China—Law Firms

Exporting Commercial Goods And Technology To China Under The New Military End-Use Restrictions

Jonathan M. Epstein and Antonia I. Tzinova

HOLLAND & KNIGHT LLP

This summer, the Department of Commerce’s Bureau of Industry and Security (BIS) implemented controversial regulations expanding the types of commercial products requiring a license for export to China. Under the rule, the exports of certain controlled U.S. goods and technology that previously could be shipped to China without a license now require an export license if the goods or technology will have a “military end-use” in China. To offset the controversial restrictions, the regulations also allow certain otherwise licensable exports to be made to “Validated End-Users” in China and India approved by BIS.

When originally proposed, the China Rule was widely contested by many in the U.S. business community because of the ambiguity and effect on U.S. business for items uncontrolled by most other countries. Although BIS made some concessions by limiting the scope of the rule, it believes that the rule targets a carefully considered list of military useful items not widely available on the world markets. Such a list was hotly contested by many in the industry, final regulations were issued this summer.

When Do The Additional Restrictions Of The China Rule Apply?

The additional licensing restrictions apply if: (1) a product, software, or technology is on the list of controlled items; and (2) the U.S. exporter knows or has reason to know that the item is going to a military end-user.

What Additional Items Are Controlled?

Expanded List of Controlled Items. All products, software, and technology controlled under the China Rule are already on the Commerce Control List (CCL); however, prior to issuance of this regulation, they could generally be exported without a license to any country, entity, or individual, except for embargoed countries and certain prohibited end-users or end-uses. These items include certain products, software, and associated technology in twenty categories, including:

• depleted uranium
• carbon fiber and prepregs for use in composite structures
• hydraulic fluids
• bearings and bearing systems
• computer and non-computer controlled machine tools used for generating optical quality surfaces
• dimensional inspection or measuring equipment

Jonathan M. Epstein is a Partner in the Washington, DC office of Holland & Knight, where he practices in the firm's International & Cross Border Transactions Group. He may be reached at (202) 836-1070. Antonia I. Tzinova is an Associate in the firm's Washington, DC office, where she practices in the International & Cross Border Transactions Group. She may be reached at (202) 419-2661.

As these terms are defined by BIS:

• an item is exported for a “deployment” of civil or militarized aircraft and aero gas-turbine engines, if such items will be assigned to Chinese military units.

When Licenses Be Granted?

If the product is on the China Rule list and will be exported for a military end-use, a company can apply for a license, but grants of such licenses are likely to be few and likely only if evidence is presented to support such a request to a lengthy interagency review process.

No License Exceptions. Generally, no license exceptions will be applicable where there is a military end-use.

Presumption of Denial. BIS has adopted a formal “presumption of denial” for any license applications for the export of all items controlled for national security, chemical, biological, proliferation reasons, or for which the item would make a direct and significant contribution to the Chinese government’s military capabilities, including major weapon systems which contain night vision systems, and the broad categories of Command Control Communications Computer Intellligence Surveillance and Reconnaissance (C4ISR).

Required End-User Statement. An “end-user statement” will be required for any licensable export to China if it exceeds $5,000 in total value, except for certain controlled cameras and computers where the limit is $5,000. This end-use certificate is issued by MOFCOM, the Chinese Ministry of Foreign Commerce. Since this rule was not coordinated with MOFCOM, it is unclear how easy it will be to obtain such certificates.

What Is The Validated End-User (VEU) Program?

The one “carrot” in these regulations is a new provision that allows a Chinese (and now Indian) company to receive advance screening as a “validated end-user.” A VEU company can receive items that would otherwise require a license to export to China or India. In theory, this could apply to any company; provided the Chinese company intends to use the item for a bona fide commercial purpose at its facility, consume it during production or transfer it subject to export. However, as a practical matter, very sensitive technologies are unlikely to fall under the VEU program.

Reduction in Licensing. Since certain industries represent a significant portion of the technologies currently licensed, BIS expects that the VEU program may reduce the number of licenses by as much as 30 percent based on the dollar value of the licensable exports.

Initial VEU’s Approved. In October 2007, BIS published the names of the first five companies that have received VEU status. BIS itself or its agents confirmed that a Chinese company has appropriate security screening and assurance that the technology is not going to a military end-user.

MOFCOM Reaction. Immediately after BIS released the names of the approved companies, the Chinese Government issued a directive stating that the United States should not visit for VEU screening any companies registered in China without prior permission from MOFCOM. U.S. officials have downplayed the Chinese move pointing out that the directive simply requires approval rather than formulating a denial policy.

Tips For Complying With The New China Rule

Any U.S. company exporting to China needs to review its existing products and customers to determine whether it is affected by the new regulations. The hardest part of compliance will be assessing whether the steps need to be taken to reasonably assure the item is not going to a military end-use. Some measures to consider are the following:

Contractual Requirements / Customer Certification. A U.S. company should consider including end-use restrictions as a contractual provision, or as part of a separate customer certification form.

Additional Due Diligence on New Customers. With respect to new customers, companies should consider conducting some level of due diligence, particularly given the wide definition of military end-use that will be applied.

Documentation Bona Fide Commercial Use On License Applications. It is not uncommon for companies to argue on license applications for commercial use in China, requiring exporters to go to great lengths to demonstrate the bona fide commercial use of its Chinese customers.

Conclusion

Because the products, software, and technology on the expanded list of controlled items are not generally subject to export restrictions to most countries, these new regulations create an additional administrative burden on companies exporting to China. In addition, underlying this new regulation is a policy goal of trying to prevent U.S. products and technology from being used to enhance the military. In this light, virtually any sale to the Chinese military or its wide-flung commercial enterprises is potentially a suspect. It may be that BIS’ recent expansion of the criteria for designating entities on the list is a precursor to allow BIS to add to the list certain Chinese entities closely associated with the Chinese military.

While U.S. industry and Chinese news sources remain highly critical of these new restrictions, when weighing the costs and benefits, significant efforts to engage U.S. exporters in formulating the regulation. As ambiguities are raised by those in the affected industries, BIS is likely to provide additional interpretive guidance.


2 See “Commerce Department Announces Updated Export Controls for China; ‘BIS Press Release (June 15, 2007.)


Please email the authors at jonathan.epstein@hklaw.com or antonia.tzinova@hklaw.com with questions about this article.