International Trade Alert

Akin Gump
STRAUSS HAUER & FELD LLP

US Government Clarifies, Reorganizes and Renames Descriptions of How Foreign-Produced Items Outside the United States Are Subject to US Export Controls as the US Contemplates New Restrictions on Russia

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Key Points

- The U.S. Department of Commerce has reorganized and clarified the regulations describing when foreign-produced items outside the United States are and are not subject to the licensing and other obligations of the EAR.
- The rule does not change the control text of the four different "foreign direct product" rules that were in various parts of the EAR before the amendment and that were not separately named. The clarity that comes from the reorganization and the new use of definitions pertaining to production equipment might, however, warrant reconsideration of earlier determinations about whether specific foreign-produced items are or are not subject to the EAR.
- From a regulatory drafting perspective, the reorganization sets the stage for easier extensions of these extraterritorial foreign direct product rules to sectors of the Russian economy as part of the possible broader sanctions package against Russia the Biden-Harris administration has forecast. Thus, the new rule (and this alert) may provide a useful guide for those wanting to prepare for or assess the scope and implications of such actions.
- The rule does not change or comment on the other three ways in which an item is subject to the EAR, i.e., if it is (i) U.S.-origin, wherever located; (ii) exported from or through the United States, regardless of where it was made; or (iii) foreign-origin and containing more than a "de minimis" amount of "controlled" U.S.-origin content. Nonetheless, those analyzing or preparing for new Russia-specific export controls should also review these rules against the items of interest to determine which ones that do not now require a license for export or reexport to Russia would require one if BIS moves Russia to the EAR's Country Group E along with Iran, North Korea, Cuba and Syria.

Contact Information

If you have any questions concerning this alert, please contact:

Kevin J. Wolf
Partner
kwolf@akingump.com
Washington, D.C.
+1 202.887.4051

Shiva Aminian
Partner
saminian@akingump.com
Los Angeles
+1 310.552.6476

Anne E. Borkovic
Partner
aborkovic@akingump.com
Washington, D.C.
+1 202.887.4432

Mahmoud (Mac) Fadlallah
Partner
mfadlallah@akingump.com
Dubai
+971 4.317.3030

Jaelyn Edwards Judelson
Partner
jjudelson@akingump.com
Los Angeles
+1 310.552.6477

Thomas J. McCarthy
Partner
tmccarthy@akingump.com
Washington, D.C.
+1 202.887.4047

Kimberly M. Myers
Partner
kmyers@akingump.com
Washington, D.C.
+1 202.887.4423

I. BIS has Clarified, Reorganized and Renamed the EAR's Four "Foreign Direct Product Rules"

On February 3, 2022, the Commerce Department's Bureau of Industry and Security (BIS) amended the Export Administration Regulations (EAR) to clarify, reorganize and rename the descriptions of the four ways in which a commodity, software or technology produced outside the United States from or with the use of specific types of U.S.-origin or foreign-origin equipment, software or technology is "subject to the EAR." The EAR use the term "subject to the EAR" to identify the U.S.-origin and foreign-origin commodities, software and technologies ("items") that are subject to the EAR's jurisdiction. An item that is not "subject to the EAR" is not subject to the EAR's licensing, recordkeeping or other obligations.

In essence, BIS has divided the foreign direct product rule into four different direct product rules and has consolidated them in a re-purposed EAR section 734.9:

- **National Security FDP Rule**: The original foreign direct product rule was created in May 1959. It evolved slightly over the decades and was set into its recent form in April 1996. It is now in section 734.9(b) and called the "National Security FDP rule." It essentially applies to dual-use items the EAR control on the Commerce Control List (CCL) for "national security" reasons, which are largely the items on the Wassenaar Arrangement's dual-use list.
- **9x515 FDP Rule**: The foreign direct product rule created in November 2014 to control specific foreign-produced commercial satellite- and space-related items is now in section 734.9(c) and called the "9x515 FDP rule." "9x515" is a reference to the Export Control Classification Numbers (ECCNs) for such items on the CCL.
- **"600 Series" FDP Rule**: The foreign direct product rule created in October 2013 to control specific foreign-produced military items is now in section 734.9(d) and called the "'600 series' FDP rule." "600 series" is a reference to ECCNs describing military items on the CCL.
- **Entity List FDP Rule**: The foreign direct product rule created in August 2020 to control reexports and transfers of foreign-produced items when a Huawei-related company is involved is now in section 734.9(e) and called the "Entity List FDP rule." From a drafting perspective, the rule could be applied to other entities on, or that would be added to, the Entity List by amending the "license review policy" entry associated with such entities on the list.

II. BIS Did Not Change the Other Three Ways in Which an Item is "Subject to the EAR"

BIS did not change or comment on the other three ways in which a commodity, software or technology not subject to the jurisdiction of another set of regulations, such as the International Traffic in Arms Regulations (ITAR), is "subject to the EAR." In essence, an item is "subject to the EAR" under one of these three rules if it is:

I. in, or moving through, the United States (734.3(a)(1));

II. U.S.-origin, regardless of location (§ 734.3(a)(2)); or

III. foreign-made and contains more than a "de minimis" amount of "controlled" U.S.-origin content (§ 734.3(a)(3)).

Tatman R. Savio
Registered Foregin Lawyer
tatman.savio@akingump.com
Hong Kong
+852 3694.3015

Elyse B. Martin
Senior Counsel
elyse.martin@akingump.com
Houston
+1 713.250.2255

George E. Pence
Senior Counsel
gpence@akingump.com
Los Angeles
+1 310.552.6475

Chris Chamberlain
Counsel
cchamberlain@akingump.com
Washington, D.C.
+1 202.887.4308

Jingli Jiang
Counsel
jjiang@akingump.com
Beijing
+86 10.8567.2229

Andrew R. Schlossberg
Counsel
aschlossberg@akingump.com
Washington, D.C.
+1 202.887.4314

The "de minimis rule" is complicated and has slightly different requirements depending upon (i) whether the foreign-made item at issue is a commodity, software or technology; (ii) the classification status of the U.S.-origin content and the foreign-made item and (iii) whether they require a license under EAR Part 738 (the Country Chart) to be shipped to the destination at issue. BIS has training materials, guidance, decision trees and flow charts of the rule on its website.

The four foreign direct product rules are different from the de minimis rule because they can subject a foreign-produced item outside the United States to the EAR's jurisdiction even if the foreign-produced item has no U.S.-origin components, software or technology incorporated, bundled or commingled into it. Where the primary extraterritorial jurisdictional hook of sanctions regulations is the U.S. dollar, the extraterritorial jurisdictional hook of the foreign direct product rules is equipment, software, and technology that is U.S.-origin or otherwise subject to the EAR.

III. The "National Security FDP Rule" Applies to Foreign-Produced Items Controlled for "National Security" Reasons Described on the EAR's CCL

A foreign-produced item is "subject to the EAR" under the National Security FDP rule if:

I. it is a type of item controlled for "national security" reasons on the CCL;

II. it is destined to a country in the EAR's Country Groups D:1 or E;

III. it is the "direct product" of:

   A. U.S.-origin technology or software that is controlled for "national security" reasons, or

   B. a complete plant or "major component" of a plant that itself is the "direct product" of technology controlled for "national security" reasons; **and**

IV. such technology or software requires a written assurance if exported under a license or License Exception TSR.

The application of this fourth prong is complicated. Its structure is a holdover from the Cold War-era EAR, which were organized differently than the current EAR. As a result, there is a difference of opinion among practitioners about whether it applies to items produced from U.S.-origin "national security"-controlled technology or software in countries where a license is not required to export such technology or software. Such countries are Canada and, with respect to the (very few types of) National Security Column 2 software and technology, countries in Country Group A:1.

IV. The "9x515 FDP Rule" Applies to Foreign-Produced Satellite- and Space-Related Items that are Described on the EAR's CCL

A foreign-produced item is subject to the EAR under the 9x515 FDP rule if it is:

I. specified in a 9x515 ECCN, which are the ECCNs that described dual-use and commercial satellites, and other space-related commodities, technology and software;

II. destined to a country listed in Country Groups D:5 or E; **and**

III. the “direct product” of either:

A. U.S.-origin software or technology that is specified in ECCNs 9D515 or 9E515; **or**

B. “direct product” of a complete plant or any “major component” of a plant that itself is the “direct product” of U.S.-origin “technology” specified in ECCN 9E515.

China is in Country Group D:5 because it is subject to an arms embargo. Russia is effectively in Country Group D:5 because of its inclusion in the ITAR’s list of proscribed countries.

V. The “‘600 Series’ FDP Rule” Applies to Foreign-Produced Military Items Described on the EAR’s CCL

A foreign-produced item is subject to the EAR under the “600 series” FDP rule if it is:

I. specified in a “600 series” ECCN or ECCN 0A919;

II. destined to a country in Country Groups D:1, D:3, D:4, D:5, or E; **and**

III. the “direct product” of either:

A. U.S.-origin technology or software that is specified in a “600 series” ECCN; **or**

B. a complete plant or “major component” of a plant that itself is the “direct product” of U.S.-origin technology that is specified in a “600 series” ECCN.

“600 series” items are military items that are not described on the ITAR’s U.S. Munitions List. ECCN 0A919 items are military commodities produced or located outside the U.S. that are not subject to the ITAR and (i) incorporate more than a de minimis amount of certain types of components used in night vision and similar products described in ECCNs 6A002, 6A003 or 6A993.a; (ii) incorporate more than a de minimis amount of U.S.-origin controlled content; or (ii) are the “direct product” of U.S.-origin “600 series” technology or software.

VI. The “Entity List FDP Rule” Applies to Foreign-Produced Items that Are Not Necessarily Described on the EAR’s CCL or Subject to Any Other Country’s Export Controls if Produced With Specific Types of U.S.- or Foreign-Origin Software, Technology or Equipment

A foreign-produced item outside the United States is subject to the EAR under the Entity List FDP rule if:

I. It is either:

A. the “direct product” of technology or software subject to the EAR and specified in ECCNs 3D001, 3D991, 3E001, 3E002, 3E003, 3E991, 4D001, 4D993, 4D994, 4E001, 4E992, 4E993, 5D001, 5D991, 5E001 or 5E991 of the CCL; **or**

B. produced by any plant, or “major component” of a plant outside the United States, when the plant or “major component,” whether made in the United

States or a foreign country, itself is a “direct product” of technology or software subject to the EAR that is specified in ECCNs 3D001, 3D991, 3E001, 3E002, 3E003, 3E991, 4D001, 4D993, 4D994, 4E001, 4E992, 4E993, 5D001, 5D991, 5E001 or 5E991 of the CCL; **and**

II. there is “knowledge” that:

A. 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 a Huawei-related entity designated on the Entity List; **or**

B. a Huawei-related entity on the Entity List is a party to any transaction involving the foreign-produced item.

The Entity List FDP rule does not refer to Huawei by name. Rather, it refers to “Footnote 1 designated entities” as the entities affected by the rule. This is a reference to footnote 1 of the Entity List. The only such entities now designated are those related to Huawei. Whether additional entities will be designated as Footnote 1 entities, as part of a Russia sanctions package or otherwise, is unknown.

The referenced ECCNs are those in the CCL Categories that describe electronics, including semiconductor-related items (Category 3), computers (Category 4) and telecommunications items (Category 5) that are either (i) dual-use items described on the Wassenaar Arrangement’s dual-use list that are controlled for “National Security” reasons (the ECCNs with a “0”) or (ii) items the U.S. unilaterally controls for “Anti-Terrorism” (AT) reasons only (the ECCNs with a “9”). This latter point means the types of foreign-produced items that could be controlled by this rule are far broader in scope than the types of items any other country regulates under its export controls.

Moreover, BIS has confirmed that this rule also controls foreign-produced consumer and other basic items that would be EAR99 items (i.e., not described on the CCL) if “produced by” covered equipment, which includes merely testing the foreign-made item with covered equipment. As noted in the rule, such covered equipment can be wholly foreign produced if produced directly from technology or software subject to the EAR. This means, for example, that a consumer item not subject to any country’s export control laws outside the United States that does not contain any U.S.-origin content and that is wholly foreign-made from wholly foreign-origin designs created by non-U.S. persons working for a non-U.S. company using only foreign-produced equipment and technology can still be subject to the EAR (and its licensing requirements) if (i) such equipment was produced directly from technology or software subject to the EAR and described in one of the ECCNs and (ii) there is knowledge that a Huawei company is involved in a transaction involving the foreign-produced item.

Analyses of all the different ways that a foreign-produced item is or is not subject to the EAR under the Entity List FDP rule is intensely fact-specific and beyond the scope of this alert. BIS has, however, published FAQs (and answers) about the scope and application of the Entity List FDP rule. BIS amended these FAQs in October 2021 to state that failure by a foreign buyer/manufacturer (or a third party at the buyer’s direction) to either (i) confirm that its component supplier had obtained a license for the shipment of a component subject to the EAR under this rule; or (ii) obtained a license for the shipment of such component from the component supplier to the

buyer/manufacturer "implicates General Prohibition 10" when a Huawei company would be involved, directly or indirectly.

BIS further wrote that:

> General Prohibition 10 prohibits proceeding with transactions with knowledge that a violation has occurred or is about to occur. See 15 C.F.R. §§ 736.2(b)(10) and 764.2(e). Specifically, absent an applicable license, [the foreign company] or its subcontractors "may not sell, transfer, export, reexport, finance, order, buy, remove, conceal, store, use, loan, dispose of, transport, forward, or otherwise service, in whole or in part" the components for incorporation into or use in the "production" or "development" of any "part," "component," or "equipment" produced, purchased, or ordered by [a designated Huawei company] entity or where a [designated Huawei company] is a party to the transaction without authorization. See §§ 736.2(b)(10) and 764.2(e) of the EAR.

VII. Key Definitions

To understand the scope of the foreign direct product rules, one must understand and apply the EAR's definitions of their key terms, particularly the following:

- **"Direct Product."** The EAR define "direct product" as the "immediate product (including processes and services) produced directly by the use of technology or software." The EAR do not define when an item is the "direct product" of a "complete plant" or a "major component." As a logical and definitional matter, a foreign-produced item that is the indirect product of U.S.-origin technology or software—such as when there is intermediate foreign-origin technology or software not subject to the EAR used to produce the item—would not be the "direct product" of U.S. technology or software. Any final answers in this regard, however, are intensely fact-specific and may warrant the advice of counsel or clarification from BIS in a commodity classification determination or in an advisory opinion.
- **"Major Component."** Although versions of the foreign direct product rules using this term have been in the EAR since 1964, BIS only defined it and applied it to all foreign direct product rules in the amendment. The term now means "'equipment' that is essential to the 'production' of an item, including testing 'equipment.'" BIS also reminded readers of its position that "any equipment that is involved in any of the production states is considered *essential*." Thus, if a company internally defined the previously undefined term in a way that is different than how it is now defined in the EAR, it may want to reconsider its past definitions and re-evaluate the new definition's impact on the jurisdictional status of items produced with such equipment.

To help with such efforts, the EAR define "**equipment**" as "a combination of parts, components, accessories, attachments, firmware, or software that operate together to perform a function of, as, or for an end item or system. Equipment may be a subset of "end items" based on the characteristics of the equipment. Equipment that meets the definition of an end- item is an end-item. Equipment that does not meet the definition of an end-item is a part, component, accessory, attachment, firmware, or software." The EAR define "**production**" as meaning "all production stages, such as: product engineering, manufacture, integration, assembly (mounting), inspection, testing, quality assurance."

- **"Knowledge."** The EAR define "knowledge" as being "knowledge of a circumstance" and "includes not only positive knowledge that the circumstance exists or is substantially certain to occur, but also an awareness of a high probability of its existence or future occurrence. Such awareness is inferred from evidence of the conscious disregard of facts known to a person and is also inferred from a person's willful avoidance of facts."
  - BIS's "Know Your Customer" Guidance states that one should take into account "red flags" during transactions, which are "abnormal circumstances" "that indicate that the export may be destined for an inappropriate end-use, end-user, or destination." According to the Guidance, self-blinding or proceeding with a transaction without resolving "red flags" creates a "risk of having had 'knowledge' that would make your action a violation of the EAR."
- **"Foreign-Produced."** Unlike rules of origin in Customs regulations, the EAR do not define "foreign-produced," "foreign-origin," "foreign-made," "U.S.-origin" or similar phrases. BIS's online decision tree tool for analyzing the de minimis and direct product rule, however, defines a "non-U.S.-made item" as "an item produced outside the United States." The online decision tree defines a "U.S. origin" item more broadly as an "item produced, refurbished, assembled, or upgraded in the United States."

VIII. Licensing Requirements and Policies for Foreign-Produced Items Subject to the EAR under a Foreign Direct Product Rule

Whether the reexport or transfer outside the United States of a foreign-produced item subject to the EAR under one of the four foreign direct product rules requires a license or the use of a license exception depends upon the type of item involved, the end use, the end user, the destination and the other parties involved in the transaction. The regulations that must be reviewed to make such a determination are set out in EAR Parts 736, 740, 742, 744, 746 and 764.

A. License Requirements and Policies for Foreign-Produced Items Subject to the EAR Under the National Security, 9x515 and 600 Series FDP Rules

The EAR require a license to export, reexport and transfer National Security Column 1 items to all countries except Canada, unless a license exception is available. National Security Column 2 items may be exported without a license to countries in Country Group A:1, but otherwise require a license or use of a license exception.

When Entity List or other proscribed entities or end uses are not involved in a transaction, the license policy for items subject to the EAR under an FDP rule or other jurisdictional rule that are "national security"-controlled items is in EAR section 742.4(b). In essence, applications to export or reexport 9x515 (space-related) and "600 series" (military) items to China, Russia and other D:5 countries will be reviewed based on the licensing policies in the ITAR, which, for most countries, results in a denial. Applications for other types of "national security"-controlled items to other countries will generally be approved, unless there is a significant risk they will be diverted to a D:1 country. Applications to export or reexport "national security"-controlled items to a D:1 country will be evaluated on a case-by-case basis regarding whether they would be for civil uses or "would otherwise not make a significant contribution to the military potential of the country of destination that would prove detrimental to the national security of the United States."

B. License Requirements and Policies for Items Subject to the EAR under the Entity List FDP Rule

The Entity List FDP rule does not apply to transactions with entities on the Entity List that are not related to a Huawei company. Rather, if an item is subject to the EAR for reasons other than the Entity List FDP rule (such as by being U.S.-origin or as a result of the de minimis rule), then a license is required, to the extent specified on the Entity List, to export, reexport or transfer the item to the listed entity or to anyone else if the listed entity is a "party to the transaction." The EAR specifically limit the meaning of "party to the transaction" in this context to situations when the listed entity is the purchaser, intermediate consignee, ultimate consignee or end user.

If, however, a foreign-produced item is subject to the EAR only because of the Entity List FDP rule, then a license is required to reexport or transfer it to a listed Huawei entity or anyone else if a listed Huawei entity is a purchaser, intermediate consignee, ultimate consignee, end user **or any other type** of party to the transaction. The reason for the difference is the Entity List FDP rule uses an "e.g." before the reference to these four types of parties to a transaction. The traditional Entity List rule, however, specifically limits the term to these four types of parties to a transaction. BIS has not defined when a Huawei-related entity can be a party to a transaction when it is not the purchaser, end user, intermediate consignee or ultimate consignee. Analysis of such issues is, therefore, complicated.

Although the licensing policy for exports, reexports and transfers involving most of the 1600+ entities on the Entity List is one of presumptive denial, there are complex licensing policies for transactions involving Huawei-related entities and completely different licensing policies for transactions involving entities related to Semiconductor Manufacturing International Corporation. Analyzing the scope and practice of such policies is beyond the scope of this notice, other than to comment that they are complex and novel.

VIII. BIS's Amendment Can Be a Guide for Analyses of the Scope and Impact of Possible New Controls Against Russia

A. Analyzing Possible New Controls if the Entity List FDP Rule Were Applied to Russia or Russian Entities

Although the Entity List FDP rule is now limited in scope to transactions involving designated Huawei companies, directly or indirectly, the Biden-Harris administration has said that it is considering applying a similar FDP rule to sectors of the Russian economy or specific entities in Russia if Russia furthers its current invasion of Ukraine. Thus, understanding the scope of the Entity List FDP rule can be useful for those preparing or analyzing the impact of a possible fifth type of FDP rule directed against specific Russian economic sectors or specific Russian entities. Questions one could ask to prepare for such new controls include:

- Which foreign-produced products of concern are the "direct product" of software or technology subject to the EAR and described in relevant ECCNs in CCL Categories 3, 4 or 5?
- Which foreign-produced products are produced by equipment that is a direct product of technology or software subject to the EAR described in the relevant ECCNs in Categories 3, 4 or 5?

- Which such products are shipped to Russia or specific Russian sectors of interest, such as the aerospace, maritime technology, oil and gas, or military sectors?

B. Analyzing Possible Changes to Russia-Related Export Controls in Light of the Other Ways in Which an Item is Subject to the EAR

Although BIS's amendment did not refer to the other ways in which an item is subject to the EAR, the amendment provides a good reminder of issues to consider when conducting such analyses. For example, the de minimis amount for reexports from outside the United States of foreign-produced items containing satellite-related or military items subject to the EAR if destined to China, Russia or other countries of concern is zero percent. In other words, even one U.S.-origin 9x515 or "600 series" item in a foreign-produced item causes the entire item to become subject to the EAR's licensing requirements if destined to such countries. Nothing about any new export controls against Russia would change this rule because it is already so strict.

The de minimis amount for most other items involving Russia, however, is now generally 25 percent. This means that if a foreign-produced item contains more than 25 percent U.S.-origin content that would be controlled if shipped to Russia separately, and the foreign-produced item is itself of a type that would require a license if shipped from the United States, then a license is required to ship the item to Russia under current rules. With respect to shipments of foreign-produced items to Russia, "controlled" content now does not include U.S.-origin content that is controlled for Anti-Terrorism reasons only.

If, however, Russia is moved to the EAR's Country Group E from its current place in Country Group D, then the rules on what is "controlled" content change to include all items described on the CCL, including those controlled for Anti-Terrorism reasons only. In addition, the de minimis amount for shipments of foreign-produced items destined to Russia would drop to 10 percent, which is the rule now for Country Group E countries, i.e., Cuba, Iran, North Korea and Syria. Also, before sending any foreign-origin technology commingled with any U.S.-origin technology controlled for Anti-Terrorism only reasons, the foreign party would need to submit to BIS a "one-time" report explaining its de minimis analysis and wait 30 days for BIS to respond before reexporting the technology to Russia.

There are many existing and novel export controls pertaining to Russia, such as those involving exports of specific items that (i) would be used in exploration for, or the production of, oil or gas in Russian deepwater locations, Arctic offshore locations or shale formations, (ii) are for military end use, military end uses, military-intelligence end uses or military-intelligence end uses or (iii) involve specific types of microprocessors and associated software and technology. Moving Russia to Country E, however, would impose license requirements on shipments of otherwise uncontrolled items to Russia from the United States, or from abroad of U.S.-origin items, if the items are controlled for Anti-Terrorism reasons only.

Also, unless BIS were to change its traditional approach to deemed exports, moving Russia to Country Group E would also impose deemed export and deemed reexport license requirements on the release in the United States and outside the United States to Russian nationals of Anti-Terrorism-only technology or source code subject to the EAR. The scope of the technology subject to Anti-Terrorism-only reasons is quite broad and includes many types of basic semiconductor, computer,

telecommunications, consumer electronic, maritime, and civil aircraft and aircraft engine technology.

Questions one could ask to prepare for such new controls include:

- Which foreign-produced items of interest incorporate U.S.-origin components or are bundled with U.S.-origin software? For such items, what is their classification status on the CCL? If controlled for Anti-Terrorism or other reasons, is their value more than 10 percent the value of the foreign-made item?
- Which foreign-produced technologies commingle U.S.-origin technologies? What is the classification status of such U.S. technologies? Is their value more than 10 percent the value of the foreign-made technology? How can one calculate the value of such U.S.-origin content?
- Which items are shipped from the United States, or are U.S.-origin items shipped from abroad, to Russia that are controlled for Anti-Terrorism only? Which ones are EAR99 items?
- Which specific Russians in the United States or abroad, even if working for non-Russian companies, now receive or would need to receive technology or source code subject to the EAR that is controlled for Anti-Terrorism or other reasons only?

Conclusion

There are now seven ways in which a commodity, software or technology is "subject to the EAR"—being (i) U.S. origin; (ii) shipped from the United States; (iii) foreign origin and containing more than a de minimis amount of controlled U.S.-origin content; (iv) foreign produced and subject to the National Security FDP rule; (v) foreign produced and subject to the 9x515 FDP rule; (vi) foreign produced and subject to the "600 series" FDP rule; and (vii) foreign produced and subject to the Entity List FDP rule. None of the seven rules is affected by the nationality of the person or the company exporting, reexporting or transferring the item at issue. Whether a license or use of a license exception is required to export such items from the United States, reexport such items from one third country to another, or transfer them within a foreign country is a separate question.

The combination of complex jurisdictional rules over foreign-produced items outside the United States with equally complex licensing, and license exception, requirements and policies makes compliance with the EAR difficult. Small changes in facts can result in significantly different conclusions. For this and other reasons, the summaries in this alert are not a substitute for legal advice based on a complete set of facts. Nonetheless, this alert attempts to describe the rules more simply than in the EAR, and with commentary to help with a general understanding of the issues and questions to ask to help ensure compliance.

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