

End-Use Monitoring of Defense Articles and Defense Services Commercial Exports FY 2005

This report describes actions taken by the Department of State during the past fiscal year to implement the “Blue Lantern” end-use monitoring program. The Blue Lantern program is established under Section 40A of the Arms Export Control Act (AECA) to monitor the end-use of commercially exported defense articles, services, and related technical data subject to licensing under Section 38 of the AECA. The Directorate of Defense Trade Controls, in the Bureau of Political-Military Affairs (PM/DDTC), Department of State, is responsible for administering the International Traffic in Arms Regulations (ITAR) that implement the AECA. DDTC’s functions include registration of manufacturers, brokers, and exporters, licensing of commercial defense trade, overseeing compliance with U.S. export regulations, supporting U.S. law enforcement agencies in criminal investigations and prosecutions of AECA violations, as well as the end-use monitoring of licensed transactions. The Blue Lantern program is managed within PM/DDTC by the Office of Defense Trade Controls Compliance’s (DTCC) Research and Analysis Division (RAD). Blue Lantern end-use monitoring entails pre-license or post-shipment checks undertaken to verify the legitimacy of a transaction and to provide “reasonable assurance that –

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

DDTC is currently authorized a full-time complement of 76 State Department personnel, which is supplemented by 8 military officers, about 40 contract personnel, and a DHS/Immigration and Customs Enforcement Special Agent working on defense trade licensing and compliance (including end-use monitoring) efforts. DDTC’s operational budget for FY 2005, in addition to American salaries, was approximately \$8.7 million.

Overseas Monitoring: The Blue Lantern Program

Initiated in September 1990 and written into law under Section 40A of the AECA in 1996 as the USG’s first systematic end-use monitoring program, the Blue Lantern program 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, 2) aiding the disruption of illicit supply networks used by governments under U.S. or international restrictions and sanctions and international criminal organizations, and 3) 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 legal and regulatory requirements and have proven particularly effective in combating the global “gray arms” trade. “Gray arms” refers to the use of fraudulent export documentation to acquire defense articles through legitimate channels for re-transfer to unauthorized end-users. U.S. embassy personnel, or, in some instances, DDTC personnel, conduct Blue Lantern end-use checks overseas to verify the *bona fides* of unfamiliar foreign companies, to ensure delivery of licensed United States Munitions List (USML) commodities to proper end-users, and to determine compliance with DDTC licensed agreements such as Technical Assistance Agreements and Distribution Agreements.

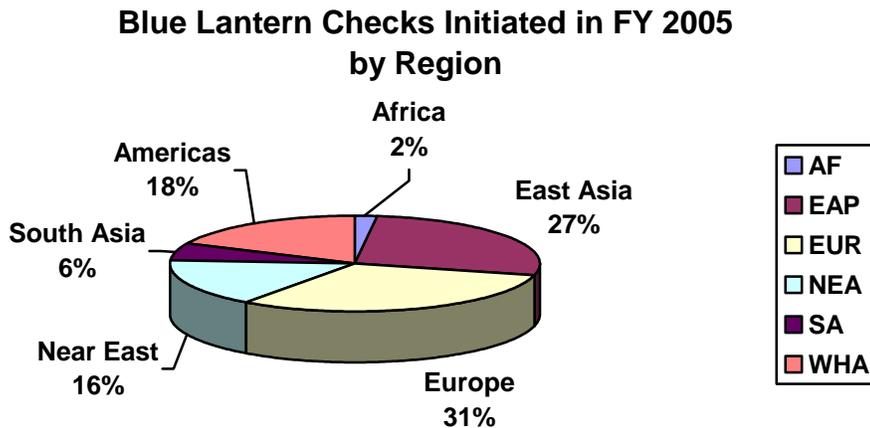
Last year, DDTC received and reviewed over 65,000 license applications and other export requests, most of them routine and legitimate. A small percentage of cases, however, may be subject to unauthorized or illicit activity. Blue Lantern checks are not conducted randomly, but are rather the result of a careful selection process to identify transactions that appear most at risk for diversion or misuse. License applications and other requests undergo review by licensing and compliance officers, 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 help DDTC licensing officers and compliance specialists to assess risks associated with the export of certain defense articles to various countries and regions, and provides significant insight into the reliability of companies and individuals involved in defense procurement overseas.¹

¹ Because Blue Lantern checks are selected based on potential risk and not a random sampling across all DDTC licenses, data on unfavorable checks should not be regarded as basis for statistically rigorous quantitative analysis.

Blue Lantern End-Use Checks in FY 2005

In FY 2005, DDTC initiated 562 end-use checks, a record number in the history of the program. Five hundred and five Blue Lantern cases were closed in FY 2005, with 80 designated as “unfavorable.” A regional breakdown of the 562 checks initiated in 2005 follows in Figure 1. Compared to FY 2004, numbers of checks in Europe, the Near East and East Asia increased slightly, and Africa, the Americas, and South Asia declined. The Americas declined most significantly, from 23% in FY 2004 to 18% in FY 2005.

Figure 1:



Analysis of Unfavorable Checks by Region

Several significant changes were observed in the global distribution of unfavorable checks closed in FY 2005. Europe, which had declined as a locale of unfavorable checks in FY 2004, shot up from 9% to 34% in FY 2005. East Asia again led all regions for the highest percentage of unfavorable checks at 36%, but actually declined (from 45% in FY 2004). A major drop in unfavorable cases was registered in the Americas (from 34% in FY 2004 to 12.5% in FY 2005).

Figure 2:

**Unfavorable Blue Lanterns by Region
(Total numbers 2004-2005)**

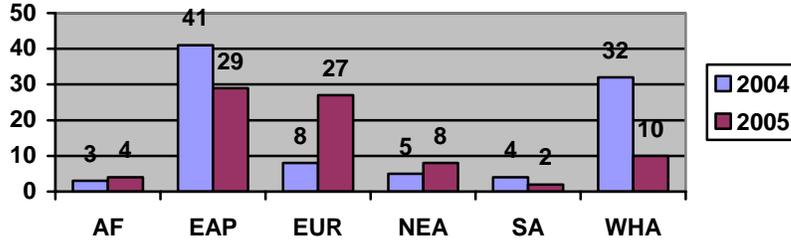
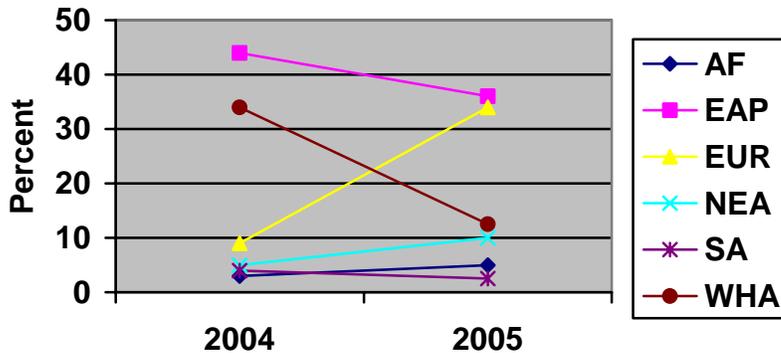


Figure 3:

**Unfavorable Blue Lanterns By Region
(Percentage of Total 2004-2005)**



Analysis of Unfavorable Checks by Commodity

The top six commodity groups for Blue Lantern checks were: Aircraft spare parts; helicopters/spare parts; electronics and communications; firearms/ammunition; night vision devices; and missile spare parts. Overall, unfavorable cases were more evenly distributed across different commodities than last year, and numbers of unfavorable cases for aviation spares, electronics/communications and firearms/ammunition all dropped significantly compared to FY 2004. Other commodities that were the subject of unfavorable Blue Lantern checks included satellite spare parts, inertial navigations systems, oscillators, military computer components, tank components/spares, riot control chemicals, and parachutes.

- The commodity group with the highest number of unfavorable checks was electronics and communications (12 unfavorables out of 72 total checks).
- The commodity group with the highest percentage of unfavorable checks was missile spare parts (4 out of 14; see Figure 5).
- By comparison, 100 firearms and ammunition cases were closed in FY05 but only 8 were found unfavorable.

A chart comparing Blue Lantern cases closed favorably versus unfavorably by commodity group can be found in Figure 4.

Figure 4:

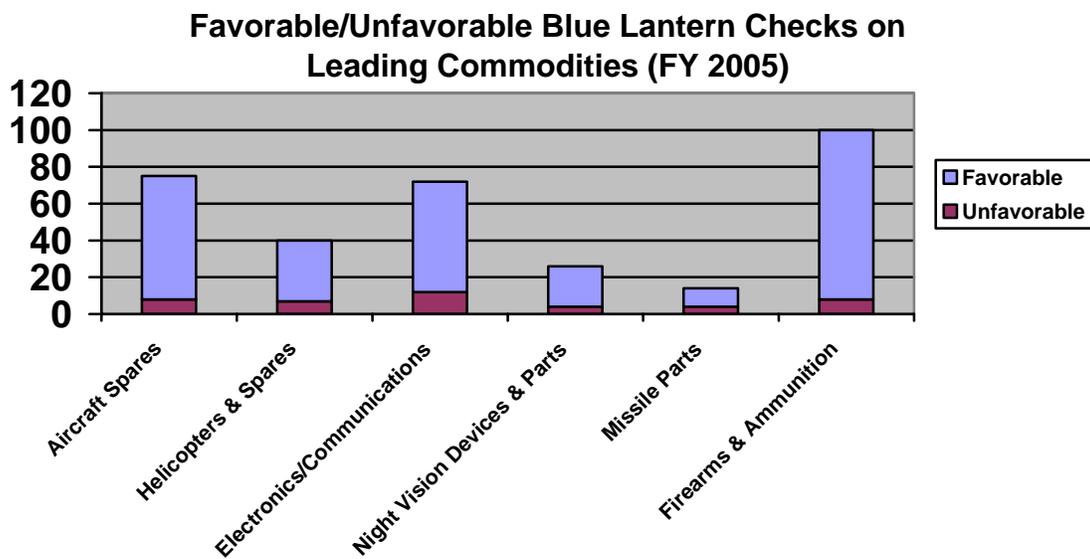
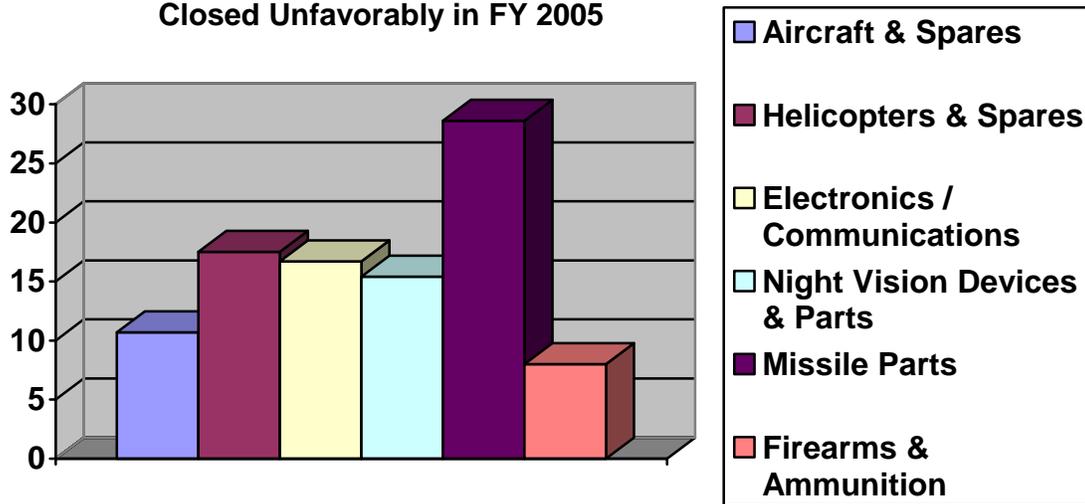


Figure 5:

Percentage of Checks Within Leading Commodities
Closed Unfavorably in FY 2005



Reasons for Unfavorable Checks in FY 2005

- In 45% of the unfavorable cases closed in 2005, the end-use or end-user could not be confirmed or justified during the Blue Lantern check.
- In 10% of cases, a foreign end-user reported that they had not ordered the items on the license – indicating possible intent on the part of the exporter or other parties to violate the ITAR and AECA.
- In an additional 10%, there was clear-cut evidence of illicit diversion or unauthorized re-export of the items.
- In 9% of cases, parties to the license could not be contacted or located.
- In 6%, the check revealed derogatory information about one or more parties; also in 6% of cases, the foreign end-user was judged by the Blue Lantern case officer to be an unreliable recipient of USML.
- 6% of cases were closed unfavorably because one or more parties refused to cooperate with the Blue Lantern inquiry.

Blue Lantern Case Studies FY 2005

The following examples illustrate the effectiveness of the Blue Lantern Program in FY 2005. In cases where derogatory information was sufficient, investigative leads were passed on to law enforcement or intelligence authorities:

- A post-shipment check of Global Positioning Systems/Inertial Navigation Systems (GPS/INS) to a company in the Persian Gulf region revealed that some of the items had been illegally re-exported to a third country. In cooperation with the host government, the company's owner was detained, remaining GPS/INS units were seized, and the Department of Homeland Security's Bureau of Immigration and Customs Enforcement (ICE) obtained a warrant for the arrest of the company's owner for AECA violations.
- A pre-license check on satellite components sought to determine the *bona fides* of an end-user identified as a university professor in an East Asian country. The Blue Lantern check found no record of the individual on the rolls of the university's faculty, or any evidence of any other association with the university. It also determined that the university specialized in medical education and had no satellite-related programs of any kind. The license application was denied.
- A pre-license check on helicopter spare parts to the armed forces of a country in Southeast Asia revealed that the officer who signed the end-use certificate was no longer in the military and instead was working for a private foreign company. The foreign company employing the former officer was believed to be operating on behalf of another foreign company with a long record of illicit gray arms activities. The license application was denied, and all parties were placed on the DDTC watchlist.
- Another pre-license check in a Persian Gulf country revealed an end-user that had no record of ordering the commodity (oscillators) on the license application. A subsequent check by the U.S. embassy on the foreign intermediate consignee in the transaction revealed that the company had no known address and no working contact number. The license application was denied and the foreign intermediate consignee was placed on the DDTC watchlist.

- A pre-license check on an application for 300 handguns to a private company in Latin America confirmed the legitimacy of the private company. Upon review of the proposed transaction, however, the host government determined that the number of guns was excessive given the high incidence of lost and stolen firearms involved in a recent surge in violent crime. The quantity of guns on the license was subsequently reduced.
- A pre-license check on ITAR-controlled military computer components destined for a former Soviet republic determined that the components would be used in a nuclear power plant rather than for meteorological measurement – as stated on the license application. The foreign end-user was placed on the watchlist and the license was denied.
- A Blue Lantern check on a temporary export of coastal defense equipment to an East Asian country confirmed that the foreign consignee was continuing to hold the equipment (in violation of the terms of the original license) and refusing to return it to the United States.
- A post-shipment check on 305 smoke pistols (for riot control) ordered by a police department in a West African nation could not confirm delivery of the pistols to the end-user. As a result of the Blue Lantern, the foreign intermediate consignee was suspected of diversion and placed on the watchlist. Future license requests for the foreign government in question will be subjected to extra scrutiny and any approval will require post-shipment verification to the USG.

Targeting: Efforts to Continue Improvements in Blue Lantern Selection Process

Due to reports of illicit diversion of night vision devices (NVDs), DDTC has initiated an increasing number of Blue Lantern checks for NVDs and related equipment. During FY 2005, DDTC closed 26 cases involving NVDs and related components; 4 of these cases were designated unfavorable. Significantly higher numbers of checks on NVDs are anticipated in 2006. DTCC/RAD compliance specialists continue to refine and improve a knowledge base derived from licensing data, past Blue Lantern checks, and

external (both classified and unclassified) sources to better guide Blue Lantern targeting by commodity and region.

Greater Coordination with Intelligence Community

The U.S. intelligence community (IC) is a critical resource in support of an effective and secure U.S. defense trade licensing regime. DDTC requires IC support to help understand international “gray arms” trends, information about foreign corrupt practices, individuals and companies believed to be involved in illicit arms trafficking, and information about ITAR-controlled commodities sought by embargoed states, terrorist organizations and criminals. DTCC/RAD has sought to deepen contacts and increase information exchanges with the IC during the past year. DTCC/RAD will continue the effort to establish collection and analysis requirements for defense trade intelligence during 2006.