

CLIENT ALERT

Recent Changes in Chinese Export Controls: Are Your China Operations Ready?

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For the first time in nearly two decades, China is revamping its export control regime and issuing its first unified *Export Control Law*, which combines concepts from more than a dozen existing Chinese laws and related regulations. This alert summarizes the most significant changes from current Chinese export control practice, highlights what may be included in the pending *Export Control Law*, and comments on anticipated impact on businesses operating in China. We also provide some recommended approaches for companies with China operations (or rely on third parties in China) to consider in advance of implementation of the *Export Control Law*.

On August 28, 2020, China's Ministry of Commerce ("**MOFCOM**") and Ministry of Science and Technology released an Amendment to the *Catalogue of Technologies Prohibited or Restricted from Export by China* ("**2020 Export Control Catalogue**"). The original catalogue was released along with the *Regulations on the Administration of the Import and Export of Technology* effective on January 1, 2002 ("**Import and Export Regulations**", amended twice in 2011 and 2019).

In addition to the *2020 Export Control Catalogue*, the Chinese government is also in the process of finalizing the draft of the *Export Control Law*. On December 28, 2019, the Standing Committee of the National People's Congress ("**NPC**") released the draft *Export Control Law*, a revised version of an earlier draft first published by MOFCOM on June 16, 2017. On July 3, 2020, the NPC published a further revised draft. With three rounds of draft being released, the *Export Control Law* will likely be finalized and published soon. This will be the first comprehensive national export control legislation in China, and China's first step towards a unified export control regime.

What are the major changes under the 2020 Export Control Catalogue?

A total of 53 categories of technologies have been deleted, revised, or added to the *2020 Export Control Catalogue*. Major changes include:

- Removing 4 items from prohibited list, including 1) microbial fertilizer technology, 2) caffeine production technology, 3) riboflavin (VB2) production process, and 4) vitamin production.
- Removing 5 items from restricted list, including 1) new city epidemic vaccine technology, 2) natural pharmaceutical production technology, 3) bioactive functional polymer material preparation and processing technologies, 4) chemical synthesis and semi-synthetic drug production technology, and 5) information security firewall software technology.
- Adding 23 items to restricted list. Among others, several here captured attention, including "computer service" and "software industry". For instance, technologies relating to AI are listed, including speech synthesis, voice recognition, interactive understanding technology, print scanning and identification, handwriting photographing and identification, and "personalized information push service technology based on data analysis".

These items, particularly the last one, could have potential impact for multinational clients seeking to leverage the

Chinese consumer base. For example, e-commerce or app based business models that rely on data analytics could be covered by the restricted list. This might include international push marketing tools that use market intelligence from Chinese consumers to suggest products for purchase. Similarly, cloud or app-based tools that multinational companies use to analyze marketing and sales data as part of determining the right product mix to sell to Chinese companies could be impacted.

In addition, technologies relating to cybersecurity, including cryptographic chips design, implementation technology, quantum cryptography technology have also been added and are now subject to restriction.

What is new under the upcoming China Export Control Law?

Based on the latest draft released on July 3, 2020, the highlights include:

- Scope of controlled items
This will cover tangible goods (such as dual-use items, military products, nuclear) and key related technologies and services.
- Blacklist management system for national security purposes
For the purpose of “national security interests”, this will include authorization to prohibit export of certain controlled items to any specific destination, country, region, or to any specific entities or individuals. This covers authorization on an ongoing basis to assess destinations, determine the level of risk, and what corresponding control measures are appropriate.
- Internal Compliance Review System
This will encourage exporters to establish an internal compliance review system, which once adopted can support the success of their license applications for controlled items.
- Exporter’s social credit record
China has imposed a “social credit” system on individuals that grades their contribution to Chinese society. It has extended this concept to companies operating in China across multiple Chinese government agencies. The social credit system helps the Chinese government determine how compliant any given company is to Chinese government regulation, perhaps in a more coordinated manner when compared to other governments. The Export Control Law establishes that companies operating in China will be examined and graded according to its level of compliance or “social credit record.” It authorizes reliance by the export control authorities on “relevant credit records of the exporter”. A company’s rating can determine, among other things, the level and intensity of the need for government oversight and scrutiny. In this case, it is expected that the export control authorities will also consider the social credit records of the license applicant available in the Chinese social rating systems of other agencies, such as China Customs, foreign exchange, tax and market/competition.
- Extraterritorial jurisdiction enforcement
In cases that endanger national security and interests, this will authorize extraterritorial jurisdiction and enforcement.

Additional guidance will be needed to answer critical strategic questions, such as how China intends to enforce activity in other countries, such as the United States or UK and EU.

What kinds of activities will be defined as technology export?

According to the *Import and Export Regulations*, the term “technology export” refers to the transfer of technology from China abroad, through trade, investment, or economic and technical cooperation, including patent assignment, transfer of patent application rights, patent licensing, transfer of trade secrets, technical services, and “other forms of technology transfer”.

The *Import and Export Regulations* define “technology export” broadly and indicate that the examples of technology export provided above are illustrative and are not meant to be exclusive. We note that the catch-all nature of the definition, (i.e., “other forms of technology transfer”) is vague and provides the Chinese authorities with broad discretion to determine if any given activity would be regulated. Theoretically, the catch-all definition could include disclosing and disseminating technical information to any individuals or organization in any form overseas. Furthermore, it is not clear currently how far China’s jurisdiction will reach. For example, it is not clear how the definition of “technology export” (and exceptions thereto) impacts transfers between and among non-China affiliates or subsidiaries. Similarly, the definition’s impact on the transfer of technology to non-Chinese individuals, whether in China or abroad remains subject to further clarification.

In similar situations, we generally encourage clients to seek additional guidance and determine the relevant Chinese authority’s posture on any given activity. For example, technology that is public, widely-known or of non-Chinese origin could fall under the catch-all definition. It would be prudent in such circumstances to seek input from the relevant Chinese authorities to determine if the *Import and Export Regulations* would apply.

What are the export control procedures for technology transfer?

Technology is classified into three categories under the draft *Import and Export Regulations* and each category is subject to different levels of scrutiny.

- Permitted (free export) Technology
Permitted technology is eligible for export, subject only to the exporter’s contract registration with the Foreign Economic and Trade Department of China’s State Council (“FETD”). After completing the registration, the exporter may proceed with relevant foreign exchange, banking, tax, and China Customs procedures to effectuate an underlying export transaction by presenting a technology export contract registration certificate issued by FETD. Such registration, however, is not a prerequisite for the exporter to enter into any underlying contract with a non-Chinese buyer.
- Restricted Technology
Restricted technology (pursuant to the existing *2020 Export Control Catalogue*) cannot be exported before obtaining approval through an application to FETD in what is a two-part process. If the application is approved, the exporter will receive a letter of licensing intent for technology export contract (“LOI”). The exporter may not undertake substantive negotiation or enter into any technology export contract with any overseas party before receiving a LOI. Once a technology export contract has been signed, the exporter must submit an application for a Technology Export License. The technology export contract will become effective when FETD grants the corresponding Technology Export License.

- Prohibited Technology

Prohibited Technology (pursuant to the *2020 Export Control Catalogue*) is strictly prohibited from export in any way. Violations are subject to warning, confiscation of illegal gains, monetary fines, revocation of foreign trade permit, and even criminal liability.

How should multinational corporations prepare for compliance with the new law?

Given the newly released *2020 Export Control Catalogue* which is now in force, and the upcoming *Export Control Law*, our recommendations for companies with operations in China:

- Closely monitor ongoing developments in the export control catalogue and implementation rules or industrial guidelines that might be released by the Chinese government;
- Consider establishing an internal export control review program with an appropriate compliance officer;
- In the event a company has an affiliate or subsidiary in China contemplating a technology export transaction
 - Establish or strengthen established risk assessment and identification processes for your current products and technology, and classify them into categories of permitted, restricted, and prohibited items;
 - Seek informal opinions or clarifications from Chinese export control authorities during the transaction planning process when any forms of technology transfer are involved;
 - Go through contract registration with FETD for permitted technology even though it is not a prerequisite for an underlying technology export contract to take effect, as the actual enforcement of export control measures might differ from the literal meaning of the law;
 - Provide export control training to employees and add export control related clauses to template export contracts, user terms, and other relevant legal documents as needed.

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