China Releases Guidelines on How to Develop Export Control Compliance Programs

On April 28, 2021, the Ministry of Commerce of China (“MOFCOM”) released an updated version of Guiding Opinion of the Ministry of Commerce on the Establishment of Internal Compliance Mechanism for Export Controls on Exporters of Dual-Use Items (“Order No. 10”) which was first published in August 2007 (“Order No. 69”). As an implementing rule of the Export Control Law (“ECL”), Order No. 10 aims to provide companies with “guidance and reference” in their establishment or enhancement of internal export compliance programs (“ECP”) to promote compliance under China’s new export control regime.

1. Changes in Core Elements of ECP

Compared with Order No. 69 which identifies 6 elements as essential to an effective ECP, including (1) management commitment; (2) organizational structure; (3) review process; (4) export compliance manual; (5) training; and (6) recordkeeping, Order No. 10 adds the following three new elements:

(1) Comprehensive Risk Assessment
An effective ECP needs to be carefully tailored to address unique PRC export control risks that any multinational company faces in China. Companies should conduct a comprehensive assessment of their PRC export control risk based on their size, industry and operational circumstances. According to Order No. 10, such a risk assessment should consider factors including the end-use and sensitivity of products, the geographic location of business and customers, the circumstance of technologies and R&D related to products, the relationship with third-party business partners, the vulnerabilities of existing ECP and the adequacy of internal risk control measures.

(2) Emergency Response Mechanism
An essential part of an effective ECP are mechanisms regarding what actions should be taken in case of incidents of export control noncompliance. Companies should establish a process for reporting and investigating suspicious orders, customers or activities that may be contrary to requirements of applicable PRC export control laws or regulations. Where an instance of noncompliance is identified, Order No. 10 requires companies to take immediate remedial measures and report the circumstance to the government in a timely manner. An early detection and handling of suspected incidents of noncompliance could help companies to properly mitigate and manage export control risks in China.

(3) Compliance Audit
An ECP is dynamic by nature and needs to be reviewed, tested and adjusted regularly and when necessary. According to Order No. 10, companies should periodically audit the “rationality, feasibility, and effectiveness” of their ECP. Audits should evaluate whether the transaction review process is followed; whether the export...
control organizational structure runs smoothly; whether the investigations of suspicious matters are effective; and whether there are any areas for improvement.

2. New Detailed Export Compliance Guidelines

Another significant change is that a detailed Internal Compliance Guidelines for Export Controls on Dual-Use Items (“Guidelines”) was released as an appendix of Order No. 10. Generally, the Guidelines follow the format or structure of the EU’s Commission Recommendation (EU) 2019/1318 on Internal Compliance Programmes for Dual-Use Trade Controls Under Council Regulation (EC) No. 428/2009 which has two sections under each core element: (1) “What is expected?” and (2) “What are the steps involved?” Similar sections can be found in the Guidelines: (1) “Main content” which describes the main requirements under each core element; and (2) “Implementation guidelines” which further specifies actions and outlines strategies for developing or implementing compliance procedures. In addition, similar with the practices in EU, U.S., UK and other jurisdictions, the Guidelines also provide templates, red flag indicators, audit checklists and other useful tools to help companies develop an ECP.

3. Clarifications on Certain Key Concepts

The ECL, which came into effect on December 1, 2020, establishes a comprehensive framework for export controls in China. However, no further implementing regulation or rule has been issued in the previous one and a half years. The issuance of the Guidelines reveals the determination and latest efforts of China to take substantive steps to implement the ECL.

The Guidelines provide more clarifications on certain key concepts under the ECL. For instance, “deemed export” is defined under the ECL as provision of controlled items by Chinese citizens or entities to foreign citizens or entities. The Guidelines further provide some specific examples of “deemed export:” (1) hiring foreign employees to engage in work related to controlled technologies; and (2) releasing information about controlled technologies in trade shows. In addition, the Guidelines provide more guidance on what constitute an “export” in the context of technology collaborations or transfers. “Exports” not only include situations where technology data is transferred via email, telephone, facsimile or domestic or foreign social media platforms, but also situations where technology data or software are stored or transferred through the “cloud” or other online storage services. Although much remains unconfirmed so far, the Guidelines provides significant new insight into how MOFCOM interprets the ECL.

4. Crowell & Moring Observations

(1) Recommended or Mandatory?

The ECL came into effect on December 1, 2020. The first draft of the ECL requires that “Exporters must establish internal export control compliance and review mechanisms.” (Article 14 of the first draft of the ECL) The second draft and the final ECL removed the above mandatory requirement and replaced it with a provision providing that “China’s export control authority shall issue export control guidelines for relevant industries at an appropriate time in order to provide guidance to exporters on their establishment or improvement of internal export control compliance mechanisms and lawful operations.” (Article 5 of the ECL) Order No. 10, however, is not a mandatory but instead recommended guideline which aims to provide “guidance and reference” in assisting companies establishing or enhancing their ECP in China.
For a multinational company operating in China, one of the major benefits of implementing an effective ECP is that it may be granted licensing facilitation such as being able to use a “general license” rather than a “specific license,” i.e. a license that is based on government approval of a specific export transaction. Establishment of an ECP itself is not a mitigating factor under the ECL and Order No. 10. However, an effective ECP could help a company to timely identify suspected incidents of noncompliance so that the company can take corrective or remedial measures to eliminate or mitigate harmful consequences of its illegal acts which is considered as a mitigating factor by MOFCOM in assessing administrative penalties. Order No. 10 requires that a company’s export control compliance or similar department must have independence in its organization and may veto a transaction that violates applicable Chinese export control laws and/or regulations.

(2) Guidelines Integrated with Global Best Practices and Chinese Characteristics

Order No. 69 was issued by MOFCOM 14 years ago. After enacting the ECL, officials from MOFCOM’s Bureau of Industrial Safety and Import and Export Control met extensively with companies in Shenzhen, Nanjing, Suzhou and Changzhou to seek their opinions and recommendations on the amendment of Order No. 69. At a press conference on April 29, 2021, MOFCOM stressed that Order No. 10 is an updated version of Order No. 69 which is promulgated based on “in-depth research and survey, extensive consultation with relevant stakeholders and reference to mature international experience.”

It appears that the guidelines were prepared in the light of practices in other jurisdictions. These similarities with jurisdictions could make it possible for multinationals to localize their existing ECP or integrate their programs. However, multinationals should also be mindful of differences between China’s and other jurisdictions’ export control regime. For instance, unlike in the U.S. and EU, the Guidelines recommend companies to set up an “export control compliance committee” and an “export control compliance department” if possible. Where companies do not have adequate resources, they may alternatively appoint a chief compliance officer and export control compliance personnel to perform export control compliance functions.

(3) Emphasis on Effectiveness of ECP

Order No. 10 removed the principle of comprehensive control or the so-called “catch-all control” from Order No. 69 which has already been a legal obligation under the ECL and replaced it with the principle of effectiveness. This change reflects that MOFCOM will likely evaluate not only whether an ECP is in place, but also whether the ECP is working effectively. The Guidelines also make effectiveness of ECP as a factor in granting licensing facilitation. It remains to be seen what specific “tests” would be used by MOFCOM to evaluate the effectiveness of an ECP. It is however, likely that an ECP not specially designed to addressing its unique export control risks in China or a paper ECP without effective implementation within the organization would be considered ineffective by MOFCOM.

(4) Creating an ECP Tailored to Your Company’s Operations and Risk Profiles in China

Export control violations may subject companies to administrative penalties, such as fines, suspension of business and/or revocation of export privilege, or even criminal liabilities in serious cases. (Article 33 – 43 of the ECL) Along with the enacting of the ECL and Order No. 10, it is now time for companies to conduct a comprehensive assessment of its PRC export control risks and establish an effective ECP to identify, manage and mitigate such risks. Given the similarities between China’s export compliance guidelines and that of other jurisdictions, for multinationals with an existing ECP, a practical approach would be localizing their existing ECP
in accordance with applicable Chinese requirements. Creating an effective ECP requires a thorough assessment of a company's operational circumstances in China, such as its product range and customer basis, and an in-depth understanding of its legal obligations under China's export control regime, especially how the ECL would interplay with other recently enacted or updated regulations including China's blocking statute, Unreliable Entity List Provisions and Technology Import and Export Control Regulations. Furthermore, an ECP should be effective. It must be risk-based and actually work. An ECP must be designed with features and functions that work to prevent noncompliance. A paper program will be worse than having no program as the authorities would likely deem it to a program that does not work.

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