

# Enhanced US Export Controls and Aggressive Enforcement Likely to Impact China

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Tariffs targeting Chinese imports into the United States garnered headlines throughout 2018. (See "[Tariff-Related Measures](#).") However, during the latter part of the year, the U.S. government more quietly initiated efforts that in 2019 and beyond could be more effective than tariffs in leveraging changes to Chinese behavior, particularly with respect to intellectual property protection. These efforts also could severely constrain Chinese growth, thereby preserving U.S. technological leadership. The moves are particularly aimed at the business sectors that comprise the "Made in China 2025" initiative. While these quieter efforts could benefit U.S. companies engaging with China over the long term, in the short term they are likely to increase the regulatory burdens associated with a variety of business relationships with China, including collaborative research and development projects or joint venture arrangements.

Specifically, the U.S. government: (1) proposed that a wide array of emerging technologies be subjected to enhanced controls under the Export Administration Regulations (EAR), which are administered by the Department of Commerce's Bureau of Industry and Security (BIS); (2) initiated a comprehensive review of the Commerce Control List (CCL) under the EAR to assess current controls on items to embargoed destinations, such as China; (3) sanctioned a Chinese semiconductor manufacturer under export-related authorities without a corollary finding of EAR violations; and (4) publicized significant enforcement matters pertaining to Chinese entities, including, in particular, Huawei Technologies Co., Ltd.

## Treatment of Emerging and Foundational Technologies

On August 13, 2018, President Donald Trump signed into law the John S. McCain National Defense Authorization Act (NDAA) for Fiscal Year 2019. A key focus of the law is the protection of U.S. technological advances through closer scrutiny of technology transfers to foreign persons and their implications for U.S. national security and foreign policy. In addition to the Foreign Investment Risk Review Modernization Act, which

enhanced reviews of foreign investment, the NDAA included the Export Control Reform Act (ECRA). The ECRA directed the establishment of a formal, ongoing interagency process to identify and review "emerging and foundational technologies that are essential to the national security of the United States" and required appropriate export controls for these technologies. The process involves the Departments of Commerce, Defense, State and Energy, along with other federal agencies as appropriate, and will identify "emerging and foundational technologies" through publicly available and classified information, as well as information derived from Commerce advisory committees and the Committee on Foreign Investment in the United States (CFIUS).

On November 19, 2018, BIS published an [advance notice of proposed rulemaking](#) soliciting comments on the criteria to be used to identify emerging technologies that are essential to U.S. national security. Such technologies could include those that have potential uses in connection with conventional weapons, intelligence collection, weapons of mass destruction or terrorist applications; or could provide the United States with a qualitative military

or intelligence advantage. In publishing the notice, BIS compiled a list of technologies (e.g., additive manufacturing, artificial intelligence and machine learning, biotechnology, microprocessors, robotics) for which export controls are only in place for comprehensively embargoed countries (such as Iran), countries designated as supporters of international terrorism (such as Sudan), and restricted end users or end uses. BIS says it will assess this representative list of technologies through the interagency process to identify any specific emerging technologies that are important to U.S. national security, for which effective controls can be implemented without negatively impacting U.S. leadership in the science, technology, engineering or manufacturing sectors. Enhanced licensing requirements are likely to inhibit exports of these technologies to China, thereby curtailing China's ability to rapidly scale domestic development in certain key industries.

Comments were due by January 10, 2019. As a next step, BIS will publish further proposed rules regarding the controls to be applied to specific emerging technologies, though there is no established timetable for the issuance of these rules.

BIS is expected to publish a similar notice soliciting comments regarding the identification of foundational technologies in early 2019. It has publicly suggested that such technologies are likely to be drawn from those that are currently subject only to unilateral anti-terrorism controls due to their removal from various multilateral control lists.

### **Comprehensive CCL Review**

The ECRA also required the Departments of Commerce, State, Defense and Energy, along with other federal agencies as appropriate, to conduct an immediate review of the license requirements for the export, re-export and in-country transfer of items to countries subject to a comprehensive arms embargo (including China).

The focus of this review is to assess existing export controls on items that currently do not require an export license and items destined for military end uses or end users. Commerce must implement any changes to existing export controls by May 2019. This review is likely to result in tighter controls on exports, re-exports and in-country transfers to China, in particular with an emphasis on technology with potential military applications and with military or government end users. As a consequence of this review, BIS likely will, for example, require licenses for items that currently do not require them or implement denial policies for license applications that otherwise would have been considered on a case-by-case basis.

### **Addition of Fujian Jinhua to BIS Entity List**

Effective October 30, 2018, BIS added Fujian Jinhua Integrated Circuit Company, Ltd., a state-owned Chinese semiconductor manufacturer, to the BIS Entity List because the company “poses a significant risk of becoming involved in activities that could have a negative impact on the national security interests of the United States.” The BIS Entity List comprises businesses, research institutions, government and private organizations, individuals, and other types of legal persons subject to specific license requirements for the export, re-export and in-country transfer of specified items that are supplemental to those found elsewhere in the EAR.

As a consequence, a specific BIS license is required for any person — whether located in the United States or not — to export, re-export or transfer (in-country) any commodities, software or technology that are “subject to the EAR” to Fujian Jinhua. The company is heavily reliant on U.S.-sourced hardware, and the impact of this action could cripple its ability to manufacture semiconductors. Any such license application will be reviewed in accordance with a policy of presumptive denial.

Notably, the listing of Fujian Jinhua did not appear to be based on any specific activity by the company in violation of the EAR. Rather, it appeared to be tied to the November 1, 2018, indictment by a federal grand jury of Fujian Jinhua, among others, for alleged crimes related to a conspiracy to steal, convey and possess the stolen trade secrets of Micron Technology, Inc., an American semiconductor company. This novel offensive use of the BIS Entity List, even in the absence of a specific violation of the EAR, may be a harbinger of how the U.S. government intends to punish alleged trade secret theft in the future.

The BIS Entity List listing and indictment are consistent with the prior blocking of Chinese-backed semiconductor-related transactions by Presidents Barack Obama and Trump in accordance with recommendations made by CFIUS as well as the increased focus on the protection of U.S. semiconductor technology as embodied in the January 2017 “Report to the President: Ensuring Long-Term U.S. Leadership in Semiconductors,” by the President’s Council of Advisors on Science and Technology. The actions also are consistent with the November 1, 2018, U.S. Department of Justice (DOJ) announcement of the “China Initiative,” which will be dedicated to the aggressive investigation and prosecution of Chinese companies for alleged trade secret theft, economic espionage, Foreign Corrupt Practices Act offenses and other violations of U.S. law. Taken together, these measures reflect a coordinated and sustained U.S. government response to Chinese economic development, particularly with respect to the “Made in China 2025” initiative — restricting Chinese access to sensitive U.S. technology, either via export or investment, and aggressively pursuing alleged trade secret theft, which will curb China’s ability to rapidly scale development in certain key industries.

## Notable Chinese-Related Export Enforcement

Bringing a notable U.S. export controls and sanctions-related enforcement action to a close in early December 2018, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) announced that Yantai Jereh Oilfield Services Group Co., Ltd. had agreed to pay \$2.77 million to settle the potential civil liability stemming from violations of the Iranian Transactions and Sanctions Regulations. Yantai Jereh was alleged to have exported or re-exported, or attempted to export or re-export, U.S.-origin goods ultimately intended for end users in Iran by way of China. Yantai Jereh also allegedly exported certain U.S.-origin items with knowledge or reason to know that the items were intended for production of, for commingling with or for incorporation into goods made in China to be supplied, transshipped or re-exported to end users in Iran. Yantai Jereh, which also appears on the BIS Entity List, agreed to pay \$600,000 to BIS for the same conduct.

Also in early December 2018, Canadian authorities, at the behest of the DOJ, arrested the chief financial officer of Huawei, allegedly in connection with ongoing OFAC and BIS investigations into U.S. sanctions violations. Like its competitor Zhongxing Telecommunications Equipment Corporation (ZTE), which was

added to and subsequently removed from the BIS Entity List and remains subject to a suspended denial order, Huawei is alleged to have engaged in re-exports of U.S.-origin equipment to embargoed destinations, such as Iran. However, it is believed that Huawei will not be listed, primarily due to its much larger size and the adverse economic consequences such a listing would have for U.S. suppliers. Nevertheless, the threat of such a listing may well be sufficient leverage to extract trade-related concessions from the Chinese government. And Huawei is not likely to escape entirely. Indeed, it has been widely reported that BIS already has declined to renew an export license required by Huawei's Silicon Valley research and development unit, and potentially substantial penalties may yet be imposed.

BIS clearly is putting Chinese companies on notice that it will vigorously pursue export-related violations, particularly those involving U.S.-embargoed countries, and has expressed a willingness — as evidenced by the ZTE action — to choke off critical supplies of U.S.-origin hardware, software and technology. U.S. suppliers should be especially mindful of this latter risk as well as of more aggressive Chinese retaliation, including, for example, delays in processing regulatory approvals and, as with the Huawei matter, detentions of personnel traveling in China.

## Tariff-Related Measures

Tariff-related measures targeting Chinese imports into the United States, including tariffs on more than \$250 billion in Chinese imports as a consequence of China's alleged unfair intellectual property-related practices pursuant to Section 301 of the Trade Act of 1974, were implemented throughout 2018. The Section 301 tariffs were rolled out in three tranches, with the third targeting approximately \$200 billion in Chinese imports. Currently, such imports are subject to a 10 percent tariff, but the tariff will be escalated to 25 percent on March 2, 2019 (as with tranches 1 and 2) if the governments of the United States and China do not meaningfully resolve their various trade issues.

The Office of the U.S. Trade Representative recently announced the first set of products excluded from the tariffs imposed on items covered by the first tranche but has yet to respond to all pending requests pertaining to the first and second tranches. There is no corollary product exclusion process for items currently subject to 10 percent tariffs under the third tranche.

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