

## BIS Proposes to Tighten Controls on Exports to China

The Bureau of Industry and Security of the U.S. Department of Commerce (BIS) has just published its long heralded proposed (but not yet implemented) amendments to the Export Administration Regulations (15 C.F.R. Part 730, *et seq.*; the (EAR)) that would stiffen controls on exports of items for military end-use to the People's Republic of China (PRC) and implement several associated changes relating to exports to the PRC. See 71 Fed. Reg. 38,313 (July 6, 2006). Comments on the proposed rule are due by November 3, 2006 and BIS has just announced a public meeting for July 17, 2006 to discuss the amendments. See 71 Fed. Reg. 39,054 (July 11, 2006). The proposal has been much anticipated and is likely to cause considerable debate due to concerns that the proposed changes may significantly increase compliance risks and impair even commercial export trade with the PRC.

### **New Controls on Exports Based on Knowledge of Military End-Use and Amendment of Licensing Review Policy for National Security Controlled Items**

The rule proposes a new licensing requirement for exports to the PRC of certain Commerce Control List (CCL) items that ordinarily do not require a license to the PRC. Under the amendment, a license would be required when the exporter has knowledge<sup>1</sup> that the subject item is intended or has been informed by BIS<sup>2</sup> is or may be intended, entirely or in part, for a military end-use.<sup>3</sup> The CCL items implicated by the proposed licensing requirement, which is set forth in proposed Section 744.21 of the EAR, are listed in a new Supplement No. 2 to Part 744 of the EAR.<sup>4</sup> The listed CCL items, which are primarily controlled for antiterrorism (AT) reasons, were identified by an interagency group as having the potential to advance the military capabilities of the PRC, and include: certain types of bearings and machine tools (Category 2); certain types of oscilloscopes (Category 3); certain telecommunications test equipment (Category 5 – Part 1); certain non-“mass market” encryption commodities and software (Category 5 – Part 2); certain types of lasers and optical sensing fibers (Category 6); certain navigation direction finding equipment, airborne communication equipment, and aircraft inertial navigation systems (Category 7); certain underwater systems and equipment (Category 8); and certain aircraft and gas turbine engines and vibration testing equipment (Category 9).

License applications would be reviewed on a case-by-case basis to determine whether the export, reexport, or transfer of the listed item would make a material contribution to the military capabilities of the PRC and advance the PRC's military activities contrary to the national security interests of the United States. In addition, such applications may be reviewed under chemical and biological weapons, nuclear nonproliferation, or missile technology review policies if the end-user may be involved in certain proliferation activities. Finally, applications for items that currently require a license for the PRC that

<sup>1</sup> The proposed rule adopts the definition of “knowledge” set forth in Section 772.1 of the EAR: “Knowledge of a circumstance . . . includes not only positive knowledge that the circumstance exists or is substantially certain to occur, but also an awareness of a high probability of its existence or future occurrence.”

<sup>2</sup> BIS would inform exporters that a license is required for specific exports, reexports, or transfers of an item due to an unacceptable risk of use in or diversion to military end-use activities in the PRC either (i) individually by specific notice; (ii) through an amendment to the EAR published in the *Federal Register*; or (iii) through a separate notice published in the *Federal Register*.

<sup>3</sup> Exporters may avoid the licensing requirements set forth in the proposed rule only if the proposed export qualifies under License Exception GOV.

<sup>4</sup> In addition, the proposed rule would amend Section 744.6 of the EAR to prohibit any U.S. person from knowingly supporting, which includes financing, transporting, and freight forwarding, such an export without the required license.

are destined for a military end-use also would be evaluated to determine whether the export, reexport, or transfer of that item would make a material contribution to the military capabilities of the PRC and advance the PRC's military activities contrary to the national security interests of the United States.

The rule proposes to define the term "military end-use" as:

. . . incorporation into, or use for the production, design, development, maintenance, operation, installation, or deployment, repair, overhaul, or refurbishing of items: (1) Described on the U.S. Munitions List (USML) (22 CFR Part 121, International Traffic in Arms Regulations); (2) Described on the International Munitions List (IML) (as set out on the Wassenaar Arrangement Web site at <http://www.wassenaar.or>); or (3) Listed under Export Control Classification Numbers (ECCNs) ending in "A018" on the CCL in Supplement No. 1 to Part 774 of the EAR.<sup>5</sup>

The rule further proposes to amend Section 742.4(b)(7) of the EAR to clarify the licensing review policy for items controlled on the CCL for reasons of national security (*i.e.*, controlled pursuant to the Wassenaar Arrangement) destined to the PRC. Specifically, the proposed rule explicitly creates a presumption of denial for license applications to export, reexport, or transfer items that BIS determines on a case-by-case basis would make a material contribution to the military capabilities of the PRC.

### Revision of End-User Certificate Requirements

The proposed rule further requires that exporters obtain an End-User Certificate issued by the PRC Ministry of Commerce (MOFCOM) for all items that require a license to the PRC for any reason and exceed a total value of \$5,000 per single ECCN entry.<sup>6</sup> However, the End-User Certificates would not be required to be submitted to BIS as supporting documentation with the license application. Instead, exporters would be required to include the serial number of the End-User Certificate on the license application, and to retain the certificate in accordance with the recordkeeping provisions of the EAR.

### New Authorization Validated End-User

Finally, the rule proposes a new authorization, Validated End User (VEU), which would allow the export, reexport, and transfer of eligible items to specified end-users in an eligible destination, including the PRC.<sup>7</sup> A list of validated end-users, respective eligible items, and eligible destinations would appear in proposed Supplement No. 7 to Part 748 of the EAR.

In conjunction with other relevant agencies, including the Departments of State, Energy, and Defense, BIS proposes to evaluate prospective validated end-users on the basis of a range of specific factors, which include the party's record of exclusive engagement in civil end-use activities; the party's compliance with U.S. export controls; the party's capability to comply with the requirements for VEU; the party's agreement to on-site compliance reviews by representatives of the United States Government; and the party's relationships with U.S. and foreign companies. BIS also would consider the status of export controls in the eligible destination and the support and adherence to multilateral export control regimes of the government of the eligible destination.

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<sup>5</sup> The proposed rule defines (1) production as "integration, assembling, inspection, or testing," (2) development as "design," including "testing and building of prototypes"; (3) maintenance as "performing work to bring an item to its original or designed capacity and efficiency for its intended purpose," including "testing, measuring, adjusting, inspecting, replacing parts, restoring, calibrating, overhauling"; (4) operation as "to cause to function as intended"; (5) installation as "to make ready for use", including "connecting, integrating, incorporating, loading software, and testing"; and (6) deployment as "placing in battle formation or appropriate strategic position."

<sup>6</sup> In addition, if a license application lists multiple ECCNs and the total value of the entries requiring a license to the PRC for any reason exceeds \$5,000, a PRC End-User Certificate covering all of the controlled items on the application must be obtained. End-User Certificates for computer exports requiring licenses to the PRC would still be required, regardless of the dollar value of the export.

<sup>7</sup> Items controlled under the EAR for missile technology (MT) and crime control (CC) reasons may not be exported or reexported under this authorization.

Requests to be listed as a validated end-user would be submitted in the form of an advisory opinion request. Such requests would be required to include a list of items identified by ECCN and a description of how each item would be used by the eligible end-user in the eligible destination. BIS would accept such requests from exporters, reexporters, and end-users.

Once an end-user is validated, exporters and reexporters who use authorization VEU would be required to submit an annual report to BIS and would be subject to auditing on a routine basis. In addition, upon request by BIS, exporters, reexporters, and validated end-users would be required to allow inspection of records on on-site compliance review.

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Although the proposed amendments underwent an extended interagency review process prior to publication, which included some informal input from the exporter community, the notice nonetheless is expected to generate considerable controversy and further comment. There is a possibility that further comments will result in some adjustments to the proposed regulations, particularly relating to the circumstances under which an exporter may be held to have knowledge of an intended military end use. Accordingly, any businesses that may be impacted by the proposed rule, and in particular those exporting items specifically covered in the amendments, should consider submitting comments. Also, to avoid undue disruption associated with the eventual implementation of the final amendments, such businesses should begin assessing how the proposal may affect their current and proposed business activities involving the PRC and the measures that may be required to ensure compliance.

#### FOR MORE INFORMATION . . .

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