks and the surveillance they have uncovered – combined with the attempts over the past year to further limit free speech on the web – have led us to conclude that we should review the feasibility of our business operations in China," a Google statement declared. "We have decided we are no longer willing to continue censoring our results on Google.cn, and so over the next few weeks we will be discussing with the Chinese government the basis on which we could operate an

unfiltered search engine within the law, if at all. We recognize that this may well mean having to shut down Google.cn, and potentially our offices in China,” it stated.

BIS Finds Offsets Are Smaller Share of Defense Export Deals

Although the number offset agreements entered with foreign governments in 2008 by U.S. defense exporters was up sharply from previous years, the offset portion of total defense sales was down significantly from the average of the last 16 years, the Bureau of Industry and Security (BIS) noted in its annual report to Congress on offset trade released Jan. 12. In 2008, the latest year for which data are available, 14 U.S. defense contractors reported entering into a total of 52 new offset agreements with 17 countries valued at \$3.48 billion. This was 57.10% of the \$6.10 billion in export contracts they reported to BIS. This compares to 2007 when the firms reported entering into 43 new offset agreements with 18 countries valued at \$5.44 billion, which was 80.73% of all defense contracts that year.

Offset deals usually require U.S. defense exporters to provide countries that are buying their weapons and equipment with special benefits as a condition for the sale. Such defense sales may require the U.S. firm to do co-production in the country doing the buying, subcontracting, technology transfer, training, licensing of production, foreign investment or purchases.

BIS says it has seen a trend toward increased use of direct offsets, such as co-production and subcontracting, and away from indirect offsets such as purchases of foreign components. “In each of the past two years, the value of direct and indirect offsets have accounted for roughly half of the value of all offset transactions,” the report notes. Over the past 16-year period, direct offsets have averaged about 40% of the value of offset transactions and indirect offsets have averaged 60%. The data did not point to any specific reason for this trend, it notes. “By applying a great number of multipliers or a higher multiplier to direct offset transactions, the offset demanding countries are providing incentives to U.S. defense firms to provide more of these types of offsets, thereby increasing the occurrence of direct offsets,” it suggests.

Kazakh Shakedown Leads to FCPA Penalties for NATCO

A shakedown by Kazakhstani immigration officials of one of its subsidiaries has led to the imposition of a \$65,000 civil penalty on Houston-based NATCO Group for alleged violations of the Foreign Corrupt Practices Act (FCPA). In a Jan. 11 settlement with the Securities and Exchange Commission (SEC), the firm agreed to pay the fine and enter a cease-and-desist order to settle a civil complaint the SEC filed in the Houston U.S. District Court based on payments that employees of a NATCO subsidiary, TEST Automation & Controls, Inc. (TEST), paid to Kazakh officials to get visas for its employees to work in the country. NATCO had made a voluntary self-disclosure to the SEC and neither admitted nor denied the SEC charges.

“In February 2007 and September 2007, Kazakh immigration prosecutors conducted audits and claimed that TEST Kazakhstan’s expatriate workers were working without proper immigration documentation,” the SEC cease-and-desist order notes. “The prosecutors threatened to fine, jail or deport the workers if TEST Kazakhstan did not pay cash fines,” it adds.

“Believing the prosecutor’s threats to be genuine, employees with TEST Kazakhstan sought guidance from TEST’s senior management in Harvey, Louisiana, who authorized making the payments. TEST Kazakhstan employees used personal funds to pay the prosecutors \$25,000 in February and \$20,000 in September, and then obtained reimbursement from TEST,” the order states. These expenses were booked as salary advances or fines, allegedly in violation of FCPA bookkeeping rules. In a 10Q filing with the SEC in November, NATCO said that it discovered the payments during a February 2008 audit. “The Company has taken a number of important steps to enhance its internal controls over compliance,” it said. “The Company added staffing,

restructured its organization, increased training and awareness and improved communications throughout the organization. The Company also has taken remedial actions to assure that record keeping is compliant with all laws and regulations of the jurisdictions in which we operate," it reported. "As of September 30, 2009, we have expended to date a total of approximately \$11.0 million on legal and other professional services related to compliance matters since commencement of the internal review," it stated. NATCO also told the SEC that it was ceasing all operations in embargoed countries.

DDTC Discovers DTrade and Windows 7 Incompatibilities

In the "oops-I-didn't-expect-that" department, State's Directorate of Defense Trade Controls (DDTC) advised defense exporters Dec. 30 that its DTrade electronic licensing system might not be compatible with Microsoft's new Windows 7 operating system. In a notice posted on its website, it "strongly encouraged" DTrade users to maintain a separate computer with Windows XP to use in filing licensing information and also to download a new Lotus Forms Viewer.

"This notice is to advise that industry users who have upgraded to the Windows 7 operating system, that there are reported issues with PureEdge View 6.5 errors preventing the digital signature function on DSP forms," DDTC noted. "According to the IBM website, the Lotus Forms Viewer is not inherently compatible with Windows 7. Industry having Windows 7 OS may have to use alternative methods for viewing and submitting PureEdge forms to DDTC," it stated.

DDTC said Lotus Version 3.5.1 is stated to resolve most of the issues surrounding its use with higher Windows OS versions. If a firm can't retain a Windows XP system, it can try to download the newer version of Lotus Forms Viewer or run IBM Lotus Forms on Windows 7 in XP compatibility mode. "Workplace Forms products do not support the Netscape browser, but do support digital certificates provided by the Netscape browser's NSS certificate store," it added.

* * * Briefs * * *

VEU: BIS in Jan. 15 Federal Register announced approval of additional Validated End-User in China. Granted authorization to receive license-free shipments of items subject to specific ECCNs listed in notice is Grace Semiconductor Manufacturing Corporation, located at 1399 Zuchongzhi Road, Zhangjiang Hi-Tech Park, Shanghai, PR China 20123.

ENTITY LIST: BIS added fifteen persons under sixteen entries to its Entity List in the Jan. 13 Federal Register. Identified parties are located in Armenia, China, Hong Kong, Singapore and Malaysia.

PHONE CAMERAS: Eastman Kodak Jan. 14 filed Section 337 complaint at ITC claiming Apple and Research in Motion are violating its patents in "certain mobile telephones and wireless communication devices featuring digital cameras, and components thereof."

LIQUOR: USTR's office Jan. 14 said it has asked the Philippines for formal WTO dispute-settlement consultations to resolve U.S. complaint against Manila's excise tax on distilled spirits. Philippines taxes liquor made from domestic plants, such as sugar and plums, at lower rate than liquor made from other ingredients, including whiskeys and gin made with wheat, which is one of prime ingredients in U.S. made booze. EU requested WTO dispute settlement consultations on these taxes in July 2009, and U.S. joined consultations and participated in meetings between EU and Philippines in October 2009.

SMALL BUSINESS: USTR's office Jan. 21 is sponsoring half-day conference on "Jobs on Main Street, Customers Around the World: A Positive Trade Agenda for US Small- and Medium-Sized Enterprises." Program is aimed at helping small and medium-size firms increase their exports.

TRADE FIGURES: Goods exports in November of \$94.6 billion were highest since November 2008, although still not as high as they were a year ago, Commerce reported Jan. 12. Services exports of \$43.6 million were best level since December 2008. Goods imports of \$143 billion were highest since December 2008, while services imports of \$31.6 billion were also at best level since December year ago.