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Inside The State Dept.'s Long-Awaited Rule On Brokering

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As part of the ongoing U.S. export control reform effort, the U.S. State Department's Directorate of Defense Trade Controls published its long-awaited interim final rule on brokering under the International Traffic in Arms Regulations in the Federal Register on Aug. 26, 2013.[1] This comes nearly two years after the DDTC published its most recent proposed brokering rule in December 2011.[2]

The interim final rule contains several significant modifications addressing concerns raised by industry regarding the proposed rule and narrowing the persons and activities subject to ITAR's brokering requirements. Importantly, the interim final rule is not effective until Oct. 25, 2013.

Background

The DDTC administers ITAR, which control exports, re-exports, and temporary imports of defense articles, defense services, and related technical data. Part 129 of ITAR contains registration, approval, recordkeeping and reporting requirements for persons engaged in brokering defense articles and defense services. A "broker" currently is defined 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." [3] "Brokering activities" currently include "financing, transportation, freight forwarding, or taking of any other action that facilitates the manufacture, export, or import or [sic] a defense article or defense service, irrespective of its origin." [4]

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In 2003, the DDTC began the process of reviewing ITAR's brokering requirements, which have posed major compliance challenges due to the ambiguity and potentially broad, extraterritorial application of the brokering provisions. The DDTC published its latest proposed brokering rule on Dec. 19, 2011. This proposed rule clarified several aspects of the regulations but also appeared to expand the coverage of such regulations.

Summary of Key Changes

The interim final rule on brokering contains several key changes, which are summarized below:

1) Limits on the Extraterritorial Application of ITAR's Brokering Provisions

One longstanding concern over the DDTC's brokering regulations has been the apparent broad, extraterritorial application of brokering registration and licensing requirements. As currently crafted, the DDTC's brokering regulations cover the activities of "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."^[5]

The DDTC's December 2011 proposed brokering rule also was fairly expansive and would have covered foreign persons located outside of the United States when their activities involved U.S.-origin defense articles or defense services, the importation of defense articles or defense services, or acting on behalf of a U.S. person.^[6] The interim final rule, however, narrows the definition of "broker" to limit the brokering registration requirements applicable to foreign persons to only those foreign person brokers located in the United States or located outside of the United States and owned or controlled by a U.S. person.^[7]

2) Exclusions from the Definition of "Brokering Activities"

As noted above, the current definition of "brokering activities" is quite broad. The December 2011 proposed rule was similarly expansive in nature and included "any action to facilitate the manufacture, export, reexport, import, transfer, or retransfer of a defense article or defense service," subject to limited exceptions.^[8] The DDTC's interim final rule requires that brokering activities be "on behalf of another" and includes activities such as soliciting or promoting defense articles or defense services. The new definition of brokering activities also includes an extensive list of specific activities that do not constitute "brokering activities."

Among other excluded activities are activities by regular employees acting on behalf of their employer and activities that do not extend beyond administrative services, including providing or arranging office space and equipment, hospitality, advertising, or clerical, visa, or translation services; collecting product and pricing information to prepare a response to a request for proposal; generally promoting company goodwill at trade shows; and activities by an attorney that do not extend beyond the provision of legal advice to clients.^[9]

In addition, activities that do not extend beyond acting as an end-user of defense articles or defense services pursuant to a DDTC license or approval or acting as a re-exporter or retransferor under such license or approval also are not considered brokering activities.[10] The December 2011 proposed rule exempted persons who engaged in such activities from several of the Part 129 requirements but did not specifically exclude these activities from the definition of brokering activities.[11]

Finally—and perhaps most importantly—the DDTC specifically has excluded from the definition of “brokering activities” 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 registrant) on behalf of another affiliate.[12] Thus, activities undertaken within the corporate family of a single registrant meeting this exception do not qualify as brokering under Part 129 of ITAR, which alleviates one concern that many multinational companies had about prior iterations of the brokering requirements. Combined with the limits described above on the coverage of activities of foreign persons, these modifications and clarifications should reduce the burden of ITAR’s brokering regulations on the defense industry.

3) Consolidation and Clarification of Registration Requirements

When a U.S. or foreign subsidiary or affiliate is deemed to be engaging in brokering activities, the interim final rule permits U.S. and foreign subsidiaries and affiliates owned or controlled by a registrant to be listed as brokers on the registrant’s manufacturer/exporter registration. Thus, a separate broker registration and broker registration fee are not required.[13] In addition, the DDTC notes in its interim final rule that the manufacturer/exporter and brokering statement of registration should only include subsidiaries and affiliates that are more than 50 percent owned or otherwise controlled by the registrant.[14]

The new interim final rule also alters the registration certification by requiring intending registrants to certify that the registrant, its parent, subsidiary, or other affiliate listed in the statement of registration (or any senior officer, senior official or board member) has not, among other representations, violated a foreign criminal law on exportation of defense articles where conviction carries a minimum term of imprisonment of greater than one year.[15]

Further, all registrants currently are required to notify the DDTC within five days if there is a material change in the information contained in the statement of registration.[16] The interim final rule clarifies that the specific material changes subject to this five-day notification requirement include changes involving the following: the registrant’s name; address; legal organization structure; ownership or control; the establishment, acquisition, or divestment of a U.S. or foreign subsidiary or other affiliate engaged in manufacturing defense articles, exporting defense articles or defense services, or brokering activities; and the board of directors, senior officers, partners, or owners. All other changes—including, for example, engaging in activities in a new U.S. Munitions List category—can be submitted as part of the annual registration renewal.[17]

4) Identification of Specific Items Requiring Prior Approval

The interim final rule specifies those items that require prior approval from the DDTC for brokering in a manner consistent with U.S. international commitments and obligations and subject to certain exemptions from the approval requirement. These defense articles and defense services include any foreign defense article or defense service and certain firearms and other weapons; rockets, bombs, grenades, and launchers; launch vehicles and missile and anti-missile systems; vessels of war; tanks and military vehicles; aircraft and unmanned aerial vehicles; night vision-related defense articles; inertial platform, sensor, and guidance-related systems; chemical agents and precursors; biological agents and biologically derived substances; equipment for the dissemination of chemical and biological agents; submersible vessels; and miscellaneous articles described by Category XXI of the U.S. Munitions List.[18]

5) Other Changes and Clarifications

The DDTC's interim final brokering rule contains other changes and clarifications to ITAR as well, several of which are highlighted below:

- A definition of "foreign defense article or defense service" is now included in ITAR's definition section (Part 120), and the definition specifically notes that "the terms defense article and defense service refer to both U.S. and foreign origin defense articles and defense services described on the U.S. Munitions List," unless otherwise noted.[19]
- Section 126.1(e) of ITAR currently provides that no sales, exports, transfers, re-exports, retransfers or proposals to engage in any of these activities may be made to a Section 126.1 ITAR prohibited country unless authorized by DDTC. It also imposes a duty on any person who knows or has reason to know of any such final or actual sale, export, transfer, re-export or retransfer to immediately notify DDTC.[20] Amended Section 126.1(e) explicitly requires persons to notify DDTC of proposed sales, exports, transfers, re-exports or retransfers to proscribed countries. In addition, both proposals and presentations to Section 126.1 countries are prohibited without a license or other approval. A new note defines proposals and presentations to mean communication of information in sufficient detail that it would permit an intended purchaser to decide to acquire the article or enter into an agreement described in Part 124 of ITAR, including communicating information on the equipment's performance characteristics, price, and probable availability for delivery.[21]
- The new rule also includes more detailed requirements for obtaining guidance from DDTC on whether an activity constitutes brokering, along with more detail on the information required in brokering reports.[22]

[1] *Amendment to the International Traffic in Arms Regulations: Registration and Licensing of Brokers, Brokering Activities, and Related Provisions*, 78 Fed. Reg. 52,680 (Dep't State Aug. 26, 2013) (interim final rule) ("Interim Final Brokering Rule").

[2] *Amendment to the International Traffic in Arms Regulations: Registration and Licensing of Brokers, Brokering Activities, and Related Provisions*, 76 Fed. Reg. 78,578 (Dep't State Dec. 19, 2011) (proposed rule) ("Proposed Brokering Rule").

[3] 22 C.F.R. § 129.2(a).

[4] *Id.* § 129.2(b).

[5] *Id.*

[6] Proposed Brokering Rule, 76 Fed. Reg. at 78,587.

[7] Interim Final Brokering Rule, 78 Fed. Reg. at 52,690. The new note to amended section 129.2(a)(3) states that "owned by a U.S. person" means more than 50% of the outstanding voting securities of the firm are owned by a U.S. person, while "controlled by a U.S. person" means that 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. Control is rebuttably presumed when the U.S. person owns 25% or more of the outstanding voting securities, unless one foreign person controls an equal or larger percentage. *Id.* As it did in its December 2011 proposed rule, DDTC removed from the definition of "broker" language requiring the person to act "as an agent for others" "in return for a fee, commission, or other consideration." *Id.*; 22 C.F.R. § 129.2(a).

[8] Proposed Brokering Rule, 76 Fed. Reg. at 78,587.

[9] Interim Final Brokering Rule, 78 Fed. Reg. at 52,690.

[10] *Id.*

[11] Proposed Brokering Rule, 76 Fed. Reg. at 78,587-88.

[12] Interim Final Brokering Rule, 78 Fed. Reg. at 52,686 & 52,690.

[13] *Id.* at 52,691. Changes to combine an existing broker registration with an existing manufacturer/exporter registration can be provided as part of the annual registration renewal for one year from October 25, 2013. *Id.* at 52,687 & 52,693.

[14] *Id.* at 52,686 & 52,692.

[15] *Id.* at 52,686-87 & 52,693.

[16] 22 C.F.R. § 122.4(a)(2).

[17] Interim Final Brokering Rule, 78 Fed. Reg. at 52,687 & 52,693.

[18] *Id.* at 52,691. The Interim Brokering Rule removes the prior notification requirements from Part 129.

[19] *Id.* at 52,686.

[20] 22 C.F.R. § 126.1(e).

[21] Interim Final Brokering Rule, 78 Fed. Reg. at 52,687-88.

[22] *Id.* at 52,693-94.