

Tightened restrictions on technology transfer under the Export Control Reform Act

New legislation seeks to tighten controls on the transfer of certain US technology to foreign persons, increase scrutiny of export licence applications, and expand jurisdiction over US persons providing foreign defence intelligence services – though not necessarily immediately, write Skadden.

On 13 August 2018, President Donald Trump signed into law the John S. McCain National Defense Authorization Act ('NDAA') for fiscal year 2019. A key focus of legislation contained in the NDAA is to protect US technological advances through closer scrutiny of technology transfer to foreign persons and its implications on US national security and foreign policy. In addition to the Foreign Investment Risk Review Modernization Act ('FIRRMA'), which enhances the review of foreign investment in the US, the NDAA includes the Export Control Reform Act ('ECRA').¹ ECRA makes significant changes to US export controls, particularly with respect to emerging and foundational technologies, and imposes additional restrictions on the transfer of technology to foreign persons.²

Although ECRA largely codifies existing US export controls on commercial and dual-use (both civil and defence applications) commodities, software and technology, it also expands the jurisdictional reach of export controls and tightens restrictions in ways that will have a meaningful impact on cross-border transactions.

As discussed in more detail below, in addition to providing a permanent statutory authority for US export controls, ECRA:

- establishes an interagency review process to identify emerging and foundational technologies and impose appropriate export controls;
- requires collaborative arrangements (i.e., joint ventures) to disclose 'significant foreign ownership' to obtain export licences for such technologies;
- directs immediate review of restrictions and licence

requirements on the export of US items to embargoed countries, including China;

- requires more rigorous and far-reaching analysis of the impact to the US defence industrial base in

ECRA expands the jurisdictional reach of export controls and tightens restrictions in ways that will have a meaningful impact on cross-border transactions.

connection with granting export licences; and

- authorises export controls on activities by US persons related to foreign military intelligence services.

Permanent statutory authority for US commercial and dual-use export controls

ECRA provides a permanent statutory authority for the Export Administration Regulations ('EAR'), the first such authority since the Export Administration Act of 1979 lapsed in 2001.³ Administered by the US Department of Commerce's ('Commerce') Bureau of Industry and Security, the EAR broadly regulate the movement around the world of US commercial and dual-use items (including commodities, software and technology). The EAR impose restrictions and licensing requirements on the export and subsequent movement of these items to other countries or end-users (i.e., re-export or in-country transfer) based on the type of item, its intended end use, the

ultimate end-user and the destination. Items are classified by an export control classification number ('ECCN') based on the item's characteristics and applications, as defined in the Commerce Control List ('CCL'), and may require a licence from Commerce that authorises the export, re-export, deemed export, deemed re-export or in-country transfer of the item.

Emerging and foundational technologies

Interagency review process

For many years, the Department of Defense and other agencies – as well as Congress – have expressed concerns about the current export control regulatory processes, arguing that technology has outpaced regulators' ability to adequately protect the technological advantages of the US military and intelligence services as well as US economic leadership. ECRA directs the establishment of a formal, ongoing process to identify and review 'emerging and foundational technologies that are essential to the national security of the United States' and requires appropriate export controls for these technologies.

This interagency review process is intended to address a concern that current export controls do not adequately restrict the transfer of newly developed technologies. Although Commerce has the authority under the EAR to impose controls (including interim controls by assigning a temporary ECCN)⁴ on new technology for military, intelligence or foreign policy reasons, companies are not obligated to seek Commerce review before exporting such technologies. Items that are subject to the EAR – but not designated on the CCL – are classified as 'EAR99' and subject to only limited export restrictions. For

this reason, new technologies could be potentially exported as 'EAR99' without review by Commerce.

The new ECRA interagency review process will involve the departments of Commerce, Defense, State and Energy, along with other federal agencies, as appropriate, and will draw on publicly available information, classified information, and information from Commerce advisory committees and the Committee on Foreign Investment in the United States ('CFIUS') to identify 'emerging and foundational technologies'. ECRA does not define such technologies, but it excludes items already on the CCL, the US Munitions List ('USML') of the International Traffic in Arms Regulations ('ITAR'), certain nuclear equipment and material, and certain biological agents and toxins. The review process is expected to focus on cutting-edge technologies, including robotics; artificial intelligence; machine learning; positioning, navigation and timing; 5G; aerospace; financial technology; and virtual/augmented reality. ECRA directs the interagency review process to consider multiple factors in assessing whether a technology is 'emerging and foundational', including (i) the development of similar technologies in foreign countries, (ii) the impact export

Transactions that do not transfer the underlying technology or technical capability to foreign persons may be exempted from export licensing requirements.

controls would have on the development of the technology in the US, and (iii) the effectiveness of export controls on limiting the proliferation of the technology to foreign countries. Significantly, ECRA does not dictate a timeline for designating a technology as 'emerging and foundational', but such a designation is subject to a public notice and comment period.

Designation of a new technology as 'emerging and foundational' triggers Commerce to impose export controls with consultation from other federal agencies, which includes interim restrictions on the export of the

technology until export controls are finalised. Although Commerce has broad discretion to specify the appropriate level of control, ECRA mandates that – subject to limited exceptions discussed below – all technologies identified as 'emerging and foundational' must at a minimum require a licence for their export, re-export, or transfer to or in a country subject to a US embargo or arms embargo, which includes China.⁵

Regulation of collaborative arrangements

Under ECRA, Commerce may require collaborative arrangements, including a 'joint venture, joint development agreement, or similar collaborative arrangement', to disclose significant foreign ownership interests in applications for a licence to export emerging and foundational technologies. However, transactions that do not transfer the underlying technology or technical capability to foreign persons may be exempted from export licensing requirements. Specifically, ECRA authorises Commerce to make exceptions to export licensing requirements for emerging and foundational technologies – including for exports to embargoed countries (e.g., China) – pursuant to any of the following transactions:

- the sale or licence of a finished item and the provision of associated technology if the US person generally makes the finished item and associated technology available to its customers, distributors or resellers;
- the sale or licence to a customer of a product and the provision of integration or similar services if the US person generally makes such services available to its customers;
- the transfer of equipment and the provision of associated technology to operate the equipment if the transfer could not result in the foreign person using the equipment to produce 'critical technologies';
- the procurement by the US person of goods or services, including manufacturing services, from a foreign person, if the foreign person has no rights to exploit any technology contributed by the US person other than to supply the procured goods or services; and
- any contribution and associated support by a US person to an

Increased civil and criminal penalties

ECRA increases the current inflation-adjusted maximum civil penalty for violations of the EAR to the greater of \$300,000 or twice the value of the underlying transaction. Criminal penalties for wilful violations remain the same at the greater of \$1 million per violation or twice the value of the gain or loss from the transaction. Criminal penalties also may include imprisonment for a maximum of 20 years. Notably, these penalties also will apply to violations of the anti-boycott regulations.

industry organisation related to a standard or specification, whether in development or declared, including any licence of or commitment to license intellectual property in compliance with the rules of any standards organisation.

Tighter restrictions on export licensing

Immediate review of export controls on arms-embargoed countries

ECRA requires the departments of Commerce, State, Defense and Energy, along with other federal agencies as appropriate, to conduct an immediate review of the licence requirements for the export, re-export and in-country transfer of items to countries with a comprehensive arms embargo (e.g., China). The focus of this review is an assessment of existing export controls on items that currently do not require an export licence and items destined for military end uses or end-users. Commerce must implement any changes to the existing export controls within 270 days of the enactment of ECRA, or by about May 2019. This review may result in tighter controls on exports, re-exports and in-country transfers to China, in particular, with an emphasis on military applications and military or government end-users (e.g., modify the current case-by-case review policy to a policy of denial).

Enhanced review of export licence applications

The ECRA introduces a new policy consideration that Commerce must weigh in granting export licences – the impact of the export on the US defence

industrial base. Specifically, Commerce must deny an application for a licence to export, re-export or transfer an item if it will have a 'significant negative impact' on the US defence industrial base. ECRA provides that a proposed export would have a 'significant negative impact' if the export would result in any of the following:

- a reduction in the availability or production of an item in the US that is likely to be required by the US government for the advancement of national security;
- a reduction in the production of an item in the US that is the result of research and development carried out or funded by either the US government or a federally funded research and development center; and
- a reduction in the employment of US persons whose knowledge and skills are necessary for the continued production in the US of an item that is likely to be acquired by the US government for the advancement of national security.

To inform this assessment, Commerce may require licence applicants to provide additional information on the purpose and effect of the export on the production of items relevant for the defence

industrial base outside of the United States.

Expanded export controls on activities of US persons

In a noteworthy jurisdictional expansion, ECRA now provides Commerce authority to regulate the activities of US persons, wherever located, related to the provision of foreign military intelligence services.

The EAR primarily regulates US-origin items (commodities, software, technology) and not the activities of US persons with respect to items that are not subject to the EAR. The few activities of US persons, wherever located, that previously were and continue to be restricted under the

ECRA now provides Commerce authority to regulate the activities of US persons, wherever located, related to the provision of foreign military intelligence services.

EAR, relate to the export, re-export or transfer of any item (whether or not subject to US export control jurisdiction) if the US person has knowledge that such item will be used in connection with nuclear explosive devices, chemical or biological weapons, and missile technology and the performance of any related contract, service or employment. In addition to codifying these existing restrictions, ECRA has added 'foreign military intelligence services' to the list of covered activities by US persons. Although ECRA does not define 'foreign military intelligence services', licensing requirements under the EAR may complicate the provision of services in the defence, aerospace and intelligence industry.

Key takeaways

ECRA is part of a concerted effort to curtail the transfer of sensitive US

technologies, particularly to China. The changes highlighted above – the tightening of export controls on emerging and foundational technologies, increased scrutiny of export licence applications and expanded jurisdiction over US persons providing foreign defence intelligence services – are all designed to preserve and protect US national security and technological advancement.

Enhanced coordination between CFIUS and Commerce is likely to capture more transactions involving critical technology for a close examination of the associated technology. Foreign access to emerging and foundational technologies is likely to require export licences issued by Commerce under increased scrutiny, including in connection with pre-existing arrangements such as joint ventures and with respect to current foreign national employees of US companies. Furthermore, companies engaged in the aerospace, defence or intelligence industries may see increased licensing obligations for the provision of services by US persons.

Critically, however, many of the new provisions in ECRA do not take immediate effect and are not subject to a set time frame for implementation. Unless otherwise noted (e.g., the immediate review of controls for embargoed countries), ECRA extends the status quo until modified, superseded, set aside or revoked by Commerce. In some instances, such a change will require a formal rulemaking process (e.g., the interagency review process and controls on foreign military intelligence services), including public notice and comment. As a result, the full impact of ECRA will not be seen for some time.

Authors:

*Michael E. Leiter (partner),
Ivan A. Schlager (partner),
Donald L. Vieira (partner),
Daniel J. Gerkin (counsel),
Malcolm Tuesley (counsel),
Nicholas A. Klein (associate)*

www.skadden.com

Links and notes

¹ The NDAA, including both FIRRMA and ECRA, is available at <https://www.congress.gov/bill/115th-congress/house-bill/5515/text>.

² ECRA also encompasses the Anti-Boycott Act of 2018, which provides statutory authority for the anti-boycott regulations that govern the participation of US persons in unsanctioned foreign boycotts.

³ Since 2001, presidential executive orders under the International Emergency Economic Powers Act have authorized the EAR.

⁴ The EAR currently allow for the imposition of temporary controls on items by classifying the item under ECCN 0Y521 for up to one year with the ability to extend the temporary classification for two additional one-year periods.

⁵ Of note, technology designated as "emerging and foundational" also is considered "critical technology" that may trigger CFIUS review even for noncontrolling, nonpassive foreign investments. ECRA requires Commerce to provide a report to Congress and CFIUS every 180 days on the results of the interagency review process.

This article is reprinted from the October 2018 issue of WorldECR, the journal of export controls and sanctions.
www.worldecr.com