

Michigan Law Review

Volume 104 | Issue 7

2006

The Executive Role in Culturing Export Control Compliance

Matthew G. Morris

University of Michigan Law School

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Commercial Law Commons](#), and the [International Trade Law Commons](#)

Recommended Citation

Matthew G. Morris, *The Executive Role in Culturing Export Control Compliance*, 104 MICH. L. REV. 1785 (2006).

Available at: <https://repository.law.umich.edu/mlr/vol104/iss7/7>

This Note is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

NOTE

THE EXECUTIVE ROLE IN CULTURING EXPORT CONTROL COMPLIANCE

*Matthew G. Morris**

TABLE OF CONTENTS

INTRODUCTION	1785
I. SELF-REGULATING REQUIREMENTS OF EXPORT CONTROLS ..	1788
II. JUSTIFICATIONS FOR ADMINISTRATIVE PENALTIES FOR EXPORT CONTROL VIOLATIONS	1791
A. <i>On the Record: Stated Goals of BIS</i>	1792
B. <i>The Goal and Challenge of Deterrence</i>	1792
C. <i>Goals in Conflict: Rehabilitation and Incapacitation</i>	1794
D. <i>The Odd Case for Retribution</i>	1796
III. COMPLIANCE CULTURE AS A FACTOR IN PRIMARY LIABILITY	1797
IV. THE ROLE OF CORPORATE CULTURE IN ACHIEVING THE GOALS OF PUNISHMENT	1800
V. THE EXECUTIVE ACCOUNTABILITY BRIDGE	1802
CONCLUSION	1807

INTRODUCTION

The control of exports in order to protect national interests is subject to a “frightful labyrinth” of laws and regulations.¹ The motive for enacting these laws varies: some are enacted to satisfy United States treaty obligations,² some for national security reasons,³ and others for humanitarian considerations.⁴ Further complicating matters, these laws issue from multiple

* J.D. May 2006. Many thanks to Amy, Maggie, and Sean. I am particularly indebted to Tim Fort for inspiration on the topic, and to Rebecca Eisenberg and the participants of the Fall 2005 Student Scholarship Workshop for hours of scrutiny and suggestions.

1. Cecil Hunt, *Overview of U.S. Export Controls*, in PRACTICING LAW INST., COPING WITH U.S. EXPORT CONTROLS 2003, at 15 (2003).

2. For example, the Chemical Weapons Convention Regulations, 15 C.F.R. §§ 710–722 (2005), implement the Chemical Weapons Convention Implementation Act of 1998, Pub. L. No. 105–277, 112 Stat. 2681–856 (codified at 22 U.S.C. §§ 6701–6771 and in scattered sections of 18 U.S.C.), which in turn implements the Convention on the Prohibition of the Development, Production, Stockpiling, and Use of Chemical Weapons and on Their Destruction.

3. See, e.g., Trading with the Enemy Act, 50 U.S.C. app. §§ 1–44 (2000).

4. For example, export of thumb cuffs and other restraint devices such as straight jackets is prohibited without a license to all countries other than Canada. 15 C.F.R. §§ 742.7(a)(4), 744 supp. 1 (2005).

sources.⁵ At times, the enabling legislation has lapsed only to be cobbled back together by interim legislation or by Executive Order.⁶ The result is a legal regime where “it can be difficult to find and piece together applicable law.”⁷

The criteria for determining sanctions for violations of export controls have been similarly vague. Consider, for example, the determination of sanctions for violations of the export controls for dual-use technologies—technologies and products that “can be used both in military and other strategic uses . . . and commercial applications”—set forth in the Export Administration Regulations (EAR).⁸ Enforcement of those controls falls to the Bureau of Industry and Security (BIS) at the Department of Commerce.⁹ In the event of a suspected violation, BIS has three options. At the extremes, it may either refer the case to the Department of Justice for criminal prosecution or issue a letter of warning. In the middle, it may pursue an administrative enforcement case.¹⁰ If the case is severe enough to merit criminal prosecution, the United States Sentencing Guidelines provide some guidance on the determination of penalties.¹¹ There has been little guidance on appropriate punishment in cases that are not severe enough to merit criminal prosecution—those cases where administrative penalties are appropriate. Until recently, the extent of published guidance has been the maximum administrative sanctions found in the EAR, with no explanation of intermediate levels of sanctions falling short of the maximum.¹²

The Department of Commerce has recently acted to provide clearer penalty guidance. On September 17, 2003, BIS proposed amendments to the EAR in order to provide guidance on “how BIS makes penalty determinations when settling administrative enforcement cases” for violation of the EAR.¹³ BIS then incorporated that proposed rule into a final ruling on February 20, 2004.¹⁴ As a result, the EAR now include a supplement at 15 C.F.R. § 766 that, for the first time, provides government criteria for setting

5. The three most significant agencies are the Department of Commerce (dual-use technologies), the State Department (military weapons), and the Treasury Department (financial exports and broad-based embargoes that cover more than exported goods). Hunt, *supra* note 1, at 16–18.

6. *Id.* at 16–17.

7. *Id.* at 15.

8. 15 C.F.R. § 730.3 (2005).

9. *Id.* §§ 730.1, 730.9.

10. *Id.* § 766 supp. 1; *see also id.* § 764.3.

11. 18 U.S.C. app. §§ 2M5.1 –.2 (2000).

12. The EAR provide that “a civil penalty not to exceed \$10,000 may be imposed for each violation, except that a civil penalty not to exceed \$100,000 may be imposed for each violation involving national security controls imposed under section 5 of the [Export Administration Act].” 15 C.F.R. § 764.3(a)(1)(i) (2005).

13. Export Administration Regulations: Enforcement and Protective Measures, 68 Fed. Reg. 54, 402 (proposed Sept. 17, 2003)(to be codified at 15 C.F.R. pts. 764 and 766).

14. Export Administration Regulations: Penalty Guidance in the Settlement of Administrative Enforcement Cases, 69 Fed. Reg. 7867 (Feb. 20, 2004) (to be codified at 15 C.F.R. pts. 764 and 766).

a penalty in these administrative proceedings.¹⁵ The penalty guidance is largely advisory. In fact, in publishing its penalty guidance, BIS included a disclaimer that the guidance was not binding on any party—even itself.¹⁶

Nevertheless, the guidance is significant for three reasons. First, it is the only published scheme for determining an administrative punishment for EAR violations, and therefore it likely would be *persuasive* to an administrative law judge presiding over an administrative enforcement action. Second, since many administrative cases are settled with BIS, it will represent the *de facto penalty determination* method in many such cases.¹⁷ Third, the guidance is *informative* since it reflects BIS's institutional experience about what factors have been relevant to determining penalties in the past.

The new penalty guidance sets out six “general factors” for determining appropriate sanctions, then lists eight aggravating factors and nine mitigating factors.¹⁸ The general factors BIS will consider are: degree of willfulness, the destination involved, the commission of related violations, the commission of multiple unrelated violations, the timing of the settlement, and any related criminal or civil violations.¹⁹ Of the eight listed aggravating factors, three are to be given “great weight”: making a deliberate effort to conceal the violation, demonstrating a serious disregard for compliance responsibilities, and “the sensitivity of the items involved and/or the reason for controlling them to the destination in question.”²⁰ Of the nine listed mitigating factors, two are to be given “great weight”: voluntary self-disclosure of the violation and the company's having an effective export compliance culture.²¹

15. *Id.* at 7870 (to be codified at 15 C.F.R. pt. 766 supp. 1) (“[I]n view of the importance of this rule, which represents the first comprehensive statement of BIS's approach toward these issues, BIS sought and considered public comments . . .”).

16. *Id.* (“This guidance does not confer any right or impose any obligation regarding what penalties BIS may seek in litigating a case or what posture BIS may take toward settling a case. Parties do not have a right to a settlement offer, or particular settlement terms, from BIS, regardless of settlement postures BIS has taken in other cases.”).

17. *Id.*

18. *Id.* at 7871-72.

19. Export Administration Regulations: Guidance on Charging and Penalty Determinations in Settlement of Administrative Enforcement Cases, 15 C.F.R. § 766 supp. 1 (2005). By “timing of the settlement” BIS indicates that the longer a violator waits to settle, the greater the penalty the bureau will seek. *Id.* at III.A (“BIS has an interest in encouraging early settlement and may take this interest into account in determining settlement terms.”).

20. *Id.* at III.B. The other aggravating factors are: likelihood of the type of harm the EAR are designed to prevent, the quantity or value of the exports, the presence of other violations of law that do not fall under the purview of BIS, prior bad acts by the exporter, and the extent that exports comprise the business of the firm in question. *Id.*

21. *Id.* The other mitigating factors are: whether the violation was a single episode of good-faith misinterpretation, whether BIS likely would have approved the action anyway, absence of prior similar acts, cooperation in the investigation, cooperating in the investigation of other parties, absence of likely harm of the type that the EAR are supposed to prevent, and general inexperience with export licensing. *Id.* The guidance directs the exporter to the Export Management System Guidelines, U.S. BUREAU OF INDUS. & SEC., EXPORT MANAGEMENT SYSTEM GUIDELINES (2005), available at <http://www.bis.doc.gov/complianceand enforcement/ExportManagementSystems.htm>,

This Note argues that this last factor—the effective export compliance culture—should be the first step in the analysis rather than a mere mitigating circumstance to be considered after weighing all the other factors. Instead of first considering what BIS describes as the general factors and then mitigating for the presence of an effective compliance program, the degree of culpability should be determined through examining the culture of compliance, tempered by considering the other general factors. Part I argues that the nature of export control enforcement requires extensive self-governing behavior on the part of exporters and that enforcement should be directed toward that end. Part II examines several possible justifications for penalizing a business entity and concludes that deterrence and rehabilitation through education are the most viable, particularly in a self-regulating industry. Part III argues that examining the export compliance program is actually a necessary prerequisite to determining the general culpability required under the general factors, and on that basis alone cannot be relegated to a mitigating factor. Part IV argues that an emphasis on corporate compliance programs in punishment is the most effective route to deterrence and rehabilitation. Finally, Part V argues that findings from the field of corporate social responsibility indicate that the creation of a culture of compliance focused on executive accountability is most likely to result in effective controls.

I. SELF-REGULATING REQUIREMENTS OF EXPORT CONTROLS

This Part argues that export controls rely largely, in fact almost entirely, on self-regulatory behavior by exporters. This is a result of the export regulations themselves, as well as the enforcement resources available to BIS and the small percentage of exports that require a license. Although BIS provides some level of after-the-fact enforcement, the primary effort is to prevent violations through education and guidance.

Only a small fraction of total United States industrial exports—four percent by one estimate—require a BIS export license.²² Given then that ninety-six percent of exports do not require licensing, and that BIS, like any government agency, must economize the use of its enforcement resources, the Department of Commerce cannot reasonably be expected to place an agent at the site of every export transaction to watch over the shoulder of industry and ensure perfect compliance.

Industrial exports can now occur at almost any location in the United States, yet BIS export enforcement field offices are located at only nine locations, with each field office providing enforcement supervision over a

developed by BIS as a model of a corporate compliance program. The EMS will be considered more fully in Part V.

22. Cecil Hunt, *Department of Commerce Export Controls*, in *COPING WITH U.S. EXPORT CONTROLS* 2003, at 90 (2003).

specified region.²³ Although these field offices provide on-site enforcement abilities, there are significant export hubs that are not serviced by an on-site enforcement team, including Seattle, San Diego, and New Orleans. And while the chosen enforcement locations are sensible, any small firm could hypothetically commit an illegal unlicensed export by placing handcuffs in a padded envelope and mailing them to Turkey.²⁴

The complicated nature of the export license process itself makes diligent efforts at self-regulation all the more necessary. When contemplating an export, it falls to the exporter to determine whether an item is restricted and what steps to take thereafter. In fact, the EAR confront an exporter with a total of at least twenty-nine steps that must be taken to determine how to comply.²⁵ If, in just the very first step, the exporter incorrectly determines whether this is an item “subject to” the EAR, the exporter might ignore the rest of the process and the export will proceed unless some outside force intervenes.²⁶ The licensing process itself is triggered only upon an application by the exporter, which comes at step twenty-six of the process.²⁷ An error in the preceding twenty-five steps, or the failure to comply with step twenty-six, could effectively remove the Department of Commerce from the equation.

Of concern to both BIS and industry, the definition of the term “export” has expanded to include many activities that do not fit the traditional description, making it even harder to predict when and where controlled exports will occur and to dispatch a government regulator to oversee the process. The so-called “deemed export” rule provides that the release to a foreign national of technology or software source code that would otherwise be subject to the EAR is deemed to be an export of the technology in question to the country of origin of the foreign national.²⁸ For example, by this standard it would be deemed an export to China to allow a Chinese professor visiting at a research university hundreds of miles from the nearest border to “visually inspect” technology that is covered by the EAR—including the object itself, plans, blueprints, schematics, or specification

23. See BIS Program Offices, <http://www.bis.doc.gov/about/programoffices.htm> (last visited Mar. 26, 2006). The field offices are located in Boston, New York, Washington, Miami, Chicago, Dallas, San Jose, Los Angeles, and Houston.

24. See 15 C.F.R. § 774 sup. 1 (2005) (Commerce Control List Category 0A982). Restraint devices, a crime-control controlled export listed under Category 0A982, require a license for export to any country other than Canada “[i]n support of U.S. foreign policy to promote the observance of human rights throughout the world . . .” *Id.* § 742.7.

25. See *id.* § 732.1.

26. See *id.* § 732 sup. 1. One would be excused for incorrectly thinking this is an easy question. For an explanation of how nuanced that first question can be, see Hunt, *supra* note 22, § 3(d). For example, an item can be subject to the EAR even if it is located outside the United States and is being reexported by foreign nationals if there is U.S. content exceeding a de minimis threshold of either ten percent or twenty-five percent by value. *Id.* § 3(d)(1).

27. 15 C.F.R. § 732.4(b)(7) (2005).

28. *Id.* § 734.2(b)(2)(ii).

sheets.²⁹ Admittedly this construction of the controls might be a necessary reflection of the changing nature of the ways that damaging items and technology can leave United States control. The point is that requiring on-site, prior inspection of every export is simply impossible.

BIS recognizes this self-regulating nature of export controls in its approach to business. Beginning in 1991, BIS initiated the Business Executive Enforcement Team town-hall meetings. BIS engages in dozens of preventative training sessions annually,³⁰ with the stated purpose of increasing export control compliance through education.³¹ BIS attributed a twenty percent increase in the number of deemed-export license applications in fiscal year 2003 to improved education and outreach on its part—not to increased numbers of deemed-exports.³² The bureau also attributed an identical twenty percent increase in deemed-export license applications in fiscal year 2004 to outreach.³³ The logical inference is that some significant fraction of the deemed-exports in fiscal years 2002 and earlier were unlicensed simply because nobody ever applied for a license, perhaps out of ignorance.

Finally, there is empirical evidence that erratic fluctuations in export licenses in recent years reflect the hit-or-miss nature of enforcement. In fiscal

29. For a flavor of the reception that this rule receives, see the following public comment posted to BIS by University of Florida professor Guido Mueller:

The consequences of this new rule on our research will be disastrous Adding an application for a 'deemed export license' for every foreign student for every high tech instrument will further diminish our capabilities to conduct our research

What a joke! . . .

In my opinion there are two ways out: the first is that you stop this BS The second option is that we will start buying international products [w]e are actually allowed to use them. Please, do . . . your great country a great favor and make sure that all our students can work in our labs without having to go through another stupid . . . hurdle.

Email from Guido Mueller, Assistant Professor, University of Florida, to the Bureau of Industry and Security (May 5, 2005), <http://efoia.bis.doc.gov/pubcomm/Revision%20to%20the%20Deemed%20Export%20Regs%202005/FINAL%20DOCUMENT.pdf>.

For one of many industry objections to the deemed export rule, see Cynthia Johnson, Vice Chair, Semiconductor Industry Association Export Controls Committee, Deemed Export Policy: A Workshop on the IG's Report to the Department of Commerce (May 6, 2005), http://www7.nationalacademies.org/rscans/C_Johnson_IG_Presentation.pdf ("The deemed export rule does not appear to be a significant contributor to national security. At the same time, it directly conflicts with and impairs efforts to maintain [U.S.] technological leadership.").

30. See Seminars and Training, <http://www.bis.doc.gov/SeminarsAndTraining/index.htm> (last visited Mar. 26, 2006).

31. See Export Enforcement Program, <http://www.bis.doc.gov/Enforcement/eeprgm.htm> (last visited May 14, 2006). The significance is that BIS does not attribute these outreach programs as being designed to prevent businesses from getting caught—which would be the goal if the export enforcement mechanism were not self-governing—but as designed to prevent damage to national security through preventing exports. This is a tacit recognition of the fact that BIS cannot enforce the regulations reactively and that the onus falls to industry to prevent most violations.

32. BUREAU OF INDUS. & SEC., ANN. REP. FISCAL YEAR 2003, at 21–25 (2004) [hereinafter FY2003], available at <http://www.bis.doc.gov/news/2004/03AnnualRept/index.htm>.

33. BUREAU OF INDUS. & SEC., ANN. REP. FISCAL YEAR 2004, at 21–25 (2005), available at <http://www.bis.doc.gov/news/2005/04AnnualRept/Chapters1to7.htm#ch2>.

year 2003 BIS recorded 12,443 license applications, a seventeen percent increase over 2002.³⁴ Yet total U.S. exports in 2003 increased only five percent over 2002.³⁵ Unless we are to conclude that there was a remarkable spike in controlled exports as a proportion of total exports, the increase in license applications indicates that exporters were simply being more vigilant in applying for licenses. Similarly, BIS recently began recording statistics on preventive enforcement activities. In fiscal year 2003, the bureau completed thirty-four administrative enforcement settlements for export control violations, yet through aggressive preventative measures, the bureau thwarted an additional 136 potential violations before they could occur.³⁶ This is a noteworthy success for the bureau, but it also underscores the suspicion that self-regulation is necessary: postviolation enforcement is catching only a fraction of the potential violations.

In summary, the nature of the regulations and the evidence from BIS enforcement efforts lead to the conclusion that export controls rely largely, in fact almost entirely, on self-regulatory behavior by exporters. Most exports are unlicensed, and even the licensed exports would overburden the enforcement teams if every export had to be individually precleared. Thus the burden is on the exporter to learn the regulations, to ensure compliance, and to report appropriately. The burden therefore falls to the exporters to develop a corporate compliance program. Part II considers the relationship between corporate compliance and culpability.

II. JUSTIFICATIONS FOR ADMINISTRATIVE PENALTIES FOR EXPORT CONTROL VIOLATIONS

Corporate punishment could potentially serve a number of objectives, including deterring violations, condemning, imposing retribution for moral blameworthiness, reforming the offending firm, or incapacitating the wrongdoer from causing further harm.³⁷ In this Part, these competing justifications for penalties are considered in light of the unusual nature of exporting firms, first by considering the stated goals of BIS enforcement efforts, then by considering in turn the nature of deterrence, rehabilitation, incapacitation, and retribution as they apply specifically to export controls. This Part argues that deterrence and rehabilitation, the stated goals of BIS, are well suited to the nature of export control violations, but that incapacitation and retribution should not be entirely dismissed as motives for tailoring enforcement actions to the compliance culture of the firm.

34. FY2003, *supra* note 32, ch. 2.

35. U.S. INT'L. TRADE ADMIN. FOREIGN TRADE HIGHLIGHTS (2004), *available at* <http://www.ita.doc.gov/td/industry/otea/usfth/aggregate/H03T06.html>.

36. FY2003, *supra* note 32.

37. In fact, the list of reasons to punish a corporation can include any of the following: fault rationales, coercive rationales, economic rationales, signaling rationales, retributive rationales, reformative rationales, and compensatory rationales. *See generally* RICHARD S. GRUNER, CORPORATE CRIME AND SENTENCING §§ 2.3.1–2.3.7 (1994).

A. *On the Record: Stated Goals of BIS*

Before considering the possible theoretical justifications for imposing penalties on offending firms, it is probably best to first consider the stated objectives of the BIS enforcement division. The published goals of the Department of Commerce indicate that prevention and education of potential violators are their objectives. In enforcing export control violations, “[t]he primary roles of BIS’s Export Enforcement program are to prevent the illegal export of dual-use items before they occur; investigate and assist in the prosecution of violators of the [EAR] . . . and inform and educate exporters, freight forwarders, and manufacturers of their enforcement responsibilities under the EAR”³⁸ Leaving aside the second objective, which as a generic commitment to prosecuting violations could be viewed as a commitment to any of the justifications for punishment, the other two stated objectives of BIS are to prevent and to educate, with prevention noticeably listed first. It is noteworthy that BIS does not make a distinction between prevention by means of deterrence, by means of rehabilitation, or by means of incapacitation.³⁹ It is also reasonable to infer from the commitment to education and information that BIS seeks to rehabilitate offending, or potentially offending, firms. These goals, along with other possible goals of administrative penalties, will be considered in the sections that follow.

B. *The Goal and Challenge of Deterrence*

One likely justification for imposing administrative penalties on errant organizations is to deter.⁴⁰ The term deterrence as applied to a business entity is, to some extent, a paradox, since it implies a potential that cannot be ascribed to a “fictional legal entity . . . [that] cannot itself be ‘deterred.’”⁴¹ At the very most, assigning culpability to an organization can deter those individuals who comprise the organization or who act as its agents.⁴² In fact, the existence of corporate liability can be supported in some cases on the grounds that only by punishing the corporate actor can the true social costs of transgression be internalized.⁴³ Individual actors within the business entity are often “judgment-proof” in that they are unable to absorb the large penalties that must be levied in order to make the deterrence effectively more painful than the gain that would otherwise be realized by the organiza-

38. BUREAU OF INDUS. & SEC., EXPORT ENFORCEMENT, <http://www.bis.doc.gov/complianceandenforcement/index.htm> (last visited Mar. 26, 2006).

39. For clarity, in this Note the term deterrence will apply to intents to prevent behavior through a fear of penalties, the term rehabilitation will refer to reforming offenders so that there is no future desire to misbehave, and incapacitation will refer to efforts to make future offenses impossible. See WAYNE R. LAFAVE, *PRINCIPLES OF CRIMINAL LAW* § 1.5 (2003).

40. See V.S. Khanna, *Corporate Criminal Liability: What Purpose Does it Serve?*, 109 HARV. L. REV. 1477, 1493–96 (1996).

41. *Id.* at 1494.

42. *Id.* at 1494–95.

43. *Id.*

tion.⁴⁴ For example, the fines involved in administrative sanctions can range up to hundreds of thousands of dollars, perhaps even millions if multiple national security violations are committed.⁴⁵ Most individuals are unable to absorb the costs of such sanctions, so marginally increasing the sanction in order to adjust deterrence has little effect, if any, on that actor. A simple example suffices: if the fine imposed for speeding were one million dollars, the marginal deterrent effect on an individual of raising the fine to two million dollars would be minimal at best. The individual is said to be judgment-proof since either fine, one million or two million, is equally destructive; the individual cannot internalize the cost of either fine. But the same marginal increase in costs to a corporate entity that *can* internalize the cost makes a difference to the entity in making compliance decisions.⁴⁶

Yet there is an alternative hypothesis. If we abandon the vision of the corporation as a rational actor and replace it with a vision of the corporation as a conglomeration of individual actors, then mathematical calculations about corporate deterrence start to lose their appeal.⁴⁷ Regardless of how well the deterrent sanction is tailored to internalize the total social costs, the decisions that lead to violations still reside in managers and other agents who might bring their own external costs and benefits to the decision-making process.⁴⁸ Executives do not always confine their decisions to the costs and benefits that will accrue to the corporation's shareholders or other stakeholders.⁴⁹

Given that deterrence is a stated goal of administrative sanctions, there is a dilemma in applying those sanctions—at least to the extent of finding the appropriate target of deterrence. If deterrence is aimed at the individual decisionmaker, the risk is that there is no way to set the sanction high enough to offset the total social cost and still be appropriate to individuals without making them judgment-proof. If deterrence is aimed at the corporation as a whole, the alternative risk is that the individual decisionmaker brings external costs and benefits to the decision that are not accounted for in setting sanctions in relation to benefits, social costs, and expected probability of punishment. Part V will return to this apparent tension between deterrence of corporations and individuals and will argue that by focusing deterrent efforts on particular key leadership positions, the tension can be resolved.

44. V.S. Khanna, *Corporate Liability Standards: When Should Corporations Be Held Criminally Liable?*, 37 AM. CRIM. L. REV. 1239, 1243–44 (2000).

45. See *supra* note 12.

46. Khanna, *supra* note 44, at 1244; see also John C. Coffee, Jr., “No Soul to Damn: No Body to Kick”: An Unscandalized Inquiry into the Problem of Corporate Punishment, 79 MICH. L. REV. 386, 389–90 (1981).

47. Compare Coffee, *supra* note 46, at 393–94 (describing this behavioral perspective) with Khanna, *supra* note 44, at 1244 (discussing deterrence in mathematical terms).

48. See Coffee, *supra* note 46, at 393–405.

49. See generally Timothy L. Fort, *The Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 NOTRE DAME L. REV. 173 (1997). For a discussion of the distinction between shareholders and stakeholders in the export context, see *infra* notes 105–117 and accompanying text.

C. Goals in Conflict: Rehabilitation and Incapacitation

There is an inherent conflict in the tasks assigned to the Department of Commerce that highlights the value of rehabilitation as a goal of corporate punishment, as well as the danger of incapacitation. The Department of Commerce wants exporters to thrive and grow, but only to the extent that they are complying with controls on which technologies go to which destination countries. In other contexts, punishment can be justified as a means of incapacitating, or preventing the offender from committing further harm.⁵⁰ For example, an incarcerated individual is no longer able to continue committing crimes even if the individual is not reformed and not deterred by the threat of future penalties. At least in theory, a company that has demonstrated a failure to adequately guard against the export of controlled dangerous technology could be prevented from exporting. For example, the firm could be denied any license to export controlled items for a period of years.⁵¹ In a more extreme example, an administrative penalty that drives the firm to insolvency would effectively amount to capital punishment of the corporate actor, preventing future violations.⁵²

There are two basic problems with carrying this rationale too far. First, as discussed in Part I, the government's ability to actually prevent most violations of export controls is questionable.⁵³ The volume of exports and the relative scarcity of enforcement agents prevent the government from being certain that every item leaving the United States is properly licensed. We could certainly imagine a firm that, once denied export licenses, simply continued to export in the shadow of an over-tasked enforcement regime. A persistent and determined exporter—or even a merely inattentive one—could circumvent such a system since the system relies so heavily on preventive actions of the exporter. This situation is significantly distinct from the case of criminal incapacitation by imprisoning a dangerous felon. In the case of an individual, the problem is reduced to separating one offender from the remainder of society—a task that the modern penal system seems capable of performing. Even assuming a regime that could effectively incapacitate the corporate actor, individuals live on even after the firm dies. When XYZ, Inc. becomes insolvent, the chief executive and the export manager are likely to find their way into PDQ, Inc., and the problem has shifted, not disappeared.

The second problem with relying too heavily on an incapacitation rationale for export controls is that the underlying behavior in question is often something that we want to encourage. The export of U.S. goods and technology is generally considered good for U.S. industry and the U.S.

50. LAFAYE, *supra* note 39, § 1.5.

51. 15 C.F.R. § § 764.3(a)(2), 766.25 (2005).

52. See, e.g., David Morris, *Capital Punishment for Corporations?*, ST. PAUL PIONEER PRESS, Sept. 22, 1998, at 9A.

53. See *supra* notes 23–27 and accompanying text.

economy.⁵⁴ The Department of Commerce is in a conflicted position, charged with both generally encouraging exports and yet specifically preventing unlicensed exports.⁵⁵ This leaves the incapacitation argument with limited appeal.

In some cases a denial of export privileges could serve the interests of preventing harm without significant costs to the economy, and it is easy to understand the inclusion of denial orders as one tool of administrative sanctions in such cases.⁵⁶ But widespread use of incapacitation as a justification for punishment could eventually cause results that conflict with other goals of the Department of Commerce, and of the United States as a whole.⁵⁷ These other goals place the Department of Commerce in the role of encouraging and facilitating exports generally, making a case for corporate rehabilitation as an objective of any punishment regime. Leaving aside social science arguments that accompany such a discussion in the case of individuals,⁵⁸ it is at least possible that offending companies can be rehabilitated.

Rehabilitation appears to have worked in the case of Hughes Electronics. After an alleged near miss on sharing satellite technology with the People's Republic of China,⁵⁹ Hughes took the initiative to empanel a commission to survey industry best practices in the creation of adequate internal compliance programs, and then implemented the commission's results for its future export operations.⁶⁰ Its conclusions, the *Nunn-Wolfowitz Task Force Report on Industry Best Practices*, have proven to be a watershed development in integrating corporate culture and export control

54. RICHARD G. LIPSEY ET AL., *ECONOMICS* 531–33, 772–80 (HarperCollins College Publishers, 10th ed. 1993). Assuming that exports do not replace domestic consumption, exports can be expected to increase production, GDP, and employment. See generally Valentino Piana, *Exports*, Economics Web Institute (2001), <http://www.economicswebinstitute.org/glossary/exports.htm>.

55. The Department of Commerce recognizes this in its strategic objective 1.2: "Advance responsible economic growth and trade while protecting American security." DEPT. OF COMMERCE, *STRATEGIC PLAN FOR FY 2004–FY 2009*, at 3 (n.d.).

56. See, e.g., *In re* Ronald O. Brown, No. 99-BXA-03 (Mar. 2, 2000). Mr. Brown was fined \$18,000 and denied export privileges for a period of three years after settling charges that he had exported shotguns to Russia in 1994. Although the export denial was suspended, the aggregate impact on the United States economy of suspending Mr. Brown's budding entrepreneurship would have been minor.

57. Compare *id.* with *In re* Federal Express Corp., Case No. E921 (Oct. 4, 2005), available at <http://efoia.bis.doc.gov/ExportControlViolations/E921.pdf>, where FedEx settled an enforcement action for accepting for international shipment a "package of used clothes" being exported by a company that had been denied export privileges. The potential impact to the U.S. economy by shutting down FedEx can only be speculated. Lest we assume that another shipper would step into FedEx's place, DHL settled the following day for exporting items on behalf of the same banned party. *In re* DHL Holdings (USA) Inc. (Oct. 5, 2005), available at <http://efoia.bis.doc.gov/ExportControlViolations/E922.pdf>.

58. LAFAVE, *supra* note 39, § 1.5(b).

59. The rest of the soap opera plays out in Howard Diamond, *House Seeks to Limit Space Cooperation with China*, ARMS CONTROL TODAY, May 1998, available at http://www.armscontrol.org/act/1998_05/hd4my98.asp.

60. NUNN-WOLFOWITZ TASK FORCE REPORT: INDUSTRY "BEST PRACTICES" REGARDING EXPORT COMPLIANCE PROGRAMS 1, (July 25, 2000) [hereinafter NUNN-WOLFOWITZ].

compliance.⁶¹ Reforming inadequate controls is a rational and informed response to a noted failure to comply. Combined with penalties whose magnitudes make individuals judgment-proof, the ability of an organization to respond effectively to such failures and to seek out solutions provides at least one argument in favor of punishing the corporation (rather than the individual agent) in the first place.⁶²

D. *The Odd Case for Retribution*

There is even a potential value in adjusting punishment in order to impose retribution on the offending firm or to express condemnation. Granted, punishing business entities for purposes of retribution faces some significant criticism.⁶³ The argument goes that the corporation—despite our desires to vilify the institution—is a mindless entity composed of no more than the sum of the actions of its components and agents. To punish such an entity, in the sense of attaching moral blameworthiness to it, is to misunderstand its nature. To ascribe moral deficiency to the corporation is not only to engage in anthropomorphism but to ignore that the processes inherent in the corporation stem from human decisions.⁶⁴ In one eloquent description of this dilemma, the problem is that business entities have “no soul to be damned, and no body to be kicked[.]”⁶⁵

But we *like* to kick the corpses and damn the souls of firms that appear to us to be particularly morally blameworthy. Contrast, for example, the news coverage of the failure of Enron with the bankruptcy of Delphi. Despite the fact that both represent corporate failures on a similar scope, one was vilified and the other has so far been treated as any other (albeit disastrously large) bankruptcy.⁶⁶ After all, there are elements of similarity between decision-making processes in humans and internal corporate decisionmaking that make the desire to express outrage or condemn particularly bad behavior understandable. Although there is certainly a retributive argument for singling out particular acts of individual agents of the corporation

61. See *infra* Part V.

62. See Khanna, *supra* note 44, at 1245.

63. See Khanna, *supra* note 40, at 1494 nn.91–93 (describing academic support for deterrence and rehabilitation rationales for corporate criminal liability, but leaving open the possibility of non-deterrent justifications for civil liability).

64. See Coffee, *supra* note 46, at 386 n.2 (“Long before Baron Thurlow’s time, ecclesiastical courts had responded to corporate misbehavior by imposing the decree of excommunication. This probably represents the first occasion on which the anthropomorphic fallacy that the corporation was but an individual misled courts.”).

65. *Id.* at 386 (quoting Edward, First Baron Thurlow).

66. See, e.g., Press Release, International Union, UAW Statement on Delphi filing for bankruptcy (Oct. 8, 2005), available at <http://www.uaw.org/news/newsarticle.cfm?ArtId=346> (noting that “[t]he UAW is deeply disappointed” but reserving the UAW’s criticism for recently renegotiated executive severance packages). But see Jill Stewart, *Enron’s a Sideshow*, SAN DIEGO CITYBEAT, <http://www.sdcitybeat.com/article.php?id=2186> (“Let’s stipulate that Enron is evil”) (last visited Mar. 26, 2006).

for their wrongdoing, it is questionable how effective it might be to extend that outrage to the corporate body itself.⁶⁷

Nevertheless, attaching a label of moral blameworthiness to an offending exporter can serve the purpose of triggering reputational sanctions not only against the company, but also against the individuals affiliated with it. In this sense, attaching a label of moral significance to a blameworthy firm allows sorting behavior in the market: other market actors can avoid interaction with particularly offensive players or a firm can be punished for the company it keeps.⁶⁸ For example, the harm to Arthur Andersen's reputation from its role in the Enron failure led to a hemorrhage of clients and its eventual demise.⁶⁹ Although there is a risk that such retributivist labeling might be used irrationally, there is at least the possibility that ascribing moral blameworthiness to an amoral entity provides valuable information to other actors.

III. COMPLIANCE CULTURE AS A FACTOR IN PRIMARY LIABILITY

This Part begins with a deceptively simple question: how do you determine the culpability of an organization? While the concept of organizational culpability or liability is by no means novel, there has been a flourishing interest in the topic in the wake of a number of highly publicized corporate failures in the last several years.⁷⁰ The first barrier to finding a simple definition of corporate culpability lies in the layers of meaning that adhere to the term "culpability" itself.⁷¹ This Part argues that considering internal compliance regimes cannot be relegated to a mere aggravating or mitigating circumstance, but actually is a necessary component of considering the major factor of "degree of willfulness."

The penalty guidance that has now been added to the EAR includes as a primary determining factor "the degree of willfulness" of the offense.⁷² The penalty guidance indicates that for cases where export violations occur due to simple negligence or carelessness, a civil penalty or letter of warning will

67. See Albert W. Alschuler, *Ancient Law and the Punishment of Corporations: Of Frankpledge and Deodand*, 71 B.U. L. REV. 307, 311–13 (1991); Khanna, *supra* note 40, at 1494 n.91 ("[T]he notion that society has a retributive need so great that it must punish nonhuman entities and label them criminal, however, requires empirical support and seems implausible.")

68. I am indebted to Doug Chartier for raising this interesting aspect of retributive sanctions in the context of corporate compliance.

69. See Floyd Norris, *Loss of Leadership*, N.Y. TIMES, Mar. 11, 2002, at A18.

70. For treatment of the historical development of corporate liability, see Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1566–67 (1990); Charles J. Walsh & Alissa Pyrich, *Corporate Compliance Programs as a Defense to Criminal Liability: Can a Corporation Save Its Soul?*, 47 RUTGERS L. REV. 605 (1995); Coffee, *supra* note 46.

71. See generally Khanna, *supra* note 44.

72. Export Administration Regulations: Penalty Guidance in the Settlement of Administrative Enforcement Cases, 69 Fed. Reg. 7867 (Feb. 20, 2004) (to be codified at 15 C.F.R. pts. 764 and 766).

be sufficient in many cases.⁷³ In cases of gross negligence, willful blindness to the EAR, or knowing or willful violations of the regulations, the penalties might be more severe, including denial of export privileges.⁷⁴

The difficulty with this approach is in determining a degree of willfulness without considering the culture of compliance within the exporter company. Assuming a case where there is no clear evidence of intent—for example no mission statement that discusses how best to violate export laws or a “smoking memo” that shows a knowing violation—one way to make those fine distinctions between simple negligence and gross negligence is to examine the internal procedures, or lack thereof, that led to the inadvertent violation. It is logically incoherent to try to consider the willfulness of such an act without considering the policies, procedures, and leadership failures that made the violation possible.

An exporter might hope for guidance from BIS on how culpability will be determined, but the penalty guidance itself acknowledges the difficulty of defining the corporate state of mind. The best that a confused exporter can get from the penalty guidance is the conclusory and circular logic that “BIS may regard a violation of any provision of the EAR as knowing or willful if the facts and circumstances of the case support that conclusion.”⁷⁵ BIS says that ignoring the so-called “red flags”⁷⁶ or “the nature and result of any inquiry made by the party”⁷⁷ indicate willful or knowing behavior. But these may be isolated cases and provide little guidance to the exporter or the judge.

These two positions are in some tension. On the one hand, lack of a requisite mental state does not preclude liability for the underlying strict liability violation. But the penalty guidance, assuming a violation has occurred, places culpability at the forefront of the considerations for sanctions. This administrative regime contrasts with criminal prosecution for such violations, where there must be some intent. For example, the EAR specifically limit criminal enforcement to cases of knowing or willful violation.⁷⁸ Punishment by administrative proceeding does not, on the surface, require such culpability. For example, administrative enforcement proceedings are begun with a formal charging letter that must, among other things, state that there is reason to believe that a violation of the EAR has occurred, set out the essential facts of the alleged violation, give notice of sanctions available, and explain the remedies available to the party charged with a violation.⁷⁹ After

73. *Id.* at 7867-71.

74. *Id.*

75. *Id.* at 7871.

76. Behavior by the foreign buyer that should raise suspicions—for example, a long-time client, a small bakery that imports flour, tries to buy sophisticated lasers.

77. Export Administration Regulations: Penalty Guidance in the Settlement of Administrative Enforcement Cases, 69 Fed. Reg. 7867 (Feb. 20, 2004) (to be codified at 15 C.F.R. pts. 764 and 766).

78. 15 C.F.R. § 764.3 (2005).

79. *Id.* § 766.3.

discovery and hearings, the role of the administrative law judge is to determine “whether there has been a violation.”⁸⁰ At no point in the process does the regulation raise the possibility that exporters can raise a defense based on a lack of intent.⁸¹

In other contexts, corporate compliance programs can be viewed as a bar to liability. Normally the acts of an employee or other agent are attributable to the corporation if they are performed within the scope of employment *even if the acts are prohibited by company policy*.⁸² By that logic, export failures on the part of an employee contrary to stated company policy would still be attributable to the company. But this need not be the case. Consider, for example, employer vicarious liability for sexual harassment committed by its agents in the wake of *Burlington Industries, Inc. v. Ellerth*.⁸³ While not reversing the long-standing rule of agency law noted above, the Court held out a theory of employer liability that allows a company to disavow actions of subordinates provided that those actions were clearly contrary to well-stated and formulated policies: in the context of sexual harassment “a defending employer may raise an affirmative defense to liability or damages, subject to proof by a preponderance of the evidence.”⁸⁴ That defense consists of showing two elements: the employer exercised reasonable care to prevent and correct the behavior, and the employee unreasonably failed to take preventative or corrective opportunities provided by the employer.⁸⁵

Applying the logic of *Burlington v. Ellerth* to export violations invites two significant objections. First, the Court explicitly limited the decision to cases where there was no tangible detriment to the plaintiff. When an agent takes tangible employment action, the employer cannot escape liability by noting a well-drafted and thorough company policy.⁸⁶ Therefore the *Burlington* logic might not perfectly stretch to include export actions that clearly are imputed to the company despite contrary policies. Second, *Burlington*'s reach might also be limited by the Court's reliance on the fact that one intended benefit of Title VII was to encourage companies to create grievance procedures and reporting methods.⁸⁷ On the other hand, BIS has stated a

80. *Id.* § 766.17.

81. There is at least some support for a requirement of intent in the revised penalty guidance found at 69 Fed. Reg. 7867. The discussion of culpability notes the distinction between penalties for willful and intentional violations and contrasts them with negligent violations. *Id.* at 7871. The absence of discussion of appropriate sanctions for violations that do not even rise to the level of negligence might be interpreted to mean that such violations are not punishable. In light of the remainder of 15 C.F.R. § 766 (2005), such a conclusion is probably not warranted.

82. RESTATEMENT (SECOND) OF AGENCY § 230 (1958). For a discussion of the value of considering corporate compliance programs as a bar to liability, see Walsh & Prych, *supra* note 70.

83. *Burlington Indus., Inc. v. Ellerth*, 524 U.S. 742 (1998).

84. *Id.* at 765.

85. *Id.*

86. *Id.* at 762–63.

87. *Id.* at 764.

desire to encourage the creation of similar reporting and grievance procedures by exporters.⁸⁸ In that sense, *Burlington* remains informative.

Despite the apparent relevance of corporate compliance to liability, the use of company policies in this context is the exception rather than the rule.⁸⁹ This need not be the case. There are several reasons that allowing corporate compliance culture as a defense to liability would be favorable. As corporations are coming to be viewed more frequently as rational actors that respond to deterrence and other costs and benefits,⁹⁰ use of compliance to disprove mens rea fits within traditional notions of criminal defense.⁹¹ Further, encouraging corporate compliance programs will increase self-regulation, encourage good corporate citizenship, and is a cost effective method of regulation not only for the corporation but also for enforcement agencies.⁹²

Corporate compliance programs provide a particularly relevant method of investigating the extent to which a corporation is culpable. Although such a program could be viewed as an outright defense to liability, the value of considering the program even after a determination of liability clearly has merits. Even if we assume that export controls are strict liability offenses, the stated priority of BIS in considering the “degree of willfulness” of the business entity cannot be easily divorced from the requirement to consider the ways that the corporation has attempted to prevent such violations. Unless we are to assume that the penalty guidance regarding “the facts and circumstances of the case”⁹³ is a purely arbitrary and standardless invitation to the enforcement agency, there must be some method to determine corporate willfulness. Even in that light, compliance regimes cannot be relegated to the role of aggravating or mitigating factors—they must inform the process of making the primary decision on culpability.

IV. THE ROLE OF CORPORATE CULTURE IN ACHIEVING THE GOALS OF PUNISHMENT

There is a second reason why compliance programs ought to be considered early in the penalty phase. The history of such programs indicates that they are particularly well-suited to the role of deterrence in self-regulating industries. While the specifics of export industries might seem unique in

88. See, e.g., BUREAU OF INDUS. & SEC., EXPORT MANAGEMENT SYSTEMS, <http://www.bis.doc.gov/ComplianceAndEnforcement/ExportManagementSystems.htm> (last visited Mar. 24, 2006) (“An EMS can . . . [r]einforce senior management commitment to comply with U.S. export laws and regulations to all parts of the company . . . [and s]erve as a vehicle to communicate red flag indicators that raise questions about the legitimacy of a customer or transaction.”).

89. See Walsh & Pyrich, *supra* note 70, at 662–66.

90. See Khanna, *supra* note 44, at 1243–45; Pitt & Groskaufmanis, *supra* note 70.

91. See Walsh & Pyrich, *supra* note 70, at 676–77.

92. *Id.* at 678–80 (arguing that compliance programs encourage self-regulation); *id.* at 680–81 (arguing that they encourage good corporate citizenship); *id.* at 681–84 (arguing that compliance programs are cost effective for the regulators and the regulated).

93. See *supra* note 75 and accompanying text.

many ways, there are significant ways in which the problems faced by companies in these endeavors mirror the problems that other industries have faced. Comparing exporting with these other industries shows that the same concerns and requirements that led to the widespread use of corporate culture programs in those industries are persuasive for exporters.

Current reliance on corporate compliance programs can be traced to a series of corporate governance failures during the second half of the twentieth century.⁹⁴ Some of the earliest, and still most widespread, uses of corporate compliance codes have been in the field of antitrust,⁹⁵ but subsequent scandals have led companies to expand these codes of conduct to include foreign corrupt practices, insider trading, racketeering, defense contracting, and even participation in clinical medical trials.⁹⁶

The trend did not end at the conclusion of the twentieth century. In the wake of several corporate financial scandals, corporate governance attention has been refocused on financial improprieties.⁹⁷ The problem, of course, is not new. In their preface to the best practices report for Hughes Electronics,⁹⁸ Senator Nunn and Ambassador Wolfowitz noted the influence of such ideas in the mid-1990s as reflected in *In re Caremark International Inc. Derivative Litigation*.⁹⁹ In the wake of Enron, WorldCom, and Global Crossing, corporate practices in financial statements have simply received new scrutiny. The provisions of the Sarbanes-Oxley Act suggest that this will not be a passing trend.¹⁰⁰ Although the scope of this Note is limited to administrative enforcement actions, it is also noteworthy that the United States Sentencing Commission has made effective compliance programs a relevant factor for criminal sentencing of organizations as well.¹⁰¹

The common element in these scandals and the reactions to them has been the recurrent return to corporate compliance methods in order to fix the

94. Pitt & Groskaufmanis, *supra* note 70, at 1575–78.

95. *Id.* at 1581–82.

96. *Id.* at 1574–1600.

97. See generally TIMOTHY L. FORT, *ETHICS AND GOVERNANCE: BUSINESS AS MEDIATING INSTITUTION* (2001).

98. See *supra* note 60 and accompanying text.

99. 698 A.2d 959 (Del. Ch. 1996). In *Caremark*, a derivative lawsuit was brought based on the board's failure to discover that employees were breaking the law. The court held that "without assuring themselves that information and reporting systems exist . . . that are reasonably designed to provide to senior management and to the board itself timely, accurate information . . . to reach informed judgments concerning both the corporation's compliance with law and its business performance[.]" the directors failed in their obligation to the shareholders. *Id.* at 970. But the directors may escape liability if there is a reporting system that "is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility." *Id.*

100. Public Company Accounting Reform and Investor Protection Act 2002, Pub. L. No. 107–204, 116 Stat. 745.

101. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2005).

damage that had been done and, significantly, to deter future failures.¹⁰² Consider, for example, General Electric's ("GE") defense of price fixing charges in the 1950s. In the face of evidence of widespread willful antitrust behavior, GE considered relying on its antitrust corporate compliance program as a defense. Although GE ultimately chose not to raise that defense and paid significant fines, the industry scrambled to implement similar programs.¹⁰³ Significantly, empirical evidence suggests but does not prove that these programs are effective at preventing antitrust violations. Just as sexual harassment compliance programs are now recognized as having a deterrent effect in that field,¹⁰⁴ antitrust compliance has been increased through corporate governance programs that reward competitive behavior and establish internal and external reporting procedures.¹⁰⁵

Corporate compliance is used to deter violations across a disparate array of regulations from sexual harassment to antitrust and corporate financial impropriety. Far more significant than the *differences* are the *similarities* among these areas of corporate behavior.¹⁰⁶ For example, as with sexual harassment and honesty in accounting, we want companies to be largely self-regulating. The burden falls to the company, whether it is trying to prevent agents from committing harassment or from falsifying financial records. As with sexual harassment and price fixing, the activities involved are not easily exposed without positive steps from either the corporation itself or from an individual empowered to bring impropriety to light. Many of the activities present a company with competing interests that tug at compliance from several directions. In some cases a failure to comply opens up potential profit for the company; in others failure to comply will have an effect on the security or reputation of the United States; and in some cases failure to comply will result in harm to third party interests. In these respects, all of these areas of the law share at least some characteristics with export control compliance.

V. THE EXECUTIVE ACCOUNTABILITY BRIDGE

Even considering that export controls are self-regulatory, that the types of behavior that we seek to encourage from exporters are well-suited to de-

102. Pitt & Groskaufmanis, *supra* note 70, at 1574 ("A short summary of each scandal reveals that codes of conduct consistently have been touted by corporations and their adversaries as a means to avoid further misconduct.").

103. *Id.* at 1578–81.

104. *See supra* notes 83–85 and accompanying text.

105. Pitt & Groskaufmanis, *supra* note 70, at 1581–82. However, it should be noted that the decline in antitrust violations might be limited only to "irrational" antitrust violations, those violations that were made out of ignorance instead of a rational cost-benefit analysis of compliance or violation. *Id.*

106. Significantly, there are fewer tools available to enforce export controls compared to other areas of regulation: competitors are unlikely to have a civil cause of action, there are no legislative incentives giving third parties standing to enforce, and there are no treble damages provisions.

terrence and rehabilitation,¹⁰⁷ and that a heavy emphasis on corporate compliance has found support in many other areas of corporate governance with positive results,¹⁰⁸ it is not compelling simply to advocate a quick look at corporate policy to determine liability or penalties. There are several areas of tension in the foregoing observations, and it is these areas of tension that this Part will address. Specifically, the role of senior leadership—managers and boards of directors—in creating a culture of compliance provides a focal point for matching the goals of the administrative penalty and the nature of export control failures. This Part argues that the role of senior leadership bridges the gap between the judgment-proof individual and the corporate actor and merits the closest scrutiny in considering whether compliance is adequate.

Simply advocating a strong reliance on corporate compliance runs into several areas where there are tensions between theoretical considerations and how we might expect industry to behave. The first such tension was touched upon, briefly, in Part II. There is an unresolved question of whether the corporation is best viewed as a rational actor or as a collection of human actors who act sometimes rationally and sometimes irrationally.¹⁰⁹ A deterrence theory that considers one and not the other will at best be only partially effective. A second tension comes out of the distinction, found in *Burlington*, among other sources, between the view of the company as a principal, accountable for the conduct of its employee-agents, and the view of the company as standing (at least in some cases) above the employees and able to divest itself of responsibility for their actions.¹¹⁰ Another tension, related to the first two, arises from strict liability violations where some level of culpability is considered in determining a penalty.

If export control regulations require a significant measure of self-regulating behavior, and if the goals of enforcement activities must include deterrence among the justifications, if not as the primary justification, then how do we structure the penalty? It is one thing to say, as in Part III, that we should make the corporate compliance culture the starting point for looking at culpability. It is another to say how that translates into applying the law to a hypothetical violator. It is the senior executives and the board of directors, from whom corporate compliance stems and to whom accountability is assigned, who can best help resolve some of the tensions identified above.

The role of the leadership, as a component of a failure to comply with regulations, is twofold: first, the executive is accountable for maximizing corporate performance; second, the executive is responsible for balancing the needs of competing stakeholders in the company.¹¹¹ Under one view of export control failures, we could view the executive as the manager who

107. *Supra* Part II.

108. *Supra* Part IV.

109. *See, e.g.*, Richard S. Gruner, *Risk and Response: Organizational Due Care to Prevent Misconduct*, 39 WAKE FOREST L. REV. 613, 616–19 (2004); Khanna, *supra* note 44, at 1243–44.

110. *See supra* notes 82–87 and accompanying text.

111. *See, e.g.*, Fort, *supra* note 49; Gruner, *supra* note 109.

needs to fix a broken system. The focus then would be how to tailor enforcement so as to maximize executive involvement and accountability for that system. Assuming that most managers want to obey the law,¹¹² and that the compliance regimes discussed in Parts III and IV are in place, evaluating corporate noncompliance can be viewed in a way similar to many other management failures.

This “defect” in performance can be traced to one or more of several potential causes within the organization. Individuals within management might direct employees toward illegal activity, management might fail to educate or motivate employees about lawful conduct, management responses to violations might not correct known problems, or the violation could have been an unforeseen by-product of legitimate corporate behavior.¹¹³ In all of these cases, the violation raises the question of what procedures were in place to prevent such lapses, and how diligent group leaders were in appropriately applying the procedures.

The first of these failures represents an extreme case. Self-regulation breaks down in such cases, where management intentionally directs subordinates to violate export controls. These cases are well-suited for criminal prosecution.¹¹⁴ The other three failure modes cannot be addressed without directly inquiring into the role that management plays within the compliance structure. For example, if the failure lies in failing to motivate employees to obey the law, the cause and remedy cannot be judged purely on the basis of whether there is a stated policy of control compliance. To borrow from recent financial scandals, the document shredding at Enron and Arthur Andersen violated written policies in both companies, yet it was encouraged—if not demanded—by executives.¹¹⁵ Likewise, if the failure of the company stems from a management failure to respond to a known problem, the existence of informal reporting procedures is not an adequate defense.¹¹⁶

Such a view of export control violations as a manageable defect of an executive’s performance can help resolve some of the tensions that exist

112. GRUNER, *supra* note 37, § 1.10.1. Admittedly, this view would not provide guidance in rare circumstances where a sizeable portion of the senior leadership of the business entity intentionally encourage, or cause, violations to occur. In such cases, the value of considering the deterrence effect of administrative sanctions under the EAR becomes less significant, and the facts would more likely indicate criminal prosecution.

113. *Id.* § 1.10.2.

114. In fact, BIS specifically notes such cases as being excellent candidates for concurrent administrative cases and criminal prosecution. Export Administration Regulations: Penalty Guidance in the Settlement of Administrative Enforcement Cases, 69 Fed. Reg. 7867 (Feb. 20, 2004) (to be codified at 15 C.F.R. pts. 764 and 766).

115. I assume here for the purpose of argument that the facts alleged at trial in *United States v. Arthur Andersen LLP*, No. H-02-121, 2002 U.S. Dist. LEXIS 26870 (S.D. Tex. May 24, 2002), are true despite the Supreme Court’s reversal for faulty jury instructions. *Arthur Andersen LLP v. United States*, 541 U.S. 696 (2005).

116. Compare such a case with the logic of *Burlington Industries Inc. v. Ellerth*: the two-prong test for a company to escape liability requires that the company has reporting procedures in place and that the plaintiff exhausted those procedures. The parallels to export controls are clear: use of compliance procedures has to be tempered by the extent to which failures within the organization are acted upon. 524 U.S. 742 (1998).

between corporate deterrence and individual action. But it does not account for the fact that the business can be making a rational export decision that simply fails to comply. A second view of corporate ethics failures can resolve some of the other tensions. An export offense might appear to be a purely rational decision. After all, the benefits of compliance with export controls accrue to society as a whole, while the costs of noncompliance are not fully internalized to the firm.¹¹⁷ Here the failure to comply can be seen as a failure to account for stakeholders whose daily influence is not felt in the corporation.¹¹⁸

In some ways, the export controls in the EAR are a way of internalizing the needs of particular discrete non-shareholder stakeholders—the United States government and society at large—into the decision-making process. Indeed, the influence and values of external stakeholders—those who have a vested interest in the activities of the corporation that transcends revenue, balance sheets, and profit—are a valid constraint on the performance of the company. The view of corporate violation as a failure to internalize the external stakeholders provides a counterpoint to the view of the offense as a failure to maximize performance. The common aspect of both, however, is the key role that the senior leadership plays in assembling the competing goals, creating the process that will turn goals into accomplishments, creating the institutional channels for feedback, and monitoring the system.

Compare, for example, the role that non-shareholder stakeholders play in *Shlensky v. Wrigley*.¹¹⁹ The plaintiff, a stockholder in the defendant baseball club, made a series of allegations in a shareholder derivative suit. Mr. Wrigley, despite shocking financial losses that were unrivalled in all of Major League Baseball, believed that “baseball is a ‘daytime sport’ and that the installation of lights and night baseball games [would] have a deteriorating effect upon the surrounding neighborhood.”¹²⁰ The complaint alleged that the failure to install lights in Wrigley Field was causing financial ruin. The evidence, as pleaded by the plaintiff, painted a bleak picture indeed for the Cubbies. Although White Sox attendance was the same for games during the weekend, White Sox attendance far exceeded Cubs attendance during the week, when the Cubs played during the day and the Sox played at night.¹²¹ The beleaguered Cubs even had to endure the fact that attendance at Cubs games on the road outpaced attendance at home.¹²² The solution, from a

117. Compare Khanna, *supra* note 44, with Gruner, *supra* note 109.

118. To clarify the distinction: a shareholder is a legal person who owns some fraction of the firm in question. By contrast, a stakeholder is any entity that has a significant interest in the actions of the firm. So although all shareholders can be presumed to be stakeholders, the latter category is significantly more expansive. Among the latter would be the government, the neighbors of the firm in question, customers, vendors, employees, alliances, and perhaps even competitor firms. See Fort, *supra* note 49.

119. 237 N.E.2d 776 (Ill. App. Ct. 1968).

120. *Id.* at 778.

121. *Id.*

122. *Id.*

financial perspective, was clear: lights and night games were the way of the future.¹²³ Mr. Wrigley, of course, would have none of it. And the court, in finding for the defendant, held that the obligation of the director to ensure financial returns for the shareholders was only one of many obligations: the obligation to the surrounding neighborhood might equally be in the interests of the corporation.¹²⁴

To reconcile the views of corporate culture, as expressed by BIS in its model Export Management System (EMS), with the views of corporate culture as a viable evaluation of culpability for the purposes of deterring export violations would require a renewed emphasis on leadership accountability. As noted above, the apparent tension between the corporation as rational actor and the corporation as a collection of potentially irrational individuals center around the leadership and accountability of executives. It is only through active involvement of senior leaders in preventing violations that a system of compliance as a defense to liability makes sense.¹²⁵

The distinction between a compliance *program* and a compliance *culture* resurfaces time and again, from *Burlington* to *Caremark* and at points in between. These distinctions are made clear in contrasting the view of executive leadership found in the EMS guidelines that BIS has published and the view of executive leadership found in the Nunn-Wolfowitz report. While both sources speak to the value, in fact the necessity, of leadership accountability, it is *Nunn-Wolfowitz* that suggests that the compliance committee report directly to the board of directors.¹²⁶ Not only does this approach speak to the concerns found in *Caremark*, but it also helps to bring into focus the obligations to stakeholders outside of the company.¹²⁷

Other distinctions between *Nunn-Wolfowitz* and EMS are subtle, but present. EMS stresses that managers should make a policy statement, preferably in writing.¹²⁸ The management should reiterate to employees, at least on an annual basis, that they are committed to export control compliance.¹²⁹ Contrast this with the language from *Nunn-Wolfowitz*: “[s]enior management must . . . place constant emphasis on . . . compliance and take every reasonably available opportunity to reiterate” this commitment.¹³⁰

123. *Id.*

124. *Id.* at 780–81.

125. By analogy: *Burlington v. Ellerth* does not stand for the proposition that any compliance system is a bar to liability, but that employers must show, as part of an affirmative defense, that they “exercised reasonable care to prevent and correct promptly” the offending behavior. 524 U.S. 742, 765 (1998).

126. NUNN-WOLFOWITZ, *supra* note 60, at 11.

127. *In re Caremark Int’l Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

128. BUREAU OF INDUS. & SEC., U.S. DEP’T OF COMMERCE, ELEMENT I: MANAGEMENT COMMITMENT POLICY, <http://www.bis.doc.gov/exportmanagementsystems/pdf/admin1.pdf>. (last visited May 12, 2006.)

129. *Id.*

130. NUNN-WOLFOWITZ, *supra* note 60, at 8.

A further example of the divide between the compliance culture as viewed by the EMS and by the *Nunn-Wolfowitz* best practices is in training. EMS recommends that the firm conduct export control training for all employees who will be involved in export-related functions.¹³¹ But *Nunn-Wolfowitz* goes further, encouraging a best practice that provides initial training and periodic reinforcement of the message to *all* employees, and then focuses the message on those employees involved in exporting.¹³² The best practices also go above and beyond the EMS with respect to the breadth and scope of desired training. *Nunn-Wolfowitz* makes the point of emphasizing periodic training even for the board of directors, including for a compliance committee thereof.¹³³ No parallel provision appears in the EMS.¹³⁴

What lessons are to be drawn from this quick survey of the role of the executive? One would be that Hughes Electronics, and their best practices task force, appear to have learned the lessons that were hard-learned by the other industries that came before. From sexual harassment and antitrust to accounting improprieties and social responsibility beyond the shareholder, corporate performance is maximized and violations minimized not merely when a compliance program is created, but also when a compliance culture is created. The executive embodies the point where the tension between the corporation as a legal person and the absence of traditional mens rea is focused. Although the executive has proven to occasionally be the source of violations, there are equally compelling examples where the executive built the necessary culture that prevented inadvertent violations of standards.

CONCLUSION

Export controls are complex rules that span multiple government agencies, have various competing objectives, and are found in numerous sources. Successfully navigating these regulations is made all the more difficult by the fact that companies are under an obligation to self-regulate. Fundamentally, it is the leadership that is responsible for creating a culture of compliance and ensuring that violations do not occur. When violations do happen, BIS is faced with the need to use postviolation enforcement to try to deter future offenses while still encouraging legitimate exports to fuel the U.S. economy.

The EAR enforcement provisions allow BIS to consider corporate compliance as an aggravating or mitigating factor once culpability is determined. In many respects, this is backwards. Understanding the role of corporate compliance culture is in fact a necessary prerequisite for determining the corporate "degree of willfulness." Even if this were not so,

131. BUREAU OF INDUS. & SEC., U.S. DEP'T OF COMMERCE, ELEMENT 4: TRAINING (2001), <http://www.bis.doc.gov/exportmanagementsystems/pdf/admin4.pdf> [hereinafter EMS ELEMENT 4].

132. NUNN-WOLFOWITZ, *supra* note 60, at 19–21.

133. *Id.* at 18.

134. EMS ELEMENT 4, *supra* note 131.

decades of experience with similar regulatory enforcement problems has shown repeatedly that it is the extent and effectiveness of compliance programs that bears most heavily on adequate deterrence.

The answer cannot stop at considering the existence and effectiveness of compliance programs. These complex questions of how and why companies act as they do cannot be reduced to such a simple model. But by bringing the individual into the equation, in the form of executive buy-in and culpability, BIS could start to resolve these tensions. The methods are effective in other areas of regulatory compliance, and could be applied in export controls as well.