



DEPUTY UNDER SECRETARY OF DEFENSE  
3015 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3015

ACQUISITION AND  
TECHNOLOGY

OCT 14 2008

The Honorable Carl Levin  
Chairman, Committee on Armed Services  
United States Senate  
Washington, DC 20510

Dear Mr. Chairman:

This report satisfies the requirements of section 890(c) of the National Defense Authorization Act for Fiscal Year 2008, Public Law 110-181.

Mindful of the fact that requirements and guidance for U.S. exporter compliance with the International Traffic in Arms Regulations (ITAR) and the Export Administration Regulations (EAR) are issued and enforced by the Department of State and the Department of Commerce, respectively, we used an interagency approach to prepare the enclosed report.

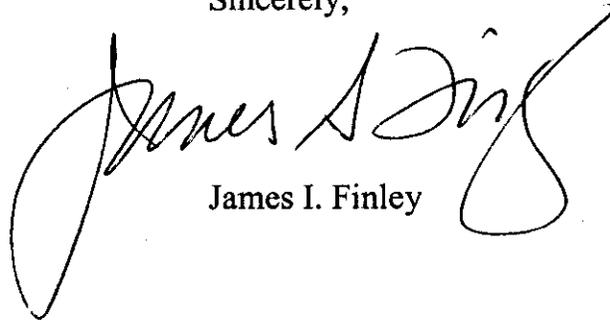
The report assesses the utility of imposing on defense contractors and subcontractors four types of requirements related to compliance with export control regulations. The assessments reflect the coordinated position of the Department of Defense, the Department of State, the Department of Commerce, and the Department of Justice. It concludes that (1) the ITAR and EAR, as enforced by responsible federal agencies, are achieving the objectives associated with the four types of requirements contemplated by section 890(c); (2) none of the four types of requirements contemplated by section 890(c) is necessary to achieve the stated objectives; and (3) the imposition of any of the requirements would likely impair rather than enhance compliance with and enforcement of export control laws and regulations.

We understand and share the desire to improve security and ensure that export control laws are effectively implemented and enforced, and recognize that these desires underlie section 890(c). However, as evidenced by the report's conclusions, imposing the types of requirements contemplated by section 890(c) would neither improve security nor enhance the effectiveness of export controls, and may actually have the opposite effect. To the extent that improvements are needed, they should be made in the context of the existing statutory framework, in consultation with the authorities in the State and Commerce Departments who have responsibility for implementing and enforcing the Arms Export Control Act and the Export Administration Act of 1979, as amended.



I am sending a similar letter to the chairman and ranking member of the House Armed Services Committee.

Sincerely,

A handwritten signature in black ink, appearing to read "James I. Finley". The signature is fluid and cursive, with a large loop at the end.

James I. Finley

Enclosure:  
As stated

cc:  
The Honorable John McCain  
Ranking Member



DEPUTY UNDER SECRETARY OF DEFENSE  
3015 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3015

ACQUISITION AND  
TECHNOLOGY

OCT 14 2008

The Honorable Ike Skelton  
Chairman, Committee on Armed Services  
U.S. House of Representatives  
Washington, DC 20515-6035

Dear Mr. Chairman:

This report satisfies the requirements of section 890(c) of the National Defense Authorization Act for Fiscal Year 2008, Public Law 110-181.

Mindful of the fact that requirements and guidance for U.S. exporter compliance with the International Traffic in Arms Regulations (ITAR) and the Export Administration Regulations (EAR) are issued and enforced by the Department of State and the Department of Commerce, respectively, we used an interagency approach to prepare the enclosed report.

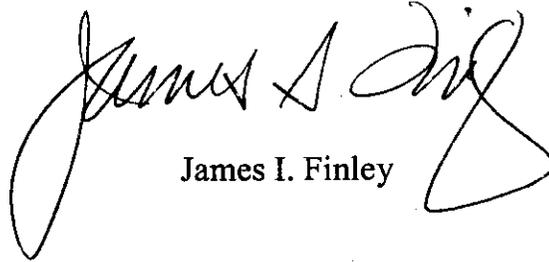
The report assesses the utility of imposing on defense contractors and subcontractors four types of requirements related to compliance with export control regulations. The assessments reflect the coordinated position of the Department of Defense, the Department of State, the Department of Commerce, and the Department of Justice. It concludes that (1) the ITAR and EAR, as enforced by responsible federal agencies, are achieving the objectives associated with the four types of requirements contemplated by section 890(c); (2) none of the four types of requirements contemplated by section 890(c) is necessary to achieve the stated objectives; and (3) the imposition of any of the requirements would likely impair rather than enhance compliance with and enforcement of export control laws and regulations.

We understand and share the desire to improve security and ensure that export control laws are effectively implemented and enforced, and recognize that these desires underlie section 890(c). However, as evidenced by the report's conclusions, imposing the types of requirements contemplated by section 890(c) would neither improve security nor enhance the effectiveness of export controls, and may actually have the opposite effect. To the extent that improvements are needed, they should be made in the context of the existing statutory framework, in consultation with the authorities in the State and Commerce Departments who have responsibility for implementing and enforcing the Arms Export Control Act and the Export Administration Act of 1979, as amended.



I am sending a similar letter to the chairman and ranking member of the Senate Armed Services Committee.

Sincerely,

A handwritten signature in black ink, appearing to read "James I. Finley". The signature is fluid and cursive, with a large loop at the end.

James I. Finley

Enclosure:  
As stated

cc:  
The Honorable Duncan Hunter  
Ranking Member

**Assessment of the Utility  
of Imposing Certain Requirements  
on Defense Contractors  
regarding Compliance with Export Control Regulations**

**DUSD (A&T)/DPAP  
September 2008  
Report to Congress  
Required by  
Section 890(c) of Public Law 110-181**

**INTRODUCTION**

Section 890(c) of Public Law 110-181 requires the Secretary of Defense to submit to the Committee on Armed Services of the Senate and the Committee on Armed Services of the House of Representatives a report assessing the utility of—

(1) Requiring defense contractors (or subcontractors at any tier) to periodically report on measures taken to ensure compliance with the International Traffic in Arms Regulations and the Export Administration Regulations;

(2) Requiring periodic audits of defense contractors (or subcontractors at any tier) to ensure compliance with all provisions of the International Traffic in Arms Regulations and the Export Administration Regulations;

(3) Requiring defense contractors to maintain a corporate training plan to disseminate information to appropriate contractor personnel regarding the applicability of the Arms Export Control Act and the Export Administration Act of 1979; and

(4) Requiring a designated corporate liaison, available for training provided by the United States Government, whose primary responsibility would be contractor compliance with the Arms Export Control Act and the Export Administration Act of 1979.

This paper assesses the utility of each of these potential requirements. The assessments reflect the coordinated position of the Department of Defense and the following agencies, which are responsible for compliance with and enforcement of export control statutes and regulations:

- Department of State, Bureau of Political Military Affairs, Directorate of Defense Trade Controls Office of Compliance
- Department of Commerce, Bureau of Industry and Security
- Department of Justice, National Security Division (Counterespionage Section)

## ASSESSMENTS:

Current export control regulations and infrastructure provide a comprehensive system for the control of exports.

Exports of defense articles and defense services and brokering activities involving defense items are controlled under Section 38 of the Arms Export Control Act (AECA) (22 U.S.C. 2778) and its implementing regulations, the International Traffic in Arms Regulations (ITAR) (22 C.F.R. Parts 120-130). Under Section 38 of the AECA, the President controls the import and export of defense articles and defense services and brokering. This activity is primarily managed by the Secretary of State, with some responsibilities (concerning permanent imports) delegated to the Attorney General. The objective of the AECA and the ITAR is to further U.S. foreign policy and national defense interests. Under the AECA and the ITAR, manufacturers, exporters and brokers of defense articles and defense services must register with the Department of State, obtain the appropriate export and/or brokering licenses from the Department, maintain records and provide the Department access to the records at all times.

The Department of State through its Directorate of Defense Trade Controls (DDTC) serves as the ITAR managing office and coordinates with other agencies on defense trade, export authorizations and compliance matters. The functions include, but are not limited to: managing the registration process of manufacturers, exporters and brokers; approving or denying export authorizations based on national security and foreign policy objectives; maintaining official records and establishing registrant record keeping requirements; conducting end use checks; assessing civil fines and penalties; conducting assessments, audits and company visits; engaging in direct in-house training and supporting external training venues for registrants and the public; receiving and adjudicating voluntary disclosures; obtaining reports on commissions, fees and political contributions; and filing mandatory reports with Congress as required.

Section 38 of the AECA provides the Department of State with civil enforcement authority. In turn, the Department of State holds registrants to strict compliance with the ITAR. DDTC further supports the Department of Justice, the Federal Bureau of Investigation (FBI) (when there is a nexus to foreign counter-intelligence), and the Immigration and Customs Enforcement (ICE) operations of the Department of Homeland Security in pursuit of export violations of a criminal nature. DDTC serves as the technical and policy resource leader for the Department of State and other agencies on defense trade, export/import authorizations, and compliance matters.

Pursuant to the Export Administration Act of 1979, as amended (EAA), and the Export Administration Regulations (EAR),<sup>1</sup> the Bureau of Industry and Security (BIS) of the

---

<sup>1</sup> Since August 21, 2001, the EAA (50 U.S.C. app. §§ 2401-2520 (2000)) has been in lapse and the President, through Executive Order 13222 of August 17, 2001 (3 C.F.R., 2001 Comp. 782 (2002)), as extended most recently by Notice of August 15, 2007 (72 Fed. Reg. 46137 (Aug. 16, 2007)), has continued the EAR (15 C.F.R. §§ 730-774) in effect under the International Emergency Economic Powers Act (50 U.S.C. §§ 1701-1707 (2000)).

Department of Commerce advances U.S. national security, foreign policy, and economic objectives by ensuring an effective export control and treaty compliance system and promoting continued U.S. strategic technology leadership. Under this mandate, BIS is charged with the development, implementation and interpretation of U.S. export control policy for dual-use commodities, software, and technology. In implementing export control policy, BIS staff engineers process classification requests and license applications for a wide range of commodities, software, and technology for items such as nuclear materials, chemicals, toxins, electronic devices and components, computers, telecommunication equipment, encryption, lasers, sensors, navigation and avionics equipment, marine vehicles, as well as aerospace and propulsion systems. Further, BIS provides regulatory guidance through advisory opinions and through seminars given domestically and abroad. In enforcing the EAR, BIS conducts pre-license checks and post-shipment verifications of transactions subject to the EAR, interdicts illegal exports, investigates violations, prosecutes administrative cases for violations of the EAR, and works with the Department of Justice on the prosecution of criminal cases.

#### **A. Requirement for Periodic Reports (Section 890(c)(1))**

Section 890(c)(1) requires an assessment of the utility of requiring defense contractors (or subcontractors at any tier) to periodically report on measures taken to ensure compliance with the International Traffic in Arms Regulations and the Export Administration Regulations.

As described above, the Departments of State and Commerce are responsible for the implementation and management of the AECA and ITAR, and the EAR, respectively. Requiring a defense contractor to report to DoD on its compliance efforts would create a dual reporting regime leading to redundant reporting, potential for DoD interpretation of another agency's regulations, and the potential for incorrect or inconsistent guidance on regulatory and compliance matters. Reporting requirements are varied and complex. Adding another agency for reporting purposes would add complexity, redundancy and would likely increase confusion, at considerable cost in time and resources for industry and government alike, with questionable added value. Such a measure would also put at risk and could undermine civil and criminal enforcement efforts due to potentially incorrect or inconsistent agency guidance.

Under the ITAR, registrants already have mandatory reporting in various ITAR sections and recordkeeping requirements (ITAR Section 122.5) in addition to those reporting requirements specified in case-by-case export authorizations. The ITAR encourages voluntary self-disclosure reporting of export violations and last year the Department of State received nearly 700 reports from registrants. The Department evaluates each case on its merits for possible export violations and to determine whether to impose additional compliance measures on the registrant, such as requiring additional training, periodic audits, and/or compliance program revisions.

Similarly, requiring reports on compliance matters to DoD is inconsistent with the EAR, which encourages companies to voluntarily self-disclose violations of the EAR to the

Commerce Department. In addition, the EAR already imposes a variety of reporting requirements on exporters to aid Commerce in its implementation of the EAR.

Therefore, a requirement for separate, additional reporting to DoD is unnecessary, would likely confuse exporters and may lead to incorrect or inconsistent guidance to contractors/companies, which could undermine civil and criminal enforcement efforts. Additionally, such reporting would likely have little, if any, utility as the level of detail provided would most likely be general in nature. Further, dual reporting requirements would result in ambiguity as to which agency is responsible for responding to the reports, and under what authority.

Both the State Department and the Commerce Department already offer outreach programs on complying with the ITAR and the EAR, including guidance concerning how to implement internal compliance programs. Exporters would not be well served by obtaining guidance and assistance from a Department that does not have the expertise and responsibility to regulate or enforce the ITAR or the EAR.

#### **B. Requirement for Periodic Audits (Section 890(c) (2))**

Section 890(c)(2) requires an assessment of the utility of requiring periodic audits of defense contractors (or subcontractors at any tier) to ensure compliance with all provisions of the International Traffic in Arms Regulations and the Export Administration Regulations.

Requiring DOD to periodically audit defense contractors to ensure compliance with the ITAR would be costly and provide limited utility while creating potential complication for current enforcement efforts.

Section 890(c)(2) appears to suggest that DoD would conduct such audits. State, however, not DOD, has the authority under the AECA for promulgating regulations, and for interpreting and enforcing (in conjunction with the Department of Justice) the law and regulations. Under the EAR, Commerce has similar authority with respect to dual-use items, and is particularly authorized to inspect books and records, and subpoena such documents when necessary. DoD does not have the expertise, resources or authority to conduct such audits.

Such a requirement as contemplated by Section 890(c)(2) is unnecessary and could create confused lines of authority that could impact civil and criminal export enforcement efforts. To the extent that periodic audits are determined to be useful, the ITAR and EAR provide the authority and the Departments of State and Commerce have the expertise to require and oversee such audits. Exporters know that the ITAR and EAR provide State and Commerce with broad enforcement authority. These clear lines of authority and communication would be compromised and confusion would likely result if redundant and additional requirements were independently imposed by DoD contracts.

Moreover, the objective of the audits contemplated under this section is so broad (all defense contractors' and subcontractors' compliance with all provisions of the ITAR and EAR) that the scope of each audit would require substantial resources and funds to implement.

Finally, having DoD conduct an audit on a defense contractor would complicate (and potentially impede) the necessary, very delicate coordination currently conducted by State and Commerce with law enforcement agencies concerning ongoing undercover investigations into violations of the EAR and ITAR of which that contractor may be the subject.

### **C. Requirement for Corporate Training Plans (Section 890(c) (3))**

Section 890(c)(3) requires an assessment of the utility of requiring defense contractors to maintain a corporate training plan to disseminate information to appropriate contractor personnel regarding the applicability of the Arms Export Control Act and the Export Administration Act of 1979.

Such a requirement is unnecessary. Companies subject to the ITAR and the EAR have training plans to support their internal controls as a matter of good business practice to ensure compliance with the regulatory requirements established in the ITAR and the EAR and to avoid civil or criminal penalties in these regulations. A separate DoD requirement for such a training plan on export compliance matters would be duplicative of current practices. It would call into question which Department would be responsible for reading, reviewing, and assessing the training plans, and what if any actions would follow after submission of such plans.

Regarding the dissemination of information to contractors concerning the applicability of the AECA and EAR, outreach and training seminars provided by the Departments of State and Commerce already reach DOD contractors. In FY07, the Department of Commerce alone educated over 5,100 people through 49 domestic export control outreach seminars conducted in 18 states.

### **D. Requirement for a Designated Corporate Liaison (Section 890(c)(4))**

Section 890(c)(4) requires an assessment of the utility of requiring a designated corporate liaison, available for training provided by the United States Government, whose primary responsibility would be contractor compliance with the Arms Export Control Act and the Export Administration Act of 1979.

Such a requirement is unnecessary as the ITAR already includes a more comprehensive requirement. The regulations require that a senior officer who has been empowered by the intended registrant to sign the registration documentation to include documents establishing its eligibility to participate in export and/or brokering activity and whether the intended registrant is foreign owned and/or controlled. The regulations further require that each registrant designate a person, known as an empowered official, who has

the knowledge, power, and authority to take actions on export control matters (reference ITAR Section 120.25): to include having independent authority to enquire into any aspect of a proposed export or temporary import by the application, and verify the legality of the transaction and the accuracy of the information to be submitted; and refuse to sign any license application or other request for approval without prejudice or other adverse recourse.

The EAR requires a principal contact for purposes of electronic license submissions, and the Department of Commerce provides an extensive outreach program for corporate liaisons and other officials on complying with the EAR and implementing an effective compliance program.

State and Commerce already have the expertise and programs in place to maintain contact with and provide education and training resources for defense contractors and other entities with respect to compliance with the AECA and the EAR.

### **III. CONCLUSION**

Consistent with agency roles and missions, an interagency effort and public rulemaking process have resulted in a new Defense Federal Acquisition Regulation Supplement Interim Rule at Subpart 204.73, "Export Controlled Items." This rule, which satisfies the requirements of Section 890(a), prescribes new clauses for DoD solicitations and contracts that inform defense contractors of their obligation to comply with export laws and regulations. These clauses do not establish an independent compliance requirement on export control matters. It remains the contractor's responsibility to comply with all applicable laws and regulations regarding export controlled items. Such responsibility exists independent of, and is not established or limited by, the new clauses or, the requirements in the new clauses. The clauses direct defense contractors to the State and Commerce Departments for official guidance regarding compliance with the ITAR and the EAR. The clauses do not create any ambiguity with regard to which agency has export control authority, expertise and enforcement responsibility.

The above assessments are intended to inform Congress that the ITAR and EAR, as implemented and enforced by State and Commerce, in conjunction with the Department of Justice and the Department of Homeland Security's Immigration and Customs Enforcement, are achieving the objectives associated with the four types of requirements contemplated by Section 890(c). The ITAR and EAR, as existing, long-standing regulations, along with their civil and criminal fines, penalties and enforcement mechanisms (described above), achieve the objectives of establishing defense contractor awareness and compliance and ensuring governmental oversight of defense contractor activities. Under the authority of the ITAR and EAR, the Departments of State and Commerce require periodic assessments, require certain regulatory reporting, offer outreach and training, establish principal points of contact, and implement the long standing principle of the contractor's strict compliance with the ITAR and the EAR. They also efficiently and effectively support export control criminal cases pursued by the

Department of Justice, the Federal Bureau of Investigation, and the Department of Homeland Security's Immigration and Custom's Enforcement.