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ARTICLE

Am I My Broker's Keeper? And Other ITAR Brokering Questions Inspired by the *BAE* Case

John Pisa-Relli*

The U.S. State Department has regulated international defense trade brokering activities involving the United States since 1997. The brokering rules are widely viewed as inscrutable and elastic, even to the most seasoned practitioners. And though the State Department has long promised much needed regulatory clarification, little has been forthcoming. Meanwhile, in May 2011, the State Department entered into a consent agreement with global defense giant, BAE Systems plc, to settle alleged brokering violations. The settlement, which is record breaking both in terms of penalties and the volume of misconduct alleged, has sent shock waves throughout the defense industry. But while the settlement documents raise numerous interpretive questions about the brokering rules, they provide scant, if any, meaningful guidance. This article examines the BAE case and its implications for parties subject to the U.S. defense brokering rules.

1. Background

On May 16, 2011, U.K.-based international defense giant BAE Systems plc entered into a consent agreement with the U.S. State Department's Directorate of Defense Trade Controls (DDTC) to settle 2,591 alleged civil violations of the International Traffic in Arms Regulations (ITAR), 22 C.F.R. Parts 120–130.[1] While neither admitting nor denying the charges, which related to activities that occurred from 1998 to 2011, BAE agreed to (1) appoint an external monitor and implement a broad range of remedial compliance measures during the four-year term of the consent agreement, (2) pay a USD 79 million fine (USD 10 million of which was eligible for credit toward existing and proposed remedial compliance), and (3) accept a policy of export denial for three designated affiliates.[2]

This record-breaking ITAR enforcement matter, both in terms of the number of violations and the amount of penalties, followed in the wake of transatlantic criminal fraud and corruption investigations that involved both the U.S. Justice Department and the U.K Serious Fraud Office and which themselves led to combined criminal fines totaling nearly USD 450 million.[3]

The State Department's civil case focused principally on the complex and misunderstood brokering requirements in ITAR Part 129, which regulate a wide range of intermediary defense trade activities on the part of both U.S. and foreign persons where there is some nexus to the United States. Both U.S. and foreign parties that qualify as brokers under Part 129 are required, with few exceptions, to register with and submit reports to DDTC. Prior approval or notification is required for specific categories of brokering activities,

Notes

* *Note: The views expressed in this commentary are exclusively mine and do not necessarily reflect those of my employer or any other party.*

1 The settlement documents, consisting of a proposed charging letter describing the alleged violations, a consent agreement setting forth the settlement terms, and an order making the settlement official, are available on Department's Directorate of Defense Trade Controls' (DDTC's) website at <www.pmddtc.state.gov/compliance/consent agreements/baes.html>. The company's U.S. subsidiary (and its subsidiaries) were cleared of any liability and were excluded from the scope of the settlement. For a more detailed summary of the terms of the BAE settlement, as well as a ten year review of all published International Traffic in Arms Regulations (ITAR) civil enforcement settlements and an overview of the DDTC civil enforcement process, see John Pisa Relli, "Monograph on U.S. Defense Trade Enforcement," revised June 2011, available from the author by email at

2 See generally U.S. State Department, Directorate of Defense Trade Controls, "BAE Systems plc Consent Agreement," May16, 2011, <www.pmddtc.state.gov/compliance/consent agreements/pdf/BAES CA.pdf>.

3 See, e.g., U.S. Justice Department Press Release, "BAE Systems plc Pleads Guilty and Ordered to Pay $400 Million Criminal Fine," Mar. 1, 2010, <//www.justice.gov/opa/pr/2010/March/10 crm 209.html>; U.K. Serious Fraud Office Press Release, "BAE Systems plc," Feb. 5, 2010, <www.sfo.gov.uk/press room/latest press releases/press releases 2010/bae systems plc.aspx>.

and ITAR-regulated brokers must maintain records of their controlled activities and produce the same to DDTC upon demand.[4]

As the first published ITAR civil enforcement case to focus on the Part 129 brokering requirements, the *BAE* settlement has sent shockwaves throughout the international exporting community. Unfortunately, DDTC missed a golden opportunity to clarify its expectations regarding compliance with the ITAR brokering requirements. In fact, the publicly available settlement documents raise unanswered questions with unsettling implications for companies that strive to comply as effectively as possible with the ITAR and, more specifically, its brokering requirements. This article examines some of those questions. But first, some context is required.

2. ITAR Brokering: A Long and Elusive Quest for Clarity

The brokering requirements are set forth in ITAR Part 129, which came into effect in late 1997 following a 1996 amendment to the ITAR's statutory authority, section 38 of the Arms Export Control Act (AECA).[5] Although the legislative history is scant at best, it provides an indication of the concerns that the U.S. Congress was seeking to address; specifically:

> [T]he AECA does not authorize the Department to regulate the activities of U.S. persons (and foreign persons located in the U.S.) brokering defense transactions overseas (except for transactions involving a small number of terrorist countries). Nor does the AECA authorize the Department to regulate the brokering of non-U.S. defense articles or technology.
>
> This provision provides those new authorities to ensure that arms exports support the furtherance of U.S. foreign policy objectives, national security interests and world peace. More specifically, in some instances U.S. persons are involved in arms deals that are inconsistent with U.S. policy. Certain of these transactions could fuel regional instability, lend support to terrorism or run counter to a U.S. policy decision not to sell arms to a specific country or area. The extension of U.S. legal authority under this provision to regulate brokering activities would help to curtail such transactions.
>
> H.R. Rep. 104-128 (identical language appears in H.R. Rep. No. 104-519).

As reflected by the House Report, and as understood by individuals involved in the original legislative process, the Congressional intent was to close a perceived loophole in U.S. defense trade control involving the participation of U.S. parties—specifically third-party middlemen—involved in foreign arms deals.[6] But as reflected by evolving administrative practice, DDTC expanded the scope of the brokering requirements much more widely, although how far these requirements extend is the subject of considerable and continuing debate.[7]

In light of this debate, DDTC has acknowledged over the years the need to provide greater clarity on brokering. In a mandated report to the Congress in 2003, DDTC announced that it was beginning a review of ITAR Part 129. Six years later, in December 2009, DDTC published on its website an unofficial draft Federal Register notice (Public Notice RIN 1400-AC37) of a proposed comprehensive rewrite of Part 129.[8] At the same time, DDTC also published on its website recommendations of the Defense Trade Advisory Group (DTAG) concerning the proposed rule.[9] Since this brief period of activity, DDTC officials have promised in numerous public forums that the revised Part 129 would be released officially for public comment. But at the time of this writing, a year and a half later, the revised rule has yet to be published officially for comment.

Notes

4 See generally 22 C.F.R. Part 129. DDTC provides a portal to the most recent official legal edition of the ITAR, as well as an unofficial consolidated edition that includes any subsequent amendments, on its website at <www.pmddtc.state.gov/regulations laws/itar.html>. Another useful unofficial resource is the *Annotated ITAR* edited by James E. Bartlett, Esq., Senior Counsel, Northrop Grumman Corporation, and available upon by request from the author by email at james.bartlett@ngc.com.

5 Section 38 of the Arms Export Control Act, 22 U.S.C. 2778, was amended to add brokering requirements by s. 151 of Pub. L. No. 104 164 (1996); the ITAR was subsequently amended (62 Fed. Reg. 67276 (Dec. 24, 2007)).

6 See, e.g., John P. Barker, "Brokering under the International Traffic in Arms Regulations" (article in the course handbook for Coping with US Export Controls 2008, a Practising Law Institute course, December 2008, at 186 187), republished at <www.arnoldporter.com/resources/documents/JBarker Brokering Article PLI.pdf>.

7 *Ibid.*

8 Draft Federal Register Notice, "Amendments to the International Traffic in Arms Regulations: Registration and Licensing of Brokers, Brokering Activities, Related Provisions, and Other Technical Changes" (undated), <www.pmddtc.state.gov/DTAG/documents/Brokering FRN November 09 Version.pdf>.

9 Annotated Draft Federal Register Notice, "Amendments to the International Traffic in Arms Regulations: Registration and Licensing of Brokers, Brokering Activities, Related Provisions, and Other Technical Changes" (undated), <www.pmddtc.state.gov/DTAG/documents/Part129BrokeringComments.pdf>; Defense Trade Advisory Group, "Part 129 Working Group Comments to DDTC Proposed Rule," Dec. 4, 2009, <www.pmddtc.state.gov/DTAG/documents/BrokeringWGPresentation.ppt>. The Defense Trade Advisory Group (DTAG) is a federal advisory committee composed of private sector representatives who advise the State Department on U.S. defense trade policy, law, and regulation. For more information on the DTAG, see generally DDTC's website at <www.pmddtc.state.gov/DTAG/index.html>.

3. The Path of Least Resistance: Everything Is Brokering

While the legislative history seems somewhat narrowly focused, both the current and proposed definitions of "broker" and "brokering activities" cover well just about *anything*. Current ITAR Part 129.2(a) defines a "broker" as:

> any person who acts as an agent for others in negotiating or arranging contracts, purchases, sales or transfers of defense articles or defense services in return for a fee, commission, or other consideration.

And current ITAR Part 129.2(b) defines "brokering activities," in pertinent part, to include:

> the financing, transportation, freight forwarding, or ***taking any other action that facilitates*** the manufacture, export, or import or [*sic*] a defense article or defense service, irrespective of its origin [emphasis added].

Exceptions are identified to exclude from regulation, among others, freight forwarders, transporting parties, and financial institutions where their participation in a defense trade transaction is incidental.

Persistent questions remain unanswered, such as what constitutes acting as an "agent" (per DDTC anecdotal guidance, it is not defined by traditional U.S. agency law principles), who is an "other" (mixed official signals, for example, whether and to what extent corporate affiliates acting on behalf of one another are "others" per Part 129), and what constitutes "consideration" (per DDTC anecdotal guidance, nearly any cognizable direct or indirect benefit to a third party could satisfy this element). Moreover, "taking any other action that facilitates" could be extrapolated to the *nth* degree and conceivably could cover nearly any activity, however attenuated from an underlying defense trade transaction.

Neither is the contemplated "clarification" of "brokering activities" necessarily helpful, as proposed ITAR Part 129.2(b) defines the term to mean:

> ***any action of an intermediary nature to facilitate*** the manufacture, export, reexport, import, transfer or retransfer of a defense article or defense service. Such action includes, but is not limited to:
> (1) Financing, transporting or freight forwarding defense articles and defense services,
> (2) Soliciting, promoting, negotiating, contracting for, or arranging a purchase, sale, transfer, loan or lease of a defense article or defense service,
> (3) Acting as a finder of potential suppliers or purchasers of defense articles or defense services, or
> (4) ***Taking any other action to assist*** a transaction involving a defense article or defense service. For the purposes of this subchapter, engaging in the business of brokering activities requires only one action described above [emphasis added].

As with the current definition, the proposed definition excludes certain incidental or irrelevant actors and activities but contains catch-all language that conceivably could apply to any activity, however attenuated from an underlying defense trade transaction.

4. ITAR Brokering Jurisdiction over Foreign Persons

Part 129 as currently written defines "brokering activities" to include such activities when undertaken by "foreign persons *subject to U.S. jurisdiction* involving defense articles or defense services of U.S. or foreign origin which are located inside or outside of the United States" (ITAR Part 129.2(b) [emphasis added]). The requirement to register as a broker under current Part 129 applies to:

> any foreign person located in the United States or *otherwise subject to the jurisdiction of the United States* . . . who engages in the business of brokering activities . . . with respect to the manufacture, export, import, or transfer of any defense article subject to the controls of . . . [the ITAR] or any 'foreign defense article or defense service' (ITAR Part 129.3 [emphasis added]).

What it means precisely to be subject to U.S. jurisdiction is left undefined in the current rule.[10] But in the unofficial draft of the proposed brokering amendments, DDTC has articulated more precise criteria to establish Part 129 jurisdiction over foreign persons. Specifically, in the proposed ITAR Part 129.2(c), DDTC provides, in pertinent part, that brokering activities include such activities:

> [1] by any foreign person located in the United States, [2] by any foreign person located outside the United States who engages in brokering activities involving a U.S.-origin defense article or defense service, [3] by any foreign person located outside the United States who engages in brokering activities involving the import into the United States of any defense article or defense service, or [4] by any

Note

10 In 2005, the United States Court of Appeals, District of Columbia, appeared initially to exclude foreign persons outside of the United States from the scope of the brokering requirements. See *United States v. Yakou* (hereinafter '*Yakou*'), 393 F.3d 231 (DC Cir. 2005). But in a subsequent order, the court clarified that it did not intend to opine on Part 129 jurisdiction over foreign persons "otherwise subject to U.S. jurisdiction." See, e.g., *supra* n. 6, at 189 190 (discussing the *Yakou* case and the DC Circuit's subsequent clarification).

> foreign person located outside the United States who on behalf of a U.S. person engages in brokering activities involving any defense article or defense service.

In the proposed rule, DDTC explains that, unless otherwise provided, the terms "defense article" and "defense service" as used in Part 129 refer both to U.S. and foreign origin defense articles and defense services of a nature described on the United States Munitions List, proposed ITAR Part 129.2(d).

Proposed ITAR Part 129 thus articulates four broad circumstances that could trigger U.S. jurisdiction over foreign persons for the purposes of the brokering requirements. Inasmuch as the proposed rule remains unofficial, it is not authoritative. Nevertheless, as the most current reflection of DDTC's collective thinking on jurisdiction, it would seem reasonable to conclude that the proposed rule is a signal of DDTC's likely approach to jurisdiction going forward.

5. The *BAE* Settlement: What Does It Mean?

At first glance, the *BAE* case concerns a foreign company that was involved in the marketing and exportation of foreign defense articles to various foreign countries, specifically (1) marketing JAS-39 "Gripen" military aircraft to Brazil, Chile, the Czech Republic, Hungary, the Philippines, Poland, and South Africa; (2) exporting "Hawk" Trainer aircraft to Australia, Bahrain, Canada, India, Indonesia, and South Africa; (3) marketing or exporting EF-2000 Eurofighter "Typhoon" aircraft to Australia, Austria, the Czech Republic, Denmark, Greece, Japan, the Netherlands, Norway, Poland, Saudi Arabia, Singapore, South Korea, and Switzerland; (4) marketing three refurbished Type 23 frigates to Chile; and (5) other unspecified defense trade transactions that took place outside the United States.[11]

So where is the jurisdictional hook? In its proposed charging letter, DDTC explains that the foreign defense articles in question contained U.S.-origin ITAR-controlled content. Under a DDTC regulatory interpretation known colloquially as the "see-through rule," ITAR-controlled defense articles, with very few exceptions, remain ITAR-controlled even when incorporated or integrated into, or installed on, a larger item, regardless of the larger item's country of origin or its classification under any other export control regime.[12]

While more subtle than a situation involving an unmistakably U.S.-origin end item, the basis for asserting jurisdiction in this case is in line both with the current jurisdictional standard (which seems capable of capturing any activity with some nexus to the United States) and the more specific criteria of the proposed rule (foreign person dealing with a U.S. defense article, even if it is a component of a foreign end item). And given DDTC's demonstrated willingness to deny ITAR authorizations involving BAE as a lever to compel settlement, any argument challenging jurisdiction would have been, at best, an academic (and undoubtedly futile) exercise.

The *BAE* case signals that DDTC is prepared to hold foreign companies accountable to verify whether a foreign defense item contains U.S.-origin ITAR-controlled content and, if so, to ensure compliance with applicable ITAR requirements. A layman might reasonably be inclined to consider the "Gripen" fighter jet to be a Swedish-origin aircraft manufactured by a foreign defense manufacturer (i.e., Saab AB) outside the United States. But as reflected by the *BAE* case, such reasoning would not necessarily shield a foreign company from liability.

Left unanswered is whether DDTC would be inclined to apply some standard of care such as knowledge or reason to know U.S. content or whether it would exercise its prerogative to allege violations on a strict liability basis. Accordingly, it is unclear whether the *BAE* case reflects an affirmative duty on the part of a foreign person in all cases to confirm the composition of a foreign defense article or whether some less rigorous standard of reasonable care is adequate (e.g., inquiry notice).

Another question raised by the case is on whose behalf did BAE act as an "agent" (in whatever sense of the term); that is, who were the "others"? The proposed charging letter lacks specificity concerning this element of brokering. Regarding the "Gripen" aircraft, it is left to the readers' imagination to determine if the "others" were any, some combination, all, or none of BAE's Swedish joint venture partner Saab AB, the joint venture itself, the ministries of defense of the end user countries, or the U.S. companies that supplied the U.S.-origin ITAR-controlled content. Regarding the "Hawk," "Typhoon," and Type 23 Frigate, it is even less apparent, as the proposed charging letter merely states in each case that BAE "did not obtain U.S. approval to engage in brokering activities

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11 See generally U.S. State Department, Directorate of Defense Trade Controls, "BAE Systems plc Proposed Charging Letter," May16, 2011, <www.pmddtc.state.gov/compliance/consent agreements/pdf/BAES PCL.pdf>.

12 In numerous public forums, DDTC has expressed its disfavor of the term "see through rule" on the reasoning that the ITAR clearly provides, without the need for additional unwritten clarification, that ITAR controlled items remain perpetually ITAR controlled in all but few cases. But even a casual Google search of the term reveals its widespread use by the international exporting community.

of the U.S. systems or sub-systems as part of the proposed . . . sale for any of the [specified] countries." Were the "others" in those cases both, one, or none of the ministries of defense of the end user countries or the U.S. companies that supplied the U.S.-origin ITAR-controlled content?

By not identifying with specificity the "others" on whose behalf BAE allegedly acted as an "agent," DDTC has left open for interpretation the possibility that any party with any connection to a defense trade transaction can trigger ITAR brokering liability on the part of any other party that benefits in some way from the transaction whenever there is some connection to the United States (in this case, the presence of U.S. content in foreign defense articles).

Perhaps even more confounding, numerous brokering violations (1,100 to be exact) were predicated on the premise that BAE financed brokering by making payments to unauthorized brokers. Or put another way, BAE was found to be its unauthorized broker's unauthorized broker. Although "financing" is specifically identified in both the current and proposed rules as an activity comprised by brokering, the commonsense view is that the type of financing contemplated would be more along the lines of extending third-party credit for an arms sale. The concept that paying one's broker makes one a broker is, put mildly, circular reasoning.

In a related vein, BAE was charged with 300 counts of "causing unauthorized brokering" because it used intermediaries that DDTC deemed to be unauthorized brokers. Thus, one is not only potentially one's broker's broker but also one's broker's keeper. The failure to police third parties and to verify that they are authorized brokers under the ITAR, assuming one knows what constitutes "brokering activities" in a given case (read: potentially anything), is yet another ITAR compliance tripwire.

It is entirely uncontroversial to predicate certain categories of liability on a failure to screen third parties. But such responsibility predominantly involves screening third parties against positive watchlists. One can (and should) determine that one's partners are not denied or debarred persons or Specially Designated Nationals under U.S. sanctions law. But left unanswered by this case is what level of due diligence is necessary or advisable to verify that one's partners are themselves properly registered as brokers under the ITAR and at what point will liability for their transgressions be imputed? Can liability be mitigated by contractual conditions?

The *BAE* settlement undoubtedly involved considerations beyond what is reflected by or discernible from the public record. Against the backdrop of a denial policy that DDTC imposed on BAE for over a year pending settlement, as well as the prior criminal investigations and settlements, it is reasonable to presume that BAE was keen to put its troubles behind it once and for all, especially taking into account the fact that the terms of settlement did not require BAE to admit or deny liability. Perhaps in this spirit the company was willing to forgo nitpicking the terms of the settlement.

State Department officials have expressed the view in closed settings that the case is, more or less, sui generis. In other words, one should not read too much into DDTC's specific verbiage, as the principal intent of the settlement was to signal DDTC's unique concerns with BAE, not to establish precise legal precedent.[13] But it is difficult to square this suggestion with the fact that the case far exceeds any prior ITAR enforcement action in terms of charges and penalties and is the first to focus on brokering. It seems hard to believe that a case of such novelty and significance would be intended to have such a limited impact.

Both DDTC and the international defense trade exporting community acknowledge that ITAR compliance is challenging and that many aspects of the ITAR are susceptible of varying good faith interpretations. Trade compliance professionals reasonably look to ITAR settlement documents so they can understand with greater clarity what constitutes compliant conduct, conform their activities to DDTC's expectations, and strengthen their compliance programs in line with the best practices reflected by the mandatory compliance measures imposed on companies in consent agreements.

When a case provides ambiguous notice of what constitutes the elements of a violation, it is a missed opportunity to educate the public and foster improved compliance. In the same manner that ancient soothsayers sought to divine the future by inspecting the entrails of sacrificial animals (known as "haruspicy," by the way), we are left to draw our own uninformed conclusions, with the same likelihood of accuracy (and potentially messy results).

An unfortunate consequence of the *BAE* settlement is that while BAE and DDTC have come to terms, everyone else is left to wonder what constitutes brokering under the ITAR. Or perhaps the more apt question is what *does not* constitute brokering? And if the legal elements of brokering indeed are potentially as elastic and inscrutable as implied by the public information in that case, how is effective Part 129 compliance attainable at all?

Certainly one way that DDTC could mitigate the (presumably) unintended consequences of the *BAE* settlement would be to publish for comment at long

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13 See, e.g., *Washington Tariff and Trade Letter*, vol. 31, no. 29 (July 18, 2011), available at <www.wttlonoline.com> (last visited July 27, 2011) (quoting DDTC enforcement director Lisa Aguirre as stating, "As far as a take away, I'd be careful, because it is not articulated. . . .)."

last the official notice of the revised brokering rules, with great deference given to the DTAG's sensible recommendations. Given the leadership that DDTC has demonstrated in the ongoing U.S. export control reform process, especially its thoughtful efforts to engage with the public on proposed rule changes, it is with a fair degree of optimism that we might expect clarity in the near future on ITAR brokering to address the questions raised by the *BAE* case and hopefully with the recognition that we, the exporting community, are eager for clear and authoritative guidance that will enable us to conform our conduct to DDTC's expectations without having to rely so heavily on haruspicy, or fear of becoming the next sacrificial goat.

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