

HOLLAND & HART LLP
THE LAW OUT WEST



Administrative and Criminal Enforcement Update

Presented by

Trip Mackintosh
Holland & Hart, LLP
555 17th Street, Suite 3200
Denver, CO 80202
303.295.8000

TMackintosh@HollandHart.com

December 3, 2008

The Corporate Environment



- **Post 9/11 regulatory environment changed**
- **Post Enron renewed government focus**
- **Current financial crisis = new corporate regulations**
- **Enhanced transparency**



Agenda



- A. Directed Disclosures**
- B. Grand Jury Subpoenas**
- C. OFAC Constraints**
- D. Search Warrants**
- E. Issues of Privilege**
- F. Investigative Protocols**
- G. Negotiated Resolutions**

A. Directed Disclosures



- **Increase in enforcement activity in FY 2007**
 - 759 voluntary disclosures (up 60%)
 - 516 directed disclosures
- **National Export Enforcement Initiative, Oct. 2007**
 - Creation of 15 Counter-Proliferation Task Forces
 - Enhanced export control enforcement training for over 500 agents and prosecutors
 - 145 charges in first year (43% involving munitions or restricted technology)
- **Not regulatory requirement but trend towards increasing directed disclosure requests from DDTC**
- **Considerations**
 - Costly
 - Dangerous exposure
 - Require affirmative compliance

B. Grand Jury Subpoenas/Indictments



- **Increase in enforcement activity**
 - 50% increase in criminal investigations in FY 2007
 - 50% increase in criminal indictments in FY 2007
- **Indictment results in presumption of denial of licenses**
- **Public relations issues**
- **Customer concerns**
- **Possibility of debarment**
- **Security clearance- NISPOM**



C. OFAC Constraints



- Inherent risks of how international business is conducted
- Can't assume that regulatory risks are the same in international commerce
- Commercial software systems
- Application of “on behalf of” standard and importance of red flags



D. Search Warrants



- Response
- False statements
- Publicity
- Minimizing v. Acknowledging
- Protocol for interviews
- Analysis and resolution
- Wait for indictment



E. Issues of Privilege



- **Holder Memo, June 1999**
 - Willingness to cooperate, including waiver of privilege, considered in mitigation
 - Includes waiver of internal investigation privilege
- **Thompson Memo, Jan. 2003**
 - Increased scrutiny of “authenticity of corporations’ cooperation”
- **McNulty Memo, Dec. 2006**
 - Waiver not usually part of cooperation assessment
 - AUSA must get written approval from USA, who must consult with DAG
 - Refusal to provide waiver cannot be used in charging decision
- **Filip Letter, July 2008**
 - Cooperation = disclosure of key facts and evidence
 - No consideration of advancement of attorneys’ fees to employees
 - No consideration of joint defense agreements
 - No consideration of employee sanctions



F. Investigative Protocols



- Use outside resources to conduct investigation, i.e. outside counsel
- Don't allow "mission creep"
- Don't discuss risk of getting caught
- Notes/minutes of meetings
- Don't fire employees
- Focus on self-disclosure before self-preservation
- Accurate procedures and protocol
- Record keeping is essential
- Control of the process, be proactive
- Public relations
- Fear and loathing among staff



G. Negotiated Resolutions



■ FY 2008 Consent Agreements

- Boeing ITAR violation (\$3 million)
- Northrop Grumman ITAR violation (\$10 million)
- Lockheed Martin ITAR violation (\$3 million)

■ FY 2007 Consent Agreement

- ITT Corporation ITAR violation
 - \$28 million fine
 - 3 year statutory debarment



■ Plea Agreements—Considerations to be Weighed

- U.S. Attorneys' Manual 9-27.420
 - Cooperation in the investigation
 - The defendant's criminal history
 - The nature and seriousness of the offense
 - The defendant's willingness to assume responsibility

HOLLAND & HART^{LLP}



Trip Mackintosh

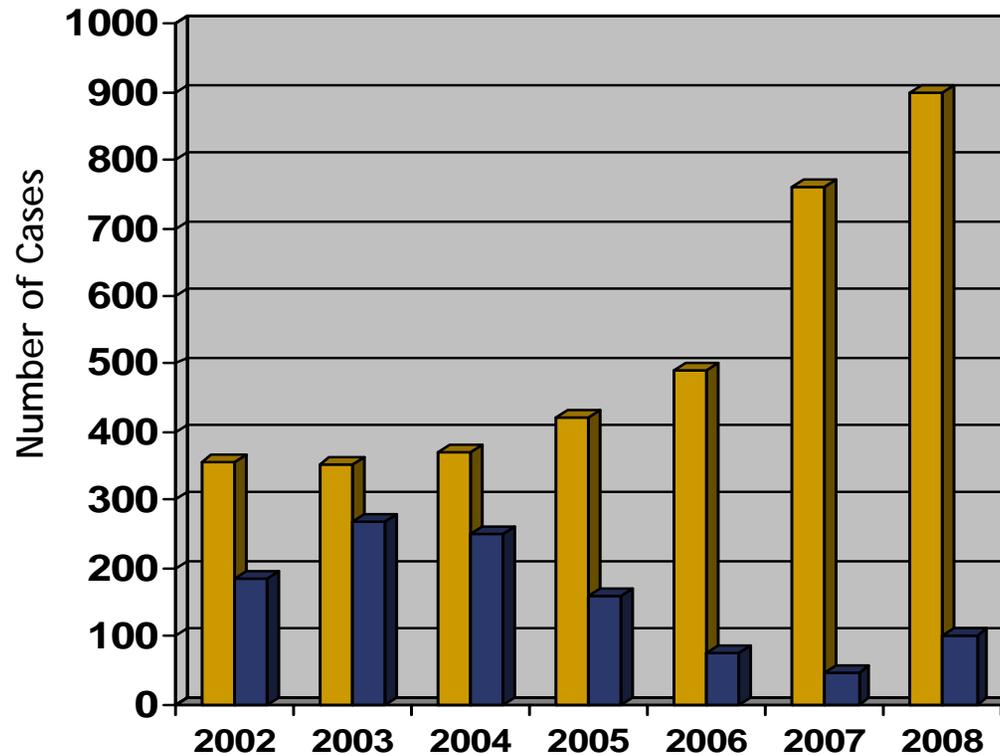
Holland & Hart, LLP
555 17th Street, Suite 3200
Denver, CO 80202
303.295.8000

TMackintosh@HollandHart.com

Compliance and Enforcement

ITAR Disclosure Trends - CY 2002-2008

Source: DDTC Compliance, November, 2008



2008 Numbers Are Projected



- Voluntary Disclosures - Up almost 20% from 2007
- Directed Disclosures - More than doubled from 2007

J.P.Morgan

© 2008 J.P. Morgan Chase & Co. All Rights Reserved.



U.S. DEPARTMENT of STATE

Directorate of Defense Trade Controls

Printer Friendly Version

DDTC Homepage/Compliance

Updated July 31st 2008

- Home
- About DDTC
- Getting Started
- Registration
- D-Trade
- Licensing
- Compliance
- AECA Debarments
- Consent Agreements
- Major Export Enforcement Actions in 2007
- Commodity Jurisdiction
- Response Team
- Regulations and Laws
- Embargoed Countries
- Treaties
- FAQs
- Outreach
- Metrics
- Reports

Compliance

To ensure compliance with U.S. export law and regulations, the Directorate of Defense Trade Controls strongly advises that registered exporters and manufacturers have in place programs that assist in monitoring defense trade activities.

These programs should include a manual that articulates the company's policy on and commitment to compliance with defense trade laws and regulations, and that outlines the procedures for dealing with licensing and compliance matters. Such a manual should also include the identification and duties of empowered and responsible persons, and procedures on record keeping and internal auditing.

To assist you, DDTC has outlined some elements that we believe should be included in your compliance program: [Compliance Program Guidelines](#).

Questions? Please call the Response Team at (202) 663-1282.

Sharing settlement lessons learned globally, vertically and horizontally within and across your organization is absolutely essential !



The Boeing Company (Boeing) [Consent Agreement (CA) Effective Date: 061908]
United States (US) Department of State (DOS) - Settlement Summary (As of 070908)

Trade compliance professionals are encouraged to read all the available related documents at http://pmdtcc.state.gov/ca_The_Boeing_Company.htm

Charges	Description of Charges	Monetary Fines		Mandated Compliance Measure Highlights
		Actual	Remedial	
General	All are in connection with exceeding the authorized values of Manufacturing License Agreements (MLAs) and with omissions and certain administrative violations.	\$3,000,000 (Civil Penalty)	None	<ul style="list-style-type: none"> - Within 12 months of the date of the CA, Boeing will institute strengthened corporate export compliance policies, procedures and training focused principally on Boeing business operations engaged in the administration of MLAs and Technical Assistance Agreements (TAAs).... - Continue with implementation of a comprehensive automated export compliance system to strengthen Boeing's internal controls for ensuring compliance with the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR) in the administration of its MLAs and TAAs. - Within 18 months of the date of the CA, Boeing shall have an audit providing a thorough assessment of the effectiveness of the mandated measures in this CA conducted by an outside consultant with expertise in AECA/ITAR matters and approved by the Director, DDTCC, focused on the administration of Boeings MLAs and TAAs. - Subsequently, within 30 months from the date of the CA, Boeing shall have another audit conducted by an outside auditor, approved by the Director, DDTCC, to confirm whether Boeing has addressed the compliance recommendations from the initial report and to assess the effectiveness of Boeing's automated export compliance system. - At the conclusion of the 3 year term of the CA, Boeing's Senior Vice President, Office of Internal Governance, shall submit to the Director, DDTCC, a written certification that all compliance measures set forth in the CA have been implemented....
1-20	- Violation of MLA terms when it exceeded the authorized values of Directorate of Defense Trade Controls (DDTCC) approved MLAs.	<p align="center">This CA remains in effect for 3 years.</p> <p align="center">The total fine of \$3,000,000 equates to \$75,000 per alleged violation.</p> <p align="center">The actual monetary fine here is 15% of the maximum of \$20,000,000 that could have been imposed for 40 administrative violations.</p> <p align="center">The worse case fine could have been \$40,000,000 for criminal violations.</p> <p align="center">Since 1998 Boeing has settled with the DDTCC 5 times for a total of \$64,200,000 in fines and 566 alleged violations of the Arms Export Control Act.</p>		
21-30	- Failure to request approval for MLA amendments when it failed to submit for approval amendments to DDTCC approved MLAs.			
31-35	- Omissions of material facts when it submitted for approval amendments to its MLAs that reflected values that were less than the actual value already manufactured.			
36-40	- Failure to comply with administrative requirements when it failed to abide by the administrative terms and conditions associated with the approvals of DDTCC approved MLAs.			
	NOTE: Due to the large number of violations over an extended period of time, the DDTCC did not identify each specific violation, but only generally described the categories of violations.			
<p>NOTABLE QUOTES: <i>"These violations represent systemic, long-term and recurring problems in Repondent's (Boeing's) Management of its MLAs and TAAs."</i> (Reference: Proposed Charging Letter, page 2, BACKGROUND, paragraph 1, last sentence) <i>"The Department considered the Respondent's Voluntary Disclosures and remedial compliance measures as significant mitigating factors when determining the charges to pursue this matter.... If the Respondent had not taken these actions, charges against and penalties imposed upon the Respondent would likely be more significant."</i> (Reference: Proposed Charging Letter, pages 1 & 2, paragraph 2, first and last sentences)</p>				
<p>BOEING DOS SETTLEMENT HISTORY: 2006 - Boeing, 86 alleged violations for unauthorized exports of the QRS-11 Quartz Rate Sensor to proscribed and other countries, misrepresentations and omissions of facts, false statements, failure to file a Shippers Export Declaration and failure to report a prohibited export, total fine \$15,000,000 and a Special Compliance Official (SCO); 2003 - Hughes Electronics and Boeing Satellite Systems, 123 alleged violations in connection with their misconduct related to the January 1995 failed launch of the Long March 2E rocket carrying the APSTAR II spacecraft, the February 1996 failed launch of the Long March 3B rocket carrying the INTELSAT 708 spacecraft and other matters concerning their business activities with the People's Republic of China, total fine \$32,000,000 including \$6,000,000 in remedial compliance measures (RCM) and a SCO; 2001 - Boeing, 110 alleged violations for violating the express terms and conditions of DOS munitions licenses and other authorizations by exporting defense articles and defense services without a munitions license or other authorization, and by omitting material facts from its applications for munitions licenses or other authorizations, total fine \$4,200,000 including \$400,000 in RCM and a Special Officer; 1998 - Boeing, 207 alleged violations for exporting technical data and defense services to Russia, the Ukraine, Norway and Germany without the required approvals from the DOS and, in other circumstances, violated the terms and conditions of approvals that were provided by the DOS, total fine \$10,000,000 including \$2,500,000 in RCM. (Reference: http://pmdtcc.state.gov/compliance.htm)</p>				

ITT CORPORATION (ITT) [Plea Agreement Date: 032707]
United States Department of Justice (DOJ) - Settlement Summary (As of 091508)

Counts	Charges	Monetary Fines		Mandated Action Plan Highlights
		Actual	Remedial	
1	- Knowing and Willful Export of Defense Articles Without a License (on or between March 2001 and August 2001) in Violation of the Arms Export Control Act (AECA)	\$100,000,800 (Criminal penalties and forfeitures)	None (See the NOTE at the bottom of this page)	<ul style="list-style-type: none"> - Establish an Export Manager of Compliance (EMC) position to ensure full compliance - Restructure management of all ITT trade compliance and security personnel to report directly to the EMC - Institute an annual comprehensive export compliance and security education/training program - Ensure all export compliance and security managers have sufficient training and experience - Keep a record of training provided to include names and positions of those attending for at least 5 years - Report all losses, compromises/suspected losses of classified material to include any attempts at unauthorized access - Make an initial written report of all violations of export control regulations to the Department of Commerce (DOC) and/or the DOS, as applicable, within one week of the discovery of the violation - Conduct a complete inventory and audit of all classified materials - Conduct export compliance audits of each ITT business unit with access to export control materials - Determine whether foreign/corporate partners have sufficient trade compliance knowledge - Determine if all export controlled materials are sufficiently marked to prevent export compliance violations - The ITT Chief Executive Officer (CEO), EMC and each business unit will sign an annual compliance certification
2	- Knowing and Willful Omission of Statements of Material Fact in Arms Exports Reports (on or between April 2000 and October 2004) in violation of the AECA			
3	- Knowing and Willful Export of Defense Articles Without a License (on or between January 1996 and May 2006) in violation of the AECA	\$2,000,800 for fines and special assessments \$20,000,000 to the US Department of State (DOS) \$28,000,000 for proceeds from illegal actions and to cover investigation costs * \$50,000,000 for Night Vision (NV) research & development over the next 5 years [Any part of that \$50M not spent after 5 years must be immediately paid to the USG.]		
<p>NOTES: In exchange for ITT's guilty plea to Counts 1 and 2, the US Government (USG) moved to defer prosecution of Count 3. This is a probationary arrangement whereby the USG agrees to not prosecute ITT on the 3rd Count in exchange for their compliance with the terms of the Deferred Prosecution Agreement.</p> <p>* Additionally, the US maintains "Government Purpose Rights" to all the technology developed under this agreement and thus can share that technology with any competing defense contractors for future contracts.</p>				
<p>EMC RESPONSIBILITIES: Reports directly to ITT's CEO with access to the Board of Directors. Will have authority and adequate resources to ensure full compliance with the National Industrial Security Program, National Industrial Security Operating Manual, AECA, International Traffic in Arms Regulations, Export Administration Act, International Emergency Economic Powers Act and Export Administration Regulations.</p>				
<p>NOTABLE QUOTE: <i>"During the course of the criminal investigation, the government uncovered a pattern of violations of the export laws of the United States spanning from the 1980s to 2006 at ITT NV."</i> (Reference, Statement of Facts, Appendix A, Page 1, Paragraph 1)</p>				
<p>ITT SETTLEMENT HISTORY: 2007 - DOC/civil (ITT Engineered Valves Group), 8 alleged violations for unauthorized exports, misrepresentation and failure to comply with recordkeeping requirements, fine \$26,400; 2005 - DOC/civil (ITT Goulds Pumps, Inc.), 26 alleged violations for unlicensed exports & false statements, fine \$123,000; 2004 - DOS/civil, (ITT Night Vision & Aerospace Communications) 95 alleged violations with 5 years of oversight for not adhering to license terms/conditions, not complying with license or Technical Assistance Agreement provisos, fine \$8,000,000 including \$5,000,000 for remedial compliance measures.</p>				
<p>OTHER FACTS: This is a first of its kind criminal conviction of a major defense contractor and largest monetary fine for export control violations in history. Further, as a result of its guilty plea, on March 28, 2007, the DOS statutorily debarred the ITT Night Vision Division for a period of 3 years from participating directly or indirectly in the export of defense articles, including technical data, or in furnishing defense services for which a license or other approval is required.</p>				
<p>NOTE: No money was specifically earmarked by the Plea Agreement to accomplish the USG Mandated Action Plan. Therefore, ITT will pay those additional costs from their own internal funds (i.e. over and above the fines, penalties and forfeitures assessed in the settlement.)</p>				

Compliance and Enforcement Update

The Trade Compliance Attitude Spectrum



- Active Enthusiastic Involvement
- Willing Participation
- Genuine Interest
- Actual Acceptance
- Begrudging Acceptance
- Fear
- Deer in the Headlights
- Doubt
- Anger
- Denial
- Total Ignorance

*You, your organization
and the people in it, all fall
somewhere in here.*

J.P.Morgan

© 2008 J.P. Morgan Chase & Co. All Rights Reserved.

Compliance and Enforcement Update

The Trade Compliance Attitude Indicators



- Active Enthusiastic Involvement - “I love to comply!”
- Willing Participation - “Here’s an idea.”
- Genuine Interest - “How can I help?”
- Actual Acceptance - “It does make sense.”
- Begrudging Acceptance - “If you say so.”
- Fear - “Jail?”
- Deer in the Headlights - “Huh?”
- Doubt - “Is that really possible?”
- Anger - “It’s in the public library!”
- Denial - “No way!”
- Total Ignorance - “What’s that?”

Shouldn't there also be upward progression from bad or worst to best practices?

What Questions Do Senior Management Ask?

- What are the odds of getting caught?
- How much is it going to cost if we do get caught?
- How much of this (due diligence) do we really have to do?

What Are Some of the Excuses for Not Taking Action?

- We've always done it this way.
- We haven't been caught before.
- It's too complicated/expensive.
- We don't have the resources.
- It's someone else's responsibility.

What's Your Excuse?

