

# point of view

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## ***Export control reforms:*** How will aerospace and defense companies operating in the global economy be impacted?

*The White House envisions a comprehensive  
reform of the export control system.*

**pwc**

### **Highlights**

The Obama administration has called for a restructuring of the export control system to readily respond to the realities of the post-Cold War globalized economy.

Many challenges to executing reform lie ahead.

The proposed reforms will change the way aerospace and defense companies operate.

Companies need to start planning now about how reforms will impact their compliance organizations and operations.

A more transparent, obvious export control system could improve a company's ability to win work in the global economy. The proposed changes to the system could make it easier for multinational companies to operate in the US market, while still ensuring that they maintain the capability to export their products to overseas customers.

The Obama administration has made modest progress in the difficult area of export control reform.

While it is true that many challenges to executing reform lie ahead (including keeping the interagency coalition for reform intact now that Secretary of Defense Robert Gates has left the administration and getting Congress to act in this controversial area with the 2012 presidential elections approaching), it is clear that some level of meaningful reform is a reality and that the scope of these changes could significantly impact aerospace and defense companies that sell or manufacture equipment overseas.

It is time for companies to proactively consider the organizational, resource, operational, and market repercussions of the proposed reforms well in advance of actual enactment in order to effectively position themselves to profit from the changes. In tackling these issues, it is important to keep in mind that reform does not necessarily mean simplification and a reduction in compliance responsibilities or workload. The new regulation on dual and third-country nationals, for example, may actually increase the burden on exporters by requiring "substantive contacts" screening of employees, record-keeping, and nebulous extra demands on compliance officers. Gray areas of the regulations seem to shift to compliance officers the burden of judging whether an employee poses the risk of diversion, and it's unclear what constitutes due diligence in this regard.

## Background

# The Obama administration proposed comprehensive reform of the export control system

On April 20, 2010, then-Secretary of Defense Robert Gates outlined the administration's vision for overhauling the country's export control system. This ambitious plan seeks to more effectively deal with the national security threats facing the United States today while streamlining and rightsizing the process so that US exporters can operate more effectively and competitively overseas.

The reformed export control system would include:

- A single control list
- A single primary enforcement agency
- A single information technology (IT) system
- A single licensing agency

### Consistent refrain

The terms used by the administration to describe the benefits of the reforms are a familiar refrain to longtime members of the export control community who speak to “one-stop shopping,” “higher walls around fewer items,” protecting our “crown jewels,” and creating a “level playing field” for US exporters. Such concepts date back to, or possibly predate, the fall of the Soviet Union, when it became clear that the control environment would need to adapt to the end of the Cold War.

Progress will require interagency cooperation, legislative support, and a consensus among stakeholders on what needs to be done to provide the government with the tools it requires to protect national security and foreign policy interests. Progress made so far (noted above) indicates that to date there appears to be a consensus among Commerce, State, and Defense to move ahead, though we have not seen an indication that Congress is ready to address the issue legislatively.

### Challenges ahead

The success of the administration's reform effort will depend on its change management skills, both at home and abroad, and on its ability to maintain momentum over several years. Although it is too early to predict the fate of the effort, the fact that the Department of Defense is leading the charge may ease concerns within Congress and the interagencies about the national security implications of the proposal. A phased approach to implementing reform over several years, however, complicates the landscape, as consensus-building in Washington is difficult in itself and consensus can become difficult to maintain over time.

Progress toward creating a level playing field abroad for US exporters will require removing “unilateral controls as appropriate” and submitting “proposals multilaterally to add or remove controls.” Consensus-building (on which technologies and items should be controlled and how to control them) among members of various multilateral export-control-focused bodies (such as the Wassenaar Arrangement) is not an easy task. The administration will surely face additional challenges here. Even bilateral efforts to streamline controls may be difficult to achieve. The three-year hiatus between the US signing of the Defense Trade Cooperation Treaties with the United Kingdom and Australia and their ratification by the US Senate is a poignant case in point.

# Companies must weigh the market impact of the proposed reforms

Ideally, the administration's proposed overhaul of the export control system should make it less complicated for aerospace and defense companies to operate in the modern global marketplace. Although, as the recent rule of dual and third-country nationals indicates, there may be need for more industry participation or clarification of potential impacts of proposed regulations up front in initial interagency reform implementation planning.

Significant progress toward enacting the proposed reforms will be complex and take time. We believe that, if enacted, the proposed reforms of the export system will affect licensing requirements, systems and controls, production decisions, and supply chain management decisions. As such, companies should continue to assess the potential business implications now, before actual comprehensive reforms take place.

Some of the business activities that need to be addressed are immediately obvious. Companies will need to take steps to understand how the single list impacts long-time understandings of how products and services are classified. Companies will need to implement controls to reduce the risk of compliance failure under the new system, Company policies and procedures will need to be revised and implemented. Staff will need to be retrained quickly to the new regulations and understand their responsibilities and roles.

Some of the business activities impacted by reform, however, are less immediately obvious and pose potential vulnerabilities and opportunities. Companies need to understand and begin to think about how they will address change early in the game.

### **Licensing requirements**

The proposed changes to the export control regime would ease licensing requirements and reduce process confusion. Companies would be able to focus their efforts on applying controls and provisions to critical technologies and information. Company resources could be used more efficiently.

Currently, the US government must process a large volume of license applications for weapon system piece parts and components in order to export the items to partners and

Allied nations for whom the Department of Defense has already authorized the export of the entire weapon system. The creation of a single, simplified export control list would allow companies to more clearly understand the requirements for submission of export licenses.

### **Systems and controls**

A unified information technology platform would allow for a better allocation of corporate resources. As former Secretary of Defense Gates stated, "A single, unified IT infrastructure will reduce the redundancies, incompatibilities, and waste of taxpayer money that our current system of multiple databases produces." To adequately perform in the existing system, companies have had to invest in a more complex infrastructure in terms of IT and personnel to prepare, track, implement, and support multiple licensing systems and databases. We believe companies should evaluate their systems and controls to determine where their infrastructure may be properly realigned should the proposed changes become effective.

### **Production decisions**

As defense acquisition programs continue to benefit from the advantages (in terms of cost, schedule, and performance) of the increased use of commercial-off-the-shelf technologies, companies must increasingly weigh the decision of Make vs. Buy. We believe that aerospace and defense companies can make improved programmatic decisions once the classification of dual-use technologies is clarified.

### **Supply chain decisions**

To remain competitive for contracts on international programs, prime contractors feel increased pressure to invest in foreign markets. However, expansion of the supply chain into the global market comes with perceived increased risk that protected technology will be incorrectly transferred to overseas suppliers.

We believe that reducing the complexities of the export control system will allow companies to benefit from choice and competition within the supply chain, providing opportunities to seek global supplier relationships based on performance delivery.

## Q&A

# Export control reform may increase a company's market performance

**Q:** Are you suggesting that licensing requirements for exporting defense articles might be removed?

**A:** No. We believe that companies must operate with continued vigilance in the regulated licensing for the export of critical data and technologies.

Reformation of the export control system should simplify companies' requirements to submit licenses and make the system more responsive. By creating a "benign list" of items and easing the ability to ship to partner and Allied countries, companies can instead focus their efforts and energies on licensing only those technologies that may pose a threat to national security

**Q:** Why would changes to export controls change utilization of commercially available products?

**A:** The proposed changes to the export control system should clarify the proper licensing requirements for dual-use technologies. As it becomes easier to incorporate, utilize, and license available technologies from the commercial industrial sector, companies can reduce costs and mitigate the programmatic risks associated with development and tooling for new military-specific items that are readily available from suppliers in the commercial market.

**Q:** You say that export control reformation will affect my supply chain decisions. How would the proposed changes expand the quantity of available participants in the defense acquisition supply chain?

**A:** Currently, many lower-tier suppliers choose not to enter into the defense acquisition arena, either due to lack of understanding of the system or lack of funds to integrate an effective compliance program. Decreasing the convolution of the export control system will allow more suppliers, domestic and global, to enter into the supply chain.

## Contact information

To have a deeper discussion about how export control reform might impact your business, please contact:

Glenn Brady  
Partner  
PricewaterhouseCoopers LLP  
+1 314-206-8118  
glenn.brady@us.pwc.com

Frank Bray  
Director  
PricewaterhouseCoopers LLP  
+1 603-387-2052  
frank.t.bray@us.pwc.com

Philip Charnas  
Director  
PricewaterhouseCoopers LLP  
+1 408 817-8183  
philip.charnas@us.pwc.com

Rob Garretson  
Manager  
PricewaterhouseCoopers LLP  
+1 703-918-4529  
robert.t.garretson@us.pwc.com