

International Trade Alert

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State Department Publishes Long-Awaited Interim Final Rule Amending ITAR Brokering Provisions

Venable's **International Trade and Customs Practice Group** is publishing a four-part series of Client Alerts to highlight the changes surrounding the ECR (Export Control Reform). Below is **Part 1** of the series.

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On August 26, 2013, the U.S. State Department's Directorate of Defense Trade Controls (DDTC) published an **Interim Final Rule** that makes significant changes to the current definitions of "broker" and "brokering activities" in Part 129 of the International Traffic in Arms Regulations (ITAR). The much-anticipated Interim Rule will go into effect on October 25, 2013.¹

The ITAR's brokering provisions implement the Arms Export Control Act's requirement that persons engaged in the business of brokering arms be registered with the State Department. As currently written, the brokering provisions are generally considered ambiguous because they fail to precisely define those activities that constitute "brokering activities." As such, questions as to what triggered the requirements of the ITAR brokering provisions, including requirements for registration, reporting, and obtaining "prior approval," were pervasive under the old rules.

The revisions contained in the Interim Final Rule have been long-awaited by the trade community. Since 2003, the State Department has indicated that DDTC would consider modifications to Part 129. Draft revisions were released in 2009 and again in 2011. Finally, in late 2012, DDTC released yet another set of draft revisions to the Defense Trade Advisory Group (DTAG), which are reflected in the key changes contained in the current Interim Final Rule. Several of those pertinent interpretations are noted below.

Definition of Brokering Activities

Under the Interim Final Rule, the definition of "brokering activities" is revised at ITAR, § 129.2(b). Although the revisions are not as seemingly significant as expected, they appear to clarify several interpretations that DDTC has promulgated in the past. "Brokering activity" is now defined as:

"Any action on behalf of another to facilitate the manufacture, export, permanent import, transfer, reexport, or retransfer of a U.S. or foreign defense article or defense service, regardless of its origin. Such action includes, but is not limited to: (1) Financing, insuring, transporting, or freight forwarding defense articles and defense services; or (ii) Soliciting, promoting, negotiating, contracting for, arranging, or otherwise assisting in the purchase, sale, transfer, loan, or lease of a defense article or defense service."

Notably, the revised definition includes activities that are undertaken "on behalf of another." At first read, this language could be interpreted more broadly than the current definition, which states "act[ing] as an agent for others." However, DDTC has historically interpreted "agent" to extend well beyond the traditional principal-agent relationship. Thus, it appears that the Interim Final Rule more accurately captures DDTC's position. It also formalizes DDTC's position that facilitation of an in-country transfer or retransfer, or a reexport from one foreign country to another, constitutes brokering activity.

Importantly, the Interim Final Rule also narrows the definition of "brokering activities" by explicitly excluding those activities performed by an affiliate (defined as a person that directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with a DDTC Registrant) on behalf of another affiliate. Thus, activities undertaken within the corporate family of a single Registrant that meet this definition do not qualify as brokering.

The narrowed definition of brokering activities also notes an extensive list of specific excluded activities,

which do not constitute "brokering activities." Examples include:

- . Activities by regular employees acting on behalf of their employer;
- . Activities that do not extend beyond administrative services; and
- . Collecting product and pricing information to prepare a response to a request for proposal.

Finally, the Rule attempts to draw a line and clarify that simply acting as an end-user of defense articles or defense services pursuant to a DDTC license or authorization, or acting as a re-exporter set forth in such authorizations are not considered "brokering activities."

Definition of Broker

The Interim Final Rule dramatically revises the definition of a "broker" in Section 129.2(a) of the ITAR to include:

"Any person who engages in the business of brokering activities who is: (1) A U.S. person, wherever located; (2) Any foreign person located in the United States; or (3) A foreign person located outside the United States where the foreign person is owned or controlled by a U.S. person."

This change represents a significant shift from DDTC's prior practice. In the past, DDTC routinely treated non-U.S. persons as "brokers" if the non-U.S. person acted as an agent in negotiating a contract for the delivery of U.S. defense articles or defense services, even if he/she had no other U.S. contacts and was not physically located in the U.S. Under the Interim Final Rule, the only foreign persons that are required to register as brokers are those within the U.S. and those outside the U.S. who are "owned/controlled" by a U.S. person. DDTC estimates that based on this change, approximately 1,300 of the currently-registered brokers will not need to maintain registration following implementation of the Interim Final Rule.

As now drafted, the Rule makes "owned by a U.S. person" consistent with other ITAR provisions, and defines it as ownership of more than 50% of the outstanding voting securities of the firm by a U.S. person. Likewise, "controlled by a U.S. person" means one or more U.S. persons have the authority or ability to establish or direct the general policies or day-to-day operations of the firm. The Interim Final Rule further establishes a rebuttable presumption of U.S.-control where U.S. persons own 25% or more of the outstanding voting securities, unless one foreign person controls an equal or larger percentage.

Registration Requirements

The Interim Final Rule will permit U.S. and foreign subsidiaries and affiliates owned or controlled by a DDTC Registrant to be listed as "brokers" on the Registrant's manufacturer/ exporter registration. Therefore, a separate broker registration and broker registration fee will not be required in those instances when an entity performs multiple roles. The Rule cautions that the manufacturer/exporter and brokering statements of registration should only include those subsidiaries and affiliates that are more than 50% owned or otherwise controlled by the Registrant and engaged in such activities. DDTC estimates that approximately 300 brokers will be eligible to consolidate their broker registration with their manufacturer/exporter registration and will no longer be required to pay a separate broker registration fee.

Prior Approval Requirement and Procedures

The Interim Final Rule substantially narrows the circumstances in which the requirement for those engaging in brokering activities are required to obtain prior approval from DDTC. Section 129.7 of the current regulations requires those engaging in a broad list of brokering activities to obtain prior approval from DDTC. Conversely, the Interim Final Rule now requires Registrants to seek and obtain prior approval before engaging in brokering activities, as defined, only if the broker is engaged in brokering of: (1) Foreign defense articles/services; and/or (2) Specific end-items, listed in § 129.4(a)(2) of the Interim Final Rule. These end-items include foreign defense articles or defense services and U.S.-origin defense articles and services contained in certain categories of the United States Munitions List (USML), as follows:

- Firearms and other weapons of a nature described by Category I(a) through (d), Category II(a) and (d), and Category III(a);
- Rockets, bombs, and grenades as well as launchers for such defense articles of a nature described

by Category IV(a), and launch vehicles and missile and anti-missile systems of a nature described by Category IV(b) (including man-portable air-defense systems);

- Vessels of war described by Category VI;
- Tanks and military vehicles described by Category VII;
- Aircraft and unmanned aerial vehicles described by Category VIII;
- Night vision-related defense articles and inertial platform, sensor, and guidance-related systems of a nature described by Category XII(c) and (d);
- Chemical agents and precursors described by Category XIV(a), (c), and (e), biological agents and biologically derived substances described by Category XIV(b), and equipment described by Category XIV(f) for dissemination of the chemical agents and biological agents described by Category XIV(a), (b), and (e);
- Submersible vessels described by Category XX; and
- Miscellaneous articles of a nature described by Category XXI.

Newly redesignated ITAR Section 129.6 states the procedures for obtaining DDTC approval. This section clarifies the information that must be submitted to DDTC *when a prior approval is required*. Under the Interim Final Rule, all requests for approval must be signed and certified by an empowered official and must include:

- The applicant's name, address and registration code;
- Certifications regarding whether certain applicant employees are the subject of an indictment, have been otherwise charged, or have been convicted of certain crimes;
- A full description of the brokering activities to be undertaken, including: (1) the actions to be undertaken by the applicant; (2) the name, nationality, address, and place of business of all persons who may participate in the brokering activities; (3) a description of each defense article or service involved (USML category, name or military nomenclature, whether the article is significant military equipment, estimated quantity of each article, estimated dollar value, security classification, and end-user and end-use); and
- A statement as to whether the brokering activities are related to a sale through direct commercial sale or under the U.S. Foreign Military Sales program (or otherwise in support of the U.S. Government).

If at the time of submission any of the required information is not yet available, this must be noted and explained in the empowered official certification.

Prior Notification Requirement

The current regulations require prior DDTC notification for brokering activities with respect to Significant Military Equipment valued at less than one million dollars, except for sharing of basic marketing information. Prior approval is required under the current regulations with respect to Significant Military Equipment valued above one million dollars. Notably, the Interim Final Rule eliminates the prior notification requirement in its entirety.

Carefully consider your business activities dealing with defense articles and defense services, whether as a manufacturer, exporter, or broker. If these changes will affect your operations and those of your affiliates, either favorably or detrimentally, **consider filing public comments before the October 10, 2013 deadline.**

Venable is well positioned to provide advice with respect to the pending rule change or any other aspects of Export Control Reform. Please contact any attorneys in our [International Trade and Customs Group](#) for assistance.

¹ Although DDTC will eventually publish a "final" brokering rule, and will accept public comments on the Interim Final Rule until October 10, 2013, absent an uproar from the trade community, we currently anticipate that the Interim Final Rule will likely take effect without significant modification.