Rolls-Royce North America Holdings Inc.
Rolls-Royce North America
450 South Meridian Street, MC-N1-08
Indianapolis, IN 46225-1103 USA

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Regulatory Policy Division
Bureau of Industry and Security
U.S. Department of Commerce
Room 2099B, 14th Street and Pennsylvania Ave. NW
Washington DC 20230

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Reference: RIN 0694-AF65 [Docket No. 120501427-2427-01]
Proposed Rule

Subject: Revisions to the Export Administration Regulations (EAR): Implementation of Export Control Reform; Revisions to License Exceptions After Retrospective Regulatory Review

Dear Mrs. Hess,

Rolls-Royce North America Holdings Inc. (Rolls-Royce) is pleased to respond to the June 21, 2012 Federal Register Notice requesting comments on the proposed *revisions to the EAR to cover the Export Control Reform and Revisions to License Exceptions*. Rolls-Royce commends the Administration's efforts on export control reform and agrees with the overall proposed structure for a smooth and seamless transition. However, Rolls-Royce believes that additional clarification is required to ensure these concepts are practical once proposed control list reforms are finalized.

Rolls-Royce has reviewed the proposed changes, and has the following comments.

Congressional Notification Requirements:
Rolls-Royce does not support the proposed Congressional Notification requirement for USML items approved for transfer to the "600 series." As a threshold matter, the Export Administration Act, as currently authorized by the International Emergency Economic Powers Act, does not specifically authorize the Congressional Notification requirements, as proposed.

That stated, we acknowledge the discretion of the Department of Commerce to craft regulatory language to implement such a requirement in the interests of national security, should it choose to do so. Given the fact that the Administration's review and proposed transfer of certain items

from the USML to the CCL, with the concurrence of Congress under the AECA's 38(f) provision, is predicated on the premise that these items are not of critical importance to U.S. national security, we strongly urge removing the proposed Congressional notification requirement.

Should the Department of Commerce move forward with the implementation of any notification requirement, we recommend two critical changes.

First, the Department should clarify that the requirement is triggered solely by the ***license value*** and not the total ***contract value*** (which will likely include ITAR items as well as the EAR-controlled exports at issue).

Second, the notification requirement should be limited solely to circumstances in which the export of the overall platform has not previously been notified to Congress and is not subject to a concurrent notification requirement in a parallel ITAR application. In most circumstances, any transaction that involves a significant volume of CML-controlled item will be tied to a prior or concurrent platform delivery that will be subject to ITAR licensing and Congressional Notification. It should not be necessary to provide duplicate notifications related to a platform, regardless of whether the CML items are delivered at the same time as the ITAR-controlled end-item or in a subsequent supply of spare or replacement parts. Congressional stakeholders will have had the ability to evaluate any such transactions.

From a practical standpoint, duplicate notifications will result in significant transaction delay and cost to both industry and government, without increasing transparency regarding defense trade for Congressional stakeholders. From a competitive standpoint it will disadvantage U.S. companies in the global market.

<u>Rationale:</u>
A single contract could include the sale of one or more complete items, as well as additional items for shipping, storage, testing, or other purposes. In such situations, the relevant ITAR application will normally require Congressional Notification, due to the high dollar value of the contract. Companion EAR license applications for parts and components would be related to the same contract. Therefore, EAR applications could inadvertently be subject to identical Congressional Notification requirements. This double-notification requirement would be an unnecessary regulatory burden for both government and industry.

We recommend removal of the Congressional Notification language in the BIS proposed rule, or alternatively the provision be amended so as to (1) base the notification requirement on the dollar threshold of the license application, rather than the contract value and (2) expressly exempt from the notification requirement any transaction that relates to a platform/end user that has already been subject to a prior notification. In this manner, parts and components subject to the EAR would not be inadvertently captured. Should the Department of Commerce move forward with the implementation of any notification requirement, we ask that you take into account the two critical changes outlined above.

Dual Licensing/Compliance Requirements for Defense Sales:
Rolls-Royce has significant concerns about the new procedures, as proposed in this rule and the separate proposed rule establishing a jurisdictional methodology based on a concept of "Specially Designed", which will create dual-licensing and compliance requirements for a single defense sale. While the proposed rule seeks to ensure that existing ITAR license exemptions are not eliminated when moving an item to the CML, it does not address the fundamental problem with requiring multiple licenses and item jurisdiction determinations for a single defense transaction.

The proposed State and Commerce rules should authorize the use of comprehensive ITAR licenses (e.g., DSP-5, DSP-73, etc.) for the exports of CML or CCL items that are parts and components of ITAR defense articles (i.e., end-items and systems), in lieu of obtaining additional authorization(s) from the Department of Commerce, if these parts and components are included as part of a USML-controlled defense article. This would be in keeping with current industry export licensing practices and would eliminate the burden on the USG and industry associated with redundant licensing and compliance requirements without adversely affecting national security interests. This approach would also be in keeping with the original intent of Export Control Reform – to create one list, licensed by one agency. Where it is possible, the U.S. Government should seek to implement that objective, not create multiple new license requirements and compliance burdens for U.S. defense trade to our allies and partners abroad.

Rationale:
If implemented in its current form, a U.S. company that is seeking to sell USML Category VIII military aircraft to a foreign government, including some assembly abroad, would need authorization from the Department of State. That sale and assembly, however, could include thousands of parts and components that would be controlled separately under the CML. Although control on the CML might expedite future sales of parts and components to this approved program, the initial transaction that currently requires only a single authorization from the Department of State would now require multiple licenses from two agencies. This will not make U.S. defense licensing more efficient.

Moreover, this dual licensing framework would require a company to parse out potentially thousands of small parts and components for individual listing on a Commerce license. Each one of these items would need to be individually evaluated to determine whether it is a CCL, CML or USML item; increasing the complexity of the existing licensing requirements. Under current USML process, these parts and components are authorized for export as general categories of items (e.g., "Category VIII(h) parts and components of the hydraulic/mechanical/electrical system.").

A possible alternate approach would be for BIS to create a license exception or other authorization to allow CCL-controlled items to be exported without an EAR license if they are part of the same transaction as ITAR-authorized exports. While in some circumstances, license exception STA may be available for such exports, there will be CML-controlled items that relate to ITAR-controlled end items for export to non-STA countries as well. Some mechanism should be available to export the CCL-controlled items without duplicate approval since the US

Government's national security and foreign policy judgment about the overall transaction will have already been made in conjunction with the ITAR license application.

A new dual-licensing regime would impose very significant additional compliance burdens and costs on international defense and aerospace trade under both the Foreign Military Sales (FMS) and direct commercial sales (DCS). The proposed rule does provide a note that states: "The export of items subject to the EAR that are sold, leased, or loaned by the Department of Defense to a foreign country or international organization must be made in accordance with the FMS Program carried out under the Arms Export Control Act." If the intent of this note is to ensure that the authorization for FMS cases will include authorization for both USML and CML items, then that should be articulated clearly and explicitly in both the Department of Commerce and Department of State proposed rules. However, even if that is the intent, this exemption would not apply to Department of State authorizations for DCS.

During the list review process, the Departments of Commerce and State considered the creation of a license exception that would authorize CML items accompanying an ITAR-licensed export. Rolls-Royce would also support this approach as a solution, if it was effectively crafted to address the duplicate license requirements and additional compliance burdens discussed above.

Temporary Exports in Support of Defense Sales/Programs:
Validity for licenses of temporary import/export and export/import (i.e., DSP-61 and DSP-73) should extend until they either expire or are returned by the applicant holder.

Rationale:
The proposed two-year expiration would have an adverse impact on many previously approved programs and sustainability efforts. The administrative burden – and potential production delays/cost increases – with reviewing hundreds of temporary licenses to assess the jurisdictional status of individual parts and components or production/test equipment would likely would far outweigh any perceived benefits of obtaining new licenses.

Reexport/Retransfer:
Reexport and retransfer of USML hardware is also a concern for our members. Licenses, agreements and other authorizations issued by the Department of State prior to the effective date of the transition regulation that authorize the reexport or retransfer of items (and related technical data) transitioning to the CML should be "grandfathered" without expiration.

Rationale:
Foreign recipients of US origin hardware may not be in a position to correctly classify post-transition reexports or retransfers of hardware and technical data originally received as USML-controlled. For example, a foreign party that purchases a defense article, authorized for export under a DSP-5 license "in furtherance of" an agreement, which permitted reexport authority to a third party, may not understand that the retransfer authorization is no longer valid, if the hardware moves to the CML. Under Technical Assistance and Manufacturing License Agreements, the Department of State has authorized the sublicensing and reexport/retransfer of literally millions of items and related technical data to many thousands of foreign persons. Accordingly, the retransfer after the effective date of the items moving to the CML would

potentially be a violation for which the original US exporter is accountable, in accordance with 127.1(c). Finally, if the USG has already conducted a comprehensive review and issued an authorization for such reexport or retransfer, it should not be required to repeat the process.

Entry Into Force:
The effective date for a final version of this rule should be of at least 180 days from its publication.

Rationale:
The proposed rule would require companies to undergo multiple implementation changes (e.g. classification changes, marking requirements, tool updates, training, and licensing) that require time, thought and substantial resources. A delayed effective date for this rule is fully consistent with the approach that has been taken, for example, by the Bureau of the Census in rules that have a wide impact across the exporting community with the processing of hardware shipments through U.S. government interfaces, such as AES. Without sufficient time to implement the complicated and resource-intensive requirements of the proposed rules, U.S. companies will be unable to comply and the chances for inadvertent compliance issues increases.

SPECIFIC COMMENTS

Part 734:

1. *"De Minimis" Content:* While Rolls-Royce understands the Administration's rationale for having a no *de minimis* level for items destined to a country subject to a US arms embargo, Rolls-Royce believes BIS is making an assumption as to when companies conduct *de minimis* calculations. Based on Rolls-Royce's experience, foreign exporters DO NOT conduct *de minimis* calculations at the point of export, but at the development stage. At this stage, the foreign manufacturer is not necessarily aware where their customers are going to be located and therefore, most likely will use the most stringent *de minimis* level. If BIS implements a zero *de minimis* rule for "600 series" items, there is the risk for foreign manufacturers to implement "CML/EAR-free" practices. Rolls-Royce believes that BIS should eliminate this exclusion for "600 series" items destined to a country subject to an arms embargo and consider substituting the current 10% *de minimis* level applicable to Country Group E.

Part 736:

1. General Prohibition Three (Direct Product Rule): Rolls-Royce does not understand the rationale behind some of the modifications proposed to General Prohibition 3. If the controls driving the "600-series" are national security (NS) and regional stability (RS), then why is BIS expanding the country scope for the direct product of "600-series" items to include countries of concern due to nuclear proliferation or missile technology reasons? Rolls-Royce recommends the removal of country groups D:3 and D:4 from the country scope proposed for General Prohibition 3.

2. Supp.1 to Part 736: Rolls-Royce encourages BIS to include in proposed General Order 5 guidance on how exporters should complete shipping documentation. Furthermore, ROLLS-ROYCE recommends that for items exported under a grandfathered license, the exporter be allowed to reference either the old USML code or the new ECCN. Given the varying needs of US exporters through the transition period, there will be times that a single company will want to ship the same part under an old USML code/license and also ship under the new ECCN. Giving exporters the maximum flexibility on this issue will greatly ease the cost and compliance burden associated with the transition.

Part 740:

1. Introduction of the term Major Defense Equipment: 15 CFR 740.2 introduces the ITAR-term major defense equipment, but does not define it in Part 772. Rolls-Royce recommends adding quotation marks to the term and including the definition in Part 772.

2. License Exception TMP: Rolls-Royce likes the proposed structure for license exception TMP. However, Rolls-Royce seeks clarification for the following paragraphs:

    a. In paragraph (a), BIS uses the phrase "order to acquire the item", but does not provide a definition or an example to what this means. Rolls-Royce seeks clarification on this term. Would a purchase order be considered an example of an "order to acquire the item"?

    b. In subparagraph (a)(1), BIS creates an exclusion for destinations in E:2, Sudan, or Syria. Rolls-Royce believes this should be replaced with country group E:1, as it is the way exclusions of this type are typically referenced in the EAR.

    c. For subparagraph (a)(3), Rolls-Royce seeks clarification that the term "their employees" in the following sentence "only US persons or their employees traveling or on temporary assignment abroad may export, reexport, transfer (in-country) or receive technology under the provisions of this paragraph (a)(3), not only includes all employees located at US locations of a company organized under the laws of the United States (US company), but also includes all employees located at foreign branches of a US company.

    d. Paragraph (a)(3)(B) creates an undue burden to employers by introducing additional logging requirements for data previously authorized to the traveling user, if the user is a non-US person. In order for a non-US person to have access to the data at issue, BIS would have granted a deemed export license or authorized its use under another license exception in the first place. It would be onerous to impose additional requirements for data that has already been licensed just because its non-US user is traveling. If the concern driving this paragraph is due to potential unauthorized transfers, BIS should rest assured that companies currently invest on encryption software and other data loss prevention tools to ensure their proprietary information stored on employees' devices is protected.

Therefore, a requirement to demonstrate the need to travel with each piece of technology stored on the device is not only impractical, but creates non-compliance risk, even if such requirement is only for non-US persons. Rolls-Royce urges BIS to remove this paragraph.

e. For paragraph (a)(10), Rolls-Royce recommends the addition of the term "materials".

f. For paragraph (a)(14)(iii), if an exporter is going to be required to apply for a license to retain an item abroad beyond one year, then the extension should match the standard validity period of a license, four years.

g. For paragraph (b)(3), Rolls-Royce seeks confirmation that it applies to technology.

3. License Exception RPL: Rolls-Royce seeks clarification that paragraph (a)(3)(ii) can be used in conjunction with license exception LVS.

4. License Exception GOV: Rolls-Royce agrees with the proposed structure for license exception GOV. However, Rolls-Royce seeks clarification for the following paragraphs:

   a. Rolls-Royce commends BIS defines cooperating countries beyond A:1, as this country group is based on a defunct trade control regime. Instead, Rolls-Royce encourages BIS to replace the references to "A:1" with "Wassenaar member countries".

   b. Rolls-Royce would like to seek confirmation that proposed paragraph (c)(2) will apply to agencies of cooperating countries, even if these agencies are no longer at the national level. For example, as part of the European Union integration, member countries delegated the airworthiness authority to the European Aviation Safety Agency (EASA). EASA's authority is identical to the FAA's, except that it reaches multiple countries as opposed to just one. It is not an international agency, at least in the traditional sense of term, because it actually mandates airworthiness rules and standards across the EU.

   c. Rolls-Royce believes that the exclusions listed in paragraphs (3)(i) and (3)(ii), should not be titled "Items on the Sensitive List" or "Items on the Very sensitive list". Since BIS is not using the same numbering system, retaining the same titles as the Wassenaar Control Lists will lead to confusion. Instead Rolls-Royce recommends BIS removes these titles and just references the supplement numbers.

5. License Exception STA: Rolls-Royce seeks clarification as to how BIS envision the implementation of proposed note 2. Will exporters be required to provide this information? If so, what type of information will the exporter be required to provide and how often will the exporter be required to provide the information. Rolls-Royce believes

that the exporter should only be required to provide the information on the initial export to the party.

Part 743:

1. Congressional Notification: As stated in our opening comments, Rolls-Royce strongly recommends the removal of a congressional notification requirement for "600-series" items not deemed major defense equipment. If the intent of reform is to transfer items that no longer warrant USML control, then it seems misguided to require congressional notification for these less sensitive items.

2. For paragraph 743.5(a), Rolls-Royce recommends moving the definition of major defense equipment to Part 772, since it is referenced in different parts of the EAR.

Part 758:

1. Rolls-Royce believes that requiring an AES filing for certain license exceptions will be burdensome, confusing, and could potentially cause compliance issues. Rolls-Royce is against any requirement for "600 series" AES filings.

2. Rolls-Royce is concerned that the proposed new destination control statement specific for 600-items will add cost to exports and not achieve the apparent goal of the proposal, to raise awareness of the restrictions on reexport of 600-series items. We believe that it is appropriate to impose a requirement that the exporter notify the recipient in writing of the items that are subject to the 600 series and the associated limitations on reexport of those items as a condition for using a license exception for any item under the 600-series. A written notification requirement will achieve the awareness goal that BIS desires without forcing exporters to reprogram shipping systems for a custom destination control statement applicable to only certain items. Further, an exporter is more likely to send the written notification to an individual in the company that would better understand the restrictions on subsequent reexport of the item (someone in contracts, sourcing or legal) vs. a destination control statement which would be primarily viewed by the individuals in a receiving area handling the physical shipment.

Simplified Network Application Process Redesign (SNAP-R)

Although not addressed in the proposed transition rule, Rolls-Royce feels this matter warrants consideration and attention. Based on public comments made by BIS staff, the Bureau has no intentions of allowing for electronic interfacing between SNAP-R and third party systems. Currently, DTRADE allows for third party interfacing, offering companies the ability to generate applications in an internal electronic environment and then through batch uploading, submit applications to and track status through DTRADE. This internal system facilitates the requesting, processing, generating, submitting, tracking status and post approval implementation and compliance.

Not allowing for third party interfacing with SNAP-R will add significant time, burden and waste to internal processes for companies. Rolls-Royce requests reconsideration and revision of the Bureau's position on this matter. Additionally, the Bureau should delay the issuance and effective date of this final rule and the publication of any "600 series" items until SNAP-R allows for third party interfacing.

Rolls-Royce continues to support the Administration's efforts on export control reform, but have concerns about the proposed transition process as indicated above. Without modifications to the proposed Department of State and Department of Commerce transition rules, the overarching control list reform effort will not have the intended effect of making the U.S. export control system more efficient and effective and may, in fact, have adverse effects on U.S. defense and aerospace trade. Accordingly, we encourage the Departments of State and Commerce to consider these potential ramifications, and the recommended changes proposed in this letter, before publishing the export control reform transition plan in final form.

Rolls-Royce appreciates the opportunity to comment on this proposed rule. Feel free to contact me if you have any questions about these comments.

Sincerely,

William J. Merrell
Vice President,
Strategic Export Control – Americas
Rolls-Royce North America Inc.