

U.S. Export Controls: Recent Developments, Key Takeaways, and Anticipated Changes Ahead

Navigating Military End Use and User Changes, Expanded Licensing, Elimination of Licensing Exception CIV, and More

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A Strafford Webinars Presentation:

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November 11, 2020

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Agenda

- ▶ Export Licensing Restrictions
 - Updates to military end use and military end user restrictions
 - Expanded export licensing and stricter review standards for licensing
- ▶ Hong Kong, China, and Huawei Updates
 - Adjusted licensing policy for Hong Kong
 - Direct product rule amendments
 - Expanded Entity List
- ▶ New Technologies
 - Emerging and foundational technologies updates
 - Transition of certain firearms controls from DDTC to BIS
- ▶ Compliance
 - Compliance challenges
 - Lessons from enforcement matters

Export Licensing Restrictions



Military End Use and Military End User Changes

When

- ▶ Final Rule of April 28, 2020
- ▶ Effective on June 29, 2020

What

- ▶ The U.S. Department of Commerce, Bureau of Industry and Security (“BIS”) published a rule expanding licensing requirements related to exports of items in support of “military end uses” and “military end users” in China, Russia, and Venezuela

Impact

- ▶ Expands the definition of “military end use,” which in turn broadens the category of “military end users,” which includes persons or entities that support “military end uses”

Military End Use and Military End User Changes (ctd)

Expanded “military end use”	<ul style="list-style-type: none">▶ Extends to items that <u>support or contribute to</u> the operation, installation, maintenance, repair, overhaul, refurbishing, “development” or “production” of military items, any one of which alone is sufficient to confer “military end use” status
Additional circumstances	<ul style="list-style-type: none">▶ Only requires that exporters have reason to know that the product could be intended “entirely or in part” for the above listed uses, or by military end users▶ Significantly expands the ECCNs subject to export license requirements, including non-sensitive and widely available items
“Military end users”	<ul style="list-style-type: none">▶ “Military end users” is defined to include army, navy, marines, air force, coast guard, national guard, national police, and government intelligence or reconnaissance organizations, or persons/entities whose actions are intended to support “military end uses”
Impact on China	<ul style="list-style-type: none">▶ Adds a new restriction on exports of certain items to “military end users” in China▶ The potential overlap in China between civilian and military entities in China potentially makes the scope of this rule particularly broad in this country

Export Licensing – Expansions and Restrictions

- ▶ In 2020, BIS has issued several new rules and guidance expanding the scope of its review of licenses and limiting the applicability of license exceptions
- ▶ For example:
 - Change in license review policy for NS-controlled items
 - The addition of Russia to Country Group D:4
 - The elimination of License Exception CIV
 - The modification of License Exception APR
 - Guidance covering human rights-related review of licenses



Licensing Review Policy – NS Controlled Items

- ▶ In a final rule effective October 29, 2020, BIS revised its policy of review for license applications for the export of NS-controlled items to China, Russia, and Venezuela
- ▶ Case-by-case review of whether the proposed export “will make a material contribution to the weapons systems capability of those countries”
- ▶ Presumption of approval for civil end users or civil end uses
- ▶ Presumption of denial for items that make a material contribution to the “development,” “production,” maintenance, report, or operation of weapons systems, subsystems, and assemblies
- ▶ Under the Export Control Reform Act of 2018, BIS will also consider the impact of the proposed export on the U.S. defense industrial base

Addition of Russia to Country Group D:4

- ▶ On February 24, 2020, the BIS proposed a rule removing Russia from Country Groups A:2 and A:4 and moving it to Country Groups D:2 and D:4. This rule became effective on March 6, 2020
- ▶ The re-designation was based on nuclear and missile technology proliferation concerns
- ▶ Yemen was also removed from Country Group B and added to Country Group D:1
- ▶ Has the effect of subjecting certain missile / rocket / UAV-related exports to license requirements



Elimination of License Exception CIV

- ▶ On April 28, 2020, BIS also published a rule eliminating License Exception Civil End Users (“CIV”)
 - CIV had been in place for decades
 - CIV authorized the export, reexport, and transfer (in-country) of items on the CCL controlled for national security reasons to civil end users for civil end uses in countries listed in Country Group D:1 (which includes China, Russia, and Venezuela)
- ▶ Without CIV, many sales to the private sector in D:1 countries will require a license
- ▶ The elimination of CIV reflects BIS’ concern regarding the integration of military and civilian entities in China
- ▶ Marks the elimination of a license exception introduced at the end of the Cold War

Proposed Modification of License Exception APR

- ▶ On April 28, 2020, BIS published a proposed rule, for which the comment period ended on June 29, that would modify License Exception Additional Permissive Reexports (“APR”)
- ▶ The proposed modification would:
 - Remove the authorization for reexports of items on the CCL that are controlled for national security purposes from countries listed in Country Group A:1 and Hong Kong to countries listed in D:1; and
 - Require a license from BIS even though the items are already outside of the U.S.
- ▶ BIS’ explicit concern is that partner countries maintain standards of review that lead to approval of licenses that the U.S. would not grant
- ▶ Though not explicit, the proposed modification also appears to reflect the concern about transfers from Hong Kong to China

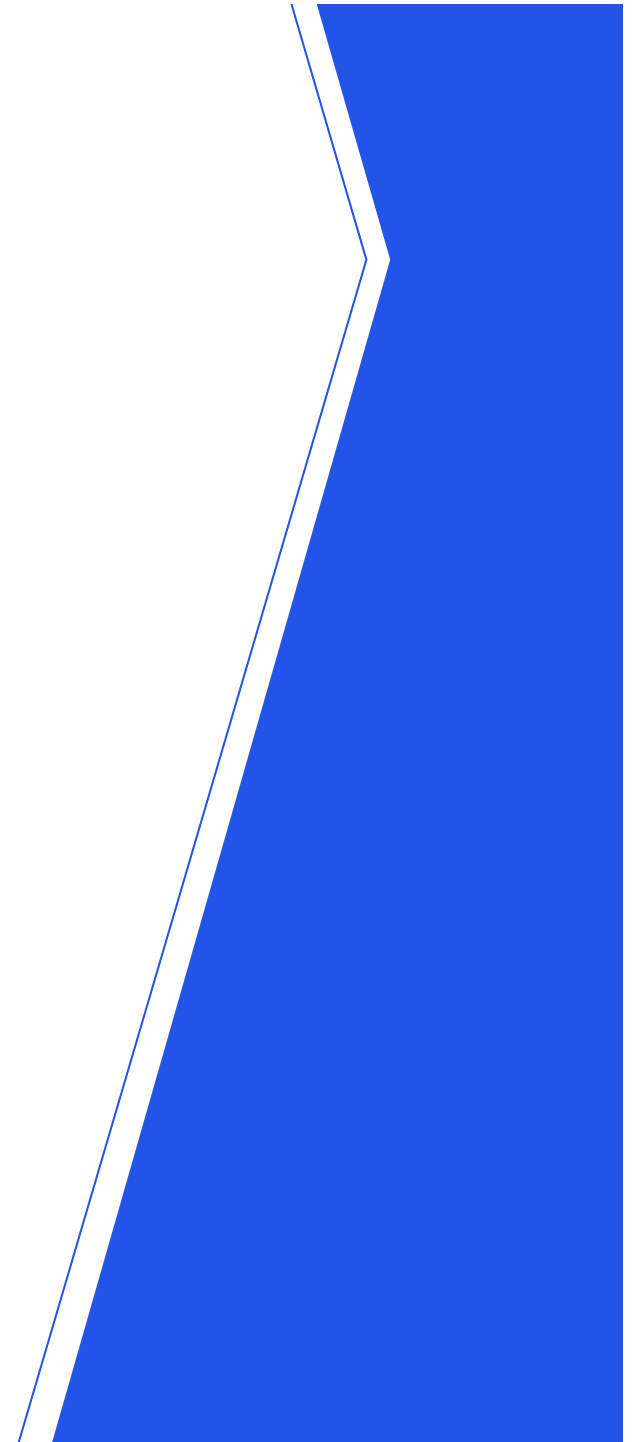


BIS Human Rights-Related License Guidance

- ▶ On October 5, 2020, BIS expanded its ability to review most license applications for human rights concerns, as well as its licensing policy for reviewing crime control items
- ▶ The new rules, effectively immediately, allow for the consideration of human rights concerns when reviewing license applications for any items except those controlled for short supply reasons
- ▶ They also expand the licensing policy for crime control items to enable consideration of human rights concerns involving parties other than the government of the importing country
- ▶ Apparent focus on use of surveillance items in China



Hong Kong, China, and Huawei Updates



Changes in Licensing Policy for Hong Kong

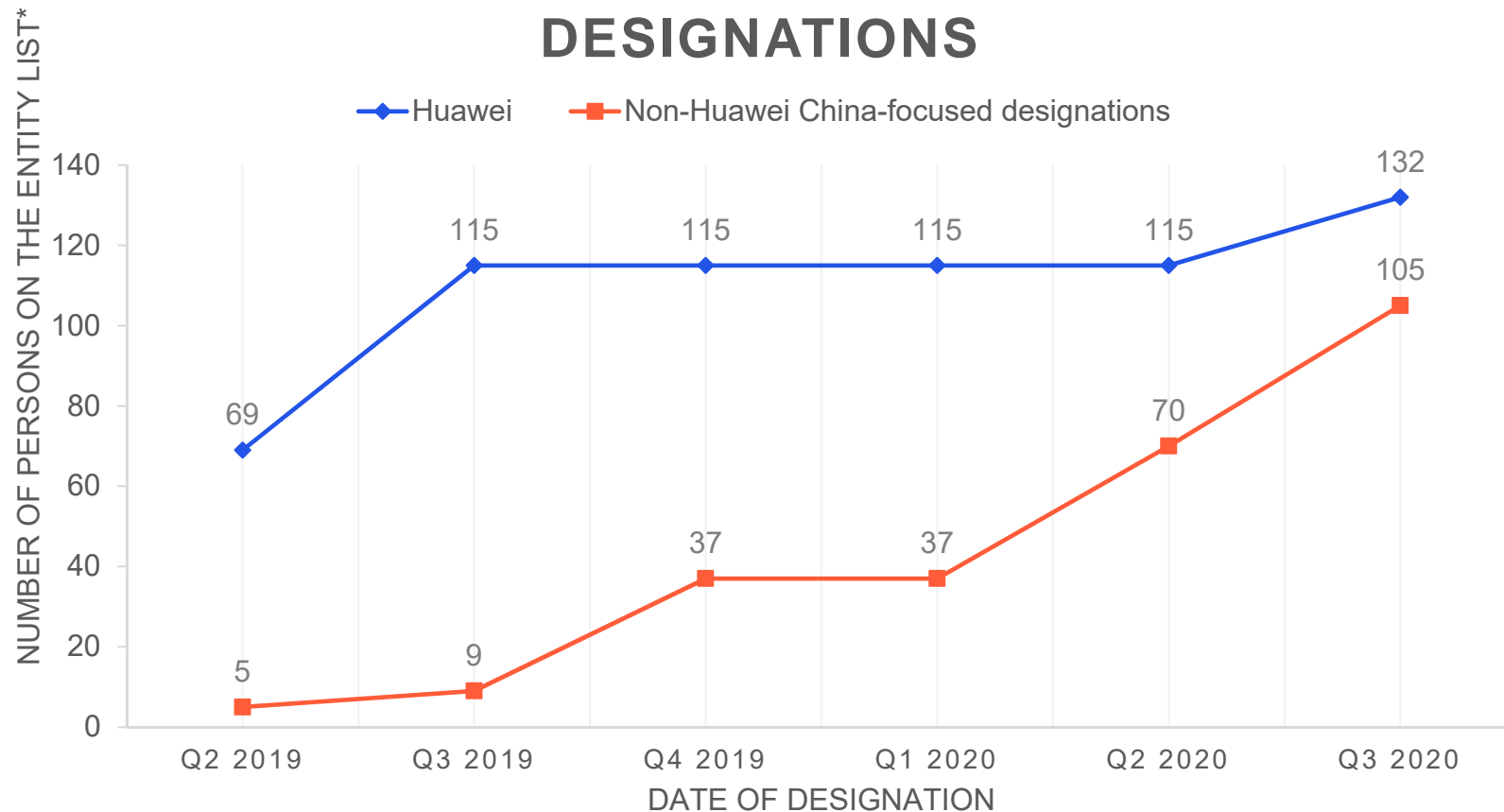
- ▶ Executive Order 13936 revoked Hong Kong's special status under U.S. export control laws, with the rule implemented on July 31
- ▶ Export Administration Regulations (“EAR”)
 - 13 License Exceptions for Hong Kong under the EAR were revoked
 - Hong Kong treated the same as China in those 13 License Exceptions
 - Awaiting full implementation of Hong Kong “normalization” throughout the EAR
- ▶ International Traffic in Arms Regulations (“ITAR”)
 - Hong Kong subject to same arms embargo as China (policy of denial)
 - Exception for Hong Kong persons physically outside of Hong Kong or China who were authorized to receive defense articles prior to the change in status
 - Hong Kong persons physically outside of Hong Kong or China who were authorized to receive defense services prior to the change in status (case by case)

Expanded Entity List – Focus on China

- ▶ Since early 2019, the U.S. Department of Commerce has made nine sets of China-focused designations on the U.S. Department of Commerce Bureau of Industry and Security's Entity List
 - Huawei (May 2019, August 2019, August 2020)
 - Abuse of minorities in Xinjiang province (October 2019, June 2020, July 2020)
 - Military and advanced technologies (June 2019, June 2020)
 - South China Sea (August 2020)
- ▶ Evolving reasons for adding parties to the Entity List
 - Traditionally often more narrowly involved actual violations of the EAR
 - Recently increasingly more broadly concerning acting contrary to national security or foreign policy interests of U.S. (e.g. evading or violating U.S. sanctions programs, threatening U.S. supply chains, human rights issues, territorial disputes)
- ▶ Human rights take on an elevated role
 - “Human rights violations and abuses in the implementation of China's campaign of repression, mass arbitrary detention, and high-technology surveillance against [minority groups in the Xinjiang province]”

Expanded Entity List – Focus on China

CHINA FOCUSED ENTITY LIST DESIGNATIONS



*There have been other Chinese parties designated on the Entity List in this period, but such designations are made in conjunction with other non-Chinese designations, as opposed to a China-focused set of designations by the U.S. Department of Commerce

Direct product rule (“DPR”) & Huawei

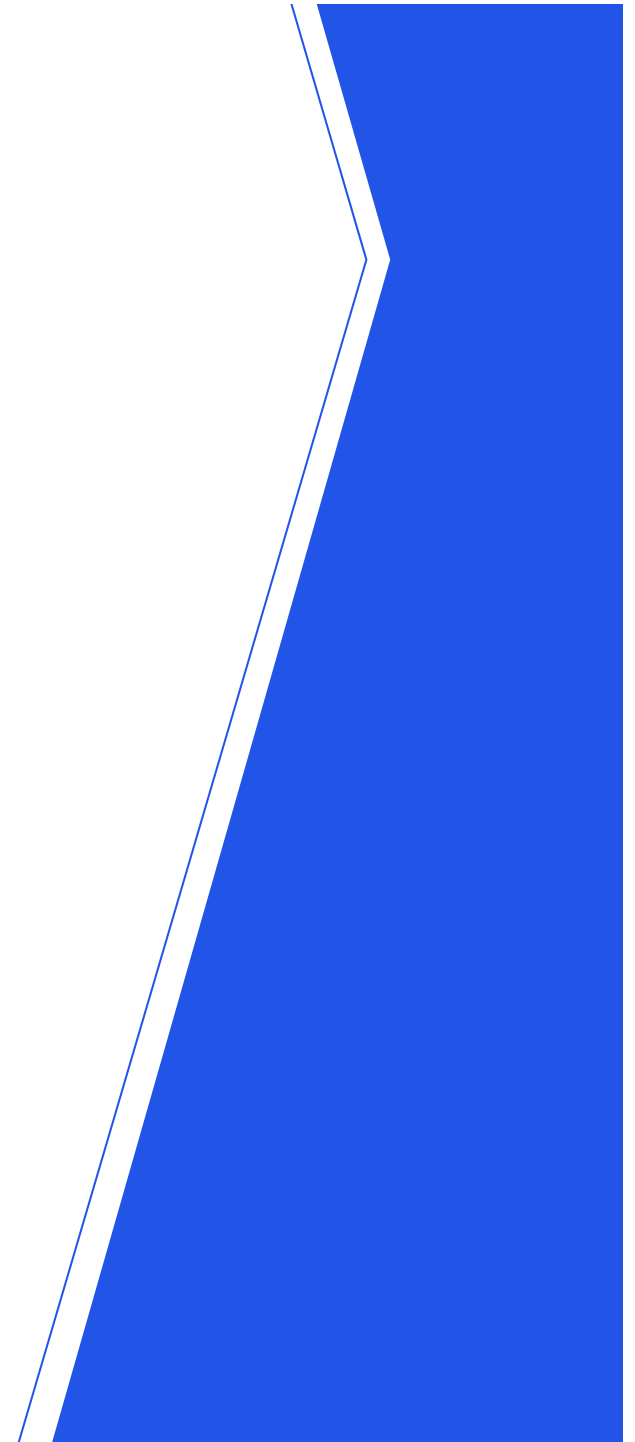
- ▶ U.S. government attempting to exert as much pressure on Huawei as possible without designating it on the SDN List
- ▶ May 19, 2020 Interim Rule
 - Expanded range of technology and software that triggers the DPR; identified specific ECCNs of concern
 - Focused on exports in support of items produced or developed by Huawei
- ▶ August 17, 2020 Final Rule
 - DPR applies to foreign produced items that are the “direct product” of certain US technology or software (specified by ECCN) exported, reexported, or transferred when there is “knowledge” that either:
 - ▶ Huawei and any designated affiliate is a party to a transaction involving certain foreign-produced items; or
 - ▶ The foreign-produced item will be incorporated into, or used in the production or development of any “equipment,” “component,” or “part” purchased or ordered by Huawei or any designated affiliates
 - Broadened May 19 rule by removing emphasis on items produced or developed by Huawei

Additional Actions: TikTok/WeChat

- ▶ In response to concerns regarding Chinese Communist Party access to American user data through mobile applications WeChat and TikTok, on August 6, 2020, President Trump issued two executive orders requiring the Commerce Department to identify prohibited transactions related to the applications
- ▶ On September 18, 2020, the Commerce Department announced a set of prohibited business-to-business transactions related to technical support for the functionality of the applications in the U.S. and processing of payments through WeChat
- ▶ Preliminary injunctions currently prohibit enforcement:
 - On September 19, 2020 a magistrate judge in the Northern District of California issued a preliminary injunction temporarily blocking the WeChat prohibitions from taking effect
 - On September 27, 2020 a district court in the District of Columbia granted TikTok's motion for a preliminary injunction; the Department of Justice appealed on October 8, 2020
 - On October 30, 2020 the November 12 TikTok restrictions were temporarily blocked by a federal judge in the Eastern District of Pennsylvania

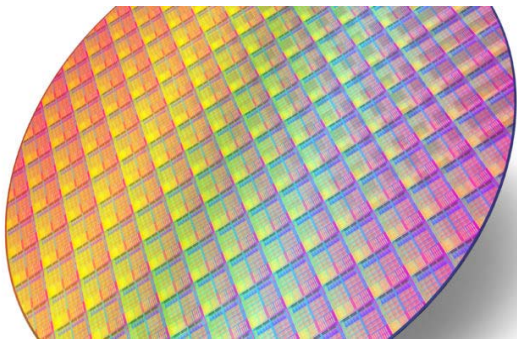


New Technologies



ECRA: Emerging Technologies

- ▶ October 5, 2020, BIS published a control list on six categories of “emerging technologies”
 - Controls agreed at Wassenaar Arrangement 2019 Plenary
 - Controls on specific criteria rather than broad categories of technology
- ▶ Direct Product Rule
 - Items subject to national security controls, including for China
 - Foreign-made product using US technology or software may be subject to the EAR



ECRA: Emerging Technologies

Forensic hacking tools
ECCNs 5A004.b;
5D002.a.3 and c.3

Surveillance software
ECCN 5D001.e

**Machine tools with
additive manufacturing
capabilities**
ECCN 2B001

**Software for extreme UV
lithography used in
microprocessor chip
production**
ECCN 3D003

**Silicon wafer production
technology for 5-
nanometer chips**
ECCN 3E004

Suborbital craft
ECCN 9A004.h

ECRA: Foundational Technologies

- ▶ August 27, 2020 BIS published an advance notice of proposed rulemaking to solicit comments relating to the establishment of new export controls on “foundational technologies” due by October 26, 2020
 - No specific categories of technology but includes “commodities and software”
 - BIS does not intend to expand its jurisdiction over technologies that are not currently subject to the EAR (e.g., “fundamental research”)
 - Technologies may already be restricted under the EAR as opposed to the “emerging technologies”
- ▶ Example provided by BIS include:
 - Items subject to control for military end use or military end user reasons, such as semiconductor manufacturing equipment and associated software tools, lasers, sensors, and underwater systems

CFIUS Impact

- ▶ Identified “emerging and foundational technologies” are also relevant for the Committee on Foreign Investment in the United States (“CFIUS”)
 - Once official controlled, are considered “critical technologies” for CFIUS purposes
 - Could require mandatory filing for certain minority investment
- ▶ On September 15, 2020, the U.S. Treasury Department published a final rule, effective October 15, impacting when investors should make a mandatory filing
 - Export controlled items could trigger CFIUS filing for controlling and certain non-controlling investments
 - NAICS code prong of critical technology filing assessment is replaced with an export controls assessment
 - Rule applies regardless of whether the company actually exports the controlled items or technology

Transition for Firearms Controls – USML to CCL

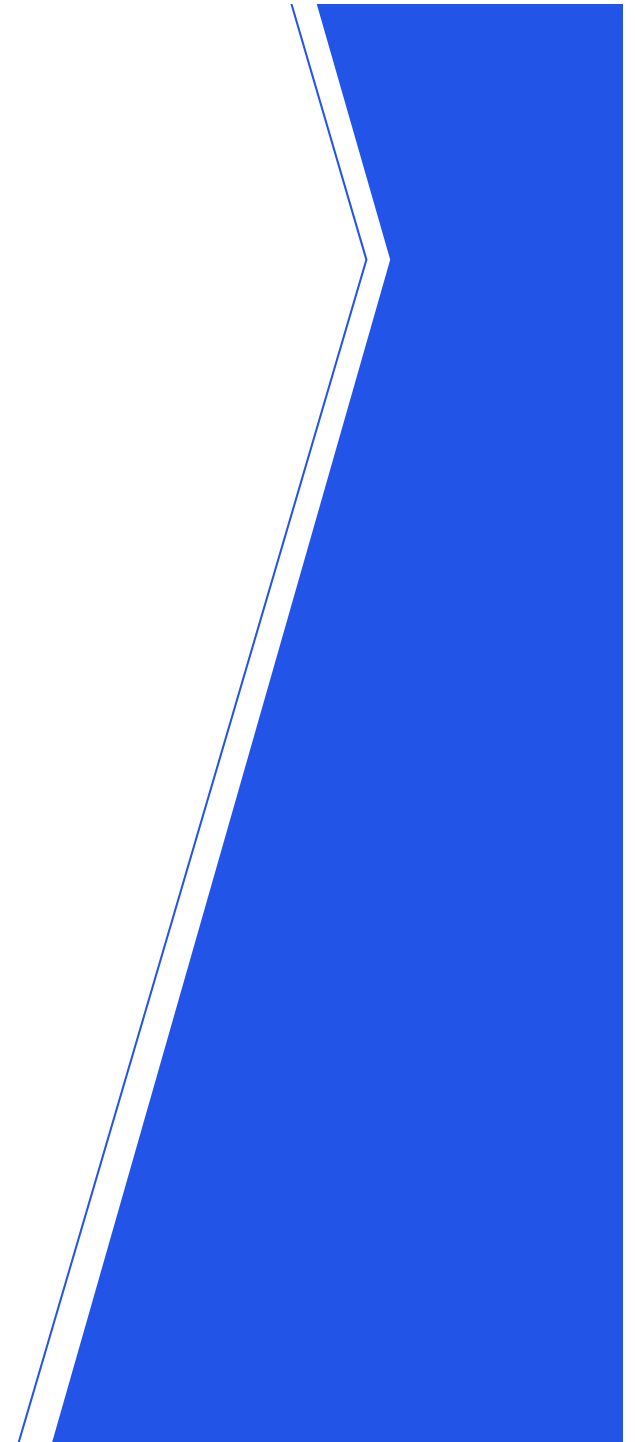
- ▶ January 23, 2020, the State and Commerce Department published their final regulations on transfer of certain firearms, ammunition, components and accessories from the ITAR to the EAR
 - Effective March 9, 2020
 - Amended Categories I, II and III of the USML
 - Transferred certain non-automatic and semi-automatic firearms, certain ammunition, parts, accessories, and attachments to the CCL
- ▶ Firearms type products remain heavily regulated
 - Removed ITAR registration
 - Requires export license application for export, deemed export, reexports, and transfer
- ▶ Transfer to CCL of 3D printing technology for gun production blocked by court order

Technology and Deemed Exports

- ▶ EAR regulates certain “technology” related to the transferred firearms products
 - Technology includes designs, drawings, specifications, technical manuals, and similar technical information
 - Both tangible and intangible
- ▶ Added a number of specific ECCN covering the technology associated to firearms
- ▶ Requires application for export license for export, deemed export, reexports, and transfer
- ▶ Adopted controls on placing firearms technology on the internet



Compliance Challenges



Compliance Challenges: Diligence and EEI Filing

- ▶ Military end use and end user diligence
 - Identifying “military end users,” which include state owned entities (including significant minority ownership), and other entities that develop, produce, maintain, or use military items
 - Remember: Even non-military end use is prohibited for military end users
 - Consider additional end use and end user statements
- ▶ New Electronic Export Information (“EEI”) filing requirements
 - In the same Final Rule that adjusted the military end use and end user controls at Section 744.21, BIS revised EAR Section 758.1 to require an EEI filing for exports of items on the Commerce Control List of *any* value to China, Russia, and Venezuela, unless the shipment qualifies for License Exception GOV
 - It also requires the ECCN be provided regardless of the reason for control, now necessitating that companies first have made sure to classify their products
 - Companies should consult with their EEI filing teams (or freight forwarders, if applicable) to confirm that adjustments to filing protocols have been implemented

Compliance Lessons from Enforcement Matters

▶ Federal Express v. U.S. Department of Commerce

- \$500,000 settlement in April 2018 for 53 alleged violations of the EAR prohibitions on causing, aiding, or abetting unauthorized exports to entities on the Entity List
- June 2019 lawsuit against Commerce in District Court in the District of Columbia, claiming the EAR restrictions violate the Fifth Amendment Due Process Clause, and the Commerce Department's scope of delegated authority under ECRA
- In September 2020, the Court granted Commerce's motion to dismiss the suit, indicating common carriers were strictly liable for export violations and affirming the importance of compliance when a party to any part of a transaction

▶ Procurement networks

- September 2020 indictment of Chicago area owner of Pakistani technology company, charged with illegal exports to the Pakistan Atomic Energy Commission ("PAEC")
- August 2020 charges against two individuals in New York for conspiracy to export dual use electronic components to Hong Kong trading companies for unauthorized re-export to China, including via transshipment through South Korea

▶ Domain name seizures

Key Takeaways

- ▶ Further restrictions on exports to military end uses and end users in China, Russia, and Venezuela will reinforce the need for good customer diligence
- ▶ Continued focus on national security and foreign policy concerns with China, Hong Kong, and particular actors designated on the Entity List will create continued compliance challenges in 2021
- ▶ Frequent additions to the Entity List emphasize the importance of maintaining current screening protocols that regularly re-screen to flag changes in counterparty status
- ▶ Publication of the first controls on ECRA “emerging technologies,” and plans to soon implement similar definitions for controlled “foundational technologies,” signals further clarification on the scope of controlled U.S. technologies in 2021
- ▶ Interconnectivity between the CFIUS filing rules and export controls underscores the importance of ensuring a strong understanding of export controls restrictions as they relate to “critical technologies”

QUESTIONS?

Kirkland & Ellis LLP, International Trade & National Security

Our International Trade and National Security Practice provides strategic and legal advice to companies, investment funds and financial institutions operating or investing across international borders.

Anchored in Washington, D.C., with a global perspective and on-the-ground presence throughout the U.S., Europe and Asia, our team has decades of combined experience working on matters involving the Committee on Foreign Investment in the United States (CFIUS) and similar national security clearance regimes, U.S., UK and EU economic sanctions (OFAC), U.S. and EU export controls (ITAR, EAR), imports and trade agreements, anticorruption (FCPA, UK Bribery Act), anti-money laundering (AML) and related areas.

We routinely work with our clients across industries and geographies on corporate transactions, strategic risk advisory and management, compliance and licensing, and investigations and enforcement matters. Our practice is widely recognized as a leading international advisory practice and is distinguished by the breadth and depth of its approach:

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Kirkland & Ellis LLP, U.S. & EU Economic Sanctions

Economic sanctions increasingly are impacting all aspects of global commerce, targeting not only dealings with traditionally embargoed countries such as Iran, but also transactions with more globally integrated countries such as Russia and China. In recent years, U.S. sanctions have expanded in scope and have become more extraterritorial in nature, while the European Union has established its own complex sanctions -- and counter-sanctions -- programs.

Our attorneys advise on all aspects of U.S. and EU sanctions compliance, addressing issues that may arise for stakeholders in a broad range of industries. Such assistance includes due diligence in the pre-acquisition context, development of compliance policies, conducting internal investigations, communications with, and disclosures to government agencies, counseling on complex transactions involving sanctioned countries or parties, advice on conflicts of law issues (such as those presented by the EU Blocking Statute) and requests for licenses and advisory opinions.

Our attorneys frequently engage with the U.S. Department of the Treasury, Office of Foreign Assets Control (OFAC) on sanctions matters, and are well-positioned to advise on matters arising under UK and EU sanctions.

Biographies



Mario Mancuso, Partner

Mario Mancuso, P.C. leads the Firm's International Trade and National Security practice. A former senior member of the President's national security team, Mario provides strategic and legal advice to companies, private equity sponsors, and financial institutions operating or investing across international borders.



Abigail Cotterill, Of Counsel

Abby Cotterill is Of Counsel in Kirkland & Ellis LLP's International Trade and National Security Practice Group in the Washington, D.C. office. Abby regularly provides legal advice to companies, financial institutions, and private equity sponsors on the regulatory and other risks of operating or investing across international borders.

Biographies



Anthony Rapa, Partner

Anthony Rapa is a partner in the Washington office of Kirkland & Ellis, where he is a member of the Firm's International Trade and National Security group. He counsels companies, private equity sponsors, and financial institutions worldwide regarding regulatory compliance in the context of cross-border operations and investments.



Sanjay José Mullick, Partner

Sanjay Mullick has a broad range of experience providing counsel on export controls administered by the Department of Commerce Bureau of Industry and Security (BIS) under the Export Administration Regulations (EAR); the Department of State Directorate of Defense Trade Controls (DDTC) under the International Traffic in Arms Regulations (ITAR); and the Department of Energy's rules on nuclear exports, as well as economic sanctions administered by the Department of the Treasury Office of Foreign Assets Control (OFAC). He also advises on compliance and enforcement matters concerning the Bureau of Customs and Border Protection (CBP) and foreign trade zones (FTZ).