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SENATE RATIFIES DEFENSE TRADE COOPERATION TREATIES WITH THE UNITED KINGDOM AND AUSTRALIA

On September 29, 2010, after a three-year delay, the U.S. Senate ratified the U.S.-U.K. and U.S.-Australia Defense Trade Cooperation Treaties, following Senate and House passage of related implementing legislation earlier in the week. The treaties will facilitate U.S. defense trade with the U.K. and Australia by eliminating the license requirements of the International Traffic in Arms Regulations (ITAR), under certain conditions, for exports to (and imports from) the U.K. and Australia of certain defense articles (encompassing defense articles, services and technical data). Removal of these license requirements will facilitate the flow of defense goods, services and technology between important trading partners and promote greater U.S. supplier presence in the U.K. and Australian markets. Although the treaties should benefit the U.S., U.K. and Australian defense industries, issues such as broad exceptions to the list of defense articles that are eligible for export under the treaties, potentially burdensome administrative requirements, and re-export restrictions for otherwise eligible items are expected to reduce the impact of the treaties.

BACKGROUND

U.S. companies apply for thousands of licenses to export defense articles and defense services to the U.K. and Australia each year, 99 percent of which are approved by the State Department. Because the export licensing process is often lengthy, however, it can hinder cooperative efforts in military and counterterrorism operations and inhibit the entry of some companies into these markets.

Recognizing the need to ease defense trade controls with two of the United States' closest allies to support joint military and counterterrorism operations, promote project collaboration and foster the joint development of superior defense equipment and technology, the United States signed treaties with the United Kingdom and Australia in 2007 that would eliminate the need for licensing many defense exports between the United States and the United Kingdom or Australia. Both treaties were submitted to the U.S. Senate for advice and consent to ratification in September 2007, and the parties signed corresponding Implementing Arrangements in early 2008.

The three-year delay in the ratification of the treaties was largely a result of a dispute between Congress and successive Administrations over whether the treaties were self-executing or would require separate legislation to make the treaties enforceable. Even though the preambles to the treaties stated that they are self-executing, the Senate Foreign Relations Committee concluded that the treaties should not be treated as self-executing. The Administration ultimately relented on the issue, allowing Congress to move forward with approval of the treaties and related implementing legislation. The implementing legislation amends the Arms Export Control Act (AECA) and authorizes the President to promulgate regulations to implement and enforce the treaties. The legislation will preclude any subsequent substantive changes to the Implementing Arrangements without the passage of additional legislation.

OVERVIEW OF THE TREATIES

The Defense Trade Cooperation Treaties and Implementing Arrangements establish a framework for facilitating the movement of defense articles within an "Approved Community" of government and non-government entities specifically vetted and approved by the participating governments. The treaties address the security risks associated with the export and transfer of such defense articles and help maintain control over the end-use of the items by conditioning the elimination of export licensing requirements on certain criteria. Specifically, the treaties eliminate ITAR license requirements only if three conditions are met: (a) the defense article or technology is not excluded from the scope of the treaty; (b) the export is to a member of the Approved Community; and (c) the purpose of the export relates to an end-use that is approved under the treaty.

A. Eligible Defense Articles

As defined in the treaties, "Defense Articles" are classified and unclassified articles, services, and related technical data, including software, in tangible and intangible form, listed on the United States Munitions List of the ITAR. However, participating governments can narrow the range of eligible defense articles by excluding particularly sensitive defense articles from eligibility for unlicensed export under the treaties. The U.K. Ministry of Defense, Australian Department of Defense and U.S. Department of Defense (DOD) (with State Department approval) each are responsible for developing and periodically publishing a list of defense articles that are exempt from the scope of the treaties. According to the lists of exempted defense articles published by the State Department, the United States will exclude from the scope of both treaties, articles (including technologies) relating to certain missile technology, biological and chemical agents, and items specific to, among others:

- anti-tamper measures;
- reduced observables or counter low observables in any part of the spectrum (such as articles relating to the reduction of radio frequencies or infrared emissions of defense platforms);
- sensor fusion (*i.e.*, the automatic combination of information from two or more sensors/sources for the purpose of target identification, surveillance or weapons engagement) beyond that required for display or identification correlation.
- countermeasures and counter-countermeasures;
- the design and testing of nuclear weapons;
- communications security;
- satellite articles and technology; and
- night vision technology.

The legislation passed last week specifically provides that certain items (*e.g.*, rocket systems or unmanned aerial vehicle systems) are excluded from the scope of the treaties. Further, the resolutions of ratification for the treaties require the Administration to notify the Senate Foreign Relations Committee and the House Foreign Affairs Committee before including items in the treaty scope that were previously excluded.

B. Approved Community

Both the exporter and recipient of a defense article exported pursuant to one of the treaties must be members of an Approved Community. The U.S. Approved Community, as defined in the treaties, includes departments and agencies of the U.S. government and companies registered with the State

Department pursuant to the ITAR. The U.K. and Australian Approved Communities include U.K. and Australian government facilities related to the scope of the treaties, as well as specifically identified nongovernmental U.K. and Australian entities that meet certain eligibility requirements and are mutually agreed to by the treaty participants.

C. Approved End-Uses

The approved end-uses under the treaties are limited to the following:

- a listed U.S.-U.K. or U.S.-Australia military or counterterrorism operation;
- a listed U.S.-U.K. or U.S.-Australia cooperative security and defense research, development, production and support program;
- specific security and defense projects where the U.K. or Australian government is the end-user; or
- a U.S. government end-use.

The treaties require the parties to cooperatively develop and maintain lists of approved end-uses for items; eligible U.S. government end-uses will be identified in government solicitations and contracts.

D. Other Restrictions and Administrative Requirements

Exports made pursuant to the treaty will still be subject to certain requirements designed to ensure the security of the exported defense articles. These requirements include, among other things, restrictions on re-exports and re-transfers of defense articles, detailed recordkeeping requirements, specific export marking and identification procedures, and restrictions on which individuals may access the articles, such as through security clearance requirements. Moreover, the treaty participants are empowered to conduct post-shipment verifications and end-use or end-user monitoring to ensure compliance with treaty provisions. In addition, pursuant to the implementing legislation adopted by Congress, Congressional notification will still be required for the proposed sale of defense articles to the U.K. and Australia that meet the dollar thresholds for notification in the AECA ($25 million for major defense equipment, $1 million for U.S. Munitions List Category I firearms and $100 million for other defense articles and services).

KEY ISSUES AND CONSIDERATIONS

Despite the significant potential upside to the treaties, there are a number of key issues related to their implementation that could reduce their effectiveness and utility.

A. Broad Exempt Lists

The benefit of the treaties depends in large part on the breadth of the exempt lists developed by the participating governments. In particular, as noted above, the exempt lists published by the State Department broadly proscribe the unlicensed export of articles specific to reduced variables or counter low observables in any part of the spectrum and sensor fusion beyond that required for display or identification correlation. These and many other specifically-excluded technologies significantly reduce companies' ability to use the treaty procedures.

Additionally, draft State Department regulations exclude defense articles specific to developmental systems that have not obtained written Milestone B approval from the DOD unless the export is pursuant to a written DOD solicitation or contract. This exclusion, if not clarified, could hamper the

treaties' objective of reducing licenses by excluding all non-DOD funded developmental systems from the scope of the treaties. "Milestone B" approval is an intermediate step related to the development process of developmental systems under U.S. DOD acquisitions programs, and must be granted by DOD's Milestone Decision Authority before the detailed design and implementation of a developmental system may proceed. Developmental systems funded by other entities, such as the U.K. and Australian governments, are not subject to Milestone B approval by the DOD. As a result, the draft regulations would, by default, exclude all non-DOD developmental systems from the scope of the treaties.

It is unclear whether the State Department intends this section to apply to all developmental systems without Milestone B approval (including those funded by the U.K, Australia or other foreign governments) or just those systems under development through the DOD without Milestone B approval. This point should be clarified in order to avoid unnecessary restrictions on non-DOD research and development projects.

Finally, the draft regulations restrict software source code export, but do not address whether open source software, used as licensed or that is modified for application by the exporter in defense articles, would be restricted as "software source code" under the regulations. Interested parties may want to seek clarification on the scope of these restrictions.

B. Administrative Requirements for Program Participation

If the implementing regulations impose unduly burdensome administrative requirements, the practical utility of the treaties will be diminished. Although the treaties and Implementing Arrangements lay out basic recordkeeping requirements, the draft regulations expand on these and impose detailed minimum recordkeeping requirements. For instance, the draft regulations require every phone call or e-mail with a colleague in the U.K. that is made without an ITAR license under the authority of the treaties to be recorded, which could be impractical. Furthermore, security clearance requirements detailed in the implementing arrangements, such as requiring all personnel who need access to defense articles to have "Restricted" (Australia) or "Security Check" (U.K.) level clearances, may pose challenges if groups of employees lack the required security clearances and it is difficult to obtain the clearances in a timely manner. As a related point, U.K. companies can only join the Approved Community if they have "List X" status (*i.e.*, they are a facility cleared by the U.K. government to work with confidential material). As some companies do not have this status and may not wish to pursue it, the List X requirement could reduce the effectiveness of the treaty with the U.K.

C. Restrictions on Re-exports and Re-transfers

The treaties' restrictive end-use provisions mean that the treaties are not applicable when re-exports or re-transfers are planned. With some limited exceptions, re-exports or re-transfers outside an Approved Community require the authorization of both the U.S. State Department and the host government (the U.K. or Australia), and thereafter, the defense article will fall outside the treaty and be subject to standard U.S., U.K. and Australian export controls. Incorporation into a foreign defense article would not eliminate the need to obtain these authorizations for a proposed re-export or re-transfer of the defense article, unless an exemption otherwise applies, such as an ITAR § 123.9(e) exemption for items incorporated into foreign end-items that are transferred to NATO or certain other foreign government entities.

NEXT STEPS

Now that the Defense Trade Cooperation Treaties have been ratified, the State Department will promulgate regulations to implement them. Because the State Department also is responsible for maintaining the lists of exempt defense articles, companies may wish to consider engaging the State Department about key issues such as those identified above. Moreover, companies may wish to evaluate their potential use of the new treaty procedures, including what company products could be eligible for coverage under the treaties and what new internal compliance procedures would be appropriate or necessary to make use of the treaties.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our international trade & finance group:

Peter Flanagan	202.662.5163	pflanagan@cov.com
Peter Lichtenbaum	202.662.5557	plichtenbaum@cov.com
Corinne Goldstein	202.662.5534	cgoldstein@cov.com
Kimberly Strosnider	202.662.5816	kstrosnider@cov.com
Damara Chambers	202.662.5279	dchambers@cov.com