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FEATURE COMMENT: DOD Issues New Proposed Rule On Export-Controlled Items In Defense Procurement

On August 14, the Department of Defense issued a proposed rule to amend the Defense Federal Acquisition Regulation Supplement addressing the treatment of export-controlled information and technology in defense procurement. See 71 Fed. Reg. 46434. This new version was issued primarily because of perceived flaws in the initial proposed rule on the topic, dated July 12, 2005 (see 70 Fed. Reg. 39976), which generated significant public comment from industry and research universities.

The new proposed rule considerably scales down the ambitious requirements set forth in 2005. However, it still contains several provisions that may be difficult to manage in practice. Public comments are due October 13.

The July 2005 Initial Proposed Rule—The original rule was created with a salutary purpose: to help ensure that export-controlled information and technology is identified and treated properly in defense contracts. With that in mind, the rule required that DOD contractors (1) maintain an export compliance program, (2) conduct training on export compliance controls, (3) perform periodic assessments and (4) develop an access control plan that includes badging and segregated work areas.

A significant problem with the initial proposed rule was DOD's lack of statutory authority to create a "supplementary" export control regime. The departments of State and Commerce—and, to a lesser degree, the departments of the Treasury and Energy, and the Nuclear Regulatory Commission—regulate export activity in the U.S. pursuant to statute. In other words, although DOD directives

and guidance sometimes discuss export controls, DOD itself does not make export control rules. Thus, although the requirements listed above are prudent compliance measures for most defense contractors, their mandate by DOD is problematic because neither the State Department's International Traffic in Arms Regulations (ITAR), which regulate military items, nor the Commerce Department's Export Administration Regulations (EAR), which regulate dual-use items, contains any such explicit requirements. Consequently, the initial proposed rule raised questions as to DOD's authority in this area, including the exercise of regulatory power by an agency lacking legal jurisdiction.

Moreover, the initial proposed rule raised potentially thorny issues of attorney-client privilege and disclosure to the Government. For instance, if "periodic assessments" were required by the DFARS, the Government might argue that such assessments—even if conducted by counsel—should be provided to the Government, particularly if they are financed under cost-reimbursement contracts. Again, while both State and Commerce urge companies to engage in periodic assessments, unless a particular company is subject to a consent decree as a result of settling allegations of export control violations, such assessments are not mandatory under the ITAR or EAR. Therefore, the initial rule might have taken the "voluntary" out of "voluntary disclosure."

The August 2006 Proposed Rule—The new proposed rule does not contain the expansive compliance requirements of the original proposal. This change likely responds to the significant number of industry commentators expressing concern that the rule was too broad. Moreover, in light of significant input from the higher education community, the new rule makes clear that it is not further circumscribing the fundamental research exception to certain export control rules, but, instead, is reminding universities of the existence of—and their need to comply with—particular aspects of Commerce and State export control rules.

That said, other aspects of the new proposed rule may merit rethinking or modification. In

particular, the new proposed rule retains a requirement that a contracting officer identify all export-controlled information and technology on a contract as determined by the requiring activity, i.e., the DOD customer. Moreover, if changes are made to the contract, the parties are supposed to work together to continue identifying export-controlled information, and the contract is to be modified to reflect the status and categorization of the new information. The added clause must flow down to subcontractors at any tier that need access to or will generate export-controlled information or technology.

In theory, the above requirements are good ideas. Obviously, it is important for the Government, contractors and subcontractors to know and understand what is and is not export controlled with respect to a particular defense contract. Indeed, identifying sensitive items and technologies early in contract performance or, preferably, even at the time of initial bid or proposal preparation—so that compliance can be worked into staffing and cost assumptions—helps all parties. In practice, however, there are several reasons why the requirement that all export-controlled technology and information be identified, and that corresponding contract modifications be issued, may be unworkable.

Overly Expansive Definition of Export-Controlled Information and Technology: As a legal matter, essentially all U.S.-origin information or technology is “export controlled,” as long as it is not publicly available. In other words, even technical data for how to manufacture a tennis ball, and tennis balls themselves, are export controlled to some end users, e.g., embargoed countries and debarred parties. Therefore, if the proposed rule’s requirement of listing everything subject to export controls is applied literally, the list of information or technology set forth by the CO essentially will enumerate every single technical aspect of every single contract. This is a significant undertaking with little value, unless highly sensitive items and technology are differentiated from lightly controlled items and technology.

One alternative is to require the CO to list only information and technology that the CO and the requiring activity believe are controlled by the ITAR and designate the ITAR category, and portions of the contract that are on the EAR’s Commerce Control List (i.e., dual-use items) and the applicable Export Control Classification Number (ECCN). If that were the case, then the rule could bypass listing minimally

controlled items and technology identified as “EAR 99” in Commerce Department regulations. However, even this approach would require extensive listing of items and technology on the Commerce Control List that are not restricted for export except to a handful of countries; thus, listing such items would not contribute to national security in this context, while the administrative burden would be significant.

Another option is to clarify that CO designations are not binding or legally dispositive, but are more of an aid to the contractor. The CO, for example, designates information that “may be export controlled,” depending on how the contractor performs the contract, staffs it, subcontracts, etc.

Contracts in Which Export Controls are Subsumed by Industrial Security: There may be circumstances that do not require identification of items by ITAR category or ECCN. For instance, many defense contracts have a workforce that is entirely cleared, and all subcontracting activity is both domestic and cleared. In these cases, traditional concerns regarding “deemed” exports of technology to foreign nationals are absent because, in most circumstances, the workforce involved comprises cleared U.S. citizens who do not pose export control concerns. Consequently, unless there is unclassified subcontracting or shipments going abroad, the need to identify items by ITAR category or ECCN is unnecessary and a waste of either Government or contractor time and resources. Perhaps, then, this DFARS provision should apply only to circumstances in which “exporting”—and thus the attendant export control compliance risks—is a credible possibility.

Jurisdictional Disputes over Scope: Having the CO designate what is export controlled may be helpful to all parties, but should not be definitive, as it may confuse the “legal” export control status of certain items and technologies. Apparently, although the rule contemplates the possibility of communication between DOD and the agencies of jurisdiction (State and Commerce), one can imagine instances in which the DOD CO or requiring activity does not identify as controlled an item that a regulating agency considers controlled, and State or Commerce initiate enforcement proceedings against an unwitting contractor. (It is unclear whether DOD’s determination could serve as a mitigating factor in a State or Commerce enforcement action.) Alternatively, out of an abundance of caution, the DOD CO may over-designate items as controlled and create an unneces-

sary compliance burden for the contractor. Indeed, the rule does not contemplate any mechanism for resolving differences of opinion between DOD COs and contractors. In short, CO determinations could become a two-edged sword. Another option is to allow the contractor to make the ultimate decision at its own risk, thereby giving the contractor the option of seeking formal export control classifications from State or Commerce, if the process can be managed in a timely manner, or relying on expert counsel assistance and evaluation.

Logistical Process of Modifying Contracts: Modifying contracts is never easy. Indeed, it is often difficult enough for contractors to incorporate the most recent FAR clauses into a contract. This situation is exacerbated if every technological change occurring during the course of a contract requires a formal modification to account for export control issues. This will be particularly true immediately after the rule's implementation, as relatively few COs have extensive training in export controls and face a steep learning curve. Perhaps DOD can solve the problem, however, by providing its acquisition workforce additional, necessary export control training resources.

Conclusion—In sum, to “contractualize” some aspects of export control laws in defense contracts is not a bad idea, but it should be done with care. Fortunately, public comments on the first proposed rule prompted DOD to recognize that its requirements cannot exceed those of the departments of State and Commerce. However, the new proposed rule still has wrinkles that need ironing out. If DOD continues to listen to public comment and revise the rule, the final version may enhance the DOD contracting community's awareness of—and compliance with—export controls, while minimizing the risk and costs—for contractors and the Government—of regulatory compliance.



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