

What U.S. and Chinese companies need to know about U.S. export control laws applicable to China



The People's Republic of China is the United States' second-largest trading partner and third-largest export market, yet U.S. exports to the country are among the most strictly controlled. Joseph D. Gustavus details the regime that governs trade between the two countries.

According to a recently published report of the U.S. Congressional Research Service, the United States and the People's Republic of China ('China') expanded economic ties substantially over the past three decades. Total U.S.-China trade rose from \$5 billion in 1981 to \$503 billion in 2012.¹ China is currently the United States' second-largest trading partner and third-largest export market.² The mutually beneficial trade relationship between China and the United States is growing increasingly complex due to the rapid pace of economic integration.

At the same time, U.S. national security concerns are at a high-water mark. U.S. technology transfers to China under U.S. export control laws receive increasing scrutiny from enforcement authorities. Significant civil and criminal penalties result from violating the confusing patchwork of U.S. export control laws, which control the possession, trade, and export of controlled items and technology. U.S. export control compliance is particularly important for companies involved in the aerospace, automotive, defence, information technology, telecommunications, and software industries.

U.S. export control laws have an extraterritorial reach, leading to the prosecution of foreign persons located abroad. The sentencing on 20 December 2012 of Xun Wang, a former managing director of PPG Paints Trading (Shanghai) Co., Ltd., to one year in prison for violating U.S. export control laws illustrates this point.³ Whether the U.S. exporter is a U.S. parent company of a Chinese subsidiary or an existing or recently acquired U.S. subsidiary of a Chinese parent company, the same concerns apply.

This article explores the purposeful tailoring of certain aspects of U.S. export control laws to regulate exports of controlled items to China.

U.S. International Traffic in Arms Regulations ('ITAR')

ITAR controls the export from the U.S. of controlled items classified as defence articles, defence services, or technical data covered by the ITAR's U.S. Munitions List ('USML').⁴ U.S. export

Shipment of U.S. defence articles licensed for export on any vessel, aircraft or other transport that is owned, operated by, or leased from a Chinese location is prohibited.

control laws under ITAR primarily affect the defence and aerospace industries.

Additionally, despite its name, the USML broadly covers many items other than munitions, such as rockets and associated technology, tanks and military vehicles, surface and submersible naval war vessels, special naval equipment, aircraft and associated technology, military electronics, optical and guidance equipment, chemical and biological agents, satellite, spacecraft systems, and associated technology. The Directorate of Defense Trade Controls ('DDTC') approves the export from the U.S. of defence articles and defence services, and technical data covered by the USML.

U.S. defence article exports to and from U.S. and China

It is the policy of the U.S. for national security reasons to deny licences and other approvals for ITAR-covered USML item exports to (and imports from) China of defence articles, defence services, and technical data.⁵ Obtaining an export licence from the DDTC for the export of U.S. defence articles, defence services, or technical data to China is prohibited.

Chinese defence article imports to the U.S

There is a U.S. prohibition on imports of Chinese defence articles into the U.S. which will apply if the item is covered by the United States Munitions 'Import' List.⁶ This list is a subset of the USML and applies to imports into the U.S. rather than exports. It should also be noted that China has its own system of export controls for weapons of mass destruction- ('WMD') related goods and technologies.

Shipment by Chinese vessels, aircraft, and other transport

Also of note is that shipment of U.S. defence articles licensed for export on any vessel, aircraft or other transport that is owned, operated by, or leased from a Chinese location is prohibited.⁷ Each ITAR export control licence issued by the DDTC has end-user limitations, which limit use to specified end-users and limit further diversion or transshipment to other end-users. Since 1990, the DDTC has operated the 'Blue Lantern' end-use monitoring programme⁸ which monitors the end use and transshipment of U.S. defence articles, defence services, and technical data subject to ITAR export controls.⁹ DDTC enforcement personnel conduct

Blue Lantern checks abroad to identify and investigate transactions and controlled items that appear to be at risk of further diversion or transshipment to prohibited destinations. Specifically, the DDTC enforcement personnel check for the diversion or transshipment of ITAR-controlled items to China from the foreign destination originally licensed for export.

Chinese companies should be careful to note that Chinese operations, their foreign personnel, their development activities, and resultant defence articles produced may become subject to ITAR export controls through any use of (a) U.S. components, services, or technology controlled under ITAR, or (b) foreign personnel possessing or having access to these controlled items. Chinese companies with any U.S. operations or U.S. market presence should engage in careful planning and coordination to ensure that their Chinese operations, their foreign personnel and their transactions with the U.S. do not become subject to U.S. export controls under ITAR.

Export Administration Regulations ('EAR')

Because of their specific technical capabilities, certain commercial-based systems, equipment and components; test, inspection and production equipment; materials; software; and technologies may be covered by the U.S. Commerce Control List ('CCL') and subject to export controls under EAR. Unlike ITAR export controls, EAR-based export controls affect all industries, including aerospace, automotive, information technology, telecommunications, and software industries. The Bureau of Industry and Security ('BIS') is charged with controlling and approving the export of those items covered by the CCL.

Current EAR section 744.21(a)(2) requires a licence prior to shipment to China of items intended for 'military end-use'.⁴⁰ However, on 16 April 2013, the BIS published a Final Rule (effective 15 October 2013) amending the EAR to create a new '600' series of military items on the CCL (i.e., items tagged as military).⁴¹ The 600 series identifies items of military significance to the U.S.⁴² As before, an export control licence from the BIS will be required prior to shipment to China of items within the 600 series. It should

Recent export control prosecutions involving China

The following are some recent prosecutions of companies and individuals for exports of U.S. items and technology to China in violation of U.S. export control laws.²²

- 30 May 2013: A Chinese citizen pled guilty in the Eastern District of New York for attempting to export weapons-grade carbon fibre from the United States to China. The carbon fibre is a high-tech material used frequently in military, defence and aerospace industries, and which is therefore closely regulated. The defendant will face up to 20 years in prison and a fine of up to \$1 million.²³
- 17 January 2013: A U.S. district court in the Eastern District of Pennsylvania sentenced a U.S. national to 42 months in prison, three years' supervised release and a \$1,000 fine for exporting 57 microwave amplifiers from the U.S. to customers in India and China without an export control licence. This investigation was conducted by the BIS under suspected EAR export control violations.
- 6 December 2012: A U.S. national was arrested on an indictment for allegedly using his U.S. company, Dahua Electronics Corporation, to export rocket nozzle coatings and other goods controlled under the ITAR to China. He also exported microwave amplifiers controlled under the EAR to China by falsely stating that the goods were destined for an educational institution in New York, rather than military uses in China. This investigation was conducted by the BIS and FBI under suspected EAR export control violations.
- 18 December 2012: The Department of Justice ('DOJ') indicted two Chinese nationals for alleged export and money-laundering violations in connection with efforts to obtain dual-use programmable logic devices ('PLDs') having possible military applications from the United States for export to China. The FBI investigated the case in cooperation with the BIS.
- 5 December 2012: The BIS charged a U.S. national for EAR export control violations for causing the export of sensitive U.S. carbon fibre from the U.S. to Belgium and then causing the illegal transshipment of the sensitive carbon fibre to China.
- 3 December 2012: The BIS charged a Chinese company, China Nuclear Industry Huaxing Construction Co., Ltd., for export control violations under EAR for engaging in the transshipment of sensitive U.S. high-performance coatings from China to a nuclear reactor in Pakistan.
- 4 October 2012: The DDTC charged a Chinese national for export control violations under ITAR for illegal weapons trafficking and exporting multiple shipments of firearms from the U.S. to China.
- 26 September 2012: The DOJ convicted a Chinese national for export control violations under ITAR for taking export-controlled technical data on military technology from a U.S. employer to China on his laptop without a U.S. export control licence.
- 24 July 2012: The BIS charged a Singapore company, which then entered into a settlement agreement and agreed to pay a fine of \$110,000 for export control violations under EAR, for engaging in the transshipment of sensitive U.S.-origin technologies to two Chinese nationals in China.
- 28 June 2012: The DDTC filed charges against United Technologies subsidiaries (Pratt & Whitney Canada and Hamilton Sundstrand), which pled guilty to criminal charges under ITAR and agreed to pay a fine of \$75 million for helping China develop a new attack helicopter by providing electronic engine control software.
- 23 May 2012: The BIS charged a Chinese national who was a sales manager at MKS Instruments Shanghai, Ltd., a Chinese subsidiary of a U.S. company, for causing millions of dollars of sensitive pressure-measuring sensors to be exported from the U.S. and delivered to unauthorised end-users by using export licences fraudulently obtained from the BIS.

be noted that the BIS has a strong presumption of denial of export control licences for items within the 600 series that make a direct and significant contribution to Chinese military capabilities.

Non-600 series items subject to EAR export controls are generally eligible for export to China upon procurement of an export control licence from the BIS or upon qualifying for a particular EAR licence exception. The availability of an export licence or

licence exception depends upon the specific item covered by the CCL and the reasons for control. The reason for imposing export controls under EAR for controlled items exported to China include U.S. national security interests; non-proliferation of chemical and biological weapons; non-proliferation of missile technology; maintenance of regional stability; nuclear non-proliferation; and, to a lesser extent, for China, syndicated crime control.⁴³ Even some select EAR-controlled items

Links and notes

- ¹ Wayne M. Morrison, Cong. Research Serv., RL 33536, China-U.S. Trade Issues 2 (2012).
- ² Id.
- ³ Press release, Dep't of Justice: 'Former managing director of PPG Paints Trading (Shanghai) Co., Ltd., sentenced to a year in prison for conspiring to illegally export high-performance coatings to nuclear reactor in Pakistan' (20 December 2012).
- ⁴ 22 C.F.R. § 121.
- ⁵ 15 C.F.R. § 126.1(a).
- ⁶ 27 C.F.R. § 447.21.
- ⁷ 15 C.F.R. § 126.1(b).
- ⁸ Defense Trade Controls Compliance, *End-use monitoring of defense articles and defense services commercial exports* (2012).
- ⁹ Id.
- ¹⁰ 15 C.F.R. § 744.21(a)(2).
- ¹¹ Amendment to the International Traffic in Arms Regulations: Initial Implementation of Export Control Reform, 78 Fed. Reg. 73, 22740 (16 April 2013) (to be codified 22 C.F.R. pts. 120, 121, and 123).
- ¹² Id.
- ¹⁴ 15 C.F.R. § 738.
- ¹⁴ 15 C.F.R. § 748.15, § 748 Supplement No. 7.
- ¹⁵ 15 C.F.R. § 744.21, § 744 Supplement No. 2.
- ¹⁶ Id.
- ¹⁷ 15 C.F.R. § 748.10.
- ¹⁸ 15 C.F.R. § 748.9(b)(2).
- ¹⁹ 15 C.F.R. § 744.21.
- ²⁰ Id. § 744.21(a).
- ²¹ Id. § 744.21(e).
- ²² See: *Summary of major U.S. export enforcement, economic espionage, trade secret and embargo-related criminal cases*, Department of Justice (February 2013), www.pmdotc.state.gov/compliance/documents/OngoingExportCaseFactSheet022013.pdf
- ²¹ Press release: *Department of Justice, Cyber-sting nets Chinese national in attempt to export sensitive defense technology* (30 May 2013).

on the CCL are eligible for export to China without an export control licence or licence exception. A determination of whether an EAR export licence or licence exception for exports to China is required and is performed on a case-by-case basis.

China-specific licence policy for EAR-controlled items

It is important for Chinese companies to note that the BIS has developed a specific licensing policy for certain high-technology exports to China. On the one hand, this China-specific licence policy facilitates exports to trusted companies in China; and on the other, it imposes additional licensing requirements for exports to China of items controlled by EAR.

a) Validated end-user programme for exports to China

The BIS has a validated end-user ('VEU') programme. This programme facilitates exports of

items controlled by EAR to trusted companies in China. Pre-screened Chinese companies may qualify for, and receive, VEU designation from the BIS. Thereafter, the Chinese company may receive U.S. exports and certain EAR-controlled items without EAR export licences. The BIS publishes a list of approved Chinese validated end-users.¹⁴ Requests for VEU designation are prepared and submitted to the BIS for consideration.

b) Additional licensing requirements for exports to China

The BIS imposes additional China-specific licensing requirements on a targeted list of items covered by the CCL ('target list items') that, though commercial, have the potential to contribute to China's military modernisation. This list of items, 30 in all, covers 20 product categories and associated technologies and software.¹⁵ These China-specific

licensing requirements impose stricter end-use controls on EAR-controlled technologies comprised of, or usable with, aircraft and aircraft engines, avionics and inertial navigation systems, lasers, depleted uranium, underwater cameras and propulsion systems, certain composite materials, and some telecommunications equipment.¹⁶ Furthermore, Chinese companies receiving target list items must provide U.S. exporters with PRC end-user statements as specified under the EAR.¹⁷ Exporters must obtain an end-user certificate from the PRC Ministry of Commerce ('MOFCOM') for any export that requires a licence to China that exceeds \$50,000 in total value.¹⁸ PRC end-user statements help facilitate the BIS's ability to conduct end-use checks on exports of controlled articles and technologies to China. Additionally, if the exporter knows that the export is destined for military end use in China, the exporter must obtain a licence.¹⁹ There are 31 items, identified by their export classification control number ('ECCN'), that are subject to this military end-use requirement.²⁰ The BIS will deny any licence where the export will make a material contribution to the PRC's military capabilities contrary to U.S. national security concerns.²¹

BIS China office

The BIS issues EAR export control licences with end-user limitations, which limit use to specified end-users and limit further diversion or transshipment to other end-users. Like the DDTC Blue Lantern programme, the BIS staffs special agents overseas as export control officers ('ECOs') in Beijing and Hong Kong to ensure compliance with the end-use licence limitations in EAR export control licences issued by the BIS.

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