Chapter 3

Treaty between the Government of Australia and the Government of the United States of America concerning Defense Trade Cooperation

3.1 The *Treaty between the Government of Australia and the Government of the United States of America concerning Defense Trade Cooperation* (the treaty) was signed by the former Prime Minister John Howard on 5 September 2007 at the time of the 19th APEC Ministerial Meeting in Sydney.[1] The Implementing Arrangement was signed on 14 March 2008. The Implementing Arrangement details the way in which the treaty will be implemented in both countries.[2] Part 3 of the bill implements the treaty.

3.2 The purpose of the treaty is to remove selected export restrictions on defence trade between Australia and the US. Implementation of the treaty is intended to create a simpler, more cost effective system.[3] Defence noted in evidence that:

> The Treaty framework is intended to remove the administrative delays associated with existing Australian and US export-licensing systems. It is expected to reduce delivery times for new projects and improve program schedules…It is intended to increase opportunities for Australian companies to bid on eligible US contracts…and to reduce obstacles for improved cooperation between US and Australian companies, which will benefit Australia's defence capability.[4]

3.3 The current US defence export control system, the International Trade in Arms Regulations (ITAR), requires that licences are sought for each separate trade transfer. Under the treaty, the US and Australia will create a framework which allows licence-free trade within an Approved Community.[5]

3.4 The treaty was considered by the Joint Standing Committee on Treaties (joint committee) which, after noting the concerns of some submitters in regards to the cost

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1 Joint Standing Committee on Treaties *Report No. 94*, 14 May 2008, p. 33.

2 Parliamentary Library, *Bills Digest No. 91, 2011-12*, 22 February 2012, p. 4; Article 14, *Treaty between the Government of Australia and the Government of the United States of America concerning Defense Trade Cooperation*.

3 Parliamentary Library, *Bills Digest No. 91, 2011-12*, 22 February 2012, p. 5.

4 Mr Michael Shoebridge, First Assistant Secretary Strategic Policy, Department of Defence, *Committee Hansard*, 2 March 2012, p. 30.

5 Parliamentary Library, *Bills Digest No. 91, 2011-12*, 22 February 2012, p. 6.

of implementing the treaty, recommended that binding action be taken in regards to the treaty.[6]

3.5 The majority of submissions received by the Senate Foreign Affairs, Defence and Trade Legislation Committee in regards to the bill expressed support for the aims of the treaty and the opportunities outlined by Defence.

Obligations under the treaty

3.6 The Defence Trade Controls Bill 2011 and the draft Defence Trade Controls Regulations 2012 address the domestic ratification requirements of the treaty. In the US, reforms to ITAR are being completed as part of ratification requirements. The treaty will come into force when Australia's and the United States' domestic requirements are complete.

3.7 Part 3 of the bill implements the treaty and comprises, amongst other things, the criteria for membership of the Australian Approved Community. Parts 4 and 5 of the bill detail the monitoring powers given to the Defence to ensure compliance in relation to the Australian Approved Community. Part 6 lists record keeping requirements for members of the Australian Approved Community.

Approved Community under the treaty

3.8 The treaty removes the requirement for a license or permit to be obtained for each transaction conducted by members of the Approved Community, and instead imposes obligations in relation to Australian and US Defence Articles traded or transferred under the treaty.[7] 'Under articles 4 and 5 respectively, Australia and the US agree to establish, maintain and monitor an Approved Community of government facilities and non-government companies'.[8] Defence has stated in relation to the Approved Community that:

> Applying for membership in the Approved Community will be a voluntary commercial decision. Those entities that choose not to join the Treaty will continue to operate within existing Australian and US defence export controls…Entry into the Australian Approved Community will be a commercial cost-benefit decision for individual companies, based on the level of businesses a company is likely to undertake with the US Government or with US defence companies.[9]

3.9 In its report on the treaty, the joint committee noted that:

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6 Joint Standing Committee on Treaties *Report No. 94*, 14 May 2008, p. 43.

7 Joint Standing Committee on Treaties *Report No. 94*, 14 May 2008, p. 35.

8 Joint Standing Committee on Treaties *Report No. 94*, 14 May 2008, p. 35.

9 Defence Export Control Office, *The Defence Trade Cooperation Treaty – Defence Export Control Office Booklet*, date not supplied, p. 1 of 2, http://www.defence.gov.au/deco/publications/brochures/DTCT.pdf (accessed 3 August 2012).

> …it is clear from the evidence that those companies who are not a part of the Approved Community will be at a competitive disadvantage.[10]

3.10 Under article 14 of the treaty, an Implementing Arrangement has been signed by both Australia and the US. The Implementing Arrangement 'supplements the provisions of the treaty by prescribing detailed procedures and standards to be adopted by the Parties'.[11] Included in the Implementing Arrangement are, amongst other things, arrangements for inclusion of an Australian entity in the Australian Approved Community and exemption of certain Defence Articles from the scope of the treaty.[12]

Approved Community–provisions in the bill

3.11 The bill lists three groups who make up the Australian Approved Community:

- A person who is a body corporate and holds a clause 27 approval;
- Employees or persons engaged under a contract for services by a body corporate approved under clause 27 can also be a Australian Community member if they meet the requirements to be specified in the requirement to be specified in the regulation under the bill; and
- Federal, State and Territory Government employees with the required minimum security clearance and a 'need to access' US Defence Articles.[13]

3.12 Clause 27 of the bill allows a person who is a body corporate to apply to the Minister for Defence for approval to be a member of the Australian Approved Community. In assessing the application, the Minister must have regard to the criteria set out in subclause 27(3).

3.13 Subclause 28(4) creates an offence for an Australian Approved Community member who holds an approval under clause 27 but does not comply with a condition specified in the regulations. The maximum penalty for this offence is up to 600 penalty units. A strict liability offence in relation to failure to comply with a condition of approval is created by subclause 28(5) and this offence attracts a maximum penalty of up to 300 penalty units.

Approved Community–concerns raised by submissions

3.14 In general, submitters saw the implementation of the treaty and the removal of the obligation to have a permit under the ITAR process to be positive for Australian industry. However, a key source of concern was that the process for becoming a member of the Approved Community would be onerous, both in terms of cost and of

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10 Joint Standing Committee on Treaties *Report No. 94*, 14 May 2008, p. 41.

11 Joint Standing Committee on Treaties *Report No. 94*, 14 May 2008, p. 36.

12 Joint Standing Committee on Treaties *Report No. 94*, 14 May 2008, pp. 36-37.

13 Defence Trade Controls Bill 2011, *Explanatory Memorandum*, pp. 61-62.

time. The Defence Teaming Centre noted the 'significant investment' needed to introduce an ITAR control regime into a company and that:

> Companies who must operate in multiple export environments will not be able to take advantage of the treaty, as the conflict between ITAR guidelines and the access needed by dual—or third country—nationals to the materiel is too great. The conflict between ITAR rules and access provisions for other control regimes will impact companies across the entire industry, including Prime contractors, Small and Medium Enterprises and ancillary service providers such as freight forwarders.[14]

3.15 Saab emphasised that the Australian export control regime should operate without 'adding cost to either government or industry' and to 'minimise competitive hurdles for Australian Defence exports whilst retaining appropriate controls'.[15]

3.16 Submitters such as Boeing were of the view that the penalties imposed under the Approved Community structure may deter potential participants. One corporation's confidential submission also noted that US Government approval is required for membership of the Australian Approved Community, whereas membership of the US Approved Community is based on registration with the US Directorate of Defense Trade Controls.

3.17 Defence has acknowledged that it is difficult to quantify the direct impact on industry of enforcing compliance given that the costs will vary depending on a range of factors such as the 'size of the business, the extent of their existing exports of controlled goods, services and technology and/or the maturity of their business practices, including record management'.[16] Such costs are separate to any additional costs associated with record-keeping as required under the legislation, staff training and any additional costs associated with determining whether a permit is required under the legislation. There may also be investment costs associated with denial of a permit or limitations imposed thereafter.[17] Other costs to industry which have been identified in the explanatory memorandum relate to the following:

- ensuring and maintaining facilities to meet the requirements to hold, store and protect treaty articles;
- ensuring and maintaining information technology infrastructure to satisfy the requirements to store or transmit treaty-related information electronically;

14 Defence Teaming Centre, *Submission 1*, p. 5.

15 Mr Andrew Giulinn, Saab Systems Pty Ltd, *Committee Hansard*, 2 March 2012, p. 9; Saab Systems Pty Ltd, *Submission 5*, p. 2.

16 Defence Trade Controls Bill 2011, *Explanatory Memorandum*, p. 14.

17 Defence Trade Controls Bill 2011, *Explanatory Memorandum*, p. 22.

- the time required by company employees to complete application forms and undertake training provided by the government to meet all membership requirements;
- meeting membership conditions including costs involved in the:
    a) development or amendment of existing policies and procedures to ensure authorised access to treaty articles;
    b) facilitation of internal audits to assure compliance with treaty membership obligations;
    c) assurance process and assistance to Authorised Offices in this regard;
    d) establishment and retention of records of prescribed activities;
    e) reporting to government of business conducted under the treaty framework including treaty article transfer and results of internal compliance processes.[18]

Re-export under the treaty

3.18 Under Articles 8 and 6, Australia and the US agree that members of the Approved Community may export and transfer Defence Articles without licences. Under Article 9, re-transfers and re-exports of Defence Articles require the approval of both the Australian and US Governments, although the treaty allows for some mutually determined exceptions. In Article 1 're-transfer' and 're-export' are defined as:

> "Re-export" means the movement of previously Exported Defense Articles by a member of the Australian Community from the Approved Community to a location outside the territory of Australia;
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> "Re-transfer" means the movement of previously Exported Defense Articles by a member of the Australian Community from the Approved Community to a location within the Territory of Australia.

Re-export—provisions in the bill

3.19 Clause 28 under Part 3 of the bill lists the approval conditions which must be met for organisations wishing to become a member of the Approved Community. The explanatory memorandum notes that the approval conditions stipulate that 'the re-transfer or re-export as defined in the treaty of a US Defence Article cannot occur without prior approvals of the US and Australian Governments'.[19]

18 Defence Trade Controls Bill 2011, *Explanatory Memorandum*, p. 33.

19 Defence Trade Controls Bill 2011, *Explanatory Memorandum*, p. 64.

Re-export—concerns raised by submissions

3.20 Submitters raised concerns with regards to the prohibitions on re-export under the bill: that articles exported under the treaty must not be re-transferred or re-exported outside the Approved Community. The Defence Teaming Centre noted that:

> Several companies also questioned the lack of ability to re-export goods. As many companies are performing integration work as part of a supply chain, Defence articles from the US occasionally need to be re-exported to a third country. The treaty provisions do nothing to simplify this process, and with the expansion of the control regime to cover more articles this will lead to increased overheads for supply-chain focussed companies.[20]

3.21 Mr Michael Kenneally from NewSat also raised concerns regarding re-export by contrasting the framework under the treaty with the current situation:

> We do not have the skills base in Australia to do a lot of what we are doing in terms of the design of a satellite, and so we have engaged a network of specialist advisers to help us on the Jabiru satellite program, most of them based out of the US. However, under the rules of ITAR, if we have a technical assistance agreement where US companies export to us, if we communicate that data to anyone else, that is a re-export of the technology and has to be listed on the TAA. We believe that this is one of the areas of complication for the bill as it is going forward, because re-export is not covered in the arrangements that we have seen.[21]

3.22 Defence responded to these concerns by noting that:

> The provisions of the Bill relevant to the Treaty reflect the intent of the Treaty itself, and are designed to enable simpler trade in defence goods between Australia and the US. Trade within the Treaty framework is confined to mutually agreed scope lists on which the included activities contain elements of eligible bilateral trade…As a bilateral Treaty, there was no intention to provide exemptions from existing controls for re-exports to other countries. Exports to countries other than the US will still require the authorisations they currently require under existing controls. As a result, the Bill does not change arrangements for re-exports to third countries—this type of activity will remain subject to export controls.[22]

3.23 The committee understands the background and purpose for the treaty, but notes that companies that need to pass goods through a non-Australian/non-US location as part of a supply chain would need to work under the current framework to

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20 Defence Teaming Centre, *Submission 1*, p. 2.

21 Mr Michael Kenneally, Vice President Satellite Strategy, NewSat Ltd, *Committee Hansard*, 2 March 2012, p. 16.

22 Defence, answers to questions on notice from public hearings, 2 and 21 March 2012 (received 20 June 2012), p. 16.

obtain permits for that location. For some companies, this would make becoming a member of the Approved Community less attractive.

Recordkeeping under the treaty

3.24 Article 12 of the treaty stipulates that each Party require entities within the Approved Community to 'maintain detailed records of all [Exporting, Transferring, Re-transferring, Re-exporting or receiving Defense Articles] movements'.[23]

3.25 Article 12 also requires that the records maintained by entities in the Approved Community be available on request to the other Party, in accordance with procedures under the Implementing Arrangements.

Recordkeeping–provisions in the bill

3.26 Part 6 of the bill outlines the requirements for the making and retaining of records as part of the Approved Community. Subclauses 58(1) to (5) provides that separate records must be kept; the time in which they must be made; and the retention of the record. Subclause 58(4) notes that the form of record may be prescribed in the regulations. Subclause 58 (6) creates an offence in relation to failure to create and retain the required records.

3.27 Clauses 59 to 62 deal with the production and inspection of records and create an offence for failure to comply with a notice to produce records (subclause 59(4)). Further information regarding record keeping requirements is also detailed in the regulations at regulation 31.

Recordkeeping–concerns raised by submissions

3.28 In its submission, Boeing argued that clarification was needed regarding the practicalities of record-keeping requirements and in particular the scope of the requirements. Boeing noted:

> For example, Section 51, subsection 1 requires the creation of 'a separate record of each activity that the person does under a permit.' For services and intangible transfers in particular, individualized record-keeping is very difficult to achieve, and could amount to many thousands of entries. As drafted, the current language does not explain whether a record is required for each controlled defence service, or if every individual email, telephone call, or fax constitutes a separate, recordable export of intangibles subject to export controls. Although some of these questions may be addressed in the more detailed implementing regulations, it is important to include clarifying language in the Bill itself, taking into consideration the practical aspects of each recordkeeping requirement.[24]

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23 Article 12, *Treaty between the Government of Australia and the Government of the United States of America concerning Defense Trade Cooperation*.

24 Boeing Australia and South Pacific, *Submission 6*, p. 3.

3.29 In Saab's view, companies will have an added compliance burden with regards to record-keeping, and the differences between requirements for the Approved Community and those for the strengthened export controls:

> There is a lot more required at the back end—for instance, on the record-keeping side because we suddenly have to keep track of a whole lot of stuff in a way that we did not have to before. We need to make a distinction between this bill's implementation of the treaty and the other two aspects of this bill, which are intangible and brokering controls, which are purely Australian.

3.30 Defence noted that Saab was correct in that the record-keeping requirements for the strengthened export controls and those for the movements of defence articles under the treaty are different:

> While Defence is able to vary the record-keeping requirements for strengthened export controls, the record keeping requirements in the Bill and the Regulations for Treaty activities have some flexibility but need to reflect Australia's commitments under the Treaty. As the Regulations are currently drafted, the record-keeping requirements for the strengthened export controls and those implementing the Treaty provisions have a high level of consistency. Any changes to the record-keeping requirements for strengthened export controls and Treaty activities may be different for each area and may introduce inconsistency between the Treaty and the strengthened export control record-keeping requirements.[25]

3.31 Given submitters' concerns regarding the definition of a record and the practical considerations of making and retaining records, the committee asked Defence if it would consider providing examples in the legislation or the explanatory memorandum. The committee is encouraged by Defence's response that 'the Government is considering options to amend the record-keeping requirements in the Regulations to include a minimum of information'.[26]

Recommendation 5

3.32 The committee recommends that Defence undertake consultation with industry in order to eliminate unnecessary record-keeping.

Security procedures under the treaty

3.33 Articles 6, 8 and 11 of the treaty 'require each Party to establish procedures to ensure that all Defence Articles are clearly marked or identified as being traded pursuant to the treaty at various points of their movement'.[27]

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25 Defence, answers to questions on notice from public hearings, 2 and 21 March 2012 (received 20 June 2012), p. 14.

26 Defence, answers to questions on notice from public hearings, 2 and 21 March 2012 (received 20 June 2012), p. 16.

27 Joint Standing Committee on Treaties *Report No. 94*, 14 May 2008, p. 35.

3.34 Security procedures, including marking and identification of Defence Articles, are detailed in the regulations at Part 3.

Security procedures—issues raised by submissions

3.35 In its evidence to the committee, Ms Stephanie Reuer from The Boeing Company raised concerns that the marking of goods and technology may cause concern for companies. She noted:

> ...the significant effort associated with the required marking and re-marking of items and data. This requirement may create an environment in which companies elect to forgo some of the advantages of the treaty. We recommend that the marking be accomplished through the marking of associated commercial documents normally provided with shipments.
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> ...
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> With the way the treaty is written, items would have to be physically marked in some manner, unless it was impracticable to do so. The examples given are aerosols and chemicals. But in the aerospace and defence business, marking components or subassemblies is a very, very difficult thing to do and a very costly thing to do. We also have to be concerned in this business about foreign object debris. So having to mark those parts is, I think, a considerable request. Once items come into the community they have to be marked. If you need to send them back to somebody outside the community for whatever reason, maybe the supplier is not part of the community, they have to be unmarked. Then if they come back in, they have to be re-marked. So you can see that that constant marking and re-marking can be very dissuasive to treaty use.[28]

3.36 Defence noted that similar concerns had been raised in regard to the regulations, and advised:

> Marking requirements to Treaty articles were seen to be onerous and unclear—Defence has raised this issue with the US and the common understanding is that marking of items is only required where it is practicable to do so—more specific implementation guidance will be developed.[29]

3.37 The committee notes that marking and handling of Defence Articles is a condition placed on members of the Approved Community. Under clause 28 of the bill, members of the Approved Community commit an offence if they fail to comply with any of the conditions of membership. In order to encourage industry to become

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28 Ms Stephanie Reuer, Director, Global Trade Controls, The Boeing Company, *Committee Hansard*, 21 March 2012, pp. 2-3.

29 Defence, answers to questions on notice from public hearings, 2 and 21 March 2012 (received 20 June 2012), p. 10.

members of the Approved Community, it is important that the sector is provided with clear practical guidance on matters such as marking requirements.

Transitioning provisions in the bill

3.38 Under Division 5 of the bill, clause 35 details procedures for transitioning Defence Articles from a previous licence to the framework established under the treaty. Under subclauses 35(1) and (2), a person must make an application to the Minister in regards to transitioning the Defence Article.

3.39 Subclause 35(5) provides that, should the Minister refuse the transition, then the Minister must inform the person of the refusal and the reasons for the refusal.

3.40 Saab made some comments in relation to the transitioning provisions, raising concerns regarding the 'practical implications of the different requirements of the proposed US and Australian implementations of the treaty with regard to the transition from existing ITAR export licences to the treaty exemption to ITAR of US-controlled items already in Australia'.[30] Mr Giulinn advised the committee, in relation to this concern, that Saab had discussed the issues with Defence. As a result:

> The department have indicated it has been proposed to the US that all transitions to the treaty instigated by Australian companies are done through the department, providing a single interface with the US Department of State on such matters. The two reasons for that being suggested are (1) it would make it easier for the Australian companies because we do not have to know who to talk to at the US Department of State and follow US processes that we are not familiar with and (2) the Australian department would know which items are being moved from the existing arrangements through to the treaty arrangements.[31]

3.41 Clearly, a number of the problems identified with Division 5 of the bill could be resolved by close consultation with industry.

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30 Saab Systems Pty Ltd, *Submission 5*, p. 3.

31 Mr Andrew Giulinn, Contracts Manager, Saab Systems Pty Ltd, *Committee Hansard*, 2 March 2012, p. 10.