Considerations in how to approach voluntary disclosures of export violations

Voluntary disclosures of export violations to the various government agencies may make good business sense but their repercussions are not always what one might expect. Jason Waite and Diego Marquez chart the best path to coming clean.

The voluntary disclosure of an export violation can be an effective tool for companies and individuals looking to mitigate the potential consequences for violations of U.S. export control laws. Given the heightened focus on enforcement in recent years and the increased civil and criminal penalties for export violations, the stakes in approaching voluntary self-disclosures have grown.

The preparation and submission of a voluntary disclosure requires exporters to consider many factors, and it is critical that exporters or otherwise concerned parties fully understand such factors before deciding to move ahead with a disclosure and in designing the best possible approach to any disclosure made.

As readers of World Export Controls Review are likely aware, several government agencies are involved in the administration and enforcement of export activity. Each agency has its own set of rules for making voluntary disclosures, and exporters should carefully consider the applicable agency rules and the resulting implications on their business when approaching a voluntary disclosure.

This article compares the rules and practice of voluntary disclosures to the Bureau of Industry and Security (‘BIS’) of the U.S. Department of Commerce, the Office of Foreign Assets Control (‘OFAC’) of the U.S. Department of Treasury, and the Directorate of Defense Trade Controls (‘DDTC’) of the U.S. Department of State. We will highlight some of the subtle but potentially significant differences between the agencies and offer guidance on the common themes and considerations that should go into deliberations over making any voluntary disclosure and, subsequently, when preparing such a disclosure.

The playing field: three agencies, three sets of rules

The three government entities discussed in this article – BIS, DDTC and OFAC – play different roles in the administration and enforcement of export activity. BIS is responsible for implementing and enforcing the Export Administration Regulations (‘EAR’) that regulate the export and re-export of dual-use items, while DDTC is charged with implementing and enforcing the International Traffic in Arms Regulations (‘ITAR’) that regulate the sale, export and re-transfer of defence articles and services. OFAC, on the other hand, administers and enforces economic and trade sanctions against targeted foreign states, organizations and individuals. (This article focuses on the voluntary disclosure of potential or actual export violations, though the regulations administered by the entities discussed can cover more than simply exports. OFAC, for example, administers a range of prohibitions and blocking mechanisms impacting banks and financial institutions.)

While the U.S. government generally encourages disclosures and looks favourably upon exporters that make disclosures, BIS, OFAC and DDTC each have different sets of rules, and through prevailing practices and trends, may each treat disclosures differently.

Exporters, therefore, need to be aware of the subtle differences between the three agencies, particularly with respect to the varying degrees of penalty mitigation afforded to exporters making disclosures. Exporters should also keep in mind that certain acts can result in violations of regulations administered by multiple agencies, and disclosure of such acts may require submission of a disclosure to more than one agency.

No amnesty but varying degrees of mitigation

Generally speaking, none of the three agencies provides complete amnesty to exporters making disclosures; as a result, exporters considering making a voluntary disclosure should be prepared to face enforcement consequences. It is important to keep in mind that such enforcement consequences can, in some cases, include referral for criminal prosecution. However, each of the three relevant agencies encourages disclosures and provides treatment intended to incentivize exporters to come forward.

OFAC provides the clearest treatment of voluntary disclosures, making it easier for exporters to weigh the impact of making a disclosure to OFAC. While the submission of a disclosure will not guarantee that an exporter can avoid the imposition of penalties or other administrative action, OFAC’s penalty guidelines...
establish mitigation to 50% of the base penalty as the starting point for a violation involving a disclosure.

BIS ‘strongly encourages’ disclosure to its Office of Export Enforcement (‘OEE’) if an exporter believes that it has committed a violation of the EAR administered by BIS, or any order licence or authorization issued pursuant to the EAR. However, unlike OFAC, BIS does not provide guidelines establishing a particular level of mitigation guaranteed as a result of a disclosure. Instead, the submission of a voluntary disclosure is considered a mitigating factor to be considered together with all other factors in OEE’s determination of an appropriate administrative sanction, if any.

BIS explains to exporters that it considers disclosures to be an excellent indicator of a party’s intent to comply with export control requirements and OEE will therefore afford the submission of a disclosure ‘great weight’ in determining an appropriate penalty for a violation.

**BIS regulations make clear that referral to the U.S. Department of Justice for criminal prosecution remains a possibility despite the submission of a disclosure.**

Penalties may be significantly reduced as a result of a disclosure and, indeed, BIS officials regularly make presentations of statistics to the public which suggest favourable treatment of disclosures. However, because the weight given by OEE to voluntary self-disclosures is solely within the agency’s discretion, it can be difficult for exporters to anticipate the consequences of making a disclosure.

Additionally, depending on the facts of a case, the presence of a voluntary self-disclosure may sometimes have the effect of requiring an exporter to disclose such violations if it intends to continue with certain business activities. For example, the EAR prohibit exporters from proceeding with transactions in the knowledge that a violation has occurred, including transactions to re-export, sell, transport or service items subject to the EAR if such items were originally exported without the appropriate authorization from BIS. Thus, where it becomes apparent that an item was improperly exported, and yet there remains a business need to sell it, transfer it or re-export it, an exporter, not wanting to compound a prior error by violating this additional prohibition, may be effectively required to disclose. Similarly, while the law may not explicitly require an exporter to disclose that it exported certain software or certain heavy machinery without the required licences, for example, the same exporter would be prohibited from delivering updates to the software or servicing the heavy equipment, again making disclosure virtually required as a practical matter if the business is to proceed without engaging in additional, potentially more egregious, knowing violations.

In other cases, an exporter’s own internal compliance programme, or the conditions of the export licences or agreements under which it engages in exports, or the terms of any past settlement of an export enforcement matter, or the emergence of information about violations in the context of certain types of corporate transactions, such as the sale of a company, may require the exporter to disclose violations as a practical matter. It is critical to consider these and other circumstances that could effectively require disclosure when evaluating how to address emerging information that indicates past violation or potential violation of U.S. export regulations.

Where no such circumstances exist, then an exporter must engage in a deliberative balancing of the risks and benefits of making a disclosure, and the risks, if any, of not disclosing the information. Of course, the primary risk of not disclosing is that the violation will be discovered and the ensuing enforcement action will be more aggressive and penalties greater than they would have been had the violation been disclosed. The gravity of this risk may depend on the nature of the violation or potential violation at issue. On the other hand, a significant risk of disclosing is that penalties will

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**Considerations for all disclosures to U.S. agencies regulating exports**

- Stop ongoing violations
- Timely notification and follow-up
- Thorough and properly scoped review of the circumstances and facts
- Accuracy – avoid incomplete or inaccurate disclosures
- Careful consideration of the appropriate remedial actions
- Involvement of senior management
- Recordkeeping – maintain all relevant records

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**Determining whether to disclose: considerations that transcend the various agencies**

While exporters are generally not required by law to disclose violations, the specific circumstances of violations may sometimes have the effect of requiring an exporter to disclose such violations if it intends to continue with certain business activities. For example, the EAR prohibit exporters from proceeding with transactions in the knowledge that a violation has occurred, including transactions to re-export, sell, transport or service items subject to the EAR if such items were originally exported without the appropriate authorization from BIS. Thus, where it becomes apparent that an item was improperly exported, and yet there remains a business need to sell it, transfer it or re-export it, an exporter, not wanting to compound a prior error by violating this additional prohibition, may be effectively required to disclose. Similarly, while the law may not explicitly require an exporter to disclose that it exported certain software or certain heavy machinery without the required licences, for example, the same exporter would be prohibited from delivering updates to the software or servicing the heavy equipment, again making disclosure virtually required as a practical matter if the business is to proceed without engaging in additional, potentially more egregious, knowing violations.

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Timing is an important consideration for over a year while a disclosure is discovered and investigated. Moving forward with a relevant agency discovered by the government) and the possible interruption of business (e.g., delays in licensing) pending the outcome of a voluntary disclosure. Indeed, voluntary disclosures will be the subject of an investigation by the concerned agency and we have seen cases where licensing has been slowed, or where licences have not been issued for over a year while a disclosure is being reviewed and investigated. Moving forward with a disclosure: timing is critical Timing is an important consideration with respect to the submission of a voluntary disclosure to any of the three agencies. A voluntary disclosure before OFAC is valid only if a notification is submitted prior to or at the same time that OFAC or any other government agency or official discovers the apparent violation or another substantially similar apparent violation. Similarly, disclosures must be made to BIS and DDTC before any U.S. government agency has learned the same or substantially similar information and has commenced an investigation or inquiry in connection with that information. Timing can also be important in terms of the steps to be taken between discovery of a violation and notification to the government. It is critical that the prohibited activity cease, regardless of whether a disclosure will be made, but exporters will often need some time to develop an understanding of the facts sufficient to evaluate and prepare a disclosure. While all agencies allow for an initial notification or disclosure, and an exporter, therefore, need not have a comprehensive view of the circumstances giving rise to the violation or potential violation, a certain level of basic understanding is, nonetheless, advisable if the exporter is to make an effective initial disclosure. The three agencies’ regulations use different language when describing the timing of a disclosure. BIS regulations, for example, ask that exporters make an initial notification of a disclosure ‘as soon as possible’ after violations are discovered, while DDTC regulations require exporters to notify the agency of a violation ‘immediately’ after discovery. A challenge in most disclosures is to gather sufficient information to understand the violations that may be disclosed while still meeting agency expectations with respect to timeliness after discovery and ensuring filing of the disclosure before the agency has taken its own related action that could justify

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<th>Key benefits of a disclosure</th>
<th>BIS</th>
<th>DDTC</th>
<th>OFAC</th>
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<tr>
<td>Mitigating factor – ‘Great weight’ in assessing and mitigating a penalty, but the weight given to disclosure is solely within agency’s discretion</td>
<td>DDTC ‘may consider’ disclosure a mitigating factor in civil penalty cases</td>
<td>Penalty mitigation (50 percent of base penalty)</td>
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<th>Risks of not disclosing</th>
<th>The failure to make a disclosure will generally not be treated as a separate violation</th>
<th>Failure to report a violation may be an adverse factor when considering such violation</th>
<th>Cooperation with OFAC is an important factor even in the absence of a voluntary self-disclosure</th>
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<td>Prior to the time that government has learned the same or substantially similar information from another source and has commenced an investigation or inquiry in connection with that information</td>
<td>Initial notification should be made ‘as soon as possible’ after discovery</td>
<td>Prior to or at the same time that government discovers the apparent violation or another substantially similar apparent violation</td>
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<th>Timing of disclosure</th>
<th>Thorough review of all export-related transactions where possible violations are suspected; a narrative account that sufficiently describes the suspected violations so that their nature and gravity can be assessed and that is accompanied by copies of documents that explain and support the narrative</th>
<th>Thorough review of all export-related transactions where a possible violation is suspected; the written disclosure should be accompanied by copies of substantiating documents</th>
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<td>Initial notification should be made ‘as soon as possible’ after discovery</td>
<td>Initial notification should be made ‘immediately’ after discovery</td>
<td>Report of sufficient detail to afford a complete understanding of an apparent violation’s circumstances</td>
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be assessed, notwithstanding the disclosure. Exporters will also want to consider the time, effort and costs involved in preparing a voluntary disclosure, thoroughly investigating potential violations, and engaging in the subsequent follow-up with the relevant agency. Another risk of disclosing is potential reputational damage (not unlike that suffered if a violation is discovered by the government) and the possible interruption of business (e.g., delays in licensing) pending the outcome of a voluntary disclosure. Indeed, voluntary disclosures will be the subject of an investigation by the concerned agency and we have seen cases where licensing has been slowed, or where licences have not been issued for over a year while a disclosure is being reviewed and investigated.
denying the validity of the disclosure. In taking on this challenge, exporters can sometimes benefit from the opportunity to disclose past activity without admitting to a violation. OFAC’s regulations, for example, allow for the voluntary self-disclosure of ‘apparent’ violations, giving exporters the option of disclosing potential violations and meeting the requirement for timeliness before then investigating the circumstances of the potential violations more fully. Similarly, BIS and DDTC encourage disclosures if you believe you ‘may have’ violated the EAR or ITAR, respectively. The extent to which activity is likely to be considered a violation should also factor into the decision as to whether to disclose, but in the current enforcement environment many exporters will elect to disclose possible violations, presenting a full report to the agency concerned while not admitting a violation. Of course, action is generally required within a certain timeframe subsequent to the initial notification of a disclosure in order to complete the disclosure, and exporters must therefore ensure timely action in investigating the facts and completing the disclosure.

**Thorough and properly scoped review: get the facts right**

The development of a complete and accurate account of the facts is critical. For example, the submission of a voluntary self-disclosure to BIS requires a narrative account that sufficiently describes the suspected violations so that the government can assess the gravity of the violations. A report of sufficient detail to afford a complete understanding of the circumstances of an apparent violation is similarly necessary for the submission of a disclosure to OFAC, and parties making a disclosure to DDTC are required to conduct a thorough review of all export-related transactions where a possible violation is suspected. To ensure the development of an accurate account of the facts with the appropriate level of detail, exporters will need to plan and conduct a thorough internal review to determine the facts surrounding the relevant transactions.

Developing an internal review of the proper scale and scope can be challenging; exporters must carefully consider the structure, content and purpose of a review as well as the personnel that should be involved. The disclosure of some violations may require extensive employee interviews, or the collection and analysis of a substantial volume of electronic records, for example, while a more limited review may be more appropriate for other violations. The resources available for conducting an internal review, including the role of the legal department and/or outside counsel, are also important considerations. These considerations will be significantly impacted by the specific circumstances of a potential violation.

**Disclosing the wrong facts, or making an incomplete disclosure, can have serious consequences.**

Internal reviews can be particularly helpful in determining the reason(s) why any potential violation occurred and identifying appropriate corrective actions to minimize the likelihood that violations will occur in the future. The identification and implementation of remedial measures can be an important part of disclosures, and a thorough review can help ensure that such measures are appropriately designed to effectively deter future violations. Throughout the preparation and submission of a voluntary disclosure, it is important for exporting companies to involve senior management and act with its full knowledge and authorization (OFAC, BIS and DDTC each require the involvement of senior company officials for a valid disclosure). This is particularly true as exporting companies consider whether relevant employees should be dismissed or otherwise disciplined.

**Conclusion**

It is critical that exporters get it right when disclosing violations to the government. Disclosing the wrong facts, or making an incomplete disclosure, can have serious consequences and sometimes exacerbate what would otherwise be a more routine penalty case. Indeed, several high profile penalty cases in recent years have been the result of disclosures that were alleged to be incomplete or misleading. Properly developing the scale and scope of an internal review, and, in many cases, sharing details of the approach to the review with the government in the course of the disclosure, helps to ensure preparation of a thorough and acceptable report to the concerned agency, while poorly structured reviews may lead to inaccurate or incomplete disclosures. For example, if an internal review covers a period of time less than the statute of limitations for the applicable violations, an exporter risks failing to discover violations that may later become the subject of a government investigation. Conversely, if a review takes on an improperly broad scope, it can lead to unnecessary work and excessive expense incurred by the exporter.

The use of the voluntary disclosure mechanism available under the regulations of each of the three primary U.S. export enforcement agencies is becoming more common as exporters seek to minimize exposure to penalties for export violations, and as export regulatory compliance takes on a more prominent place in internal corporate compliance programs. In addition to the differences between each agency’s rules discussed above, exporters must remain current with prevailing trends and practices at the agencies and must carefully evaluate any decision to disclose and calibrate their approach to making a disclosure.

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Jason Waite is a partner in the law firm of Alston & Bird in Washington, DC. He counsels clients on all aspects of export controls and economic sanctions, with an emphasis on compliance, transactional planning, and enforcement defence.

Jason.Waite@alston.com

Diego Marquez is an associate in the firm who specializes in international trade and regulatory compliance and enforcement matters.

diego.marquez@alston.com