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## DEPARTMENT OF COMMERCE

### Bureau of Industry and Security

#### 15 CFR Part 701

[Docket No. 080722875-91412-02]

RIN 0694-AE40

#### Reporting of Offsets Agreements in Sales of Weapon Systems or Defense-Related Items to Foreign Countries or Foreign Firms

**AGENCY:** Bureau of Industry and Security, Department of Commerce.

**ACTION:** Final rule.

**SUMMARY:** This final rule amends title 15 of the Code of Federal Regulations, part 701, which implements Section 309 of the Defense Production Act of 1950 ("Section 309"), as amended. The Bureau of Industry and Security ("BIS") is amending part 701 to update and provide clarification with regard to the information U.S. firms are required to submit each year to BIS to support BIS's preparation of the annual report to Congress on offsets in defense trade.

**DATES:** *Effective date:* This rule is effective January 22, 2010.

**FOR FURTHER INFORMATION CONTACT:** Ronald DeMarines, Bureau of Industry and Security, U.S. Department of Commerce, 14th Street and Constitution Avenue, NW., Room 3876, Washington, DC 20230, telephone: (202) 482-3755, e-mail: [redemarin@bis.doc.gov](mailto:redemarin@bis.doc.gov).

#### SUPPLEMENTARY INFORMATION:

##### I. Background

The Defense Production Act Amendments of 1992 required the Secretary of Commerce to promulgate regulations for U.S. firms to furnish information on sales of defense articles or defense services to foreign countries or foreign firms when such sales are made pursuant to a contract subject to an offset agreement exceeding \$5,000,000 in value. The Secretary of Commerce designated BIS as the organization responsible for promulgating such regulations. In 1994,

BIS published the Reporting of Offsets Agreements in Sales of Weapon Systems or Defense-Related Items to Foreign Countries or Foreign Firms regulation (15 CFR part 701) (the "Offset Reporting Regulation"). BIS aggregates and uses the information provided by U.S. firms pursuant to the Offset Reporting Regulation to determine the impact of offset transactions on the defense preparedness, industrial competitiveness, employment, and trade of the United States. Pursuant to Section 309, BIS submits reports annually to Congress.

On April 29, 2009, BIS published a proposed rule (74 FR 19466) requesting comments on proposed amendments to the Offset Reporting Regulation. This final rule implements the amendments to the Offset Reporting Regulation.

##### II. Reasons for This Rule

This rule will allow BIS to improve its assessment of the economic effects of offsets in defense trade. The amendments in this rule clarify the information BIS is seeking to receive from industry. BIS believes that these amendments will lead to less ambiguity and more consistency in industry submissions. BIS is also making these amendments to update its instructions to industry specific to the means of submission and the format of submitted data.

This final rule also responds to a recommendation made by the Government Accountability Office ("GAO") in its June 26, 2008 report entitled *Defense Production Act: Agencies Lack Policies and Guidance for Use of Key Authorities* (GAO-08-854). In its report, the GAO stated that Commerce provides useful summaries of offsets issues in its annual report to Congress, but the type of data collected from prime contractors limits BIS's ability to effectively analyze the impact of offsets on the U.S. economy.

Consequently, the GAO recommended that Commerce update its Offset Reporting Regulation to require more precise information on the industry sectors in which offset activity occurs.

##### III. Comments on the Proposed Rule

The comment period for the proposed rule ended on June 29, 2009. BIS received a total of three written submissions. The written submissions comprised nine distinct comments from two defense contractors and one industry association. BIS posted all comments received by the end of the comment period for public viewing at <http://www.regulations.gov> and on the BIS Web site at <http://efoia.bis.doc.gov>.

The comments focused on the following topics: the proposed requirement to classify products and services involved in offset agreements and transactions using the North American Industry Classification System ("NAICS") codes and the added burden created by this requirement; the proposed linking of offset transactions to offset agreements; the proposed increase in data specificity for performance measures and non-performance penalties associated with offset agreements; and the importance of protecting the business proprietary information submitted by U.S. firms.

#### *Comments on the Classification of Offset Agreements and Transactions Products and Services*

BIS received three comments regarding the proposed requirement that certain information reported to BIS be classified using NAICS codes. All three commentators indicated that the NAICS reporting requirement was burdensome and time consuming. One commenter noted that BIS estimated that the requirement to classify offset agreements and transactions would add 33 percent to the total time required to prepare an annual submission pursuant to the Offset Reporting Regulation. Another commenter stated that the defense contractor industry does not track NAICS codes during sales and that many offset transactions would require more than one NAICS code. The third commenter stated that it would require at least an 18-month lead time to implement the changes to its database and to train users.

BIS determined that the requirement to classify offset agreements and transactions would not result in an undue burden on the defense industry for several reasons. First, all companies conducting business with the U.S. Government, including those regularly involved in military export sales reported to Commerce, are required to classify their products and services, in accordance with the NAICS (See Central Contractor Registration Handbook, <http://www.ccr.gov>). The U.S. Census Bureau ("Census") posts instructions on its Web site on how to properly classify products and services in accordance with the NAICS. The Census web site also contains a search feature that allows users to find the proper NAICS codes for their products based upon a keyword search.

Moreover, Census requires the reporting of industrial activity using NAICS codes for all U.S. companies for the economic census it conducts every five years. Further, Census collects NAICS-based data monthly from the

aerospace industry for its *Current Industrial Report on the Civil Aircraft and Aircraft Engines* report. According to Census, pursuant to Title 13 of the U.S. Code, U.S. companies are required to report multiple NAICS codes for individual economic transactions to Census for both of these reports.

In BIS's 15-year history of compiling offset data pursuant to the Offset Reporting Regulation, approximately 80 percent of offset activity involves products and services of the aerospace industry, which has a limited number of NAICS codes. The limited number of NAICS codes applicable to military export sales in general should also limit this burden. Given that companies are already required to report information including multiple NAICS codes for individual transactions to a U.S. Government agency other than BIS, and noting the limited number of applicable NAICS codes in the military export sales sector, BIS has determined that identifying military export sales and offset transactions by multiple NAICS codes, as applicable, would not cause an undue burden on industry.

BIS is implementing this change in part as a response to the GAO's June 26, 2008 report entitled *Defense Production Act: Agencies Lack Policies and Guidance for Use of Key Authorities* (GAO-08-854) in which the GAO recommended that Commerce update its Offset Reporting Regulation to require more precise information on the industry sectors in which offset activity occurs. Further, this requirement will permit BIS to better utilize the NAICS-based Benchmark Input-Output Accounts (Input-Output) of the United States published by the U.S. Department of Commerce's Bureau of Economic Analysis in the preparation of its annual report to Congress. The Input-Output account is a representation of the United States economy used to predict how changes in one industry affect other U.S. industries and is a much more accurate economic model than the methodologies BIS used to analyze the impact of offsets in the past. BIS began using this model to calculate the economic impact of offset agreements and offset transactions for its 13th Annual Report to Congress in December 2008. The inclusion of data that includes six-digit NAICS codes provided by industry will allow BIS to better utilize this model to provide a more accurate assessment of the economic impact of offsets in defense trade. This will allow BIS to better fulfill its mandate under Section 309 in its annual reports to Congress.

With regard to the comment that reporting NAICS codes for offset agreements and transactions would add

as much as 33 percent to the hourly burden incurred by firms in compiling information for its submissions to BIS, BIS notes that the 33 percent increase amounts to the addition of three hours to the existing nine hour burden. The commenter stated that for a larger company, this increase would be more substantial than for a small company because the compilation of data is more time consuming in a large company with many offset obligations. BIS notes that the nine hour burden estimate for the collection of the existing information under the Offset Reporting Regulation and the three additional hours estimated for the burden of reporting on NAICS codes is based upon an average for all U.S. firms subject to reporting under this regulation. BIS does not believe that this additional burden outweighs the long term benefits to both BIS and industry of abandoning use of the outdated Standard Industrial Classification codes and instead using the NAICS codes.

In response to the request that BIS wait 18 months after publishing this final rule to make its changes effective, BIS has chosen to make this rule effective 30 days after publication because this rule contains only one significant additional requirement. U.S. firms reporting under the Offset Reporting Regulation should incorporate the new requirements in this rule in their submissions to BIS for calendar year 2009 (reportable to BIS by June 15, 2010). Although BIS recognizes that the changes included in the final rule will require adjustments to the internal tracking and filing systems used by U.S. firms reporting under this rule, given the existing reporting requirements administered by another U.S. Government agency and the limited number of significant changes included in this rule, BIS has determined that firms will be able to make these changes in time to comply with the final rule in their June 2010 submission. Note that this rule's requirements specific to the use of NAICS codes are only applicable to offset agreements and transactions reported to BIS beginning with calendar year 2009.

BIS made one change in this final rule on the basis of comments specific to the NAICS requirement. In the proposed rule, BIS included a requirement for U.S. firms to assign NAICS codes to the credit value of each offset transaction. BIS has determined that it does not need this information to complete the analysis provided in the annual report and has thus removed the requirement in this final rule, easing some of the reporting burden for industry. In making this determination, BIS recognized that

because credit value is generally assigned by foreign offset authorities and can involve multipliers, it would be difficult for U.S. firms to determine how to assign NAICS codes to credit values, given that the transaction could involve multiple codes and the credit value could be different than the actual value of the transaction.

#### *Comments on Linking Offset Transactions to Offset Agreements*

BIS received one comment on the new requirement to link offset transactions to a particular offset agreement. The commenter stated that properly assigning each transaction to its agreement will be time consuming for U.S. companies because many companies have multiple offset agreements for the same product in the same country. The commenter noted that it may take some companies as much as a week of additional staff time to comply with this requirement.

BIS reviewed this comment and notes that U.S. firms that report to BIS under the Offset Reporting Regulation are required by their foreign government customers to keep records of each offset transaction for which offset credit is claimed. The firms are also required to report their offset activities to the foreign government customers in order to account for their fulfillment of offset obligations. Both U.S. firms and their foreign government customers must track how much of a U.S. firm's offset obligation has been satisfied and what offset transactions are counted toward that obligation. Given this practice, BIS believes that the information BIS is requesting should be available to U.S. firms.

#### *Comments on Increasing the Specificity of Performance Measures and Non-Performance Penalties*

BIS received one comment regarding the proposed increase in the level of specificity required to be reported related to Performance Measures and Non-Performance Penalties. The commenter stated that providing more specific information on these topics could be cumbersome and would disadvantage U.S. companies in the global market place because such information, if released, would "exacerbate U.S. industry's ability to negotiate a fair contract."

BIS notes that the requirement to report offset agreement performance measures and non-performance penalties is not a new requirement. The previous Offset Reporting Regulation required companies to report performance measures. The change in this final rule only requires industry to

report performance measures and non-performance penalties as separate line items. Therefore, this change will not add any additional burden on industry.

Specific to the concern regarding U.S. industry negotiations, BIS does not include the specific performance measures and non-performance penalties submitted by industry in its annual report. Instead, BIS uses this information to better understand the trends in offset activities in defense trade. Country-specific offset policies that BIS has included in past reports were obtained from publicly available sources.

#### *Comments on Protection of Business Proprietary Information*

BIS received three comments regarding the confidentiality of the offset-related data that companies submit to BIS in relation to the public availability of the annual report. One commentator stated that the release of proprietary information could be damaging to companies and to the defense industry. Two commentators expressed concerns that foreign governments use or may use the data from the annual report to win concessions from U.S. defense contractors in offset negotiations.

Although the availability of the offset report and the confidentiality of offset-related data are outside the scope of this final rule, BIS is cognizant of the negative impacts of the release of proprietary information. As provided by Section 309(c) of the DPA, and § 701.5 of the Offset Reporting Regulation, BIS is precluded from publicly disclosing the specific information it receives from U.S. companies pursuant to the Offset Reporting Regulation. Therefore, the offset-related information collected by BIS from defense contractors is highly aggregated so that the activities of individual companies cannot be determined. Additionally, in recent years, BIS has revised the annual report to remove certain sections that were identified as beneficial to foreign governments and made other sections of the report available only within the U.S. Government. BIS will continue to consider additional measures specific to this concern.

#### **IV. Overview of Final Rule**

BIS is amending the Offset Reporting Regulation to update and provide clarification with regard to the information U.S. firms are required to submit each year to support the preparation of the annual report to Congress on offsets in defense trade.

#### *Changes to § 701.1*

This final rule amends the last sentence of § 701.1 of the Offset Reporting Regulation to reflect that Commerce has already submitted and will continue to submit reports to Congress. The previous § 701.1 suggested only that Commerce will be submitting reports in the future.

#### *Changes to § 701.2*

This final rule amends certain definitions in § 701.2 of the Offset Reporting Regulation to reflect BIS's 15-year experience in preparing the annual report to Congress. Specifically, this rule updated the illustrative list of activities in the definition of "offset transaction" in § 701.2(f) and the definitions of "direct offset" in § 701.2(g) and "indirect offset" in § 701.2(h).

In the definition of "offset transaction" in § 701.2(f), this rule removes reference to activities not commonly reported to BIS (*i.e.*, countertrade, barter, counterpurchase, and buy back) and adds reference to activities that are frequently reported (*i.e.*, credit assistance, training, and purchases). Note that this list remains illustrative. Additionally, to clarify the meaning of the different types of offset transactions specified in § 701.2(f), this final rule provides examples for each type of offset transaction listed. These examples were not included in the proposed rule and are intended to ensure better consistency in the data submitted to BIS. None of these terms are currently defined in the Offset Reporting Regulation.

Example 1 to § 701.2(f), clarifies that "co-production" includes transactions that are based upon a government-to-government agreement authorizing the transfer of technology to permit a foreign company to manufacture all or part of a U.S.-origin defense article. Such transactions are based upon an agreement specifically referenced in a Foreign Military Sale ("FMS") Letter of Offer and Acceptance (LOA) and a government-to-government co-production Memorandum of Understanding. In Example 6, on the other hand, a foreign company receives technology to produce a component of a U.S. defense article, but in part because this transfer wasn't made pursuant to a co-production agreement specifically referenced in an LOA and co-production Memorandum of Understanding, it is classified as "licensed production" instead of "co-production." Both of these examples also include "technology transfers", and

that term is further described in Example 2.

Additionally, in Example 4 to § 701.2(f) a U.S. company makes arrangements for a line of credit at a financial institution, which is "credit assistance" (distinguishable from the use of credited or "banked" offset credits, which would be classified as "other"). In its 15 years of collecting data for its report, BIS has observed that U.S. firms have submitted data on transactions under the "credit assistance" category for a wide variety of transactions, some of which BIS would not consider to be "credit assistance." Section 701.2(f) also lists examples for all other terms referenced in the definition of "offset transaction."

This final rule amends the definitions for "direct offset" and "indirect offset" in § 701.2(g) and § 701.2(h) by removing the references to "defense articles" and "defense goods." This change was made to clarify that U.S. firms are required to report on all offset transactions for which offset credit of \$250,000 or more has been claimed from a foreign representative, even if the offset transaction itself does not involve a defense article or service (*i.e.*, items or services controlled pursuant to the International Traffic in Arms Regulations (22 CFR parts 120–130) (ITAR)). This change clarifies the intent of the reporting requirement and reflects current reporting practices.

#### *Changes to § 701.4*

This final rule modifies § 701.4 of the Offset Reporting Regulation by reordering the section. The revised section begins with information pertaining to the reporting period and the date by which reports must be submitted to BIS each year, followed by updated reporting instructions on how to submit the report and on how the report should be formatted, and the contents of the required reports. This reordering will make it easier for companies affected by this regulation to identify all of the information they need to submit timely and accurate reports. This section also notes for the first time that BIS publishes an annual notice in the **Federal Register** to remind companies of their responsibility to report on offset agreements and transactions and to advise them of the reporting deadline (*see* § 701.4(a)).

This final rule also amends § 701.4(b) to update the address to which reported offsets data should be submitted and provides an e-mail address for electronic submissions and notes that data should be submitted in both hardcopy format and electronic format. This final rule deletes references to

outdated software and hardware formats that were described in § 701.4(c) of the previous Offset Reporting Regulation. Section 701.4(b)(1) also contains the notice, previously found in § 701.4(a), that only the firms directly responsible for reporting to the foreign customer should report offset transactions to BIS. This notice has been slightly updated in this final rule to further clarify the scope of reporting required by BIS. Note that the term “U.S. firm” used in § 701.4(c)(1) and § 701.4(c)(2) refers to the prime contractors that are physically located in the “United States” (defined in § 701.2(d)), and who are directly responsible for reporting to the foreign customer as described in § 701.4(b)(1). Section 701.4(b) states that U.S. firms must generally only report on offset agreements they have entered into with a foreign customer, not agreements entered into by their foreign subsidiaries or affiliates. However, U.S. firms must report on all offset transactions that they are directly responsible for reporting to the foreign customer, including transactions performed by a foreign subsidiary or affiliate that are credited toward the U.S. firm’s offset agreement.

In order to better reflect the business cycle, the provisions of the Offset Reporting Regulation that required description of the contents of reports on offsets transactions (previously § 701.4(d)) and offsets agreements (previously § 701.4(e)) were reordered so that offset agreement reporting requirements are described in § 701.4(c)(1), before the offset transaction reporting requirements now found in § 701.4(c)(2).

Also in new §§ 701.4(c)(1) and 701.4(c)(2), the term “military export sale” (a defined term in § 701.2) has replaced the term “weapon system,” in order to clarify that not all reported defense sales involve weapon systems. Further clarifying changes made to the descriptions of information required to be reported under § 701.4 are described below.

In new § 701.4(c)(1)(ii), this final rule expands the information required to be submitted to BIS to describe offset agreements. Whereas the previous Offset Reporting Regulation requested only the name or description of the defense article and/or service subject to the offset agreement, this change requires that both the name and description of such articles and/or services be provided as well as the month and year that the offset agreement was signed. These changes will ensure that offset agreements are correctly reported for the appropriate year and will facilitate BIS’s ability to track the fulfillment of offset obligations.

New §§ 701.4(c)(1)(iii) and 701.4(c)(2)(iv), respectively, require companies to assign the appropriate North American Industry Classification System (“NAICS”) code(s) to each military export sale for which there is an offset agreement triggering a reporting requirement and to each offset transaction reported under the Offset Reporting Regulation. In addition, new §§ 701.4(c)(1)(v) and 701.4(c)(2)(viii), respectively, require the value of each military export sale and offset transaction to be classified by NAICS code. Note that for military export sales and offset transactions involving items categorized under more than one NAICS code, all codes should be listed and values should be listed by each of the applicable NAICS codes. This final rule includes illustrative examples in §§ 701.4(c)(1)(iii) and 701.4(c)(2)(iv) to assist industry in classifying military export sales and offset transactions by NAICS codes.

Previously, BIS required industry to classify offset transactions by broad industry classification and to provide a name and description of the military export sale. Firms were directed to the Standard Industrial Classification (“SIC”) codes for assistance in identifying an appropriate industry category for offset transactions. As NAICS is the standard industrial classification system used in the United States and officially replaced the SIC in 1997 (see 62 FR 17288, Apr. 4, 1997), this change updates BIS’s instructions to industry. This change allows BIS to gather more accurate information on military export sales and offset transactions and will enhance BIS’s ability to assess the economic impact of offsets on the U.S. industrial base by allowing BIS to better utilize other data published by statistical agencies of the U.S. Government.

This final rule eliminates the requirement, previously found in § 701.4(e)(1)(iii) of the Offset Reporting Regulation, that companies report the names and titles of the signatories to offset agreements. BIS has determined that this information is not necessary for the preparation of BIS’s annual report to Congress. Under the new § 701.4(c)(1)(iv), companies are required to report only the identity of the foreign government agency or branch that is a signatory to the offset agreement.

In order to clarify the individual status of performance measures and non-performance penalties, the final rule separates their reporting requirements by moving them from old § 701.4(e)(1)(vii) to new § 701.4(c)(1)(viii) and new

§ 701.4(c)(1)(ix), respectively. This rule also includes lists of examples for each.

In new § 701.4(c)(2)(ii), this final rule requires companies to report for each offset transaction the date when the related offset agreement was signed. This data will allow BIS to better track the fulfillment of offset agreements and identify trends in offset transaction activity.

This final rule revises examples of offset transaction categories. The section entitled “Description of Offset Product/Service” in the previous Offset Reporting Regulation has been replaced by new § 701.4(c)(2)(iii), entitled “Offset Transaction Category.” The categories of offset transactions listed as examples in the new section more accurately reflect the types of offset transactions that have been reported to BIS since 1994. For example, the category of “cash payment” has been removed, and the categories of “licensed production,” “investment,” and “credit assistance” have been added, as was an “other” category (for which the reporting company must include a description). The final rule makes one minor change in this section from the proposed rule. The category entitled “overseas investment” in the proposed rule has been renamed “investment.” BIS made this change because it is aware that there may be investment-related activities for which U.S. firms claim offset credit that may not be accurately labeled as “overseas investment.”

Finally, this final rule adds new § 701.6 to describe the penalties available under the Defense Production Act (50 U.S.C. App. 2155) should companies not comply with this regulation. Willful violation of the Defense Production Act may result in punishment by fine or imprisonment, or both. The maximum penalty provided by the Defense Production Act is a \$10,000 fine, or one year in prison, or both. The Government may also seek an injunction from a court of appropriate jurisdiction to prohibit the continuance of any violation of, or to enforce compliance with, the Defense Production Act.

## V. Rulemaking Requirements

1. This rule has been determined to be significant for purposes of Executive Order 12866.

2. Notwithstanding any other provision of law, no person is required to respond to nor be subject to a penalty for failure to comply with a collection of information, subject to the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) (“PRA”), unless that collection of information displays a currently valid

Office of Management and Budget ("OMB") Control Number. This regulation contains a collection previously approved by the OMB under control number 0694-0084, which carries a burden hour estimate of nine hours for a reporting firm to prepare and submit once per year. In addition, this final rule amends that collection for reporting on offset agreements and transactions by NAICS code, which carries an estimated additional burden of three hours for companies submitting annual reports to BIS.

3. This rule does not contain policies with Federalism implications as that term is defined in Executive Order 13132.

4. The Regulatory Flexibility Act ("RFA"), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"), 5 U.S.C. 601 *et seq.*, generally requires an agency to prepare a regulatory flexibility analysis of any rule subject to the notice and comment rulemaking requirements under the Administrative Procedure Act (5 U.S.C. 553) or any other statute, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. Under section 605(b) of the RFA, however, if the head of an agency certifies that a rule will not have a significant impact on a substantial number of small entities, the statute does not require the agency to prepare a regulatory flexibility analysis. Pursuant to section 605(b), the Chief Counsel for Regulations, Department of Commerce, certified to the Chief Counsel for Advocacy, Small Business Administration, that this rule will not have a significant impact on a substantial number of small entities. The text of that certification was printed in the preamble to the proposed rule (74 FR 19468, April 24, 2009) and it is not repeated here. No comments were received regarding the economic impact of this final rule. As a result, no final regulatory flexibility analysis was prepared.

#### List of Subjects in 15 CFR Part 701

Administrative practice and procedure, Arms and munitions, Business and industry, Exports, Government contracts, Reporting and recordkeeping requirements.

■ For the reasons set forth in the preamble, the National Security Industrial Base Regulations (15 CFR parts 700-709) are amended as follows:

#### PART 701—[AMENDED]

■ 1. The authority citation for part 701 is revised to read as follows:

**Authority:** 50 U.S.C. App. 2099 and Executive Order 12919, 59 FR 29525, 3 CFR, 1994 Comp. 901 and Executive Order 13286, 68 FR 10619, 3 CFR, 2003 Comp. 166.

■ 2. In § 701.1, revise the last sentence in the section to read:

##### § 701.1 Purpose.

\* \* \* Summary reports are submitted annually to Congress pursuant to Section 309 of the Defense Production Act of 1950, as amended.

■ 3. In § 701.2, revise paragraphs (f), (g), and (h) to read as follows:

##### § 701.2 Definitions.

\* \* \* \* \*

(f) *Offset Transaction*—Any activity for which the U.S. firm claims credit for full or partial fulfillment of the offset agreement. Activities to implement offset agreements are categorized as co-production, technology transfer, subcontracting, credit assistance, training, licensed production, investment, purchases and other. Paragraphs (f)(1) through (f)(8) of this section provide examples of the categories of offset transactions.

(1) *Example 1.* Company A, a U.S. firm, contracts for Company B, a foreign firm located in country C, to produce a component of a U.S.-origin defense article subject to an offset agreement between Company A and country C. The defense article will be sold to country C pursuant to a Foreign Military Sale and the production role of Company B is described in the Letter of Offer and Acceptance associated with that sale and a government-to-government co-production memorandum of understanding. This transaction would be categorized as co-production and would, like all co-production transactions, be direct.

(2) *Example 2.* Company A, a U.S. firm, transfers technology to Company B, a foreign firm located in country C, which allows Company B to conduct research and development directly related to a defense article that is subject to an offset agreement between Company A and country C. This transaction would be categorized as technology transfer and would be direct because the research and development is directly related to an item subject to the offset agreement.

(3) *Example 3.* Company A, a U.S. firm, contracts for Company B, a foreign firm located in country C, to produce a component of a U.S.-origin defense article subject to an offset agreement between Company A and country C. The contract with Company B is for a direct commercial sale and Company A does not license Company B to use any technology. The transaction would be

categorized as subcontracting and would, like all subcontracting transactions, be direct.

(4) *Example 4.* Company A, a U.S. firm, makes arrangements for a line of credit at a financial institution for Company B, a foreign firm located in country C, so that Company B can produce an item that is not subject to the offset agreement between Company A and country C. The transaction would be categorized as credit assistance and would be indirect because the credit assistance is unrelated to an item covered by the offset agreement.

(5) *Example 5.* Company A, a U.S. firm, arranges for training of personnel from Company B, a foreign firm located in country C. The training is related to the production and maintenance of a U.S.-origin defense article that is subject to an offset agreement between Company A and country C. The transaction would be categorized as training and would be direct because the training is directly related to the production and maintenance of an item covered by the offset agreement.

(6) *Example 6.* Company A, a U.S. firm, contracts for Company B, a foreign firm located in country C, to produce a component of a U.S.-origin defense article that is subject to an offset agreement between Company A and country C. The contract with Company B is a Foreign Military Sale and Company A licenses Company B to use Company A's production technology to produce the component. There is no co-production agreement between the United States and country C. The transaction would be categorized as licensed production and would be direct because it involves the item covered by the offset agreement.

(7) *Example 7.* Company A, a U.S. firm, makes an investment in Company B, a foreign firm located in country C, so that Company B can create a new production line to produce a component of a defense article that is subject to an offset agreement between Company A and country C. The transaction would be categorized as investment and would be direct because the investment involves an item covered by the offset agreement.

(8) *Example 8.* Company A, a U.S. firm, purchases various off-the-shelf items from Company B, a foreign firm located in country C, but none of these items will be used by Company A to produce the defense article subject to the offset agreement between Company A and country C. The transaction would be categorized as purchases and would, like all purchase transactions, be indirect.

(g) *Direct Offset*—an offset transaction directly related to the article(s) or service(s) exported or to be exported pursuant to the military export sales agreement. See the examples illustrating offset transactions of this type in §§ 701.2(f)(1), 701.2(f)(2), 701.2(f)(3), 701.2(f)(5), 701.2(f)(6) and 701.2(f)(7) of this part.

(h) *Indirect Offset*—an offset transaction unrelated to the article(s) or service(s) exported or to be exported pursuant to the military export sales agreement. See the examples illustrating offset transactions of this type in §§ 701.2(f)(4) and 701.2(f)(8) of this part.

■ 4. Section 701.4 is revised to read as follows:

#### § 701.4 Procedures.

(a) *Reporting period.* The Department of Commerce publishes a notice in the **Federal Register** annually reminding the public that U.S. firms are required to report annually on contracts for the sale of defense-related items or defense-related services to foreign governments or foreign firms that are subject to offset agreements exceeding \$5,000,000 in value. U.S. firms are also required to report annually on offset transactions completed in performance of existing offset commitments for which offset credit of \$250,000 or more has been claimed from the foreign representative. Such reports must be submitted to the Department of Commerce no later than June 15 of each year and must contain offset agreement and transaction data for the previous calendar year.

(b) *Reporting instructions.* (1) U.S. firms must only report on offset agreements they have entered into with a foreign customer. U.S. firms must report offset transactions that they are directly responsible for reporting to the foreign customer, regardless of who performs the transaction (*i.e.*, prime contractors must report for their subcontractors if the subcontractors are not a direct party to the offset agreement).

(2) Reports must be submitted in hardcopy to the Offset Program Manager, U.S. Department of Commerce, Bureau of Industry and Security, Room 3876, 14th Street and Constitution Avenue, NW., Washington, DC 20230, and as an e-mail attachment to [OffsetReport@bis.doc.gov](mailto:OffsetReport@bis.doc.gov). E-mail attachments must include the information in a computerized spreadsheet or database format. If unable to submit a report in computerized format, companies should contact the Offset Program Manager for guidance. All submissions must include a point of contact (name and telephone number) and must be submitted by a

company official authorized to provide such information.

(c) Reports must include the information described below. Any necessary comments or explanations relating to the information shall be footnoted and supplied on separate sheets attached to the reports.

(1) *Reporting on offset agreements.* U.S. firms shall provide an itemized list of new offset agreements entered into during the reporting period, including the information about each such agreement described in paragraphs (c)(1)(i) through (c)(1)(ix) of this section.

(i) *Name of foreign country.* Identify the country of the foreign entity involved in the military export sale associated with the offset agreement.

(ii) *Description of the military export sale.* Provide a name and description of the defense article and/or defense service referenced in the military export sale, as well as the date (month and year) that the related offset agreement was signed.

(iii) *Military export sale classification.* Identify the six-digit North American Industry Classification System (“NAICS”) code(s) associated with the military export sale. Refer to U.S. Census Bureau’s U.S. NAICS Manual for a listing of applicable NAICS codes (<http://www.census.gov/epcd/www/naics.html>). Paragraphs (c)(1)(iii)(A) through (c)(1)(iii)(E) of this section provide examples that illustrate how to select the appropriate NAICS code(s).

(A) *Example 1.* Company A enters into an offset agreement associated with the sale of 24 fighter aircraft and guided missiles to country B. Fighter aircraft manufacturing is classified in the NAICS as NAICS 336411, Aircraft Manufacturing. Guided missiles are classified in the NAICS as NAICS 336414, Guided Missile and Space Vehicle Manufacturing. This military export sale should be classified under NAICS 336411 and NAICS 336414.

(B) *Example 2.* Company B enters into an offset agreement associated with the sale of a navigation system for a fleet of military aircraft to country C. Navigation system manufacturing is classified in the NAICS as NAICS 334511, Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing. This military export sale should be classified under NAICS 334511.

(C) *Example 3.* Company C enters into an offset agreement associated with the sale of radio communication equipment to country D. Radio communication equipment is classified in the NAICS as NAICS 334220, Radio and Television Broadcasting and Wireless Communication Equipment

Manufacturing. This military export sale should be classified under NAICS 334220.

(D) *Example 4.* Company D enters into an offset agreement associated with the sale of 30 aircraft engines to country E. Aircraft engines are classified in the NAICS as NAICS 336412, Aircraft Engine and Engine Parts Manufacturing. This military export sale should be classified under NAICS 336412.

(E) *Example 5.* Company E enters into an offset agreement associated with the sale of armored vehicles to country F. Armored vehicles are classified in the NAICS as NAICS 336992, Military Armored Vehicle, Tank, and Tank Component Manufacturing. This military export sale should be classified under NAICS 336992.

(iv) *Foreign party to offset agreement.* Identify the foreign government agency or branch that is the signatory to the offset agreement.

(v) *Military export sale value.* Provide the U.S. dollar value of the military export sale. Should the military export sale involve more than one NAICS code, please separately list the values associated with each NAICS code.

(vi) *Offset agreement value.* Provide the U.S. dollar value of the offset agreement.

(vii) *Offset agreement term.* Identify the term of the offset agreement in months.

(viii) *Offset agreement performance measures.* Identify each category that describes the offset agreement’s performance measures: best efforts, accomplishment of obligation, or other (please describe).

(ix) *Offset agreement penalties for non-performance.* Identify each category that describes the offset agreement’s penalties for non-performance. For example, the agreement may include penalties such as liquidated damages, debarment from future contracts, added offset requirements, fees, commissions, bank credit guarantees, or other (please describe).

(2) *Reporting on offset transactions.* U.S. firms shall provide an itemized list of offset transactions completed during the reporting period, including the elements listed in paragraphs (c)(2)(i) through (c)(2)(x) of this section for each such transaction (numerical estimates are acceptable when actual figures are unavailable; estimated figures shall be followed by the letter “E”).

(i) *Name of foreign country.* Identify the country of the foreign entity involved in the military export sale associated with the offset transaction.

(ii) *Description of the military export sale.* Provide a name and description of the defense article and/or defense

service referenced in the military export sale associated with the offset transaction, as well as the date the offset agreement was signed (month and year).

(iii) *Offset transaction category.*

Identify each category that describes the offset transaction as co-production, technology transfer, subcontracting, training, licensing of production, investment, purchasing, credit assistance or other (please describe).

(iv) *Offset transaction classification.*

Identify the six-digit NAICS code(s) associated with the offset transaction. Refer to U.S. Census Bureau's U.S. NAICS Manual for a listing of applicable NAICS codes (<http://www.census.gov/epcd/www/naics.html>). Paragraphs (c)(2)(iv)(A) through (c)(2)(iv)(E) of this section provide examples that illustrate how to select the appropriate NAICS code in the instances described therein.

(A) *Example 1.* Company A completes an offset transaction by co-producing aircraft engines in country B. Aircraft engine manufacturing is classified in the NAICS as NAICS 336412, Aircraft Engine and Engine Parts Manufacturing. This offset transaction should be classified under NAICS 336412.

(B) *Example 2.* Company B completes an offset transaction by licensing the production of automotive electrical switches in country C. Company B also assists in structuring a wholesale distribution network for these products. Automotive electrical switch manufacturing is classified in the NAICS as NAICS 335931, Current Carrying Wiring Device Manufacturing, and the wholesale distribution network is classified in the NAICS as NAICS 423120, Motor Vehicle Supplies and New Parts Merchant Wholesalers. This offset transaction should be classified under NAICS 335931 and NAICS 423120.

(C) *Example 3.* Company C completes an offset transaction by transferring technology to establish a biotechnology research center in country D. Biotechnology research and development is classified in the NAICS as NAICS 541711, Research and Development in Biotechnology. This offset transaction should be classified under NAICS 541711.

(D) *Example 4.* Company D completes an offset transaction by purchasing steel forgings from a steel mill in country E. Steel forgings are classified in the NAICS as NAICS 331111, Iron and Steel Mills. This offset transaction should be classified under NAICS 331111.

(E) *Example 5.* Company E completes an offset transaction by providing training assistance services in country F to certain plant managers. Training assistance is classified in the NAICS as

NAICS 611430, Professional and Management Development Training. This offset transaction should be classified under NAICS 611430.

(v) *Offset transaction type.* Identify the offset transaction as a direct offset transaction, an indirect offset transaction, or a combination of both.

(vi) *Name of offset performing entity.* Identify, by name, the entity performing the offset transaction on behalf of the U.S. entity that entered into the offset agreement.

(vii) *Name of offset receiving entity.* Identify the foreign entity receiving benefits from the offset transaction.

(viii) *Actual offset value.* Provide the U.S. dollar value of the offset transaction without taking into account multipliers or intangible factors. Should the offset transaction involve more than one NAICS code, please list the U.S. dollar values associated with each NAICS code.

(ix) *Offset credit value.* Provide the U.S. dollar value credits claimed by the offset performing entity, including any multipliers or intangible factors.

(x) *Offset transaction performance location.* Name the country where each offset transaction was fulfilled, such as the purchasing country, the United States, or a third country.

■ 5. § 701.6 is added to read as follows:

**§ 701.6 Violations, penalties, and remedies.**

(a) Willful violation of the Defense Production Act may result in punishment by fine or imprisonment, or both. The maximum penalty provided by the Defense Production Act is a \$10,000 fine, or one year in prison, or both.

(b) The Government may seek an injunction from a court of appropriate jurisdiction to prohibit the continuance of any violation of, or to enforce compliance with, the Defense Production Act and this regulation.

Dated: December 18, 2009.

**Matthew S. Borman,**

*Deputy Assistant Secretary for Export Administration.*

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**DEPARTMENT OF COMMERCE**

**Bureau of Industry and Security**

**15 CFR Parts 736, 738, 740, 742, 743, and 772**

[Docket No. 0907241162-91276-01]

RIN 0694-AE62

**Amendments to the Export Administration Regulations (EAR) Based Upon the Accession of Albania and Croatia to Formal Membership in the North Atlantic Treaty Organization (NATO)**

**AGENCY:** Bureau of Industry and Security, Commerce.

**ACTION:** Final rule.

**SUMMARY:** The Bureau of Industry and Security (BIS) is publishing this final rule to amend certain requirements in the Export Administration Regulations (EAR) that apply to Albania and Croatia. These changes are based upon the accession of Albania and Croatia to formal membership in the North Atlantic Treaty Organization (NATO) on April 1, 2009. Consistent with the EAR license requirements and licensing policies that apply to members of NATO, this final rule amends the EAR to remove certain crime control (CC), national security (NS), and regional stability (RS) license requirements for these two countries. A license continues to be required for exports and reexports to Albania or Croatia of items on the Commerce Control List (CCL) controlled for national security or regional stability reasons that are identified as requiring a license to destinations indicated under NS Column 1 (also NS Column 2, for Albania) or RS Column 1, respectively, on the Commerce Country Chart. Certain restraint devices, discharge type arms, and related technology described on the CCL continue to require a license for crime control reasons to Albania or Croatia. A license also continues to be required for specially designed implements of torture described on the CCL. Furthermore, this rule does not affect any license requirements that apply to these countries based on other reasons for control identified in the EAR. This final rule also removes the EAR prohibition that applied to certain in transit shipments through Albania, removes Albania from Country Group D, and adds Albania to Country Group B. Croatia has already been designated in the EAR as a Country Group B country. In addition, this rule amends the provisions of License Exception APR (Additional Permissive Reexports) that apply to reexports of certain thermal