

End-Use Monitoring of Defense Articles and Defense Services Commercial Exports FY 2016

This report summarizes the Department of State's administration of the Blue Lantern end-use monitoring program for fiscal year (FY) 2016. The Blue Lantern program fulfills requirements stipulated in section 40A of the Arms Export Control Act (AECA) (22 U.S.C. 2785) and delegated to the Department of State in Executive Order 13637 (March 8, 2013). 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. The program 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/pre-shipment, 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 2016 DDTC had a full-time complement of approximately 91 State Department personnel, which was supplemented by eight active-duty military officers, approximately 70 contract personnel, a Department of Homeland Security Investigations Special Agent, and a Federal Bureau of Investigations Special Agent. In FY 2016 DDTC had a diplomatic and consular programs budget of approximately \$134,605 and received approximately \$36 million in registration fees. Nine 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 2016 RAA conducted outreach trips to Germany, United Arab Emirates, Indonesia, Thailand, Malaysia, Switzerland, Paraguay, Vietnam, the Philippines, France, South Korea, the Czech Republic, and Singapore. In FY 2016 RAA's Blue Lantern Post Support Program, which facilitates end-use monitoring efforts by funding in-country travel costs associated

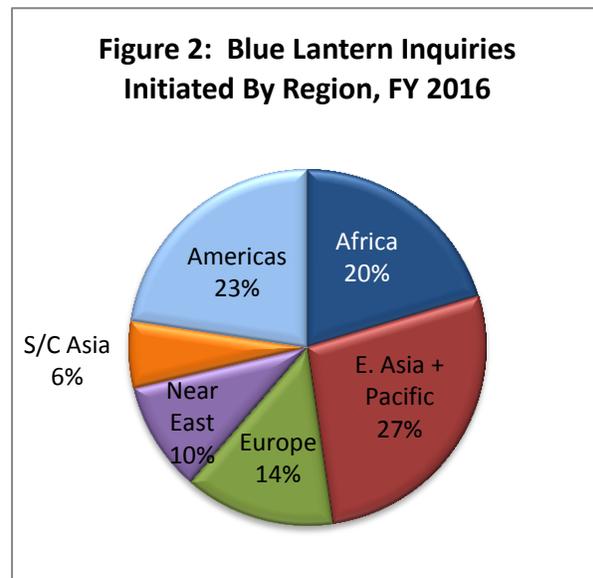
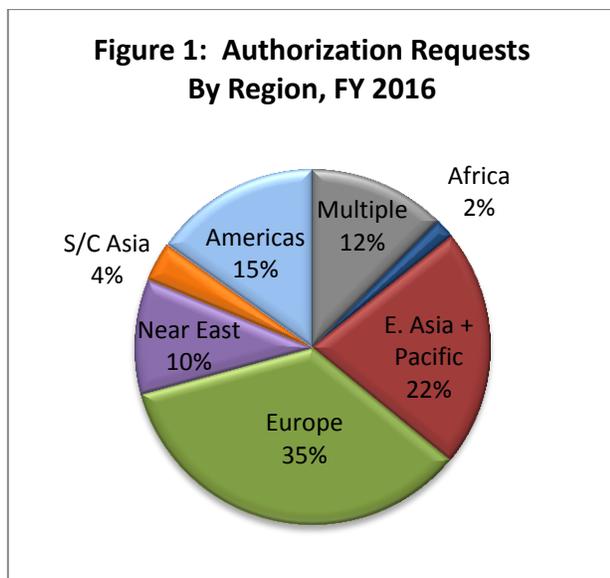
¹ Section 40A(c) of the AECA, requires the submission to the Congress of a report describing actions taken to implement the end-use monitoring of defense articles and defense services exported abroad, including a detailed accounting of the costs and number of personnel associated with the monitoring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

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

with site visits as well as outreach efforts, supported regional training seminars in Berlin and Manila as well as end-use checks in Ecuador, Germany, Papua New Guinea, and the Philippines. 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 by 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 2016

In FY 2016 DDTC authorized 38,398 export license applications. This decrease of more than 50 percent from the record volume in 2012 is a result of the transfer of less sensitive items, such as minor components, from the United States Munitions List to the Commerce Control List under the Export Control Reform (ECR) initiative. This shift has allowed DDTC to focus its resources on the most sensitive commodities. RAA initiated 673 Blue Lantern checks (295 pre-license, 16 post-license/pre-shipment, and 362 post-shipment) in 97 countries in FY 2016. This represents approximately 1.75 percent of adjudicated license applications, which is a moderate increase over prior years and a record high in percentage terms. Figures 1 and 2 illustrate the regional distribution of authorization requests and Blue Lantern inquiries, respectively.³

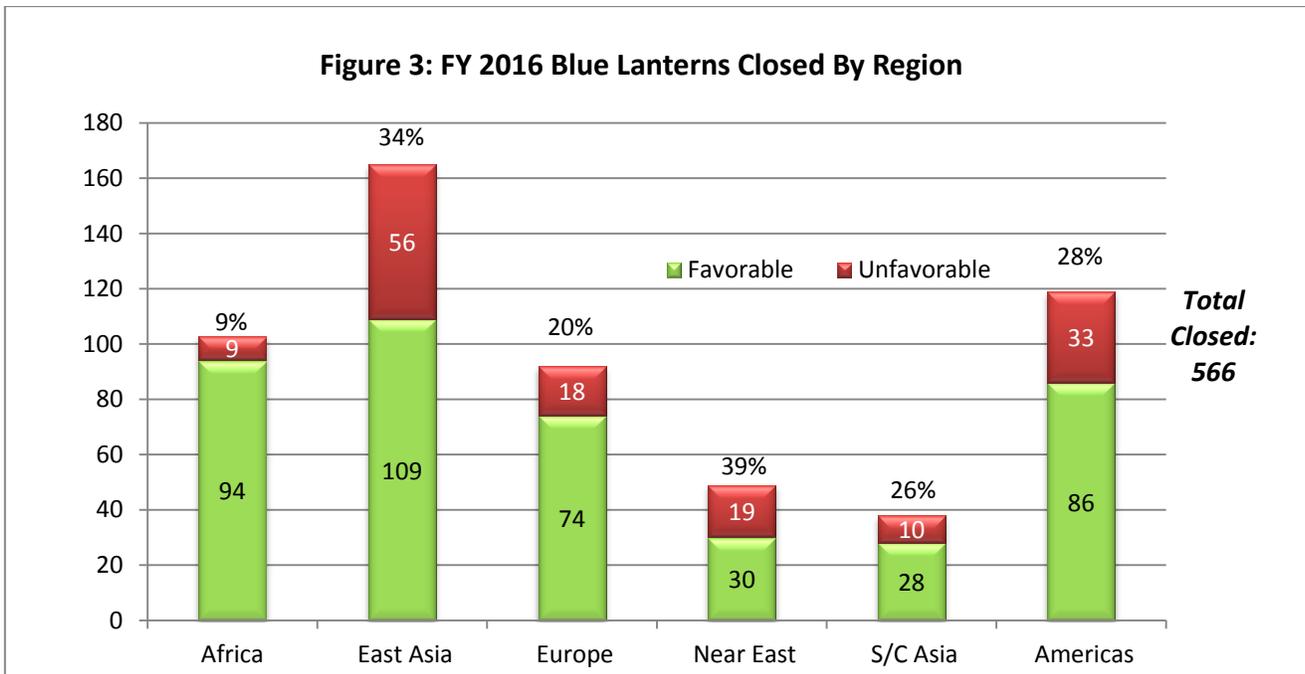


Blue Lantern End-Use Inquiries Closed in FY 2016

RAA closed 566 Blue Lantern cases in FY 2016. Figure 3 illustrates the number of Blue Lantern cases closed, broken down by region. Of the cases closed, 421 (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.

³ For statistical purposes, RAA attributes a Blue Lantern check to the country of the end-user listed on the license application request. Blue Lantern inquiries, however, may be initiated due to concerns over foreign intermediaries in third countries.

RAA closed 145 (26 percent) cases as “unfavorable,” meaning that the findings of fact were inconsistent with information in the license application, or that information could not be verified. Some of these checks prevented or uncovered illicit transactions or nefarious procurement agents. The average global unfavorable rate over the four fiscal years before 2016 was 20.6 percent.⁴ The likely reasons for this year’s above-average unfavorable rate were improved targeting and an increase in unfavorable findings in East Asia and the Pacific, South and Central Asia, Africa, and the Near East. The number of cases closed as unfavorable in East Asia and the Pacific jumped from 19 percent in FY 2015 to 34 percent in FY 2016 largely because many inquiries in Southeast Asia uncovered the involvement of undisclosed private consignees. South and Central Asia and Africa also saw an increase in unfavorable cases due to unresponsive government end-users. Nearly 40 percent of all cases in the Near East were closed unfavorable in FY 2016, up from only nine percent in FY 2015, largely due to multiple unfavorable post-shipment checks on the same private entity.



DDTC’s Watch List is an internal screening tool containing over 170,000 entities, ranging from the suspect to the sanctioned. RAA uses this database to flag export license applications for possible Blue Lantern checks. In FY 2016 RAA reviewed 27,732 Watch List name matches, or “hits” (including false hits), and made 8,397 new entries and 8,625 modifications to the Watch List.

Reasons for Unfavorable Checks in FY 2016

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 2016 was *derogatory information / foreign party deemed unreliable* (40 cases). This broad category includes criminal records, derogatory

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.

information from various sources, and concerns regarding an entity’s *bona fides*. For example, a pre-license check on the export of firearms to a Caribbean country revealed that the proposed end-user had been out of business for months.

The second most common reason for an unfavorable check in FY 2016 was the *involvement of an unlicensed party* (32 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. Nearly half of these cases involved the omission of foreign consignees on license applications to a country in Southeast Asia. These problems were attributed to administrative oversights deemed to be not malicious. DTCP conducted outreach in the country to spread awareness of the U.S. government’s requirements for license applications.

The third most common reason for an unfavorable check in FY 2016 was foreign end-users or foreign consignees that were *uncooperative or failed to respond* (23 cases). Most of these cases in FY 2016 involved government end-users in the Near East and South and Central Asia regions.

Derogatory information/ foreign party deemed unreliable recipient of USML	40
Unlicensed party	32
Uncooperative/failure to respond	23
Administrative accounting/inventory problems	15
Indications of potential or actual diversion	12
Physical security concerns	9
Evidence of stockpiling	4
Unauthorized re-export/retransfer (administrative violation)	3

Figure 4: Reasons for Unfavorable Results and Number of Instances (FY 2016)

Since FY 2015 RAA has disaggregated the previously used category *indications of diversion or unauthorized retransfer or re-export* into two categories in order to differentiate unauthorized retransfers due to poor compliance from intentional or nefarious actions. In FY 2016 RAA documented 12 cases of *indications of potential or actual diversion* and three cases of *unauthorized re-exports/retransfers*. Thus only two percent of Blue Lantern cases closed in FY 2016 discovered indications of willful diversion tactics. While this represents a slight uptick from FY 2015, it suggests that the incidence of observed illicit procurement attempts through licensed defense trade channels remains very infrequent. One example involved a pre-license check on the export of aircraft spare parts to a military in Africa through a private Middle East-based consignee on DDTC’s Watch List. The proposed end-users denied ever ordering the parts.

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. Blue Lantern checks and Watch List screening led RAA to recommend denial or removal of an entity from 65 license applications, return without action of 47 license applications, and revocation of 14 licenses. RAA referred 23 unfavorable Blue Lanterns to DTCC, which in turn directed companies to disclose information related to suspected ITAR violations. DTCC referred three of these unfavorable cases to law enforcement.