PROPOSED ITAR BROKERING RULES SIGNAL EXPANDED COVERAGE

The International Traffic in Arms Regulations ("ITAR") regulate not only the export of defense articles and services, but also "brokering." Under current regulations, a "broker" is any person who acts as an agent for others in negotiating or arranging contracts, purchases, sales or transfers of defense articles or defense services in return for a fee, commission, or other consideration.

As part of the effort to revise and update U.S. export controls, the Directorate of Defense Trade Controls ("DDTC") has proposed to extend the regulatory reach of the brokering rules to include many entities and activities that are currently outside the scope of the ITAR, with significantly expanded extraterritorial application. If approved, entities with only attenuated exposure to the defense trade could face potentially severe penalties for violations that arguably have only a tangential relationship to national security. Other proposed (and less controversial) changes include streamlining the registration process by eliminating duplicative manufacturer/exporter and broker registrations for many DDTC registrants.

"Brokering activities" under the current ITAR means 1) acting as a "broker" and 2) include financing, transportation, freight forwarding, and any other action that facilitates the manufacture, export, or import or a defense article or defense service. DDTC proposes to change the definition of brokering activities so that it includes, but is not limited to, "any action to facilitate the manufacture, export, re-export, import, transfer or retransfer of a defense article or defense service," including both "financing, insuring, transporting, or freight forwarding defense articles or defense services," as well as "soliciting, promoting, negotiating, contracting for, arranging or otherwise assisting in the purchase, sale, transfer, loan, or lease of a defense article or defense service." (Emphasis supplied.) In addition, DDTC proposes to eliminate the requirement that brokers act as an agent for others or that they do so for a fee. Instead, DDTC proposes to define a broker as "any person who...engages in brokering activities."

Key exemptions would blunt the impact of the proposed changes, although they have not stifled criticism. For example, the proposal maintains the current exclusion for activities by a U.S. person in the United States that are limited exclusively to U.S. domestic sales or transfers, and makes clear that brokering does not include exclusively administrative services, such as providing or arranging office space and equipment, hospitality, advertising, clerical, visa, or translation services, or activities by an attorney that do not extend beyond providing legal advice. Nevertheless, under the proposal, the universe of entities required to register with DDTC as brokers is expected to expand significantly.

A review of the public comments received by DDTC shows that industry -- both U.S. as well as foreign -- is overwhelmingly opposed to these definitional changes. TechAmerica, a trade association representing the 1,200 U.S. technology companies, bluntly states a common sentiment, that "[t]he expansive scope of the proposed brokering rule undermines the Administration's stated goals of enhancing US national security and global competitiveness." Echoing a consistent theme, the American Bar Association Section of International Law ("ABA") argues that the proposal is beyond the scope of Congressional intent in the Arms Export Control Act, and strongly criticizes the proposed standard on "facilitation."

> "[T]he proposed definitions ... do not clearly set forth the activities that constitute 'facilitation' of defense-related activities, and...remove well settled, legally justified, and important limitations of the term 'brokering'...."

Some observers note that "facilitation" has been deemed by the Department of the Treasury's Office of Foreign Assets Control ("OFAC") to capture even the smallest of transactions. Although facilitation is also covered by the current rule, the expansion of the definition, coupled with removal of the requirement that brokers act as the agent for others or do so for a fee, makes the concept of facilitation more closely resemble the OFAC model. The ABA argues:

> "[J]ust about any activity linked to defense trade could be interpreted to 'aid' or 'help' the manufacture, export, import or transfer of a defense article or defense service. [M]any non-administrative actions could be viewed as 'aiding' in defense trade. Absent further clarity, it would be extremely difficult for persons to conform their conduct to the proposed law without effectively boycotting all defense companies."

Moreover, if adopted as proposed, entities newly captured by the expansive new definitions of "broker" and "brokering activities" would be subject to all of the registration, record keeping and licensing requirements for brokers under the ITAR. This is of particular concern to foreign companies, since the regulation would significantly expand the extraterritorial application of the ITAR. As the National Association of Manufacturers observed:

> "[T]he proposed rule could require a foreign person negotiating a sale between foreign entities to register as a broker if the product had any ITAR controlled content. It could require a foreign company that incorporates ITAR-controlled U.S. components into their product to register as a broker to sell that product -- above and beyond the current licensing requirements on re-transfer of that product. It could require a foreign company listed as a sublicensee on an approved Technical Assistance Agreement...to register as a broker. If these scenarios unfold, the proposed rule would significantly disrupt manufacturing processes and inhibit trade."

Echoing this theme, the AeroSpace and Defence Industries Association of Europe warned, "...given that no boundaries are placed on the definition of 'brokering activities'...[it] could mean that any and all European companies handling ITAR material would be obligated to register as brokers..." ADS noted that this requirement could apply even to "any non-US firms seeking to export military equipment *to* the USA..." (Emphasis supplied.)

New Proposed Exemptions from Registration as a Broker

Notwithstanding the expanded scope of the proposed rule, a number of proposed exemptions would simplify the regulatory process for some DDTC registrants.

First, persons "exclusively" engaged in financing, insuring, transporting, or freight forwarding would not need to register as brokers, seek prior approval for their services, or maintain records. This assumes, however, that the activities do not extend beyond mere financing, etc. and do not extend (for example) to arranging transactions, or to other activities for which registration is required.

Further, registration and prior approval would not be required of U.S. subsidiaries, joint ventures, and affiliates of ITAR registrants identified in registration statements, their "bona fide and full-time regular employees," and their identified and exclusive foreign brokers, provided that activities are limited to the DDTC-approved exports of the registrant or are conducted on behalf of the registrant and involve the DDTC-approved exports of a U.S. supplier. (Recordkeeping, however, would be required.)

In addition, the proposed rule would eliminated the duplicate registrations required of ITAR registrants as both manufacturers/exporters and brokers. Under the proposed rule, many persons registered as manufacturers or exporters, including their U.S. subsidiaries, joint ventures, and other affiliates, including foreign affiliates, would not need to register as brokers. Corresponding changes to the ITAR would give DDTC discretion to permit a broker that is a parent entity of a registered broker to be covered by the registrant's Statement of Registration. Although this streamlining is subject to numerous caveats, it could simplify the annual registration requirements for many companies.

The Administration's export control reform initiative is intended to address the failures of the existing system. As then-White House Chief of Staff Bill Daley explained in July of 2011, "the current export control system..., in trying to control too much, diminishes our ability to focus on the most critical national security priorities, impairs the interoperability of our Armed Forces with our Allies in the field, and undermines the competitiveness of sectors key to U.S. national security." Critics argue that the brokering proposal is at odds with these stated goals of export reform, and the breadth and depth of the criticism makes it unlikely that it will be finalized anytime soon. Nevertheless, it is unlikely to go away altogether. Companies engaged in the marketing, distribution, and sale of defense articles, including foreign entities, are well advised to prepare for new rules on brokering within the year.

For a copy of the proposed brokering rule, or to learn more about export control reform or Kaye Scholer's National Security/CFIUS practice, please contact us:

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