

Commerce Department Extends Export Controls over Foreign-Made Items in Huawei's Contract Manufacturing Supply Chain

May 19, 2020

Key Points

- The U.S. Department of Commerce has published a highly complex and novel **interim final rule** extending the controls of the Export Administration Regulations (EAR) over foreign-made items in Huawei's contract manufacturing supply chain. The rule has two main paragraphs—(a) and (b).
- Under paragraph (a) of the interim final rule, foreign-made commodities, software, and technology that are not otherwise subject to U.S. export controls require a license to be shipped from outside the United States if they are known to be destined to Huawei or its designated affiliates when the items are: (1) produced or developed by Huawei or its designated affiliates; **and** (2) are the direct product of specific types of electronics (including semiconductor), computer, and telecommunications technology or software subject to the EAR.
- Under paragraph (b) of the interim final rule, foreign-made commodities, software, and technology that are not otherwise subject to U.S. export controls require a license to be shipped from outside the United States if they are known to be destined to Huawei or its designated affiliates when the items are: (1) produced from equipment that is the direct product of specific types of U.S.-origin technology or software; **and** (2) the direct product of software or technology produced or developed by Huawei or one its designated affiliates.
- These changes are described in a footnote to a revised list of Huawei-affiliated entities in China and other countries that are on the EAR's Entity List.
- The "interim final rule" published in the Federal Register on May 19, 2020, but Commerce stated that it was effective on May 15, 2020. The public may submit comments on its impact by July 14, 2020.
- Commerce announced on the same day that the Temporary General License authorizing specific types of transactions involving the listed Huawei entities has been extended to August 13, 2020.

Background to the Foreign Direct Product Rule

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For several decades, the Export Administration Regulations (EAR) have subjected foreign-made items outside the United States to their controls if the foreign-made items (i) contain more than a *de minimis* amount of “controlled” U.S.-origin content or (ii) are the “direct product” of technology or software controlled on the EAR’s Commerce Control List (CCL) for “national security” reasons. This latter control is known as the “foreign direct product rule” and is described primarily in the EAR’s General Prohibition 3. (U.S.-origin items, wherever located, and items in the United States are generally subject to the EAR.)

Expansion of the Foreign Direct Product Rule

The “**interim final rule**” amends the foreign direct product rule so that two types of foreign-made items outside the United States are subject to the EAR “when there is ‘knowledge’” they are “destined to” Huawei or a designated affiliate. The list of designated Huawei and affiliated entities, including HiSilicon entities, is lengthy, has been updated from previously published lists, and is not limited to companies in China. The changes are described in a footnote to the Entity List.

One of the new controls (paragraph (a)) applies to foreign-made items that are the “direct product” of specific types of **technology or software** subject to the EAR. The second of the new controls (paragraph (b)) applies to foreign-made items produced from **equipment** that is the “direct product” of specific types of technology or software that is U.S. origin.

Paragraph (a) Prohibition -- Foreign-Made Items that are the Direct Product of Technology or Software Subject to the EAR

Paragraph (a) of the amendment prohibits without a license shipments or transfers from outside the United States of any foreign-produced commodity, software, or technology:

- That “is produced or developed by” Huawei or its designated affiliates;
- That is the “direct product” of technology or software subject to the EAR and identified in many of the Commerce Control List’s entries describing technologies and software required for the production or development of many types of electronics (including semiconductors) (Category 3), computers (Category 4), and telecommunications equipment (Category 5); and
- When “there is ‘knowledge’” that the foreign-produced item is “destined to” Huawei or a designated affiliate.

In other words, to comply with this part of the new rule, those that ship or transfer foreign-made commodities, software, or technology outside the United States with “knowledge” they are destined to a designated Huawei entity will need to determine whether the items:

- Were “produced or developed” by a listed Huawei entity; and
- Are the “direct product” of software or technology subject to the EAR that is described in the referenced entries in Categories 3, 4, or 5 of the EAR’s Commerce Control List.

Paragraph (b) Prohibition -- Foreign-Made Items Produced from Equipment that is the Direct Product of U.S.-Origin Technology or Software

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Paragraph (b) of the amendment prohibits without a license shipments or transfers from outside the United States of any foreign-produced commodity, software, or technology:

- When “there is ‘knowledge’” the items are destined to Huawei or a designated affiliate;
- The items are produced from equipment that is the direct product of specific types of U.S.-origin electronics, including semiconductor, computer, or telecommunications technology or software listed in CCL Categories 3, 4, or 5, respectively, “that is essential to the ‘production’” of the item to be shipped “to meet the specifications of a” Huawei company design; and
- The items to be shipped are the “direct product” of software or technology “produced or developed by” Huawei or one its designated affiliates.

EAR Definitions and References

The amendment is novel because it applies the EAR’s licensing jurisdiction to foreign-made items outside the United States only if they are destined to specific companies and produced or developed by specific companies. The amendment is also complex because it contains many references to existing EAR terms and provisions. For example:

- The EAR defines the term “direct product” to mean “**the immediate product** (including processes and services) produced directly by the use of technology or software.”¹
- The EAR defines the term “knowledge” to include “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.”²
- The Commerce Control List references to technologies and software subject the EAR that are relevant to an analysis of whether a foreign-made item is controlled by the new rule are Export Control Classification Numbers (ECCNs) 3E001, 3E002, 3E003, 4E001, 5E001, 3D001, 4D001, 3E991, 4E992, 4E993, 5E991, 3D991, 4D993, 4D994, and 5D991. These ECCNs describe many types of technologies and software required to develop or produce a wide range of items related to semiconductors and other types of electronics, computers, and telecommunications equipment.³ Some of the entries describe items controlled by the United States and its export control regime allies. The remaining entries—those with “99” in the number—are controlled only by the United States.

Effective Dates

The rule was published in the Federal Register on May 19, 2020. Commerce wrote that the rule went into effect on May 15, 2020. Commerce will accept comments on its impact until July 14, 2020. The rule contains a savings clause stating that foreign-made items subject to the EAR as a result of the new paragraph (b) may be shipped or transferred without a license before September 14, 2020, if they were in production before May 15, 2020. Foreign-made items subject to the EAR as a result of the new paragraph (a) that were, in essence, *en route* as of May 15, 2020 may continue without a license.

Stated Licensing Policy and Reasons for the Amendment

Because Huawei and the designated affiliates are on the EAR's [Entity List](#), applications for licenses to ship newly controlled foreign-made items to a designated Huawei entity will be presumptively denied. The situations under which this policy would be overcome and Commerce would decide to approve such an application are unknown.

Commerce stated in the rule that it "is warranted to promote the national security and foreign policy interests of the United States." Commerce provided more of the justification for the rule in a [press release](#) and emphasized that the rule was focused on semiconductors manufactured abroad. Secretary of Commerce Ross stated the following regarding the amendment:

"Despite the Entity List actions the Department took last year, Huawei and its foreign affiliates have stepped-up efforts to undermine these national security-based restrictions through an indigenization effort. However, that effort is still dependent on U.S. technologies. . . . This is not how a responsible global corporate citizen behaves. We must amend our rules exploited by Huawei and HiSilicon and prevent U.S. technologies from enabling malign activities contrary to U.S. national security and foreign policy interests."

In a [May 15, 2020 press conference](#), Keith Krach, the State Department's Under Secretary for Economic Growth, Energy, and the Environment, stated that:

"Since its addition to the entity list one year ago today, Huawei has persisted in its efforts to circumvent U.S. export controls. Huawei benefited from a loophole that allowed it to make use of U.S. electronic design software and manufacturing equipment to continue to produce its own semiconductors. That ends today. The United States is closing this loophole to prevent Huawei from exploiting U.S. technology and threatening our national security. Quite simply, Huawei cannot be trusted to respect the rule of law. It is required by the PRC to cooperate with Beijing's security and intelligence services, and that really relates to the law that I've talked with you many times about in terms of the National Intelligence Act of the PRC. We urge our allies and our partners to join us in aligning their domestic export-control laws to address the very real security threat posed by Huawei and the PRC. Huawei is a PRC state-supported firm serving as a tool for the Chinese Communist Party. The United States will continue to restrict most exports to Huawei."

At the same press conference, Dr. Christopher Ashley Ford, the State Department's Assistant Secretary for the Bureau of International Security and Nonproliferation, expanded on these comments and the U.S. government's policies pertaining to Huawei.

What the Amendment Does Not Change

- The rule does not change the EAR's *de minimis* rule. Thus, for example, otherwise uncontrolled items made overseas by U.S. or foreign companies that do not contain more than a *de minimis* (usually 25 percent, but sometimes less) amount of "controlled" U.S.-origin content remain not subject to the EAR, and thus not subject to the EAR's Entity List-related prohibitions. There were media reports suggesting that Commerce had been considering a change to the controls so that they applied

to foreign-made items containing more than 10 percent U.S.-origin content even if the content was not controlled.

- It does not change other aspects of the foreign direct product rule. Thus, for example, otherwise uncontrolled foreign-made items outside the United States that are not described in the new rule that are the direct product of U.S.-origin technology or software not controlled for “national security” reasons remain not subject to the EAR.
- The amendment does not impose any controls over the export of specific types of items from the United States, such as semiconductor production equipment.

As these examples indicate, the rule—and the related EAR and Entity List controls—are quite complex. Thus, any final answer regarding whether the EAR impose a license requirement over a particular shipment is intensely fact specific and requires a careful parsing of existing and the new regulations. Given the complexity, it is possible that Commerce will issue guidance or clarifications regarding the rule’s meaning and scope.

90-Day Extension of Huawei Temporary General License

BIS also announced on May 15, 2020, that the Temporary General License (TGL) authorizing exports, reexports, and transfers to listed Huawei entities of specific types of items subject to the EAR **would be extended until August 13, 2020**. Commerce stated the following in a **press release** regarding the extension:

“In announcing this extension, the Department is also notifying the public that activities authorized in the TGL may be revised and possibly eliminated after August 13, 2020. Companies and persons relying on TGL authorizations should begin preparations to determine the specific, quantifiable impact of elimination if they have not done so already. Those companies and persons should be prepared to submit license applications to the Department to determine which, if any, activities will be authorized in the event that their TGL authorization is eliminated. The Department will provide prior notice via the Federal Register of a need to submit such applications.”

¹ 15 C.F.R. § 734.3(a)(4).

² Id. § 772.1.

³ Id. Supp. No. 1 to Part 774.

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