Largest-ever penalty ushers in new era of BIS enforcement

On 19 April 2023, the Department of Commerce's Bureau of Industry and Security ("BIS") announced[1] that it had imposed a $300 million civil penalty – the largest standalone administrative penalty in BIS history – against Seagate Technology LLC of Fremont, California and Seagate Singapore International Headquarters Pte. Ltd. of Singapore ("Seagate"), for 429 violations of the Export Administration Regulations ("EAR") involving the company's sale of foreign-origin hard disc drives ("HDD") to Huawei Technologies Co. Ltd. ("Huawei"), a party in China that is on the Entity List. This action, which is described in further detail below, is symbolic of a larger shift of BIS's administrative enforcement priorities, resulting in the issuance of substantial monetary penalties against companies for the most serious violations. Further, it shows BIS is committed to enforcing the most complex and geographically far-reaching portions of its rules, such as the Foreign-Direct Product Rule ("FDPR"), placing great pressure on both US and foreign manufacturers to carefully scrutinize their manufacturing processes.

> The Seagate action is symbolic of a larger shift of BIS's administrative enforcement priorities.

Recent changes to BIS enforcement policy

As described in Issue 25 of *Export Compliance Manager* ("Changes to OEE Enforcement Policy and Voluntary Self-Disclosure Calculus"), BIS issued a memorandum in June 2022 ("the June 2022 Enforcement Memo")[2] announcing the agency's intention to focus enforcement on the most serious violations and to prioritize cases that involve the greatest harm to national security. Among other changes, BIS stated that it would devote greater attention to serious cases, impose higher penalty amounts on the most serious cases, and eliminate the use of "no admit, no deny" settlements, in which parties resolve cases without admitting to violating the EAR.

On the eve of issuing the Seagate penalty, BIS updated its enforcement policy in a memorandum ("the April 2023 Enforcement Memo")[3] encouraging companies to self-disclose significant violations of the EAR, despite the risk of increased BIS scrutiny, greater monetary penalties, and negative publicity under BIS's enforcement policy. To incentivize the submission of voluntary self-disclosures regarding "significant" violations that reflect potential national security harm, BIS stated that it will consider a company's decision not to disclose a significant violation to be an "aggravating factor" that could substantially increase the size of the monetary penalties imposed on a company. Of course, self-disclosure is not the only means by which BIS may learn of EAR violations. To encourage companies to notify BIS of possible EAR violations by other companies (even competitors), BIS announced that it would award "exceptional cooperation" credit to companies that disclose possible EAR violations by others, and consider such disclosure as a "mitigating factor if a future enforcement action, even for unrelated conduct, is ever brought against the disclosing party."

One day after issuing the April 2023 Enforcement Memo, BIS announced the $300 million civil penalty against Seagate, emphasizing BIS's current enforcement approach. Not only was the penalty the largest in BIS history (in line with BIS's promise to escalate penalty amounts for the most serious violations), but Seagate was forced to admit that it violated the EAR (in line with BIS's statement that it would eliminate the use of "not admit, no deny" settlements). The order, settlement agreement, and proposed charging letter[4] are silent as to whether Seagate self-disclosed or BIS learned of the violations through other means. Nonetheless, in announcing the penalty,[5] Director of the Office of Export Enforcement ("OEE") John Sonderman said that "[C]ompanies that discover violations should submit voluntary self-disclosures to OEE," suggesting that non-disclosure may have been an aggravating factor when calculating the size of the penalty against Seagate.

BIS enforcement of the Foreign Direct Product Rule

The $300 million monetary penalty in this case is notable not only for its size, or that

[1] https://www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/3264-2023-04-19-bis-press-release-seagate-settlement/file
[2] https://www.bis.doc.gov/index.php/documents/enforcement/3062-administrative-enforcement-memo/file
[3] https://www.bis.doc.gov/index.php/documents/enforcement/3062-administrative-enforcement-memo/file
[4] https://efoia.bis.doc.gov/index.php/documents/export-violations/export-violations-2023/1497-e2836/file
[5] https://www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/3264-2023-04-19-bis-press-release-seagate-settlement/file
[6] See 15 CFR 734.9(e)(1). https://www.ecfr.gov/current/title-15/subtitle-B/chapter-VII/subchapter-C/part-734/section-734.9#p-734.9(e)

it is evidence of BIS's shift in enforcement policy, but also because it highlights BIS's commitment to the FDPR, which has been expanded in recent years to extend the reach of US export regulations to address foreign policy concerns involving China and Russia.

As background, parties are prohibited from exporting, reexporting, or transferring (in-country) items subject to the EAR, even certain foreign-produced items, where a party to the transaction is on the Entity List. Based on the information provided in the order, settlement agreement, and proposed charging letter, it appears that Seagate sold Huawei foreign-origin HDDs that were subject to the EAR under the FDPR for Huawei Entity List parties ("Entity List FDPR"), which provides that a foreign-produced item is subject to EAR control if it meets certain product scope and end-user scope requirements.[6] The settlement agreement describes a number of additional facts and circumstances that may have contributed to the substantial monetary penalty in this case, and therefore may be instructive to others in their compliance efforts:

- After BIS established the Entity List FDPR in August 2020, two of the three companies capable of making HDDs for Huawei promptly and publicly stated that they had ceased sales to Huawei, and indicated that they required authorization from BIS to resume sales. By contrast, Seagate continued HDD sales and transactions involving Huawei for another year, until September 2021.
- In January 2021, one of Seagate's suppliers of production equipment notified Seagate that its equipment was subject to US export controls, and certain equipment used in the Seagate HDD manufacturing process was made from US-origin technology that would cause the Seagate HDDs to require an EAR license for export to Huawei. Nonetheless, Seagate continued to ship HDDs to Huawei for another eight months after receiving this notice.
- During the period from August 2020 through September 2021, Seagate entered into strategic partnership and cooperation agreements with Huawei. During this period, Seagate also extended Huawei multiple temporary credit lines of over a billion dollars.

BIS Assistant Secretary for Export Enforcement, Matthew S. Axelrod emphasized these factors when announcing this penalty: "Even after Huawei was placed on the Entity List for conduct inimical to our national security, and its competitors had stopped selling to them due to our foreign direct product rule, Seagate continued sending hard disk drives to Huawei...Today's action is the consequence: the largest standalone administrative resolution in our agency's history. This settlement is a clarion call about the need for companies to comply rigorously with BIS export rules, as our enforcement team works to ensure both our national security and a level playing field."

Conclusion

This case is a reminder that the FDPR gives BIS jurisdiction over certain foreign-made products. US and foreign companies manufacturing abroad must therefore take great care to closely analyze (or re-analyze) their manufacturing processes as well as the recipients and/or destinations of their products to properly determine if the FDPR might impose a license requirement. As Director Sonderman explained, "Those who would violate our [FDPR] restrictions are now on notice that these cases will be investigated and charged, as appropriate...Any company exporting to an entity subject to the additional [FDPR] restrictions needs to evaluate its entire manufacturing process to determine if specified US technologies or software were used in building the essential tools used in production." ■

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