

Client Alert

BIS Creates a Special "Direct Product" Rule for Huawei

May 18, 2020

Asserting that Huawei has taken advantage of a "loophole," Secretary of Commerce Ross on Friday, March 15, 2020, announced an amendment of the direct product rule that for now applies only to Huawei and its affiliates on the Entity List. The amendment expands the scope of the rule to capture certain foreign manufactured items, making them "subject to the EAR." Items captured under the amended rule require a BIS license prior to export, reexport, or transfer to Huawei or its listed affiliates.

The amended rule captures items two ways:

First, if the foreign manufactured items are the:

"Direct product of "technology" or "software" subject to the EAR and specified in certain Category 3, 4 or 5 ECCNs." The foreign-produced item is produced or developed by any entity with a footnote 1 designation in the license requirement column of this Supplement and is a direct product of "technology" or "software" subject to the EAR and specified in Export Control Classification Number (ECCN) 3E001, 3E002, 3E003, 4E001, 5E001, 3D001, 4D001, or 5D001; of "technology" subject to the EAR and specified in ECCN 3E991, 4E992, 4E993, or 5E991; or of "software" subject to the EAR and specified in ECCN 3D991, 4D993, 4D994, or 5D991 of the Commerce Control List in Supplement No. 1 to part 774 of the EAR.

Second, if the foreign manufactured items are the:

"Direct product of a plant or major component of a plant." The foreign-produced item is: (1) Produced by any plant or major component¹ of a plant that is located outside the United States, when the plant or major component of a plant itself is a direct product of U.S.-origin "technology" or "software" that is specified in Export Control Classification Number (ECCN) 3E001, 3E002, 3E003, 4E001, 5E001, 3D001, 4D001, or 5D001; of U.S.-origin "technology" that is specified in ECCN 3E991, 4E992, 4E993, or 5E991; or of U.S.-origin "software" that is specified in ECCN 3D991, 4D993, 4D994, or 5D991 of the Commerce Control List in Supplement No. 1 to part 774 of the EAR; and (2) A direct product of "software" or "technology" produced or developed by an entity with a footnote 1 designation in the license requirement column of the Entity List.

The rule became effective immediately May 15, 2020, but includes a delayed implementation of 120 days (through September 14, 2020) for newly captured products currently in production. BIS is also accepting public comments on the effects of this new control until July 14, 2020.

¹

BIS explained that it “is amending its longstanding foreign-produced direct product rule and the Entity List to narrowly and strategically target Huawei’s acquisition of semiconductors that are the direct product of certain U.S. software and technology.” Essentially, the new rule is intended to prevent Huawei from using controlled U.S.-origin equipment, technology, and software located outside the United States. Secretary Ross’ [statement explained](#), “We must amend our rules exploited by Huawei and HiSilicon and prevent U.S. technologies from enabling malign activities contrary to U.S. national security and foreign policy interests.” This amendment applies to both General Prohibition Three § 736.2(b)(3)(iv) and the Entity List; BIS preserved the traditional “direct products rule” for all other transactions.

The key interpretive issue for the amended rule’s two prongs is the phrase “produced or developed by.” These terms are not defined in the rule, nor are they in quotation marks, meaning they are not a reference to those terms as defined in the EAR at § 772. The use of the term “by,” though, limits the scope of the new rule to capture only items that are “produced or developed by” Huawei or its listed affiliates - hence it does not cover off-the-shelf designs or chips made by other companies that are merely sold to Huawei. As is evident from the stated intent of the rule, BIS does not want Huawei to use any U.S. -origin technology or equipment within the controlled electronics, computer and telecommunication categories. The rule does not extend to companies selling their foreign manufactured products to Huawei, as long as the products do not involve technology or equipment controlled by the enumerated ECCNs.

The complexity of the new rule will no doubt generate interpretive questions, as well as new compliance challenges for anyone doing business with Huawei.

¹ **Note to paragraph (b)(1) of footnote 1**: *A major component of a plant located outside the United States means equipment that is essential to the “production” of an item, including testing equipment, to meet the specifications of a design specified in (b)(2).*

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