

williams mullen

Thomas B. McVey
Direct Dial: 202.293.8118
tmcvey@williamsmullen.com

IS MY COMPANY SUBJECT TO ITAR?

By: Thomas B. McVey, Esq.¹
Washington, DC
February 6, 2012

There is an important area of regulation often overlooked by U.S. companies – ITAR. ITAR stands for International Traffic In Arms Regulations. ITAR are State Department regulations governing products, technologies and services developed for military use that are most often associated with defense and government contracts firms. However ITAR frequently extends far beyond these firms to companies in the engineering, communications, manufacturing, transportation, software, chemical, maritime, technical services and other fields. In light of the broad reach and severe sanctions for ITAR violations (including civil and criminal penalties for companies and their employees), every company should determine if it is subject to ITAR. The purpose of this Memorandum is to help companies analyze if they are subject to ITAR and the requirements that may apply to them.

1. What Is ITAR?

(a) Introduction. The International Traffic In Arms Regulations² are controls that regulate the manufacture, export and import of products designated by the State Department as having military significance, along with technical data, software and services related to such products. They are promulgated under the Arms Export Control Act³ and administered by the Directorate of Defense Trade Controls (“DDTC”) within the U.S. State Department.⁴ Under the AECA, the President has broad authority to identify products that are subject to regulation under ITAR and to establish legal controls related to such products.⁵

¹ Thomas B. McVey is a Partner with Williams Mullen in Washington, DC where he advises clients on the federal regulation of international business transactions including under the International Traffic In Arms Regulations, the Export Administration Regulations and the U.S. Sanctions Programs administered by the Office of Foreign Assets Control.

² The International Traffic In Arms Regulations are set forth at 22 CFR Part 120 et seq.

³ 22 U.S.C. sec. 2778.

⁴ The Department of Defense is also involved in administering these regulations through the Defense Technology Security Administration and other Defense agencies.

⁵ The legal standard used by the President to designate items to be regulated under ITAR is set forth at 22 CFR § 120.3 as follows: An article or service may be designated or determined in the future to be a defense article (see §120.6) or defense service (see §120.9) if it: (a) Is specifically designed, developed, configured, adapted, or modified for a military application, and (i) Does not have predominant civil

ITAR has historically applied to the defense and government contracts industries. However, as many products and technologies that were originally developed for the military are transformed into commercial products, these regulations have come to apply far beyond the military/government field to many other industries. They also apply beyond commercial firms to universities, research institutions and other not-for-profit organizations involved in technology research and development.⁶ Since the evolution of products from the military to commercial sectors is so prevalent in our society (satellites, GPS and encryption, to name just a few), ITAR reaches into many corners of our economy.

(b) Note Regarding Export Control Reform Initiative. At the time of this writing, the Obama administration has initiated a broad series of proposed amendments to rationalize and update the U.S. export control laws, including ITAR (the “Export Control Reform Initiative”). As part of this Initiative, proposals have been promulgated by DDTC and the Bureau of Industry and Security within the Commerce Department (“BIS”) to transfer export controls for certain products from the jurisdiction of DDTC and ITAR to BIS.⁷ Products that are proposed to be transferred include end-items as well as parts, components and accessories of certain USML items. These proposals would also implement other changes in the export control laws. At the time of this writing it is not clear when, or even if, such proposed changes will actually be adopted. Parties reviewing this article should use care to verify if any of the proposed amendments referenced above have become effective since the date of this article.

(c) The U.S. Munitions List. The starting point in analyzing if a Company is subject to ITAR is the U.S. Munitions List (“USML”).⁸ The USML is a list of products, technical data, software and services subject to ITAR controls. If a company’s product or related technical data, software or services are listed on the USML, it is subject to

applications, and (ii) Does not have performance equivalent (defined by form, fit and function) to those of an article or service used for civil applications; or (b) Is specifically designed, developed, configured, adapted, or modified for a military application, and has significant military or intelligence applicability such that control under this subchapter is necessary. The intended use of the article or service after its export (*i.e.*, for a military or civilian purpose) is not relevant in determining whether the article or service is subject to the controls of this subchapter. Any item covered by the U.S. Munitions List must be within the categories of the U.S. Munitions List. The scope of the U.S. Munitions List shall be changed only by amendments made pursuant to section 38 of the Arms Export Control Act (22 U.S.C. 2778).

⁶ The Department of Defense has also been increasing defense procurement from traditionally commercial firms to reduce costs and broaden the defense industrial base, further drawing companies into ITAR jurisdiction.

⁷ See, e.g., Federal Register Vol. 76, No 136, p. 41985 (July 15, 2011); Federal Register Vol. 76, No 215, p. 68675 (November 7, 2011); Federal Register Vol. 76, No 215, p. 68694 (November 7, 2011); Federal Register Vol. 76, No 234, p. 76085 (December 6, 2011); Federal Register Vol. 76, No 234, p. 76100 (December 6, 2011); Federal Register Vol. 76, No 247, p. 76072 (December 6, 2011); Federal Register Vol. 76, No 247, p. 76097 (December 6, 2011); Federal Register Vol. 76, No 247, p. 80282 (December 23, 2011); Federal Register Vol. 76, No 247, p. 80302 (December 23, 2011); Federal Register Vol. 76, No 247, p. 80291 (December 23, 2011); Federal Register Vol. 76, No 247, p. 80305 (December 23, 2011).

⁸ 22 C.F.R. Part 121.

regulation under ITAR.⁹ Thus the USML is the foundation of ITAR regulation and the starting point in analyzing ITAR jurisdiction.

The USML is comprised of 21 categories of items, which range from computers to navigational devices to satellites¹⁰. A complete list of the USML Categories is set forth in Appendix A. However, reviewing the categories alone is insufficient to properly analyze if a company’s items are on the USML – a company must review each sub-item on the list in detail as well as the USML interpretations set forth at 22 C.F.R. §121.2 et seq. The following are a sampling of the types of items listed on the USML:

WHAT IS ITAR?	
Category	Article
XI(a)	Electronic systems and equipment designed, modified or configured for intelligence, security or military purposes;
XI(a)(6)	Computers designed or developed for military application or modified for use with any USML item;
VIII(e)	Navigation systems;
X	Protective personnel equipment and shelters;
XI(a)(1)	Underwater sound equipment;
V, XIV	Chemical and toxicological agents;
VIII	Drone aircraft;
XI(a)(7)	Experimental or developmental equipment designed or modified for military application;
XI(a)(5)	Command, control and communications systems including radios (transceivers) and identification equipment;
VI	Naval vessels and related equipment, parts, technologies and software;
VIII(e)	Flight control products, software and technologies;
XV	Satellites, launch vehicles and ground control equipment, including parts, technologies and software;
XVII	Classified products, technical data and software;
IX	Military training services and equipment;
X(a)(3)	Anti-gravity and pressure suits, atmosphere diving suits
X(a)(1)	Body armor;
XIII	Auxiliary military equipment.

(d) Technical Data and Software. The USML includes not just physical products, but also technical data and software. If a physical product is on the list, technical data related to such product is typically also included on the list and subject to ITAR controls. The term “technical data” is broadly defined under ITAR to include information that is required for the design, development, production, manufacture,

⁹ In addition, providing services related to defense articles using only commercial products or even public domain information can trigger ITAR requirements as discussed in Section 1(g) below. See discussion of Analytics Methods, Inc. in Section 1(g) below.

¹⁰ In 1998, Congress passed the Strom Thurmond National Defense Authorization Act, which states that “all satellites,” including commercial communication satellites, research satellites, and other non-military satellites, as well as satellite fuel, ground support equipment and other related items, are subject to the ITAR. Pub.L. 105-261§1513 (Oct. 17, 1998)

assembly, operation, repair, testing, maintenance or modification of articles listed on the USML.¹¹

Thus information in the form of blueprints, manuals, specification sheets, drawings, photographs, plans, instructions and other documentation, in both hard copy and electronic form, are included on the USML. Information concerning general scientific, mathematical or engineering principles commonly taught in schools, colleges and universities or information in the public domain as defined in §120.11 is excluded from the definition of Technical Data.¹²

Similarly, software¹³ is also regulated on the USML. The term software is defined at 22 C.F.R. §121.8(f) to include the system functional design, logic flow, algorithms, application programs, operating systems and support software for design, implementation, test, operation, diagnosis and repair. Typically, if a product is on the USML, software used to operate such item is also on the USML, and certain software is listed independent of any specific products.

(e) **Services.** ITAR also applies to the performance of services related to items on the USML. The term “Defense Services” is defined at 22 C.F.R. §120.9 as:

- (1) The furnishing of assistance (including training) to foreign persons, whether in the United States or abroad, in the design, development, engineering, manufacture, production, assembly, testing, repair, maintenance, modification, operation, demilitarization, destruction, processing or use of defense articles;
- (2) The furnishing to foreign persons of any technical data controlled under this subchapter (see §120.10), whether in the United States or abroad; or
- (3) Military training of foreign units and forces, regular and irregular, including formal or informal instruction of foreign persons in the United States or abroad or by correspondence courses, technical, educational, or information publications and media of all kinds, training aid, orientation, training exercise, and military advice. (See also §124.1.)

As discussed further below, defense services can be provided using only public domain information or commercial products.¹⁴ It should be noted that, at the time of this writing, DDTC has proposed an amendment of the definition of Defense Services that would make technical changes to the provisions in this section.¹⁵

¹¹ See 22 C.F.R. § 120.10.

¹² In addition, Technical Data does not include basic marketing information on function or purpose or general system descriptions of defense articles. See 22 C.F.R. §120.10(a)(5).

¹³ See 22 C.F.R. §121.8(f).

¹⁴ See discussion of Analytics Methods case in Section 1(g) below.

¹⁵ See Department of State Proposed Rule, Federal Register Vol. 76, No. 71, p.20590, April 13, 2011. At the time of this writing, the amendment is in proposed form and has not yet been adopted.

(f) **Category XXI.** One of the USML categories is Category XXI – a catch-all placed as the last item on the list. Category XXI reads as follows:

(a) Any article not specifically enumerated in the other categories of the U.S. Munitions List which has substantial military applicability and which has been specifically designed, developed, configured, adapted, or modified for military purposes. The decision on whether any article may be included in this category shall be made by the Director, Office of Defense Trade Controls Policy.

(b) Technical data (as defined in §120.10 of this subchapter) and defense services (as defined in §120.9 of this subchapter) directly related to the defense articles enumerated in paragraph (a) of this category.

Thus many other items that were originally developed or modified for a military purpose are listed on the USML. Many government contracts firms that supply products or perform services for the Department of Defense – including hardware, components, software, studies and analyses, and technical services – fall within this requirement.¹⁶

(g) **Other Items.** The following are additional items that are included on the USML:

- **Modified Products.** If a company develops a purely commercial product, and later modifies it for a military application, there is a strong chance that the modified product will be treated as on the USML and subject to ITAR.
- **SBIR; Government Research Funding.** If a product, technology, software or service is developed using government military funding, such as under SBIR research contracts, the items developed under such contracts are often classified on the USML. This includes products, software and technical data developed under such contracts. In some cases the SBIR contract will actually state if the subject matter and work product developed under the contract are covered under ITAR. However, if the contract is silent, companies should not presume that the work product is not covered – they should go through their own analysis of whether ITAR applies to make this assessment. Drawing the incorrect conclusion can result in significant liability for the company. This is a major issue for universities that receive research funding from the U.S. government – in one recent case a university professor was convicted of ITAR violations and sentenced to four years imprisonment for violations related to university research involving technical data listed on the USML.¹⁷

¹⁶ In an advisory issued on September 8, 2009, DDTC directed parties submitting licensing documents to identify the USML categories for their products using the specific USML categories I – XX rather than the “catch-all” Category XXI, unless such party was specifically authorized to use Category XXI in a Commodity Jurisdiction determination letter or a letter of authorization from the Director of Defense Trade Controls Policy.

¹⁷ See United States v. John Reece Roth, 628 F.3d 827, U.S. Court of Appeals for the Sixth Circuit (2011).

- Components, Parts and Accessories. If a product is on the USML, parts, components and accessories related to such product are also frequently included on the USML and subject to ITAR requirements, especially if such parts and components have been specifically designed, developed or modified for the military item. (Note that under the Export Control Reform Initiative, the proposed regulations promulgated by DDTC as referenced in Section 1(b) above, provide for the transfer of many parts, components and accessories of USML items off of the USML and onto the Commerce Control List to be regulated by BIS under the Export Administration Regulations).
- End Products and the See-Through Rule. DDTC has a general policy that, if an item is on the USML and it is used as a component in an end-product, the entire end-product is then considered on the USML and subject to ITAR. This rule, called the “See-Through Rule,” is not set forth in any regulation but rather is applied through DDTC’s licensing practices. The “See-Through Rule” has significant ramifications for companies bringing products to market – if even only parts or components used in their commercial products are on the USML, the entire finished product can be listed on the USML and subject to ITAR.
- Associated Manufacturing and Testing Equipment. If a product is on the USML, specialized equipment used in the manufacture or testing of such product are also frequently on the USML and subject to ITAR, especially if such equipment was developed or modified specifically for use with the USML item. Software, technical data and services related to such manufacture and testing equipment are most likely also on the USML.
- Computers Modified to Operate USML Items. Under USML Category XI(a)(6), any computer that is modified to be used with any item on the USML is itself also listed on the USML.
- Classified Items. Classified articles, technical data and defense services are on the USML (Category XVII). Consequently, if a company produces classified items or performs classified services for a government agency, it is regulated under ITAR.
- Services Using Public Domain Information or Commercial Items. Certain services can be subject to ITAR regulation even if the underlying product associated with such services is not on the USML. For example, in a well known DDTC enforcement case involving Analytics Methods, Inc.,¹⁸ the company was performing services for a foreign military organization using commercial software programs that were “dual- use” (EAR99) and not on the

¹⁸ See United States Department of State, Bureau of Political-Military Affairs, In the Matter of: Analytics Methods, Inc. Copies of the Proposed Charging Letter, Consent Agreement and Order are available on the DDTC website.

USML. DDTC claimed that the services were “defense services” regulated under ITAR since they were performed on a military system, even though the software programs were dual-use, and charged the company with ITAR violations.¹⁹ The company eventually entered a Consent Agreement related to the violations.

(h) Brokering. Persons engaged in the business of “brokering activities” as defined under the ITAR brokering controls are subject to ITAR regulation²⁰. The term “Broker” is defined in ITAR §129.2 as “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.” The term “Brokering Activities” is defined in §129.2 as: “acting as a broker as defined above and includes 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, irrespective of its origin.”²¹ Parties who fit within these definitions are subject to a number of requirements, including the following²²:

- Registration – parties must register with DDTC pursuant to ITAR §129.3;
- Prohibited Transactions – parties are prohibited from entering into brokering transactions involving countries set forth in ITAR §§ 126.1 or 129.5(b) or that are subject to United Nations Security Council arms embargoes without DDTC approval (it is DDTC’s policy that requests for such approvals shall be denied);
- Advanced Approval For Transactions – for most brokerage transactions, such transactions are prohibited unless the broker receives advance approval pursuant to a license by DDTC; exceptions exist for certain transactions involving NATO countries as set forth in ITAR §129.6(b)(2);

¹⁹ In the Analytics Methods, Inc. Proposed Charging Letter DDTC stated: “Although some of the Respondents CFD programs have been ITAR-controlled, the majority of the Respondent’s CFD software programs are dual-use. However, these dual-use software programs can be used in providing an ITAR regulated defense service when consulting on military systems.” See Analytics Methods Proposed Charging Letter at p. 3.

²⁰ See 22 C.F.R. Part 129.

²¹ The complete text of the definition of “Brokering Activities” is as follows: The term “Brokering Activities” is defined in ITAR §129.2 as “acting as a broker as defined above and includes 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, irrespective of its origin. This includes activities by U.S. persons who are located inside or outside of the United States or foreign persons subject to U.S. jurisdiction involving Defense Articles or Defense Services of U.S. or foreign origin which are located inside or outside of the United States. But, this does not include activities by U.S. persons that are limited exclusively to U.S. domestic sales or transfers (e.g., not for export or re-transfer in the United States or to a foreign person). Engaging in the business of brokering activities requires only one action as described above.”

²² DDTC has issued a proposed rule to amend the broker regulation that would provide changes to this definition and change other provisions of the regulation. See Department of State Proposed Rule, Federal Register Volume 76, No. 243, p. 78578, December 12, 2011.

- Prior Notification – brokering activities for certain significant military equipment valued at less than \$1,000,000 requires prior notification to DDTC pursuant to ITAR §129.8; and
- Reporting – parties registered with DDTC as munitions brokers are required to file annual reports with DDTC pursuant to ITAR §129.9.

Thus the categories of items subject to ITAR regulation are quite broad. They include physical products, technical data, software and services. They include items specifically enumerated on the USML as well as items covered under the “Catch-All” in Category XXI. They include items developed under government contracts, and government funded research, as well as commercial products that are modified for a military application. They include parts and components as well as end-products under the “See Through Rule”. They also cover activities under the “broker” regulations. They extend to manufacturers, distributors, services firms, importers, exporters and organizations involved in research and development. ITAR reaches into many corners of our economy far beyond military and government contracts.

WHAT IS ITAR?	
<u>Industries Affected</u>	<u>Items Covered</u>
<ul style="list-style-type: none"> • Manufacturing • Engineering • Technical services • Electronics • Maritime • Communications • Navigation • Information technology • High performance materials • Aerospace • Chemicals • Architecture/design • Construction • Satellites • Transportation • Training • Consulting • Security services • Intelligence services • Protective personnel equipment and shelters • Exports/Imports 	<ul style="list-style-type: none"> • Products, technical data, software and services on U.S. Munitions List • Items originally designed, developed or configured for military use • Commercial items modified or adapted for military use • Items developed with SBIR or other defense research funding • Parts, components and accessories of USML items • End-products that contain ITAR-controlled parts (See-Through Rule) • Manufacturing and testing equipment used to manufacture USML items • Services using only commercial items for military organizations • Computers modified to be used with USML items • Imports of USML items • Classified products, technical data and services • Activities regulated under ITAR “broker” rule

(i) Penalties For Violations. Penalties for violations of ITAR are severe, including criminal penalties of up to twenty years imprisonment and significant financial

finer. Criminal penalties are often imposed both against corporate defendants as well as officers, directors and employees in their individual capacities. Other sanctions include debarment, seizure and forfeiture of goods and interim suspension.

2. Requirements For Companies Subject to ITAR.

If a company's products, software, technical data or services are on the USML, the company is subject to a number of requirements including the following:

- Registration - the company must register with the U.S. State Department, even if it does not export any of its products²³;
- Transfer of Technical Data And Software to Foreign Nationals – the company is prohibited from sending or taking software or technical data on the USML out of the U.S., or disclosing it to foreign nationals in the U.S., without an export license;
- Defense Services – the company is prohibited from performing services related to items on the USML for foreign parties, either in the US or abroad, without obtaining a State Department license called a Technical Assistance Agreement (“TAA”);
- Export License – the company is prohibited from exporting products listed on the USML without obtaining an export license;
- Temporary Imports – the company is prohibited from importing defense items listed on the U.S. Munitions List in temporary import transactions without obtaining a temporary import license²⁴;
- Recordkeeping Requirement – the company is required to maintain records in accordance with the ITAR recordkeeping requirements;
- Brokering – the company is prohibited from brokering the sale of defense items without complying with the DDTC brokering requirements;
- Reports For Payments of Sales Commissions, Fees and Political Contributions – the company is subject to restrictions on the payment of sales commissions, fees and political contributions made in connection with defense transactions;

²³ While there are a number of exceptions from the registration requirement under 22 CFR Part 122, if a company is exempt from the registration requirement, it may still be subject to many of the other requirements under ITAR.

²⁴ In addition, parties that import items on the US Munitions Import List in permanent import transactions are subject to regulations promulgated by the Bureau of Alcohol, Tobacco, Firearms and Explosives. See 27 CFR Subpart C.

- Transactions With Debarred Parties – the company is prohibited from entering into transactions subject to ITAR regulation with certain debarred parties identified on the State Department’s two Debarred Party Lists.

The above are summary points only and are qualified in their entirety by the provisions of ITAR.

3. Steps For Determining If Your Company is Subject to ITAR.

In light of the broad reach of ITAR, companies should undertake a formal assessment of whether they are regulated under ITAR and the requirements that apply to them. The following are a number of steps to help assess if your company is subject to ITAR.²⁵

(a) Review of the USML. Companies should carefully review the USML to determine if items that they produce or sell, or that are within their control or possession, are listed on the USML. They should review the list for physical items, software, technical data and defense services. They should review the specific categories in I-XX as well as the “Catch-All” in Category XXI. They should also review the USML interpretations set forth at 22 C.F.R. §121.2 et seq. The Company should establish an internal procedure to conduct an initial review as well as periodic reviews thereafter, based upon the development of new products, contracts or new areas of business that the company introduces. If an item within the company is listed on the USML, this should be recorded on a list of items subject to export control restrictions along with the USML category of the controlled item. This listing then serves as the foundation for the company’s ongoing ITAR compliance efforts.

(b) Review of Origin of the Product. An important part of the ITAR review involves analyzing the origin of the product and the technology upon which it is based. Questions to ask include: was the product originally developed for a military use? Was it developed using military specifications?²⁶ If the answer is yes, there is a strong chance that the item will be considered on the USML and subject to ITAR. The ultimate authority for determining if an item is on the USML lies with DDTC, and the agency has broad legal authority for making this determination.²⁷

²⁵ The determination of the export classification of a product is commonly undertaken through a two step process: (i) determine if jurisdiction for the item lies with DDTC (and is subject to ITAR) or with BIS (and subject to the EAR) (referred to as the determination of “jurisdiction”); and then (ii) determine the exact category (for USML) or export control classification number (for EAR) for the item (referred to as “classification”). This article addresses the first of these two steps.

²⁶ These include, for example, radiation-hardening, surveillance or intelligence gathering capability, TEMPEST capability, thermal or infrared signature deduction capability, ballistic protection, etc.

²⁷ The legal standard used by DDTC to designate an item on the USML is set forth at 22 CFR Sec. 120.3 and included in footnote 4 above.

(c) **Service Companies.** Companies whose business activity includes the performance of services, such as engineering, IT, consulting, analytics or other technical services, may be subject to ITAR and should undergo the ITAR review. As referenced above, if a company performs services related to USML items for foreign parties, the company will be regulated under ITAR. This obligation arises regardless of whether the services are performed for the foreign party overseas or in the United States.²⁸ In addition, even if the company only performs services for U.S. parties, if it handles USML items, ITAR obligations still might arise, including requirements to register with DDTC, to comply with recordkeeping requirements, to obtain import licenses and to comply with restrictions on transferring ITAR-controlled technical data to foreign nationals in the U.S. (including to foreign national employees). Thus it is of vital importance for service companies to undergo the ITAR review. Service companies frequently have an internal procedure under which they conduct an ITAR review for each new contract, task order or piece of new business awarded. Such reviews are conducted both (i) upon the award of the contract;²⁹ and (ii) at the conclusion of the performance of the contract. In many instances, companies will conduct an ITAR review prior to the award upon receipt of the Request For Proposal to determine if there are any ITAR requirements that apply as part of their marketing activities.

(d) **Modified Products.** If a company deals with commercial products, but one of its commercial products is “modified” to create a version for a military customer, the modified version of the product will most likely be on the USML and subject to ITAR. Thus the company should assess if it has modified any of its products for military customers.

(e) **Parts, Components and Accessories.** As referenced above, if a company’s product is determined to be on the USML, specialized parts, components and accessories related to such product are very frequently determined to be on the USML and subject to ITAR. This is especially true if such parts, components or accessories are specially designed for the USML item. Thus, the company will not only be required to apply its internal ITAR compliance controls/processes for the product itself, but also for each of such parts, components and accessories.

(f) **ITAR-Controlled End Products and the “See-Through Rule”.** If a company purchases parts, components, software or technical data that are ITAR-controlled and uses these as components in a new end-product that it manufactures, the entire end-product could become ITAR-controlled and subject to ITAR requirements. The Company should carefully review its components to verify if they have been “classified” for export control purposes and if they are ITAR-controlled. Often product labeling, invoices or other documents will state if an item is ITAR-controlled or, upon request, a vendor will advise you of the export jurisdiction/classification of the product. However, the Company should not rely solely on that advice; as the Company will be

²⁸ Examples of the performance of services for a foreign party in the U.S. include performing engineering services for a foreign client from the company’s office in the U.S., providing technical services related to a foreign owned vessel in a U.S. port and providing advice via telephone to a foreign customer.

²⁹ This includes new contracts as well as amendments or extensions of existing contracts.

responsible for ITAR compliance even if the component supplier did not provide adequate notification. Purchasers should use care in requesting this information from suppliers or otherwise verifying this information.³⁰

(g) Software Programs. If a company's product is on the USML, the company must review if there are any software programs associated with, embedded in or used in connection with such product. If so, the software will also be on the USML and subject to ITAR controls. If a software program is controlled, user manuals and other technical data associated with the program will also be controlled.

(h) Technology; Research and Development. As referenced above, technology, inventions, trade secrets and other intellectual property related to USML items are considered "technical data" and are also listed on the USML. Technology developed under defense research funding such as SBIR contracts are very frequently on the USML, as are technologies developed under other government contracts (however, even technologies developed independent of government funding with the company's own funds or other funding sources can be subject to ITAR control if they are listed on the USML or relate to USML products). The company should review its intellectual property to assess if any items fall within the parameters of the USML.

(i) Manufacturing and Testing Equipment. If a company's product is on the USML, the company should review the specific USML category to determine if specialized equipment used to manufacture or test such product that is in the company's possession is also covered under such USML category. If so, such equipment is also subject to ITAR and must be maintained in accordance with the company's ITAR compliance processes.

(j) Acquiring Distribution, Reseller, Marketing Rights. If your company is acquiring the right to distribute a product, software or technical data and the item is on the USML, your company will become subject to ITAR. This includes purchasing and reselling as a distributor, licensing or sub-licensing, serving as a value-added reseller, and selling as a mere commissioned sales representative or technical consultant. This will have implications even if your company will only sell the product in the U.S. Companies acquiring marketing or distribution rights should inquire in advance as to the item's export jurisdiction and classification and if it is subject to ITAR regulation. If you fail to inquire and inadvertently market the product in violation of ITAR restrictions, your company could be committing ITAR violations and be subject to fines and penalties.

(k) Computers Modified For Use With USML Items. As referenced above, if the company has modified or customized any computers to operate in conjunction with

³⁰ At the time of this writing, DDTC has promulgated a proposed ITAR amendment that provides that if ITAR-controlled components are used in an end-product and fall below a certain "de minimus" threshold, the entire finished product would not be subject to ITAR control. See Department of State Proposed Rule, Federal Register Vol. 76, No. 50, p. 13928, March 15, 2011. However, as of this date the proposed rule has not been adopted in final form and is not yet in effect.

another item on the USML, the computer is also listed on the USML.³¹ The company should assess this issue as part of its ITAR review.

(l) Defense Services Using EAR-Controlled Items. As referenced above, in certain instances if a company is performing services using a commercial product for a foreign military organization or related to a military system, such services could constitute a “defense service” under 22 C.F.R. §120.9 and be subject to ITAR even if the product is not listed on the USML. Companies should review their service contracts carefully – even if products provided are not listed on the USML, services related to military systems or performed for military customers could be considered a defense service and trigger ITAR obligations.

(m) Imports. The company should monitor its import transactions to determine if products that it imports are on the USML or the US Munitions Import List.³² If the answer is yes, such products may be subject to ITAR or regulation by BATFE.

(n) Other Processing, Handling or Forwarding of ITAR-Controlled Items. Even if a company merely receives, processes, stores, or otherwise handles USML items without providing any other value-added functions, ITAR requirements will arise. Companies should review their supply chain operations and inventory to determine if ITAR-controlled items are received, stored or otherwise handled by the company in its operations.

(o) ITAR Items Acquired In Mergers and Acquisitions. A common entry point for ITAR-controlled items into a company is through mergers and acquisitions. If your company acquires another company and the target company has items in its possession that are on the USML (including in the form of finished products, parts and components, research and development, inventory, or other items elsewhere in its supply chain), upon consummation of the acquisition the acquiring company will own the USML items and be subject to ITAR controls. This can occur regardless of whether the acquisition is structured as the purchase of stock, purchase of assets or merger. (In addition, if the target company has committed ITAR violations prior to the acquisition, the acquiring company could step into the target company’s shoes and become liable for such violations if proper precautions are not taken.)³³ Companies undertaking acquisition transactions should conduct careful ITAR due diligence of the target company prior to the acquisition to ascertain if there will be any impact on the acquirer related to ITAR following the completion of the acquisition transaction.

(p) Commodity Jurisdiction Determination Versus Self-Classification. A company can determine if its product is on the USML either by conducting its own

³¹ See USML Category XI(a)(6).

³² See 27 CFR Subpart C.

³³ For a detailed discussion of ITAR issues in merger and acquisition transactions, including a checklist of ITAR due diligence issues, see Export Control Issues in Mergers and Acquisitions at: <http://www.williamsmullen.com/files/Publication/6b248ae0-c1e5-4dff-bf39-aae77ff78c1b/Presentation/PublicationAttachment/b997c198-361c-414a-aafe-b22710c09ee5/Export-Compliance-Issues-In-Mergers-And-Acquisitions%202011.pdf>

internal assessment (called a “self-classification”) or by requesting a formal ruling from DDTC. DDTC has a procedure under which companies can submit a description of their product and DDTC will provide a formal ruling as to whether the item is on the USML and, if so, the USML category that applies to the product. This process is called a “Commodity Jurisdiction request.” However, companies should use care in submitting Commodity Jurisdiction requests - we recommend that, in submitting these requests the company not only describe its product carefully but also provide proper legal substantiation for why the product should not be listed on the USML, and provide factual evidence to support this position. Failure to do so can result in the product being listed improperly on the USML. If readers are interested in obtaining additional information regarding the preparation and submission of Commodity Jurisdiction requests, the author will be pleased to provide it.

(q) Previous Commodity Jurisdiction Determinations Issued By DDTC.

At the time of this writing, DDTC recently initiated a practice whereby it publishes commodity jurisdiction determinations from requests submitted by parties. As a result, if you are not sure if your company’s product is on the USML and if another party has obtained a commodity jurisdiction determination for a product similar to yours, this might be helpful in assessing the jurisdiction/classification of your product. If the product that is the subject of a published commodity jurisdiction determination is identical to yours, you might be able to use this determination in conducting a self-classification of your product. If there are some differences between your product and the one covered in the published commodity jurisdiction determination, you might nonetheless be able to cite the prior determination as precedent in a new commodity jurisdiction request that you submit for your product.

(r) Activities Within the Definition of ITAR Broker. As discussed further above, even if a company does not produce or sell an item on the USML, merely facilitating the manufacture, export or import of a USML item can constitute brokering under the ITAR brokering rules and trigger ITAR regulation. The ITAR brokering rules³⁴ are a broad set of requirements that apply to U.S.-origin products as well as foreign items, and apply to both U.S. and foreign companies. Companies should review the ITAR brokering rules carefully to determine if they are subject to these requirements. A discussion of the ITAR brokering rules is set forth in Section 1(g) above.

(s) Classification Under the Export Administration Regulations. If a Company’s products, software or technical data are not subject to ITAR, they still might be subject to regulation under the Export Administration Regulations (“EAR”). The EAR are a set of controls administered by BIS for dual-use products, i.e., products that are fundamentally commercial products but are useful in military applications. While the controls under the EAR are beyond the scope of this article, if a Company determines that its products are not subject to ITAR, it should nonetheless classify its products under the EAR to determine their compliance obligations thereunder.³⁵

³⁴ See 22 C.F.R. Part 129.

³⁵ For additional information regarding export controls under the EAR, please refer to [An Overview of the U.S. Export Laws](#) by Thomas B. McVey.

WHAT IS ITAR?	
<u>Violations</u>	<u>Penalties</u>
<ul style="list-style-type: none"> • Exporting or reexporting, or attempting to export or reexport, any U.S. origin defense article or technical data without obtaining a license from DDTC • Furnishing a defense service without obtaining a license • Importing or attempting to import a defense article that requires a license without obtaining a license • Conspiring to export, reexport or import a defense article that requires a license without obtaining a license • Violating any terms or conditions of DDTC licenses or approvals • Engaging in the U.S. in the business of either manufacturing or exporting a defense article or furnishing a defense service without complying with the ITAR registration requirement • Engaging in the business of brokering for which registration or obtaining a license is required without first registering and obtaining a license • Knowingly or willfully causing, aiding, abetting, counseling, demanding, inducing, procuring or permitting the commission of any act prohibited by the AECA or ITAR • Using any export or import control document containing a false statement or misrepresenting or omitting a material fact for the purpose of exporting any defense article or technical data or furnishing any defense service for which a license or approval is required 	<ul style="list-style-type: none"> • Criminal penalties of up to 20 years imprisonment • Civil penalties of up to \$1,000,000 per violation • Parties held liable include companies and employees, officers and directors in their individual capacities • Statutory debarment • Administrative debarment • Seizure and forfeiture of articles used in illegal transactions • Interim suspension

4. Application To Both Domestic and Foreign Companies.

Foreign companies can be subject to ITAR’s long reach as well as domestic firms. If a foreign company acquires a product overseas that is covered under ITAR, the company subjects itself to regulation by DDTC and ITAR. For example, if a foreign company purchases and re-sells a USML item in a foreign country, this would constitute a “reexport”³⁶ or “retransfer”³⁷ and such transaction would require approval by DDTC.³⁸

³⁶ A “reexport” is when a product is exported from the U.S. to a foreign country, and the foreign recipient sells or transfers the product to another foreign country.

Similarly, if a foreign company purchases an ITAR-controlled component and uses it in a foreign manufactured end-product, the entire end-product becomes regulated under ITAR under DDTC's "See-Through" Rule and becomes subject to the myriad ITAR requirements. Even if the foreign company has no operations in the U.S., once the company incorporates an ITAR-controlled item into its overseas supply chain, this raises ITAR obligations. Many foreign companies attempt to eliminate the use of any ITAR-controlled products, components, technical data, software or services in products that they manufacture overseas so that the products will be "ITAR free."

Foreign companies are also subject to the ITAR brokering rules (see §1(g) above). Even if a foreign company provides just a minimal level of support for a U.S. company (including its wholly-owned U.S. subsidiary) in manufacturing, exporting or importing a USML item, such activity could constitute "Brokering Activities" under 22 CFR §129.2 and trigger ITAR obligations. In one recent major case, a foreign defense manufacturing company was charged with multiple violations of the ITAR brokering regulation for merely providing business support to its U.S. subsidiary.³⁹

Finally, if a foreign company exports a product to the U.S. that is listed on the USML or the USMIL, such transactions could be subject to import licensing requirements under ITAR or regulations promulgated by BATFE,⁴⁰ along with other ITAR requirements.

A number of major enforcement cases have been brought against foreign companies for ITAR violations. In one major case, BAE Systems plc was subject to criminal prosecution in the U.S. for ITAR violations and sentenced by a U.S. court to \$400,000,000 in criminal penalties, The company separately agreed to \$79,000,000 in civil penalties.⁴¹ See also the major enforcement action by DDTC against Interturbine Aviation Logistics GmbH.⁴²

6. Compliance Programs.

As referenced above, if a company is subject to ITAR, it is subject to the various requirements summarized in Section 2 above. Due to the breadth and complexity of these requirements, and the severe criminal and civil sanctions for the company and its

³⁷ A "retransfer" is when a product is exported from the U.S. to a foreign country, and the foreign recipient sells or transfers the product to another party in that country.

³⁸ In such transactions, typically the U.S. company that exported the item would apply to DDTC for a license to reexport or retransfer the item.

³⁹ See United States Department of State, Bureau of Political-Military Affairs, In the Matter of BAE Systems plc, May 16, 2011 (Charging Letter, Order and Consent Agreement available on DDTC website); and United States of America v. BAE Systems plc, Crim. No.10-035, in the United States District Court for the District of Columbia, order dated March 1, 2010.

⁴⁰ See 27 CFR Subpart C.

⁴¹ See United States of America v. BAE Systems plc cases cited above.

⁴² See United States Department of State, Bureau of Political-Military Affairs, In the Matter of Interturbine Aviation Logistics GmbH, January 4, 2010 (Charging Letter, Order and Consent Agreement available on DDTC website).

employees, companies are advised to adopt ITAR Compliance Programs to reduce the likelihood of legal violations.

An ITAR Compliance Program is a formal company-wide management program to foster compliance with ITAR requirements. The program includes: (i) appointment of a company employee with the responsibility to oversee ITAR compliance; (ii) establishing written policies and procedures for employees in performing activities that are subject to ITAR, such as the receipt, handling, storing and shipping of ITAR-controlled items and procedures for dealing with foreign nationals; (iii) conducting training for key employees; (iv) a procedure for auditing compliance activities; and (v) a procedure for actions to be taken if a violation is discovered.

If a company is found to have committed an ITAR violation, prosecutors, enforcement officials and the courts will often reduce or “mitigate” penalties for companies that have adopted compliance programs.

Taken together, the above steps provide the formal structure and process for a company to undertake a serious effort to protect against ITAR violations. They also provide a firm foundation for a company’s defense in the event the company is subject to an ITAR investigation in the future.

Please note: This article contains general, condensed summaries of actual legal matters, statutes and opinions for information purposes only. It is not meant to be and should not be construed as legal advice. Readers with particular needs on specific issues should retain the services of competent counsel.

For more information, please visit our website at www.williamsmullen.com or contact Thomas B. McVey, 202.293.8118 or tmcvey@williamsmullen.com. For a subscription to the William Mullen ITAR newsletter please submit the request to tmcvey@williamsmullen.com. For mailing list inquiries or to be removed from this mailing list, please contact Julie Layne at jlayne@williamsmullen.com or 804.420.6311.

**CATEGORIES ON THE
U.S. MUNITIONS LIST**

- Category 1: Firearms, weapons
- Category 2: Guns and armaments
- Category 3: Ammunition, ordnance
- Category 4: Launch vehicles, missiles, rockets
- Category 5: Explosives, incendiary agents
- Category 6: Naval vessels
- Category 7: Military vehicles
- Category 8: Aircraft and equipment
- Category 9: Military training services, equipment
- Category 10: Protective personnel equipment and shelters
- Category 11: Military electronics
- Category 12: Optical and guidance control equipment
- Category 13: Auxiliary equipment (cameras, encryption, camouflage)
- Category 14: Toxicological, chemical, biological agents, protective equipment
- Category 15: Space systems and equipment
- Category 16: Nuclear weapons, technology
- Category 17: Classified technical data and services
- Category 18: Directed energy weapons
- Category 19: Reserved
- Category 20: Oceanographic equipment
- Category 21: Other items designed or adapted for military use