MILLER CANFIELD

Export Controls: Relaxed Rules on Defense Article Transfers to Dual and Third-Party National Employees of Foreign Licensees and End-Users under ITAR

January 2012

The International Traffic in Arms Regulations (ITAR) was recently amended to reflect the U.S. Department of State's new policy regarding transferring unclassified Defense Articles to dual and third-country national employees of authorized foreign business entities, foreign governmental entities, and international organizations (Foreign Licensees) and their authorized end-users (End-Users).

Prior to the amendment, Foreign Licensees and their End-Users receiving Defense Articles from a U.S. exporter could not transfer Defense Articles to any of their dual or third-country national employees unless certain additional personal information was provided to the U.S. Department of State's Directorate of Defense Trade Controls (DDTC).

Providing personal information created a significant administrative burden on U.S. exporters and on the Foreign Licensees and End-Users. In addition, since many foreign countries have enacted privacy and human rights legislation that restrict a company's ability to collect personal data on nationality and make employment decisions based on nationality, in some instances the requirement caused the Foreign Licensees and/or their End-Users to violate labor, privacy, and human rights legislation of their home countries. Such violations in turn created tension between the U.S. and some of its allies.

To alleviate the administrative burden on U.S. exporters and their Foreign Licensees and End-Users and to avoid impairing the relationship of the U.S. with its allies, the U.S. Department of State amended the ITAR on August 15, 2011.

The amendment added the definition of "regular employee" to ITAR Section 120, slightly modified the existing ITAR Sections 124.8(5) and 128.16, and added a completely new ITAR Section 126.18.

The amended ITAR Section 124.8(5) provision now requires all Technical License Agreements and Manufacturing License Agreements to include the following clause:

The technical data or defense service exported from the United States in furtherance of this agreement and any defense article which may be produced or manufactured from such technical data or defense service may not be transferred to a foreign person except pursuant to Sections 124.16[1] and 126.18, as specifically authorized in this agreement, or where prior written approval of the Department of State has been obtained.

The new ITAR Section 126.18 addresses situations where ITAR Section 124.16 cannot be implemented because of applicable domestic law. Under this new provision, no approval is needed from the DDTC for the transfer of unclassified Defense Articles to or within a Foreign Licensee and its End-User, including the transfer to dual or third country nationals who are bona fide, "regular employees," directly employed by the Foreign Licensee or End-User.

In order to utilize the exemption, the following conditions must be met:

1. The transfer must take place wholly within the physical territory of the country where the Foreign Licensee conducts official business or operates or where the End-User is located;

2. The transfer must be within the scope of an approved export license, other export authorization, or a license exemption; and

3. The Foreign Licensee and End-User must have "effective procedures to prevent diversion" to destinations, entities or for purposes other than those authorized by the applicable export license or other authorization.

The new amendment shifts the compliance burden of having "effective procedures to prevent diversion" to the authorized Foreign Licensee or End-User. This burden can be met in two ways.

First, if the Foreign Licensee or End-User has received security clearance for its employees approved by its host nation's government, it will be considered to have "effective procedures to prevent diversion."

Second, if such a security clearance has not been received, the Foreign Licensee or End-User can still meet the requirement of having "effective procedures to prevent diversion" if it:

has in place a process and a technology security/clearance plan to screen its employees to make sure that the employees do not have any "substantive contacts" with restricted or proscribed countries listed in ITAR Section 126.1

<u>and</u>

has executed a Non-Disclosure Agreement with its employees that provides assurances that the employee will not transfer any Defense Articles to persons or entities unless specifically authorized by the Foreign Licensee or End-User.

Moreover, the Foreign Licensee and End-User must maintain records of its screening activities for five years, and records must be made available to the DDTC or its agents.

While the compliance burden has shifted to the Foreign Licensee and End-User, the U.S. exporter will still be held responsible if something goes wrong.

Accordingly, if U.S. exporters wish to rely on the new exemption, they should carefully review the screening policies and procedures of their Foreign Licensees and End-Users to confirm that they are effective and that the policies and procedures are adequately being followed.