

Client Advisory

April 2007

*The ITT Settlement**by Joseph P. Covington and Richard W. Arnholt*

At the end of March 2007, ITT Corporation, a leading manufacturer of night vision equipment sold to the United States military, settled claims relating to violations of the Arms Export Control Act ("AECA") and the International Traffic in Arms Regulations ("ITAR") for \$100 million. Jenner & Block represented an individual during the grand jury process and we believe three key points can be drawn from the settlement: (1) creative settlement structures may be available where they benefit a specific agency; (2) full and early cooperation with government investigations may result in leniency; and (3) the government will continue to focus on defense contractor compliance for the foreseeable future.

The statement of facts details a pattern of export violations in an effort to reduce costs between the 1980s and 2006 by ITT Night Vision, a division of ITT Corporation that develops and manufactures sophisticated night vision equipment for the American war fighter. The investigation, which began in August 2001, uncovered evidence that ITT knowingly omitted required information from export reports and willfully exported sophisticated night vision technology to Singapore and China, among other countries, without a license. These illegal exports, according to the Department of Justice, "put in jeopardy our military's night time tactical advantages and America's national security."

ITT Corporation pled guilty to two willful violations of the AECA and entered into a deferred prosecution agreement regarding a third count. In addition to agreeing to subject itself to independent monitoring and taking a number of remedial actions relating to export

control, ITT agreed to pay a \$20 million monetary penalty to the Department of State, a \$2 million statutory fine, \$28 million in forfeiture of proceeds of its illegal actions, and a \$50 million deferred prosecution penalty. Under the agreement, ITT may, over the 60-month suspension period, receive dollar-for-dollar credit against the \$50 million penalty for monies spent to "accelerate and further the development and fielding of the most advanced night vision technology so that members of the United States Armed Forces can maintain their battlefield advantage of having the most capable night vision equipment in the world." The credits must be approved in advance by the division of the United States Army Research, Development & Engineering Command responsible for night vision electronic sensors.

The government may well take the position that the accelerated research costs are not allowable under the Federal Acquisition Regulation ("FAR") Cost Principles, as the deferred prosecution agreement signed on March 26, 2007, describes the \$50 million as "a deferred prosecution monetary penalty." FAR § 31.205-15 ("Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, Federal, State, local, or foreign laws and regulations are unallowable..."). The settlement did not, however, expressly deal with the issue, which we expect will be covered by forthcoming consent agreements with the Departments of Defense and State. We will issue another Client Alert as soon as those consent agreements become public.

Even if the \$50 million is not allowable, by agreeing to let ITT decrease any monetary fine

for accelerated research, the settlement agreement gives ITT an additional incentive to gain a technological advantage over its night vision competitors. In other words, should ITT take full advantage of the dollar-for-dollar research offset, it may emerge from settlement in a much stronger competitive position. This agreement had strong support from DoD, which will gain from any technological advances encouraged by the settlement. In contrast, had ITT been forced to pay the \$50 million in cash, those funds would have gone to the Treasury.

While it is possible that earlier cooperation would have resulted in lower fines and an earlier resolution of the matter, ITT's cooperation at the late stages of the government investigation was key to allowing it to remain in the night vision business. According to the U.S. Attorney's statement accompanying the settlement, ITT and its outside counsel fought the investigation from its initiation in August 2001 through the fall of 2005, when ITT was notified that DoJ was prepared to seek an indictment. At that point, ITT's new CEO replaced outside counsel, instructed the company to provide full cooperation and ordered an internal investigation, the results of which were shared with the government. The U.S. Attorney believes that cooperation "may have saved ITT from permanent ruin."

ITT's late cooperation likely also influenced the decision to limit the impact of the statutorily required debarment. Section 127.7 of the ITAR, 22 C.F.R. § 127.7, provides for "statutory

debarment" of anyone convicted of violating or conspiring to violate the AECA. On April 11, 2007, the Department of State issued a Federal Register notice stating that, in accordance with section 127.7, ITT would be debarred for a period of three years, effective March 28, 2007, as a result of its guilty plea. The debarment notice also stated that ITT may request reinstatement after one year and, importantly, that "transaction exceptions" were being granted to ITT Night Vision "with respect to certain existing authorization and pending authorizations ... that have been identified as necessary to U.S. national security and foreign policy interests." 72 Federal Register 18,310 (April 11, 2007). Further, the notice allows for approvals of future exception requests where warranted by "overriding U.S. foreign policy or national security interests," where it "would further law enforcement concerns that are consistent with foreign policy or national security interest[s] of the United States," or where there are "other compelling concerns ... that are consistent with the foreign policy or national security interests of the United States." *Id.*

No further detail is currently available regarding the specific programs subject to the exception. It is interesting, however, that the ITT division responsible for the violations appears to be the only ITT division whose current operations are specifically excluded from the debarment order.

Please let us know if you have any questions regarding the ITT settlement.

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