

LEGAL UPDATES

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Commerce Announces Revocation of License Exception CIV and New Rules to Further Restrict Transactions With China, Russia and Venezuela

On Tuesday, April 28, 2020, the U.S. Department of Commerce's Bureau of Industry and Security ("BIS") issued two new final rules scheduled to take effect on June 29, 2020, which will implement amendments to the U.S. Export Administration Regulations (the "EAR"). Both rules stem from the Trump Administration's National Security Strategy ("NSS"), which was first issued in December 2017. One of these rules will revoke the License Exception Civil End-Users ("CIV") set forth in 15 C.F.R. § 740.5, which will require exporters and reexporters to first obtain BIS licenses prior to exporting or reexporting certain items to the 22 countries listed in the EAR's Country Group D:1. The other rule will further enhance existing export restrictions applicable to exports, reexports and in-country transfers involving "military end uses" or "military end users" in the countries of China, Russia and Venezuela. Parties who stand to be affected by these new rules should begin planning now in order to ensure that they are in compliance when the new rules officially take effect.

Revocation of license exception CIV

The EAR's Commerce Control List ("CCL") sets forth specific Export Control Classification Numbers ("ECCNs") which capture certain items that are "subject to the EAR" (i.e., items of U.S. origin wherever they may be located, items physically located in the U.S. or moving through the U.S. in transit, and items produced abroad which contain qualifying amounts of U.S.-origin content). When an item is classified under an ECCN, that ECCN will state one or more "reasons for control" applicable to the item. The EAR then imposes

certain restrictions to prohibit exports, reexports or in-country transfers of that item based on its “reason(s) for control”.

One of the EAR’s “reasons for control” is “National Security”, which is commonly abbreviated as “NS” within the EAR. When an item is classified under an ECCN and controlled for NS reasons, the EAR will require a license from BIS in order to export or reexport that item to any country except Canada. However, License Exception CIV authorizes exports and reexports of ECCN-classified items that were only controlled for NS reasons to civil end-users for civil end-uses in certain Country Group D:1 countries without a BIS license. These Country Group D:1 countries include Armenia, Azerbaijan, Belarus, Cambodia, China, Georgia, Iraq, Kazakhstan, Kyrgyzstan, Laos, Libya, Macau, Moldova, Mongolia, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, Venezuela, Vietnam and Yemen.

Transactions are not eligible for License Exception CIV if the item in question will be exported, or reexported for a military use or to a military end user. In its Federal Register notice announcing this change, BIS noted that the Country Group D:1 countries present national security concerns under the NSS and that the revocation was motivated in part by “U.S. Government enforcement actions identifying diversion of U.S.-origin items to military end uses and military end users by purported civil end-users in [Country Group D:1 countries].” BIS specifically cited the “increasing integration of civilian and military technology development in [Country Group D:1 countries]” and stated that “[t]his integration also makes it more difficult for industry to know or determine whether the end use and end users of items proposed for export, reexport or transfer (in-country) will not be or are not intended for military uses or military end users.”

Approximately thirty (30) different ECCN classifications are currently eligible for License Exception CIV and will be impacted by this revocation. The affected items include (but are not limited to):

Certain circuits, field programmable logic devices, electronic assemblies, manufacturing equipment and technology classified under Category 3 of the CCL;

Certain telecommunications equipment classified under ECCN 5A001;

Certain marine acoustic systems, optical equipment, lasers and radar systems classified under Category 6 of the CCL; and

Certain aviation production and testing equipment classified under Category 9 of the CCL.

When License Exception CIV is revoked effective June 29, 2020, these items will require a BIS license for export or reexport to any Country Group D:1 country, regardless of whether the item is being exported or reexported for a civil or military use. BIS will then generally review license applications involving Country Group D:1 countries on a case-by-case basis when the items are for civilian use or

would not otherwise make a significant contribution to the destination country's military potential that would threaten U.S. national security.

Companies in the semiconductor industry doing business with Country Group D:1 countries should be especially mindful of this rule change. Various semiconductor components, equipment, materials and technology classified under ECCNs 3A001, 3A002, 3B001, 3C002, 3C005, 3C006 and 3E002 will no longer be eligible for License Exception CIV and will require export or reexport licenses if provided to a Country Group D:1 country after June 29, 2020. Additionally, if those companies are currently relying on License Exception CIV in order to provide their foreign national employees who are citizens or permanent residents of Country Group D:1 countries with certain technology classified under ECCN 3E002 for the development or production of certain controlled microcircuits, they will need to obtain a license from BIS in order to provide such foreign nationals with the aforementioned ECCN 3E002 technology going forward after License Exception CIV is revoked.

Imposition of additional licensing controls on exports, reexports and in-country transfers to China, Russia and Venezuela

Supplement No. 2 to EAR Part 744 currently identifies over 30 different ECCN item classifications (the "Supplement No. 2 items") which trigger specific compliance concerns in transactions involving China, Russia or Venezuela. Section 744.21 of the EAR currently requires a BIS license in order to export, reexport or make a transfer (in-country) of any Supplement No. 2 item: (i) to China for a "military end use", or (ii) to Russia or Venezuela for either a "military end use" or to a "military end user". EAR Section 744.21 currently defines a "military end use" as a use where the item is incorporated into certain other military items or otherwise used for the "use", "development" or "production" of such military items (using the definitions for "use", "development" and "production" provided in the EAR). Section 744.21 defines a "military end user" in China, Russia or Venezuela as "the national armed services (army, navy, marine, air force or coast guard), as well as the national guard and national police, government intelligence or reconnaissance organizations, or any person or entity whose actions or functions are intended to support 'military end uses'."

In order to implement the NSS, BIS is now making several amendments to the EAR which will take effect on June 29, 2020, and which will impose additional licensing requirements on exports, reexports and transfers (in-country) involving "military end uses" or "military end users" in China, Russia or Venezuela. BIS's Federal Register notice explained these amendments by citing two statements in the NSS which observed, "China and Russia challenge American power, influence and interests, attempting to erode American security and prosperity. They are determined to make economies less free and less fair, to grow their militaries, and to control information and data to repress their societies and expand their influence," and, "Both China and Russia support the

dictatorship in Venezuela and are seeking to expand military linkages and arms sales across the region.”

These amendments will make the following changes to the EAR:

Adding an additional seventeen (17) ECCN item classifications to the EAR’s list of Supplement No. 2 items and expanding the range of items captured under three (3) existing ECCN item classifications that are already listed on Supplement No. 2. These new classifications capture items in the categories of materials processing, electronics, telecommunications, information security, sensors and lasers, and propulsion;

Adjusting EAR Section 744.21’s scope so that it also requires BIS licensing for exports, reexports or transfers (in-country) of Supplement No. 2 items to any “military end user” in China;

Expanding EAR Section 744.21’s definition of “military end use” to include any use for the operation, installation, maintenance, repair, overhaul, refurbishing, development or production of a covered military item. As a result of this change, Section 744.21’s licensing requirements will apply to a significantly broader range of export, reexport and transfers (in-country) involving China, Russia and Venezuela;

Changing BIS’s review policy for license applications submitted under EAR Section 744.21 from a “case-by-case basis” standard to a “presumption of denial” standard; and

Updating the U.S. Census Bureau’s Automated Export System (“AES”) filing process to require exporters to file Electronic Export Information (“EEI”) filings for all exports to China, Russia or Venezuela, even if the shipments are under \$2,500 in value (unless covered under License Exception GOV). These amendments will also require that EEI filings submitted for exports to China, Russia or Venezuela must include the correct ECCN classification for all items included in the shipment, regardless of the reason for control. These new EEI filing requirements will apply to all exports to China, Russia or Venezuela, even if those transactions do not involve a “military end use” or “military end user.”

BIS did provide a savings clause in its final rule enacting these new amendments to EAR Section 744.21 and will allow shipments that would not have required a BIS license under the old rules to proceed without a license as long as: (i) those shipments are on a dock for loading, on lighter, laden aboard an exporting carrier or en route aboard a carrier to a port of export on June 29, 2020,

pursuant to actual orders, and (ii) the shipments have been exported, reexported or transferred (in-country) before midnight on July 27, 2020. If the items are not actually exported, reexported or transferred (in-country) before that deadline, then they will require a license from BIS under the new rules.

As a result of these amendments, persons conducting transactions with China, Russia or Venezuela which involve Supplement No. 2 items should carefully diligence their counterparties and their counterparties' intended uses of such items in order to ensure that the items will not be provided to a "military end user" or for a "military end use" under EAR Section 744.21. Although various end uses might ordinarily appear to be civil in nature, it is possible that they could qualify as "military end uses" under EAR Section 744.21's new expanded definition of the term. This is particularly important in transactions with China, where BIS has specifically advised that these amendments "will require increased diligence with respect to the evaluation of end users in China, particularly in view of China's widespread civil-military integration."

What this means to you

Both of these new final rules demonstrate that the Trump Administration and BIS consider compliance with U.S. export controls to be a matter of national security. It is likely that BIS will continue revising existing rules (and possibly adopting new rules) in order to maintain and advance U.S. national security interests. The regulated community should continue to closely monitor these developments.

In particular, persons doing business with China, Russia or Venezuela should evaluate their transactions and consider implementing some or all of the following compliance practices:

Carefully reviewing and confirming their products' ECCN classifications under the EAR in order to be aware of when their transactions are subject to these new rules. Even if transactions with China, Russia or Venezuela will not require a BIS license under these new rules, exporters will still be required to provide correct ECCN classification data on EEI filings for all outgoing shipments to China, Russia and Venezuela occurring after June 29, 2020.

Properly diligencing their counterparties and being especially cautious in transactions that potentially implicate the Chinese, Russian or Venezuelan military sectors (even if the immediate counterparties for those transactions appear to be civil in nature).

Being aware of and complying with additional export controls and trade sanctions which apply to China, Russia and Venezuela. For example, this article is focused on items that are "subject to the

EAR”, but prospective exporters should also be aware of the International Traffic in Arms Regulations (the “ITAR”), administered by the Department of State’s Directorate of Defense Trade Controls, which apply to certain “defense articles” listed on the U.S. Munitions List and which impose additional export controls which are significantly more restrictive than the EAR’s. Additionally, the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”) imposes various trade sanctions against Russia and Venezuela which U.S. exporters must comply with.

Contact us

If you have questions about the proposed rule, please contact Cortney Morgan or Grant Leach with Husch Blackwell’s Export Controls & Economic Sanctions Team.