

## DEFENSE TRADE ADVISORY GROUP

### Compliance Working Group White Paper November 2016 DTAG Plenary

Pursuant to a request by the Deputy Assistant Secretary for Defense Trade Controls, Mr. Brian Nilsson, the Defense Trade Advisory Group ("DTAG") organized a Compliance Working Group to address compliance issues designated by DAS Nilsson. On September 14, 2016, DAS Nilsson asked the DTAG overall to review past DTAG reports on issues previously examined and identify those issues/reports that remain relevant, warrant further DTAG review/update and/or should be considered by the Directorate of Defense Trade Controls ("DDTC" or "State" or "the Department") for implementation. Mr. Nilsson also asked the DTAG to identify any new issues and present the Department with a list of priorities for DDTC consideration and DTAG action. This White Paper addresses the tasking and summarizes the Working Group's efforts.

#### **Working Group Members**

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#### **Working Group Efforts**

The Compliance Working Group reviewed the DTAG's past published presentations and white papers to identify those issues that related directly to compliance. The majority of the DTAG's past activities involve some aspect of compliance with the International Traffic in Arms Regulations ("ITAR") and the first challenge the Group addressed was to focus its review on those issues that directly affect compliance since other Working Groups would be addressing licensing, policy and related issues that touch upon compliance.

The Working Group held a day-long in-person meeting during which it identified the following legacy and new issues (in no particular order):

1. Export Control Modernization
2. Definitions
3. Voluntary Disclosure Guidance and Forms
4. Cloud Computing and Export of Encrypted Data
5. Publication of Advisory Opinions

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6. Coordination of Controlled Unclassified Information ("CUI") Definition and Implementation with other US Government Agencies
7. Updates to DDTC Compliance Guidelines
8. Updates to the DDTC Company Visit Programs
9. Publication of Mitigating and Aggravating Factors in Export Enforcement
10. Legal Impediments to Investigations and Disclosures for US Government and regulated entities
11. Impact of the October 2016 Department of Justice Guidelines on Disclosures of Export Violations
12. Competing US Government Agency Requirements Impacting Export Controls
13. Brokering
14. Recordkeeping
15. UK and Australia Defense Cooperation Treaties and Implementation
16. Audit Standards
17. Screening Mechanisms; and
18. Export Classification of Nonfunctional, Prototype or R&D Related Products and Technology.

The Working Group discussed the merits of each topic, analyzed the presentations made by past DTAG Working Groups on voluntary disclosures and CUI, reviewed other US Government agencies' approaches to certain issues (for example: aggravating and mitigating factors, electronic submission of voluntary disclosures, mandatory versus voluntary disclosures, and on-site visits), and prioritized the issues the Working Group believed would respond to DAS Nilsson's requests and address industry and Government objectives. Based on this review, the Working Group also developed recommendations for further follow-up within specific topics and, in areas where significant overlap with other Working Groups exists, decided to share certain recommendations with the Licensing, Information Technology and/or Policy Working Groups.

Of the 18 topics identified, Working Group members did not consider the following topics to require further DTAG review:

1. Brokering
2. Recordkeeping
3. UK and Australia Defense Cooperation Treaties and Implementation
4. Audit Standards
5. Screening Mechanisms; and
6. Export Classification of Nonfunctional, Prototype or R&D Related Products and Technology.

We concluded that these topics had either been:

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1. Addressed by substantive regulatory revisions (e.g., brokering)
2. Overtaken by the Export Control Reform ("ECR") effort (e.g., the UK and Australia Defense Cooperation Treaties and implementation)
3. Subsumed into broader licensing and compliance issues (e.g., audit standards and screening mechanisms); or
4. Handled by other Working Groups (or would be handled by other Working Groups)(e.g., nonfunctioning, prototype and R&D product and technology classifications).

The Group decided that issue number 4 above could be more ably handled by the Licensing Working Group and any recommendations by Compliance Working Group members regarding this topic would be shared with the Licensing Working Group.

Of the remaining issues, the Group believes that each has merit and could benefit from continued DTAG review and recommendations. Within the 12 issues<sup>1</sup>, Working Group members provided the following input:

1. Export Control Modernization: This topic is part of the ongoing development of ECR and a number of substantial steps have been taken to address longstanding issues that have plagued both the Government and industry. As the ECR effort continues, the Working Group recommends that the DTAG and DDTC continue to address the following issues, some of which may be better addressed by the Licensing Working Group:
  - a. Process improvements designed to streamline and automate current licensing and other DDTC related interaction with industry through maximum use of electronic submissions and correspondence: The Group recognized the Department's ongoing efforts to enhance electronic submissions, expand the submissions filed with DDTC electronically and update the type of information collected through electronic submission. The Working Group recommends that the expanded submissions include, at a minimum registrations, registration changes and advisory opinion requests. Some within the Working Group also recommended that electronic submissions encompass voluntary disclosures, correspondence on disclosures and ITAR § 126.1(e) notifications. We understand that DTCC Compliance is reviewing the comments related to a Federal Register notice requesting reactions to proposed electronic

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<sup>1</sup> Based on the interrelated nature of some of these topics, the White Paper consolidates a number of issues under broad categories (such as Export Modernization or Definitions) rather than addressing them as separate items.

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voluntary disclosure forms and will provide additional guidance to reflect the comments received.

In conjunction with the Department's ongoing efforts, the Working Group recommends that further improvements to the electronic filing of Commodity Jurisdiction ("CJ") Requests, the new DECCS platform, coordination with a variety of browsers, digital signatures, and flexibility to accommodate a variety of applicant business processes as well as parties who may file with State (e.g., internal corporate personnel, in-house counsel, outside counsel or consultants) would continue to enhance the national security and business equities of the Government and industry. The Working Group further identified the following areas where the IT or Licensing Working Groups may wish to develop implementation recommendations for DDTC:

- i. DECCS applicant interface development
- ii. Advanced publication of API or other interface specifications
- iii. Automation of links for amendments and other changes to authorizations
- iv. Two-way communication between State and industry through DECCS; and
- v. Direct inquiries from industry to Government staffing points and to the system to inquire on an authorization's status (e.g., suspension, revocation, policy change, issuance, etc.)

These recommendations will be shared with the Licensing and IT Working Groups.

- b. Publication of Advisory Opinions: Sharing information regarding US Government interpretations allows industry to better understand the regulatory requirements and streamline its compliance efforts. The Working Group suggested that the Department publish its advisory opinions in the same manner that other agencies, such as the Department of Commerce/Bureau of Industry and Security ("BIS") and the Department of Justice ("DOJ") do. Currently, advisory opinions related to ITAR interpretations are shared within industry inconsistently. Some organizations may publish advisory opinions they obtain, others include them as part of lawsuits against the Department and still some share the opinions within a smaller circle of affected industry members. These opinions, however, provide a wealth of information that would benefit industry as a whole. As with the publication of aggravating and mitigating factors discussed below, advisory opinions present the Government's responses to

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specific questions and may be seen as guideposts. Although not binding, they nonetheless include insight into how the Department may address a particular situation and are excellent learning tools. The Working Group recommends that the Department publish advisory opinions. We understand that the opinions may need to be redacted to protect business confidential or other sensitive information; but even redacted guidance is useful.

- c. Updates to the DDTC Compliance Guidelines: The Working Group considered this issue relevant and worthy of further consideration. In international trade, "compliance" may be seen as how well an organization observes the laws and regulations that govern its international business. To achieve compliance under the ITAR, organizations who participate in activities governed by the ITAR, are required to register and expected to implement a compliance program designed to address the organization's regulatory obligations.

Currently, organizations utilize the DDTC Compliance Guidelines published on the DDTC website to develop a compliance program which takes into consideration the regulatory requirements, the manner in which the organization conducts its business and other specific risk based compliance obligations. While a helpful starting point, the Compliance Guidelines more closely reflect a recitation of the ITAR, than a more structured outline of compliance program expectations.

The Working Group recommends that the Department update its guidelines and would like to revise the version to provide more details regarding compliance program elements, processes and procedures that could align with the coordinated efforts reflected in ECR. As ECR harmonization continues, the Working Group suggests that a more refined compliance program outline will level industry expectations, streamline compliance overall, and enhance industry's ability to manage compliance to achieve both business and national security objectives.

In light of ECR and ongoing efforts to coordinate regulatory requirements between State and Commerce, the Working Group suggests that DDTC consider combining compliance program elements that adhere to both ITAR and EAR requirements. A more robust set of guidelines that reflect the common elements among export regimes could ensure consistent interpretation and

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more effective operational implementation of compliance obligations.

In conjunction with updates to the Compliance Guidelines, the Working Group also recommends that State revise its Company Visit Program - Outreach (CVP-O) guidelines to provide clarity on the Government's expectations and projected outcome of a visit. Currently, potential misconceptions exist regarding the scope of the program, although the Department has stated that the program is not an audit nor is it designed to identify noncompliance for enforcement actions. Regardless of these statements, confusion and sometimes concern exists that the visits serve objectives beyond those which are included in the Department's currently published materials.

Given this uncertainty, the Working Group identified revisions and clarification of the Company Visit Program - Outreach guidelines as a priority.

2. Definitions: Coordination between the Departments of State and Commerce to harmonize ITAR definitions with Export Administration Regulations' ("EAR") definitions has been underway since the beginning of ECR. Within the last year, State and Commerce published a number of definitional changes, primarily impacting the ITAR. Proposed rules remain pending, in particular the definitions associated with the export of encrypted data and the Working Group recommends that DDTC continue to address the differences between the EAR and the ITAR in this area.

The Working Group consistently hears about confusion with undefined terms or terms that draw from other laws or regulations but do not clearly draw distinctions between other agencies' and State's interpretations. In addition to the export of encrypted data, the Working Group recommends that certain terms should be defined and published in the ITAR:

- a. "Directly related" as used with technical data: Although case law sheds some light on this term (see, e.g., United States v. Edler Industries, United States v. Posey, and United States v. Van Hee), regulatory clarity can limit confusion and enhance compliance. The Working Group suggests the Department consider developing a tailored definition. For example, USML Category VIII(i) states: "Technical data and defense services directly related to the defense articles described in paragraphs (a) through (h)" appears to capture all technical data and defense services related to specified aircraft. If the Department intended to reach this broadly, the Working

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Group recommends that State explain the necessity for such an expansive application and work to refine the terms in alignment with ECR and specific national security concerns.

- b. Legal impediments to investigations and disclosures: Although also a separate area of concern, lack of clarity or consistency in ITAR definitions contributes to difficulties in investigations and disclosures. Where the ITAR speaks in broad terms susceptible of multiple interpretations, both industry and the Government may face compliance or enforcement challenges. Determining whether certain requirements extend beyond US borders, identifying the manner in which information may be collected from non-US persons without violating other sovereigns' laws and/or contending with conflicting national security and foreign policy value judgments can affect the manner in which an investigation is conducted as well as the scope of any disclosures. Given the US Government's focus on individual liability -- as reflected in part by Deputy Attorney General Sally Yates' memorandum on individual liability as well as other US exporting agencies' comments on individual liability (e.g., Assistant Secretary for Export Enforcement David Mills, BIS) -- and the Department of Justice's publication of its own guidelines on voluntary disclosures for criminal violations of US export laws and regulations -- understanding the limits that apply through robust or clarified definitions would potentially reduce confusion and legal impediments to compliance. In addition, a better understanding of DDTC's views of other sovereigns' laws that conflict with US requirements would be beneficial and perhaps defuse some of the current concerns that are raised when DDTC registrants indicate that they are unable to obtain requested information because of other sovereigns' laws.
- c. Coordination of CUI with other US Government Agencies: The Compliance Working Group reviewed the presentations and white paper prepared by a prior DTAG Working Group that addressed the challenges related to CUI and its applications beyond the Department of Defense ("DOD"). The Working Group thanks the prior DTAG members for their thoughtful and insightful presentation of the various issues and recommends that this topic continue to be reviewed by both State and the DTAG Working Group.

DOD has published several regulations and the President issued an Executive Order that defined the contours of CUI and both the Government's and industry's obligations under the new framework. DOD's regulations and the Executive Order overlap, in some

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fashion, with technical data as defined under the ITAR - an overlap that could create inconsistencies or confusion regarding compliance. As identified in prior DTAG materials, establishing the limits of CUI, addressing conflict between Government agencies' requirements and ensuring that compliance obligations are addressed in alignment with specific Government agency authorities remain as challenges which the Compliance Working Group would like to continue to address.

3. Voluntary Disclosures, Electronic Submission, Forms, Aggravating and Mitigating Factors and Prioritization of Violations: Prior DTAG Working Groups devoted substantial time and focus on addressing a tasking originally assigned by DAS Kenneth Handelman, DAS Nilsson's predecessor. Mr. Handelman sought the DTAG's assistance to identify ways to prioritize violations to better address more serious violations or compliance matters that could harm US national security interests. The former DTAG Compliance Working Group published a violations matrix and white paper identifying the manner in which the Department could triage violations or disclosures and how other US Government agencies address similar issues. We thank our colleagues for the tremendous effort reflected in the materials prepared and commend them on their diligence and cogent suggestions.

The current Compliance Working Group reviewed and discussed the violations matrix and the detailed comparative assessment of how other US Government agencies triage or prioritize violations. The Working Group believes that the prior recommendations should continue to be considered by DDTC, or a revised version to be prepared by this Working Group at DDTC's request, and offers to discuss those aspects of the prior recommendations that could be implemented now or in the near future.

In addition to the violations matrix and comparative assessment, the Compliance Working also identified other areas where voluntary disclosures or assessments of violations could be improved:

- a. Clarify the requirements of ITAR § 127.12: ITAR § 127.12 identifies the elements required for voluntary disclosures. While helpful, industry sometimes struggles with the scope and requirements related to disclosures. These struggles manifest themselves through, for example, extended exchanges with compliance specialists, questions which appear unrelated to disclosures that have been submitted, and clarifications that relate to information that was previously included with the disclosure.



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While not fully discussed, some Working Group members suggested that State publish "sample voluntary disclosures" or a recommended template. This suggestion merits further discussion in light of State's publication in 2016 of an electronic form for voluntary disclosures. It is the Working Group's understanding that DDTC-Compliance is updating the published form to address a number of comments provided by industry. The Working Group would appreciate the opportunity to address the comments and other concerns that arise from the electronic submission of disclosures.

- b. Publication of aggravating and mitigating factors: Industry and Government generally benefit from clear guidelines or rules when it comes to compliance. Inconsistent application of laws and regulations results in missteps by industry and Government as well as the potentially wasteful expenditure of resources that could be better allocated. The Working Group recommends that State working with the DTAG to develop a list of aggravating and mitigating factors to allow industry to gauge the potential impact of violations and allow the Government to focus its efforts on those circumstances which damage (or could damage) substantial US national security or foreign policy concerns. Publication of these factors is common and other export agencies -- *i.e.*, the Department of Commerce and the Office of Foreign Assets Control (Department of Treasury) have published such guidance. The Department of Justice has also published guidance regarding these factors, as has the Securities and Exchange Commission (for Foreign Corrupt Practices Act matters) and the US Sentencing Commission through its guidelines. These resources could inform the development of similar guidelines for the ITAR and would assist all ITAR registrants, in particular the smaller and medium sized companies.

In conjunction with the publication of these factors, the Working Group recommends that the Department publish some of the common errors or violations it has seen. The Working Group appreciates the efforts of DDTC leadership to share such insights at conferences or other similar gatherings of industry, but suggests that publication through more formal means -- *e.g.*, on the DDTC website or through publication of guidance in the Federal Register - - would expand the reach of such critical information to more than those who can attend a conference or seminar. Such publication can enhance overall compliance efforts.

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The Working Group commends State's timely posting of consent agreements and other enforcement actions. These resources help inform compliance officials' and management' decisions across the compliance landscape. Additional guidance regarding the manner in which these consent agreements should be interpreted and the precedential value they do or do not have would also be useful.

4. Cloud Computing and Export of Encrypted Data: The DTAG Compliance Working Group identified the electronic transmission and storage of technical data as a legacy issue that remains relevant and requires regulatory action. Since first raised by a prior DTAG working group in May 2013, both DDTC and BIS have adopted some of the DTAG's prior recommendations, published proposed rules and, in BIS' case, published a final rule that conceptually accepted certain suggestions raised by the DTAG in 2013. The Compliance Working Group recognizes the considerable efforts and engagement by the prior DTAG working group. Given the impact that cloud computing and flexible transfer of technical data may have on industry and Government interests, the Working Group considers this an issue which merits continued input and development from the DTAG.

Some of the Working Group members recommend that the DDTC align the ITAR definition of "export" with the definition adopted by BIS. The BIS approach excludes from the definition of "export" the transmission to or storage of unclassified technical data with foreign persons as long as the transmission or storage meets specified cryptographic standards and the foreign person is not provided the cryptographic tools at the time of transmission or storage. Revising the ITAR definition to mirror the EAR approach would be consistent with ECR and increase harmonization. It would also reduce the risk that companies will inadvertently make unauthorized exports by placing unclassified technical data in a cloud environment.

Although the members of the DTAG Compliance Working Group agree that the definition of "technical data" and/or "export" should be revised, some expressed concerns regarding confusion, compliance and licensing when regulatory distinctions are drawn on the basis of form, rather than substance. Additional discussions focused on the similar challenges State faced between when the ITAR distinguished encryption export controls on the basis of whether the encryption was on a disc or published in a book. Eventually the distinctions were addressed, but the issue of whether the form technical data takes should be dispositive of the manner in which it is controlled. Overall, however, the Working Group concluded that the ITAR

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requires revisions, harmonization and consistency with the Commerce Department approach.

These issues overlap with tasks that the Licensing and/or IT Working Group may be addressing and the Compliance Working Group intends to share its thoughts with other working group members to inform DTAG and State's analysis.

### **New Proposed DTAG Project:**

As Mr. Nilsson requested, the Working Group identified the following projects as ones which merit review:

1. Guidelines for the Company Visit Program - Outreach (CVP-O)
2. Publication of Mitigating and Aggravating Factors that apply to voluntary disclosures and enforcement actions
3. Outline of the issues associated with the extraterritorial application of the Arms Export Control Act and the ITAR

### **Proposed Working Group Priorities:**

Also in accordance with Mr. Nilsson's request, the Working Group identified the following priorities (in no particular order):

1. Propose revisions to the DDTC Compliance Guidelines
2. Draft Mitigating and Aggravating Factors guidelines
3. Draft white paper on the legal impediments to investigations and disclosures, including the effect of recent DOJ Guidelines on Disclosing Export Violations
4. Draft revised guidelines for prioritization of disclosures
5. Draft guidance on the utility of information included in consent agreements