

## **End-Use Monitoring of Defense Articles and Defense Services Commercial Exports FY 2009**

This report describes actions taken by the Department of State during fiscal year 2009 to implement the “Blue Lantern” end-use monitoring program. The Blue Lantern program, operated in accordance with section 40A of the Arms Export Control Act (AECA) (22 U.S.C. 2778), as amended, monitors the end-use of defense articles (including related technical data) and defense services exported through commercial channels and subject to Department of State licenses or other approvals under section 38 of the AECA.

The Department of State’s Directorate of Defense Trade Controls in the Bureau of Political-Military Affairs (PM/DDTC) is responsible for administering the International Traffic in Arms Regulations (ITAR) (22 C.F.R. Parts 120-130) that implement section 38 of the AECA. PM/DDTC’s functions include registration of manufacturers, brokers, and exporters; licensing of defense trade; insuring compliance with the ITAR and implementing civil enforcement; supporting the Department of Justice and other U.S. law enforcement agencies in investigations and prosecutions of AECA and ITAR criminal violations; as well as the end-use monitoring of transactions licensed or authorized by PM/DDTC.

The Blue Lantern program is managed within PM/DDTC by the Office of Defense Trade Controls Compliance (DTCC) and its Research and Analysis Division (RAD). Blue Lantern end-use monitoring entails pre-license, post-license, or post-shipment inquiries or “checks” undertaken to verify the bona fides of proposed foreign consignees and end-users, to confirm the legitimacy of proposed transaction, and to provide “reasonable assurance that –

- i) the recipient is complying with the requirements imposed by the U.S. Government with respect to use, transfers, and security of defense articles and defense services; and
- ii) such articles and services are being used for the purposes for which they are provided.”<sup>1</sup>

PM/DDTC is currently authorized a full-time complement of 78 State Department personnel, which is supplemented by 8 military officers, approximately 60 contract personnel, a DHS/Immigration and Customs Enforcement Senior Special Agent, and an FBI Supervisory Special Agent. PM/DDTC’s operational budget for FY

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<sup>1</sup> See section 40A(a)(2) of the AECA, 22 U.S.C. 2785(a)(2).

2009, in addition to American salaries, was approximately \$1.7 million. Four State Department personnel and two contract personnel currently work on the Blue Lantern program, in addition to other duties, within RAD.

### Overseas End-use Monitoring: The Blue Lantern Program

Initiated in September 1990 as the United States Government's first systematic end-use monitoring program, Blue Lantern has strengthened the effectiveness of U.S. export controls and has proven to be a useful instrument in:

- 1) deterring diversions to unauthorized end-users and identifying possible ITAR violations,
- 2) aiding the disruption of illicit supply networks used by international criminal organizations or governments under U.S. or international restrictions and sanctions,
- 3) educating foreign governments and private companies about U.S. export controls, and
- 4) helping the Department to make informed licensing decisions and to ensure compliance with the AECA and the ITAR.

End-use checks performed under the Blue Lantern program have significantly encouraged compliance with statutory and regulatory requirements and have proven effective in combating the global "gray arms" trade. "Gray arms" refers to the use of fraudulent export documentation or deliberate misrepresentation of the facts of a transaction to acquire defense articles through legitimate channels for illicit re-transfer to unauthorized end-users.

U.S. embassy personnel, or in some instances PM/DDTC personnel, conduct Blue Lantern end-use checks overseas to verify the *bona fides* of unfamiliar foreign parties, to ensure delivery of licensed United States Munitions List (USML) articles/services to authorized end-users, to confirm proper end-use, and to determine compliance with PM/DDTC licenses and agreements and provisos imposed thereon.

In fiscal year 2009, PM/DDTC completed action on over 82,000 license applications and other requests. Blue Lantern inquiries are not conducted randomly, but rather are carefully selected to identify transactions that appear most at risk for diversion or misuse. License applications and other requests undergo review by licensing officers and compliance specialists, who check case details

against established criteria for determining potential risks: unfamiliar foreign parties, unusual routing, overseas destinations with a history of illicit activity or weak export/customs controls, commodities not known to be in the inventory of the host country's armed forces, and other indicators of concern. The information derived from Blue Lantern checks helps PM/DDTC licensing officers and compliance specialists assess risks associated with the export of certain defense articles and services to various countries and regions, and provides significant insight into the reliability of companies and individuals involved in defense procurement overseas.<sup>2</sup>

### Blue Lantern End-Use Inquiries in FY 2009

For the seventh year in a row, the Blue Lantern program set a new record on the number of inquiries initiated by initiating 774 inquiries in FY 2009 (Figure 1). These checks were conducted in 104 countries, also a record number. Of the 649 Blue Lantern cases closed in FY 2009, 87 (13%) were determined to be “unfavorable.” An unfavorable determination means that the Blue Lantern's findings of fact are not consistent with the information contained in the application or license. Problems identified during a pre-license check may result in denial of the license, removal of a party or parties, or the license being returned without action. Problems identified during a post-shipment check, if sufficiently serious, may result in revocation of the existing license. Entities of concern identified in pre-license or post-shipment checks are entered into DTCC's Watch List for further monitoring.

Unfavorable Blue Lantern cases are referred to DTCC's Enforcement Division for review. Where appropriate, parties involved in unfavorable Blue Lantern cases may be subject to civil enforcement actions or referred to federal law enforcement agencies for criminal investigation. FY 2009 Blue Lantern checks resulted in 10 directed disclosures and three referrals for possible criminal investigation. The chart on the following page illustrates the number of Blue Lantern checks initiated by year. The charts on the next page thereafter illustrate the regional distribution of export requests and of Blue Lantern checks initiated, completed, and found to be unfavorable. For statistical purposes, PM/DDTC attributes a Blue Lantern check to the region of the end-user listed on the application or license. Blue Lantern inquiries, however, may be initiated or determined to be “unfavorable” due to foreign intermediaries in third countries.

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<sup>2</sup> Because Blue Lantern checks are selected based on potential risk and not a random sampling across all PM/DDTC licenses, data on unfavorable checks should not be regarded as statistically representative of all license applications.

Figure 1:

### Total Blue Lanterns Initiated FY 2003 to FY 2009

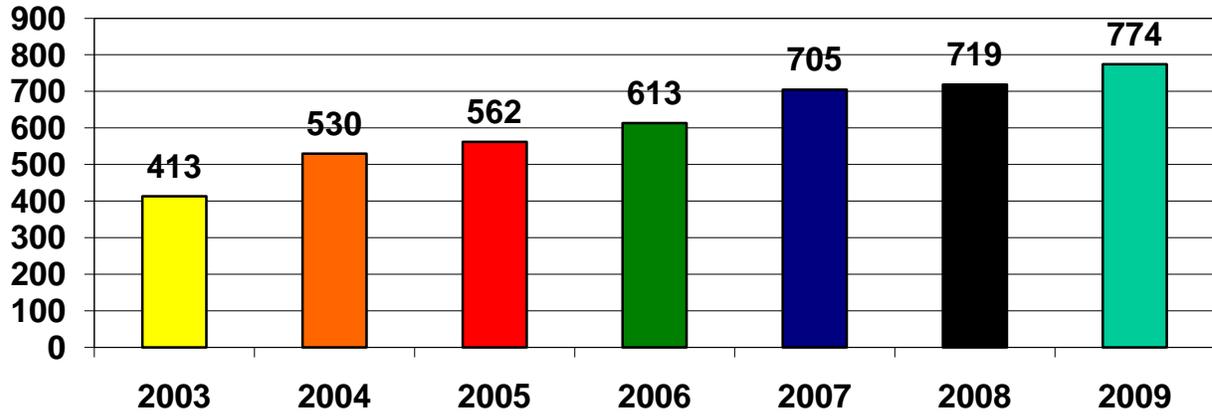


Figure 2:

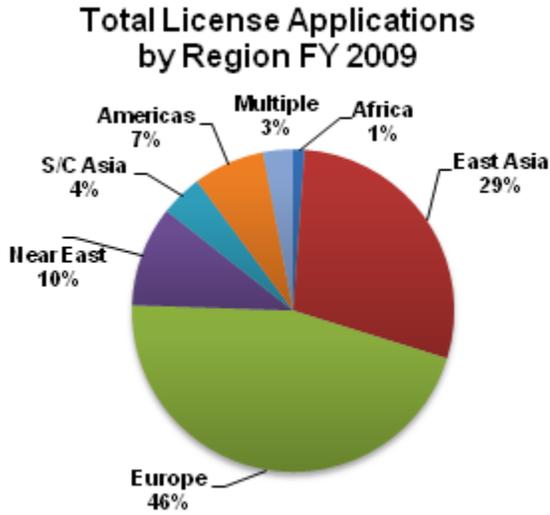


Figure 3:

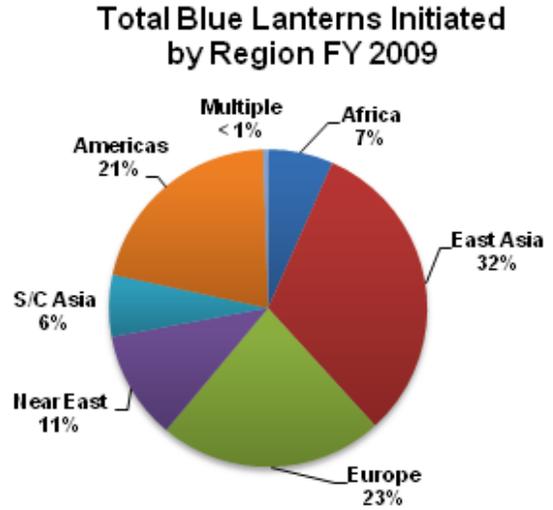


Figure 4:

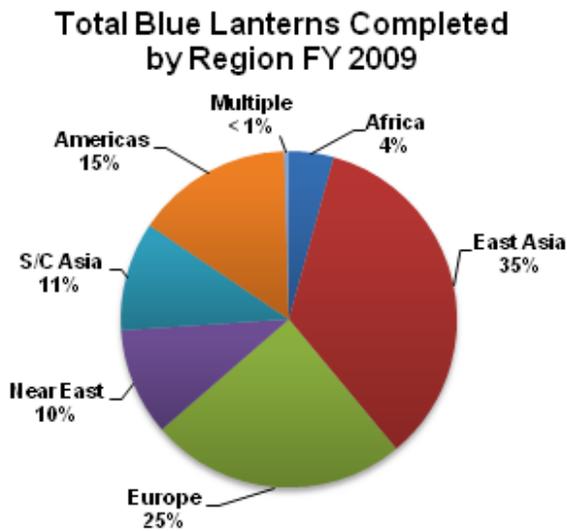


Figure 5:

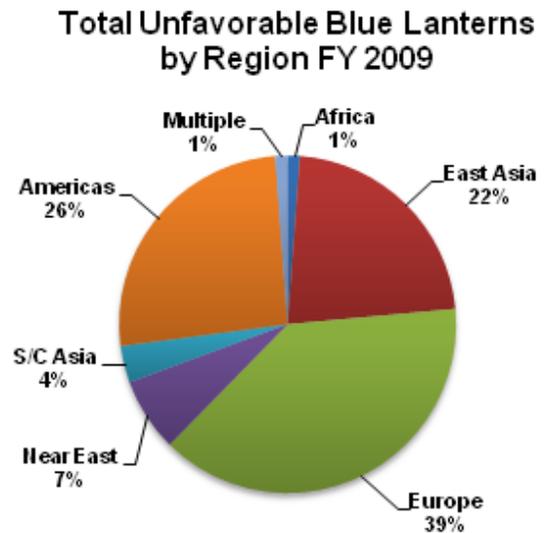
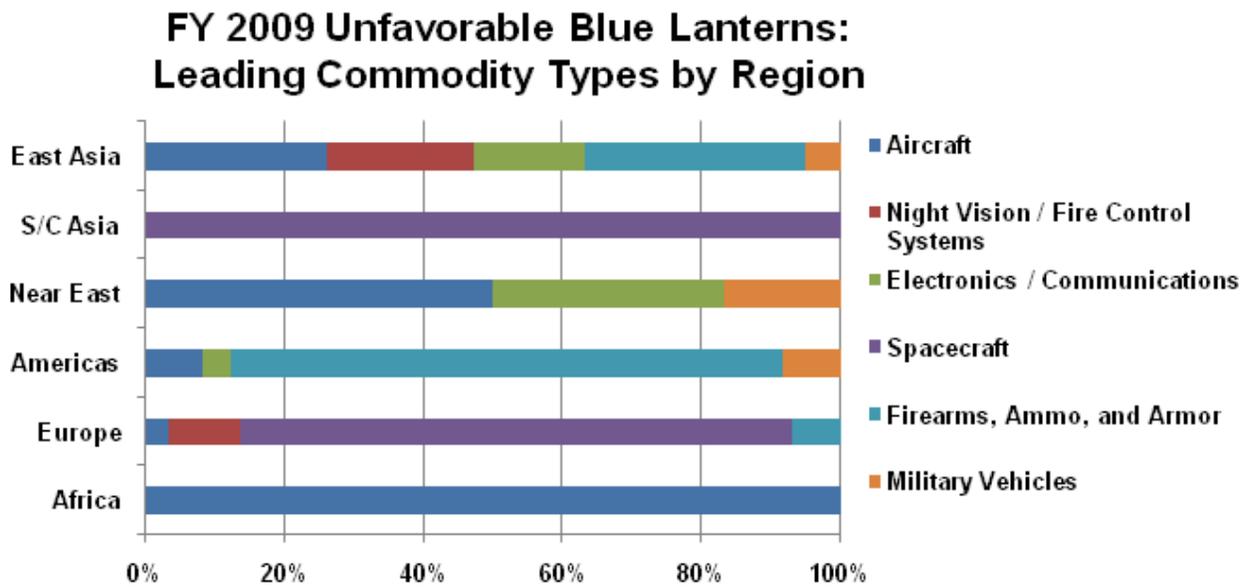


Figure 2 illustrates the regional distribution of USML export license applications.

As Figure 3 illustrates, the geographical distribution of Blue Lantern inquiries initiated during FY 2009 does not necessarily match that of license applications received. As has been the pattern for several years, Europe has relatively fewer Blue Lantern checks (23%) proportionate to the number of applications (46%). The Americas, conversely, was the site of 21% of all Blue Lantern checks despite representing only 7% of applications. Likewise, the proportion of Blue Lantern checks initiated in Africa was significantly greater than the region's respective shares of applications.

Figure 4 illustrates the regional distribution of Blue Lanterns completed during FY 2009, which provides a useful baseline for the regional distribution of unfavorable Blue Lantern results illustrated in Figure 5. Here again, the Americas region is noteworthy for representing more than one-fourth (26%) of unfavorable Blue Lantern results despite comprising fifteen percent (15%) of checks completed. Europe represents nearly forty percent (40%) of the unfavorable checks despite having one-fourth of all Blue Lanterns being completed in the region. This is explained below. Except for the Americas and Europe, the respective proportions of unfavorable checks for all other regions were less than their proportion of completed checks.

Figure 6:



### Reasons for Unfavorable Checks in FY 2009

- Refusal to cooperate: 36% (n=31)
- Derogatory information / foreign party deemed unreliable recipient of USML: 30% (n=26)
- Indications of diversion or unauthorized retransfer or re-export: 13% (n=11)
- Unable to confirm order or receipt of goods by end-user: 10% (n=9)
- Party violated terms of license or agreement: 9% (n=8)
- Warehousing or stockpiling: 8% (n=7)
- Foreign party (end-user and/or consignee) involved in transaction but not listed on license/application: 6% (n=5)
- Unauthorized brokering: 6% (n=5)
- Unable to confirm existence of foreign party listed on license: 1% (n=1)

The relative frequency of reasons for unfavorable determinations in FY 2009 shifted, in some cases significantly, compared to the previous fiscal year. The new leading category, ***Refusal to cooperate***, represented 36% of unfavorable results in FY 2009 but only 5% in FY 2008 (eighth place). Likewise, 30% of unfavorable cases were due to ***Derogatory information / foreign party deemed unreliable*** in FY09, making this the second leading category compared to only 5% of such cases in FY08.

Though the leading category of unfavorable Blue Lanterns in FY09, ***Refusal to cooperate***, showed a marked increase from the previous year, the drastic spike is directly linked to one specific European aerospace company. While the company claimed to produce an “ITAR-free” satellite system, the company refused to provide any information to USG officials on the countries of origin for many of the parts and components used in that system. This particular company was the subject of twenty-three unfavorable checks. Interestingly, these twenty-three checks also

account for the significant increase in Europe's share of unfavorable Blue Lanterns (see Figures 5 and 6). While Europe's share of total licenses remained relatively unchanged from FY08 to FY09 (41% and 46%, respectively – see Figure 2), the continent's share of unfavorable checks spiked from 11% in FY08 to 39% in FY09.

The second leading category, as noted above, is ***Derogatory information / foreign party deemed unreliable***. Admittedly, this is a broad category that spans issues with inventory control to criminal records and negative intelligence information. Failure to maintain proper records, inventory controls, and security measures will lead DDTC to deem an entity “unreliable.” Several entities have also been deemed unreliable due to the discovery of derogatory information. As all USML items are considered sensitive for one reason or another, all parties to a license must establish a certain level of reliability. The Blue Lantern program is the main vehicle through which DDTC verifies such reliability.

Under Section 123.9 of the ITAR, prior written approval is required for the retransfer or re-export of defense articles to any end-user, end-use, or destination other than that stated on the export authorization. In FY 2009, 13% of unfavorable Blue Lantern cases were the result of an entity's failure to fulfill that regulatory requirement. The causes of such cases, categorized above as ***Indications of diversion or unauthorized retransfer or re-export***, ranged from the lack of knowledge of U.S. regulations to willful diversion. This was the leading category in FY08, constituting 24% of all unfavorable Blue Lanterns that year. In FY09, however, the category fell to the third leading cause of unfavorable Blue Lanterns.

Similarly, the second leading cause of unfavorable checks in FY08 fell significantly in FY09, from 20 instances in the previous year to only 5. This category, ***Foreign party involved in transaction but not listed on license/application***, constituted 23% of all unfavorable cases in FY08, but made up only 6% in FY09 (seventh overall). Under part 126.13(b) of the ITAR, U.S. applicants are required to identify all parties to a license request. While in some cases this appears to be a minor oversight, identification of all parties is a critical element in the ability of PM/DDTC to maintain a secure chain of custody from U.S. exporter to foreign end-user. Without transparency regarding all parties to a transaction, diversion to unauthorized end-users and end-uses is far more likely to occur.

The fourth most common reason for unfavorable results in FY09, at 10%, was ***Inability to confirm receipt or order of USML items by the end-user listed on the license application***. As in many categories, this category contains both benign and

malign cases. While some instances seem to be due to poorly prepared paperwork or ineffective tracking mechanisms, others appear to represent foiled attempts at diversion. This category is down from 18% of unfavorable cases in FY08.

Nine percent (9%) of unfavorable checks in FY 2009 were due to a party violating the terms of a license or agreement. This category in FY09 combines two categories from the previous year: *End-use differs from that listed on license* and *Party violated terms of license or agreement*. The combined category increased this year, as such violations accounted for only 2% of unfavorable checks in FY08.

*Warehousing and stockpiling* remained relatively unchanged from FY08, as only two more instances were detected in FY09, leaving the category with an 8% share of unfavorable checks. While maintaining an inventory of ITAR-controlled parts may make good business sense for foreign suppliers, this practice reduces the Department's ability to control defense exports effectively and can lead to illicit diversion. A foreign company maintaining an inventory of defense articles must be party to an approved Warehouse and Distribution Agreement per ITAR section 124.14.

The final two categories experienced minor decreases in FY09. *Unauthorized brokering* decreased by 2 instances and *Unable to confirm existence of foreign party listed on license* decreased by 3 instances, leaving their respective shares at 6% and 1%.

### Blue Lantern Case Studies FY 2009

#### **Case Study #1: East Asian Company Likely Re-exporting to China (Post-Shipment Check)**

##### **Request for Temporary Import**

*Items:* Annunciators (aircraft instrument panels)  
*End-User:* Unknown  
*Foreign Consignee:* East Asian Company

##### **Reasons for Check**

- Request from Immigration and Customs Enforcement (ICE) following voluntary disclosure by U.S. company of unlicensed export

##### **Findings**

- Private company uncooperative/evasive about transaction and end-use
- U.S. company previously had license application denied for similar items with Chinese end-user

## **Case Study #2: Private Entity Re-transfers, Diverts NVGs (Post-Shipment Check)**

### **License for Permanent Export**

*Items:* Night Vision Goggles (NVGs)  
*End-user:* Ministry of Defense, Western European Country  
*Foreign Consignee:* Private European Company

### **Reasons for Check**

- Multiple licenses, sensitive commodity

### **Findings**

- Private company failed to transfer all items to MOD; could not account for over 200 NVGs
- Evidence of illicit retransfer, document fraud, false statements
- Private company subject of criminal indictment in host country; U.S. policy of denial

## **Case Study #3: Company Diverting Firearms (Post-Shipment Check)**

### **Multiple Requests for Permanent Export**

*Items:* Assault rifles  
*End-Users:* Military Agency, East Asian Country  
*Foreign Consignee:* East Asian Private Company

### **Reason for Check**

- Reported concerns from U.S. Embassy about private company

### **Findings**

- Military Agency had terminated contract for 29 carbines with private company
- Company sought export of 180 carbines falsely claiming military agency as end-user
- Company subject of foreign and U.S. law enforcement investigation for false statements, illicit diversion of firearms

## **Case Study #4: Use of Bogus Purchase Order to Procure USML**

**(Pre-License Check)**

**Request for Permanent Export**

*Item/End-Use:* Abrasion-resistant steel plating  
*End-User:* Law Enforcement Agency, North American Country  
*Foreign Consignees:* North American Company

**Reason for Check**

- Pre-license checks requested on several licenses due to suspicious documentation

**Findings**

- Company used same purchase order on multiple license requests claiming different official end-users
- Apparent attempt to stockpile and/or divert USML to unauthorized end-use/end-users (armor plating sought by criminal organizations)

**Case Study #5: Suspicious Transaction/Possible Graft  
(Pre-License Check)**

**Request for Permanent Export**

*Item/End-Use:* Claymore mines and accessories  
*End-User:* Ministry of Defense, Eastern European Country  
*Foreign Consignee:* Middle Eastern Company

**Reason for Check**

- Concerns about private company
- Apparent large discrepancy between value of items and price of contract

**Findings**

- MOD confirmed the order of claymore mines but analysis of documents also confirms huge (400%) mark up by private company
- High suspicion of graft/internal corruption in the transaction
- Interesting coincidence: Owner of private company was arrested in U.S. law enforcement sting several months later for similar crimes

**Case Study #6: Refusal to Cooperate with End-Use Monitoring**

**(Post-Shipment Check)**

**Proposed Amendment to Manufacturing License Agreement (MLA)**

*Item:* Satellite Parts and Components  
*Foreign Consignee:* European Company #1  
*End-User:* European Company #2

**Reason for Check**

- Sensitive technology
- Concerns end-product re-exported to China containing USML components

**Findings**

- The parent company of both European Company #1 and #2 refused to provide information regarding the country-of-origin for many parts and components used in its “ITAR-free” satellite sold to China

**Case Study #7: Foreign Company in Violation of Local Laws  
(Pre-License Check)**

**Request for Permanent Export**

*Items:* Firearms  
*End-User:* Firearms Dealer, Caribbean Country

**Reason for Check**

- Previous check indicated that end-user may have imported items other than those listed on an import authorization issued by host government

**Findings**

- Several items imported by end-user where not approved by host government
- License to import defense articles issued to end-user had been revoked
- End-user attempted to use revoked import authorizations to acquire USML

**Case Study #8: USG Unable to Confirm Company Had Adequate Facilities**

**(Pre-License Check)**

**Request for Permanent Export**

*Items:* Night Vision Devices  
*End-User:* Armed Forces, East Asian Country  
*Foreign Consignee:* East Asian Trading Company

**Reason for Check**

- Unfamiliar consignee
- Sensitive night vision technology

**Findings**

- Address provided was in a residential zone
- USG officials visited address and confirmed that the company did not reside at that location
- Company representatives continued to provide the same address, and Post was unable to verify the company had any physical space

**Insight: Use of the Canadian Exemption**

Use of license exemptions under the ITAR is extensive. Both exemptions of general applicability (ITAR 125.4) and the Canadian exemptions (ITAR 126.5) are claimed on thousands of license-free exports per annum. Focusing on use of the Canadian exemption, DTCC reviewed nearly 35,000 uses of the exemption during a two year period in order to assess compliance with the ITAR. As use of the exemption is limited to exports to Canadian end-users for end-use in Canada, we checked to verify that Automated Export System (AES) filings by exporters identified Canada as ultimate destination. Also, DTCC checked to verify that only commodities permitted for export utilizing the exemption were in fact exported. Finally, we checked companies listed on AES filings using the exemption against our Watch List.

The results of the research overall were highly positive: out of the nearly 35,000 uses of the exemption, representing over \$17 billion in defense exports, the overwhelming majority showed full compliance with the ITAR. In 154 examples, DTCC found countries other than Canada listed as the ultimate destination; a series of Blue Lanterns and Directed Disclosures revealed that in nearly all of these cases, freight forwarders and/or exporters erroneously cited the Canada exemption

(vice a different exemption) in their AES filings. Research also identified at least 25 examples where restricted commodities (e.g., subject to MTCR controls such as missile component parts, also aircraft engines and rocket launchers) *may* have been exported under the exemption. DTCC initiated Blue Lanterns to Canadian end-users seeking clarification on these matters and results are still pending. Finally, Blue Lantern inquiries were also initiated checking into the bona fides of eight Watch Listed companies who were listed as end-users in AES filings. Of these checks, only one thus far indicated shipment to a company about whom there were persistent compliance concerns. The export in question, however, did not result in diversion or misuse and the Watch List entry on the company was updated accordingly.