

November 28, 2012

DTAG Brokering Working Group

Working Group Members:

Greg Hill, Working Group Co-Chair, DRS Technologies, Inc.

Debbie Shaffer, Working Group Co-Chair, Southwest Research Institute

- Lisa Bencivenga, Lisa Bencivenga LLC
- Dennis Burnett, EADS North America, Inc.
- Rebecca Conover, Intel Corporation
- Mike Cormaney, Luks Cormaney LLP
- Barbara Dudas, Northrop Grumman Corporation
- Andrea Dynes, General Dynamics Corporation
- Jeremy Huffman, Huffman Riley Kao PLLC
- Krista Larsen, FLIR Systems, Inc.
- Spencer Leslie, Tyco International
- Christine McGinn, Interglobal Trade Consulting, Inc.
- Beth Mersch, Northrop Grumman Corporation
- Roger Mustian, Daniel Defense, Inc.
- Brenda Nicacio, PPG, Inc.
- Terry Otis, Otis Associates, LLC
- Beth Parrish, Lockheed Martin Aeronautics Company
- Dale Rill, Honeywell International, Inc.

Purpose:

The task was: “Review the latest draft regulation for brokering that takes into consideration the public comments received on the proposed ruleⁱ. Report on the potential impacts to industry if the proposed rule is adopted as final.”

General Comments:

- Proposed rule significantly changed and greatly improved the December 2011 proposed ruleⁱⁱ
- In order to be subject to registration/licensing requirements, a series of checkpoints must be evaluated
- New regulation significantly narrows persons and activities subject to registration/licensing requirements
- Addresses major concerns expressed over December 2011 proposed rule (extraterritoriality, lack of clarity, overly broad)
- DTAG has concerns with
- Determining when brokering begins
- Potential double licensing.

Working Group Discussion:

The discussion centered on how well the draft addresses industry concerns as stated in the public comments on the December 2011 proposed rule and the draft rule positive and negative impact to industry. To accomplish this, the group reviewed the draft rule, the comments published regarding the December 2011 proposed rule, the AECA, and the current brokering provisions published in the ITAR. The group generated a track-changes document of draft rule overlaid on the existing sections of the ITAR to enable us to easily see the impact of the draft to the current state of affairs. This working document is attached to this paper.

The draft starts with four groups of persons, who have the potential for being a broker and then refines that through activities those persons would have to perform to actually be a broker. Once a person is actually determined to be a broker the registration requirements are limited and further to that, the situations where actual prior approval would be required is then further limited.

The consensus of the group was the definition of persons to be considered is significantly better defined in this draft. It includes US persons worldwide, foreign persons located in the US, foreign persons owned or controlled by a US person (see next paragraph for discussion), and foreign persons located outside the US involved in the temporary import to the US (see two paragraphs down for discussion). Overall these groups are fairly clear, with finite limits to the extraterritoriality application of the brokering provisions.

Foreign persons owned or controlled by a US person was equally well defined. A note states ownership is when a US person owns at least 50 percent of outstanding shares. Control is when a US person has the authority or ability to establish or direct the general policies or day-to-day operations of the firm and control is presumed when a US person owns 25 percent or more of the outstanding voting securities, unless a foreign person controls an equal or larger percentage.

Foreign persons involved in temporary imports to the US presents a possible issue. The result of such a control could be foreign companies will stop sending items temporarily to the US and will send them as a permanent import, as that is not regulated under these draft provisions. The group consensus is to either remove this provision or provide an exemption if the item is the subject of an ITAR temporary import license or exemption.

The scope of activities remains a concern, albeit less of one than previously. The draft activity scope encompasses financing, insuring, transporting, soliciting, promoting, negotiating, contracting for, arranging, or otherwise assisting in the purchase, sale, transfer, loan, or lease. It does contain language that the activities must be performed on behalf of another to facilitate the manufacture, export, import, or transfer of a defense article or service, which is an improvement and 129.3 exempts financing, insuring, and transporting from any registration requirement. Soliciting and promoting were discussed at length as these activities could encompass a range of parties of which their activities are not truly brokering, such as an

industry trade association or business council. The consensus was for additional clarifying language in 129.2 to better define what promotion and solicitation actions would be controlled here and what actions would not.

The draft registration requirements appear to be significantly reduced. Regular employees of the company are covered as are foreign subsidiaries/affiliates of persons registered under part 122 would not be required to submit a separate registration.

Prior approval in the draft appears to be a significant improvement as prior approval is limited to mainly to upper level end items and ignores parts, components, accessories, etc. For example, prior approval is required for a category VIII aircraft and UAV, but nothing else cited in category VIII.

The draft contains a new part 120 definition for an affiliate. "An affiliate of a registrant is a person that directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such registrant. Note: for the purposes of this subsection, control means having the authority or ability to establish or direct the general policies or day-to-day operations of the firm. Control is presumed to exist where there is ownership of 25 percent or more of the outstanding voting securities if no other person controls an equal or larger percentage." This new definition would appear to cover any possible brokering activities by foreign subsidiaries and parent companies acting on our behalf. One discussion point was regarding the board of directors of a US company as they do not appear to meet the definition of a regular employee nor an affiliate. To clarify that such persons are covered a recommended change was made to include parties listed on the registration as being included in the definition of an affiliate.

Suggested Changes:

DTAG members have identified a few areas within the regulation that they believe would benefit from some clarifying language. Specific suggested changes are as follows:

Change 129.2(a)(4) to read:

(4) Any foreign person located outside the United States ~~involving~~ **involved in** the temporary import into the United States of any **foreign** defense article ~~or service~~ **that is not the subject of a temporary import license or exemption.**

Rationale: Given such actions by foreign persons relating to permanent imports are not considered to be brokering, temporary imports should not be regulated as such and if they must be, it should be limited to those not lawfully authorized by the department.

Change 129.2(b)(2) to read:

(2) Such action does not include:

- (iii) Activities that do not extend beyond administrative services, such as providing or arranging office space and equipment, hospitality, advertising, or clerical, visa, or translation services, **research and data gathering (such as collecting product and pricing information from non-US suppliers to prepare a response to Request for Proposal), general business promotion activities (such as promoting company goodwill or capabilities at trade shows),** or activities by an attorney that do not extend beyond providing legal advice to their client; ~~or~~
- (iv) Activities performed by an affiliate, **as defined in 120.40,** on behalf of another affiliate; **or**
- **Add new 129.2(b)(v): Activities performed by a regular employee as defined in §120.39.**

Rationale: To clarify promoting and soliciting activities not considered to be brokering.

Change 129.40 to read:

An affiliate of a registrant is:

- **a) a person that directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such registrant; or**
- **b) is any party listed on a US Person's Statement of Registration.**
- Note: For purposes of this subsection, control means having the authority or ability to establish or direct the general policies or day-to-day operations of the firm. Control is presumed to exist where there is ownership of 25 percent or more of the outstanding voting securities if no other person controls and equal or larger percentage.

Rationale: To ensure persons largely controlled by the company, but not meeting the definition of a permanent employee, such as members of the board, are covered by the registrant.

Summary of Results:

Draft rule significantly clarifies persons considered to be brokers and do so within the scope of the legislation. Activities considered to be brokering though still present problems for US registered manufactures and exporters determining when registration and prior approval thresholds apply. The activities identified are not dependent on an actual transfer of defense articles, a key component of the legislation (manufacture, export, import, transfer) nor even being directly related to such a transfer (ex. soliciting and promoting). These thresholds are routinely met in normal business operations that routinely do not result in such a transfer.

ⁱ *proposed rule published Dec 2011

ⁱⁱ See attached DTAG working paper of proposed rule