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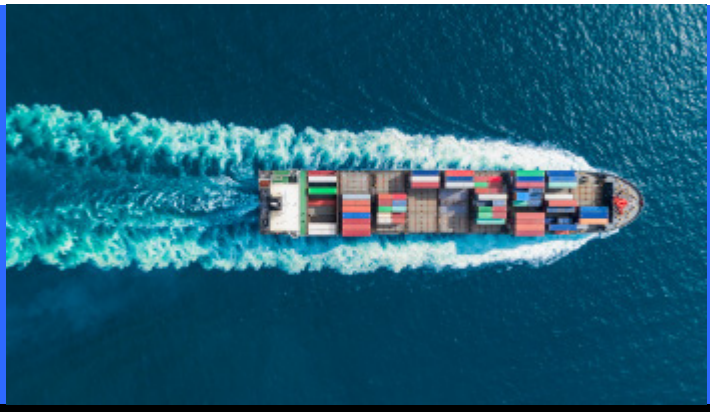

International Trade Update September 17, 2024

BIS Final Rule on Voluntary Self-Disclosure Process and Penalty Guidelines Highlights Significant Export Control Violations and Higher Penalties

With this final rule, BIS seeks to tip the scales in favor of more frequent disclosures and introduces new factors to consider when assessing engagement with U.S. regulators.

In a final rule effective September 16, 2024, the Department of Commerce's Bureau of Industry and Security ("BIS") updated its process for handling voluntary self-disclosures from industry and expanded its discretion to impose higher monetary penalties for violations of export control laws. Whether to submit a voluntary self-disclosure remains a fact-dependent decision and requires careful weighing of factual, legal, practical and policy considerations.

Background

Corporate violations of U.S. sanctions, export control laws, and foreign direct investment determinations are a key enforcement priority for BIS, the Department of Justice, the Department of the Treasury, and the Committee on Foreign Investment in the United States ("CFIUS"), with each taking an increasingly aggressive enforcement posture through new guidance, compliance expectations, and record-setting penalties in recent years.

On September 12, 2024, BIS announced the publication of a final rule updating its policies regarding voluntary self-disclosures ("VSD") and the BIS Penalty Guidelines, found at

Supplement No. 1 to Part 766 of the Export Administration Regulations ("EAR"). The rule finalizes a series of policy changes by the Office of Export Enforcement ("OEE") that were first articulated in memoranda publicly issued by BIS beginning in 2022 and that seek to strengthen BIS's administrative enforcement program and encourage voluntary disclosures of apparent export control violations.[1]

As we summarized in our 2023 Year-End Sanctions and Export Control Update, these changes aim to:

1. streamline self-disclosure of minor or technical violations, facilitate corrective action that might otherwise be prohibited, and prioritize enforcement actions against "significant" violations by establishing a dual-track process for VSD submission and processing;
2. incentivize VSDs by treating failure to disclose significant apparent violations as an aggravating factor;
3. enhance OEE's discretion in assessing penalties when warranted;
4. incentivize compliance-minded firms to report violations committed by *other* firms or competitors; and
5. coordinate enforcement efforts through the appointment of a new Chief of Corporate Enforcement position.

The final rule, outlined in greater detail below, highlights BIS's continued commitment to streamlining the VSD program to facilitate faster resolutions of non-egregious apparent violations and at the same time highlights BIS's desire to focus its resources on significant infractions, including by expanding its discretion to impose higher civil monetary penalties.

1. Dual-Track VSD Processing, Streamlined Submission of Minor or Technical Violations, and Corrective Action Provisions

a. Dual-Track VSD Processing

Minor or Technical Violations Track

Section 764.5 of the EAR previously set forth a single track for handling VSDs, regardless of the severity of the violation at issue. The final rule adds a new paragraph regarding disclosure of minor or technical violations, defined as any violation that does not include aggravating factors.

These revisions permit firms to disclose minor or technical violations through a "fast-track" process that will be resolved in 60 days, either through a no-action letter or a warning letter. For such apparent violations, firms may submit by email an abbreviated narrative report in lieu of more burdensome narrative and documentation requirements previously set forth in Sections 764.5. For minor or technical violations, the rule also removes the recommendation that firms conduct a five-year lookback, unless OEE suspects that aggravating factors are present. Firms may also "bundle" multiple minor or technical apparent violations into a single submission, if such apparent violations occurred within the prior quarter.

OEE offered several examples of "minor or technical" violations, including immaterial Electronic Export Information filing errors and the incorrect use of one license exception where another license exception was available.

"Significant" Violations Track

For VSDs that concern a "significant violation," firms should follow the prior procedures, including submission of a full narrative report.

The rule notes that parties unsure whether a disclosure involves a minor or technical violation or a significant violation are advised to follow the procedures for disclosing a significant violation.

Following disclosure of a "significant" apparent violation, OEE will conduct an investigation and may, depending on the facts and circumstances of the case, issue a warning letter or initiate an administrative enforcement proceeding. OEE may also refer the matter to DOJ for criminal prosecution.

b. Treatment of Unlawfully Exported Items

The final rule revises the EAR with regards to the treatment of unlawfully exported items. Consistent with a 2024 policy memorandum, the final rule clarifies that OEE authorizes any person, not just a party submitting a VSD, to request permission to engage in corrective activities otherwise prohibited by Section 764.2(e) (often referred to as a "General Prohibition 10 Waiver"). The rule also authorizes firms to seek the return of any unlawfully exported item to the United States following notification to OEE and removes the need for firms to receive authorization from OEE for such return-related activities. Further, items that have been returned to the United States do not require additional authorization from OEE, provided that those future activities comply with any applicable EAR requirements. This change is likely due in part to the increase in General Prohibition 10 Waiver requests related to items exported, reexported, or transferred (in-country) to Russia and Belarus (including aircraft) following the imposition of strict export controls on these destinations.

Any re-export from abroad or transfer outside of the United States of an item that has been the subject of a self-disclosure would require a license from BIS.

2. Nondisclosure as Aggravating Factor

Assistant Secretary Axelrod previously explained in a January 2024 speech at NYU Law School, "when someone affirmatively chooses not to file a VSD, [BIS] want[s] them to know that they risk incurring concrete costs."

Consistent with that statement and previous policy memoranda, the final rule confirms that BIS will consider a deliberate decision by a firm not to disclose a significant apparent violation to be an aggravating factor when determining what administrative penalty, if any, should be applied.

A “deliberate decision” occurs when a firm uncovers a significant apparent violation but then chooses not to file a VSD.

The rule adds a new Aggravating Factor D to the BIS Penalty Guidelines for “[f]ailure to disclose a significant violation.”

3. Penalty Guidelines and Increased Discretion

The final rule enhances OEE’s discretion in calculating potential penalties for apparent violations in several significant ways.

First, the rule removes the base penalty caps for non-egregious cases and instead links penalties to transaction value and other circumstances.

As a result, for non-egregious VSD cases, the base penalty amount is no longer capped at a maximum of $125,000, but is instead capped at one-half of the transaction value. For a non-egregious case that is *not* initiated by a VSD, the base penalty amount is no longer capped at $250,000, but is instead capped at the full transaction value. The rule describes this change as permitting OEE to “impose penalties with sufficient deterrent effect in situations where transaction values are high.”

For egregious VSD cases, the base penalty amount is capped at one-half of the statutory maximum—which is $364,992 or twice the full transaction value, whichever is greater. For an egregious case that is *not* initiated by a VSD, the base penalty amount is capped at the statutory maximum.

Second, the rule permits BIS to issue non-monetary resolutions for non-egregious conduct that has not resulted in serious national security harm yet nonetheless merits stronger response than a no-action or warning letter. The final rule indicates that such resolutions are likely to “require remediation through the imposition of a suspended denial order with certain conditions, such as training and compliance requirements.”

Third, the final rule removes from the Penalty Guidelines all specific percentage ranges for potential penalty reduction based on mitigating factors. As the rule explains, “[t]he inclusion of specific percentage ranges for some mitigating factors and not for other factors led parties to incorrect assumptions about the range of reduction to which they were entitled.” With the revisions, “OEE is making clear that the civil monetary penalty will be adjusted (up or down) to reflect the applicable factors for administrative action set forth in the BIS Penalty Guidelines.”

Fourth, the final rule amends Aggravating Factor C, “Harm to Regulatory Program Objectives,” to include transactions that enable human rights abuses as a specific consideration when assessing the potential impact of an apparent violation on U.S. foreign policy objectives.

Fifth, the final rule amends General Factor E (previously D), for “Individual Characteristics,” by expanding the scope of past corporate criminal resolutions that OEE may consider when calibrating an enforcement response. Previously, this factor only mentioned prior conviction of an export-related criminal violation. As revised, it includes not only where a respondent has been

convicted or entered a guilty plea, but also where a party has entered into any other type of resolution with the Department of Justice or other authorities, including a Deferred Prosecution Agreement or a Non-Prosecution Agreement.

4. Exceptional Cooperation for Third-Party Tips

As explained by Assistant Secretary Axelrod in his January 2024 speech, BIS seeks to ensure a "level playing field" for compliance-minded firms, recognizing that rule-following firms can suffer as firms that flout regulations book business.

The revised Penalty Guidelines now clarify that disclosure of conduct by *others* that leads to an enforcement action counts as "exceptional cooperation." BIS will provide cooperation credit for such tips in "a future enforcement action, even for unrelated conduct," if such an action is ever brought.

The decision to provide cooperation credit for tips as to suspected third-party violations is unusual and marks a significant departure from other VSD programs with uncertain implications for industry.

5. Chief of Corporate Enforcement

Mirroring action taken by the Department of Justice's National Security Division ("NSD") in 2023, BIS announced the appointment of Raj Parekh as the agency's first Chief of Corporate Enforcement. An accompanying press release to the final rule indicates that Mr. Parekh will "serve as the primary interface between BIS's special agents, the Department of Commerce's Office of Chief Counsel for Industry and Security, and the Department of Justice," with the aim of "advance[ing] significant corporate investigations."

Mr. Parekh joins BIS from the U.S. Attorney's Office for the Eastern District of Virginia, where he served as Acting U.S. Attorney. He previously worked at DOJ NSD, and the press release notes that this appointment "further reflect[s] BIS's commitment to this effort."

Conclusion

In his January speech, Assistant Secretary Axelrod touted the early successes of recent changes to BIS's VSD program. Specifically, BIS received nearly 80 percent more VSDs containing potentially serious violations in FY2023 than in FY2022, even as the overall number of VSDs remained relatively constant. BIS also experienced a 33 percent uptick in third-party disclosures from industry.

The revised rule reflects BIS's continued focus on corporate compliance with export controls and the increased centrality of economic statecraft to U.S. national security policy. It also demonstrates that BIS seeks to focus its investigative resources on infractions most likely to damage U.S. national security interests, and its willingness to impose steeper penalties to incentivize compliance. In April 2023, for instance, BIS announced the largest standalone penalty in the agency's history—a $300 million civil penalty against affiliates of a technology company that allegedly sold hard disk drives to Huawei Technologies Co. Ltd. BIS is not alone in

this prioritization, with CFIUS announcing in August 2024 that it imposed the largest penalty in its history—$60 million—for the breach of a mitigation agreement that resulted in harm to U.S. national security equities, and the Treasury's Office of Foreign Assets Control levying two of the largest civil penalties in its history last year, including a $968 million settlement, for violations of U.S. sanctions law.

In addition, over the last two years, officials at DOJ have sounded a drumbeat of announcements indicating that criminal enforcement of U.S. export control and sanctions law is one of their highest priorities, with the Department hiring 25 new NSD prosecutors to "investigate national security-related economic crimes" and the publication of an updated NSD Enforcement Policy that "strongly encourages companies to voluntarily self-disclose directly to NSD all potentially criminal … violations of the U.S. government's export control and sanctions regimes."

While a decision to submit a voluntary self-disclosure will be the result of considering many factors, BIS is seeking to raise the consequences of a decision not to submit a self-disclosure where aggravating factors are present. The factors highlighted in this new rule, as well as the heightened importance of international trade controls in the United States' response to global challenges, should remain at the forefront when considering a voluntary self-disclosure of any apparent export control violations to BIS or other regulators.

[1] *See* Memorandum from Bureau of Indus. & Sec., Further Strengthening Our Administrative Enforcement Program (June 30, 2022), https://www.bis.gov/sites/default/files/files/Administrative%20Enforcement%20Memo.pdf; Memorandum from Bureau of Indus. & Sec., Clarifying Our Policy Regarding Voluntary Self-Disclosures and Disclosures Concerning Others (Apr. 18, 2023), https://www.bis.gov/sites/default/files/files/VSD%20Policy%20Memo%20%2804.18.2023%29.pdf; Memorandum from Bureau of Indus. & Sec., Further Enhancements to Our Voluntary Self-Disclosure Process (Jan. 16, 2024), https://www.bis.gov/sites/default/files/files/VSD%20MEMO.pdf.

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Gibson Dunn lawyers are monitoring the proposed changes to U.S. export control laws closely and are available to counsel clients regarding potential or ongoing transactions and other compliance or public policy concerns.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these issues. For additional information about how we may assist you, please contact

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