

Commerce Issues Interim Final Rule Addressing Foreign-Produced Direct Products and Specifically Targets Huawei Technologies Co., Ltd.

Key Notes:

- Commerce amends provisions of the Export Administration Regulations to tighten “foreign-produced direct product” reexport rule.
- Transactions involving Huawei Technologies Co., Ltd. and numerous non-U.S. affiliates will be significantly impacted as these entities’ ability to acquire semiconductors with ties to U.S. technology and software will be substantially reduced.
- Interim Final Rule was effective as of May 15, but public comment is allowed until July 14, 2020.
- Continued shipment of certain items already in production may continue until September 14, 2020.

The Department of Commerce’s Bureau of Industry and Security (BIS) has issued an [Interim Final Rule](#) amending General Prohibition Three, also known as the foreign-produced direct product reexport rule, so that this General Prohibition applies to certain additional foreign-made items destined for certain persons designated with a new footnote on BIS’ Entity List. Specifically, this new rule targets Huawei Technologies Co., Ltd. (Huawei) and its non-U.S. affiliates listed on the Entity List and is intended to impose controls on their access to foreign-produced semiconductor chips produced outside the United States using U.S.-origin software or technology. This rule is effective as of May 15, 2020; however, BIS is accepting public comment on the Interim Final Rule until July 14, 2020.

Background

The Export Administration Regulations (EAR) apply to (i) the export of any item (product, software or technology) from the United States, (ii) the reexport (from one foreign country to another) of any item of U.S. origin, (iii) the reexport of items with more than *de minimis* levels of U.S. content, and (iv) the reexport of a limited number of items that are the direct product of specified U.S. technology or produced at a plant when that plant or major component of a plant itself is a direct product of specified U.S.-origin technology or software (“direct product rule”). Currently, few items fall under the direct product rule. The Interim Final Rule would expand the direct product rule in a limited fashion.

Interim Final Rule

The direct product rule is contained in General Prohibition Three of the EAR. The Interim Final Rule amends General Prohibition Three by adding a new footnote to the Entity List (FN 1) to establish a limited set of items that may not be exported, reexported or transferred in-country to any entities on the Entity List that have a FN 1 designation. Currently the only entities on the Entity List with a FN 1 designation are Huawei and its affiliates.

The items covered by FN 1 are:

- (a) An item produced or developed by a FN 1 Entity and a direct product of:
 - “technology” or “software” subject to the EAR, and specified in Export Control Classification Numbers

(ECCN) 3E001, 3E002, 3E003, 4E001, 5E001, 3D001, 4D001, or 5D001;

- “technology” subject to the EAR and specified in ECCN 3E991, 4E992, 4E993, or 5E991; or
- “software” subject to the EAR and specified in ECCN 3D991, 4D993, 4D994, or 5D991 of the Commerce Control List (CCL) in Supplement No. 1 to part 774 of the EAR produced or developed by a FN 1 Entity.

(b) An item that is:

- Produced by a plant or major component of a plant located outside the United States where the plant or major component of a plant itself is a direct product of U.S.-origin “technology” or “software” as specified in the above-noted ECCNs, **and**
- A direct product of “software” or “technology” produced or developed by a FN 1 Entity.

The Interim Final Rule also notes that a “major component of a plant located outside the United States” means equipment that is essential to the “production” of an item to meet the specifications of any design produced or developed by designated entities, including testing equipment.

Public comments will be accepted by BIS until July 14, 2020. Comments may be submitted using the Federal eRulemaking Portal at <http://www.regulations.gov>, docket number BIS 2020-0011.

Impact on Huawei and Related Exports

The Interim Final Rule will likely significantly decrease the ability of Huawei and its affiliates to acquire semiconductors with ties to U.S. technology and software. Prior to the promulgation of this rule, news reports indicated that Huawei regularly purchased semiconductors from U.S. companies that were manufactured at foreign locations and not subject to the EAR.

Notably, the changes in FN 1 only cover items produced or developed by FN 1 entities. In effect, items that might otherwise fit the description but were produced and developed without input from FN 1 entities should be excluded. Whether this is a commercially significant set of

items that FN 1 entities would wish to purchase remains to be seen.

Note that persons transacting with Huawei, either as vendors or customers, or involved with supply chains that involve Huawei will also need to consider General Prohibition 10 of the EAR, which prohibits engaging in certain transactions with reason to know an export violation has occurred or will occur. BIS could also invoke this General Prohibition when initiating enforcement actions against U.S. companies.

Timing

The Interim Final Rule is effective as of May 15, 2020, and revises 93 Entity List entries, which list Huawei and its 114 non-U.S. affiliates. BIS states that shipments of foreign-produced items affected by this Interim Final Rule that were on dock for loading, on lighter, laden aboard an exporting or transferring carrier, or en route aboard a carrier to a port of export or to the consignee/end-user as of May 15, 2020 pursuant to the existing regulations may proceed to that destination.

Further, shipment of any items controlled under part (b) of FN 1 above may continue to be shipped until September 14, 2020 if authorized by rules in effect as of May 15, and if production had started by May 15.

FOR MORE INFORMATION

Please contact your Thompson Hine attorney or one of the professionals listed below to discuss how we can assist you in reviewing the impact of this Interim Final Rule on your supply chain. We are also available to discuss assisting you in preparing comments on the Interim Final Rule.

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