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New From BIS:

Changes to EAR Direct Product Rule to Tighten Supply Chain for Certain Designated Entity List Organizations

US – May 20, 2020

A new Interim Final Rule (New Rule) issued by the US Department of Commerce's Bureau of Industry and Security (BIS), which amended the Export Administration Regulations (EAR) (15 CFR Parts 730-774) by expanding the direct product rule as applied to certain organizations on the entity list took effect on May 15, 2020. The New Rule, along with request for comments, was published in the *Federal Register* on May 19, 2020.

Purpose of the New Rule

The New Rule expands the scope of foreign-made items subject to the EAR. Prior to the New Rule, foreign-made items that were the direct product of US technology and software were subject to the EAR **only if** (i) the US technology and software were subject to national security controls, (ii) the direct product was subject to national security controls, and (iii) the foreign made product was destined for a D:1, E:1 or E:2 country. With respect to the output of plants, Foreign-made items were subject to the EAR if they were the direct product of a complete plant or any major component of a plant, but **only if** (i) such plant or component is the direct product of technology were subject to national security controls, and (ii) such foreign-made direct products of the plant or component were subject to national security controls.

Under the New Rule, additional foreign-made items and output of plants are subject to the EAR and would require a license or license exception for reexport, export from abroad or transfer (in country) under certain circumstances when there is knowledge that the foreign-produced item is destined to a designated organization on the Entity List. This New Rule is intended to close down those business structures that may have been put in place to avoid the application of placing organizations, like Huawei Technologies Co., Ltd. and its 114 non-US affiliates (collectively, Huawei), on the Entity List. The New Rule would effectively prohibit non-US companies from supplying certain items to Huawei listed entities and certain other transactions that previously were not subject to the EAR, but now are.

How the New Rule Captures Foreign-made Items as Subject to the EAR

BIS amended the foreign-produced direct product rule in General Prohibition Three by adding prohibitions on the reexport, export from abroad, or transfer (in-country), without a license or license exception, of any foreign-produced item controlled under a new footnote 1 of Supplement No. 4 to part 744 ("Entity List") when there is "knowledge" that the foreign-produced item is destined to any entity with a footnote 1 designation in the license requirement column of the Entity List (a "**Designated Entity**"), including Huawei, for example. The newly-added footnote 1 creates paragraphs "(a)" and "(b)" to describe the items that are now subject to the EAR.

Paragraph (a) to footnote 1 makes certain items that are produced or developed by a Designated Entity subject to the EAR. It reads:

> *The foreign-produced item is produced or developed by any [Designated Entity] and is a direct product of "technology" or "software" subject to the EAR and specified in Export Control Classification Number (ECCN) 3E001, 3E002, 3E003, 4E001, 5E001, 3D001, 4D001, or 5D001; of "technology" subject to the EAR and specified in ECCN 3E991, 4E992, 4E993, or 5E991; or of "software" subject to the EAR and specified in ECCN 3D991, 4D993, 4D994, or 5D991 of the Commerce Control List in Supplement No. 1 to part 774 of the EAR ("***Specified Technology or Software***").*

Under the paragraph (a), a person (US or non-US) would be in violation of the EAR, if:

- The person reexported, exported from abroad or transferred (in country) of a foreign-made item without a license or license exception; and
- The person had "knowledge" that the foreign-produced item was destined to a Designated Entity; and
- The foreign-made item was produced or developed by a Designated Entity; and
- The foreign-made item is the direct product of Specified Technology or Software (including US-origin Specified Technology or Software or foreign-made Specified Technology or Software that is subject to the EAR).

For example, if a Designated Entity produces or develops an integrated circuit design utilizing Specified Technology or Software (subject to the EAR), such as Electronic Design Automation software, that foreign-produced integrated circuit design is subject to the EAR, if it is reexported, exported from abroad or transferred (in country) to a Designated Entity or with knowledge that it is destined for a Designated Entity.

Paragraph (b) to footnote 1 makes certain items that are produced by suppliers to a Designated Entity subject to the EAR. It reads:

> *The foreign-produced item is: (1) Produced by any plant or major component1 of a plant that is located outside the United States, when the plant or major component of a plant itself is a direct product of [Specified Technology or Software]; and (2) a direct product of "software" or "technology" produced or developed by [Designated Entity].*

Under the paragraph (b), a person (US or non-US) would be in violation of the EAR, if:

- The person reexported, exported from abroad or transferred (in country) of a foreign-made item without a license or license exception; and
- The person had "knowledge" that the foreign-produced item was destined to a Designated Entity; and
- The foreign-made item is the direct product of a plant or major component of a plant located outside the US when the plant or major component of a plant itself is a direct product of Specified Technology or Software; and
- The foreign-made item is a direct product of software or technology produced or developed by Designated Entity.

For example, if a foreign company produces integrated circuits outside the US in a foundry containing equipment subject to the EAR, that is essential to the "production" of the integrated circuit to meet the specifications of its design, including testing equipment (i.e., a major component of a plant), and the design for the integrated circuit was produced or developed from "software" or "technology" by a Designated Entity, then that foreign-produced integrated circuit is subject to the EAR.

Savings Clause

The New Rule contains a savings clause, which provides that shipments of those foreign-produced items controlled under paragraph (a) of footnote 1 that were on dock for loading, on lighter, laden aboard an exporting or transferring carrier, or en route aboard a carrier to a port of export or to the consignee/end-user on May 15, 2020, pursuant to actual orders for exports, reexports, and transfers (in-country) to a foreign destination or to the consignee/end-user, may proceed to that destination under the previous license exception eligibility or without a license. Also, those shipments of foreign-produced items controlled under paragraph (b) of footnote 1 and started "production" prior to May 15, 2020, may proceed as not being subject to the EAR, if applicable, or under the previous license exception eligibility or without a license, provided that they have been exported, reexported or transferred (in-country) before 120 days after September 14, 2020.

Comment Period

Parties wishing to submit comments on this new rule may submit their comments, identified by docket number BIS-2020-0011 or RIN 0694-AH99, through BIS. Comments must be received on or before July 14, 2020.

1 Note to paragraph (b)(1) of footnote 1: A major component of a plant located outside the United States means equipment that is essential to the "production" of an item, including testing equipment, to meet the specifications of a design specified in (b)(2).

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