

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

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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.<sup>i</sup> China is currently the United States' second-largest trading partner and third-largest export market.<sup>ii</sup> 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, defense, 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 December 20, 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.<sup>iii</sup> 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 defense articles, defense services, or technical data covered by the ITAR's U.S. Munitions List ('USML').<sup>iv</sup> U.S. export control laws under ITAR primarily affect the defense and aerospace industries.

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 defense articles and defense services, and technical data covered by the USML.

### U.S. defense article exports to and from U.S. and China

For national security reasons, U.S. policy is to deny licenses and other approvals for ITAR-covered USML item exports to (and imports from) China of defense articles, defense services, and technical data.<sup>v</sup> Obtaining an export license from the DDTC for the export of U.S. defense articles, defense services, or technical data to China is prohibited.

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### Chinese defense article imports to the U.S.

The U.S. prohibits imports of Chinese defense articles into the U.S. if the item is covered by the United States Munitions 'Import' List.<sup>vi</sup> 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

Shipment of U.S. defense articles licensed for export on any vessel, aircraft or other transport owned, operated by, or leased from a Chinese location is prohibited.<sup>vii</sup> Each ITAR export control license 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 program<sup>viii</sup> which monitors the end-use and transshipment of U.S. defense articles, defense services, and technical data subject to ITAR export controls.<sup>ix</sup> 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 defense 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 license prior to shipment to China of items intended for "military end-use."<sup>x</sup> However, on April 16, 2013, the BIS published a Final Rule (effective October 15, 2013) amending the EAR to create a new '600' series of military items on the CCL (i.e., items tagged as military).<sup>xi</sup> The 600 series identifies items of military significance to the U.S.<sup>xii</sup> As before, an export control license from the BIS will be required prior to shipment to China of items within the 600 series. The BIS has a strong presumption of denial of export control licenses for items within the 600 series that make a direct and significant contribution to Chinese military capabilities.

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Non-600 series items subject to EAR export controls are generally eligible for export to China upon procurement of an export control license from the BIS or upon qualifying for a particular EAR license exception. The availability of an export license or license 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 nonproliferation; and, to a lesser extent, for China, syndicated crime control.<sup>xiii</sup> Even some select EAR-controlled items on the CCL are eligible for export to China without an export control license or license exception. A determination of whether an EAR export license or license exception for exports to China is required. This determination is performed on a case-by-case basis.

### China-specific license 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 one hand, this China-specific license policy facilitates exports to trusted companies in China. On the other hand, it imposes additional licensing requirements for exports to China of items controlled by EAR.

#### *a) Validated end-user program for exports to China*

The BIS has a validated end-user ('VEU') program. This program 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 licenses. The BIS publishes a list of approved Chinese validated end-users.<sup>xiv</sup> 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 modernization. This list of items, 30 in all, covers 20 product categories and associated technologies and software.<sup>xv</sup> 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.<sup>xvi</sup>

Furthermore, Chinese companies receiving target list items must provide U.S. exporters with PRC end-user statements as specified under the EAR.<sup>xvii</sup> Exporters must obtain an end-user certificate from the PRC Ministry of Commerce ('MOFCOM') for any export that requires a license to China that exceeds \$50,000 in total value.<sup>xviii</sup> PRC end-user statements help facilitate the BIS's ability to conduct end-use checks on exports of controlled articles and technologies to China. Also, if the exporter knows that the export is destined for military end use in China, the exporter must obtain a license.<sup>xix</sup> Thirty-one items are subject to this military end-use requirement, and are identified by their export classification control number ('ECCN').<sup>xx</sup> The BIS will deny any license where the export will make a material contribution to the PRC's military capabilities contrary to U.S. national security concerns.<sup>xxi</sup>

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## BIS China office

The BIS issues EAR export control licenses 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 program, the BIS staffs special agents overseas as export control officers ('ECOs') in Beijing and Hong Kong to ensure compliance with the end-use license limitations in EAR export control licenses issued by the BIS.

*Joseph D. Gustavus is a partner in the Troy office of Miller Canfield where he advises clients primarily in the automotive, defense, aerospace, software and information technology sectors on corporate and export control matters.*

gustavus@millercanfield.com +1.248.267.3317

## 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.<sup>xxii</sup>

- **May 30, 2013:** A Chinese citizen pled guilty in the Eastern District of New York for attempting to export weapons-grade carbon fiber from the United States to China. The carbon fiber is a high-tech material used frequently in military, defense 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.<sup>xxiii</sup>
- **January 17, 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 license. This investigation was conducted by the BIS under suspected EAR export control violations.
- **December 18, 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.
- **December 6, 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.
- **December 5, 2012:** The BIS charged a U.S. national for EAR export control violations for causing the export of sensitive U.S. carbon fiber from the U.S. to Belgium and then causing the illegal transshipment of the sensitive carbon fiber to China.
- **December 3, 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.

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- **October 4, 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.
- **September 26, 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 license.
- **July 24, 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.
- **June 28, 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.
- **May 23, 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 unauthorized end-users by using export licenses fraudulently obtained from the BIS.

<sup>i</sup> Wayne M. Morrison, Cong. Research Serv., RL 33536, China-U.S. Trade Issues 2 (2012).

<sup>ii</sup> *Id.*

<sup>iii</sup> 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' (December 20, 2012).

<sup>iv</sup> 22 C.F.R. § 121.

<sup>v</sup> 15 C.F.R. § 126.1(a).

<sup>vi</sup> 27 C.F.R. § 447.21.

<sup>vii</sup> 15 C.F.R. § 126.1(b).

<sup>viii</sup> Defense Trade Controls Compliance, End-use monitoring of defense articles and defense services commercial exports (2012).

<sup>ix</sup> *Id.*

<sup>x</sup> 15 C.F.R. §744.21(a)(2).

<sup>xi</sup> Amendment to the International Traffic in Arms Regulations: Initial Implementation of Export Control Reform, 78 Fed. Reg. 73, 22740 (April 16, 2013) (to be codified 22 C.F.R. pts. 120, 121, and 123).

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- xii Id.
- xiii 15 C.F.R. § 738.
- xiv 15 C.F.R. § 748.15, § 748 Supplement No. 7.
- xv 15 C.F.R. § 744.21, § 744 Supplement No. 2.
- xvi Id.
- xvii 15 C.F.R. § 748.10.
- xviii 15 C.F.R. § 748.9(b)(2).
- xix 15 C.F.R. § 744.21.
- xx Id. § 744.21(a).
- xxi Id. § 744.21(e).
- xxii See: Summary of major U.S. export enforcement, economic espionage, trade secret and embargo-related criminal cases, Department of Justice (February 2013).
- xxiii Press release: Department of Justice, Cyber-sting nets Chinese national in attempt to export sensitive defense technology (30 May 2013).