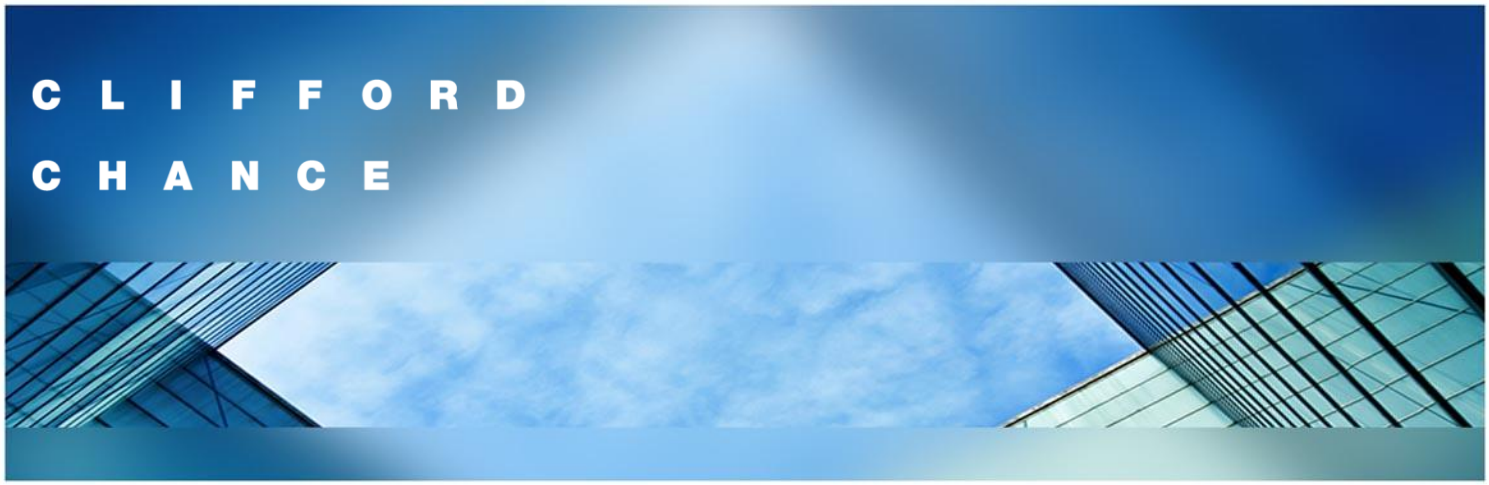

CLARIFICATIONS AND INCENTIVES: COMMERCE ISSUES CLARIFICATION MEMORANDUM ON VOLUNTARY SELF-DISCLOSURES AND DISCLOSURES CONCERNING OTHERS

On April 18, 2023, Matthew Axelrod, Assistant Secretary for Export Enforcement at the U.S. Commerce Department's Bureau of Industry and Security ("**BIS**"), issued a Memorandum "Clarifying Our Policy Regarding Voluntary Self-Disclosures and Disclosures Concerning Others" ("**VSD Memorandum**").

The VSD Memorandum emphasizes the importance of compliance by U.S. businesses and universities, who are at the forefront of technological advances, in order to protect sensitive U.S. technologies and goods from being used by U.S. adversaries for malign purposes, and states that "an important part of a robust export compliance system is a process for making two different types of disclosures to [the] Office of Export Enforcement [OEE]: (1) voluntary self-disclosures (VSD) about parties' own possible violations of the Export Administration Regulations (EAR); and (2) disclosures about possible EAR violations by someone else." While the Memorandum specifically references U.S. businesses and universities, given that EAR jurisdiction follows the product and technology, non-U.S. businesses and universities should also take note. In addition, the repeated reference to universities is also in line with the "Academic Outreach Initiative" Commerce announced in June 2022, indicating a continued trend of BIS highlighting the important role universities and academia have in EAR compliance.

A drastic shift in enforcement policy, the VSD Memorandum provides both incentives for reporting potential violations of the EAR (including disclosures about the conduct of third parties) and punishments for companies that decide not to voluntarily report "significant possible violations."

As further discussed below, BIS now will consider a company's decision not to submit a VSD as an aggravating factor in an enforcement action. When it comes to whistleblowing on a third party, if "that tip results in enforcement action – then [BIS] will consider that a mitigating factor if a future enforcement action, even for unrelated conduct, is ever brought against the disclosing party" and, given the

possible overlap with OFAC sanctions, the disclosure could also qualify for a bounty under the U.S. Treasury Department's whistleblowing program administered by the Financial Crimes Enforcement Network ("**FinCEN**").

VOLUNTARY SELF-DISCLOSURES

The VSD Memorandum emphasizes that this policy announcement is an incentive for both industry and academia given the risk calculus under existing BIS settlement guidelines (available here), as a timely and comprehensive VSD with full cooperation substantially reduces the applicable civil penalty under the base penalty matrix (by up to one-half the transaction value, capped at a max of USD $125,000 per violation; some non-egregious matters may qualify for a full suspension of penalty). However, to further incentivize filings of VSDs for significant possible violations of the EAR, the VSD Memorandum clarifies, effective immediately, that failure to disclose an identified violation will now be considered an aggravating factor under existing guidelines. Thus, increasing the risk (including the risk of higher penalties) for companies and universities that decide not to file a VSD moving forward.

The VSD Memorandum also notes that the decision to submit a VSD will be used in the evaluation of the disclosing party's compliance program, both at the time of the disclosed violations and at present. This essentially means that a company that has a well-functioning compliance program will be able to identify issues in a timely manner, allowing the company to make a timely VSD and mitigate their risk profile (with the opposite also holding true).

The VSD Memorandum further specifies that this action is targeted at so-called "significant possible violations," a new term BIS said it is using to differentiate the types of disclosures they are focused on from those that are for more minor technical violations. BIS does not provide examples of what would be considered a "significant possible violation," instead suggesting that such violations are those that reflect a "potential national security harm," leaving companies and universities to attempt a judgment call subject to a hindsight review by BIS.

In practice, the policy shift announced in the VSD Memorandum is that when "someone chooses to file a VSD, they get concrete benefits; when someone affirmatively chooses not to file . . . [OEE] want[s] them to know that they risk incurring concrete costs."

Interestingly, this new policy approach is quite different from the recent updates announced by the U.S. Department of Justice ("**DOJ**") which we wrote about here, where the DOJ continues to focus on incentives and benefits for submitting a VSD and has not (yet) sought to explicitly penalize companies who do not file VSDs. Similarly, OFAC's VSD policy considers a VSD as a mitigating factor that could result in a reduction in the base amount of any proposed civil penalty, but it does not explicitly state that a failure to file a VSD would lead to additional penalty.

NEW WHISTLEBLOWING INCENTIVES: DISCLOSURES ABOUT THE CONDUCT OF OTHERS

The VSD Memorandum further highlights the need for strong compliance programs and general compliance with the EAR, while stressing the importance of protecting U.S. technology and alerting authorities of potential EAR violations,

including whistleblowing on potential activities by third parties. To do so, the VSD Memorandum asks individuals, companies, and universities who become aware that others appear to be violating the EAR, to notify BIS.

While BIS stops short of offering a new whistleblowing bounty, the VSD Memorandum does emphasize the benefits under the existing BIS settlement guidelines for disclosing parties. Particularly, if an enforcement action arises from the tip, that disclosure will be considered as a mitigating factor if a *future* enforcement action for *unrelated* conduct is brought against the disclosing party. Furthermore, the VSD Memorandum confirmed that if the disclosed conduct includes not only an EAR violation but also a potential U.S. sanctions violation, monetary rewards may also be available under the FinCEN whistleblowing program – if the tip leads to an enforcement action. Additional information on the FinCEN whistleblowing program can be found here, where we note that the awards are possible in connection with enforcement actions that lead to the collection of more than $1 million and that non-U.S. persons are eligible to receive awards for qualifying tips. Accordingly, a special U.S. fund being set up under the FinCEN program could be the source for financial awards on Export Control Reform Act penalties, as long as OFAC or DOJ, the agencies responsible for administering/prosecuting U.S. sanctions violations, "take a qualifying action based on the same original information" provided by the disclosing party.

Similarly, OFAC violations may also constitute EAR violations and the whistleblowing bounty for OFAC violations incentivizes third parties to disclose EAR violations to the extent of such overlap. Further, FinCEN and BIS recently issued a joint advisory warning of the AML consequences associated with processing payments involved in an export control violation, placing financial institutions on higher alert to identify and to disclose to FinCEN, through a Suspicious Activity Report (SAR), transactions involving an export control violation and including the known parties involved. Additional information about this development can be found in our alerter here.

The upshot of all of this is that the growing risk of third-party whistleblowers, the increasing likelihood of financial institution reporting of SARs, as well as the disincentive for failing to make an EAR VSD, must all factor into a company or university's decision on whether to make a disclosure and when. Under the BIS policy, credit will only be provided for a VSD when the information is "received by OEE for review prior to the time that OEE, or any other agency of the United States Government, has learned the same or substantially similar information from another source and has commenced an investigation or inquiry in connection with that information" (EAR Part 764).

MOVING FORWARD

Given the Administration's focus on protecting sensitive U.S. technologies and goods, as well as the new heightened risks for non-compliance highlighted by the VSD Memorandum, companies and universities should review their compliance policies to mitigate potential EAR violations and consult with counsel regarding any potential violations. At a minimum, companies and universities must make sure that their compliance programs can quickly identify and escalate such issues, including when raised by individuals, and have a process in place to ensure that

an informed and timely decision can be made on whether a VSD should be submitted.

CLIFFORD CHANCE

CONTACTS

Renée Latour
Partner

T +1 202 912 5509
E renee.latour
@cliffordchance.com

Joshua Berman
Partner

T +1 202 912 5174
E joshua.berman
@cliffordchance.com

David DiBari
Partner

T +1 202 912 5098
E david.dibari
@cliffordchance.com

George Kleinfeld
Partner

T +1 202 912 5126
E george.kleinfeld
@cliffordchance.com

Vasu Muthyala
Partner

T +65 6661 2051
E vasu.muthyala
@cliffordchance.com

Michelle Williams
Partner

T +1 202 912 5011
E michelle.williams
@cliffordchance.com

Jamal El-Hindi
Counsel

T +1 202 912 5167
E jamal.elhindi
@cliffordchance.com

Jacqueline Landells
Counsel

T +1 202 912 5061
E jacqueline.landells
@cliffordchance.com

John-Patrick Powers
Counsel

T +1 202 912 5048
E john-patrick.powers
@cliffordchance.com

Holly Bauer
Associate

T +1 202 912 5132
E holly.bauer
@cliffordchance.com

Weisiyu Jiang
Associate

T +1 202 912 5303
E weisiyu.jiang
@cliffordchance.com

Kimberly Shi
Associate

T +1 202 912 5922
E kimberly.shi
@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 2001 K Street NW, Washington, DC 20006-1001, USA

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Delhi • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.