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international trade and government contracts alert

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DoD Contractors and Subcontractors: Are You Complying with the New Flowdown Notice Requirement on U.S. Export Control Laws?

Compliance with U.S. export control laws is critical during this time of heightened enforcement. A recent U.S. Department of Defense ("DoD") Final Rule requires that a clause mandating strict compliance with U.S. export control laws and regulations be included in all DoD solicitations and contracts, including contracts between prime contractors and subcontractors. On April 8, 2010, the DoD amended the Defense Federal Acquisition Regulation Supplement ("DFARS") to include this new requirement, which is provided at DFARS, 252.204-7008.[1] This "flowdown" clause must be contained in all subcontracts arising from a DoD prime contract.

Background

As finalized, the DFARS clause imposes upon contractors the following obligations:

- *The Contractor shall comply with all applicable laws and regulations regarding export-controlled items, including, but not limited to, the requirement for Contractors to register with the Department of State in accordance with the ITAR.*
- *The Contractor's compliance responsibility regarding export-controlled items exists independent of, and is not established or limited by, the new clause.*
- *The Contractor shall consult with the Department of State regarding any questions relating to compliance with the International Traffic in Arms Regulations (which govern defense articles and defense services and associated technical data) and shall consult with the Department of Commerce regarding any questions relating to compliance with the Export Administration Regulations (which govern civil and "dual use" items and technology).*
- *The Contractor shall include the substance of the DFARS clause, including the requirement to further flow down the clause, in all subcontracts.*

The U.S. Department of State's Directorate of Defense Trade Controls ("DDTC") administers the ITAR, which regulates the temporary import, and temporary or permanent export, reexport, transfer or retransfer, *including to non-U.S. persons in the United States*, of defense articles, technical data, and defense services. *Any such exports, reexports, or retransfers must be licensed by DDTC absent a license exemption*. Companies that manufacture defense articles or provide defense services are required to register with DDTC even if they do not engage in any actual export activity that may require a license.

The Department of Commerce's Bureau of Industry and Security ("BIS") controls the exports of dual-use (military and commercial) technology and products. Under the BIS regulations, an item's license requirements are dependent upon factors such as an item's technical characteristics, the destination, the end-user, and the end-use.

Oddly, the new DFARS provision is silent with respect to other export-related requirements such as the Office of Foreign Assets Controls ("OFAC"), Department of the Treasury's economic and trade sanctions against targeted foreign countries and regimes (*e.g.*, Cuba, Iran, North Korea, Sudan), terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy or economy of the United States.

Implications for Government Contractors

Defense contractors take note -- the final rule requires the clause to be included in every DoD solicitation and contract. The interim rule, required the inclusion of the clause *only* when the contracting agency determined that export-controlled items were expected to be involved in the performance of the contract. According to DoD, the final rule "clearly makes the point" that the contractor is responsible for understanding and complying with all applicable laws and regulations, independent of the DFARS clause. Unlike earlier proposed and interim rules, the final rule does not require that Contractors and Subcontractors adopt any particular type of compliance system or training programs.

Also, the new rule requires contractors to flow down this clause and integrate it into agreements with subcontractors. This reflects an increased emphasis by DoD on compliance with export controls by prime and sub-contractors, despite the fact that sub-contractors may have less experience in export activities. It might never occur to a sub-contractor that hiring a foreign national employee is treated as a deemed export or that answering a technical question from a foreign source via e-mail might constitute an export violation. Unfortunately, it is not uncommon for U.S. Government contractors, especially smaller companies that do not seek out international work or engage in traditional export activity, to be unaware of ITAR registration and ITAR and EAR licensing requirements.

Finally, while the clause does not include language setting forth a specific contractual remedy in the event of

a breach, it does illustrate the inherent contractual obligations of compliance requirements. Subsections (c) and (d) of the DFARS, 252.204-7008 clause state clearly that parties ultimately remain subject to the full scope of U.S. export control laws and regulations beyond the confines of the contract at issue, as well as the accompanying penalty provisions, which can be assessed at up to $500,000 per civil violation and up to $1 million per criminal violation and/or imprisonment, along with the denial of export privileges and other penalties depending upon the particular violation.

A good starting point for government contractors to ensure compliance with the DFARS export requirement is the implementation of an effective export compliance program. Key elements of such a program include:

- Developing written export policies and procedures;
- Establishing procedures to properly classify items, technology and services for licensing purposes and determining whether the company is required to register with DDTC as a manufacturer of defense articles or provider of defense services;
- Analyzing available license exceptions or exemptions;
- Limiting employee access to export-controlled projects to appropriate U.S. persons or foreign persons licensed by DDTC or BIS;
- Enforcing and publicizing the export policy through compliance monitoring and annual employee training; and
- Maintaining accurate and complete books and records.

With record numbers of investigations and multi-million dollar penalties imposed for U.S. export control violations, it is critical to ensure that your company is complying with this requirement and, if appropriate, putting your defense subcontractors on notice, as well.

For assistance navigating these reforms; enhancing and/or modernizing your company's export compliance program; or reviewing your current U.S. Government contract provisions, Venable can help. For more information, please contact: Lindsay B. Meyer at lbmeyer@Venable.com or 202.344.4829; Carrie A. Kroll at cakroll@Venable.com or 202.344.4574; Andrew Bigart at abigart@Venable.com or 202.344.4323; Terry Elling at tlelling@Venable.com or 202.344.8251; Jeff Chiow at jchiow@Venable.com or 202.344.4434; or any member of Venable's International Trade or Government Contracts teams.

1. Defense Federal Acquisition Regulation Supplement: Export-Controlled Items (DFARS Case 2004-D010) 75 Fed. Reg. 18,030 (April 8, 2010), codified at 48 C.F.R. § 204.73.