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ION Comments on "Specially Designed" Definition

Re: Comments on BIS-2012-0021

DEPARTMENT OF COMMERCE
Bureau of Industry and Security

Input on "Specially Designed" Definition

ION Geophysical Corporation is a leading provider of geophysical products, services, and marine seismic solutions for the oil and gas industry. ION's offerings are designed to allow Exploration & Production operators to obtain higher resolution images of the subsurface to reduce the risks of exploration and reservoir development and to enable seismic contractors to acquire geophysical data safely and efficiently. ION provides equipment for both marine and land-based seismic acquisition.

We appreciate the opportunity to comment regarding the proposed definition of "specially designed" published June 19, 2012. We provide our comments below.

A. The proposed regulation and the Export Control Reform Initiative (ECRI) will lead to controls that are more stringent for items currently listed on the Commerce Control List and industry overall. BIS has tackled "The Sisyphean task of export control reform*" with the major challenge being the chore of reconciling multiple agencies' objectives along with the military International Traffic in Arms Regulations (ITAR) and the commercial Export Administration Regulations (EAR) into one positive detailed list without limiting commerce or threatening national security. Essential to this effort is a seamless and shared definition of "specially designed" which traditionally has meant very different things on the USML versus the CCL. Key to this endeavor and the Export Control Reform Initiative (ECRI) in general is the ability to accommodate commercial business with reform objectives.

Merriam-Webster defines "compromise" as:

1 *a* **:** settlement of differences by arbitration or by consent reached by mutual concessions
b **:** something intermediate between or blending qualities of two different things

2 **:** a concession to something derogatory or prejudicial <a *compromise* of principles>

The key word within this definition that concerns those of us with purely commercial goods is "concessions." Our subsequent concerns are only fueled by the stalwart determination to combine two divergent agendas (promoting commerce versus protecting national security) with separate purposes amid announcements of the closing of industry's long-term partner in

advancing trade, the Commerce Department. To compromise requires concessions and "meeting in the middle", which inevitably means that the EAR will become more stringent as the lower-level USML items are moved into it.

*"The Sisyphean task of export control reform" by Jeff Foust, The Space Review, November 7, 2011

B. We also believe that the objectives of the Definition are not being met as described below.

1. **Objectives (ii) and (iii) Are Not Met:**

This third proposed definition of "specially designed" is again overly complex and confusing. The definition is not readily understandable to export practitioners. When a definition is not easily comprehensible to export practitioners then it is not going to be decipherable by industry as a whole. In addition, adding the words "as a result of 'development'" is simply another way of saying design intent so we assert that an exporter still must "investigate and divine the intentions of the original designer."

To quote Eric Hirschhorn from this year's BIS Update Conference, "If exporters can't understand the rules, then they can't comply with them." We agree with Mr. Hirschhorn wholeheartedly and contend that the number (ii) objective for the definition spelled out below is not met.

> "ii) Be easily understood and applied by exporters, prosecutors, juries, and the U.S. Government—*e.g.,* by using objective, knowable, and clear requirements that do not rely upon a need to investigate and divine the intentions of the original designer of a part or the predominant market applications for such items;"

In analyzing *Lachman*, the decision's ruling on the definition seems overly broad and far-reaching. In fact, it rejects the official minutes of a 1975 COCOM meeting, whereby the minutes reflected the United States delegation's statements that:

> "it was standard practice in the context of [the COCOM List] to make use of the term `specially designed' and that [COCOM] had resorted to it in a number of cases when it had been difficult to define exactly the equipments it was desired to embargo" and that the term was used to mean "**an equipment used solely for a particular purpose**."*

These U.S. delegation minutes at COCOM emulate the current MTCR definition stated below:

> *"Specially designed".* (MTCR context)-- Equipment, parts, components or "software" that, as a result of "development", have unique properties that distinguish them for certain predetermined purposes. For example, a piece of equipment that is "specially designed" for use in a "missile" will only be considered so if it has no other function or use. Similarly, a piece of manufacturing equipment that is "specially designed" to produce a certain type of component will only be considered such if it is not capable of producing other types of components.

And *Lachman* also rejects the MTCR definition as "not relevant" when the defendants point to it as another source.*

BIS refers to the First Circuit's ruling in *Lachman* as providing "a definition of the term 'specially designed'" and points out that determining the meaning of "specially designed" "[would require]

reviewing the Lachman decision to understand the court-provided definition." We can infer from this statement that BIS' definition is intended to be consistent with *Lachman*. Yet, BIS also claims that their "proposed definition is not inconsistent with the MTCR definition."

**Justia U.S. Law, 387 F.3d 42: United States of America vs. Walter L. Lachman, Maurice H. Sublia, Jr.*

It is not possible for BIS' definition to be consistent with Lachman and consistent with MTCR if Lachman and MTCR's definitions are inconsistent. Again, we contend that the proposed definition of "specially designed" is unclear and confusing and that objective (ii) is not met. In addition, it appears that objective (iii) outlined below is also not achieved.

> "(iii) Be consistent with definitions used by the multilateral export control regimes;"

2. Objectives (viii) and (ix) Are Not Met

Perhaps commercial industry's biggest fear is that adoption of this proposed "specially designed" definition will over-control purely commercial goods in the effort to insure that military items moved from the USML to the CCL be properly controlled, tracked and notifications made to cover any risk to national security. With the adoption of the following new terms: "end item," "accessories," "attachments," "part" and "component," industry cannot fathom how these new implementations pasted directly from the ITAR could affect our products and upcoming offerings in the future.

Prior to this exercise and the Export Control Reform Initiative in general, Commerce has not had the need to elaborately define the following words: end item, accessories, attachments, part and component. In fact, it seems that the only reason these words must be defined now is to support this proposed and overly intricate "specially designed" definition and ultimately to simply move the lower-level USML items into the CCL 600 Series slot. Defining these words does not fulfill any need driven by companies who sell commercial goods.

The only reason for this proposed and overly convoluted "specially designed" definition is also in order to move these USML military items into the commercial CCL. With the admission of *Lachman,* it is evident that in 24 years (various *Lachman* trials and appeals went on for 20 years, from 1988 – 2008), only one case pertaining to the meaning of specially designed was ever tried.

We believe that without further tests and trials, one cannot determine if objectives (viii) and (ix) illustrated below can feasibly be met by this definition for EAR items:

> "(viii) Not increase the current control level to ''600 series'' control or other higher end controls of items (*i.e.,* not move items currently subject to a lower control status to a higher level control status), particularly current EAR99 items, which are now controlled at lower levels; *and*
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> (ix) Not, merely as a result of the definition, cause historically EAR controlled items to become ITAR controlled."

INDUSTRY'S CONCERNS ARE JUSTIFIED

The commercial industry is having a hard time spelling out the problems with the definition more succinctly because we have not had to implement a definition of this magnitude in Commerce's history. We have a hard time driving down to the part, component, accessory and attachment level because we have never had reason to do so.

Certainly our concerns are justified. Currently, we have the bright line that the ECRI claims to seek – ***design intent***. It has successfully protected purely commercial items from being captured in the ITAR for decades but instead of creating exemptions within the USML to release the lower-level nuts and bolts from the higher level of control, the ECRI dictates that we integrate (and help you integrate) the USML and our CCL. The initiative only focuses on improving trade for the 600 Series items that are to be moved from the ITAR to the EAR. The problem seems to be that the ECRI does not have the purely commercial industry's best interests at heart.

As a small-medium company who sells commercial items, we do not believe that we will recognize benefits from the ECRI. We do see substantial burdens in adapting our Export Administration Regulations and adopting ITAR terms with ITAR definitions that have not been properly vetted to accommodate a small subset of items to which we have no connection. In contrast, a result of the ECRI in the EAR is a new ECCN, 0Y521, which falls in the ***CATEGORY 0 - NUCLEAR MATERIALS, FACILITIES, AND EQUIPMENT [AND MISCELLANEOUS ITEMS]*** classification and captures commercially available products as "emerging technology" until a proper control level is determined. This period can last one year with an optional two-year extension. The 0Y521 series was described in a proposed rule published on July 15, 2011 (76 FR 41958) that identified a framework for how articles, which the President determines, as part of the Administration's Export Control Reform Initiative, no longer warrant control on the USML would be controlled under the CCL. BIS explained in the July 15, 2011 proposed rule that this new temporary holding classification is equivalent to United States Munitions List (USML) Category XXI (Miscellaneous Articles), but with a limitation, as described in the rule. Since this rule applies to the U.S. and not its Wassenaar partners BIS has by default created an un-level playing field. If an item is classified under 0Y521, potential customers will have to accept the risk of purchasing products that will require strict level of control for an unknown period of time and they must abide by licensing conditions that they would not have to endure if purchasing from European competitors. With the stringent Regional Stability control requirements, this would mean export licenses would be required for exportation to all countries except Canada and thus would result in lost sales for ION and our U.S. counterparts.

When discussing the ECRI with many 2012 BIS Update attendees, the comments appeared to fall into various categories:

1. Companies with USML items moving to 600 Series: Lower fences: The pain is administrative as obtaining export licensing is easier and less risky than using De Minimus and STA with its large record-keeping requirements. These ITAR companies must learn a new set of regulations i.e. the EAR. Discomfort could be temporary with hopefully a good end result in ultimately facilitating more trade.
2. Companies with EAR AT Level items and USML/non-600 Series: Seemingly equal fences but could be higher fences in facilitating trade. ECRI may or may not have an effect as it depends on whether 0Y521 will capture EAR99 items and perhaps ultimately place them on the USML, which we have seen happening recently.
3. Companies, like ours, regulated at the 6A001 and other 001 levels: Higher fences. ECRI is debilitating because the higher fences are being built around our commercial

> products such as the new 0Y521 ECCN where for the first time ever the government is adding new levels of classifications without getting multi-level regime agreement first rendering companies such as ours severely less marketable against our competitors who will not be subject to these restrictions.

The way small-medium businesses see it is that the "higher fences" were created to control stringently our commercial goods on the Commerce Control List while the fences are being lowered on the 600 Series items. We don't understand the reasoning behind building higher fences around purely commercial items and don't believe that this situation supports the goals of the initiative.

THE EFFECT ON SMALL BUSINESSES HAS NOT BEEN ASCERTAINED

On page 36417 under number 4. of the Rulemaking requirements, the Proposed Rule states:

> "The Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), 5 U.S.C. 601 *et seq.,* generally requires an agency to prepare a regulatory flexibility analysis of any rule subject to the notice and comment rulemaking requirements under the Administrative Procedure Act (5 U.S.C. 553) or any other statute, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. Under section 605(b) of the RFA, however, if the head of an agency certifies that a rule will not have a significant impact on a substantial number of small entities, the statute does not require the agency to prepare a regulatory flexibility analysis. Pursuant to section 605(b), the Chief Counsel for Regulations, Department of Commerce, submitted a memorandum to the Chief Counsel for Advocacy, Small Business Administration, certifying that proposed rule published on July 15, 2011, will not have a significant impact on a substantial number of small entities. This proposed rule re-proposes, with certain changes, the definitions of ''specially designed,'' of ''end item,'' and of ''accessories and attachments'' that BIS originally proposed in the July 15 proposed rule. The changes proposed here do not impact the original certification. Consequently, BIS has not prepared a regulatory flexibility analysis. A summary of the factual basis for the certification is provided below.
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> *Number of Small Entities*
> The Bureau of Industry and Security (BIS) does not collect data on the size of entities that apply for and are issued export licenses. Although BIS is unable to estimate the exact number of small entities that would be affected by this rule, it acknowledges that this rule would affect some unknown number."

Given that changes of this magnitude incorporating definitions from the USML into the CCL have never been made previously, we do not feel that a memorandum on the impact on small businesses between Chief Counsels is sufficient. We contend that the effect of this proposed rule on small businesses has not been properly assessed. We respectfully request that BIS prepare a regulatory flexibility analysis so the effect on small entities can be accurately determined.

In its Conclusion on page 36418, BIS admits that it "is unable to determine the precise number of small entities that would be affected by this rule." BIS then claims that:

> "Based on the facts and conclusions set forth above, BIS believes that any burdens imposed by this rule would be offset by the benefits that will occur with the fundamental changes being made to the U.S. export control system under the Export Control Reform

Initiative and the USML-to-CCL process, which the definition of "specially designed" will be an important role. In addition, any burdens would be offset by the benefits of defining this key term used extensively on the CCL. For these reasons, the Chief Counsel for Regulations of the Department of Commerce certified to the Chief Counsel for Advocacy of the Small Business Administration that this rule, if adopted in final form, would not have a significant economic impact on a substantial number of small entities."

We feel that without proper vetting of the effect on small businesses, BIS cannot accurately assert "any burdens [to small entities] would be offset by the benefits." Without appropriately ascertaining the effect on small entities, we believe that the proposed rule should not be implemented. In addition, given the complexity of the definition, we feel that the issue of interpretation of the definition will fall to industry - exporters who may not have outside export counsel and the resources available to receive legal assistance required for the necessary clarification.

ION'S RECOMMENDATION

Unlike the implementation of 0Y521, we recommend a phased implementation of the new definition. As stated in the proposed rule, BIS believes that the definition will need to be "tailored and refined over time as necessary." We agree with BIS and believe that our recommendation is in line with this statement.

We recommend that BIS implement a phased implementation of this definition applying it to the 600 Series items only to properly test and trial it. The definition should initially be applied to the 600 Series items whose exporters could actually benefit from its application. As the beneficiary of the ECRI and the main reason for adopting an elaborate definition of "specially designed", the 600 Series items could serve as the variable group while the remaining EAR items would serve as the control group. It makes sense for the ECRI beneficiaries to trial the definition, as they are the reason that the definition was developed in the first place.

Thank you for the opportunity to provide input on this proposed rule. We appreciate that you solicit our feedback as part of the process. Please contact us directly if you have any questions regarding these comments.

Sincerely,

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