

# Export Controls—Major Developments in the International Supply Chain

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# Agenda

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- Enforcement environment--stings and more enforcement in general
- Technology controls
- Export Control Reform proposals
- Compliance pitfalls in a multilateral supply chain

# Enforcement Environment

- Stings and more enforcement in general
- Increasing internationalization of the defense industrial base
- The role of the individual is changing (sticks and carrots)
- Greater clarity and enumeration of items controlled over the next 7 months in Export Control Reform will make prosecutions easier to enforce
- More of the same

# Stings and More Enforcement in General

- The use of stings to enforce export controls is common
- Special agents (Export Enforcement, Immigration and Customs Enforcement, the FBI, and various investigative agencies of the Department of Defense are all active in export control enforcement)
- Export Enforcement commonly investigates export control violations along with violations of the Foreign Corrupt Practices Act

# SHOT Show Arrests and the Sting

- 21 arrests at the January 18, 2010 SHOT Show in Las Vegas
- Additional arrest in Miami
- January 10, 2010-DOJ announced indictments for FCPA violations, conspiracy, and money laundering in connection with a bribe of a minister of defense of an African country
- This was the result of a sting



## How Did the Sting Start?

- Richard Bistrong, former VP Int'l Sales of Armor Holdings, introduced each of the SHOT Show individuals to an FBI agent posing as a sales agent
- Apparently Bistrong had substantial contacts in the defense and law enforcement products industry and cooperated in identifying targets of the sting in order to reduce his own risk of jail time for (a) unlicensed vests and helmets to Iraq, and (b) \$4.4m in payments to third party intermediaries to secure sales to UN peacekeeping forces to government buyers in Nigeria and the Netherlands

## How Did the Sting Start? (cont'd)

- By certain estimates, Bistrong's support of the sting reduced his recommended sentence by two years for his unrelated violations

# How Did the USG Conduct the Investigation?

- According to Reuters:
  - 5,287 tapped phone calls
  - More than 800 hours of video and audio recordings
  - 231 recordings of meetings between undercover agents and the defendants





# Shot Show Outcomes and Lessons

- On February 21, 2012, the DOJ ended what U.S. District Court Judge Richard J. Leon called "a long and sad chapter of white-collar criminal enforcement," by filing a motion to dismiss charges
- The government's motion follows on the heels of two consecutive mistrials.
- During the second trial, Judge Leon dismissed conspiracy charges against six other defendants, which led to the acquittal of one; two other defendants in that trial were cleared by the jury; and Judge Leon declared a second mistrial for the remaining three defendants when the jury became deadlocked.
- Faced with these results, the government chose to abandon its case

# More Information on the SHOT Show Cases

- <http://www.millerchevalier.com/Publications/MillerChevalierPublications?find=60408#shot>
- <http://www.millerchevalier.com/Publications/MillerChevalierPublications?find=42304#Shot>
- <http://www.millerchevalier.com/Publications/MillerChevalierPublications?find=30601#Vegas>
- <http://www.millerchevalier.com/Publications/MillerChevalierPublications?find=24405>

# Debarment from Government Contracting

- Example of a “bet the company” risk that went bad
- July 2011-A New Jersey firm pleads guilty for sending drawings and sample gun parts to China without a license
- Related to the M4 and M16 rifles and M249 machine gun parts Swiss Technology told DOD it made in the U.S.
- Paid \$1.1m in restitution and was debarred by DOD from government contracting

# Prosecutors Are Stepping Up Criminal Actions Against Individuals

- DOJ regularly announces indictments of individuals for export control violations
- Political appointees of the Obama Administration have announced that even when a corporation is charged, the USG will seek criminal sanctions (jail time and criminal fines) and administrative sanctions (fines and denial orders for violations of the Export Administration Regulations)



# Highest Fines

## ITAR

- BAE (UK) (2010):  
\$470 million
- Xe Services (2010):  
\$42 million
- ITT (2007):  
\$128 million
- Qioptiq (2008):  
\$25 million
- Hughes (2003):  
\$32 million

## OFAC Regulations

- Barclays (2010):  
\$474 million
- Lloyds (2009): \$350  
million
- Credit Suisse (2009):  
\$536 million
- ANZ (2009):  
\$5.75 million
- ABN Amro (2005-10):  
\$580 million

## EAR

- PPG (2010):  
3.75 million
- DHL (2009):  
\$9.5 million
- Balli Aviation (2010):  
\$17 million
- Carrington (2006):  
\$12.6 million
- Ebara (2004):  
\$6.4 million

# Technology Controls

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# Deemed Exports & Release to Foreign Persons

- The obligation to get a license *before* releasing controlled technology to a foreign person is informally referred as the “deemed export” rule.
- Determine whether an export license is required for technology that a foreign national will see?
  - U.S. Department of State (Directorate of Defense Trade Controls/Defense services and articles), or
  - U.S. Department of Commerce (BIS) -dual-use (civilian and military applications) items.

# Deemed Exports & Release to Foreign Persons (cont.)

- The release of controlled technology to foreign persons in the U.S. is “deemed” to be an export to the person’s country or countries of nationality.
- The release of controlled technology to dual nationals or third country nationals outside the U.S. is subject to a new ITAR rule re vetting of employees of a consignee company
- Under the ITAR, license determination must be performed for all countries and citizenship and permanent resident status (apply the most restrictive control)
- Under the EAR, a reexport license determination is based upon the most recently acquired status



# Deemed Exports & Release to Foreign Persons (cont.)

- Server access
- Release of writings in any form
- Meetings
- Concalls
- Emails
- Plant tours
- Other releases of technical data and source code
- (Note public domain exclusion from the ITAR and publicly available treatment from the EAR)

# Export Control Reform

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## President's Export Reform Initiative per State

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Announced in August 2009, jointly Chaired by the NSC and NEC. Announcement recognized the significant changes in procurement, business practices and technology since the 70's. There were no pre-conceived conclusions on its outcome.

In the Spring of 2010, the Departments began action to reform the way the US does exports in 3 phases:

- I: Immediate improvements, create the framework
- II: Implement the new framework within existing structures
- III: Complete transition: Merge and consolidate

# Ongoing Export Control Reform Actions per State

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New definitions of defense services and levels of maintenance\*

New policy on defense articles embedded in commercial items\*

New exemption for replacement parts\*

New definition of "specially designed" to replace "specifically designed, modified, or adapted"\*

USML to CCL Transition Guidance

USXports Transition

USML Rewrite (all categories)

\*published as proposed rules

# Other ECR Actions per State

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Updated "by or for" the USG exemption

Legislation

Harmonize other ITAR and EAR definitions

Single Licensing Form

Government Program Licenses

Eliminate the requirement for foreign party signature on TAAs

# USML Rewrite Status per State

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DoC, DoS and DoD have completed rewrites of all categories of the USML

Categories VI, VII, VIII, XIX and )0( have been published as proposed rules and the final rules are under interagency development

Category V: Pending publication

Categories I, II, III, X, XIII, XIV are in review at OMB

Proposed rules on the other USML categories are awaiting submission to OMB for initial review

# Next Steps per State

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Finalize Transition Guidance

Finalize "specially designed" definition

Final decision on brokering, temporary imports, and registration requirements for items moving to the CCL

Begin 38(f) notifications on final rules, in turn

ECR objective remains publishing final rules by EOY

# Myths and Legends per State

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Purpose of USML revision is to get around Tiananmen Square sanctions:

No, the thrust of the ECR effort is the reduction of unnecessary regulatory burdens on transactions with NATO allies and multi-regime partners regarding items that do not provide the US with a critical military or intelligence advantage and, as such, do not otherwise warrant the ITAR's worldwide licensing and other collateral controls. Controls on exports to China are not affected by any of these objectives.



# Myths and Legends per State

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Former USML items now on the CML will be allowed for export to China and other embargoed countries: There will continue to be an embargo/presumptive denial policy for such items destined for export or reexport to China.

## Closing Comments by DDTC of State

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Reform of the US export control system has begun and will continue. But whatever changes take place in the near term must address the requirements of the AECA; The ITAR implements the AECA — it cannot change it.

Whatever changes are forthcoming will use US National Security as the litmus test and will be consistent with our international commitments.

Any changes will undoubtedly impact on established practices - it will be up to all of us to ensure the changes are improvements.

# Proposed Defense Services Definition

- Proposed April 2011 (no action since)
- Old Definition
  - Furnishing of assistance to foreign persons, whether in U.S. or abroad, in the design, development, production, testing, repair, maintenance, etc., (even if based on public domain data or data and source code subject to the EAR)
  - Furnishing technical data to foreign persons

# Proposed Defense Services Definition (cont'd)

- Proposed Definition

- Furnishing of assistance to foreign persons, whether in U.S. or abroad, in the design, development, production, testing, *intermediate or depot level* repair or maintenance, etc. *using anything other than public domain data*

- *intermediate: second-level performed “off-equipment” (on removed components and parts) by designated maintenance shops or centers, e.g., repair, testing, and replacement of parts, components, and assemblies*
- *depot: third level performed “on-” or “off-equipment” by major repair facility with extensive equipment and of higher technical skill*

# Proposed Defense Services Definition (cont'd)

- *Furnishing of assistance to foreign person, whether in the U.S. or abroad, in the integration of any USML- or CCL-listed item into a defense article*
- *Removed furnishing of technical data to foreign persons (but still captured under defense article definition)*
- *Explicitly excludes:*
  - *Training in basic operation and maintenance*
  - *Mere employment of U.S. citizen by a foreign person*
  - *Testing, repair, or maintenance of EAR-controlled item incorporated into a defense article*

# Proposed Defense Services Definition (cont'd)

- Potential Benefits to Timken

- Organizational level maint./repair on a ITAR-controlled bearing not a defense service (first level maintenance performed “on-equipment” by end user org’n; probably not applicable to Timken)
- Assistance related to ITAR-controlled bearing, based on public domain data, not a defense service
- Training in basic maint. of ITAR-controlled bearing not a defense service
- Activities of U.S. person employees of Timken’s foreign subsidiaries are not a defense service
- Testing, repair, or maint. of EAR- controlled bearing, even when incorporated or installed into a defense article, not a defense service

# Key Points on ECR—Personal Evaluation

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The USML categories published thus far are quite responsible and benefit national security because they are clearer and capture only enumerated items

If you like a proposal, make a supporting comment

The major changes will involve parts and components and will benefit suppliers without damaging national security whether or not controlled under the EAR or ITAR

## Key Points on ECR—Personal Evaluation (cont.)

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“specially designed” remains a critical definition

“defense services” is proposed, not final, and a good proposal is languishing

“brokering” is still too broad and includes sales activity by wholly owned subsidiaries



# Compliance pitfalls in a multinational supply chain

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Collaboration across business units in a multinational

Export of designs for production outside the U.S.

Unique documentation required for returns and repairs

Trade shows

Complex and narrowly interpreted ITAR license exceptions

# Mergers and Acquisitions

- Mandatory 60-day advanced notice to DDTC of control to be acquired of a U.S. firm or its assets by a non-U.S. firm
- Committee on Foreign Investment in the United States (acquisition may be unwound if a CFIUS filing is not filed or the Committee does not approve the acquisition)
- Foreign ownership control and influence (“FOCI”) and mitigation agreement under the NISPOM



# Parts and Components -- Not Just Guns and Missiles

- The ITAR apply to parts, components, attachments and accessories
- The current United States Munitions List (“USML”) includes broad categories of parts and components “specifically designed” for defense articles
- The current USML covers items designed, modified (tweaked), adapted, or configured for military and intelligence applications.
- Commodity jurisdiction is the biggest compliance program challenge for many companies

# Imports, Not Just Exports

- ATF regulates the permanent import of certain defense articles
- The Import Munitions List is narrower than the USML
- DDTC regulates temporary imports of defense articles under the ITAR
- Returns for repairs or calibration are highly regulated and while technically license exception may apply, the documentation requirements are significant, and must be planned BEFORE importation

# False Claims Act, ITAR, and Whistleblower Suits

- False Claims Act allows a person to bring a *qui tam* suit to enforce commitments related to government contracts and ITAR-violations
- This permits the individual to claim a significant portion of the fine the offending company owes the USG for violating the ITAR



# False Claims Act, ITAR and Whistleblower Suits (cont'd)

- DOJ may take over the litigation and prosecute it for the individual who still receives a percentage of the fine
- Companies may face such suits from its their employees or ex-employees who are in a position to see ITAR violations first-hand

# What are the most important elements in an export control program?

- Commitment from top management (Have you received a written reminder in the last year?)
- Training (In the last year, has your office received specialized training unique to its compliance procedures?)
- Processes and procedures (Does your office have unique work procedures for your office and its part in compliance?)
- Assessments (In the last two years, has your office been assessed in terms of compliance procedures and documentation?)

# Thank You!

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## May I Take Your Questions?

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