



EXPORT CONTROLS UPDATE

DDTC Proposes Long-Awaited Changes to Defense Trade Brokering Rules

On December 19, 2011, the U.S. State Department's Directorate of Defense Trade Controls (DDTC) [proposed](#) long-awaited changes to the rules governing the brokering of defense articles and defense services under the International Traffic in Arms Regulations (ITAR). Comments on the proposed changes are due by February 17, 2012.

The proposed rule entails far-reaching changes to the ITAR brokering provisions, as well as certain related provisions applicable to manufacturers and exporters of defense articles and defense services. The principal changes proposed by DDTC are summarized below.

Clarified Definition of "Brokering Activities"

The proposed rule would clarify the definition of "brokering activities" in several respects. As an initial matter, DDTC proposes to revise the definition to more closely track the Arms Export Control Act (AECA), which provides that brokering activities include the financing, transportation, freight forwarding or taking of any other action that facilitates the manufacture, export or import of a defense article or defense service. The proposed rule would delete the phrases "who acts as an agent for others" and "in return for a fee, commission, or other consideration" that appear in the current regulatory definition but not in the AECA. The deletion of these phrases would expand the activities subject to the brokering provisions of the ITAR, as companies often have relied upon this language when determining that certain activities did not constitute brokering.

However, the proposed rule also would limit the applicability of the brokering provisions in certain respects. Specifically, under the proposed rule, brokering expressly would not include activities limited to administrative services, such as providing or arranging office space and equipment, hospitality, advertising services, clerical services, visa services, translation services and the provision of legal advice. This clarification is consistent with industry's current understanding of the ITAR brokering provisions.

In addition, the proposed rule makes clear the situations in which the activities of foreign persons constitute ITAR-controlled brokering, which has been the source of some confusion under the current regulatory definition. Specifically, the proposed rule specifies that foreign persons are engaged in ITAR-controlled brokering when they undertake brokering activities either (1) while physically located in the United States, or (2) when they are located outside the United States and (a) dealing in U.S.-origin defense articles or defense services, (b) involved in the import into the United States of a defense article or defense service of any origin, or (c) acting on behalf of a U.S. person.

Streamlined Registration Process

The proposed rule also would streamline the registration process to ameliorate the administrative burden associated with the expanded definition of brokering activities. Entities such as banks, freight forwarders and insurance companies would continue to be exempted from the registration requirement. In addition, a separate broker registration would no longer be required for a company registered under the ITAR as a manufacturer or exporter, so long as the registration statement identifies certain information related to brokering activities. Importantly, a single registration statement also could cover the brokering activities of all entities in a single corporate/control group, so long as the entities involved in brokering activities are identified in the registration statement and their brokering activities involve only (1) the registered entity's licensed defense articles or defense services or (2) transactions on behalf of the registered entity involving licensed U.S.-origin defense articles or defense services exported from the United States.

For example, if a U.S. manufacturer/exporter of defense articles uses a network of U.S. affiliates to sell its licensed products, these affiliates can be included in the U.S. manufacturer/exporter's ITAR registration. The affiliates would not have to be registered separately as brokers. Similarly, the U.S. manufacturer/exporter's foreign brokers (which could include foreign affiliates of the U.S. manufacturer/exporter) also could be covered by the manufacturer/exporter's registration statement, thereby avoiding the separate broker registration requirement. Such foreign brokers must be "exclusive" to the U.S. manufacturer/exporter, but it is unclear if this undefined exclusivity requirement applies to U.S. entities included in a U.S. manufacturer/exporter's ITAR registration.

Importantly, if additional entities are included in a U.S. manufacturer/exporter's registration statement, the certification accompanying the statement would have to cover all of these entities. This certification requires the registrant to disclose any convictions, indictments and other charges under certain U.S. laws involving all covered entities, as well as their senior officers and directors. Under the proposed rule, certifications for registrations covering brokering activities also would require disclosure with respect to the same entities and individuals of convictions, indictments or charges under the foreign analogs of the U.S. laws.

Moreover, both registrants and entities exempted from registration requirements (*e.g.*, banks, freight forwarders, insurance companies) would be subject to DDTC's policy concerning defense trade embargoes. This policy requires such entities to refrain from engaging in (or proposing to engage in) ITAR-controlled brokering activities (as defined above) involving countries, areas or persons subject to defense trade embargoes.

Simplified Brokering Approval Requirements

The proposed rule also would simplify brokering approval requirements. Prior notification of certain brokering activities, which was confusing to industry and difficult to administer, would be eliminated. Instead, prior approval (*i.e.*, an authorization) would be required for all brokering activities unless an exemption applied. In addition to clarifying certain existing exemptions (such as the exemption applicable to banks, freight forwarders and insurance companies), the proposed rule would add two new exemptions. First, brokers identified in a U.S. manufacturer/exporter's registration (as described above) would be exempt from prior approval requirements. This change recognizes that the transactions in which these brokers would be involved necessarily would be subject to export licensing requirements, rendering duplicative a separate prior approval for brokering activities.

Second, brokering activities outside of North Atlantic Treaty Organization member countries, Australia, Japan, New Zealand or the Republic of Korea would be exempt from prior approval if they involve only U.S.-origin defense articles that are not significant military equipment and foreign government or international organization end-users. Brokering activities involving certain enumerated categories of defense articles would be ineligible for this exemption. A \$25 million cap for defense articles and defense services also would apply.

In addition, the proposed rule would clarify the procedures for requesting prior approval (as well as advisory rulings). The proposed rule recognizes that, in certain instances, all of the information required in a request for prior approval may not be available. Brokers would have the opportunity to explain the omission of the information, which DDTTC would have the discretion to take into account when evaluating the request for prior approval.

Public Comments Requested

DDTTC has requested public comments concerning its proposed changes to the ITAR brokering provisions. Comments are due by February 17, 2012.

Sidley Austin LLP has a team of lawyers well-versed in the brokering provisions of the ITAR. We would be pleased to assist in the preparation of comments concerning the proposed changes to these provisions, as well as the evaluation of current brokering compliance procedures to determine their compatibility with the proposed changes.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

Export Controls Practice

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