Reuters Legal News

Restricting exports of sensitive technology to China

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OCTOBER 17, 2022

On Oct. 7, the U.S. Department of Commerce's Bureau of Industry and Security (BIS) issued an interim final rule aimed at restricting export of sensitive technology to the People's Republic of China (PRC), specifically with respect to advanced computing, supercomputing, and semiconductor capabilities.

This sweeping rule builds upon prior regulatory and enforcement actions implemented by the Administration over the past few months and is part of the overarching policy to address concerns stemming from the PRC's use of these particular technologies to the detriment of U.S. national security and foreign policy interests.

The multi-tiered interim rule implements a number of updates and additions to technology controls relating to China that will become effective in phases, with effective dates starting from Oct. 12, 2022, and going through Oct. 21, 2022.

Separately, BIS added new entities to the Unverified List and signaled potentially more aggressive use of the Entity List in the future. Those operating in the impacted computing sectors — or otherwise dealing in these technologies — are advised to implement adequate, risk-based compliance policies and procedures, particularly regarding end users and end uses, to comply with the new rule.

Below, we discuss the actions taken by BIS and offer related takeaways.

Interim rule relating to advanced computing and semiconductor manufacturing

The multi-tiered interim rule implements a number of updates and additions to technology controls relating to China that will become effective in phases, with effective dates starting from Oct. 12, 2022, and going through Oct. 21, 2022.

Additions to the Commerce Control List (CCL). The interim rule adds new export control classifications to the CCL in the Export Administration Regulations ("EAR") for certain (i) high performance computing chips and related computer commodities and (ii) semiconductor manufacturing equipment and related items. These additions to the CCL are effective on Oct. 21, 2022.

End-use restrictions. The interim rule imposes new license requirements for certain chips and computer commodities listed on the CCL for export to and from the PRC.

There will be a presumption of denial for most license applications relating to China, with limited exceptions for a case-by-case review (e.g., for companies headquartered in the U.S. with end users in China). In these cases, the interim rule indicates that BIS will take into account factors such as the end users' "technology level, customers, and compliance plans" in its assessment of the license application. The license requirements will take effect on Oct. 21, 2022.

U.S. person "support" restrictions. The interim rule also serves as a notice that activities by U.S. persons that "support" the "development" or "production" of integrated circuits (ICs) at Chinese semiconductor fabrication facilities could also trigger the need for an export license.

The term "support" is used broadly to include "shipping, transmitting or transferring (in-country) items," even though they are "not subject to the EAR," if the items meet specific technical parameters under the CCL or are being used to make particular types of ICs. License applications will be subject to a presumption of denial except for in limited cases.

Additionally, support by U.S. persons will trigger a license requirement if it pertains "to the provision of items used to produce the most advanced semiconductors for military programs of concern," even if U.S. persons are unable to determine the end use of the items. These restrictions are effective Oct. 12, 2022.

Updates to the Foreign Direct Product rule. The interim rule creates two new Foreign Direct Product (FDP) rules with respect to products in the advanced computing and supercomputing spaces. The rules stipulate that if a foreign item meets specific product and destination scope tests as set forth in detail in the interim rule (https://bit.ly/3RZcqGl), the items will be "subject to the EAR" and any associated licensing requirements.

For example, if foreign-made items are specified under Export Control Classification Numbers ("ECCNs") related to advanced computing and are the direct product of software or technology subject to the EAR and listed under particular ECCNs, and the foreign product is destined to China, the rule will be triggered.

Similarly, if a foreign-made item is the direct product of software or technology subject to the EAR and listed under particular ECCNs, and the foreign-made product will be used for certain supercomputer uses in China, the rule will also be triggered. Notably, these new FDP rules apply to all Chinese entities, not just those on the Entity List. These rules are effective Oct. 21, 2022.

Companies operating in or with a nexus to advanced computing, supercomputing, and semiconductors, should carefully review the new rule and establish procedures to flag any possible direct or indirect dealings in or with China.

Additionally, the interim rule revises the already implemented Entity List FDP Rule. The revision does not alter the scope or requirements of the existing rule; however, it expands the rule to cover additional products for 28 Chinese entities that were included on the Entity List. The revision to the Entity List FDP rule is effective Oct. 21, 2022.

Temporary General License. In an effort to mitigate disruptions to semiconductor supply chains, BIS implemented a Temporary General License (TGL) from Oct. 21, 2022, through April 7, 2023. This allows certain companies to continue specific manufacturing activities in the PRC for items covered by the new and revised ECCNs not ultimately destined for the PRC.

Updates to the Unverified List

In a separate notice announced by BIS on Oct. 7, BIS designated an additional 31 Chinese entities on the Unverified List (the UVL) (https://bit.ly/3evbsnM) and removed nine previously designated Chinese entities from the UVL, effective immediately. Entities are moved onto the UVL because the agency is unable to verify the entities' "legitimacy and reliability relating to the end use and end user of items subject to the EAR." Consequently, UVL entities are not eligible for license exemptions under the EAR.

In addition to the UVL, BIS utilizes the more restrictive Entity List. Entities on this list have been deemed by the agency to have engaged in activities that oppose U.S. national security or foreign policy. They are subject to additional individual licensing requirements.

In the recent notice, BIS expanded upon the criteria used to determine whether an entity will be added to BIS' Entity List, such as "sustained lack of cooperation by the host government," indicating the initial UVL designations are the first step in BIS potentially implementing more strict export restrictions with respect to UVL designated entities. The updates to the UVL are effective on Oct. 7, 2022.

Key takeaways

- Companies operating in or with a nexus to advanced computing, supercomputing, and semiconductors, should carefully review the new rule and establish procedures to flag any possible direct or indirect dealings in or with China. In particular, companies should ensure they have visibility into final end users and end uses of their products.
- The rule seeks to expand BIS' jurisdiction to non-U.S. companies, particularly through the new foreign direct product rules. Companies manufacturing wholly or in part outside of the U.S. will not be immune to these restrictions.
- BIS continues to expand its restrictions on U.S. person "support" of certain activities that potentially harm national security, even when no items "subject to the EAR" are involved. This also reflects Commerce's broad application of its authorities to try and reach activity that does not neatly fall within export licensing.
- The interim rule follows the recent passage of the CHIPS and Science Act of 2022, which authorized $52 billion in funding and additional tax credits for semiconductor manufacturing and research. While the passage of the bill is a significant step forward in addressing the chip shortage, the interim rule serves as a complementary tool and signal to China that as the U.S. boosts its competitiveness and domestic manufacturing capabilities, it will also continue to crack down on unfettered technology transfer to China.
- Enforcement of these rules will likely be strict due to the heightened prevalence and the threat China presents to U.S. national security and foreign policy through its use of advanced technology, including supercomputing, semiconductor production and AI to enhance and modernize its military.
- The interim rule effectively broadens the reach of the Committee on Foreign Investment in the United States (CFIUS) through the addition of new CCL entries. The new CCL entries, certain of which are controlled for "regional stability," expand CFIUS' jurisdiction to cover a wider range of companies engaged in the production, design, testing, manufacture, fabrication, or development of the newly controlled items and technology.

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This article was first published on Reuters Legal News and Westlaw Today on October 17, 2022.