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PROPOSED ITAR AMENDMENTS WOULD ELIMINATE LICENSING REQUIREMENT FOR CERTAIN DEFENSE ARTICLES

The Department of State recently proposed two amendments to the International Traffic in Arms Regulations ("ITAR") that, if adopted, would ease the requirements relating to certain defense-related exports and reexports. One amendment would exempt from licensing requirements the export of replacement parts and components for U.S.-origin defense end-items that were previously exported from the United States and are now held in the inventory of a foreign government; the other would allow the export and reexport, without a license from the State Department, of defense articles incorporated into commercial items, if certain conditions are met. The State Department's Directorate of Defense Trade Controls ("DDTC"), which administers the ITAR, is accepting comments on the proposed rule until Thursday, April 14, 2011. The proposed amendments to the ITAR are part of DDTC's efforts to implement the Administration's export control reform initiative.

The proposed new license exemption for replacement parts/components is significant because of the licensing burden it promises to eliminate, benefiting not only exporters but also U.S. allies using U.S.-supplied end-items abroad. However, the conditions that would apply could significantly limit the usefulness of the exemption.

The proposed new policy on the export and reexport of defense articles that are incorporated into commodities subject to the Export Administration Regulations ("EAR") also contains significant limitations, but is nonetheless noteworthy as a step away from the strict "see-through rule" that DDTC has long enforced. As exporters of defense articles are aware, the "see-through rule" requires authorization under the ITAR for the export or reexport of defense articles that are incorporated into commercial items, even if the defense content in the commercial item is minimal. By eliminating ITAR controls on certain defense content incorporated into commercial items, the proposed rule limits, to some extent, the broad extraterritorial reach of the ITAR and may help focus DDTC controls more tightly on embedded defense items that raise plausible diversion concerns.

THE PROPOSED REPLACEMENT PARTS/COMPONENTS LICENSE EXEMPTION

An important rationale for the Administration's export control reform initiative is to improve U.S. defense collaboration with its allies and partners. One obstacle to enhanced collaboration is the delay in exporting from the U.S. spare/replacement parts, in large part due to the burdensome and redundant licensing requirements for such parts and components. The proposed replacement parts/components rule would add a new section to the ITAR, Section 123.28, that could facilitate more expeditious repairs of U.S.-supplied end-items abroad by eliminating license requirements for some parts and components.

Currently, the export of replacement parts/components generally requires a DDTC license, with the exception of certain very low-value shipments of spare parts. With its broader application, the proposed exemption has the potential to authorize many more exports of replacement parts and components, thus allowing swifter repairs to U.S.-supplied end-items abroad.

According to the proposed rule, parts or components of U.S.-origin end-items may be exported without a license under specified conditions, including the following:

- The replacement parts/components must be for U.S.-origin end-items held in the inventory of a foreign government;
- The exporter of the parts/components must have been the applicant of a previously approved authorization to export the U.S.-origin end-item;
- The exporter must have a purchase order for the replacement parts/components and must be able to cite the original license number authorizing the export of the end-item;
- The parts must not upgrade the capability of the end-item; and
- The consignee for the replacement parts/components must be the foreign government approved under the original export authorization for the end-item.

Several of these limitations could be significant in terms of exporters' ability to use the exemption.

First, the exemption would not authorize exports of parts and components by anyone other than the applicant on the prior end-item authorization. DDTC has indicated that it may consider expanding the exemption to include exports by "major subcontractor component suppliers." If DDTC were to make that change, it likely would significantly increase use of the exemption, since subcontractors play an essential role in the provision of replacement parts and components.

Second, the exemption would be limited to parts and components exported directly to a foreign government. The exemption therefore would not be useful to defense contractors who export spare/replacement parts to foreign private parties who perform maintenance for foreign governments.

Third, the exemption would apply only to exports of parts/components for end-items exported pursuant to a prior DDTC license and to orders supplied pursuant to a purchase order. This means that the exemption would not cover replacement parts sold under direct commercial sale contracts to support systems delivered pursuant to the U.S. Foreign Military Sales program, where no DDTC license is issued. Nor would the exemption cover any parts that are exported without a purchase order, as is often the case for parts being provided under warranty.

THE PROPOSED REVISION TO THE "SEE-THROUGH RULE" OF THE ITAR

The second aspect of the proposed rule is a policy, to be set forth in a new ITAR Section 126.19, that would identify two situations in which a license or other approval under the ITAR is not required for the export or reexport of defense articles incorporated into items subject to the EAR. As noted above, this policy would reflect a change in the "see-through rule," by which DDTC controls the export and reexport of ITAR-controlled content in commercial items. The application of this "see-through rule" has led to significant designing-out of U.S. content by foreign manufacturers who are loathe to have their products subject to ITAR licensing requirements as a result of the incorporated U.S.-origin defense parts and components.

Under the first part of the proposed new policy, a DDTC export/reexport license would not be required if the defense article were incorporated into an end-item subject to the EAR if the end-item would be "rendered inoperable" by the removal of the defense article and if the value of the defense article constituted less than 1% of the value of the end-item. Rendering the end-item inoperable means that the end-item could not perform the intended applications or demonstrate the enhanced capabilities for which the defense article was incorporated.

The second part of the proposed new policy would allow the export or reexport without a DDTC license of a defense article incorporated into a component or end-item subject to the EAR when the defense article would be destroyed (*i.e.*, rendered useless) by its removal from the commercial item. There is no limitation on the value of the defense article under this second part of the policy.

Both parts of the policy also would be subject to several other requirements:

- Technology subject to the EAR for the development, production, or use of the commercial item into which the defense article was incorporated could not include any ITAR-controlled technical data or defense services. In other words, DDTC is apparently signaling that it does not intend the new policy on incorporated defense articles to reduce or limit controls on technical data or defense services related to those incorporated defense articles.
- The incorporation of the defense article cannot provide or be related to a "military end-use" or result in the commercial item becoming a "military commodity," as those terms are defined by the EAR.
- The new policy would not apply when the defense article is being exported or reexported as a replacement part or component for an item subject to the EAR.

The State Department has indicated that this new section of the ITAR would not be adopted until the Department of Commerce amends the EAR to provide complementary coverage "of the articles in question." It is not clear what that EAR amendment would cover or when it might be published.

While likely to be a welcome loosening of the "see-through rule" for some items, exporters may find the proposed policy too restrictive to significantly lighten their licensing burden. First, the value limitation on the first part of the policy, relating to defense articles incorporated into end-items subject to the EAR, is low and may be difficult for exporters to calculate, especially if the incorporated defense articles are not priced separately. Second, the proposed policy applies only to defense articles embedded in products that are subject to the EAR, which would include U.S.-origin items and foreign-made items with significant amounts of controlled U.S. content. The policy would not apply to defense articles incorporated or to be incorporated into foreign-made items that are not subject to the EAR. Thus, absent some change to the application of the "see-through rule" in that context, foreign manufacturers may continue to design out U.S. content from their defense products in order to avoid the application of U.S. controls.

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Clients may wish to determine the potential impact of these proposed ITAR amendments on their operations. We are well-positioned to assist clients in understanding the proposed rule and any final rule that the State Department generates, as well as evaluating the overall application of the ITAR and EAR to their operations.

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

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