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The Broad Scope Of ITAR-Controlled 'Defense Services'—Lessons Learned From The Analytical Methods Case

In February 2009, the U.S. Department of State's Directorate of Defense Trade Controls (DDTC) and Analytical Methods Inc. (AMI) entered into a consent agreement to settle 29 violations of the of the Arms Export Control Act (AECA) and the AECA's implementing International Traffic in Arms Regulations (ITAR). The violations included several unauthorized exports of defense services and ITAR-controlled defense articles to the People's Republic of China, Israel, Turkey, Singapore and the UK. The unauthorized export of defense services included consulting on foreign military aircraft, unmanned aerial vehicles (UAVs) and submarines using AMI-developed, dual-use software. In the consent agreement, AMI agreed to pay a total fine of $500,000.

The AMI settlement highlights important compliance issues that U.S. companies not significantly involved in the defense sector often do not recognize. Many U.S. companies not normally engaged in the export of ITAR-controlled defense articles or technology are unaware of the potential applicability to their activities of the ITAR rules governing "defense services," and of the need to enter into a DDTC-approved technical assistance agreement (TAA) for the provision of defense services when they deal with foreign military clients. In this article, we first examine the unauthorized export of defense services in the DDTC settlement with AMI. We then review when TAAs may be required for providing defense services to foreign persons using dual-use products and technologies—even if no export of U.S.-origin, ITAR-controlled products or technology is involved. Finally, we address the "creation" of defense articles when non-defense items are modified for a military purpose—which makes the items subject to the ITAR—an issue that also resulted in export violations for AMI.

AMI Violations and Penalties—*Violations*: According to the DDTC charging letter, AMI specializes in the development of Computation Fluid Dynamic (CFD) software programs. AMI charging letter at 2. These programs are used to create three-dimensional computer models of items for design testing in simulated environments such as flying or traveling through water. The majority of AMI's CFD software programs are so-called "dual-use" items and are controlled under the Export Administration Regulations (EAR) of the U.S. Commerce Department's Bureau of Industry and Security (BIS). Depending on the nature of the item, the country of destination, the identity of the end user and the intended end use, items controlled under the EAR may or may not require an export license. However, by using these dual-use EAR software programs in consulting on foreign military programs, AMI provided an ITAR-regulated "defense service," which almost always requires Government authorization—not from BIS, but from DDTC under the ITAR.

In a November 2007 voluntary disclosure, AMI disclosed that it used CFD software while providing various defense services without authorization to Israel, Singapore, Turkey and the UK. AMI charging letter at 5. The disclosure explained that AMI believed this CFD software was not ITAR-controlled. Id. Nevertheless, as the consent agreement explains, "software designated as dual-use [and, thus, not directly controlled by DDTC] can be used to provide an ITAR regulated defense service ...." AMI consent agreement at 6. As such, even though no DDTC or BIS license was required for export of most of the AMI software items (as discussed below, DDTC did determine that some were export-controlled defense articles), the use of the software to provide a "defense service" required a DDTC authorization.

The charging letter cites several instances between 2003 and 2005 in which AMI provided unauthorized defense services related to consulting on military aircraft, UAVs and submarines. Specifically, AMI provided unauthorized ITAR-regulated defense services when it:

- conducted a design presentation for a new Israeli UAV;
- conducted design analysis for adapting an Israeli aerial reconnaissance camera pod to SU 30 MK1 aircraft;
- conducted a virtual-world test of the impact of modifying a Cheyenne III aircraft with an Israeli radome and the impact of modifying an E-2C Hawkeye early warning aircraft's navigation antennas;
- performed aerodynamic analysis for an Israeli UAV program and conducted a design presentation for a new Israeli UAV;
- designed an Israeli camera pod for aerial reconnaissance using F-16 aircraft;
- participated in two Singaporean projects specifically performing underwater submarine maneuver calculations;
- provided training using an ITAR-controlled modified software specifically developed to perform chaff/flare trajectory calculations from aircraft to improve defense effectiveness; and
- analyzed maneuvers on several UK submarine cases.

AMI charging letter at 5–6. As a result of these violations, DDTC charged AMI with 13 counts of unauthorized exports of defense services in violation of ITAR § 127.1(a)(1). Id. at 8.

Penalties: Considering AMI's voluntary disclosure letter and describing it as a "significant mitigating factor," DDTC imposed a total fine of $500,000 on AMI in settlement of the 29 civil violations alleged in the charging letter. DDTC could have imposed a maximum of $500,000 *for each violation.* AMI consent agreement at 3. The order stipulated that $100,000 be paid to the State Department within 15 days. Id. The remaining $400,000 was suspended, including $200,000 that AMI had already applied to self-initiated remedial compliance measures determined by DDTC. Id. The remaining $200,000 of the $400,000 was suspended on the condition that AMI apply this amount to other consent agreement-authorized remedial measures over a three-year period. Id.

Remedial measures provided for in the consent agreement are comprehensive and demanding, starting with the designation of a qualified ITAR-experienced individual to serve as a senior compliance officer (SCO). Id. at 7. This SCO must implement more robust oversight and compliance programs, including a formal ITAR export compliance program, and create an ITAR compliance manual for company use. Id. at 7–8. The consent agreement further calls on AMI to arrange and facilitate, with minimum advance notice, on-site reviews by DDTC, as well as provide periodic status reports on ITAR compliance program enhancements. Id. at 8. Additionally, the consent agreement stipulates that an outside consultant must assess the effectiveness of AMI's remedial measures and compliance programs, and submit a draft audit plan to DDTC. Id.

ITAR-Controlled "Defense Services"—In light of the heightened enforcement efforts of the past few years, often resulting in stiff penalties, most defense companies understand the requirement to register with DDTC and obtain the proper export licenses or approvals before exporting ITAR-controlled items or technical data. But as the AMI settlement demonstrates, companies that may not consider themselves to be defense-oriented, and that typically engage in the export of EAR-controlled, dual-use items and technologies, can also run afoul of the ITAR. Understanding the broad scope of ITAR-controlled defense services is critical for commercial companies seeking to avoid liability for an unanticipated ITAR violation.

Definition of Defense Service under ITAR § 120.9(a): The ITAR makes it unlawful to furnish a defense service without first obtaining the required license or written approval from DDTC. 22 CFR § 127.1(a)(1). A close examination of the ITAR reveals the numerous activities that can qualify as ITAR-controlled defense services and therefore require DDTC approval.

Section 120.9(a) of the ITAR defines a defense service to include:

> (1) The furnishing of assistance (including training) to foreign persons, whether in the United States or abroad, in the design, development, engineering, manufacture, production, assembly, testing, repair, maintenance, modification, operation, demilitarization, destruction, processing or use of defense articles; or
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> (2) The furnishing to foreign persons of any technical data controlled under this subchapter (see § 120.10), whether in the United States or abroad; or
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> (3) Military training of foreign units and forces, regular and irregular, including formal or informal instruction of foreign persons in the United States or abroad or by correspondence courses, technical, educational, or information publications and media of all kinds, training aid, orientation, training exercise, and military advice.

Although not obvious at first glance, the comprehensive nature of ITAR-controlled defense services in this definition has several important implications for companies such as AMI.

No U.S.-Origin Defense Articles Need Be Involved: To begin with, there is no mention of U.S.-origin defense articles in the ITAR's definition of defense services. That is, ITAR-controlled defense services can exist even if no U.S.-origin defense article or defense technology is involved; the simple furnishing of assistance or training to foreign persons on foreign-origin defense articles falls within the definition of defense services. See 22 CFR § 120.9(a)(1), (a)(3). The AMI settlement provides excellent real-world examples of this. AMI violated the ITAR by providing assistance on foreign-origin defense articles, even though no U.S.-origin defense article or defense technology was involved. See AMI charging letter at 5–6.

The Export of ITAR-Controlled Defense Services Can Occur if Using Dual-Use Items: Another important lesson from the AMI settlement is that an unauthorized provision of ITAR-controlled defense services can occur if a company uses dual-use products or technical data to furnish assistance on a foreign defense project. AMI consent agreement at 6. The nature of the project for which assistance is provided is the critical distinction of which companies must be mindful. Services provided using dual-use software technology for defense projects are often identical or substantially similar to the services provided for commercial projects using the same technology. Thus, for example, a company that typically uses dual-use technology to provide technical analysis on civilian aircraft may not realize it is providing an ITAR-controlled defense service when it provides the same technical analysis for a foreign military aircraft, even though the underlying technology is not ITAR-controlled.

Such was the case in the AMI settlement, in which AMI provided defense services by analyzing and testing defense items and defense services for foreign military customers. Although much of the CFD software that AMI used in assisting its foreign customers was dual-use technology, the assistance became an ITAR-controlled defense service because it aided foreign military applications. So, although the use of dual-use technology to provide assistance on a defense project may be indistinguishable from assistance provided on a commercial project using the same technology, when related to defense articles, the assistance is an ITAR-controlled defense service, even if no ITAR-controlled technology is involved.

Modifications to a Dual-Use Item Can Result in an ITAR-Controlled Defense Article: Similarly, U.S. commercial companies should be mindful that modifications made to an EAR-controlled, dual-use item or technology for use in a military application could result in the creation of an ITAR-controlled defense article that is subject to ITAR export licensing requirements. U.S. persons that produce and export such items must be registered with DDTC, and DDTC approval is required before export. 22 CFR § 127.1(a)(1). AMI also found itself in trouble on this count.

DDTC charged AMI with the unauthorized export of a defense article in violation of ITAR § 127.1(a)(1) because it exported defense-related software to Turkey without authorization. AMI charging letter at 6. This software was originally dual-use, but it had been modified specifically "to perform chaff/flare trajectory calculations from aircraft in order to improve defense effectiveness." Id. As a result, AMI not only engaged in an unauthorized provision of defense services by using this modified software, but it engaged in a direct export of a defense article without a DDTC export license because it made this modified software available to its Turkish customer. Companies must therefore be aware of the ITAR implications if modifying a dual-use item for a defense purpose.

The Export of ITAR-Controlled Defense Services Can Occur Even if Using Public Domain Information: A final point of note is that an ITAR-controlled defense service occurs even if the information relied on in providing the defense service is in the public domain. 22 CFR § 124.1(a). Although AMI was not accused of providing a defense service using public domain information, in its charging letter against AMI, DDTC went out of its way to explain the breadth of defense services and that defense services can arise even if only public domain information is used to provide the service. AMI charging letter at 6.

Public domain information is published information that is generally accessible to the public through various outlets. 22 CFR § 120.11(a). Normally, public domain information is exempt from export license requirements. 22 CFR § 120.10(a)(5). Given the exempt status of public domain information from the definition of technical data elsewhere in the ITAR, one might incorrectly assume that no ITAR-compliance issues exist if furnishing assistance using public domain information. However, ITAR § 124.1(a) states that a company needs DDTC approval before it may provide a § 120.9(a) defense service, and § 124.1(a) further applies this requirement

whether or not the information relied on in providing the defense service is in the public domain or otherwise exempt from license requirements:

> The requirements of this section apply whether or not technical data is to be disclosed or used in the performance of the defense services described in § 120.9(a) of this subchapter (e.g., *all the information relied upon by the U.S. person in performing the defense service is in the public domain or is otherwise exempt from licensing requirements* ...).

22 CFR § 124.1(a) (emphasis added). Once again, the determining factor is the § 120.9(a) prohibition on furnishing assistance on the use of defense articles. Thus, it does not matter whether the information used to provide that assistance is in the public domain. Key distinctions such as this one illustrate the importance of having an understanding of the ITAR even for companies not normally engaged in the export of ITAR-controlled products or technology.

The Need for a TAA before Defense Services May Be Furnished—Once clear on the activities that qualify as ITAR-controlled defense services, informed U.S. companies can take steps to obtain the proper DDTC approvals before furnishing those services. Section 124.1(a) of the ITAR requires DDTC approval before providing a § 120.9(a) defense service. 22 CFR § 124.1(a). This approval can be obtained by submitting a proposed agreement to DDTC, usually in the form of a TAA. Other agreements that may be required, depending on the circumstances, include manufacturing license agreements, and warehouse and distribution agreements.

A TAA is an agreement for the performance of a defense service or the disclosure of technical data, as opposed to an agreement granting a right or license to manufacture or export defense articles. 22 CFR § 120.22. The TAA serves as an agreed-upon "rule book" governing how a defense service will be provided to a foreign national. It is more time-consuming to prepare and takes longer for approval than regular export licenses, but once approved, it offers more flexibility than specific transaction licensing.

Preparing the TAA for Submission: A properly prepared TAA addresses every aspect of the defense service a U.S. company proposes to furnish to a foreign national. (A company must be registered with DDTC before submitting a TAA for approval. 22 CFR § 122.1(a).) Section 124 of the ITAR details the DDTC requirements for submitting a proposed TAA. Generally, information that must be included in proposed TAAs includes:

- a description of the defense article to be manufactured and all defense articles to be exported, including any test and support equipment or advanced materials;
- a description of the assistance and technical data, including any design and manufacturing know-how involved, to be furnished;
- the proposed duration of the agreement;
- specific identification of the countries or areas in which manufacturing, production, processing, sale or other form of transfer is to be licensed; and
- six required clauses described in ITAR § 124.8.

22 CFR §§ 124.7, 124.8. A transmittal letter containing additional information is also required. 22 CFR § 124.12. Being informed of these requirements can help U.S. companies avoid unnecessary delays in the approval of the proposed agreement, which can take three months in the normal course.

Providing all of the required information in a proposed TAA also is essential to avoiding a DDTC denial of the agreement, or a so-called "return without action" response. TAA proposals should include a thorough description of the purpose of the agreement and how the parties involved will execute it. This description should include the scope of the assistance being provided for defense articles and who the end users of the defense articles are. Additionally, the proposed TAA should contain a complete description of the assistance, training and data being proffered, including any technology being used. See also DDTC Guidelines for Preparing Agreements at 11, available at *www.pmddtc.state.gov/licensing/agreement.html*. The contents of the TAA should be carefully considered because changes to the scope of an approved TAA, including modifications, upgrades, addition of other parties or extensions, must be submitted to DDTC for approval. 22 CFR § 124.1(c). Thinking critically about the participants and duration in preparing the TAA can help avoid unnecessary delays in providing services to foreign clients if the TAA must be amended.

Conclusion—As illustrated by the AMI settlement, the unauthorized provision of defense services to foreign persons can be extremely costly. U.S. companies not normally engaged in the export of ITAR-controlled defense articles or technologies need to be aware that assisting foreign clients for a defense purpose can result in the unauthorized provision of ITAR-controlled defense services. Unintended violations can be avoided through familiarity with the ITAR's rules governing defense services, and with the process for entering into

a DDTC-approved TAA if seeking to provide defense services to foreign clients. Even commercially oriented companies should have compliance programs in place to help identify whether work for foreign clients may cross over into the ITAR-controlled defense services domain.

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***This article was written for INTERNATIONAL GOVERNMENT CONTRACTOR by* Alan Kashdan*, counsel in Hughes Hubbard & Reed LLP's International Trade Group, and* Andres A. Castrillon*, an associate in the firm's International Trade Group. All information discussed in this article is from public documents, including the DDTC charging letter, order and consent agreement regarding the AMI case, available at* www.pmddtc.state.gov/compliance/consent_agreements/AnalyticalMethods.html.**