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ITAR and EAR Compliance Review and Investigations

Conducting Internal Audits and Evaluating Whether to Disclose
Potential Violations to Mitigate Penalties

WEDNESDAY, JUNE 26, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Thaddeus R. McBride, Partner, **Sheppard Mullin Richter & Hampton**, Washington, D.C.

Reid Whitten, **Sheppard Mullin**, Washington, D.C.

Randall H. Cook, Senior Attorney, **Sikorsky Aircraft**, Stratford, Conn.

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Export Compliance Reviews and Investigations

Strafford Webinar
June 26, 2013

SheppardMullin



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Agenda

- Background
- Identifying potential violations
- Commencing an investigation
- Conducting an investigation
- The disclosure decision
- Discussion



Defense Exports

- Articles designed or modified for military use
 - Includes defense services and technical data
- *Regulator*: U.S. Department of State, Directorate of Defense Trade Controls
- *Regulations*: International Traffic in Arms Regulations



Defense Exports (cont'd)

- Defense articles, technical data, and services listed on U.S. Munitions List
- License or other authorization required for most exports to most destinations
- Certain destinations subject to embargo
 - Includes China and other trading partners



Dual Use / Commercial Exports

- All items not designed or modified for military use and not otherwise listed on USML
 - Includes technology and software
- *Regulator*: U.S. Department of Commerce, Bureau of Industry & Security
- *Regulations*: Export Administration Regulations



Commercial Exports (cont'd)

- Items classified on Commerce Control List
 - Based on performance characteristics
- Licensing requirements based on:
 - Destination controls
 - End-use restrictions
 - End-user restrictions
- “License Exception” or exemption covers exports of most items to most places



Export Classification

- Essential to know whether item is controlled under the ITAR or EAR
 - Tailor appropriate compliance measures to classification
 - Only way to assess if there's been a violation
 - Investigative steps will depend on determination



A blue-tinted world map is visible in the background of the slide. The title text is overlaid on the map.

Identifying Potential Violations

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How Violations are Identified

- Internally
- Compliance review or audit
- Whistleblower
- Government inquiry



Internal Identification

- Compliance “red flag” raised by employee. Could arise in ways such as the following:
 - Diligence during license preparation
 - Diligence on transaction partner
 - Screening of customer
 - End user of product proposes unusual shipping route
 - Question raised during compliance training



Compliance Review / Audit

- Compliance best practice to conduct appropriate, periodic reviews of export compliance systems
- May identify violations during steps such as:
 - Personnel interviews
 - Reviews of export licenses and other records
 - Site inspections, e.g., walking the floor



Whistleblower

- Ensure personnel are aware of means to report violations
- Provide for anonymity if whistleblower desires it
- No retaliation for good faith reports
- Review all allegations appropriately



Government Inquiry

- Customs seizure
- Informal inquiry
 - Letter requesting information / a meeting
 - FBI Outreach (e.g., ANSIR)
- Subpoena
 - Is company a witness or target?
 - Communicate with prosecutor / agent
 - Review materials before submission





Commencing an Investigation

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Initial Review

- Is compliance red flag indicative of actual violation?
- Is any immediate containment necessary?
- Should counsel be consulted?
- Who will prepare the investigative plan?



Investigation Plan

- **IMMEDIATE** steps to preserve data
- Identify members of team and contact information
- Memorialize scope of investigation
- Establish clear benchmarks to guide the investigation

Investigation process should be standard

Investigation plan should respond to facts



Preserving Data

- Preservation or other retention notice
- Initial notice may be OK; can supplement later
- Broad, clear language about what to preserve
- Disseminate widely
- Require acknowledgment from recipients



Investigation Team

- Should outside counsel be involved?
- Are forensic accountants needed?
- Should internal audit have a role?
- What J/C resources are required?
- What internal IT resources are needed?
- Reporting line to GC? Board? Audit Committee?



Stakeholder Buy-in

- Ensure investigation process engages the enterprise
 - Devise investigation plan to minimize business disruption
 - Make business leaders a resource for information
 - Improve chances of cooperation and efficiency
 - Establish rapport for implementation of corrective actions



Investigation Scope

- Cover all possible violations related to identified issue
 - Is problem isolated? Systemic?
 - Does it cut across enterprise? Is it endemic to particular business operation or unit?
- *Focus*: set reasonable boundaries
- *Managed*: Scope should be able to evolve
 - Adjust scope and plan to account for facts
 - Engage executives and decision makers
 - Manage scope to time available



Containment

- Halt any ongoing violation, especially if “knowing”
 - Seek return of wrongfully exported item
 - Request segregation or destruction of escaped technology or data
- Implement immediate steps to protect against similar violations



Conducting an Investigation

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Collecting Data

- Ensure integrity of data collected
 - Can data be self-collected?
 - Are forensic images needed?
 - Is information needed from individuals' laptops, PDAs, etc?
 - Do data privacy laws protect any of the information needed for the investigation?

- Make sure appropriate universe of data is collected



Reviewing Data

- Use search terms, dates, and other filters to narrow universe of data
- Volume of data:
 - Is tiered review appropriate?
 - Should contract attorneys be engaged?
- Recognize compliance considerations
 - US person review may be required
 - Export authorization for foreign person reviewers if needed



Interviews

- **Timing**
 - Think about the order of interviews but recognize practical considerations
 - Interviews are usually best after document review
- **Location**
 - Company's facility to minimize disruption
 - Offsite to maximize discretion



Interviews (cont'd)

- Interviewee
 - Issue *Upjohn* warning or not
 - Whether interviewee needs counsel

- Attendance at the interview
 - Internal investigation personnel?
 - Outside counsel? How many?
 - Develop and follow interview outline
 - Interview notes – how detailed?



Site Visits

- Gather information about the site prior to visit
 - Identify personnel with relevant information
 - Learn who key management personnel are
 - Understand day-to-day facility/site operations
- Careful observation and notes of the site
- Inspect sensitive areas for accessibility



Transaction Audits

- Review specific transactions as needed
- Consider forensic or data analysts
- Look for markers of problems
 - Poorly maintained records
 - Incomplete license files
 - Other compliance red flags
 - No record of prohibited party screening
 - Shipping documents lack destination control statement
 - Shipment volumes that exceed license



Developing Corrective Actions

- Build causal analysis and corrective action development into investigation
 - Relevance of reported facts determined by materiality to root causes and corrective actions
 - Root cause analysis should grapple with why escape occurred and what action or process would have addressed it
 - Corrective actions should effectively efficiently address root causes
 - Engage business in analysis and commitment



Internal Coordination

- Build disclosure coordination, alignment and review into investigation plan timing
 - Disclosure report of investigation's scope, analysis and corrective actions must be vetted and endorsed by client and EO
 - Build a process that facilitates engagement and alignment
 - Don't jam the process at the end, get the report into the review process timely



Memorialize Findings

- Investigative report
 - Summary of issue and review conducted
 - Detailed analysis of issues reviewed
 - Recommend corrective actions / next steps
 - Consider who should receive the report
- Reporting to senior management and/or Board
 - When is it appropriate?
 - What is the correct form?



Disclosure

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Disclosure under the ITAR

- Mandatory disclosure: exports to countries listed in § 126.1 of the ITAR
- DDTC 'may consider' voluntary disclosure to be a mitigating factor when determining penalties
- DDTC considers failure to report violation an adverse factor when determining actions in response to violation



Disclosure under the EAR

- No mandatory disclosure
- BIS considers disclosure an indicator of a party's intent to comply with export control requirements
- Disclosure given 'great weight' in determining appropriate penalty



Disclosure Considerations

- **Benefits**
 - Disclosure credit
 - Mitigation of potential penalties
 - Goodwill with regulating agency
 - Predictability

- **Drawbacks**
 - Risk to reputation of violation
 - Opening up new investigations or inquiries
 - Endure penalties that might not have been imposed



Considerations (cont'd)

- Timing
 - After violation is confirmed?
 - Before conducting investigation? In middle of investigation? Once investigation is complete?

- Initial notifications
 - ITAR specifically provides for written initial notification
 - May make sense to call agency even prior to that
 - Consider amount of detail to include
 - Want to give government sense of issue
 - Don't want to provide inaccurate information



Considerations (cont'd)

- Final Disclosure
 - Explain review conducted so government understands review was thorough
 - Outline findings (limit your advocacy here)
 - Specify corrective actions taken
 - Identify mitigating factors (this is your chance to advocate!)



Thank You

Randy Cook
Sikorsky Aircraft Corporation
+1 (203) 383-7081
randall.cook@sikorsky.com

Thad McBride
Sheppard Mullin
+1 (202)469-4976
tmcbride@smrh.com

Reid Whitten
Sheppard Mullin
+1 (202) 469-4978
rwhitten@smrh.com

SheppardMullin



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