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Client Alert

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United Technologies Fined $75 Million for Export Control Violations

On June 28, United Technologies, Inc. (UTC) and two of its affiliates pled guilty to illegal sales of sensitive military software to China and a cover-up of those sales. Under the deferred prosecution agreement, the companies were fined an aggregate of $75 million and agreed to hire an independent monitor, to be paid for by them, to monitor export compliance for the three entities for two years. The entities face criminal prosecution or additional fines if they further violate export laws during the monitoring period.

UTC admitted that the company's Canadian affiliate sold US-origin engine-control software, made by a UTC affiliate based in the US, to China in 2002 and 2003. The sale by the Canadian affiliate was made with knowledge by that affiliate that the software would be used to develop an attack helicopter. The Canadian affiliate did not tell UTC about the exports to China for several years, but once UTC discovered the sale, it and its affiliates tried to cover up the issue.

Under the Arms Export Control Act, as implemented by the International Trade in Arms Regulations, any export of items defined as "defense articles" or "technical data," as well as the provision of "defense services," requires a license (or license exception) issued by the State Department. Under those same regulations, the US has imposed a prohibition upon the export to China of all US defense articles and associated technical data; there also is a prohibition upon licenses or approvals for the export of defense articles to China.

The software in question was of US-origin, was modified for a military helicopter application, and was thus a "defense article" that required a US export license. The Canadian affiliate knowingly and willfully caused six versions of this software to be exported to China without a U.S. export license. Further, the Canadian affiliate knew that the software was to be used in China to assist in the development of an attack helicopter and that supplying it with U.S.-origin components would be illegal. According to court documents, the Canadian affiliate anticipated that its work on the military attack helicopter in China would open the door to a far more lucrative civilian helicopter market in China. Shortly after the initial software export, the Chinese claimed that a civilian version of the military helicopter would be developed in parallel with the military item. The Canadian affiliate's personnel expressed skepticism about this claim, but internally used the claim to shield questions about exports for the military helicopter project.

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These companies failed to disclose to the U.S. government the illegal exports to China for several years and only did so after an investor group queried UTC in early 2006 about whether the Canadian affiliate's role in China's attack helicopter might violate U.S. laws. The companies then made an initial disclosure to the State Department in July 2006, with follow-up submissions in August and September 2006.

The 2006 disclosures contained numerous false statements. Among other things, the companies falsely asserted that they were unaware until 2003 or 2004 that the Chinese development program involved a military helicopter. In fact, by the time of the disclosures, all three companies were aware that the Canadian affiliate's officers knew at the project's inception in 2000 that the program involved an attack helicopter.

UTC's prosecution is another example of the US government's commitment to pursue and punish those who violate US export control regulations. US companies, and others subject to US export control regulations, should learn the following from the UTC case:

- proper classification of all articles, data, technology, services and products under US export control regulations is crucial—and such classification should be made with a singular reference to regulatory compliance;

- the export and re-export of controlled US-origin "defense articles" requires a license or an exemption therefrom, and the US government maintains embargoes the export of "defense articles" to specific jurisdictions;

- when defining what is a "defense article," remember that related, controlled "technical data" also exists and would be exported along with the "defense article;"

- the conduct of non-US affiliates is subject to US export control regulations at least insofar as US-origin products are concerned;

- a US company with onshore and offshore affiliates should have a global export compliance process and policy;

- as part of an export compliance policy, the determination of an item's classification as a "defense article" or as otherwise subject to US export controls should be made at a single point—the export control officer--within the organization;

- even if a "defense article" could be used in a civilian project, it is still a "defense article" subject to US export control regulations;

- an export compliance program should allow for periodic training of personnel involved in export transactions, audits of operational units engaged in exports, and a system to accept, escalate, and determine internal concerns on export control violations;

- companies should carefully consider when allegations of export control violations deserve an independent investigation by counsel; and

- if a company makes a voluntary disclosure to the State Department about export control violations, under relevant law and regulation, such disclosure should be timely, complete and accurate.