

Aerospace and Defense Industries

ROBERT CLIFTON BURNS AND HOWARD STANISLAWSKI*

I. Recent Developments Regarding DDTC's Rules on Brokering

Applicants for licenses to export defense articles controlled by the International Traffic in Arms Regulations (ITAR)¹ began, a year or so ago, to have license applications returned by the Department of State's Directorate of Defense Trade Controls (DDTC) based upon a new interpretation by DDTC of the brokering requirements contained in Part 129 of the ITAR. These applications were returned where a party listed on a DSP-5 as a foreign consignee (other than a known freight forwarder) had not registered as a broker pursuant to the procedures set forth in Part 129. Public statements by certain DDTC officials have suggested that DDTC now interprets Part 129 to cover anyone dealing in U.S. origin defense articles or services—including foreign persons with no contacts with the United States.² Thus, under this new interpretation, a foreign consignee—other than freight forwarders exempted under Section 129.3(a)(3)—would, by definition, be a broker covered by Part 129.

Part 129 defines a broker as any person who, in return for a fee, acts as an agent for another in arranging for the sales of defense articles.³ Virtually all exporters of defense articles typically employ such local agents to assist in the negotiation of contracts with foreign governments and militaries. But not all brokers are required to be registered. Under Part 129, only the following brokers are required to register: (a) U.S. persons wherever located and (b) foreign persons in the United States “or otherwise subject to the jurisdiction of the United States.”⁴

In the past this “otherwise subject to” language had been interpreted to impose something similar to a minimum contacts test in determining whether foreign brokers outside

* Robert Clifton Burns, author of the section on DDTC's Rules on Brokering, is a Partner at Powell Goldstein LLP, Washington, D.C., and an Adjunct Professor of Law at Georgetown University Law Center. Howard Stanislawski, author of the section on the Berry Amendment, is a Partner at Sidley Austin LLP, and Chair of the Aerospace and Defense Industries Committee.

1. 22 C.F.R. §§ 120-30 (2006).

2. Statement made by DDTC official at a conference of the Society of International Affairs (SIA) at which the author was present. As a condition to attending SIA conferences, members agree not to name the DDTC officials involved or refer to the specific conference at which the statement was made. Members are, however, permitted by SIA rules to cite un-named officials at un-named conferences.

3. 22 C.F.R. § 129.2 (2006).

4. 22 C.F.R. § 129.3(a) (2006).

the United States were required to register. DDTC has informally suggested, however, that it believes that this test is met any time the overseas sales representative is involved in the sale of U.S. origin defense articles or defense services. This broad interpretation of that language means, in effect, that all overseas sales representatives for U.S. defense manufacturers are brokers and must register under Part 129.⁵

As a result of DDTC's jaw-boning, a number of defense manufacturers have required their overseas sales representatives and distributors to register as brokers with DDTC. The onslaught of new registrations at DDTC, however, has led to a number of administrative and practical problems that it clearly did not anticipate when it broadened the class of foreign parties required to register as brokers.

First and foremost, there appears to be an extensive backlog of applications for registration pending at DDTC, although the exact size of that backlog has not been revealed by DDTC. The size of the backlog can be inferred from the length of time some potential registrants have reported it takes DDTC to process their registrations. In some instances, more than six months have elapsed between the filing of registration applications and the assignment by DDTC of a registration number. One official of DDTC has admitted that currently there are only 600 registered brokers (as opposed to 4,000 registered manufacturers), which also suggests that a number of applications have not made it through the processing queue.⁶ DDTC has admitted a backlog in processing license applications and agreements and has, as a result, announced that licensing officers will no longer take incoming calls until at least January 2007.⁷ It is not unreasonable to suppose that this backlog will exacerbate the ability of the agency to process registration applications.

The practical difficulty for a defense exporter is that under the amendments to the ITAR adopted on April 21, 2006,⁸ an exporter will arguably be in violation of DDTC's rules if it does business with a broker that has not filed its registration. Relying on the broker's word that it has filed a registration entails some risk, particularly since DDTC will not respond to third-party inquiries regarding the status of a broker's registration. The only way to be certain is to require the broker to provide its registration number, which will now cause significant delays given the processing backlog.

Second, the flood of applications from foreign registrants has created certain logistical problems. Section 129.4 of the ITAR provides that the registration application must be accompanied with a "payment by check or money order payable to the Department of State" of the required fees. The rule does not require that those checks and money orders be drawn on U.S. banks. Even so, DDTC has returned applications accompanied with checks and money orders drawn on foreign banks, even well-known European banks.

5. DDTC's interpretation of "otherwise subject to the jurisdiction of the United States" flatly contradicts the legislative history of the statute pursuant to which Part 129 was adopted. See Robert Clifton Burns, *Expansion of Brokering Rules Gives Headaches to Exporters*, THE EXPORT PRACTITIONER, Aug. 2006.

6. Statement made by DDTC official at a conference of the SIA at which the author was present. As a condition to attending SIA conferences, members agree not to name the DDTC officials involved or refer to the specific conference at which the statement was made. Members are, however, permitted by SIA rules to cite un-named officials at un-named conferences.

7. Licensing Procedures Through January 2007, DIRECTORATE OF DEFENSE TRADE CONTROLS (Oct. 2006), available at http://www.pmdtcc.state.gov/licensing_procedures.htm.

8. Amendments to the International Traffic in Arms Regulations: Office Names, Corrected Cross-Referencing, Reference to Wassenaar Arrangement, and Other Corrections/Administrative Changes, 71 Fed. Reg. 20,534 (Apr. 21, 2006).

Some foreign applicants have reported that DDTC is asking them to send the registration fees via Western Union, which is often impractical and results in a significant increase in the cost to the foreign registrant.

Third, the wave of foreign registrations has raised an issue as to the interpretation of Section 129.4 of the ITAR, which requires that a broker registrant submit with its registration application "documentation that demonstrates that it is incorporated or otherwise authorized to do business in the United States."⁹ Needless to say, foreign brokers doing business overseas do not have or need such authorization. Initially, DDTC told foreign registrants to ignore the documentation requirement. Then, in April 2006, DDTC revised Section 129.4 to require "substantially similar" information, ("e.g., foreign business license or similar authorization to do business").¹⁰ Even this clarification has posed problems because many foreign jurisdictions do not require individual overseas sales representatives to be licensed to do business in their own country.

Fourth (and some may see this as the first good news), it appears that many of the licensing officers at DDTC have begun to depart from the practice of returning license applications if the application shows an unregistered party as an intermediate consignee. Instead, there have been reports that in those cases the licensing officers have called the applicants and asked if the unregistered individuals could be deleted from the application.

Finally, DDTC officials continue to promise that new regulations will be issued confirming the new interpretation of the registration requirement and providing further guidance on the interpretation thereof. DDTC has been promising these regulations for several years and there is nothing to suggest that they are any more imminent now than they have been in the past. At a recent conference in Washington, D.C., a DDTC official suggested that the guidelines when issued might define two separate types of foreign brokers and impose different requirements upon them, although the details of such a plan, according to the official, were not yet worked out.¹¹ The distinction, the official suggested, would be between traditional arms brokers who were the original targets of the legislation that led to Part 129 and foreign sales representatives.

A two-tier system of the sort described seems to be a sensible policy. Traditional arms brokers under that two-tier system would be companies and individuals that deal with multiple foreign governments, whereas foreign sales representatives would principally act with respect to a single government, namely, the government of the country in which the representative resided. Foreign sales representatives would be required to register under Part 129 but would be relieved of the obligation to obtain licenses for particularly brokering transactions. In most instances involving foreign sales representatives, the export from the United States would already require a license, thereby making a brokering license duplicative and unnecessary. For traditional arms brokers, however, it may make sense to require brokering licenses even if the transaction also requires an export license because of

9. 22 C.F.R. § 129.4 (2006).

10. 71 Fed. Reg. at 20,534. The current version of the registration form, DS-2032, has not been updated and is still causing confusion by requiring foreign parties to provide documentation of their authorization to do business in the United States.

11. Statement made by DDTC official at a conference of the SIA at which the author was present. As a condition to attending SIA conferences, members agree not to name the DDTC officials involved or refer to the specific conference at which the statement was made. Members are, however, permitted by SIA rules to cite un-named officials at un-named conferences.

the additional national security considerations raised by the participation of such a party in an arms export transaction.

II. Recent Developments Involving the Specialty Metals Requirement of the Berry Amendment

A. BACKGROUND TO THE SPECIALTY METALS REQUIREMENT OF THE BERRY AMENDMENT

For more than thirty years, the protectionist provisions of what is generically referred to as the Berry Amendment have established an almost absolute ban on the Department of Defense's (DOD) use of appropriated funds for the purchase of certain non-domestic items, including, *inter alia*, specialty metals.¹² Regarding the specialty metals requirement, the expressed reason for the ban has been the preservation of the domestic industrial base for such specialty metals; however, over the years it has become clear to many parties that the specialty metals ban is very difficult, if not impossible, to implement, and both contractors and political leaders have argued that the ban may in fact be counter-productive to the national interest. In 2006, numerous contractor groups sought to persuade Congress to liberalize the Berry Amendment's terms.¹³ Notwithstanding the agreement of many parties on the need for such liberalization, however, Congress retained restrictive Berry Amendment provisions on specialty metals in the DOD Authorization Act for FY 2007, signed by President Bush in mid-October 2006.¹⁴ On December 6, 2006, the DOD issued guidance interpreting the new statutory provisions, and that guidance provides some limited broadening in the exceptions to the prohibition.¹⁵ Thus, developments in 2006 in this regard, while clarifying the coverage of the prohibition and liberalizing it in

12. The Berry Amendment was originally passed by Congress in 1941 to promote the purchase of certain U.S. goods. This 1941 promulgation date relates to the earliest of this group of restrictive provisions that, taken together, are commonly referred to as the Berry Amendment; the specialty metals provisions date back only to the early 1970s. These provisions were included in defense appropriations acts until it was made permanent in FY 1994 by Section 8005 of Pub. L. No. 103-139 and were subsequently codified as 10 U.S.C. 2533a in 2002 by Pub. L. No. 107-107, § 832. In addition to restrictions on the purchase of non-U.S. specialty metals (now codified at 10 U.S.C. § 2533b), the Berry Amendment also restricts the DOD from using any funding, appropriated or otherwise available, to buy the following end items, components, or materials unless they are wholly of U.S. origin:

An article or item of food; clothing; tents, tarpaulins, or covers; cotton and other natural fiber products; woven silk or woven silk blends; spun silk yarn for cartridge cloth; synthetic fabric or coated synthetic fabric (including all textile fibers and yarns that are for use in such fabrics); canvas products or wool (whether in the form of fiber or yarn or contained in fabrics, materials, or manufactured articles); or any item of individual equipment (Federal Supply Class 8465) manufactured from or containing such fibers, yarns, fabrics, or materials; and hand or measuring tools.

10 U.S.C. § 2533a (2006).

13. See, e.g., Roxanna Tiron, *Specialty-metals Industry Clashes with Defense Giants*, PENTAGON, The Hill (MAY 16, 2006), available at http://thehill.com/thehill/export/TheHill/Business/051606_barry.html.

14. On October 17, 2006, the President signed the John Warner National Defense Authorization Act for FY 2007. Pub. L. No. 109-364. Under Section 842 of this Act, the restrictions relating to specialty metals were deleted from 10 U.S.C. § 2533a and placed into 10 U.S.C. § 2533b.

15. Office of the Under Secretary of Defense, Memorandum for Commander, United States Special Operations Command, *Class Deviation—Restriction on Procurement of Specialty Metals*, 2006-2051-DPAP (Dec. 6, 2006), available at <http://www.acq.osd.mil/dpap/policy/policyvault/2006-2051-DPAP.pdf>.

some small respects, generally did not reflect what had been sought by the contractor community and many in the political leadership.

Since its enactment in the early-1970s, the Berry Amendment on specialty metals has prohibited the DOD from using appropriated funds for procurements involving certain specialty metals, defined to include: steel with certain specified alloy content; metal alloys consisting of nickel, iron-nickel, and cobalt base alloys containing a total of other alloying metals (except iron) in excess of 10 percent; titanium and titanium alloys; and zirconium and zirconium base alloys.¹⁶ From the outset, the DOD understood that such a near-total ban was impractical, and a memorandum was issued in 1972 by then-Secretary of Defense Melvin Laird stating that because the great bulk of the relevant specialty metals were procured for six major classes of programs—aircraft, missiles, ships, tank-automotive, weapons, and ammunition—the most rigorous form of implementation of the ban on specialty metals, at all tiers of the procurement process, would only apply to these six categories of procurements. For other types of procurements, the ban would only extend in general to the final end item, and it did not have to be extended down through indefinite tiers of the procurement process.

Over the years, as well, exceptions to the ban for specialty metals have been promulgated relating, *inter alia*, to procurement of specialty metals: (a) produced, reprocessed, or reused within a qualifying country (i.e., with which the United States has had certain types of trade agreements relating to defense procurement); (b) procured in very small quantities; (c) determined to be unavailable in the United States in substantial quality and quantity; and (d) under unusual and compelling urgent conditions. Notwithstanding these exceptions, over the years, beginning in the late 1990s, there have been public reports of alleged deficiencies in compliance with the Berry Amendment.¹⁷ And in early and mid-2006, the DOD issued a number of memoranda and policy decisions that recognized the problems that had arisen in enforcement.¹⁸

B. THE 2006 AMENDMENTS TO THE SPECIALTY METALS REQUIREMENT OF THE BERRY AMENDMENT

Expectations were high until late September 2006 that the efforts of contractor groups would yield significant liberalization of the ban. In the Senate, various proposed modifications of the prohibition were adopted in legislation;¹⁹ however, the House of Representatives remained inclined towards a more rigorous form of protectionism in this regard and therefore towards retention of major aspects of the decades-old ban.²⁰ In the waning days

16. 10 U.S.C. § 2533a, 2533b (2006); *see also* U.S. DEP'T OF DEFENSE, DEFENSE FED. ACQUISITION REG. SUPP. 225.7002-2, 252.225-7014 (2006).

17. *See, e.g.*, General Accounting Office Report (GAO-05-957), *Defense Procurement: Air Force Did Not Fully Evaluate Options in Waiving Berry Amendment for Selected Aircraft* (Sept. 23, 2005), available at <http://www.gao.gov/text/d05957.html>.

18. *See, e.g.*, Joseph C. Anselmo, David A. Fulghum & Douglas Barrie, *Zealous Pentagon Enforcement of Domestic Metal Use Holds Up Deliveries*, AVIATION WEEK (Mar. 12, 2006), available at http://www.aviationweek.com/aw/generic/story_generic.jsp?channel=awst&id=news/031306p2.xml.

19. National Defense Authorization Act for Fiscal Year 2007, S. 2766, 109th Cong. (2006) (sponsored by Sen. Warner).

20. National Defense Authorization Act for Fiscal Year 2007, H.R. 5122, 109th Cong. (2006) (sponsored by Rep. Hunter).

prior to the adjournment of both Houses for the 2006 elections, the Conference Committee, considering the two disparate versions of Berry Amendment provisions that had been passed in the House and Senate, decided upon a final text that was considerably closer to the House version than that which had been approved by the Senate.²¹ Consequently, when the Conference Committee's reported text appeared and was passed by both Houses as part of the DOD Authorization Act for FY 2007, most of the significant changes included in the Senate bill were gone, and relatively little had been done to liberalize the existing regime.

Embodied in Sections 842 and 843 of the DOD Authorization Act for FY 2007,²² the new statute contained, *inter alia*, the following elements:

- Establishment of a new statutory provision, 10 U.S.C. §2533b, focusing solely on specialty metals;
- A limit on application of the prohibition to the six types of products identified in the 1972 Laird memorandum and to specialty metals purchased directly by the DOD or a prime contractor of the DOD;
- Recognition of a non-availability exception to the prohibition (with some changes), as well as exceptions for qualifying countries, very small purchases, purchases made during contingency operations, and purchases made when there is unusual and compelling urgency;
- Addition of an exception for the procurement of "commercially available electronic components whose specialty metal content is de minimis in value compared to the overall value of the lowest level electronic component produced that contains such specialty metal";²³
- Inclusion of a somewhat ambiguous one-time waiver provision related to noncompliant specialty metals incorporated into items produced, manufactured, or assembled in the United States before the enactment of the 2006 changes, if the contracting officer makes a number of determinations regarding (1) impracticability, (2) the contractor's having in place a remedial plan to ensure compliance in the future, and (3) that the noncompliance was not knowing or willful. In addition, the new statute indicated that the items to be covered by the one-time waiver were to be delivered and have their final acceptance by the DOD after the date of enactment of the statute and before September 30, 2010.

In contrast to the liberalizing provisions that had been sought by various parties, the statute as passed not only did not exempt commercial items from coverage, but in fact specifically stated that the prohibition applied to commercial item procurements.

In the face of such a relatively disappointing outcome in the legislative process, contractors awaited with interest the issuance of the first DOD guidance on implementation of the Berry Amendment's new specialty metals coverage, and that guidance appeared late in

21. John Warner National Defense Authorization Act for Fiscal Year 2007, H. R. Rep. No. 109-702 (2006), available at http://thomas.loc.gov/cgi-bin/cpquery/?&dbname=cp109&sid=cp109z668u&refer=&r_n=hr702.109&item=&sel=TOC_0&.

22. John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, 120 Stat. 2083 (2007), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_public_laws&docid=f:publ364.109.pdf.

23. 10 U.S.C.A. § 2533b(g).

the year on December 6, 2006.²⁴ In the DOD guidance, all of the new statutory provisions are necessarily recognized, so that it is clear that the prohibition will apply only to procurements of the six types of items identified in the Laird memorandum or their components, as well as direct procurement of specialty metals themselves. In addition, the guidance provides some new information in the following areas:

- For the first time, a definition is provided that applies to the tank-automotive category. Specifically, “automotive item” is defined as “a self-propelled military transport vehicle, primarily intended for personnel and cargo carrying, such as a car, truck, or van. The term does not include construction equipment (such as a bulldozers [sic], excavators, lifts, or loaders) or other self-propelled equipment (such as cranes or aircraft ground support equipment).”²⁵
- The term “component” is defined to mean “those first-tier parts and assemblies that are incorporated directly into the end product (i.e., first-tier components). Parts and assemblies that are incorporated directly into a first-tier component are also components (i.e., second-tier components). Third-tier and below parts and assemblies are not components.”²⁶ A Class Deviation implements this provision. But the guidance states that what is intended through this provision is not a limitation on application of the prohibition at all tiers when an end product, first-tier component, or second-tier component is purchased by the DOD; rather, the guidance states, in all such situations, compliance with the Berry Amendment’s prohibitions applies at all tiers. The exclusion to third-tier and below components from application of the Berry Amendment applies when the DOD is procuring the third-tier or lower component directly, and not when the lower-tier component is being procured by a prime contractor or a first- or second-tier subcontractor. This provision appears to be both internally contradictory in its use of the term components and somewhat illogical since it appears to indicate that third-tier items should be exempt from the Berry Amendment’s coverage when DOD procures them directly, but not when they are procured by higher-tier contractors for incorporation into a higher-tier item.
- To determine whether a past noncompliance was inadvertent for purposes of the one-time waiver, the guidance states that, for violations involving commercial items, it is likely that the noncompliance was inadvertent and, in that connection, the contracting officer should obtain and may rely on a contractor’s representation that “the noncompliance is not knowing or willful.”²⁷
- With respect to the new exception for commercially available electronic components whose specialty metal content is de minimis in value compared to the overall value of the lowest level component produced that contains such specialty metal, the guidance establishes a “does not exceed 10 percent” standard for such de minimis content.²⁸ This provision is also established through the Class Deviation, which states that it is not necessary to know the exact value of the specialty metal,

24. Office of the Under Secretary of Defense, Memorandum for Commander, *supra* note 15.

25. *Id.* at 4.

26. *Id.*

27. *Id.* at 10.

28. *Id.* at 2.

only to reasonably estimate that it is less than 10 percent of the total value of the electronic component in question.

- Finally, with respect to the domestic non-availability exception, the guidance states that a consideration in such a finding would be whether the price of compliant metal is fair and reasonable, which may be a relevant factor in determining whether compliant specialty metal of satisfactory quality, sufficient quantity, and in the required form, cannot be procured as and when needed.²⁹

Taken together, the new statutory provisions relating to the Berry Amendment's coverage on specialty metals and the new DOD provisions implementing those new provisions provide some additional clarification relating to the coverage of the ban on specialty metals, as well as some modest liberalization compared with the prior coverage. On balance, however, they will likely continue to represent a significant ongoing issue confronting both the DOD and its contractors. In fact, no sooner was the new statute passed than many parties with an interest in this area began to speak about possible additional changes that might be considered by Congress in the spring of 2007. The change in control of both the House of Representatives and the Senate as a result of the 2006 midterm elections adds an additional element of uncertainty to the complex political mix that resulted in the limited changes made during 2006 in the Berry Amendment's coverage and what consideration might be given to this issue in the new Congress. Whatever happens in 2007, it is likely that this issue will remain on the agenda of many people in Washington, D.C. and around the United States for some time to come.

29. *Id.* at 3.