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In Compliance....

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The New Export Player: the U.S. Department of Defense

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On August 14, 2006, the Department of Defense (“DOD”) published its second proposed rule regarding the inclusion of export clauses in certain U.S. Government contracts. These rules substantially limit the obligations contractors and subcontractors (collectively “contractors”) must meet in comparison to the requirements published on July 12, 2005. Originally, the rule identified specific compliance program obligations contractors needed to satisfy DOD, in addition to placing the burden on the contracting officers to classify technology, services and technical data within affected acquisitions. The August 14th rule substantially alters the original requirements and:

places the burden on the “requiring activity” and the contracting officer to identify export-controlled information and technology and reference the appropriate International Traffic in Arms (“ITAR”) or Export Administration Regulations (“EAR”) cites; and

provides little guidance to contractors on the substantive compliance obligations created by the inclusion of the export clauses in affected Government contracts.

In addition, the revised rule suffers from a number of serious infirmities, a few of which are noted below. At a minimum, DOD and contractors need to be aware of the following:

1. The exclusion of hardware from export controls. The scope of the rule limits its applicability to information and technology. Rarely, however, does the Government seek contracts for information or technology that is devoid of application. Concept studies and related assessments, even in the abstract, are tied to some product or innovation that likely includes the creation or use of hardware or software. The exclusion of hardware – either as the product or as the equipment that could be used to produce the subject of the Government contract – leaves a gap in the regulations through which one could drive a truck.

2. The rule places the export determinations on DOD personnel, not the contractor. In the abstract, requiring DOD to advise a contractor whether export-controlled information will be used or produced through a Government contract appears to make sense. However, that obligation represents only half the equation. Even if DOD identifies export-controlled information or technology in a solicitation, the regulation permits that designation to be challenged or claimed as “fundamental research” but does not provide any liability protection from later assertions that the challenge was justified. Because the Arms Export Control Act (“AECA”) does not vest DOD with any licensing or jurisdictional authority, a question exists as to whether a contractor could reasonably rely on the export determinations included in any Government contract.

3. The rule narrowly identifies those circumstances where

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export-controlled clauses must be flowed down. As noted by several commentators, universities present a unique challenge for contractors in that universities consistently refuse to comply with export laws and regulations. Under the ostensible umbrella of “fundamental research” or “burdens” associated with identifying foreign nationals on campus who could participate in Government contracts, contractors are faced with a Hobson’s choice of either not working with the institutions or seeking some middle ground that leaves both parties in noncompliance. This rule does not adequately address the risks taken by contractors in instances where universities refuse to incorporate

mandatory flowdown clauses nor does it sufficiently identify the limits that exist within the definition of “fundamental research.” This infirmity leaves both the Government exposed from a national security perspective and the contractor exposed to severe fines and penalties in case of violations. To date, with the exception of the Office of Foreign Assets Control, neither the Department of State nor the Department of Commerce has published an enforcement action against any university, even though the General Accountability Office has indicated in a number of reports that violations exist in that arena. The use of these clauses in Government contracts, therefore, begins with the rebuttable

presumption that noncompliance is likely.

DOD and contractors should consider the utility of this type of regulation when the ultimate result is not likely to protect national security nor provide the certainty that is needed for DOD and contractors alike to handle export-controlled information and technology properly.

About the Author

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