



Government Procurement & Export UPDATE

LAW OFFICES

**JOHN J. FAUSTI &
ASSOCIATES, LLC**

Export Compliance Guide for Defense Articles and Munitions List Items

Complying with State Department's Defense Trade Controls' rules

The Federal Government recently indicted a number of U.S. companies and individuals on criminal charges for alleged export violations. The indictments resulted from a law enforcement "sting" operation involving a government-operated "buyer" that solicited various U.S. aircraft parts suppliers to ship or export, without a license, what were allegedly "defense articles." These indictments serve as a vivid reminder to anyone who buys and

sells defense articles and munitions items to make certain that their operations are in full compliance with the import and export laws. The purpose of this edition of the Fausti & Associates' newsletter is to provide you with a review of the law in this important area. The advice contained herein is not intended to be legal advice. Such advice may only be given when related to specific fact situations

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I. Introduction

The export and temporary import of a defense article are governed by the Arms Export Control Act ("AECA"), 22 U.S.C. 2778, and the International Traffic & Arms Regulations ("ITAR"), 22 CFR 121 et seq. Pursuant to the AECA, the President is authorized to control the import and export of items and articles that fall within the definition of "defense articles." See 22 CFR 120.1. The State

Department, specifically the Office of Defense Trade Controls ("ODTC"), has been delegated the authority to oversee and regulate the export of defense articles and items that are listed on the ITAR's Munitions List, which, by definition, are defense articles. The ITAR provides that if a defense article is being exported, a license from ODTC is required unless a license exemption applies. (The various

exemptions that may apply will be discussed in a future edition of the Fausti & Associates' newsletter.¹⁾

With regard to aircraft and their respective parts and equipment, the AECA and ITAR provide that "aircraft, including but not limited to helicopters, ... which are **specifically designated, modified or equipped for military purposes**" are defense articles and are included among those items listed on the Munitions List. (Emphasis added.) Therefore, the importation or exportation of such aircraft and helicopters and their respective parts requires a license and/or permit. However, the following categories of aircraft and helicopters (and their parts) are expressly exempted from the Munitions List and will not require a license provided "...they have not been specifically equipped, reequipped, or modified for military operations." Among these exceptions are:

- "cargo aircraft bearing 'C' designations that are numbered C-45 through C-118 inclusive, and C-121 through C-125 inclusive, and C-131, **[providing they are]** using reciprocating engines only,";
- "trainer aircraft bearing 'T' designations **and** using reciprocating engines or turboprop engines with less than 600 horsepower,";
- "utility aircraft bearing 'U' designations **and** using reciprocating engines only,";
- "all liaison aircraft bearing an 'L' designation,"; and

- "all observation aircraft bearing 'O' designations **and** using reciprocating engines."

22 CFR 121.3 (emphasis added). As set forth above, in order to determine whether a license is required for a utility aircraft or helicopter, one must consider the vehicle's engines. If the utility aircraft or helicopter uses only reciprocating engines, it is not a defense article and not regulated by the State Department. However, if the engines are turbine, the aircraft or helicopter is a defense article and a request to the State Department for a license is required.

This newsletter contains suggestions for protecting you and your company from becoming a party to an illegal transaction. The suggestions contained herein are not meant to be all inclusive or serve as a substitute for careful and prudent behavior on your part. Based on our experience, questions of whether an item is a defense article and whether a license from the State Department is required prior to export or temporary import are factually based or driven questions that require a thorough and comprehensive analysis of all the relevant facts. Having said that, there are some guidelines that you may be able to follow to help you operate your business. The Government places the burden on you and your company to correctly answer the aforementioned questions and to obtain the appropriate license(s) if one or more is required.

¹ The ITAR identifies a number of exempted shipments that will not require a license. They include certain (but not all) shipments to Canada and sometimes the return of U.S.-origin items for repair in the United States. These exemptions should not be used without a thorough understanding of the ITAR's exemption rules and the facts surrounding your use of the exemption.

II. Sales Within the United States

Before even beginning to address the topic of exports, it is first important to discuss domestic sales. Even though the sale of a defense article *within the United States* generally will not require an export license, we strongly recommend that you incorporate certain standard language into all of your domestic sales paperwork in order to place the purchaser on notice that he or she may not export the item outside the United States without a license. You should do this in order to protect yourself in the event the purchaser later illegally exports the item without a license and then tries to convince the U.S. Customs Service that he did that on your advice.² Some purchasers when they are in trouble will look to shift the blame back to you. Don't let them do that.

Therefore, **for all your domestic sales**, we recommend that you incorporate the following language in all of your standard quotes, invoices and shipping materials when you sell a Munitions List or commerce controlled item:

“Unless otherwise noted, this sale, order or quote may include Munitions List Items (MLI) or Commerce Controlled List Items (CCLI). MLI/CCLI property is controlled by the U.S. Government and in many cases cannot be transferred (exported, sold or given) to a foreign country, a non-U.S. Citizen/National or a non-Permanent U.S. Resident without valid State/Commerce Department export authorization. It is the responsibility of you (the purchaser) to determine what the applicable requirements may be and to obtain all necessary authorizations, licenses or approvals.”

This language will help to protect you by placing your purchaser on notice that it is his or her responsibility to determine whether an export license is required in order to export the items.

There are additional requirements that may apply to domestic sales involving certain categories of former Government-owned surplus parts. These include property that has been marked by the Government as DEMIL Code B for demilitarization purposes and that are subject to an End-Use Certificate (“EUC”) Form 1822. *For domestic transactions that are subject to a Defense Logistics Agency EUC 1822,*³ you must instead use the following language in all of your standard quotes, invoices and shipping materials when you sell a Munitions List or commerce controlled item⁴:

“Unless otherwise noted, this sale, order or quote may include Munitions List Items (MLI) or Commerce Controlled List Items (CCLI). MLI/CCLI property is controlled by the U.S. Government and in many cases cannot be transferred (exported, sold or given) to a foreign country, a non-U.S. Citizen/National or a non-Permanent U.S. Resident without a valid State/Commerce Department export authorization. It is the responsibility of you (the purchaser) to determine what the applicable requirements may be and to obtain all necessary authorizations, licenses or approvals. The use, disposition, export and re-export of the property covered or included in this sale, order or quote is subject to the provisions of law referenced in End-Use Certificate DLA Form 1822, DEC

²While the State Department issues licenses and administers the export laws, it is the U.S. Customs Service that enforces these laws and monitors or polices the nation's borders.

³Property that is subject to an EUC 1822 will include certain former government-owned property that was purchased from the Defense Reutilization & Marketing Service or from its sales contractor Government Liquidation, Inc. since the EUC 1822 form's implementation two years ago, and the property was coded as DEMIL Code B for purposes of demilitarization.

⁴A “commerce controlled item” is an item that is under the export control jurisdiction of the Bureau of Industry and Security of the U.S. Department of Commerce. See Export Administration Regulations, 15 CFR 730 et seq.

2001, including, but not limited to, the Arms Export Control Act (22 USC 2751 et seq.); Export Administration Act of 1979 (50 USC App. 2401 et seq.) as contained under Executive Order 12924; International Traffic in Arms Regulations (22 CFR 120 et seq.); Export Administration Regulations (15 CFR 730 et seq.); Foreign Assets Control Regulations (31 CFR 500 et seq.) and the Espionage Act (18 USC 793 et seq.).”

The difference in the two approaches is that EUC 1822 expressly requires you to use certain language when you re-sell property that is covered by EUC 1822. Therefore, the second approach, which is rather lengthier, incorporates the language called for by EUC 1822. The first approach, which is shorter, is not tied to EUC 1822 and, therefore, does not incorporate all the 1822 language.

In addition to the aforementioned language, we recommend that when you make a domestic sale of defense articles or commerce-controlled items, you ask questions of your purchaser regarding the item’s end-use. For example, a person in New York could, without an export license, ship spare parts for military aircraft to a “foreign person” in New Jersey (or anywhere else within the U.S. for that matter) **unless**

- (1) the foreign purchaser is considered to be an embassy or agency or subdivision of a foreign government; **or**
- (2) the foreign person is a foreign national from a proscribed country (under the ITAR, it is illegal to sell or transfer defense articles to nationals of proscribed countries without ODTIC’s written permission. The list of proscribed countries is set forth in the ITAR at section 126.1. Generally, ODTIC will deny license applications and other requests for approval for the export or import of defense articles and services from or to proscribed countries); **or**
- (3) a transfer or shipment within the U.S. to a foreign person would be treated as an “export,”

within the meaning of the ITAR, if the foreign transferee could ascertain technical data from the item transferred, based on pure visual inspection or reverse engineering-type analysis.

The ITAR defines a “foreign person” as “any natural person who is not a lawful permanent resident” of the United States. Aliens who are lawfully admitted for permanent residence or aliens granted asylum in the United States are not considered “foreign persons” under the ITAR. See 8 USC 1324b(a)(3). A foreign person also includes “any foreign corporation, business association, partnership, trust, society or any other entity or group that is not incorporated or organized to do business in the United States.” **Of significant importance, the ITAR’s definition of a “U.S. person” includes a corporation “that is incorporated to do business in the United States.” 22 CFR 120.15.** Consequently, if you are shipping to a company located, for example, in New Jersey, and that company provides documentation showing that it is incorporated in New Jersey, that company then qualifies as a U.S. person under the ITAR, regardless of the nationality or status of the individual owners of the corporation.⁵

Consequently, we suggest that when you make domestic sales, you should inquire as to whether the purchaser is a “foreign person.” If your domestic purchaser is not a foreign person, no export license is required. If, however, the domestic purchaser is a foreign person, you should inquire as to whether he or she is either a citizen of a proscribed country or employed or affiliated with an embassy or foreign government. If the answer to either of those questions is “yes,” you can not make this domestic shipment without an export license. However, even if the answer is “no” to both questions you will still need a license if the foreign transferee could ascertain technical data from the item transferred, based on pure visual inspection or reverse engineering-type analysis. Remember, no license will be required and you will have met your responsibilities under the ITAR if you simply confirm that your purchaser is a corpora-

⁵Lastly, a foreign person also includes any “international organizations, foreign governments and any agency or subdivision of foreign governments.” 22 CFR 120.16.

tion that is incorporated in any state in this country. **This makes it easier for you since most of your purchasers will be corporate entities. You will be spared from seeking copies of passports or birth certificates. It will be sufficient for you to ask your corporate purchaser the simple question of whether it is incorporated in the United States. Have them give you that answer in writing - and you will be protected from liability - and no license will be required for your domestic shipment. Follow these steps - and also remember to use the standard language that we suggested above to include in all your sales paperwork - and you should be okay.**

There are certain procedures which must be followed for a U.S. company to export a defense article to a foreign embassy within the United States. A direct reading of the ITAR states that the mere shipment of a defense article to a foreign embassy within the United States is considered an export, as defined by the ITAR, and a license is required. However, if the foreign embassy has an existing export license to export

the defense article in question out of the country, although a strict reading of the ITATR suggests that the U.S. company would also need a license (or a second license) simply to transfer the article to the embassy prior to the embassy exporting it out of the U.S., to avoid "double licensing," the State Department recently advised our office that it will allow the U.S. company to ship the article to the embassy under the embassy's license. Prior to shipment, the U.S. company must ask to see a copy of the foreign embassy's export license to ensure that the article is covered under the embassy's license. The State Department further advised us that the U.S. company, in order to be prudent, should also contact the State Department with the license number for a confirmation that the article is in fact covered under the existing license held by the foreign embassy. Finally, the State Department also suggested to us that the U.S. company - in order to further protect itself - should request that the State Department fax a letter stating that the article was covered under the embassy's license and no license from the U.S. company was necessary.

III. Exports and Shipments Outside of the United States

For exports, sales abroad, transfers abroad and/or shipments abroad, the exporter must register with ODTIC and obtain an export license before exporting a defense article, unless an exemption is claimed. As stated herein, the first question to ask is whether the item in question is a "defense article." The Government places the burden on the parties to the transaction to determine whether the item that is intended for export is a "defense article" under the ITAR. If the item is a defense article and is intended for export, an export license is generally required. Legal counsel can assist companies that have questions as to whether they are exporting defense articles.

Additionally, the country designated on the export license application or on the Shipper's Export Declaration as the country of ultimate destination must be the country of ultimate end-use. Otherwise, even after a license is obtained, further authorization from ODTIC must be obtained prior to reselling, trans-

ferring or disposing of a defense article to any other end-user or destination besides that which is claimed on the export license or Shipper's Export Declaration. See 123.9. Moreover, pursuant to section 123.9 of the ITAR, the following language must be incorporated into the exporter's bill of lading and invoice whenever the export involves Munitions List items:

"These commodities are authorized by the U.S. Government for export only to [country of ultimate destination] for use by [end-user]. They may not be transferred, transshipped on a non-continuous voyage, or otherwise be disposed of in any other country, either in their original form or after being incorporated into other end-items, without the prior written approval of the U.S. Department of State."

As with domestic sales or shipments of military equipment, it is prudent to ask questions when you intend to export defense articles abroad. For example,

if an Austrian company contacts you to purchase F-14 parts, there is a real problem because the F-14 aircraft is flown in only two countries (the U.S. and Iran), and Iran is on the ITAR's list of proscribed countries. Likewise, if a Swiss company wants F-16 parts, it is probably going to another country since the Swiss do not operate F-16 aircraft. As the exporter, you have the responsibility of determining who the ultimate end-user or destination is and correctly providing this information on your license application (or Shipper's Export Declaration) and invoices. Generally speaking, this is true of any information that you provide to ODTC, *i.e.*, as the exporter you have the responsibility to make certain that all the information you provide to ODTC on your license application or Shipper's Export Declaration is correct to the best of your knowledge.

Another example that underscores the importance of carefully determining who your ultimate end-user is and/or the item's ultimate end-use is the recently reported Federal "sting" operation that resulted in a series of federal indictments charging three companies and at least three individuals with violations of the export laws. According to published reports:

Federal prosecutors said the companies sought to sell aircraft engines, gear assemblies, spare parts and munitions for fighter planes and military helicopters without the necessary approval from the State Department.

The U.S. Attorney in Milwaukee, heading up the investigation, commented that **"it's the seller's obligation to make sure export laws are followed, and these companies acted as if they just didn't care."** (Emphasis added). Prosecutors stated that the companies and individuals, if convicted, face prison terms of up to 10 years and fines up to \$1 million. In these cases, the Government was not contending that any of the charged companies knew that the parts were heading to unfriendly or terrorist nations. Rather, as the U.S. Attorney stated:

the indictment alleges not that the defendants knew that the parts were destined for (terrorist nations). Rather, the charges allege that the **defendants took no action to ascertain this information.** The indictments allege that these companies acted as if they did not care.

(Emphasis added). In light of the above, we cannot stress enough the importance of asking questions in order to determine whether your transaction requires prior written authorization from the State Department. Legal counsel can assist you in this endeavor. You can also direct your questions in writing to the State Department for help in determining whether an item is a defense article that requires an export license. However, a recent U.S. General Accounting Office ("GAO") audit report was highly critical of the State Department for prolonged delays in responding to such questions.⁶

IV. Export Compliance Program

In order to ensure compliance with the export laws, we suggest that every exporter or manufacturer that is registered with ODTC give careful consideration to the implementation of an export compliance program. The purpose of such a program would be to ensure that all company employees are in strict compliance with the laws and regulations governing exports to foreign nations.

The first step in having a comprehensive export compliance program is to adopt written procedures that clearly articulate the steps that your employees must follow when working in the export arena. Important elements of an effective company policy and program should include the following.

⁶The State Department is required by law to answer your written questions as to whether an item is a defense article within 95 days of its receipt of your letter. However, the GAO found that the State Department failed to meet that 95 day deadline in over 60% of the cases. The median time for responding was 118 days and in 25% of the cases, the State Department took approximately 190 days to respond.

1. **An understanding of your organization.** Depending upon your size, an organizational structure should include: organizational charts or a description of the company's defense trade function(s); and a description of any management and control structures for implementing and tracking compliance with U.S. export controls.
2. **Corporate commitment to and policy for complying with the AECA and the ITAR.** A showing of corporate commitment and policy should include: a directive by senior management to comply with the AECA and the ITAR; knowledge and understanding of when and how the aforementioned laws and regulations affect the company; and knowledge of corporate internal controls that have been established and implemented to ensure compliance with the AECA and ITAR.
3. **Identification of and accountability for controlled items and technical data.** A methodology should be used, specifically tailored to company structure and functions, which can identify and account for controlled items/technical data that the company handles.
4. **Procedures for re-exports and retransfers.** Regardless of the size of your company, procedures should be in place for re-exports/retransfers. These procedures would be utilized for obtaining written State Department approval prior to the retransfer/re-export of an item to a party that was not included originally on the export license or Shipper's Declaration. Procedures should also be in place to track retransfers/re-exports.
5. **Procedures for restricted/prohibited transfers.** Regardless of your size, procedures should be in place for restricted/prohibited exports and transfers. This includes procedures for screening customers, carriers, and countries; screening procedures for high-risk transactions to combat illegal re-exports/retransfers; and procedures to investigate any evidence of diversion or unauthorized use of U.S. origin items.
6. **Record-keeping system.** Companies should maintain a comprehensive record keeping system which includes: procedures for maintaining records relating to U.S. origin products for five years from the date of expiration of the license or other State or Commerce approval(s); and, a regular internal review of files to ensure proper practices and procedures are followed by persons reporting to top management.
7. **Internal company audits.** An internal monitoring system should be in place to perform audits periodically to ensure the integrity of your export compliance program. Emphasis should be on validation of full export compliance, including adherence to license and other approval conditions. This monitoring system should also measure the effectiveness of day-to-day operations, adopt procedures for highlighting any compliance areas that need more attention, and report known or suspected violations to the company's export administration office.
8. **Company training programs.** Each company compliance manual or bulletin should contain an explanation of the company training program for U.S. export control laws and regulations. A process should be in place to ensure education, training, and provision of guidance to all employees involved in exports and imports.
9. **Potential violations procedures.** The purpose of an export compliance program is to avoid violations and penalties. Therefore, every compliance manual should contain procedures for notification of potential violations, including use of voluntary disclosure and an Ombudsman to report any violation of the company's internal control program or U.S. export controls. To avoid jeopardizing your business and severe sanctions against the corporation and liability against responsible individuals, emphasis should be made on the importance of compliance. A description of AECA and ITAR penalties should also be included, since violating any provision of the aforementioned rule and regu-

lation may result in hefty fines, imprisonment, forfeiture and seizure of goods, and disbarment.

10. **Ombudsman.** For companies seeking to prevent violations, the establishment of an Ombudsman is an optional step. The

Ombudsman is meant to serve as a prominent source of confidential advice and information for company employees and to assure that the company's exports and transactions are being closely monitored and conducted according to the highest standards.

The preceding outline does not address everything that must be included in order to implement or maintain a good export compliance program. These suggestions are meant to briefly touch on some of the concerns your company should consider in order to ensure compliance with the AECA and ITAR. Depending upon the size of your company, some of these suggestions may not be appropriate. For more information on how to get started with drafting and implementing your own export compliance program, please contact the Law Offices of Fausti & Associates at (202) 237-0505.