

Trade Compliance Flash: Latest ITAR Consent Agreement Reveals Key Enforcement Trends and Practical Considerations for Industry

International Alert

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On January 31, 2022, the U.S. Department of State's Directorate of Defense Trade Controls (DDTC) announced that it has entered into a [new consent agreement](#) with Torrey Pines Logic, Inc., and its Chief Executive Officer (CEO), president, and sole owner, Dr. Leonid B. Volfson (collectively, Torrey Pines). Torrey Pines is a small business involved in producing electro-optics communications equipment for military and civilian customers. At least some of the items Torrey Pines produces are subject to the International Traffic in Arms Regulations (ITAR) as they are defense articles controlled on the U.S. Munitions List (USML).

This latest consent agreement reveals some interesting ITAR enforcement trends, as this is the fourth consent agreement out of the last 10 to be issued against a relatively small business. It indicates that DDTC is taking a balanced approach to ensure that companies of all sizes recognize they are on equal footing to the risk of an enforcement action. DDTC also continues to emphasize the risks of misclassifying items – this marks the fifth consent agreement out of the last seven to require jurisdiction and classification review as part of the consent agreement's remedial measures. And DDTC keeps affording exceptional benefits to companies that voluntarily disclose or otherwise cooperate with substantially reduced penalties.

Summary

The consent agreement resolves the five alleged violations of the ITAR detailed in the [Proposed Charging Letter](#). These alleged violations include the unauthorized export and unauthorized attempted export of defense articles, involvement in ITAR-controlled activities while Torrey Pines was ineligible to do so, and failure to maintain required records.

Charge 1 alleges that Torrey Pines attempted to export defense articles without the appropriate authorization via carry-on luggage on a commercial flight from the United States to Singapore. That attempt, however, was stopped by Customs and Border Protection (CBP), who seized the two items when Torrey Pines failed to produce the necessary documents showing that it had authorization to export the thermal imaging systems. Torrey Pines disputed that the items were defense articles, but DDTC confirmed jurisdiction via a directed commodity jurisdiction (CJ) decision, which was re-affirmed after Torrey Pines filed a CJ appeal.

Charge 2 alleges that Torrey Pines exported defense articles without authorization because it misclassified and exported those items as subject to the Export Administration Regulations (EAR). Torrey Pines' sister company had received a commodity classification (CCATS) from the Department of Commerce (Commerce), which classified one of the versions under the then-existing Export Control Classification Number (ECCN) of 0A987. Nevertheless, while later seeking an EAR license for that version, Commerce questioned its jurisdiction and returned the license without action while recommending a CJ submission. Torrey Pines immediately submitted a CJ request for all versions, which nearly one-and-a-half years later determined that all versions of that product series are defense articles.

DDTC provided some additional allegations regarding the CJ request and period while the case is pending. According to DDTC's proposed charging letter, although Torrey Pines had exported the items in question, it allegedly did not reveal to the government those previous exports, despite that being a question on the CJ application. Torrey Pines also allegedly advised DDTC that it treated one version of the item as ITAR-controlled while the CJ case was pending, but according to its invoices, it had exported the item 13 times without authorization while the CJ request was pending. The invoices showed that exports were apparently made to proscribed countries (such as China) and to Russia (then under a restrictive policy).

Charge 3 alleges that Torrey Pines engaged in ITAR-controlled activities while it was considered an ineligible party and unregistered

with DDTC. For example, between August 2013 to February 2015, Torrey Pines was suspended from government contracting, which also means that it was generally ineligible to engage in ITAR-regulated activities. However, it is alleged that during its period of ineligibility, Torrey Pines impermissibly participated in some aspects of an ITAR-controlled transaction. Additionally, while both ineligible and unregistered with DDTC, it is alleged that Torrey Pines engaged in manufacturing defense articles.

Charges 4 and 5 allege that Torrey Pines made additional exports of a defense article without authorization to Japan and failed to maintain and produce records as required under 22 C.F.R. § 122.5. As part of the allegations, DDTC noted that Torrey Pines had received a CJ determination prior to those exports that the item is a defense article and controlled as Significant Military Equipment. In addition, Torrey Pines was charged over its alleged failure to maintain and produce required records under the ITAR, which DDTC further asserted constrained its ability to assess the potential harm to national security caused by the alleged violations.

Aggravating Factors and Imposed Penalty

Even though Torrey Pines filed a voluntary disclosure, DDTC determined that there were several aggravating factors to warrant a consent agreement in this case. Those factors included: (1) alleged unauthorized exports, including to proscribed countries such as the China and Lebanon, as well as to Russia; (2) alleged violations involving items designated as Significant Military Equipment; and (3) exporting items pending a CJ determination (which were ultimately determined to be defense articles) without ITAR authorization.

In effect for a term of three years, the consent agreement will require Torrey Pines to appoint a Special Compliance Officer, perform a jurisdiction and classification review, improve its policies and procedures, conduct an audit, and pay a \$840,000 fine (of which \$420,000 is suspended and may be applied towards Torrey Pines' remedial compliance costs). In addition, Torrey Pines will not engage in ITAR-controlled activities, although it may engage in some limited manufacturing of defense articles, such as if for domestic purposes or for unaffiliated third parties.

Notable Observations

Enforcement and Penalty Trends

- **Balanced Industry Enforcement.** Notably, four of the last 10 consent agreements by DDTC were against relatively small companies. This reveals that DDTC is focusing its enforcement efforts against not only large and middle level players in the defense trade industry but also against relatively small businesses, like Torrey Pines. This should signal to industry that even small companies are subject to enforcement action and thereby all industry participants need to focus on compliance.
- **Jurisdiction and Classification.** DDTC continues to highlight the critical importance of companies ensuring the correctness of their jurisdiction and classification assessments. Over the last three years, this is the *fifth* consent agreement out of seven to impose the requirement for the penalized company to review and verify the jurisdiction and classification status of its hardware, including any software or directly related defense services and technical data. That is one of the most rigorous consent agreement requirements.
- **Disclosures and Cooperation.** DDTC keeps affording exceptional benefits to companies who submit voluntary disclosures or who otherwise cooperate with its investigation. The five alleged violations in this case could have resulted in a maximum fine of \$6,361,255 (since the ITAR can impose a maximum civil penalty of \$1,272,251 per violation). The \$840,000 fine thus represents a reduction of nearly 87 percent of that maximum amount and it represents a nearly 94 percent reduction if the \$420,000 suspended amount is forgiven.

Practical Considerations

- **Exports During CJ Review.** DDTC continues to assert, now for the second consecutive consent agreement, that not seeking an

ITAR authorization to export an item while that item is pending a CJ decision can be an aggravating factor should it be determined as ITAR-controlled. Although it was not the first time to have happened in an enforcement case, DDTC elevated such situations as an aggravating factor in the proposed charging letter for the August 2021 consent agreement with [Keysight Technologies, Inc.](#)

DDTC's [public position](#) is that a CJ applicant "is strongly encouraged to treat [the item] as subject to the ITAR and to obtain any required licensing approvals prior to export [. . . because it . . .] may avoid export violations should the item or service be determined to be subject to the ITAR." While DDTC's position should not have changed, practically speaking when deciding a course of action, the potential prospect of poor optics (as a CJ is generally submitted when the applicant has jurisdictional "doubt") and export violations should be considered.

- **Maintaining Credibility.** The proposed charging letter alleges that Torrey Pines made several inconsistent statements during the investigation, which may have called into question its credibility. For example, DDTC alleges that Torrey Pines indicated in its disclosures that it treated an item as ITAR-controlled while it was pending a CJ decision — yet there was evidence indicating the item was exported 13 times during that time without authorization. This demonstrates the importance of maintaining credibility with accurate and consistent statements, as once a disclosing party's credibility is lost, it can be impossible to regain. It can also result in an enforcement case going from a no-action letter to a penalty.
- **Expanding Investigations.** The proposed charging letter indicates that although Torrey Pines submitted two voluntary disclosures, DDTC also directed two disclosures to seek additional information. That situation should remind disclosing parties that its work may not be complete through one or more voluntary disclosures and that the continued internal investigation or government investigation may uncover further issues. In the latter case of a directed action, that situation can also have the government call into question whether the company took appropriate action to uncover any violations or has systemic compliance failures. As such, companies should be mindful that the scope of the investigation may expand, which may involve more disclosures.

Miller & Chevalier will be monitoring these developments closely and will be putting on a series of webinars to discuss these important issues. For any questions you may have about the potential impact of these developments on your business, please contact a member of the Miller & Chevalier team to discuss further.

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