

End-Use Monitoring of Defense Articles and Defense Services Commercial Exports FY 2019

Executive Summary

The Department of State's Blue Lantern end-use monitoring program addressed the evolving nature of arms trade and subsequent challenges associated with diversion in FY 2019. The Bureau of Political-Military Affairs' Directorate of Defense Trade Controls (PM/DDTC) accomplished this by developing and initiating the first-ever series of joint end-use monitoring checks between the Departments of State and Defense and the completion of the first tranche of Blue Lantern visits tailored to assess the risk of diversion of U.S. defense articles due to the acquisition of foreign companies by entities that pose a potential enhanced risk of diversion.

During FY 2019, PM/DDTC's Blue Lantern program achieved other notable successes. PM/DDTC enhanced its work with posts in order to improve their ability to keep pace with the rate of checks requested and conduct the checks in a more timely and effective manner. The results were significant, with the Directorate initiating 187 checks and posts closing almost as many (181), and PM/DDTC recommending non-approval of more than 130 license applications, up from 57 during FY 2018. This non-approval rate was supported by better execution of and reports on Blue Lantern checks, the expansion of end-use monitoring efforts described above, and enhanced and regular application of intelligence products.

In addition to these efforts, PM/DDTC modified the way it tabulates its end-use monitoring activities to ensure the numbers it reports better reflect the work being done. The new method, which takes into account only those license applications with a direct bearing on a Blue Lantern check, is a departure from the previous approach, which considered all applications that could be indirectly impacted by Blue Lantern findings. This change in methodology effectively minimizes the possible inclusion of irrelevant cases that could provide false assurances of favorable results.

PM/DDTC's FY 2019 successes are further notable given the 35-day lapse in appropriations spanning December 22, 2018, to January 25, 2019. This circumstance interfered with the onboarding and training of new personnel to replace departed colleagues. Further, it hindered travel, embassy operations, and the planning needed to initiate and conduct Blue Lantern checks in FY 2019. Coupled with the new check tabulation method, this was a major factor in an overall reduction in the number of Blue Lantern checks conducted in FY 2019.

Discussion

This report summarizes the Department's administration of the Blue Lantern end-use monitoring program for FY 2019. 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 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 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 Country and End-Use Analysis Division (CEA), Office of Defense Trade Controls Policy (DTCP), PM/DDTC.¹

Blue Lantern's mission is to help ensure the security and integrity of the U.S. defense trade. The program minimizes the risk of 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 to the extent possible, 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 2019 five State Department full-time employees and three to four contractors in CEA managed the Blue Lantern program, among other duties, at a total cost of \$1,400,000. End-use checks are largely conducted by U.S. embassy personnel. CEA staff also conducted overseas outreach visits to meet with embassy personnel and host government officials and foreign businesses engaged in the trade of defense articles and defense services subject to the ITAR. 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 2019, CEA expended approximately \$51,760 in conducting and planning outreach trips to Indonesia, the Republic of Korea, Saudi Arabia, Serbia, Sweden, Taiwan, Ukraine, and the United Arab Emirates. In FY 2019, CEA's Blue Lantern post support program, which facilitates end-use monitoring efforts by funding in-country travel costs associated with site visits, expended \$10,500.

Blue Lantern End-Use Inquiries Initiated in FY 2019

In FY 2019, DDTC authorized 36,754 export license applications. Figure 1 below depicts the regional breakdown of those requests. CEA initiated 114 Blue Lantern inquiries, involving 187 licenses checked (85 pre-license, 41 post-shipment, and 61 comprising both pre-license and post-shipment checks) in over 40 countries.³ This figure represents approximately 0.5 percent of adjudicated license applications. Distribution of those checks according to their respective regions is represented in Figure 2.⁴ The number of entities checked in FY 2019 was 131.

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).

³ As noted, PM/DDTC changed the methodology for tabulating its end-use monitoring activities. As a result, the figures reported here are not directly comparable with the figures provided in prior reports.

⁴ The regions are based on the areas of responsibility of State Department regional bureaus: AF for African Affairs, EAP for East Asian and Pacific Affairs, EUR for Europe and Eurasia, NEA for Near Eastern Affairs, SCA for South and Central Asian Affairs, and WHA for Western Hemisphere Affairs.

The totals for FY 2019 declined from previous years due to several factors. Of note, the 35-day lapse in appropriations spanning December 22, 2018, to January 25, 2019, significantly interfered with the onboarding and training of new personnel to replace departed colleagues. In addition, the lapse in appropriations also affected travel to sites from Washington, D.C., the operations of our embassies and consulates abroad, and planning for future checks.

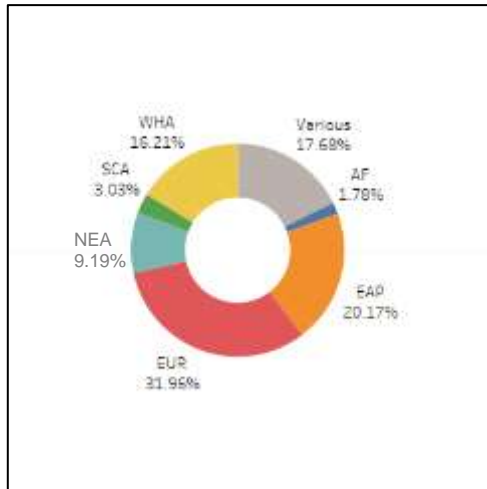


Figure 1 – Regional Distribution of Authorization Requests

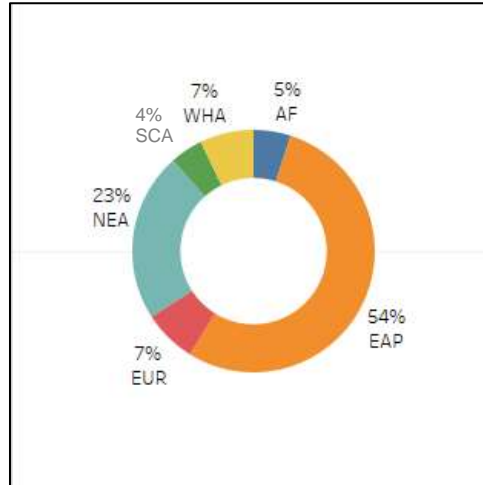


Figure 2 – Regional Distribution of Blue Lantern Checks

In light of the evolving nature of arms trade and the potential challenges associated with diversion, and despite these constraints, CEA expanded its portfolio of data collection tools to meet the program requirements of AECA §40A. For example, whereas standard end-use monitoring checks focus strictly on verifying the bona fides of license applications or confirming receipt of shipments, during FY 2019, CEA introduced a variant of the Blue Lantern check geared specifically toward conducting diversion risk assessments on certain proposed direct commercial sales (DCS) transactions. These checks analyze the management structure and security controls of foreign companies that may pose a risk of diversion due to their acquisition by another foreign entity, potentially impacting dozens of licenses and agreements per entity. The licenses and agreements impacted by this type of check usually are not counted toward the total number of licenses checked, as the inquiry typically focuses on the foreign company's relationship with the parent company rather than on confirming the details of a particular transaction.⁵ Additionally, CEA expanded coordination with the Department of Defense's Defense Security Cooperation Agency, which oversees the Golden Sentry end-use monitoring program for Foreign Military Sales (FMS), to combine efforts where official records indicate defense articles exported via DCS and FMS coexist in a given government's inventory. This enhanced coordination included the first-ever joint visits by the Blue Lantern and Golden Sentry teams to gain a comprehensive overview of End Use Monitoring status across the defense exports realm. Based on this expanded toolkit of end-use monitoring options, augmented outreach and education provided to posts, and expanded reliance on

⁵ Hence the reason for supplying data reflecting *the number of entities checked* at the beginning of this section. Prior to this year, these figures were not a regular feature of this report.

intelligence products, CEA recommended non-approval of over 130 applications in FY 2019, up from 57 such recommendations in the previous fiscal year.

Finally, in anticipation of reduction in licenses due to the pending transition of certain firearms and related ammunition to the control of the Department of Commerce (85 Fed. Reg. 3819; January 23, 2020), CEA anticipates expanding its number of post-shipment checks on end-users of defense articles posing a greater critical military or intelligence advantage. Such checks would include but not necessarily be limited to revisiting previously checked entities, with the intent of helping to validate and/or facilitate further improvements in their compliance programs.

Blue Lantern End-Use Inquiries Closed in FY 2019

CEA initiated 187 Blue Lantern checks into license cases in FY 2019 and worked with posts to close 181 checks into license cases in the same period. Figure 3 illustrates the number of Blue Lantern cases closed, broken down by region. Of these cases, 101 (55.8 percent) reported “favorable” results. These favorable checks verified that defense articles were received and secured by authorized end-users, confirmed the bona fides of parties (especially foreign intermediaries), and enhanced the parties’ understanding of U.S. export laws and regulations.

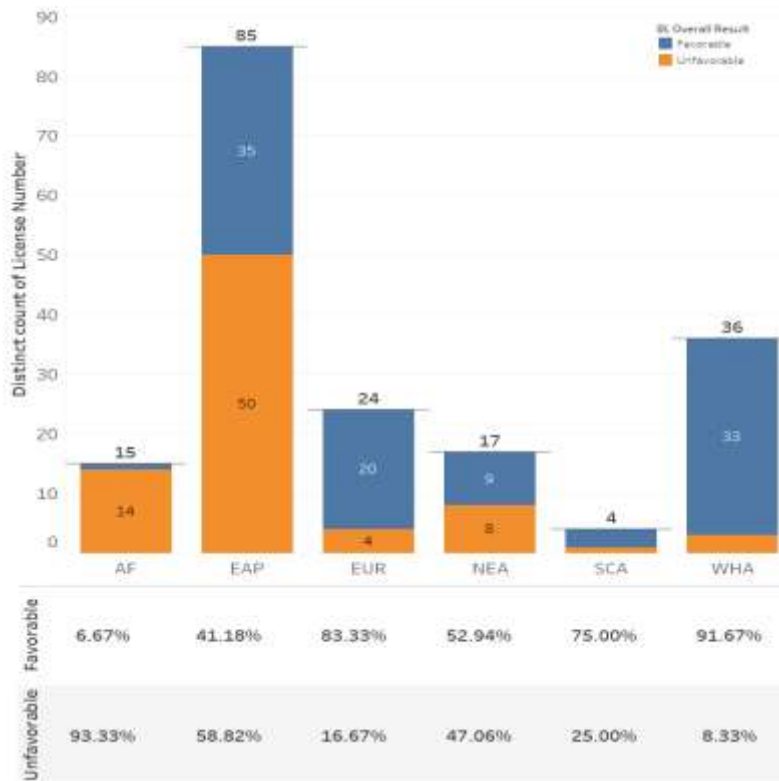


Figure 3: Checks Closed by Region

Unfavorable Checks in FY 2019

CEA closed 80 cases (44 percent) as “unfavorable,” where either the findings did not correlate with the information on the license applications or the items exported could not be fully verified. A common reason for the latter was lack of responsiveness by the foreign party. Only one of these

checks revealed indications of a possible illicit transaction or nefarious procurement practice. This matter was subsequently referred to law enforcement for further action.

FY 2019 saw an increase in unfavorable ratings. CEA attributes the rise in negative ratings to several factors. The number of risk factors by which Blue Lantern checks are selected increased, as noted earlier. In addition to investigating cases due to factors such as the presence of unfamiliar foreign parties, the level of sensitivity of the technology involved in the transaction, or unusual shipping patterns, Blue Lanterns now focus on other concerns as well, such as trends like foreign investment in the foreign trading partners of the United States. Second, in order to improve the quality of data submitted in this report, CEA adjusted its methodology for counting the number of cases checked per visit. Whereas previously CEA occasionally included data for all cases that ultimately *could be impacted* by a given check, in FY 2019, CEA implemented a new standard to include “only those licenses *directly related to and/or that have a direct bearing* on the proposed visit.” This change in procedure effectively minimizes the possible inclusion of irrelevant cases as a metric in the review of a single end-user that could provide false assurances of favorable results. It also means that for most regions, where proportionally the majority of findings tends toward the favorable, this change may result in an increase in the overall proportion of unfavorable findings.

Figure 4 depicts the reasons unfavorable checks were closed. Because a case may be designated “unfavorable” for a variety of factors, the cumulative total for this table exceeds the total number of unfavorable cases recorded for the year. In FY 2019, the leading cause of an unfavorable finding was *derogatory information/unreliable foreign party* (40 checks), meaning the end-use check generated information that called into question the ability of the foreign party to comply with the ITAR. The second most common reason for an unfavorable check was *unlicensed party* (22 checks), where the check detected the participation of an entity not listed on the license or authorization request. The third most common reason was *inability to confirm order or receipt of goods* (13 checks). This broad category includes cases where the information provided by the foreign consignee or end-user did not correlate with the details in the authorization request. Examples include documented inconsistencies between quantities ordered and those reported as accounted for by the end-user.

For FY 2019, CEA documented no instance of *indications of potential or actual diversion* and five instances of *unauthorized re-exports/retransfers*.

In general, unfavorable Blue Lantern cases resulted in several types of actions, including returning or denying license applications, removing parties from licenses, updating the DDTC 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 DDTC Watch List screening led CEA to recommend denial, removal of an entity, or return without action on over 130 license applications in FY 2019. CEA referred eight

Derogatory information/foreign party deemed unreliable recipient of USML	40
Unlicensed Party	22
Unable to confirm order or receipt of goods	13
Unauthorized re-exports/retransfers	5
Refusal to Cooperate	4
Inability to confirm existence of a foreign party	1
Lack of secure storage facilities	1

Figure 4: Reasons for Unfavorable Results and Number of Instances / multiple reasons maybe associated with the same case

unfavorable Blue Lantern checks to DTCC, including to that office's Law Enforcement Liaison Division, which is responsible for referring potential criminal cases involving violations of the AECA and ITAR to U.S. law enforcement agencies.

Regional Distribution of Unfavorable Cases in FY 2019

The number of cases closed as unfavorable in **Africa** was 93 percent in FY 2019, largely due to the identification of foreign consignees and end-users who were not listed on the license application. **East Asia and Pacific** also saw a majority of FY 2019 checks in the region closed unfavorable (over 58 percent), often due to derogatory information on a foreign party or a foreign party's lack of awareness of their obligations under the ITAR. All instances of unauthorized re-export or retransfer occurred in this region, though the incidents were the result of insufficient education on the requirements of §123.9(c) of the ITAR rather than nefarious intent. The unfavorable rate of checks closed in the **Near East** was over 47 percent, with the most frequent reason for unfavorable checks in that region being derogatory information on the end-user. **South and Central Asia** saw an unfavorable rate of 25 percent with the primary reason being the identification of foreign parties not listed on the license application. While there were relatively few checks closed unfavorable in **Europe** (about 16 percent), the average does not reflect those cases involving foreign companies acquired by third-country entities posing a risk of diversion. As such inquiries do not verify the details of specific licenses and agreements but rather review the relationship between the acquired firm and the parent company, CEA does not count them toward the total number of favorable or unfavorable checks. CEA expects additional similar reviews to be conducted primarily in Europe owing to its advanced aerospace and defense industry as well as varying levels of investment screening by governments in that region. Finally, the **Western Hemisphere** had an average unfavorable rate of over 8 percent with the reasons being derogatory information on the foreign end-user, the presence of parties not listed on the license application, as well as inability to confirm orders.

Blue Lantern Checks on Firearms Closed in FY 2019

Of the 181 Blue Lantern checks closed by CEA in FY 2019, 83 cases involved U.S. Munitions List (USML) Category I, *Firearms, Close Assault Weapons and Combat Shotguns*, including 38 cases closed as unfavorable. Figure 5 depicts the regional breakdown of these cases. The unfavorable rate for checks involving USML Category I articles (over 45 percent) was similar to the rate of unfavorable cases involving all USML categories (44 percent) for the year.

DDTC Watch List

DDTC maintains a non-public unclassified database of over 226,000 U.S. and foreign persons ranging from the suspect to the sanctioned that triggers more extensive review by DDTC when license applications submitted to the Department list such persons as parties. This internal screening tool, known as the "Watch List," is used by CEA to flag export authorization applications for possible Blue Lantern checks and is automatically updated with information from a range of publicly available lists of sanctioned and/or debarred persons such as the Consolidated Screening List. In FY 2019, CEA reviewed 11,382 DDTC Watch List name matches, or "hits" (including false hits), added 3,393 new entries, and made 6,663 modifications to the DDTC Watch List.

In FY 2019, PM/DDTC and the Department of Commerce's Bureau of Industry and Security (BIS) also took steps to establish the systematic sharing of lists between State and Commerce in

anticipation of the transition of certain firearms and related ammunition to the control of Commerce. This information sharing, which was put forward as a recommendation by the GAO in its March 2019 report “19-307, State and Commerce Should Share Watch List Information If Proposed Rules to Transfer Firearms are Finalized,” was especially important, because BIS did not historically collect this information as they did not control these commodities. By receiving data from the DDTC Watch List, BIS may better scrutinize parties when it ultimately begins reviewing such license applications. The first transfer of watch list data between departments occurred in February 2020.

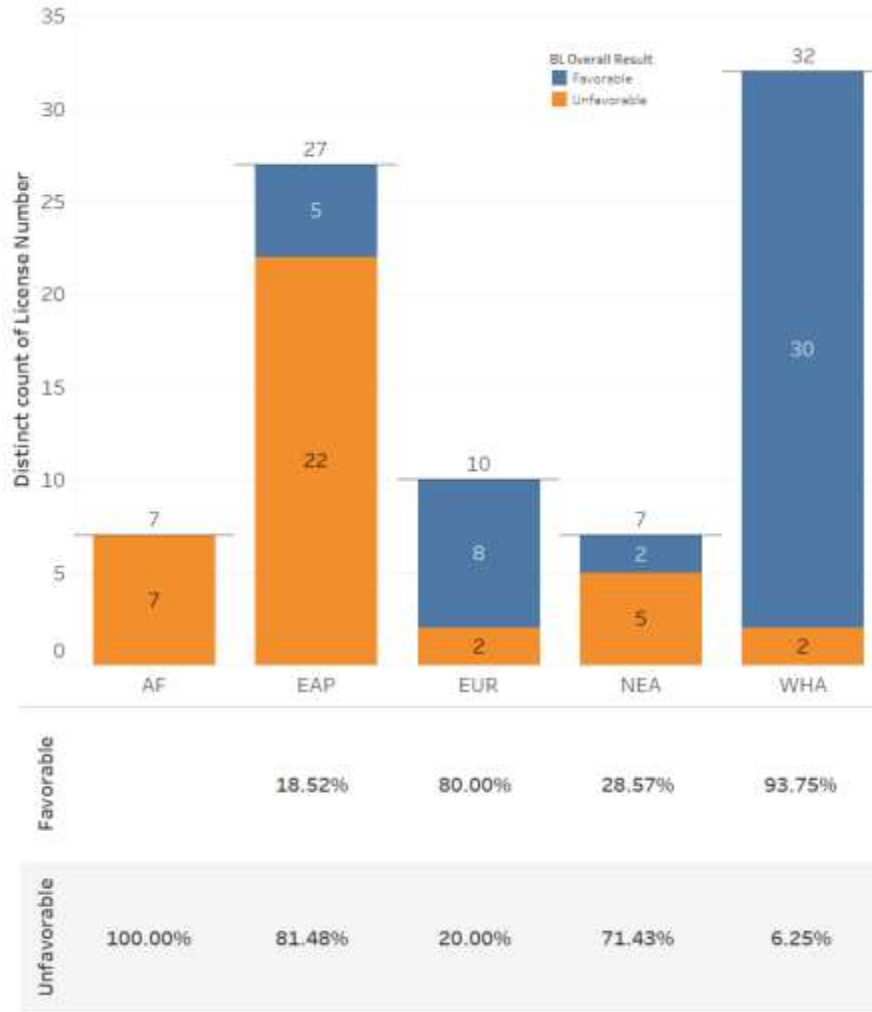


Figure 5: Checks Closed by Region (USML Category I)