

United Technologies Settles Criminal Arms Export Charges for \$76 Million

Written by Nick Sanders
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First, we'd like to thank the Justice Department for an unusually detailed [press release](#), in which it announced that several subsidiaries of the United Technologies Corporation (UTC) had agreed to plead guilty to (1) violating the Arms Export Control Act, (2) making false statements in connection with "belated" disclosures of making illegal exports to China, and (3) failing to make timely disclosure of defense related exports to China. As part of the deferred prosecution agreement worked out with the DOJ, the UTC companies agreed to pay \$75.7 million and to retain an Independent Monitor for the next two years (who will watch over UTC's compliance with export control laws and regulations).

Ouch.

The settlement concerned the actions of two UTC subsidiaries, Pratt & Whitney Canada Corp. (PWC) and Hamilton Sunstrand Corporation (HSC). The matter involved illegal sales of defense equipment to China in connection with China's development of a modern attack helicopter, the Z-10. As the DOJ press release reminded readers—

Since 1989, the United States has imposed a prohibition upon the export to China of all U.S. defense articles and associated technical data as a result of the conduct in June 1989 at Tiananmen Square by the military of the People's Republic of China. In February 1990, the U.S. Congress imposed a prohibition upon licenses or approvals for the export of defense articles to the People's Republic of China. In codifying the embargo, Congress specifically named helicopters for inclusion in the ban.

Dating back to the 1980s, China sought to develop a military attack helicopter. Beginning in the 1990s, after Congress had imposed the prohibition on exports to China, China sought to develop its attack helicopter under the guise of a civilian medium helicopter program in order to secure Western assistance. The Z-10, developed with assistance from Western suppliers, is

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China's first modern military attack helicopter.

PWC sold China engines for the Z-10. But according to the DOJ, "PWC determined on its own that these development engines for the Z-10 did not constitute 'defense articles,' requiring a U.S. export license, because they were identical to those engines PWC was already supplying China for a commercial helicopter." That sounds somewhat legit, but (as the DOJ reported), "because the Electronic Engine Control software, made by HSC in the United States to test and operate the PWC engines, was modified for a military helicopter application, it was a defense article and required a U.S. export license."

So because the software that controlled the engines was modified for military applications, that made the (otherwise commercial) engines into military articles, subject not only to export control but also to a flat-out export prohibition by Congress. DOJ reported, "PWC knowingly and willfully caused this software to be exported to China for the Z-10 without any U.S. export license. In 2002 and 2003, PWC caused six versions of the military software to be illegally exported from HSC in the United States to PWC in Canada, and then to China, where it was used in the PWC engines for the Z-10."

Notice the use of the phrase "knowingly and willfully." The Justice Department was convinced that this export control violation was more than an "oopsie." It told readers—

PWC knew from the start of the Z-10 project in 2000 that the Chinese were developing an attack helicopter and that supplying it with U.S.-origin components would be illegal. When the Chinese claimed that a civil version of the helicopter would be developed in parallel, PWC marketing personnel expressed skepticism internally about the 'sudden appearance' of the civil program, the timing of which they questioned as 'real or imagined.' PWC nevertheless saw an opening for PWC 'to insist on exclusivity in [the] civil version of this helicopter,' and stated that the Chinese would 'no longer make reference to the military program.' PWC failed to notify UTC or HSC about the attack helicopter until years later and purposely turned a blind eye to the helicopter's military application.

Apparently, PWC was not a good corporate citizen and kept any doubts about the ultimate use of its engines (and software) to itself, and pulled the wool over HSC's eyes. DOJ stated, "HSC in the United States had believed it was providing its software to PWC for a civilian helicopter in China, based on claims from PWC." One wonders whether PWC felt pressure to make its sales numbers, or whether there was another reason it felt compelled to lie to its sister UTC subsidiary and make the China engine deal happen. The Justice Department thinks it knows the answer to that question. It reported—

According to court documents, PWC's illegal conduct was driven by profit. PWC anticipated

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that its work on the Z-10 military attack helicopter in China would open the door to a far more lucrative civilian helicopter market in China, which according to PWC estimates, was potentially worth as much as \$2 billion to PWC.

But eventually, HSC realized that it was being lied to. DOJ stated, “By early 2004, HSC learned there might an export problem and stopped working on the Z-10 project.” But that didn’t stop PWC from its determination to make the sale. DOJ stated, “Regardless, PWC on its own modified the software and continued to export it to China through June 2005.”

According to the DOJ, it took pointed “queries” by an outside “investor group” to make UTC realize it had an export control problem on its hands. In July 2006, UTC made an initial disclosure to the State Department and followed up with subsequent disclosures over the next few months. The problem was—according to DOJ—UTC made “numerous false statements” in its disclosures. DOJ reported—

Among other things, the companies falsely asserted that they were unaware until 2003 or 2004 that the Z-10 program involved a military helicopter. In fact, by the time of the disclosures, all three companies were aware that PWC officials knew at the project’s inception in 2000 that the Z-10 program involved an attack helicopter.

The U.S. Attorney summarized the case thusly—

PWC exported controlled U.S. technology to China, knowing it would be used in the development of a military attack helicopter in violation of the U.S. arms embargo with China. PWC took what it described internally as a ‘calculated risk,’ because it wanted to become the exclusive supplier for a civil helicopter market in China with projected revenues of up to two billion dollars. Several years after the violations were known, UTC, HSC and PWC disclosed the violations to the government and made false statements in doing so.

We wonder if the UTC subsidiary (Pratt & Whitney Canada) took a \$76 million fine into account, when it calculated the risks associated with its intentional export control violation? We think not.