

ALERT

Export Control Reform Act Paves the Way for Tighter Controls on Emerging and Foundational Technologies and U.S. Arms Embargoed Countries

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On August 13, 2018, President Trump signed the John S. McCain National Defense Authorization Act for Fiscal Year 2019 (NDAA). In addition to significantly expanding the jurisdiction of the Committee on Foreign Investment in the United States (CFIUS) to review transactions, the NDAA also includes the Export Control Reform Act of 2018 (ECRA). Along with establishing permanent statutory authority for U.S. export controls on commercial, dual-use, and less sensitive military items, the ECRA requires a formal interagency process for identifying emerging and foundational technologies that are essential to U.S. national security and provides authority for tightening export controls on countries subject to U.S. arms embargoes. Below are a few key takeaways.

Permanent Statutory Authority for Export Controls

The U.S. Department of Commerce's (Commerce) Bureau of Industry and Security (BIS) administers the Export Administration Regulations (EAR), which are the export controls applicable to commercial, dual-use, and certain less sensitive military hardware, software, and technology. The EAR also include antiboycott reporting requirements and prohibitions to counter the effectiveness of the Arab League's boycott of Israel. The Export Administration Act of 1979 served as the authority for BIS's EAR, but it lapsed in 2001, requiring the President to issue successive Executive Orders so that the EAR could continue in effect. The ECRA solves this problem by providing permanent statutory authority for Commerce's export controls and antiboycott

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requirements.

Overall, the ECRA codifies many existing regulations, rules, agency practices, and definitions (including by correcting an error in the definition of “U.S. person” in an earlier draft of the bill that potentially would have excluded U.S. subsidiaries of foreign parent companies from the definition and would have been a significant departure from current law and agency practice). It also codifies the civil and criminal penalties for violations of these rules. Consistent with pre-ECRA authority, criminal penalties can include fines of up to \$1 million and, for individuals, up to 20 years in prison. Civil penalties include fines of up to \$300,000 or twice the value of the transaction at issue, revocation of export licenses, and the denial of export privileges.

Interagency Process for Identifying Emerging and Foundational Technologies

While BIS has a regulatory process for imposing temporary export controls on new technologies that provide a significant military or intelligence advantage to the United States, the ECRA requires the President to establish a formal, robust interagency process that includes the U.S. Departments of Commerce, Defense, Energy, State, and other appropriate federal agencies to identify early in the development process “emerging and foundational technologies” that are essential to U.S. national security. This process could impact a wide-range of U.S. technologies and industries, including Artificial Intelligence, robotics, and aerospace.

Once these technologies are identified, the ECRA requires the Commerce to impose fairly stringent controls on exports, reexports, and in-country transfers of such technologies. At a minimum, and unless a statutory exception applies, Commerce must require a license for transactions to or in any country subject to an embargo. Notably, this includes not only countries subject to comprehensive U.S. sanctions, such as Iran, Cuba, North Korea, and Syria, which generally could not receive these items anyway, but also countries subject to a U.S. arms embargo, including China and other countries identified in Country Group D:5 in the EAR. U.S. companies submitting license applications on behalf of a joint venture or other collaborative arrangement to export emerging and foundational technology also may be required to identify any foreign person with a significant ownership interest in the foreign partner.

As noted, there are potential exceptions to this broad technology restriction, including for transactions where a U.S. person makes the finished item and associated technology available to customers, distributors, or resellers; contributions by U.S. persons to an industry organization related to development of a standard or specification; and foreign procurement where the foreign person has no rights to exploit the U.S. technology other than to supply the procured goods or services.

Increased Scrutiny for Countries Subject to a U.S. Arms Embargo

Separate from the strict controls that will be applied to potential exports of emerging and foundational technologies to countries subject to a U.S. arms embargo, the ECRA also includes a mandatory interagency review of all other license requirements for these countries. This review will cover the scope of controls on exports to military end-users or for military end-uses as well as U.S. products and technologies that currently do not require a license for export to the arms embargoed countries. Depending on the results of the review,

U.S. companies may face even more export restrictions on shipments to these countries, including China.

Licensing Process Safeguards to Protect the Defense Industrial Base

Further, the ECRA codifies a requirement in the export license review process to assess the impact of a proposed export and the denial of a license request on the U.S. defense industrial base. This will require license applicants to provide certain pertinent information, such as whether the purpose or effect of the transaction is to allow for significant production of items outside the United States. In making this assessment, Commerce will consider factors such as the potential reduction in any of the following: (1) the availability of a U.S. item that is likely to be acquired by the U.S. Department of Defense (DOD) or another national security-related department or agency, (2) U.S. production of an item that resulted from government-funded research and development, or (3) employment of U.S. persons with the knowledge and skills required for continued production of an item likely to be acquired by DOD or another national security-related department or agency.

No Restatement of the Export Ban on ZTE Corporation

Much to the relief of many U.S. and foreign companies, Congress did not include in the final NDAA a provision in the Senate's version of the bill that would have required Commerce to reinstate a denial order on Chinese telecom giant ZTE Corporation. In July, Commerce lifted the order in exchange for compliance commitments from ZTE, paving the way for companies to reengage in business with the company. Nevertheless, and although not technically part of the ECRA, the NDAA includes a provision prohibiting the U.S. government from procuring or using certain telecommunications and video surveillance equipment and services. Among others, the targeted companies include ZTE and Huawei.

Wiley Rein further addresses other important aspects of the 2019 NDAA, including sections reforming the Committee on Foreign Investment in the United States (CFIUS), important cyber provisions, and provisions impacting government contractors. The firm also hosted a webinar titled, "Everything You Need to Know About the FY 2019 National Defense Authorization Act". For more information on the webinar, please contact one of the authors of this alert.