

Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF COMMERCE

Bureau of Industry and Security

15 CFR Parts 732, 736, 740, 744, 752, 764, and 772

[Docket No. 040915266-4266-01]

RIN 0694-AC94

Revised "Knowledge" Definition, Revision of "Red Flags" Guidance and Safe Harbor

AGENCY: Bureau of Industry and Security, Commerce.

ACTION: Proposed rule.

SUMMARY: This proposed rule would revise the knowledge definition in the Export Administration Regulations to incorporate a "reasonable person" standard and to replace the phrase "high probability" with the phrase "more likely than not." It also would update the "red flags" guidance and would provide a safe harbor from liability arising from knowledge under that definition.

DATES: Comments must be received by November 12, 2004.

ADDRESSES: Send comments on this proposed rule to: the Federal eRulemaking Portal: <http://www.regulations.gov>, via e-mail to rp22@bis.doc.gov, fax them to 202-482-3355, or on paper to Regulatory Policy Division, Office of Exporter Services Room 2705, U.S. Department of Commerce, Washington, DC 20230. Refer to Regulation Identification Number 0694-AC94 in all comments.

FOR FURTHER INFORMATION CONTACT: For further information regarding this proposed rule, contact: William Arvin, Office of Exporter Services, at warvin@bis.doc.gov, fax 202-482-3355 or telephone 202-482-2440

SUPPLEMENTARY INFORMATION:

Background

Knowledge Definition

The current definition of "knowledge" in § 772.1 of the EAR

encompasses "not only positive knowledge that a circumstance exists or is substantially certain to occur, but also an awareness of a high probability of its existence or future occurrence. Such awareness is inferred from evidence of the conscious disregard of facts known to a person and is also inferred from a person's willful avoidance of facts." This proposed rule would amend the definition of knowledge in four ways, incorporating a "reasonable person" standard, replacing the phrase "high probability" with the phrase "more likely than not," adding the phrase "*inter alia*" to the description of the facts and circumstances that could make person aware of the existence or future occurrence of a fact, and eliminating the phrase "known to the person" from the sentence in the knowledge definition that states that knowledge may be inferred from "conscious disregard of facts known to the person." The proposed rule also limits the applicability of the definition to certain actors in transactions subject to the Export Administration Regulations (EAR) and excludes certain usages from the definition.

BIS believes that incorporating the reasonable person standard into the definition will facilitate public understanding of the definition, particularly as it applies to knowledge-based license requirements, and restrictions on use of License Exceptions. Under this revised definition a party would have knowledge of a fact or circumstance if a reasonable person in that party's situation would conclude, upon consideration of the facts and circumstances, that the existence or future occurrence of the fact or circumstance in question is more likely than not.

BIS believes that replacing the phrase "high probability" with the phrase "more likely than not" is not a change from current policy and practice. The phrase "more likely than not" is better understood than "high probability." Moreover, companies with a strong compliance commitment are unlikely, even under the current definition, to proceed with transactions if they conclude that the circumstance of concern is "more likely than not."

Adding the phrase "*inter alia*" to the description of the circumstances under which knowledge may be inferred

emphasizes that the factors cited in the definition, *i.e.* the conscious disregard or willful avoidance of facts are not the only factors from which knowledge may be inferred.

Removing the phrase "known to the person" from the sentence in the knowledge definition that states that knowledge may be inferred from "conscious disregard of facts known to the person" would eliminate the use of the defined term in the definition.

Other proposed changes to the definition address the scope of its application. The phrase "When referring to an actor in a transaction that is subject to the EAR" would be added to the beginning of the definition, and language would be added to specify that the definition concerns knowledge of a fact or circumstance relating to such a transaction. These changes would make clear that the definition would not apply to provisions of the EAR in which "knowledge" and related terms are used: (1) To refer to technology; (2) to "personal knowledge" or to knowledge of the EAR; (3) to describe the basis for an agency or official to take an enforcement or administrative action; (4) to indicate an alternative name (as in the phrase "also known as"); (5) in explanatory text that has no legal effect; (6) in a requirement that a party certify that a statement is true to the best of its knowledge; or (7) when referring to the requirements or prohibitions of a law other than those implemented by the EAR. Finally, language would be added excluding from the definition the use of "knowledge" terms in the description of criminal liability in Section 764.3(b). The proposed definition, like the current definition of "knowledge" in § 772.1, would also not apply to Part 760 of the EAR (Restrictive Trade Practices or Boycotts).

Enhanced Red Flags

BIS is proposing to update and augment the "red flag" guidance and to increase from 12 to 23 the number of circumstances expressly identified as presenting a red flag. The revised guidance would reflect experience gained since the existing red flags and guidance were developed in the mid-1980s. The "red flags" would continue to provide guidance that BIS believes is useful in preventing the diversion of items that are subject to the EAR to proliferation related purposes as well as

other potential violations of the EAR. Although the “red flags” provide guidance, this rule would also incorporate them by reference into the proposed safe harbor and the Internal Compliance Programs requirements of Special Comprehensive Licenses. To clarify the role the red flags would play under this rule, BIS is proposing to add a statement that the red flags and know your customer guidance do not derogate from obligations imposed elsewhere in the EAR and to remove the statement “This guidance does not change or interpret the EAR” from supplement No. 3 to part 732.

BIS believes that many conscientious participants in export transactions are following the current “red flag” guidance. BIS anticipates that the added benefit of the safe harbor provision would encourage more parties to take these measures and thereby prevent diversions to proscribed or inappropriate end-uses.

Safe Harbor

BIS is proposing to create a safe harbor from liability arising from knowledge-based license requirements, knowledge-based restrictions on use of License Exceptions, and other knowledge provisions in the EAR that are subject to the proposed definition of knowledge described above. Under this safe harbor, parties who take steps identified in a new § 764.7 will not have knowledge imputed to them by application of the “reasonable person” standard stated in the new definition. Parties who report to BIS’s Office of Enforcement Analysis, prior to shipment, all material information regarding the existence, assessment, and satisfactory resolution of the red flag(s) and who do not otherwise have “knowledge,” as defined in § 772.1, will be eligible for a safe harbor from any enforcement action arising from the red flag(s) that they have addressed.

The steps to be listed in § 764.7 are:

(1) Comply with any item and/or destination-based license requirements and other notification or review requirements;

(2) Determine whether parties in the transaction are subject to a denial order or to certain sanctions, whether they appear on the Entity List or the Unverified List, whether the transaction is governed by a general order issued by BIS; and

(3) Follow the procedures for identifying and resolving red flags set forth in Supplement No. 3 to Part 732.

If BIS concludes that a reported transaction involves unresolved red flags, it will so advise the submitting party. If a party has actual knowledge or

awareness that the fact or circumstance in question is more likely than not, then even if the party receives BIS concurrence (based on a report to the Office of Enforcement Analysis) that red flags are resolved, the party will not be eligible for the safe harbor nor will BIS concurrence bind a subsequent enforcement action or prosecution, because the report would have misstated or withheld relevant information.

BIS expects to respond to most such reports within 45 days of receipt. BIS will acknowledge in writing receipt of all reports and will provide a telephone number for the reporting party to call to learn the status of the report if it has not heard from BIS by the date stated in the acknowledgment. BIS may consult with other government agencies before responding to the party submitting the report. However, until receiving written confirmation from BIS or contacting BIS after the date specified in the acknowledgment and learning that BIS will not be responding to the report, the party is not entitled to conclude that BIS concurs in the party’s assessment that any red flags have been successfully resolved.

Parties who have filed such reports may not file a license application relating to the same situation while the report is under review by BIS. Such license applications will be returned without action. In addition to language in the new § 764.7, § 748.4(f) would be modified to implement this prohibition.

Other Clarifying Amendments and Conforming Changes

The proposed rule would also amend the EAR in the following ways:

(1) Removal of Superfluous or Potentially Confusing Uses of a “Knowledge” Term

The proposed rule would revise three provisions of the EAR to clarify that they refer to all requirements under part 744, not just to requirements based on knowledge. These amendments would not change the substance of any provision. The provisions to be amended in this way are:

—General Prohibition Five, which references the recipient and end-use based export and reexport requirements of part 744 and which is found at § 736.2(b)(5);

—The prohibition on using License Exception AGR for transactions in which a license is required by part 744 found at § 740.18; and

—The prohibition on using Special Comprehensive Licenses to meet license requirements imposed by part 744 found at § 752.9(a)(3)(ii)(H).

(2) Consolidation of “Red Flags” Terminology

—The recitation of the text of the “red flags” that are currently described as “* * * signs of potential diversion * * *” in § 752.11(c)(13)(i) would be replaced with a reference to supplement No. 3 to part 732.

Request for Comments

BIS is seeking public comments on this proposed rule. BIS will consider comments about all aspects of this proposed rule, but is particularly seeking comments on whether the proposed changes to the definition of the term “knowledge” will increase the burden on small entities and whether the economic impact of the proposal will be significant and on whether the “safe harbor” provision is likely to be useful. The period for submission of comments will close November 12, 2004. BIS will consider all comments received before the close of the comment period in developing a final rule. Comments received after the end of the comment period will be considered if possible, but their consideration cannot be assured. BIS will not accept public comments accompanied by a request that a part or all of the material be treated confidentially because of its business proprietary nature or for any other reason. BIS will return such comments and materials to the persons submitting the comments and will not consider them in the development of the final rule. All public comments on this proposed rule must be in writing, including fax or e-mail, and will be a matter of public record, available for public inspection and copying. The Office of Administration, Bureau of Industry and Security, U.S. Department of Commerce, displays these public comments on BIS’s Freedom of Information Act (FOIA) Web site at <http://www.bis.doc.gov/foia>. This office does not maintain a separate public inspection facility. If you have technical difficulties accessing this web site, please call BIS’s Office of Administration at (202) 482–0637 for assistance.

Rulemaking Requirements

1. This proposed rule has been determined to be significant for purposes of E.O. 12866.

2. Notwithstanding any other provision of the law, no person is required to respond to, nor shall any person be subject to a penalty for failure to comply with a collection of information, subject to the requirements of the PRA, unless that collection of information displays a currently valid

OMB control number. This proposed rule involves a collection-of-information requirement approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act (PRA). The OMB control number for this collection is 0694-0088, which relates to BIS's application forms. This proposed rule also would create a new information collection in which private parties provide the government information about suspicious circumstances they encounter and how they resolve them. This information collection would require OMB approval before being implemented.

3. This rule does not contain policies with Federalism implications as this term is defined in Executive Order 13132.

4. The Chief Counsel for Regulation of the Department of Commerce has certified to the Counsel for Advocacy that this proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

To estimate the number of small entities that would be affected by this rule, BIS evaluated its licensing database to determine the number of businesses that applied for export licenses where "knowledge" of a particular circumstance concerning the end-use or end-user triggers a license requirement. A total of 149 entities applying for such licenses in 2003 were identified. BIS then conducted an Internet search of those businesses to determine which of those businesses disclosed their sales or employment levels on Web sites. BIS compared those sales or employment levels to those found in the Small Business Administration's Table of Small Business Size Standards Matched to North American Industry Classification System published on its Web site at <http://www.sba.gov/size/sizetable2002.html>. That table provides maximum sales or employment levels that constitute a small business for a number of industries. BIS does not have similar industry classification for the entities in its licensing database so it adopted a conservative approach and used the maximum sales and employment values from the SBA table. Those values were \$28.5 million and 1500 employees, respectively. BIS excluded any entity that it could identify as exceeding either of these values. Forty-three entities were excluded by this method, leaving a total of 106 that might be small entities. All of these entities would be subject to this rule. In addition, this rule would not increase the number of entities that are subject to the Export Administration

Regulations or to the provisions of those regulations under which knowledge triggers a requirement to act or refrain from acting.

BIS does not have data to indicate how many enforcement proceedings under the Export Administration Regulations apply to small entities. However, in its Fiscal Year 2003 Annual Report, BIS reported the criminal "conviction of 21 individuals and businesses" and "34 administrative enforcement settlements" for the fiscal year. In addition, there were three administrative proceedings that resulted in denials of export privileges. Some of these actions probably did not involve small entities and there may be some overlap in cases where a single entity received both criminal and administrative sanctions.

Assuming that all of BIS's FY 2003 enforcement actions were against small entities and that 106 of the 149 entities that applied for a license in FY 2003 were all small entities, the rule would affect a substantial number of small entities. However, although there would be a substantial number of small entities affected by this rule, this rule will not have a significant economic impact on a substantial number of small entities because the overall economic costs associated with this rule are minimal. As discussed below, BIS does not believe that businesses will see this change as imposing a materially different standard on their compliance activities.

Although this proposal has the potential to impact a substantial number of small entities, BIS does not believe that it will have a significant economic impact on the affected small entities. Fundamentally, BIS does not believe that moving to a "more likely than not" formulation increases a company's responsibility with respect to knowledge. Rather, as stated in the rule, we see this as a clarification of the current standard and as consistent with existing BIS and industry practice.

From a practical perspective, based on BIS's experience with industry compliance with the existing standard, BIS believes that companies treat facts that are "more likely than not" as creating a "high probability" of the fact. In other words, in our experience, companies would take the position that there is a "high probability" of a given fact if the fact is "more likely than not." Those who must comply with these regulations are in businesses engaged in exporting and reexporting and must make decisions quickly based on practical considerations. The likely scenarios are that either (1) the party has knowledge of some facts that suggest a

proliferation end-use, an obligation to disclose or a possible violation of law and with that knowledge decides to either apply for a license or to forego the business, or (2) that the party has no knowledge of any such facts, and would not be required to obtain a license under either the old or the new definitions. Thus, even if there were a distinction between the terms "high probability" and "more likely than not," the distinction would be unlikely to affect the decision making process of a business person who is deciding whether to proceed with a sale. Stated otherwise, if a party preparing to undertake an export transaction encounters a reason to believe that a fact or circumstance exists that implicates a licensing requirement under the Regulations, that party can reasonably be expected either to apply for a license or forego the transaction, regardless of whether "knowledge" is defined by reference to a "more likely than not" or "high probability" formulation.

To the extent that a business engages in this kind of legal analysis, use of the term "more likely than not," which is a well known legal standard, will reduce uncertainty among those who make these decisions, and thereby will reduce the economic impact of the control and the necessity of legal counsel. In addition, BIS does not believe that small entities will incur additional costs due to training or legal counseling to comply with the new requirements. BIS provides a number of opportunities for counseling or training to assist businesses in their compliance efforts at no charge or at a reasonable cost. BIS maintains telephone advice lines in California and Washington to provide timely answers to people who have questions concerning its regulations. It also provides an e-mail address where such questions may be submitted. BIS gives written advisory opinions concerning its regulations. BIS provides training seminars in cooperation with trade associations and other groups around the country. The costs of this training ranges from \$75 to \$350 depending on the nature, length and location of the program. However, one should not attribute the entire training cost or even a significant portion of it to this proposed rule. Even if one did, BIS does not believe that \$350 would constitute a significant economic impact.

In terms of the costs of the inquiry that BIS recommends companies conduct in response to red flags, BIS does not believe that the costs will significantly increase when compared to the company's responsibility under the existing rule. Companies are currently

expected to make inquiries before proceeding when information indicating a proliferation end-use, an obligation to disclose, or a violation of law comes to their attention. The Regulations currently provide an illustrative list of red flags, but do not limit any duty to inquire to the circumstances on that list. By increasing the number of circumstances that are specifically called out as “red flags,” BIS is reducing any uncertainty that a company faces in determining what information provides such indications. BIS expects that, under the proposed rule, the cost of the inquiries performed by companies will not increase and will continue to be reasonable given the information that the company has received and the items involved in the transaction. The proposed rule makes this point clear by stating that:

You are expected to conduct an inquiry that is reasonable for a party in your circumstances. Thus, if you are exporting specially ordered equipment that you manufactured as part of a negotiated sale to an end-user in an industry with which you do a substantial part of your business, you may be expected to conduct a more thorough and better targeted inquiry than a distributor exporting off-the-shelf equipment that is used in a wide range of commercial and industrial contexts.

The purpose of the rule is to clarify responsibilities and provide greater certainty to parties involved in export transactions when confronted with indications of a proliferation end-use, an obligation to disclose or a possible violation of law.

Finally, in assessing the possible economic impact of this rule, one should look at it in its entirety. The rule contains a safe harbor provision that enables a business to learn, before proceeding with the transaction, whether BIS concurs that its actions qualify for the safe harbor. This opportunity to avoid fines and penalties mitigates the impact of this rule.

Accordingly, the Chief Counsel for Regulation of the Department of Commerce has certified to the Chief Counsel of Advocacy that this proposed rule will not have a significant economic impact on a substantial number of small entities. BIS invites comment on this certification, including, but not limited to whether the proposed changes to the definition of the term “knowledge” will increase the burden on small entities and whether the economic impact of the proposal will be significant.

List of Subjects

15 CFR Parts 732, 740, 748, and 752

Administrative practice and procedure, Exports, Reporting and record keeping requirements.

15 CFR Parts 736, and 772

Exports.

15 CFR Part 744

Exports, Reporting and record keeping requirements.

15 CFR Part 764

Administrative practice and procedure, Exports Law enforcement, Penalties.

Accordingly, parts 732, 736, 740, 744, 752, 764, and 772 of the Export Administration Regulations (15 CFR 730–799) are amended as follows.

PART 732—[AMENDED]

1. Revise the authority citation for part 732 to read as follows:

Authority: 50 U.S.C. app. 2401 *et seq.*; 50 U.S.C. 1701 *et seq.*; E.O. 13026, 61 FR 58767, 3 CFR, 1996 Comp., p. 228; E.O. 13222, 66 FR 44025, 3 CFR, 2001 Comp., p. 783; Notice of August 6, 2004, 69 FR 48763 (August 10, 2004).

2. Revise supplement No. 3 to part 732 to read as follows:

Supplement No. 3 to part 732—BIS’s Know Your Customer Guidance and Red Flags

(a) Introduction. Several provisions of the EAR are applicable if a party has knowledge (as defined in § 772.1 of the EAR) of a particular fact or circumstance. Examples include § 764.2(e), which prohibits taking certain actions regarding an item that is subject to the EAR with knowledge that a violation has occurred, is about to occur or is intended to occur with respect to that item and § 744.4, which requires a license to export or reexport any item subject to the EAR if the exporter or reexporter knows that the item will be used in the design, development, production, stockpiling, or use of chemical or biological weapons in or by any country. The following guidance is provided with respect to these knowledge standards. It is also useful with respect to other EAR requirements because a heightened awareness of the signs of potential diversion can help to prevent violations. This guidance and the red flags are also incorporated by reference in § 764.7 (Safe Harbor from Certain Knowledge-based Requirements) of the EAR. The red flags are incorporated into the system for screening customers that is

part of the internal control program required of Special Comprehensive License holders and consignees and described in § 752.11(c)(13)(i) of the EAR. The “red flags” and know your customer guidance do not derogate from obligations imposed elsewhere in the EAR.

(b) *Know Your Customer Guidance.*

(1) Look out for red flags. In all transactions subject to the EAR, look out for any abnormal circumstances that indicate that the transaction may involve an inappropriate end-use, end-user or destination or otherwise violate the EAR. Such circumstances are referred to as “red flags.” Red flags may be presented by information provided by a customer or information obtained from another source (e.g., a credit report that you might run on a new customer wishing to place a large order).

(i) Red flags point to a heightened risk of a problem with the transaction. Most commonly, red flags indicate a heightened risk that a claimed end-use, end-user or ultimate destination is not the actual one. Red flags of this type thus can point to the possibilities that the export or reexport is actually destined for an embargoed country, an end use that triggers a license requirement under part 744 of the EAR, a person denied export privileges under part 764 of the EAR, a person on the Entity List in supplement No. 4 to part 744, specially designated global terrorists (*see* § 744.12), specially designated terrorists (*see* § 744.13), designated foreign terrorist organizations (*see* § 744.14), persons on the list of specially designated nationals identified by the bracketed suffix IRAQ2 (*see* § 744.18), a transaction that would violate a BIS General Order (*see* supplement No. 1 to part 736), persons on the Unverified List published by BIS, or an end-use or end-user that is restricted under part 744.

(ii) What constitutes a red flag depends on the context. A fact or circumstance that raises a red flag for an export of one type of item, to a given destination, or a particular business model may be innocuous for an export involving a different item, a different destination, or different business model. The role that you are playing in a transaction is also relevant to what facts or circumstances you are expected to recognize as red flags. For example, a manufacturer who is exporting one of its products will be expected to be highly familiar with the configurations or specifications required for an end-use stated by a customer. Thus, a manufacturer should be able to recognize when a deviation from such parameters is indicative of an end-use

other than what is stated. Similarly, if a freight forwarder is better able than an exporter to recognize that the location of an intermediate consignee is incongruous with the claimed ultimate destination, then such information could be regarded as a red flag for the freight forwarder, but not the exporter. The general rule is that you should treat a fact or circumstance as a red flag if it would cause a reasonable person in your situation (*e.g.*, manufacturer/exporter, freight forwarder, distributor/reexporter) to suspect that a transaction may involve an inappropriate end-use, end-user or destination, or otherwise violate the EAR.

(iii) Red flags may also be raised in exports that have been licensed by BIS; for example, information you receive after obtaining an export license may suggest a risk of diversion. Parties should identify and respond to red flags in all transactions, including ones for which an export license has been obtained.

(2) *Make those who act on your behalf aware.* Your employees and others acting on your behalf (for example, a contractor hired to perform export-related functions) need to know how to take the steps described below, especially identifying and responding to red flags. If such persons have knowledge or reason to know a fact or circumstance, that knowledge or reason to know can also be imputed to employers or other principals, so that the latter are also liable for a violation. Thus, it is especially important for firms to establish clear policies and effective compliance procedures to ensure that knowledge about transactions can be evaluated by responsible senior officials. Failure to do so could be regarded as a form of self-blinding (*see* paragraph (b)(5) of this supplement No. 3 and § 772.1, definition of *knowledge*).

(3) *If there are red flags, inquire.* When there is a red flag, you have an affirmative duty to inquire into the circumstances giving rise to the red flag and whether they in fact present a heightened risk of an inappropriate end-user, end-use or ultimate destination, or of some other possible violation of the EAR. In so doing, your object is to verify or substantiate whether the concerns indicated by the red flag are really present (*e.g.*, the real end-use, end-user or ultimate destination). This duty of heightened scrutiny is present in all transactions subject to the EAR involving red flags. Absent red flags (or an express requirement in the EAR), you do not have an affirmative duty to inquire, verify, or otherwise “go behind” the customer’s representations. Thus, if there are no red flags, you can

rely upon representations from your customer in preparing and submitting export control documents and any license application that may be required.

(i) In responding to red flags, you are expected to conduct an inquiry that is reasonable for a party in your circumstances. Thus, if you are exporting specially ordered equipment that you manufactured as part of a negotiated sale to an end-user in an industry with which you do a substantial part of your business, you may be expected to conduct a more thorough and better targeted inquiry than a distributor exporting off-the-shelf equipment that is used in a wide range of commercial and industrial contexts.

(ii) The following are means of inquiry that, depending on particular circumstances, you should pursue in response to a red flag:

(A) Seek further information or clarification from the customer, the ultimate consignee, and/or end-user.

(B) Conduct searches of relevant publications or public information on the Internet for additional information or to confirm representations you have received.

(C) Where appropriate for a particular industry or commercial context, consult standard references or official sources. For example, the International Atomic Energy Agency (IAEA) makes available information about what nuclear facilities are under IAEA safeguards, which is relevant to determining whether export or reexport for use at a particular nuclear facility requires a license under § 744.2.

(4) *Reevaluate all of the information after the inquiry.* The purpose of your inquiry is to provide a basis for making an honest, well-informed assessment of whether the concerns indicated by the red flag are really present in your transaction. One way of making this assessment is to determine that the red flag is in fact explained by circumstances that, in the context of your transaction, do not present the concerns generally associated with the red flag. For example, a sudden change in delivery instructions can present a red flag, but the red flag could be resolved by establishing that the facility to which the items were originally to be delivered had been recently damaged by fire. If the result of your reasonable inquiry and reevaluation is that this red flag does not point to a risk of diversion or concealed end-use, you could proceed with the transaction. On the other hand, if after evaluating in good faith all of the facts and circumstances you have ascertained, you believe that the export is actually destined for a

country, end-user or end-use for which an export license is required, you should not proceed with the transaction without complying with that license requirement. In making such an assessment, you are expected to bring to bear whatever relevant background or expertise you have.

(5) *Do not self-blind.* Throughout the process of identifying and responding to red flags, you must honestly take into account the facts and circumstances presented to you. Do not cut off the flow of information obtained or received in the normal course of business. For example, do not instruct the sales force to tell potential customers to refrain from discussing the actual end-use, end-user, and ultimate destination for the product your firm is seeking to sell. Do not put on blinders that prevent learning relevant information. An affirmative policy of steps to avoid “bad” information would not insulate a company from liability, and would be considered evidence of knowledge or reason to know the facts in question.

(6) *If there are still reasons for concern, refrain from going forward with the transaction or contact BIS.* If you continue to have reasons for concern after your inquiry and reevaluation, then you should either refrain from going forward with the transaction or submit all of the relevant information to BIS in the form of an application for a license or in such other form as BIS may specify. You have an important role to play in preventing exports and reexports contrary to the national security and foreign policy interests of the United States. BIS will continue to work in partnership with the private sector to make this front line of defense effective, while minimizing where possible the regulatory burden on legitimate participants in export transactions. If you have any question about whether you have encountered a red flag or what steps you should take in response to a red flag, or if you decide to refrain from the transaction, but believe you have information relating to completed or attempted violations of the EAR, you are encouraged to advise BIS’s Office of Export Enforcement through BIS’s Web site or at 1–800–424–2980 or the Office of Exporter Services at (202) 482–4811.

(c) *Red Flags: Examples.* As described below, BIS has identified a number of red flags that apply in different contexts. This discussion is not all-inclusive, but is intended to illustrate the types of circumstances to which you should be alert. BIS may supplement this description of red flags in future guidance on its Web site. Examples of red flags in various situations include:

1. The customer or purchasing agent is vague, evasive, or inconsistent in providing information about the end-use of a product.

2. The product's capabilities do not fit the buyer's line of business or level of technical sophistication. For example, a customer places an order for several advanced lasers from a facility with no use for such equipment in its manufacturing processes.

3. A request for equipment configuration is incompatible with the stated ultimate destination (e.g., 120 volts for a country with 220 volts).

4. The product ordered is incompatible with the technical level of the country to which the product is being shipped. For example, semiconductor manufacturing equipment would be of little use in a country without an electronics industry.

5. The customer has little background in the relevant business. For example, financial information is unavailable from ordinary commercial sources and the customer's corporate principal is unknown.

6. The customer is willing to pay cash for an expensive item when the normal practice in this business would involve financing.

7. The customer is unfamiliar with the product's performance characteristics, but still wants the product.

8. Installation, testing, training, or maintenance services are declined by the customer, even though these services are included in the sales price or ordinarily requested for the item involved.

9. Terms of delivery, such as date, location, and consignee, are vague or unexpectedly changed, or delivery is planned for an out-of-the-way destination.

10. The address of the ultimate consignee, as listed on the airway bill or bill of lading, indicates that it is in a free trade zone.

11. The ultimate consignee, as listed on the airway bill or bill of lading, is a freight forwarding firm, a trading company, a shipping company or a bank, unless it is apparent that the ultimate consignee is also the end-user or the end-user is otherwise identified on the airway bill or bill of lading.

12. The shipping route is abnormal for the product and destination.

13. Packaging is inconsistent with the stated method of shipment or destination.

14. When questioned, the buyer is evasive or unclear about whether the purchased product is for domestic use, export or reexport.

15. The customer uses an address that is inconsistent with standard business

practices in the area (e.g., a P.O. Box address where street addresses are commonly used).

16. The customer does not have facilities that are appropriate for the items ordered or end-use stated.

17. The customer's order is for parts known to be inappropriate or for which the customer appears to have no legitimate need (e.g., there is no indication of prior authorized shipment of system for which the parts are sought).

18. The customer is known to have or is suspected of having dealings with embargoed countries.

19. The transaction involves a party on the Unverified List published by BIS in the **Federal Register**.

20. The product into which the exported item is to be incorporated bears unique designs or marks that indicate an embargoed destination or one other than the customer has claimed.

21. The customer gives different spellings of its name for different shipments, which can suggest that the customer is disguising its identity and/or the nature and extent of its procurement activities.

22. The requested terms of sale, such as product specification and calibration, suggest a destination or end-use other than what is claimed (e.g., equipment that is calibrated for a specific altitude that differs from the altitude of the claimed destination).

23. The customer provides information or documentation related to the transaction that you suspect is false, or requests that you provide documentation that you suspect is false.

PART 736—[AMENDED]

3. Revise the authority citation for part 736 to read as follows:

Authority: 50 U.S.C. app. 2401 *et seq.*; 50 U.S.C. 1701 *et seq.*; 22 U.S.C. 2151 (note), Pub. L. 108–175; E.O. 12938, 59 FR 59099, 3 CFR, 1994 Comp., p. 950; E.O. 13020, 61 FR 54079, 3 CFR, 1996 Comp., p. 219; E.O. 13026, 61 FR 58767, 3 CFR, 1996 Comp., p. 228; E.O. 13222, 66 FR 44025, 3 CFR, 2001 Comp., p. 783; E.O. 13338, 69 FR 26751, May 13, 2004; Notice October 29, 2003, 68 FR 62209, 3 CFR, 2003 Comp., p. 347; Notice of August 6, 2004, 69 FR 48763 (August 10, 2004).

4. In § 736.2, revise paragraph (b)(5) to read as follows:

§ 736.2 General prohibitions and determination of applicability.

* * * * *

(b) * * *

(5) *General Prohibition Five—Recipient and end-use license requirements.* If a license is required

because of the recipient or end use as specified in part 744 of the EAR, you may not export or reexport without such license.

* * * * *

PART 740—[AMENDED]

5. Revise the authority citation for part 740 to read as follows:

Authority: 50 U.S.C. app. 2401 *et seq.*; 50 U.S.C. 1701 *et seq.*; Sec. 901–911, Pub. L. 106–387; E.O. 13026, 61 FR 58767, 3 CFR, 1996 Comp., p. 228; E.O. 13222, 66 FR 44025, 3 CFR, 2001 Comp., p. 783; Notice of August 6, 2004, 69 FR 48763 (August 10, 2004).

6. In § 740.18, revise the last sentence of paragraph (c)(4) to read as follows:

§ 740.18 Agricultural commodities (AGR).

* * * * *

(c) * * *

(4) * * * (Note that the fact that you have been advised that no agency has objected to the transaction does not exempt you from other license requirements under the EAR, including those based on recipient or end-use in part 744 of the EAR.)

* * * * *

PART 748—[AMENDED]

7. Revise the authority citation for part 748 to read as follows:

Authority: 50 U.S.C. app. 2401 *et seq.*; 50 U.S.C. 1701 *et seq.*; E.O. 13026, 61 FR 58767, 3 CFR, 1996 Comp., p. 228; E.O. 13222, 66 FR 44025, 3 CFR, 2001 Comp., p. 783; Notice of August 6, 2004, 69 FR 48763 (August 10, 2004).

8. In § 748.4, revise paragraph (f) to read as follows:

§ 748.4 Basic guidance related to applying for a license.

* * * * *

(f) *Redundant submissions prohibited.* You may not submit a license application for a transaction if:

(1) You have already submitted a license application for that transaction and the license application is still pending before BIS; or

(2) You have submitted a safe harbor report for the transaction pursuant to § 764.7(c) of the EAR and the BIS decision is still pending.

* * * * *

PART 752—[AMENDED]

9. Revise the authority citation for part 752 to read as follows:

Authority: 50 U.S.C. app. 2401 *et seq.*; 50 U.S.C. 1701 *et seq.*; E.O. 13020, 61 FR 54079, 3 CFR, 1996 Comp., p. 219; E.O. 13222, 66 FR 44025, 3 CFR, 2001 Comp., p. 783; Notice of August 6, 2004, 69 FR 48763 (August 10, 2004).

10. In § 752.9, revise paragraph (a)(3)(ii)(H) to read as follows:

§ 752.9 Action on SCL applications.

- (a) * * *
(3) * * *
(ii) * * *

(H) A notice that the consignee, in addition to other requirements may not sell or otherwise dispose of any U.S. origin items under the SCL if a license is required by part 744 of the EAR.

* * * * *

11. In § 752.11, revise paragraph (c)(13) to read as follows:

§ 752.11 Internal Control Programs.

* * * * *

- (c) * * *

(13) A system for screening customers and transactions to identify any circumstances (“red flags”) that indicate an item might be destined for an inappropriate end-use, end-user, or destination. This system must:

(i) Be able to identify, as a minimum, the red flags in paragraph (c) of supplement No. 3 to part 732 of the EAR, and;

(ii) Function in conformance with the “know your customer” guidance provided in paragraph (b) of supplement No. 3 to part 732 of the EAR:

* * * * *

PART 764—[Amended]

12. Revise the authority citation for part 764 to read as follows:

Authority: 50 U.S.C. app. 2401 *et seq.*; 50 U.S.C. 1701 *et seq.*; E.O. 13222, 66 FR 44025, 3 CFR, 2001 Comp., p. 783; Notice of August 6, 2004, 69 FR 48763 (August 10, 2004).

13. Add § 764.7 to read as follows:

§ 764.7 Safe harbor from knowledge-based requirements.

Parties involved in exports, reexports or other activities subject to the EAR who meet the requirements of this section can avail themselves of a “safe harbor” against being found to have had knowledge of a fact or circumstance under the definition of *knowledge* in § 772.1. The safe harbor can apply only to requirements or prohibitions of the EAR that incorporate knowledge, as defined in § 772.1, as an element.

(a) *You must not have actual knowledge or actual awareness that the fact or circumstance at issue is more likely than not.* The safe harbor is available only to parties who do not have actual knowledge or actual awareness that the fact or circumstance in question is more likely than not. For example, if you are about to export an item subject to the EAR and are aware that it is more likely than not that the

item will be used in the design, development, production, stockpiling, or use of chemical or biological weapons in any country, § 744.4 of the EAR requires you to obtain a license for that export and the safe harbor will not relieve you of that license requirement.

(b) *You must take the following steps.*

(1) *Comply with item and/or destination-based license requirements and other notification or review requirements.* Determine whether a license is required because of the destination and the item’s status on Commerce Control List and comply with any such license or other review requirements. If you are an exporter or reexporter, you must either make a good faith effort to classify the item or you must obtain a classification from BIS. You must obtain any licenses required to send the item to the destination you intend to send it to. If the item’s reason for control on the Commerce Control List is EI, you must comply with any requirements to notify the U.S. government or to obtain U.S. government approval prior to export or reexport.

(2) *Determine whether the parties to the transaction are subject to a denial order, or to certain sanctions, and whether they appear on the Entity List or Unverified List, and whether the transaction is governed by a BIS General Order.* If you are an exporter or reexporter, or a freight forwarder or other party acting on an exporter’s or reexporter’s behalf, determine whether the parties to the transaction fall within any of the following categories:¹

(i) Persons subject to denial of U.S. export privileges under a BIS order. Such orders are published in the **Federal Register**. BIS also makes available unofficial lists of denied persons on its Web site at <http://www.bis.doc.gov> and in an unofficial version of the EAR, which is published by the Government Printing Office and to which members of the public may subscribe. If an end-user, ultimate consignee or principal party in interest is subject to a denial order that prohibits your proposed transaction, you must not proceed.

(ii) Persons appearing on the Unverified List, which is published by BIS in the **Federal Register** and unofficially maintained on BIS’s Web site. The Unverified List identifies

¹ If you find that a party to your transaction has a name or address that is similar, but not identical, to a party within one of the listed categories, you should take reasonable steps to determine whether the party to your transaction is in fact identical to the party within that category, then act in accordance with your determination and this guidance.

persons in foreign countries that were parties to past transactions for which an end-use visit (either a pre-license check or a post-shipment verification) could not be conducted for reasons outside of the control of the U.S. Government. The presence on the Unverified List of an end-user, ultimate consignee or principal party in interest presents a red flag for the transaction, as described in supplement No. 3 to part 732 of the EAR.

(iii) Persons appearing on the Entity List in supplement No. 4 to part 744. To the extent described in that supplement, a license is required to export or reexport items subject to the EAR to persons on the Entity List. *See* § 744.1(c). Any applicable license requirements must be met before you proceed with the transaction.

(iv) Specially designated global terrorists [SDGT], (*see* § 744.12), specially designated terrorists [SDT] (*see* § 744.13), designated foreign terrorist organizations [FTO] (*see* § 744.14), and persons on the list of specially designated nationals identified by the bracketed suffix [IRAQ2] (*see* § 744.18). License requirements for exports and reexports to such parties are described in the referenced sections of part 744. Any applicable license requirements must be met before you can proceed with the transaction.

(v) The requirements of a BIS General Order. These General Orders, which are published in the **Federal Register** and codified in supplement No. 1 to part 736, may place special restrictions on exports and reexports certain destinations or to named persons. Before you may proceed with the transaction, you must comply with any applicable license requirements or other restrictions imposed by any applicable General Order.

(3) *Identify and respond to red flags.* If you are a party involved in an export, reexport or other activity subject to the EAR, comply with the guidance on how to identify and respond to red flags as set forth in paragraphs (b) and (c) of supplement No. 3 to part 732 of the EAR.

(c) *Report to BIS.* To be eligible for the safe harbor, parties must report the red flags that they identified and how they resolved them. BIS will respond to such reports indicating whether it concurs with the party’s conclusion. BIS may consult with other government agencies in developing its response to any such report.

(1) Prior to proceeding with the transaction a party seeking to be eligible for the safe harbor must submit a written report by first-class mail, express mail, or overnight delivery to

the Bureau of Industry and Security, Office of Enforcement Analysis, 14th Street and Constitution Avenue, NW, Room 4065, Attn: Safe Harbor Guidance, Washington, DC 20230. The report must demonstrate that the party has taken the actions described in paragraph (b) of this section. In particular, the report must include all material information relating to the red flags and the steps the party took to resolve the concerns raised by the red flags.

(2) BIS will acknowledge receipt of all reports received and provide the reporting party with a telephone number at which to contact BIS if it does not receive a response by the date stated in the acknowledgement. BIS expects to respond to most reports within 45 days of its receipt of the report. The response shall:

(i) State that BIS concurs with the party's judgement that it has adequately addressed the concerns raised by the red flags;

(ii) State that BIS does not concur with the party's judgement that it has adequately resolved those concerns and describe additional information that would be necessary to resolve them adequately;

(iii) Issue an "is informed" notice (pursuant to §§ 744.2(b), 744.3(b), 744.4(b), 744.6(b) or 744.17(b) of the EAR) informing the party of a license requirement under §§ 744.2, 744.3, 744.4, 744.6, or 744.17(b) of the EAR; or

(iv) state that more time is needed to review the submission.

(3) The party is not entitled to conclude that BIS concurs with the party's judgement that the party has adequately resolved the concerns raised by the red flags until it either receives a response from BIS so stating or contacts BIS at the telephone number indicated in the acknowledgment and is told that BIS will not be responding to this report.

(4) A response by BIS stating that it concurs with the party's judgement that it has resolved the concerns raised by the red flags or a statement by BIS that it will not be responding to the reexport shall, provided the party submitting the report has taken the steps in paragraph (b) of this section, serve as confirmation, based on the information in the party's submission, that the party has adequately resolved the concerns raised by the red flags. However, such confirmation shall not bind a subsequent enforcement action or prosecution if the submitting party had actual knowledge or actual awareness that the fact or circumstance in question was more likely than not, or if the submission misstated or withheld relevant material information.

(5) If BIS responds as described in paragraph (c)(2)(ii) of this section and the party proceeds without taking the additional steps to resolve the concerns, then it will not qualify for the safe harbor.

(6) In this paragraph (c), the date of BIS's receipt of the report shall be the date of receipt by the Office of Enforcement Analysis as recorded in a log maintained by that office for this purpose and the date of BIS's response shall be the postmark date of BIS's response.

PART 772—[AMENDED]

14. The authority citation for part 772 continues to read as follows:

Authority: 50 U.S.C. app. 2401 *et seq.*; 50 U.S.C. 1701 *et seq.*; E.O. 13222, 66 FR 44025, 3 CFR, 2001 Comp., p. 783; Notice of August 6, 2004, 69 FR 48763 (August 10, 2004).

15. In § 772.1 revise the definition of *knowledge* to read as follows:

§ 772.1 Definition of terms as used in the Export Administration Regulations (EAR).

* * * * *

Knowledge. When referring to an actor in a transaction that is subject to the EAR, knowledge (the term may appear in the EAR as a variant, such as "know," "reason to know," or "reason to believe") of a fact or circumstance relating to the transaction includes not only positive knowledge that the fact or circumstance exists or is substantially certain to occur, but also an awareness that the existence or future occurrence of the fact or circumstance in question is more likely than not. Such awareness is inferred, *inter alia*, from evidence of the conscious disregard of facts and is also inferred from a person's willful avoidance of facts. This usage of "knowledge" incorporates an objective, "reasonable person" standard. Under that standard, a party would have knowledge of a fact or circumstance if a reasonable person in that party's situation would conclude, upon consideration of the facts and circumstances, that the existence or future occurrence of the fact or circumstance in question is more likely than not. **Note:** This definition applies to §§ 730.8(a)(4)(iv); 732.1(d)(1)(x); 732.3(m); 732.4(a); Supp. No. 2 to part 732; §§ 734.2(b)(2)(ii); 736.2(b)(7); 736.2(b)(10); Supp. No. 2 to part 736, Administrative Order Two, paragraph (a)(1)(ii)(E); §§ 740.13(e)(4); 740.13(e)(6); 740.16(i); 740.17(e)(3); 740.5; 740.7(b)(4); 740.9(a)(3)(iii)(B); 742.10(a)(2)(ii); 742.8(a)(2); Supp. No. 6 to part 742, paragraph (d)(1); §§ 744.17; 744.2; 744.3; 744.4; 744.5; 744.6; 745.1(a)(1)(ix); 746.3(a)(4), 746.3(f)(2)(i),

746.7(a)(2)(ii); 748.11(e)(4)(ii)(2); 748.14(g)(2)(vii); 748.3(c)(2)(iii); 748.4(d)(1); 748.9(g)(3); Supp. No. 1 to part 748; Supp. No. 2 to Part 748, paragraphs (g)(2)(iii) and (iv); Supp. No. 2 to Part 748, paragraph (j)(3)(ii); Supp. No. 2 to Part 748, paragraph (l); Supp. No. 2 to Part 748, paragraph (o)(3)(i); Supp. No. 5 to part 748, paragraph (a)(5)(ii); §§ 750.7(h)(3); 752.4(b); 752.11(c)(12); 752.11(c)(13); 752.4; 754.2(j)(3)(i)(D); 758.3(c); 762.1(a)(2); 762.6(a)(2); 764.2(e); 764.2(f)(2); 764.2(g)(2); Supp. No. 1 to part 764(b), paragraph (d) under the heading "SECOND"; Supp. No. 1 to part 766, III, A paragraphs headed "Degree of Willfulness" and "Related Violations"; and § 772.1 definition of "transfer." This definition does not apply to part 760 of the EAR (Restrictive Trade Practices or Boycotts) or to the following EAR provisions: §§ 730.8(b); 732.1(c); 732.3(n); 734.1(a); 734.2(b)(3); Supp. No. 1 to part 734, questions D(5) and F(1); 738.4(a)(3); 740.11(c)(1)(ii)(C); 742.12(b)(3)(iv)(B)(8); 742.18; Supp. No. 4 to Part 742, paragraph 2; 744.12; 744.14; 745.1(b)(2); 745.2(a)(1); 748.7(a)(2)(ii); 748.11(c)(1); 748.11(c)(3); 748.11(e)(4)(i); 750.8; 752.5(a)(2)(iv); 752.8(d)(9); 754.4(d)(1); 758.7(b)(6); 764.5(b)(5); 764.5(c)(5); 766.3(b); 766.6(b); 770.3(d)(1)(i)(A) and (B); 772.1 definitions of "basic scientific research," "cryptography," "deformable mirrors," "defense trade controls," "expert systems," "multilevel security," "recoverable commodities and software," "technology," and "time modulated wideband"; Supp. No 1 to part 774, Category 1, ECCN 1C351, Reason for Control paragraph; Supp. No. 1 to part 774, Category 1, ECCN 1C991, Related Controls paragraph; Supp. No 1 to part 774, Category 2, ECCN 2B119 Note to List of Items Controlled; Supp. No. 1 to part 774, Category 3, ECCN 3A001, N.B. to paragraph 8 of List of Items Controlled; Supp. No 1 to part 774, Category 3, ECCN 3A002, Related Definitions and List of Items Controlled; Supp. No. 1 to part 774 Category 3, ECCN 3A225, Heading and List of Items Controlled; Supp. No 1 to part 774, Category 4, ECCN 4A994, List of Items Controlled; and Supp. No. 1 to part 774, Category 6, ECCN 6C004 List of Items Controlled.

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Dated: October 5, 2004.

Peter Lichtenbaum,

Assistant Secretary for Export Administration.

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