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REPORT

Export Controls

Proposed Export Control Rule Would Significantly Impact Contractors

BY JASON SILVERMAN AND JOHN LIEBMAN

In March 2010, President Obama established a National Export Initiative with the goal of stimulating the economy by easing barriers to exports. Since that time, the Department of State has been proposing and adopting revisions to the International Traffic in Arms Regulations, 22 C.F.R. Parts 120-130 (''ITAR'') intended to simplify and streamline the export controls applicable to items, technology and services controlled by the United States Munitions List (''USML''). As part of that initiative, the Department of State has proposed rules that ease restrictions on the export of replacement and spare parts and, more recently, has enacted amended rules regarding the employment of dual and third-country nationals by foreign companies working on U.S. defense programs.

On April 13, 2011, the State Department published the most recent proposed rule in this initiative. If adopted, it will have significant implications for United States defense contractors and other companies performing work involving items and information subject to ITAR controls. It would significantly modify the current definition of defense services under the ITAR. Under the proposed rule, ''defense services'' would no longer include services using only ''public domain'' information, as that term is defined in the ITAR. It would also eliminate certain other activities, such as instruction in basic operation and maintenance of defense articles, from the scope of defense services. The proposed rule would also add a new class of an activity that constitutes defense services and would clarify the provisions of the existing rule regarding training of foreign military forces. Finally, the proposed rule would add examples of activities that do not constitute defense services.

''Defense Services'' Defined. Under the current definition, defense services require approval by the Department of State's Directorate of Defense Trade Controls (''DDTC''), where they involve the ''furnishing of assistance . . . to foreign persons . . . in the design, development, engineering, manufacture, production, assembly, testing, repair, maintenance, modification, operation, demilitarization, destruction, processing or use of defense articles.'' 22 C.F.R. § 120.9. Any ''assistance'' of

the sort described by the rule constitutes a defense service, provided that it involves a defense article. In other words, defense services can be provided using exclusively public domain information, with no exchange of controlled technical data whatsoever. Basic defense services associated with the sale of a defense article to a foreign end user, such as basic operation and maintenance, may be provided under the authorization of the permanent or temporary export license granted for the end item. For services beyond basic ones or for services provided by someone other than the original exporter of an article, however, DDTC has required an approved Technical Assistance or Manufacturing License Agreement, even where those services employ solely public-domain information.

In practice, this policy has led to confusion and inadvertent violations. Most defense contractor employees are well aware of what constitutes ITAR-controlled technical data or defense articles. A lack of public or civilian availability is common to ITAR-controlled items and information. Indeed, the ITAR excludes from the definition of Technical Data information that is in the ''public domain.'' A common misconception in light of this is that, so long as only ''public domain'' information is exchanged with foreign entities, all such exchanges are permissible. For instance, an engineer from a U.S. defense contractor may believe that he may discuss with an engineer from a foreign company how fundamental principles of lift and drag might warrant certain design changes in an aircraft. If that aircraft is a defense article, however, such a discussion would constitute a defense service under the current definition. Such a scenario does not present merely an academic concern. Such exchanges have in the past led to enforcement actions. Following a disastrous rocket launch incident in China in 1995, DDTC charged Space Systems / Loral (''SS/L'') with violations arising out of the company's provision of satellite launch failure analysis to engineers from the People's Republic of China.[1] While the underlying activity was conducted pursuant to export licenses for the satellite, SS/L was expressly prohibited under the terms of those licenses from providing technical assistance to the PRC. After the launch failed, however, SS/L engineers had numerous technical discussions with their counterparts in China. Among the topics discussed were such seemingly-innocuous subjects as implementing or enhancing quality control procedures.

More recently, DDTC sanctioned Analytical Methods, Inc. (''AMI''), a company that produced fluid dynamics modeling software, much of which was not ITAR-controlled but was rather controlled under the Export Administration Regulations (''EAR''). According to the charging letter in the case, AMI provided services to foreign persons in connection with defense articles such as military aircraft, submarines, and unmanned aerial vehicles.[2] Much of the conduct at issue related to software that had been specifically modified for a defense article and therefore was itself controlled. However, the charging letter also described conduct that did not expressly involve ITAR-controlled software. In charging the company, moreover, DDTC pointed out that defense services ''include the furnishing of assistance to foreign persons in the design, development, engineering, modification, or use of a defense article, even if the technical data being used is in the public domain.'' This sends a clear message that, even if the software had not been ITAR-controlled, it could still be used to provide a defense service provided a defense article was involved.

Proposed Rule Would Narrow Definition. This expansive reach has led to the criticism that the defense services definition is excessively broad. The State Department, in publishing the proposed rule, acknowledged as much, noting that it sweeps within its reach ''certain forms of assistance or services that do not warrant ITAR control.'' The proposed amendment seeks to restrict the broad sweep of the existing rule. It would revise the definition to state that a defense service is the ''furnishing of assistance (including training) *using other than public domain data* to foreign persons . . . in the design, development, engineering, manufacture, production, assembly, testing, *intermediate or depot-level* repair or maintenance . . . , modification, demilitarization, destruction, or processing of defense articles.'' (emphasis added).

The most prominent change in this definition is the express exclusion of services using only ''public domain'' data from the definition of defense services. It also omits ''operation'' and ''use'' from the types of assistance controlled, and limits the type of maintenance controlled to intermediate or depot-level.

In most respects, these proposed changes are welcome revisions. Some would argue, however, that the proposed rule does not go far enough to narrow the definition of defense services. At the crux of this criticism is the relatively narrow definition under the ITAR of what constitutes ''public domain'' information. At first glance, that definition may appear to be quite broad. It includes printed matter that is widely available through bookstores and libraries, patents, materials available at public domestic conferences, fundamental research, as well as material available through ''public release. . . after approval by the cognizant U.S. government department or agency.'' 22 C.F.R. § 120.11. The proposed changes to the defense services rule would not alter this existing definition of ''public domain.''

This definition of ''public domain'' is in fact quite narrow – or at least it is narrower than the ''common sense'' meaning of the term. Significantly, in light of how information is most commonly disseminated today, it does not extend to information that is publicly available on the internet. At a time when WikiLeaks makes frequent appearances in the news, it makes sense that the government would not go so far as to concede that any information available on the internet is in the public domain. Any reasonable definition of ''public domain'' should exclude leaks or other unauthorized disclosures of controlled or classified information.

However, the definition of public domain also would not include information deliberately placed on the internet by private parties about their own products or services, even where that information is not ITAR-controlled. It also would not include the use of proprietary methods or techniques.

[1] http://www.pmddtc.state.gov/compliance/consent_agreements/pdf/SpaceSystemsLoral_DraftChargingLetter.pdf

[2] http://www.pmddtc.state.gov/compliance/consent_agreements/pdf/AnalyticalMethods_ChargingLetter.pdf

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Rule Would Limit What Constitutes Defense Services. As a practical matter, therefore, if the proposed rule is adopted, it will narrow the scope of the types of activities that constitute defense services. Companies, nevertheless, will need to remain vigilant as to the source of information being used to provide services to foreign persons in connection with defense articles in order to ensure that information is truly ''public domain.'' Companies will also need to continue to ensure that their employees are aware of what does or does not constitute public domain information under the ITAR. The need for continued vigilance is particularly acute with regard to corporate research and development activities. With such activities, lines between public domain information and controlled information may be blurred. Similarly, companies should keep in mind that merely providing access to technical data to foreign persons may be viewed either as an export of technical data or the provision of a defense service, or both. These challenges are best met by rigorous management of data at all levels of the organization.

The proposed rule also eliminates ''use'' and ''operation'' from the types of assistance that constitute defense services. As noted above, licenses to export defense articles generally permit the exporter to instruct the foreign recipient on basic use and operation as part of the export. This proposed change would benefit exporters whose services are limited to instruction or assistance as to use or operation of defense articles not already licensed for export. Such companies will no longer need an agreement to provide these services to foreign persons generally. Notably, however, this is not the case when the person receiving the assistance is a member of a foreign military. As explained further herein, providing assistance to a member of a foreign military in the ''employment'' of a defense article would still constitute a defense service.

Finally, the proposed rule limits the sort of ''repair or maintenance'' that constitutes a defense service to ''intermediate or depot-level repair or maintenance.'' The ITAR presently does not define or differentiate among different levels of maintenance. The armed services do, however, and DDTC has been known to use these terms in proviso letters. The new proposed rule would define three levels of maintenance: ''organizational,'' ''intermediate,'' and ''depot-level.''

''Organizational maintenance'' would encompass simple inspection, cleaning, lubrication, testing, calibration, and minor replacements performed on the end-item itself. It would not be a defense service under the proposed rule. ''Intermediate'' maintenance would be defined as maintenance performed on a removed component of an end-item ''by designated maintenance shops or centers, tenders, and mobile teams in direct support of end-users units or organizations. Its phases consist of: Calibration, repair, or testing and replacement of damaged or unserviceable parts, components, or assemblies.'' ''Depot-level'' maintenance occurs at a ''major repair facility'' or ''shipyard'' and is performed by personnel with ''higher technical skill'' than those performing lower-level maintenance. Its phases also include ''inspection, testing, calibration or repair, including overhaul, reconditioning and one-to-one replacement of any defective items, parts or components; inspection, testing, calibration or repair, including overhaul, reconditioning and one-to-one replacement of any defective items, parts or components.''

It should be readily apparent that distinctions between the various maintenance levels become blurred fairly quickly and there is potential overlap. The distinctions appear to turn primarily on where maintenance is performed, the skill level of the persons performing it, and the extent to which the item requires repair. There are several types of maintenance activities that are common across the levels.

In principle, the proposed revision to the rule should reduce the need to obtain Technical Assistance Agreements. However, in order to take advantage of this narrowed scope, contractors will first need to determine the applicable category for all maintenance activities in order to determine which activities are subject to the rule. That may prove challenging in practice.

Defense Services Includes 'Integration'. The proposed rule would expressly place the ''integration'' of items into items on the USML within the scope of defense services. Such activity would constitute a defense service regardless of whether technical data is involved in the activity, and irrespective of whether the item being integrated into the USML item is also a USML item.

While this additional guidance is helpful, it does not appear particularly surprising and does not appear to be a significant departure from existing interpretations of the rules. Most people familiar with the regulations would agree that ''integrating'' something into a USML item would be ''modification of a defense article'' and, therefore, could constitute a defense service.

Training of Foreign Military Forces Addressed. The proposed rule would also clarify the existing rule regarding provision of training to foreign military forces. Currently, defense services include ''military training of foreign units and forces.'' ''Military training'' is not defined in the ITAR. This ambiguity has required defense contractors involved in providing any form of training to foreign forces (for instance, under various foreign assistance programs) to assess whether the training fell within the scope of the ITAR. For instance, it can be difficult to determine whether certain homeland security and counter-terrorism activities are ''military'' or law enforcement. Complicating matters further, in many foreign countries, the lines separating ''military forces'' and certain law enforcement and security forces are often unclear. In some countries, for example, functions such as border control and drug interdiction are performed by the military, while in others, they are performed by civilian law enforcement agencies

The revised definition clarifies that defense services comprises ''training or providing advice'' to foreign forces ''in the employment of defense articles.'' The rule would also specify that law enforcement training using solely public domain data would *not* constitute a defense service. These changes would appear to obviate the need to determine whether training is ''military.'' They should simplify contractors' determinations whether services to be provided to foreign military forces require a Technical Assistance Agreement.

There remains some potential ambiguity, however. As noted above, ''use,'' ''operation,'' and basic maintenance have been removed from the definition of defense services; however, the proposed rule would require an approved agreement when training foreign forces in the ''employment of defense articles.'' It is reasonable to conclude that ''employment'' of defense articles encompasses their ''use'' and ''operation.'' This

creates a dichotomy: training on basic use of defense articles is not a defense service unless it is being provided to a member of ''foreign forces.'' In light of this dichotomy, it is especially important that contractors make accurate determinations concerning whether foreign entities constitute ''foreign units or forces'' as opposed to civilian security or law enforcement agencies. The same training that requires a license or approval for one would not require such approval for the other.

Examples of Activities That Are Not 'Defense Services'. Finally, the proposed rule adds the following examples of activities that are not defense services:

- training in the basic operation (functional level) or basic maintenance of a defense article
- mere employment of a U.S. citizen by a foreign person
- testing, repair, or maintenance of a commercial item that has been incorporated or installed into a defense article
- providing law enforcement, physical security or personal protective training, advice, or services to or for a foreign person using only public domain data
- providing assistance (including training) in medical, logistical (other than maintenance), or other administrative support services to or for a foreign person.

Some of these examples are illuminating. Two of these examples amplify the changes to the rules regarding training of foreign forces. They make clear that defense services do not encompass law enforcement-type training or training in medical, logistical, or administrative support. Other examples seem perplexing. Few companies would have concluded that mere employment of a United States person by a foreign person, without more, would constitute a defense service.

Conclusion. The proposed rule, if adopted, should ease licensing burdens on contractors somewhat by reducing the number of activities that require an agreement or other approval. However, contractors will still need to make informed and well-reasoned determinations under the revised rule concerning which services will no longer require such approval. And, if the rule is adopted in its current form, contractors will still need to grapple with certain ambiguities regarding its scope, particularly when performing services involving ''foreign units and forces.''

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