

Insights

KEEPING UP WITH THE CHANGES: HAS YOUR COMPLIANCE PROGRAM BEEN ADAPTED TO ACCOUNT FOR RECENT CHANGES TO U.S. EXPORT CONTROLS? (PART 1)

Nov 03, 2020

While the pandemic has slowed down many things this year, it did not impede progress by the Department of Commerce's Bureau of Industry and Security ("BIS") in publishing various regulatory changes aimed at addressing national security concerns related to certain countries of interest, including China, Russia and Venezuela. With significant changes having been introduced this year, it is critical to ensure that your compliance program is keeping up with the changes.

1. Expansion of the military end-use/military end-user rule

As of June 29, 2020, BIS amended the military end-use/military end-user rule in § 744.21 of the Export Administration Regulations ("EAR") to cover additional items and expand the definition of military end-use for transactions destined to China, Russia, and Venezuela. In addition, the rule restricted transactions to China that are destined to military end-users, which restriction already existed with respect to transactions for Russia and Venezuela. Companies that engage in exports to China, Russia, or Venezuela should ensure that they have procedures in place to vet end-users and end-uses in connection with the export of any items covered by the rule. With the expansion of the definition of military end-use – and, in turn, the scope of the definition of military end-user – this vetting will likely require entities to conduct additional diligence related to exports covered by the rule, particularly when such exports involve parties included in the Section 1237 list published by the Department of Defense. Although the Section 1237 list, which specifies "Communist Chinese military companies" operating directly or indirectly in the United States, is not itself a legal determination that a particular entity is a "military end-user" for purposes of the rule, it is a red flag that additional diligence is warranted. Note also that this rule expanded the requirement for filing Electronic Export Information to all shipments destined to China, Russia, and Venezuela, except for transactions involving only items designated EAR99.

2. Expansion of the foreign direct product rule

Effective August 17, 2020, BIS again increased the scope of transactions that would be considered subject to the EAR pursuant to General Prohibition Three of the EAR (often referred to as the “foreign direct product” rule). The expansion of the foreign direct product rule is particular to certain transactions or activities involving Huawei Technologies Co., Ltd. (“Huawei”) and its affiliates that are listed on the Entity List (“Listed Affiliates”). In particular, a license is now required under the EAR in order to export, reexport, or transfer (in-country) goods, technology, or software to Huawei or a Listed Affiliate when the foreign-produced item is:

1. The direct product of “technology” or “software” subject to the EAR and specified in Export Control Classification Number (“ECCN”) 3D001, 3D991, 3E001, 3E002, 3E003, 3E991, 4D001, 4D993, 4D994, 4E001, 4E992, 4E993, 5D001, 5D991, 5E001 or 5E991 of the Commerce Control List (“CCL”); or
2. Produced in a plant outside the United States where “the plant or a major component of the plant, whether made in the US or a foreign country, itself is a direct product of US-origin ‘technology’ or ‘software’ subject to the EAR and specified in ECCN 3D001, 3D991, 3E001, 3E002, 3E003, 3E991, 4D001, 4D993, 4D994, 4E001, 4E992, 4E993, 5D001, 5D991, 5E001 or 5E991.” Footnote 1 in Supplement No. 4 to Part 744 of the EAR.

These restrictions apply to any transaction in which there is knowledge that:

- The foreign-produced item will be incorporated into, or will be used in the production or development of any part, component, or equipment produced, purchased, or ordered by Huawei or a Listed Affiliate; or
- Huawei or a Listed Affiliate is a party to any transaction involving the foreign-produced item (e.g., as a purchaser, intermediate consignee, ultimate consignee, or end-user).

It is important to note that an item will be considered the direct product of covered technology or software if it is produced in a plant outside the United States in which “the plant or a major component of the plant is a direct product of covered software or technology. Under the rule, a “major component of a plant located outside the United States” includes any equipment that is essential to the production of an item; this includes testing equipment. Moreover, foreign-produced items can include foreign-produced wafers, regardless of whether the wafer is finished or unfinished.

In order to ensure compliance with these changes, companies should ensure they are aware of all transactions that involve Huawei or any of the Listed Affiliates. Entities both in the United States and outside the United States should consider how their affiliates and business partners outside the United States might interact with Huawei or the Listed Affiliates, particularly to the extent the entity deals in any way with goods, software, or technology classified under Category 3, 4, or 5 of the CCL. In some cases, entities outside the United States may need more information from their equipment suppliers, for instance, to understand fully whether the equipment might be the direct

product of software or technology that is captured by this rule, such that anything produced using that equipment (whether goods, software, or technology) might itself be captured by this expanded foreign direct product rule if there is a nexus to Huawei or any of the Listed Affiliates in the transaction. Reviewing this information up front is key to mitigating the risks of compliance concerns as business proceeds, especially because a violation of these rules is likely to catch the attention of the enforcement teams given the national security concerns driving the changes in the first place.

3. Revision to the license review policy for exports of items controlled for National Security (NS) reasons to China, Russia, or Venezuela

BIS also revised its license review policy for items controlled for National Security (NS) reasons to China, Russia, and Venezuela in a final rule that became effective on October 29, 2020. Under the rule, BIS will consider whether an export, reexport, or in-country transfer of items controlled for NS reasons will make a material contribution to the weapons systems capability of China, Venezuela, or Russia. This determination will be based on several factors, including the following:

- appropriateness of the item for the stated end-use,
- the significance of the item to the weapons system capabilities of the importing country,
- whether a party is a military end-user,
- the reliability of the parties to the transaction,
- the involvement of any party to the transaction in military activities,
- government strategies and policies posing a risk of diversion to military end-use, and
- the effectiveness of export controls in the importing country.

In addition to this review, BIS will also consider the impact that the proposed activity would have on the US defense industrial base. Entities who engage in exports of items controlled for NS reasons to Russia, China, or Venezuela should ensure that they are addressing these considerations when preparing license applications for such exports.

RELATED CAPABILITIES

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MEET THE TEAM



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