

December 15, 2004

Sent Via Electronic Mail: rp2@bis.gov

The Honorable Peter Lichtenbaum
Assistant Secretary of Commerce for Export Administration
Office of Exporter Services
Room 2705
U.S. Department of Commerce
Bureau of Industry and Security
Washington, DC 20230

Re: Regulation Identification Number 0694-AC94, Notice of Proposed Rulemaking on Revised "Knowledge" Definition, Revision of "Red Flags" Guidance and Safe Harbor

Dear Assistant Secretary Lichtenbaum:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits this comment to the Department of Commerce, Bureau of Industry and Security (BIS) on its proposed rule to revise the definition of knowledge for determining whether or not an exporter knew that he/she was violating exporting controls. The Office of Advocacy believes BIS has not analyzed properly the full economic impact of the proposal on small entities as required by the Regulatory Flexibility Act (RFA). Advocacy recommends that BIS prepare and publish for public comment an initial regulatory flexibility analysis (IRFA) to assess the economic impact on small entities before proceeding to a final rule.

Advocacy Background

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or of the Administration. Section 612 of the RFA requires Advocacy to monitor agency compliance with the Act, as amended by the Small Business Regulatory Enforcement Fairness Act.¹

On August 13, 2002, President George W. Bush enhanced Advocacy's RFA mandate when he signed Executive Order 13272, which directs Federal agencies to implement policies protecting small entities when writing new rules and regulations. Executive Order 13272 also requires agencies to give every appropriate consideration to any comments provided by Advocacy. Under the Executive Order, the agency must include, in any explanation or discussion

¹ Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

accompanying the final rule's publication in the Federal Register, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.

The Proposed Rule

On October 13, 2004, BIS published a proposed rule on *Revised "Knowledge" Definition, Revision of "Red Flags" Guidance and Safe Harbor*.² The proposed rule revises the definition of knowledge for determining whether or not an exporter knew that he/she was violating exporting controls. The proposal would revise the Export Administration Regulations to incorporate a "reasonable person" standard. The current regulations require a "high probability" that the exporter knew that he was violating exporting controls. BIS is proposing to replace the phrase "high probability" with "more likely than not." BIS is also proposing to update the "red flags" guidance to increase the number of circumstances identified as expressly creating a red flag of potential violations of Export Administration Regulations. The proposed rule also creates a safe harbor from certain knowledge-based violations if the exporter takes certain steps.

Requirements of the RFA

The RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Pursuant to the RFA, the agency is required to prepare an initial regulatory flexibility analysis (IRFA) to assess the economic impact of a proposed action on small entities. The IRFA must include: (1) a description of the impact of the proposed rule on small entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives of, and legal basis for the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statutes and minimize any significant economic impact of the proposed rule on small entities. In preparing its IRFA, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable. The RFA requires the agency to publish the IRFA or a summary of the IRFA in the Federal Register at the time of the publication of general notice of proposed rulemaking for the rule.³

Pursuant to section 605(a), an agency may prepare a certification in lieu of an IRFA if the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. A certification must be supported by a factual basis.

² 69 Federal Register 60829.

³ 5 USC §603.

Advocacy Disagrees with BIS's Decision to Certify the Proposal

Rather than prepare an IRFA, BIS certified that the rule would not have a significant economic impact on a substantial number of small entities. BIS did provide a factual basis for its decision to certify; however, Advocacy disagrees with its conclusion. According to BIS, approximately 106 of the 149 entities that applied for export licensing in 2003 were small businesses. Since all of these small entities would have to comply with the new regulations, BIS concluded that the proposed rule would impact a substantial number of small entities. However, BIS contends that the proposal will not have a significant economic impact on these small entities, and therefore, chose to certify the rule.

Advocacy questions BIS's decision that the proposal will not have a significant economic impact on the regulated small entities. We disagree with BIS's contention that moving to a "more likely than not" formulation does not increase a company's responsibility with respect to knowledge. BIS also states that the proposed change is a clarification of the current standard and consistent with existing BIS and industry practice. Advocacy also disagrees with this proposed change.

Changing the definition for determining whether an exporter has knowledge from "highly probable" to "more likely than not" is more than a mere clarification. Courts have stated that from an evidentiary standpoint, a preponderance of evidence means "more likely than not." Clear and convincing evidence is a higher standard and requires a "high probability" of success. In the Matter of Briscoe Enterprises, LTD v. Briscoe Enterprises, 994 F.2d 1160; In re Arnold and Baker Farms, 177 B.R. 648 (9th Cir. BAP 1994), aff'd 85 F.3d 1415 (9th Cir. 1996), cert. denied, 519 U.S. 1054 (1997); Kelley v. Locke, 300 B.R. 11; In re Midland Plaza Associates, 247 B.R. 877 (2000). Although these are bankruptcy cases, Advocacy believes they provide a clear indication that courts do not believe that the terms "highly probable" and "more likely than not" are synonymous.

BIS is changing the definition in a way that lowers the requirements of knowledge, imposing a less stringent test for determining whether a small business should have had knowledge of their potential violation of the export control regulations. Accordingly, small businesses that may not have been liable in the past could be held liable under the new standard. As such, small businesses are more likely to incur legal expenses, fines and penalties than they would have under the current regulations. Small businesses may also incur additional legal expenses by having to hire attorneys to help them understand the implications of the new standard as well as incur costs due to expenses related to employee training (including lost man hours) to assure that employees understand the new standard and the additional red flags proposed by BIS. Indeed, the Small Business Exporters Association is concerned that the proposed rule appears to place small exporters in greater legal jeopardy without BIS's explaining the need for the change.⁴

In addition, Advocacy has spoken with members of the International Law Section of the American Bar Association (ABA) and we understand that the ABA will also provide comments to the BIS stating that changing the definition from "highly probable" to "more likely than not" is more than a mere clarification and that the change may be harmful to small businesses. The

⁴ Telephone conversation with Jim Morrison, President Small Business Exporters Association, December 13, 2004.

ABA is concerned that small businesses may incur additional expenses if they err on the side of caution and apply for a license even if one is not needed. This could be a costly and time consuming process that may lead to a delay in shipment of the export. The ABA has also advised Advocacy that the new red flag provisions will require exporters to resolve the issue as though a license has not been granted even if the issue arises after the license is granted. This may also lead to additional expenses and time for small businesses.

Safe Harbor

BIS is proposing a “safe harbor” provision which would allow businesses to learn whether BIS agrees that the transaction qualifies for a safe harbor. The safe harbor provision is intended to help business avoid fines and penalties, and BIS believes this would therefore mitigate the impact of the rule.

Although Advocacy welcomes the inclusion of the safe harbor provision, BIS does not indicate the amount of time that it will take to provide a small business with an opinion about whether or not the transaction may qualify for a safe harbor. The failure to provide a timeframe could lead to a business waiting an inordinate amount of time for the opinion which could cause a business to lose current and future exporting opportunities. It is Advocacy’s understanding that the International Law section of the American Bar Association may recommend a 30-day time frame for BIS to provide an opinion on whether the transaction qualifies for a safe harbor. Advocacy encourages BIS to give full consideration to this and other suggestions to improve the utility of the safe harbor provision.

In addition, Advocacy understands that the ABA is requesting that the proposal be rewritten to allow for the concurrent consideration of license applications while an exporter’s request is pending a determination through the safe harbor process. The ABA asserts that concurrent consideration will prevent small exporters from losing a transaction due to potential time delays from having to obtain a license after completing the safe harbor process. Advocacy encourages BIS to give full consideration to this and other suggestions that could reduce the potential burden on small entities. Such suggestions and other significant regulatory alternatives should be analyzed and considered by BIS as part of its initial regulatory flexibility analysis.

Conclusion

The RFA requires agencies to consider the economic impact on small entities prior to proposing a rule and to provide the information on those impacts to the public for comment. Advocacy recommends that BIS perform an initial regulatory flexibility analysis to determine the full economic impact on small entities and to consider significant alternatives to meet its objective while minimizing the impact on small exporters. In addition, such an analysis provides the public with insight into the reasons for the change. Because Advocacy believes comments to the record will demonstrate that BIS cannot certify the final rule, publishing an initial regulatory flexibility analysis for comment will provide BIS with the information it needs to prepare a final

regulatory flexibility (FRFA). Courts have held that an agency cannot prepare an adequate FRFA if the agency did not prepare an IRFA at the proposed rule stage.⁵

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. Advocacy is available to assist the BIS in its RFA compliance. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact Jennifer Smith at (202) 205-6943.

Sincerely,

/s/

Thomas M. Sullivan
Chief Counsel for Advocacy

/s/

Jennifer A. Smith
Assistant Chief Counsel for
Economic Regulation and Banking

Cc: The Honorable John D. Graham, Administrator, Office of Information and Regulatory Affairs

⁵ Southern Offshore Fishing Association v. Daley, 995 F. Supp. 1411 (M.D. Fl. 1998).