

End-Use Monitoring of Defense Articles and Defense Services Commercial Exports FY 2015

This report summarizes the Department of State's administration of the Blue Lantern end-use monitoring program for fiscal year (FY) 2015. The Blue Lantern program fulfills requirements stipulated in section 40A of the Arms Export Control Act (AECA) (22 U.S.C. 2785). The program monitors the end-use of defense articles, technical data, services, and brokering activities exported through commercial channels and subject to Department of State licenses or other approvals under section 38 of the AECA and the International Traffic in Arms Regulations (ITAR) (22 CFR Parts 120-130), which implement section 38 of the AECA. The Blue Lantern program is managed by the Regional Affairs and Analysis Division (RAA), Office of Defense Trade Controls Policy (DTCP), Directorate of Defense Trade Controls (DDTC), Bureau of Political-Military Affairs (PM).¹

Blue Lantern's mission is to help ensure the security and integrity of U.S. defense trade. Blue Lantern prevents diversion and unauthorized use of U.S. defense articles, combats gray arms trafficking, uncovers violations of the AECA, and builds confidence and cooperation among defense trade partners.

Blue Lantern end-use monitoring includes pre-license, post-license, and post-shipment checks to verify the *bona fides* of foreign consignees and end-users, confirm the legitimacy of proposed transactions, and 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 defense articles and defense services; and
- ii) such articles and services are being used for the purposes for which they are provided."²

In FY 2015, DDTC had a full-time complement of approximately 70 State Department personnel, which is supplemented by eight active-duty military officers, approximately 64 contract personnel, a Department of Homeland Security Investigations Special Agent, and a Federal Bureau of Investigations Special

¹ Section 40A(c) of the AECA, requires the submission to the Congress of a report describing actions taken to implement the end-use monitoring of defense articles and defense services exported abroad, including a detailed accounting of the costs and number of personnel associated with the monitoring program, which is commonly known as "Blue Lantern."

² Section 40A(a)(2)(B) of the AECA, 22 U.S.C. 2785(a)(2)(B).

Agent. In FY 2015, DDTC had a diplomatic and consular programs budget of approximately \$1.5 million and received approximately \$39 million in registration fees. Six State Department employees and three contractors in RAA managed the Blue Lantern program, among other duties. End-use checks were conducted by U.S. embassy personnel. RAA staff also conducted overseas outreach visits to meet with embassy personnel, host government officials, and foreign businesses engaged in defense trade of ITAR-controlled items. These visits educated foreign defense trade partners about the Blue Lantern program and U.S. defense trade controls and policy as well as fostered cooperation with U.S. end-use monitoring and compliance with U.S. defense trade controls. In FY 2015, RAA conducted outreach trips to the Netherlands, Poland, Taiwan, Hong Kong, Japan, Brazil, Haiti, Indonesia, India, Ukraine, and the Philippines. In FY 2015, RAA started its new “Blue Lantern Post Support Program,” which facilitates end-use monitoring efforts by funding in-country travel costs associated with site visits as well outreach efforts, such as training seminars. The Blue Lantern program also has been cited as a model by international organizations promoting end-use monitoring as a best practice for responsible defense exporters, including the United Nations Institute for Disarmament Research (UNIDIR) and the Group for Research and Information on Peace and Security (GRIP).

Blue Lantern End-Use Inquiries Initiated in FY 2015

In FY 2015, DDTC adjudicated 44,103 export license applications. This is approximately a 50% drop in volume from its peak in 2012, as Export Control Reform (ECR) has moved less sensitive items, such as minor spare parts, off the munitions list. This shift has enabled DDTC, including RAA, to focus its resources on more sensitive commodities. RAA initiated 570 Blue Lantern checks (329 pre-license checks and 241 post-shipment checks) in 83 countries. This represents approximately 1% of adjudicated export licenses and is consistent with prior years. Figures 1 and 2 illustrate the regional distribution of license application requests and Blue Lantern inquiries, respectively.³

Figure 1: Authorization Requests By Region FY 2015

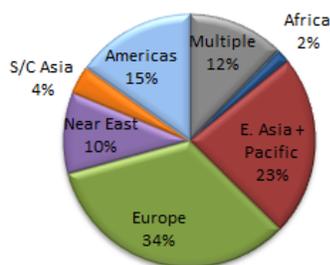
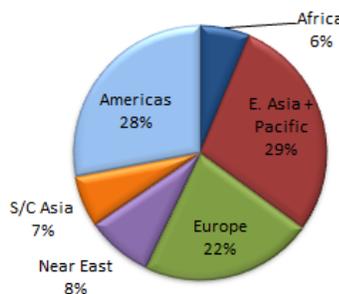


Figure 2: Blue Lantern Initiated By Region FY 2015



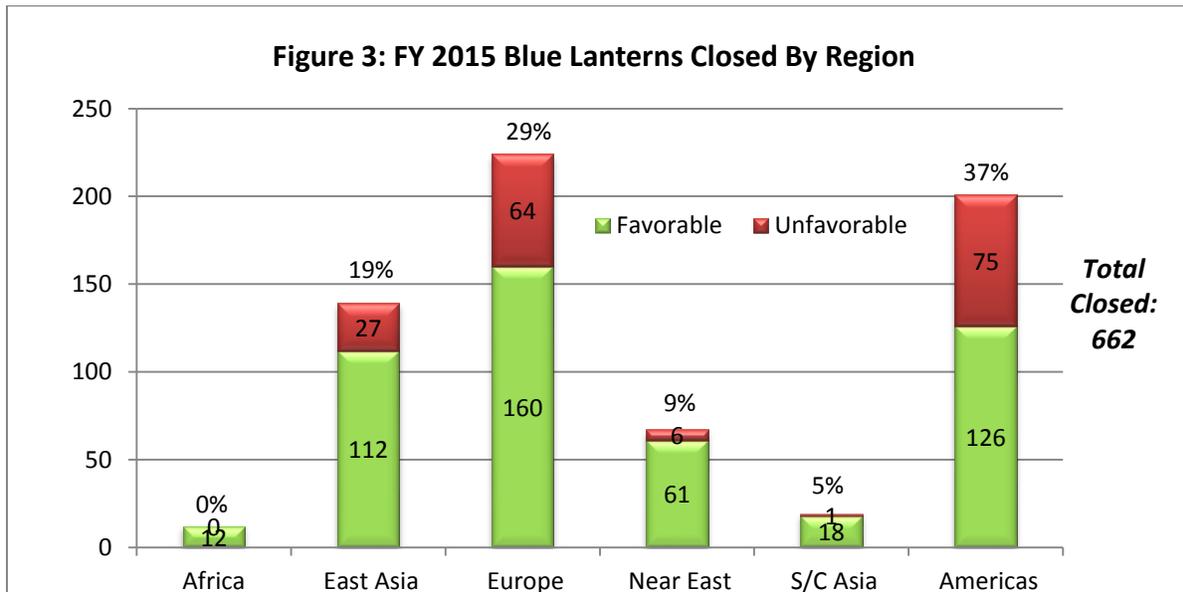
Blue Lantern End-Use Inquiries Closed in FY 2015

In FY 2015, RAA closed 662 Blue Lantern cases. Figure 3 illustrates the number of Blue

country of the end-user listed on the license due to concerns over foreign intermediaries

Lantern cases closed, broken down by region. Of the cases closed, 489 (74 percent) reported “favorable” results. These favorable checks verified that defense articles were received and secured by authorized end-users, verified the bona fides of parties, especially foreign intermediaries, and enhanced understanding of U.S. export laws and regulations. In addition, the Blue Lantern program identified problematic transactions (“unfavorable” checks), which in some cases prevented or uncovered illicit exports and nefarious procurement agents.

In FY 2015, RAA had 173 unfavorable Blue Lantern cases (26 percent), meaning the findings of fact were not consistent with information in the license application. The average global unfavorable rate for the four fiscal years before 2015 was 21 percent.⁴ This year’s unfavorable rate skewed above average due to the high rate in the Western Hemisphere (mostly involving firearms) and a significant number (27) of checks in Europe involving two entities which failed to adequately cooperate with end-use inquiries. The unfavorable rate in the Western Hemisphere increased significantly in FY 2015 to 37 percent, compared to 9 percent in FY 14 and 20 percent in FY 13. In FY 2015, Africa had no unfavorable end-use checks, compared with 52 percent in FY 14 and 16 percent in FY 13. RAA attributes these fluctuations within this relatively small sample size to the targeting of checks according to “warning flags” such as unfamiliar or Watch-Listed parties, sensitive or in-demand commodities, unusual shipment routing, or weak end-use documentation.



⁴ Blue Lantern checks are selected based on several risk factors, including unfamiliar foreign parties, sensitive technology, or unusual shipping routes. Because of this risk-based selection process, transactions targeted for Blue Lantern checks are more likely to result in unfavorable findings than a random sampling of license applications.

DDTC's Watch List is an internal screening tool containing over 160,000 entities, ranging from the suspect to the sanctioned. RAA uses this database to flag export license applications for possible Blue Lantern checks. In FY 2015, RAA reviewed 27,732 Watch List name matches, or "hits" (including false hits), and made 2,666 additions and 3,321 modifications to the Watch List.

Reasons for Unfavorable Checks in FY 2015

While Blue Lantern cases may be unfavorable for multiple reasons, for statistical purposes each case is assigned a single, predominant reason for an unfavorable determination. As in years past the leading cause of an unfavorable finding in FY 2015 was ***derogatory information / foreign party deemed unreliable*** (61 cases). This broad category includes criminal records, derogatory information from various sources, and concerns regarding a company's *bona fides*. For example, a pre-license check on the temporary export of night vision devices (NVDs) for marketing purposes revealed that the proposed end-user had provided an incorrect corporate address, lacked secure storage facilities, operated a casino as a side business, and included a known gray arms dealer as part of the chain-of-custody. Two firearms pre-license checks also illustrate derogatory findings. The first revealed that a European firearms dealer was under investigation for suspected breaches of national firearms laws. The second uncovered an improperly licensed Caribbean firearms dealer who was operating out of a private residence without adequate security measures and utilizing a customs broker without appropriate authorizations.

The second most common reason for an unfavorable check in FY 2015 was ***refusal to cooperate*** (33 cases). Eighty percent of these unfavorable checks (27 cases) are attributable to multiple checks on just two entities.

For FY 2015, RAA separated the category ***indications of diversion or unauthorized retransfer or re-export*** used in previous reports into two groups in order to differentiate unauthorized retransfers due to poor compliance versus intentional or nefarious actions. In FY 2015, RAA documented 28 cases of ***unauthorized re-exports/retransfers*** and 12 cases of ***indications of potential or actual diversion***. This means that of the 662 Blue Lantern cases closed in FY 2015, only 12 (or 1.8 percent) showed indications of willful diversion tactics. This suggests that the incidence of observed illicit procurement attempts through licensed defense trade channels is very infrequent. However attempts to exploit the system underscore the importance of a strong export control regulatory

framework. One example involves a pre-license check on the proposed export of two demilitarized helicopters to a private European company. The company is on DDTC’s Watch List for diversion to a proscribed country. During the Blue Lantern check the company was unable to provide evidence that could verify the helicopters’ end-use with a bona fide government customer. In a second example a pre-license check for the export of rifle stocks to an outdoor supply reseller in the Middle East showed the company had significant business ties to a country prohibited from receiving U.S. defense articles, indicating substantial risk of unauthorized re-exports to a proscribed destination.

Lack of knowledge of defense trade rules and requirements also creates opportunities for unauthorized retransfers. Sixteen of the 28 cases related to *unauthorized re-export/retransfer* involved firearms licensed for a single end-user in the Caribbean. In these cases the licensed end-user, the national police, ordered firearms on behalf of other unlicensed government entities with no system to account for their disposition. In another example a European firearms re-seller failed to obtain U.S. government permission to re-export firearms outside the country.

Derogatory information/ foreign party deemed unreliable recipient of USML	61
Refusal to cooperate	33
Unauthorized re-export/retransfer	28
Foreign party involved in transaction but not listed on license/ application	25
Indication of potential or actual diversion	12
Deficient accounting or inventory errors	9
Regional concerns	4
Lack of secure storage facilities	1

Figure 4: Reasons for Unfavorable Results and Number of Instances Based on Licenses (FY 2015)

Checks continued to reveal the involvement of unauthorized foreign parties (25 cases). This is often because of poor due diligence on the part of the U.S. exporters or the failure of foreign consignees to properly disclose the full chain-of-custody.

Unfavorable Blue Lantern cases resulted in several types of actions, including returning or denying license applications, removing parties from licenses, revoking licenses, updating the Watch List, or referring cases to DDTC’s Office of Defense Trade Controls Compliance (DTCC) and/or U.S. law enforcement agencies for appropriate civil and/or criminal enforcement investigation and action. In FY 2015, Blue Lantern checks and Watch List screening led RAA to recommend denial or removal of an entity from 71 license applications, return without action of 35 license applications, and revocation of 19 licenses. In FY 2015, RAA referred 14 unfavorable Blue Lanterns to DTCC, which in turn directed companies to disclose information related to suspected ITAR violations.