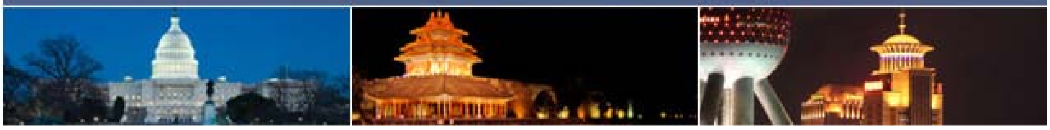
Larkin Trade International

LTI Associates

Strategic Trade Consultants

Compliance • Strategy • Research



LTI Newsletter

Bringing you the latest developments in U.S. And Chinese Strategic trade compliance policy

Summer 2008

Note from the President

Since the publication of our last newsletter, we at LTI have seen a number of positive developments in the area of export controls in China. While these developments do not necessarily mean large policy changes in U.S.-China export control relations, they certainly represent progress in this difficult and sensitive area. These positive developments include news that discussions to address VEU implementation may soon begin between the U.S. and China, and an increase in the number of Chinese companies, both State Owned and private, adopting internal compliance programs. On the negative side, it appears that China is still moving forward with its plans to issue implementing regulations related to the latest encryption registration and certification requirements despite repeated attempts by the U.S. Government and industry to engage in discussions on this issue. LTI believes these encryption regulations could greatly impact foreign companies doing business in China and hopes the Chinese Government will realize the need for open and frank discussions on this matter.

Recent Developments

Export Controls

Call for Public Comment on Deemed Exports

On 19 May, 2008, the U.S. Department of Commerce Bureau of Industry and Security (BIS) published a call for public comment on two recommendations put forth by the Deemed Export Advisory Committee (DEAC) regarding license requirements for deemed exports. Specifically, BIS wants to know if the scope of technologies requiring licenses for deemed export is appropriate or should be narrowed. If the scope should be narrowed, BIS would like recommendations on which technologies should be excluded from licensing requirements and which should remain controlled.

BIS is also seeking input on whether the criteria used to determine a foreign national's home country should be amended. For example, for the purposes of deemed exports, should a person who emigrated from his or her home country shortly after birth be considered the same as a person who emigrated as an adult? The period for public comment will end on 18 August 2008.

U.S. Federal Court Supports Searches and Seizures of Travelers' Laptops, Blackberries, and Other Electronics

On 21 April, 2008, a federal appeals court upheld the right for U.S. Customs and Border Patrol Agents to search and seize travelers' electronic devices, including laptops, blackberries, I-pods, etc., without needing reasonable suspicion. In the same way that Customs has the right to look through luggage and briefcases and examine and seize hard-copy documents, it is now acceptable for border agents to browse passengers' electronic documents, files, pictures, and data. As a result, the Association of Corporate Travel Executives recommends that business travelers remove proprietary information from electronic devices before international travel if they do not want it to be examined by border officials. To mitigate the damage from seizure, the Association recommends that travelers back-up their personal and proprietary information before crossing U.S. borders with electronic devices.

Crime Control Equipment in China Receiving High-Level U.S. Government Attention

From 16-19 April, 2008, China's Ministry of Public Security hosted the China International Exhibition on Police Equipment in Beijing. Reports of American companies exhibiting crime control equipment, such as bulletproof fabric, police radios, and surveillance equipment for riot control purposes, raised eyebrows in the U.S. export control community. Though U.S. exhibitors maintained that they were in compliance with U.S. regulations, Undersecretary of Commerce for Industry and Security Mario Mancuso issued a written statement emphasizing that export controls on crime control equipment to China, introduced by the Tiananmen Square Sanctions Law of 1990, are in effect and will be enforced. In the run-up to the Beijing Olympics, high-level U.S. government officials are paying particular attention to the enforcement of export controls on crime control equipment to China, in particular surveillance technology.

CFIUS

In October 2007, H.R. 556, the Foreign Investment and National Security Act of 2007 (FINSA), went into effect. The purpose of the law is to promote foreign investment in the United States, while at the same time, protecting national security through an improved national security review process, carried out by the hereby established Committee on Foreign Investment in the United States (CFIUS), and reviewed by the President of the United States.

The new multi-agency statutory committee, CFIUS, is comprised of the Secretaries of Treasury, Homeland Security, Commerce, Defense, State, Energy, Labor, National Intelligence, the Attorney General, and other executive agency heads as directed by the President. CFIUS will complete national security reviews and investigations into foreign investment activities, including mergers, acquisitions, and takeovers by foreign entities, within 45 days and submit reports to the U.S. Congress. Investigations will be required in the event that a CFIUS review determines that a transaction impairs national security, is a foreign government-controlled transaction, would grant control of key U.S. infrastructure to a foreigner, or is otherwise recommended by CFIUS. Additionally, H.R. 556 grants CFIUS the authority to enter into the transaction negotiations to mitigate threats to national security and grants the President decision-making authority on canceling foreign investment transactions that are deemed to threaten national security. The President has 15 days after the completion of the CFIUS investigation to make the decision.

The original regulations required a decision from the President to suspend or prohibit a covered transaction; executive order 13456, issued on 23 January 2008, changes the requirement so that a presidential decision is only necessary in cases in which CFIUS deems it necessary. The Treasury Department has just completed a period of public comment on this change to FINSA and the Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons. Click here for more information on H.R. 556: http://www.govtrack.us/congress/bill.xpd?tab=main&bill=h110-556.

FCPA

U.S. Department of Justice Steps up Enforcement of Foreign Corrupt Practices Act (FCPA)

On 8 May 2008, Martin Self, former president of Pacific Consolidated Industries, a private U.S. defense equipment manufacturing company, pleaded guilty to violating the U.S. Foreign Corruption Practices Act (FCPA) when he made payments to a U.K. Ministry of Defense official to secure contracts for his company with the Royal Air Force. The U.K. official provided no services in return for the payments. Self faces eight months in prison. On 3 June 2008, a Minnesota medical equipment manufacturing company, AGA Medical Corporation, agreed to pay $2 million in criminal penalties for bribing Chinese doctors working at government-run hospitals. AGA also made payments to Chinese government officials in order to gain patents for AGA products from the China State Intellectual Property Office. On 5 June 2008, a Florida company that manufactures electronic measuring devices for the testing and inspection of machinery, Faro Technologies Inc., agreed to pay a $1.1 million criminal fine after confessing to making corrupt payments to Chinese employees of state-owned-enterprises in order to secure contracts and disguising them as referral fees. These cases are part of an overall increase in enforcement of the FCPA by the Department of Justice. According to Law.com, In-House Council, the U.S. Department of Justice brought ten cases against U.S. individuals for violating the Foreign Corrupt Practices Act (FCPA) in 2007, which is the same number of cases raised altogether in 2005 and 2006.

VEU Update

The U.S. Department of Commerce Bureau of Industry and Security (BIS) has extended the Validated End-User (VEU) application process to India. Indian companies are now fully eligible to submit applications to BIS for VEU status, which will remove individual license requirements on U.S.-controlled items to pre-screened Indian companies. China was the first country whose companies received VEU authorization. BIS is currently accepting applications from Indian companies and expects to see the first authorized companies emerge this summer.

In other VEU related news, it appears the U.S. and China will engage in further discussions relating to implementation of the VEU for China. LTI believes the VEU is a benefit to U.S. and Chinese companies and can only help to expand high tech trade between the two countries. We are hopeful that the U.S. and China can come to an agreement on implementing the VEU, so industry can receive the benefits of this new license exception.

Recent Developments in China's Aviation Industry

China Establishes First Large Passenger Aircraft Company and Talks of Merging Two Major Aircraft Groups

China's first large passenger aircraft company was officially inaugurated in Shanghai on 11 May 2008 under the name of the Commercial Aircraft Corporation of China Ltd. (CACC), with a registered capital of 19 billion RMB (US$2.7 billion). The project began in November 2003, when the Ministry of Science organized a team of experts to research the feasibility of large domestic aircraft projects in China. On 26 February 2007, during the executive meeting of the State Council, Premier Wen Jiabao gave his approval for the establishment of large domestic aircraft projects.

CACC will be headed by President Zhang Qingwei, former Director of the Commission of Science, Technology and Industry for National Defense (COSTIND), and General Manager Jin Zhuanglong, former Vice Director of COSTIND. The Chinese central government and the Shanghai municipal government will be the largest shareholders of CACC, injecting RMB six billion and five billion respectively. Shanghai Aircraft Manufacturing Factory (SAMF), China Aviation Industry Corporation I (AVIC I) First Aircraft Institute, and Commercial Aircraft Co. Ltd will invest a total of RMB four billion, while AVIC II, Baosteel Group, Chinalco, and Sinochem will invest RMB one billion each. CACC General Manager Jin has indicated that in the future both private domestic capital and foreign capital could also be used for the research and manufacturing of large Chinese aircraft programs.

According to President Zhang, CACC's near term goals include: 1) developing the domestic capability and technology to manufacture large passenger aircraft, 2) receiving aircraft certifications and approvals from CAAC, 3) successfully producing and selling aircraft to numerous customers, 4) completing the certification of the Chinese regional jet ARJ21, and 5) improving the manufacturing efficiency of the ARJ21.

After the official inauguration of CACC, reports stated that AVIC I and AVIC II would be merged or restructured. The government has not approved the details of the plan. The plans currently under discussion include a division between the management and operations of commercial and military aircraft programs, but the completeness of such a division is not yet clear. In January 2008, it was reported that the aviation restructuring may take one of the two possible methods.

The first option would require AVIC II to move its commercial aircraft business and projects to AVIC I, thereby centralizing the resources for commercial aircraft manufacturing under AVIC I and moving the military aircraft programs under AVIC II.

The second restructuring option would merge AVIC I and AVIC II under one group with a single business registration, but would divide the commercial programs from military and other civil aircraft programs by placing them under separate and independently operating departments.   Under this plan, AVIC I would become the department responsible for the research of the ARJ21, Xinzhou 60 (also known as MA60), and other commercial aircraft, while AVIC II would become the department responsible for military aircraft, such as fighter jets and Unmanned Aerial Vehicles (UAVs) as well as other civil aviation vehicles such as helicopters, cargo-transport planes, and training planes.

The development of China's commercial aviation industry, as well as the potential division of commercial and military end-uses under AVIC I and AVIC II will have large implications for U.S. companies wishing to export civil aviation technology to China. LTI will keep you informed of further developments in this area and what they mean for your company.

Manufacturing China's Large Passenger Aircraft

Initial discussions have begun about which Chinese aircraft manufacturing companies will participate in the manufacturing of parts and sections for China's large passenger aircraft program. While no final determinations have been verified, Chinese news reports indicate that Hafei Aviation Co., with its strong background in aerospace composite materials, is a possible candidate to work on the large aircraft program. The Harbin Aircraft Manufacturing Co., Xi'an Aircraft Manufacturing Co., Shenyang Aircraft Manufacturing Co., and Chengdu Aircraft Manufacturing Co., which produce fuselage, wing, nose, and tail parts for commercial aircraft in China, and Shaanxi Aircraft Manufacturing Co., which produces engines and engine parts for commercial aircraft in China, are also being considered as manufacturers for the program.

As noted in the previous article, private enterprises will, for the first time, be included as participants in the national large aircraft program. Chinese news reports indicate that two engines produced by Dema Frequency Mechanic R&D and Manufacturing Co. are being used in wind tunnel testing exercises for research projects under the large aircraft program. A third engine, produced by China Air Power Center, will be used in Turbulent Wind Tunnel testing next year.

Airbus has also announced that it would like to participate in the Chinese national research projects on large commercial aircraft.

Conferences and Seminars

TransLog Asia Summit 2008

On 8 April 2008, John Larkin and Ingrid Lombardo, alongside Mitch Weinberg of Mondial Trade Compliance Services and Solutions, taught a Master Class on Asian export controls at TransLog Asia Summit 2008 in Singapore. The class addressed the nuances of the export control systems of the United States, China, Japan, and Singapore. It also focused on the strategic challenges of export compliance for shippers and logistics companies operating in the Asia/Pacific. Participants included representatives from the Singapore Ministry of Trade and Security, the Singapore Institute of Materials Management, the Global Institute of Logistics, the European Intermodal Association, and DHL.

LTI Teaches Export Control Class at CNITA Seminar in Hangzhou

LTI President John Larkin, who serves as the export compliance advisor to the China Nonwovens and Technical Textiles Industry Association (CNITA), gave a course on export controls at the CNITA seminar in May in Hangzhou. John gave an overview of the U.S. and Chinese export control systems and covered the control levels of materials that association members would find of interest, such as para aramids and carbon fibers. The course was well received and a similar course will be included in the next CNITA seminar. LTI is also discussing providing similar courses to a number of other Chinese industry associations this year.

BIS Expands Online Training Options

The Department of Commerce Bureau of Industry and Security recently added an Online Training Room to its website. Exporters can now access training modules and webinars, free of charge, on the following topics: export control basics, classifying items, general prohibitions, license exceptions, license applications, recordkeeping, deemed export controls, re-export controls, the SNAP-R online registration system, China's export control policy, and U.S. export controls in Spanish. The presentations consist of slides and audio commentary by BIS officials. LTI recommends that your export compliance personnel utilize the BIS Online Training Room as a means of keeping current on U.S. export control policy. The BIS Online Training Room can be accessed via the following link: http://www.bis.doc.gov/seminarsandtraining/seminar-training.htm.

LTI News

LTI Welcomes Intern from Monterey Institute's Center for Nonproliferation Studies

During the months of June and July 2008, LTI welcomes intern Jasper Liao to Beijing. Jasper is an M.A. candidate in Nonproliferation and Chinese Studies at the Monterey Institute of International Studies. Jasper also works part-time as a Graduate Research Assistant at the world-renowned Center for Nonproliferation Studies in Monterey, California. While working in LTI's Beijing office, Jasper will conduct research on Chinese and U.S. export controls. He is fluent in Mandarin Chinese.

LTI in Washington, DC

LTI is now up and running in Washington, DC. On June 1, 2008, LTI opened its home office in downtown Washington, two blocks from the Gallery Place/Chinatown Metro stop. Ingrid Lombardo, Director of the new office, is available to meet your trade compliance needs on Eastern Standard Time. You may contact her via telephone at 202-384-9052 and via email at ilombardo@larkintrade.com.

Coming Soon

Combining of AVIC I and AVIC II

As mentioned above, keep on the lookout for news about the combining of AVIC I and AVIC II and subsequent separation of commercial and military activities there under. While the Chinese government has not yet made any formal announcements, LTI will keep you informed as this issue develops.

BIS Issuing Expanded Entity List

BIS announced that within weeks it will issue an expanded Entity List of end users of concern, found in Supplement No. 4, Part 744 of the EAR. While the current Entity List includes companies and persons suspected of WMD-related proliferation activities, the expanded list will include entities suspected of terrorist support and conventional arms proliferation. U.S. exporting companies are encouraged to familiarize themselves with the expanded entity list. There are increased license requirements to entities on this list, even if, under normal circumstances, a particular commodity does not require a license for export to the country in which the entity resides. LTI will send out an alert when the list is published.

New Mandatory Automated Export System

On 2 July 2008, the U.S. Bureau of Census, Foreign Trade Division published an announcement requiring the use of the Automated Export System (AES) when exporting goods from the United States. In the past, exporters were required to fill out a shippers' export declaration (SED) on paper, but that information will now be filed electronically. Exporters have until 30 September 2008 to come into compliance with the new regulations. Anyone submitting a paper SED on 1 October or after will be in violation of the regulations and subject to penalties.

BIS Seminars in Washington, DC

On 22 and 23 July, the Department of Commerce Bureau of Industry and Security will host two seminars, "Essentials of Export Controls" and "How to Classify Your Item" in Washington, DC. Admission to the seminars is $100 and $75 respectively.

Kentucky Corner

Latest from the Kentucky China Trade Center

The second quarter of 2008 proved to be quite busy for the Kentucky China Trade Center (KCTC). From 27-30 March, we arranged and maintained a Kentucky booth at Interzum Guangzhou 2008, an international furniture manufacturing and woodworking trade fair in Guangzhou, China. KCTC assisted three different Kentucky lumber companies, (Roy Anderson Lumber, Begley Lumber and Somerset Wood Products), who traveled to participate in the show. In addition to booth design and assistance on the tradeshow floor, the KCTC also facilitated meetings for these companies with Chinese lumber importers.

In April, the KCTC partnered with the US Commercial Service in conducting outreach seminars in Louisville, Covington, Bowling Green, and Lexington, Kentucky. Stewart Ballard, (Senior Commercial Officer, US Consulate in Hong Kong), David Snodgrass (KCTC) and John Larkin (LTI Associates) all presented valuable insights and opportunities to Kentucky businesses on how to access the Chinese marketplace and even visited several local businesses.

In addition to recent tradeshows and outreach, the KCTC recently welcomed high-level business executives from KY companies Lexmark, Texas Roadhouse, and Alltech to our trade center in Beijing. KCTC arranged appoints for and provided guidance to these executives on how to expand their businesses in China. We welcome the opportunity to work with more companies in the next half of 2008!