

DTAG Working Group



**Reporting Changes in Ownership or Control
by 126.1 Persons of Recipients of
US-Origin Defense Articles & Services**

In Preparation for DTAG Plenary Session

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Initial Tasking

DTAG request:

"Entities that receive defense articles, defense services, or related technical data pursuant to licenses or exemptions may find themselves **under new ownership or control by entities or individuals from 126.1 countries.**

To ensure that the parties best situated to inform DDTC of these changes have a process to do so, **please identify the issues that exist in establishing such a process and what options DDTC has to address them."**



Tasking Restated

- How can industry help DDTC discover when a recipient of U.S.-origin defense articles and services becomes owned or controlled by a 126.1 entity?
- *This is an export authorization issue under ITAR Parts 123-126, not an M&A issue under Part 122, because Part 122 regulates only the U.S. exporters, not foreign recipients.*



Assumptions

- Only changes in ownership and control (“O/C”) of foreign recipients and intermediate consignees of U.S.-origin defense articles are at issue.
 - Because changes in O/C of U.S. entities by foreign entities is a CFIUS review/ existing Section 122.4 matter outside the scope of this discussion.

Issue # 1: Location of Entities and Citizens of 126.1 Countries



Q: Does DDTC want information about O/C changes by any person located in or acting on behalf of a prohibited country (as currently stated in 126.1) or also about any person who is owned or controlled by a person who is a citizen of a proscribed country regardless of location?

Example: Would information about an export to a French company be required if that French company becomes controlled by a Chinese citizen living in France?



Issue # 2: How Much Diligence is Due?

- If DDTC requires US exporters to report to DDTC the O/C of foreign recipients, how will the U.S. exporter discover that information?
- Using "reasonable due diligence" may reveal a well-publicized Chinese buy-out, but few companies have access to non-public information.
 - Companies such as Dow Jones and Thompson/Reuters sell such information, but it may be too expensive and burdensome for smaller companies.

Issue # 3: What is the scope of review?



- Should the exporter be responsible to report changes only for new exports and services or to continue look for changes O/C on licenses and agreements for as long as they remain valid?
 - *The burden of continuing O/C reviews for thousands of valid licenses and agreements would be unreasonable*
 - *O/C review before every use of an exemption would be unmanageable.*

Issue # 4: Limited Access to Non-Public Information



- U.S. parties who ask foreign recipients for detailed O/C information may face objections because of:
 - Foreign privacy laws such as GDPR* prevent companies from asking about, or if they know, revealing the nationality of an owner;
 - Reluctance to share proprietary information with industry;
 - Prohibition on revealing information covered by non-disclosure agreements (standard in M&A).

* *EU General Data Protection Regulation 2016/679.*



Existing Regulations

§ 120.37 Foreign Ownership and Foreign Control

Foreign ownership: 50 percent or more of the outstanding voting securities

Foreign control: 25 percent or more of the outstanding voting securities



Applicable Existing ITAR Sections

126.1(a). “It is the policy to deny licenses and other approvals for exports and imports of defense articles and defense services destined for or originating in certain countries. ...”

– *But the above does not state that the current policy is to deny approvals to companies that are or become owned or controlled by persons in 126.1 listed countries or persons who are citizens of 126.1 countries.*



Applicable Existing ITAR Sections

126.1(e)(1) “Proposed and final sales. No sale, export ... any defense articles or defense services...may be made to any country referred to in this section...or to any person acting on its behalf...without...approval of [DDTC].”

126.1(e)(2) “Duty to notify. Any person who knows of an export described in paragraph (e)(1) of this section must immediately inform [DDTC].”

- *So the US exporter is already required to inform DDTC if it becomes aware that an item will be exported to a person acting on behalf of a 126.1 country, but what about O/C by a citizen of a 126.1 country who is not acting on behalf of that country? Report still required?*

Applicable Existing ITAR Sections



§ 123.9 Country of Ultimate Destination and Approval of Reexports or Retransfers

“(a) . . . Exporters must determine the specific end-user, end-use, and destination prior to submitting an application to the Directorate of Defense Trade Controls or claiming an exemption under this subchapter.

Note to paragraph (a): In making the aforementioned determination, a person is expected to review all readily available information, including information readily available to the public generally as well as information readily available from other parties to the transaction.”

DDTC Notice on License Support Documentation (published 2008)



“Section 123.1(c)(4) ... establishes that [DDTC] may require all pertinent documentary information in order to consider the issuance of a license or other approval. DTCL may require a signed contract to be submitted with any application for the permanent export of defense articles. ... The [PO], letter of intent, or other documentation must state the ultimate end-user and end-use of the requested defense articles. ... ”

Option Considered – ITAR Amendments



Amend § 124.7 to require all parties to the agreement to report to DDTC if any party is or will likely become owned or controlled by a person who is a citizen of or is located in a proscribed destination.

Amend § 123.1(c) to require information on O/C as a condition to the issuance of a license or other approval.

Option Considered – ITAR Amendments



Amend § 123.9(b) to require the commercial invoice to include the requirement for the recipient entity to state that:

- it is not owned or controlled by a person who is a citizen of or located in a proscribed destination under § 126.1 of this subchapter, and that
- it will report to DDTTC if the recipient becomes owned or controlled by a person who is a citizen of or is located in a proscribed destination under § 126.1 of this subchapter.



Concerns with ITAR Amendments

- Many foreign country laws (e.g., GDPR) prohibit the collection of this information, and even if they have the information, prohibit sending it to the United States.
- Foreign recipients may be unwilling to commit to a purchase from a U.S. supplier if the purchase is subject to the risk that those articles or services will be suspended or revoked by the failure of the recipient to provide information that is unobtainable or would be prohibited by local law.



Summary

DTAG supports the efforts of DDTC to determine, through voluntary methods, when persons or entities in or from 126.1 countries gain ownership or control of recipients of U.S.-origin defense articles and services.

However, DTAG believes that amending the ITAR to require either U.S. registrants or foreign recipients to supply such information to the U.S. registrant would be unworkable.

THE END.

Thanks for your attention.