

U.S. International Traffic in Arms Regulations (“ITAR”)

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1.Introduction

Not infrequently, companies not members of the U.S. defense and aerospace industries misunderstand the scope and application of the U.S. International Traffic in Arms Regulations (“ITAR”).

As its name suggests, the ITAR governs transfers of arms. However, the ITAR can apply to business activities far removed from what one might consider to be arms exports (the shipment from the U.S. of, for instance, missiles, tanks, military aircraft, and warships).

The “arms” to which the ITAR applies are identified on the United States Munitions List (“USML”). In addition to commodities that are clearly weapons, the USML governs common electronic devices such as infrared focal plane arrays and lasers that are specifically modified or configured for military application, as well as all spacecraft (including research and commercial communications satellites and components). Virtually any modification to a commercial product specifically for a military (or space) application will subject the modified product to the ITAR.

The word export, as used in the ITAR, includes the obvious activities of sending or taking any ITAR-controlled commodity or information out of the United States. However, the term export also includes transferring ITAR-controlled commodities or information within the United States to anyone not a U.S. citizen or lawful permanent resident (with certain narrow exceptions). Given this definition, transfers of ITAR-controlled commodities or information to non-U.S. employees of U.S. companies entirely within the U.S. are exports.

Finally, the ITAR also has extraterritorial application such that control over a commodity or information adheres to such a commodity or information wherever the commodity or information is located in the world. Thus, not only does sending or taking any ITAR-controlled commodity or related data out of the U.S. require prior U.S. State Department approval, but subsequent transfers of the commodity or data outside of the U.S. also require prior State Department approval.

Although the ITAR was promulgated decades ago, today the ITAR is receiving perhaps more attention than at any prior time in its history. The heightened focus on the ITAR is due primarily to: (i) increased enforcement and (ii) industry’s growing interest in attempting to reform the U.S. Department of State export authorization process and the ITAR itself.

2.Key ITAR Definitions

In order to gain a basic understanding of the ITAR, it is critical first to understand definitions of key words and phrases used in the ITAR, some of which can have a different meaning than as used in everyday English– as well as in other U.S. Government regulations.

The most important phrase, from which most other ITAR definitions flow, is the phrase “defense article.” The ITAR defines “defense article” as any item or “technical data” identified on the USML, which is set forth in Part 121.1 of the ITAR. (This basic definition of defense article creates some confusion because “technical data” is also separately defined, as discussed below.) The definition of defense article additionally includes models, mockups, and other physical forms that reveal technical data directly relating to USML items.

A “U.S. person,” as noted above, is any U.S. citizen or lawful permanent resident, as well as certain refugees to the U.S. and individuals to whom the U.S. has granted asylum. The phrase also includes any corporation, business association, partnership, society, trust, or any other entity, organization or group that is incorporated to do business in the United States. A “foreign person” is, in essence, any person or entity that is not a U.S. person.

The word “export,” as also discussed briefly above, means sending or taking a defense article out of the U.S. in any manner (other than mere travel outside of the U.S. by a person whose personal knowledge includes “technical data”). Significantly, however, export also means disclosing, including oral or visual disclosure, or transferring any “technical data” to a foreign person, or providing a “defense service” to a foreign person – whether within the United States or outside of the United States. In addition, the word export includes the transfer of control or ownership of, among other commodities, any satellite controlled by the ITAR in whole or in part.

The definitions of “technical data” and “defense services” are closely related. Technical data are, in essence, any information required for the design, development, production, manufacture, assembly, operation, repair, testing, maintenance or modification of defense articles. “Defense services” are the providing of assistance to foreign persons regarding the foregoing as well as regarding engineering, demilitarization, destruction, processing or use of defense articles. Both definitions are quite broad. Note that a U.S. person can provide a foreign person defense services with respect to, for instance, a commercial communications satellite. The satellite need not have any defense application whatsoever in order for the U.S. person’s assistance to the foreign person to constitute a defense service.

3.Significance of the ITAR for Japanese Industry

Although Japan does not engage in external defense trade, Japanese manufacturers of Japanese defense articles, such as military aircraft and warships, that incorporate any ITAR-controlled subsystems or components into the aircraft or warship, or use ITAR-controlled technical data in the manufacture of the aircraft or warships or components of either, clearly must have a comprehensive understanding of the ITAR. As noted above, ITAR jurisdiction stays with defense articles and ITAR-controlled technical data (as well as any defense services that a Japanese company may receive from a U.S. company) regardless where in the world the defense article or technical data are located. Such manufacturers not only must properly control within the company defense articles and ITAR-controlled technical data received from the U.S., but also must have appropriate State Department authorization to work with Japanese suppliers and subcontractors who will receive ITAR-controlled technical data or defense articles in the course of working with the manufacturer.

Less obvious to those outside the respective industries, Japan's satellite industry (as well as certain Japanese universities) and commercial launch industry must have a similar comprehensive understanding of the ITAR. This understanding is necessary not only for purposes of properly controlling defense articles and ITAR-controlled technical data received from the U.S., but also, for instance, for purposes of obtaining required State Department authorization prior to shipping from Japan a satellite with U.S. components to be launched in another country, or launching a U.S. satellite (or satellite with major U.S. subsystems or components) from Japan. Note that State Department authorization is required to "reexport" from Japan even a single U.S. component incorporated into a satellite that is otherwise constructed entirely of Japanese subsystems, components, and parts. These reexport controls highlight an important difference between the ITAR and the U.S. Commerce Department's Export Administration Regulations ("EAR"). The EAR does not extend reexport jurisdiction to any foreign-origin item that contains less than 25% U.S. content (10% to embargoed nations). Under the EAR, this is known as the "*de minimis*" rule. The ITAR has no *de minimis* rule.

Even less obvious is that it would be prudent for Japan's nascent regional jet industry to be familiar with the ITAR. U.S.-origin inertial navigation systems, for instance, can be ITAR-controlled. Incorporation of an ITAR-controlled inertial navigation system into a regional jet manufactured in Japan would, in essence, make the entire aircraft ITAR-controlled. That result would make such a jet worthless for all practical purposes, since operators of the jets would have to obtain State Department approval prior to each landing of an aircraft that incorporates the ITAR-controlled item.

Outside of Japan, it is also important that U.S. subsidiaries of Japanese companies be familiar with the ITAR. Consider the following example. Assume that Company A, a U.S. subsidiary of a Japanese company, has never directly or indirectly sold any of its products to the military of any country (nor for any space application), or received any funding from the military (or for any space application), directly or indirectly. Then assume that Company B, a U.S. company, approaches Company A seeking to order one of Company A's products with some minor modifications. If Company B makes the

request for the minor modifications to meet a military (or space) requirement, then Company A's modified product will very likely thereafter be ITAR-controlled.

To be more specific, assume that Company A manufactures thermo-electric coolers for the commercial telecommunications industry. Assume that Company B manufactures missile guidance systems. Assume further that the modification that Company B wishes to have Company A make to a particular type of Company A's standard thermo-electric cooler product involves merely changing the physical shape of the cooler slightly. If Company A makes this modification to its product, the product will thereafter likely be ITAR-controlled.

4. "Deemed Exports" at U.S. Subsidiaries of Japanese Companies

Japanese national officers, managers, and employees of a U.S. subsidiary of a Japanese company are not excluded from the definition of export by virtue of their respective positions with the subsidiary. Therefore, such a subsidiary must obtain appropriate authorization from the U.S. State Department before any Japanese national officer, manager, or employee may (i) receive ITAR-controlled technical data, (ii) receive defense services from the subsidiary's U.S. person officers, managers, or employees, or (iii) obtain access to any defense article that discloses technical data.

Generally, the minimum authorization that the U.S. subsidiary will need to obtain for any of its Japanese national officers, managers, or employees who need access to ITAR-controlled technical data, defense services, or defense articles is an "employment" DSP-5/License for Permanent Export. If the U.S. subsidiary wishes to provide particular Japanese national officers, managers, or employees technical data, defense services, or both that include design methodology, engineering analysis, manufacturing know-how, or any combination of the foregoing, the subsidiary must obtain approval from the State Department of a "technical assistance agreement" ("TAA") that the U.S. subsidiary and the foreign national officer, manager, or employee must both sign. In addition, if the foreign national officer, manager, or employee is likely to have technical interaction with another U.S. company (or any U.S. person), the U.S. subsidiary must so inform such U.S. company or person, which company or person is then required to obtain State Department appropriate authorization to permit it to interact with the U.S. subsidiary's Japanese national officer, manager, or employee. Finally, if the U.S. subsidiary has a TAA with its Japanese parent (or with any other foreign person), any technical interaction that a Japanese national officer, manager, or employee of the U.S. subsidiary will have with Japanese nationals at the parent company (or with any other foreign persons) must be identified in the TAA.

5. Penalties for Violation of the ITAR

The penalties for violating the ITAR are severe. Civil penalties are \$500,000 per violation, and multiple shipments of the same defense article without appropriate State Department authorization are usually charged as multiple violations. In addition to any basic ITAR violation, ancillary violations, such as shipping documentation that is

incorrect because of the basic ITAR violation, can also be alleged. Civil penalties may be imposed without showing any intent to violate the ITAR. In other words, a mistake is not a defense to a civil charge of violation of the ITAR.

Criminal penalties for violation of the ITAR are \$1,000,000 per violation, with the potential for violations to be multiplied in the same manner as civil violations, and up to one year in prison. In order to impose criminal penalties, the government must prove willful violation of the ITAR; a simple mistake is not sufficient to support a criminal charge. Companies convicted of violating the ITAR are also automatically barred from exporting under the ITAR (though an agreement not to debar can be part of a plea agreement), and usually under the EAR as well. In addition, such a company will also likely be barred from selling to the U.S. Government directly or indirectly.

A powerful tool that the U.S. State Department has to punish foreign persons for violation of the ITAR, should it not civilly fine or prosecute a foreign person, is to make the foreign person ineligible to be a party to any ITAR export authorization.

In terms of the magnitude of recent ITAR fines, in 2008 Northrup Grumman paid \$10 million, and Lockheed Martin and Boeing each paid \$3 million, in civil penalties. In 2007, ITT Corporation paid \$28 million in civil penalties and \$100 million in criminal penalties. In 2006, several companies paid over \$25 million in civil penalties.

6. The ITAR and the EAR Differ Considerably

In addition to the *de minimis* rule, there are other significant differences between the ITAR and the EAR. The most significant difference is that the EAR's controls are more calibrated than the ITAR's. The EAR's controls are, in essence, based on (i) the technical sophistication of a commodity, technology, or other item to be exported (or reexported), (ii) the country of end use, (iii) the intended end use of the commodity, technology, or other item, and (iv) the intended end user. In contrast, the ITAR requires State Department authorization prior to the export of most defense articles, technical data, and defense services – even to the closest allies of the U.S. The EAR therefore places responsibility upon exporters (and reexporters) to make many licensing determinations on their own based upon the above factors (and other factors). Under the ITAR, exporters and reexporters face challenges as well. But making a determination as to whether State Department export authorization is required based upon the above factors is not one of them.

Another significant difference between the ITAR and EAR involves the treatment, for purposes of export authorizations, of employees of a company whose nationality is different from the country in which the company itself is incorporated (for instance, a U.S. subsidiary of a Japanese company that employs a Ukrainian national). The State Department considers the country of birth as well as current nationality of individual employees when making determinations as to whether to authorize exports to particular employees. The Commerce Department, in contrast, considers only the most recent nationality of an employee. Finally, under the ITAR no defense article, defense service

or ITAR-controlled technical data whatsoever may be transferred to any Chinese entity or national, including Chinese national employees of U.S. companies. The EAR contains a number of restrictions on transfers to Chinese entities and nationals, but contains an absolute bar only on certain commodities and technology such as those that involve missile technology.

7. Managing ITAR Compliance

ITAR control of a company's product or products and any related technical data requires a company to take important management steps to ensure that the company does not violate the ITAR. A company may, of course, choose not to perform any work that would subject the company to any ITAR restrictions. However, ITAR compliance can be managed just as the company manages compliance with other laws and regulations to which the company is subject.

Assuming that a company has not previously performed any ITAR-controlled work, the company will want to establish procedures to ensure ITAR compliance. The essence of managing defense articles and related technical data requires, first, ensuring that the company identifies all defense articles and/or technical data that the ITAR controls. This step includes, but is not limited to, marking any defense articles and/or ITAR-controlled technical data with an appropriate legend that warns that the articles or data are ITAR controlled. If the company is a U.S. subsidiary, the company is also required to register with the State Department (and keep such registration current) if the company manufactures defense articles, even if the company does not export any of the defense articles. Next, the company must ensure that dissemination of the defense articles and/or technical data – even within the company – is limited to those persons authorized to have access to a particular defense article and/or technical data (all U.S. persons have authorization). Finally, the company must ensure that it has appropriate State Department authorization to transfer outside of the company any defense articles, ITAR-controlled technical data, or both, or to provide defense services, and ensure particularly that it has appropriate State Department authorization to transfer defense articles, ITAR-controlled technical data, or both overseas or to perform defense services overseas.

In addition to minimizing the possibility of violating the ITAR, there are strong commercial reasons for instituting the above compliance measures. If a company uses any ITAR-controlled technical data that it has received to modify, upgrade, or change in any way the company's non-ITAR-controlled products, such products will very likely become ITAR-controlled as well. Thus, it is important that an export compliance program require that the company's ITAR work be segregated from the remainder of the company's work – physically and virtually. Otherwise, a company may find that it must seek State Department authorization prior to exporting or reexporting commodities that were previously subject to the EAR, and may not have required a license under the EAR.

8. The Future of the ITAR

There is active debate today in the U.S. regarding “reforming” the ITAR and the State Department’s export authorization process. This debate is not entirely new. For instance, prior to the 9/11 attacks on the U.S., some top U.S. policymakers spoke of “higher fences around fewer items.” The debate has recently intensified, however, due primarily to concerns about the slow pace of processing ITAR export authorizations, increased U.S. international defense cooperation, the competitiveness of the U.S. defense (and satellite) industry internationally, and ITAR control of items perceived to no longer be essential to U.S. national security. A task force of the widely respected U.S. Defense Science Board recently concluded that, “Despite globalization, U.S. policy continues to not allow the nation to gain the security and economic benefits that could be realized; instead focusing on . . . obsolete International Traffic in Arms Regulations . . .”

Many of the issues regarding the processing of ITAR authorizations can be addressed within the U.S. Executive Branch, and some important improvements have in fact recently been made in the area. Major “reform” of the ITAR, however, will require that the U.S. Congress perceive that there is a need for reform of both the ITAR and the State Department export authorization process. With respect to the ITAR itself, under the Arms Export Control Act, which the ITAR implements, Congress can veto a State Department proposal to remove any item from the USML. Four hundred thirty-five members of Congress face election every two years. With the threat of terrorism on most Americans’ minds to one extent or another, most congressmen and congresswomen do not wish to be portrayed as being “soft” on defense/homeland security – even if control of a particular item on the USML may contribute little or nothing to U.S. national security. In addition, in the near term, with the course of the U.S. economy uncertain ITAR “reform” is not likely to be perceived to be a high priority of the American public.

9. Conclusion

The ITAR in its present form is a regulation that Japanese industry should at a minimum be aware of depending, of course, upon the nature of a particular company’s business. In the near term Japanese companies should not expect fundamental changes to the ITAR that would lighten the costs of ITAR compliance. On the positive side, the State Department’s processing of export and reexport authorizations has recently improved and further incremental improvements appear likely. But significant changes in processing, as with changes to the ITAR itself, will require Congressional attention. For the foreseeable future, the attention of Congress is likely to be focused on U.S. economic issues.