
Enforcement Activity Mounts as Department of Justice Focuses on Exporters

By Jason M. Waite and Jeffrey M. Schwartz

Recent events demonstrate that enforcement of export controls for sensitive goods and technology is among the Department of Justice's (DOJ) top priorities. A year ago, the DOJ executed an organizational change to consolidate export enforcement activities under a new National Security Division, but the most telling evidence of the DOJ's focus on export controls is the flurry of export enforcement activity to hit the headlines in the past few months.

Among the DOJ's recent export enforcement accomplishments are a groundbreaking \$100 million plea agreement with one of the largest defense contractors in the United States, a five-count indictment against another defense contractor and its owner in Alabama, and a 15-count indictment of two individuals residing in South Carolina, all for violations of the Arms Export Control Act (AECA) and other laws restricting the export of goods and technology.

Key to these enforcement actions is the fact that "technology" can include any type of information, drawings, or data related to the development, production, or use of export-controlled articles; indeed, two of the three recent cases concern the unauthorized transfer of drawings and design data to foreign manufacturers.

ITT Corporation, whose ITT NV division is a leading manufacturer of high-technology night vision equipment, pleaded guilty to multiple criminal charges of AECA violations. ITT is currently the 12th largest supplier of defense systems to the US military. The plea deal includes a \$100 million settlement, one of the largest penalties ever in a criminal case. ITT NV is also prohibited for three years from participating in exporting defense articles or furnishing defense services by the US State Department's Directorate of Defense Trade Controls (DDTC), which administers the International Traffic in Arms Regulations (ITAR).

Within a week of its announcement of the ITT plea agreement, the DOJ secured a five-count indictment against Huntsville, AL-based Axion Corporation and its owner. Axion is alleged to have exported technical

drawings of controlled articles to an overseas manufacturer without the required DDTC licenses. That announcement was followed by a 15-count indictment against several individuals operating out of South Carolina, Singapore, and India for violations of the AECA and the Export Administration Regulations. These charges arise from goods allegedly exported or re-exported to Indian companies on the Department of Commerce's Entity List.

The implications of these criminal investigations, and the resulting plea agreement in the ITT case, are far-reaching and offer several critical lessons for exporters, including:

- The importance of maintaining a company-wide commitment to export control compliance that is supported by the highest levels of management;
- The susceptibility of individuals—employees, executives, and owners—to prosecution;
- The broad scope of the United States Munitions List and the potential expansion of its reach by DDTC and the DOJ;
- The need to carefully manage all technology transfers within and between US operations and offshore manufacturers and suppliers and properly prepare export license applications and technical assistance agreements to obtain needed authorizations; and
- The importance of conducting an appropriate level of due diligence and exercising caution to ensure that voluntary disclosures are complete and accurate.

The ITT Night Vision Case

On March 28, 2007, ITT Corporation, whose ITT NV division is a leading manufacturer of high-technology night vision equipment, pleaded guilty to multiple criminal charges of AECA violations.¹

Exports of Controlled Specifications and Drawings Without a License

The first charge against ITT arose from the military contractor's export of classified technical data related

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to night vision goggles to China, Singapore, and the United Kingdom without a license or authorization from DDTC.

In the late 1990s, ITT possessed classified specifications for filters that prevent lasers from causing damage or degradation to night vision goggles. ITT originally subcontracted to source parts of the classified filter from a California-based company. According to the statement of facts filed with the plea agreement, in early 2000 ITT began to explore offshore manufacturing options as a way to reduce costs. In 2001, despite its awareness that it could not share the classified filter specification with any foreign country and despite its awareness that it had no export license, ITT sent the classified drawings and specifications to a Singapore supplier.

Based in part on a recommendation from an ITT manager in the United States, the Singapore supplier exported the controlled drawings and specifications to a facility in China to begin low-cost production of certain filter components. As part of the same project, ITT also turned to a UK-based sister company of its Singapore supplier as a source of coating technology used in the classified filter. In early 2001, ITT sent the classified filter specifications to this UK company to obtain a quote on the production of the coating. ITT never obtained an export license for this transfer and failed to verify the security clearance status of the UK company.

Offshore production plans for the classified night vision filter components were quite advanced—and the classified technical data had been shared with multiple offshore entities—before ITT finally submitted a license application to DDTC for offshore production in June 2001. However, the DOJ's investigation later concluded that the application was not only late but also contained false information.

Shortly after ITT submitted its export license application for the night vision filter technology, an ITT employee mentioned to a Department of Defense employee that ITT had been sourcing some of the filter parts offshore. This statement prompted the government to request that ITT recover all of the technical data that had been exported to offshore suppliers. ITT failed to comply with this request. In addition, ITT continued to push forward with the unauthorized foreign production of the night vision filters. At a time when the government was already aware of ITT's illegal exports, ITT issued additional purchase orders. More than 1,000 filter parts were already produced in the United Kingdom, and an additional 20,000 filter components were produced in China before ITT told these offshore suppliers to cease production in February 2002. In October 2002, the government executed a search warrant on ITT's facilities.

Material Omissions in a Voluntary Disclosure

The second charge against ITT arose from ITT's apparent omission of material facts during the course of a voluntary disclosure made to DDTC. This voluntary disclosure was unrelated to the technology transfer that led to the first criminal charge.

According to the statement of facts, ITT regularly leased or consigned night vision equipment to foreign customers for evaluation and testing. ITT held a license for these export consignments, but the license required the company to verify the return of the exported equipment after four years. Throughout the 1990s, however, ITT had failed to ensure the return of the consigned night vision equipment.

ITT compiled a list of these past-due consignments by March 1998. However, the company failed to take any corrective action until nearly two years after the list of violations was compiled, when ITT's outside law firm prepared a preliminary notification of voluntary disclosure in April 2000. ITT's preliminary disclosure indicated that the consignment license violations were "recently discovered," and in the final disclosure letter sent in May 2000, counsel described several forms of corrective action that ITT supposedly had undertaken.

According to the DOJ, it was in reliance on the representations made during the voluntary disclosure that the Department of State ultimately elected not to refer ITT for criminal prosecution. Instead, ITT and DDTC entered into a civil penalty consent agreement in October 2004, under which ITT agreed to pay an \$8 million penalty. But, based on its further investigation, the DOJ concluded that ITT had made numerous false statements and withheld material facts regarding the consignment violations in an attempt to minimize the civil penalty that it would receive.

Among the false statements and omissions cited by the DOJ was the outside counsel's statement that the violations were "recently discovered," when in fact the evidence obtained by the government established that ITT had delayed the voluntary disclosure for quite some time. The DOJ also cited the statements in the disclosures that ITT had taken immediate corrective action when most of the corrective action did not take place until the time of ITT's filing of its final disclosure.

Exceeding the Scope of an Existing TAA

Prosecution of a third charge, which related to the unlicensed and unauthorized export of night vision technical data to China, Singapore, and Japan, was deferred under the plea agreement. According to the statement of facts, ITT for years had been sharing export-controlled technical specifications with its Singapore-based supplier. ITT did so first without a

license and then continued to do so in violation of the build-to-print limitations set forth in a technical assistance agreement (TAA) that had been approved by DDTC. Indeed, contrary to the narrowly defined limits of the TAA, ITT actually brought engineers of Singaporean and Chinese nationality into close collaborative efforts with its own engineers to share and develop controlled night vision technology. According to the statement of facts, ITT was aware of these violations and chose not to disclose them.

Failed Corporate Compliance Culture

The statement of facts also provides numerous examples of executive and manager-level disregard for the company's export control responsibilities.

For example, an export license manager hired by ITT in May 2000, shortly after the initial disclosure of the consignment violations, resigned after just seven weeks on the job when he realized that ITT's management disregarded export compliance.

Also, in November 1998, an ITT employee told an ITT manager that she was not willing to violate export license requirements. The manager ordered the employee to make an illegal export anyway. After the employee informed high-level executives of this violation, ITT promoted the manager to a position of even greater responsibilities regarding export compliance. While many of these internal weaknesses cited in the statement of facts were not themselves violations of law, they appear to have influenced the government's aggressive stance toward the case and the severity of the punishment imposed.

The ITT Plea Agreement

The plea agreement between the government and ITT calls for \$100 million in fines, forfeitures, and other payouts. The US Attorney described the agreement as the "first of its kind." The first portion of the penalty is a \$20 million penalty to the Department of State. Second, ITT will pay the statutory maximum criminal fine of \$2 million as part of its guilty plea. Third, the company will forfeit \$28 million—an amount considered to be proceeds traceable to the violations—to various law enforcement agencies to reward their work in the investigation. Fourth, ITT will pay \$50 million in "restitution to the victims of their crimes—the American soldier."

This \$50 million restitution penalty is the most unusual aspect of the massive settlement. Over the next five years, ITT must invest the \$50 million to accelerate the development of the most advanced night vision equipment for US military use. The Army's Night Vision and Electronic Sensors Lab must approve every dollar spent as part of this project. Further, the US military retains

"Government Purpose Rights" to all technology that emerges from this effort. The Government Purpose Rights enable the US military to share the technology with ITT's competitors. Finally, any of the \$50 million that remains after five years will be immediately paid to the government.

The plea agreement also requires ITT to implement several export control compliance measures, including the hiring of an independent export monitor and staff, annual audits, mandatory reporting of violations, extensive export compliance training, and the submission of annual compliance certifications. The plea agreement's \$50 million investment requirement will give ITT the opportunity to maintain its role as a developer and producer of sophisticated night vision equipment for the US military. But, as noted earlier, ITT's industry-leading night vision division suffered a three-year DDTC debarment. Persons subject to DDTC debarment are prohibited from participating directly or indirectly in the export of defense articles, including technical data.

The Axion Indictment

Two days after announcing the plea agreement with ITT, the DOJ announced indictments in the Northern District of Alabama against Huntsville-based Axion Corporation. The charges arise from the firm's alleged unlicensed export of technical drawings to overseas manufacturers, as well as Axion's submission of false documents with regard to the supply of tank parts. Axion's owner was indicted, too. He could face up to 30 years in prison and \$1.75 million in fines if convicted on all five counts.

The indictment charges that beginning in September 2003 Axion Corporation exported technical drawings of the bifilar weight assembly for the Black Hawk helicopter to overseas purchasers without first obtaining a required license from DDTC.² In a statement similar to the announcement of the ITT plea agreement, the DOJ described this indictment as "a warning to companies seeking to enhance their profits at the expense of America's national security."

Indictments and Arrests for Selling Electronic Components to Entity List Companies

Four days following the announcement of the Axion indictments, the DOJ indicted four persons and arrested two of them in connection with alleged exports of electronic components to Vikram Sarabhai Space Centre and Bharat Dynamics, Ltd., both Indian companies on the Bureau of Industry and Security's Entity List (Supplement No. 4 to Part 740 of the Export Administration Regulations (EAR)). Under EAR, exports to anyone

on the Entity List require an export license from the Department of Commerce, regardless of the nature of the articles exported. One of the arrested defendants has been denied bail. Two defendants have not been arrested because they reside in Singapore and India.

The first set of criminal charges in the indictment allege EAR violations, namely the export to Entity List buyers of commercial electronic components, including SRAMs (Static Random Access Memory), capacitors, semiconductors, rectifiers, and resistors. These items allegedly have missile guidance and firing systems applications. The defendants did business through a company named Cirrus, with offices in South Carolina, Singapore, and India. The South Carolina defendants are said to have obtained orders from Entity List companies and then negotiated with commercial vendors in the United States, sometimes deceiving the vendors by preparing false end-user certificates. The defendants would then arrange for initial export through their Singapore office, thus concealing the actual destination from US authorities.

The remaining charges of the indictment allege violations of the ITAR in connection with exports of certain microprocessors and capacitors allegedly covered by the United States Munitions List (USML). The indictment states that these items were sold to an enterprise affiliated with India's Ministry of Defense for use in light combat aircraft.³

Lessons Learned

These cases highlight several issues that warrant attention from the exporting community, particularly in the defense and technology sectors.

First, the DOJ's emphasis on export enforcement appears to be translating into increased investigation and prosecution of export violations, raising the already high stakes for exporters.

Second, all three cases reveal the importance of implementing export control compliance mechanisms with high-level management support. For example, if ITT management had not displayed such disregard for export compliance, the government may not have pursued a record-breaking \$100 million penalty. Likewise, Axion and its owner, if the facts alleged in the indictment are true, needed to appreciate the imperative of technology controls, but they apparently neglected this area of compliance even while achieving success as a Department of Defense contractor.

Third, executives, owners, and individual employees are not immune from prosecution. The owner of Axion Corporation was charged along with the corporation and could face up to 30 years in prison and \$1.75 million in fines if convicted. Further, although

ITT Corporation has already pleaded guilty, its managers and executives may not be off the hook. Meanwhile, one of the individuals indicted for illegal exports to India remains jailed pending trial.

Fourth, the India export case, and possibly the *Axion* case, raises questions about the scope of the USML and DDTC's and DOJ's interpretation of the USML. These cases should focus exporters' attention on DDTC's commodity jurisdiction mechanism.

Fifth, the *ITT* and *Axion* cases demonstrate the myriad challenges that arise when exporters simultaneously deal in controlled articles and work with foreign manufacturers or foreign purchasers. Such business initiatives increase the need for internal controls over technology and the careful management of export licensing and TAA processes.

Finally, the *ITT* case raises significant questions regarding the proper approach to voluntary disclosures. In *ITT*'s case, its outside counsel helped prepare a preliminary voluntary disclosure, followed by an internal investigation, and eventually a more complete final disclosure to the government. Statements made in the preliminary disclosure, however, were cited by the government as evidence of *ITT*'s willful disregard for complying with export control laws. Thus, the prospect of having every word in disclosure submissions subject to scrutiny, or interpreted as misstatements, will give companies and their counsel pause, especially since *ITT* still had to pay an \$8 million penalty as part of its voluntary disclosure. Thus, the *ITT* case illustrates a new level of care that must go into preparing and presenting voluntary disclosures.

Given *ITT*'s stature as a major military contractor and given its pattern of violations and apparent lack of cooperation during the investigation, the DOJ used the prosecution and plea as an opportunity to "send a clear message that illegally exporting our nation's most important secrets will be prosecuted and punished." The several indictments obtained in the week following the *ITT* announcement echoed that message. Exporters and global technology companies should take notice that export control enforcement is among the DOJ's top priorities.

Notes

1. The facts presented regarding *ITT*'s export control violations are based on the statement of facts that was appended to the plea agreement filed with the US District Court for the Western District of Virginia in late March. According to the plea agreement, *ITT* agreed that "the Statement of Facts . . . is true and accurate to the best of its knowledge and belief and establishes an adequate factual basis for *ITT*'s plea to Counts One and Two."

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2. In addition, according to the indictment, in January 2004 Axion submitted an allegedly false document to the government in connection with a military contract. The document reported that certain testing of a defense article had been performed, when the defendants allegedly knew that the test reports were false. Then, in February 2004, Axion and its owner made an allegedly fraudulent representation to the US Army concerning the origin of an aircraft part it supplied pursuant to a military contract.
 3. As a legal matter, actual use by a military entity does not alone make the commercial electronic components described in the indictment USML items. Absent evidence that the microprocessors and capacitors at issue in the alleged ITAR violations were specially designed, configured, or adapted to a military use or otherwise specifically described on the USML, the allegation that DDTC export licenses were required for these shipments of commercial technology could be subject to legal challenge.