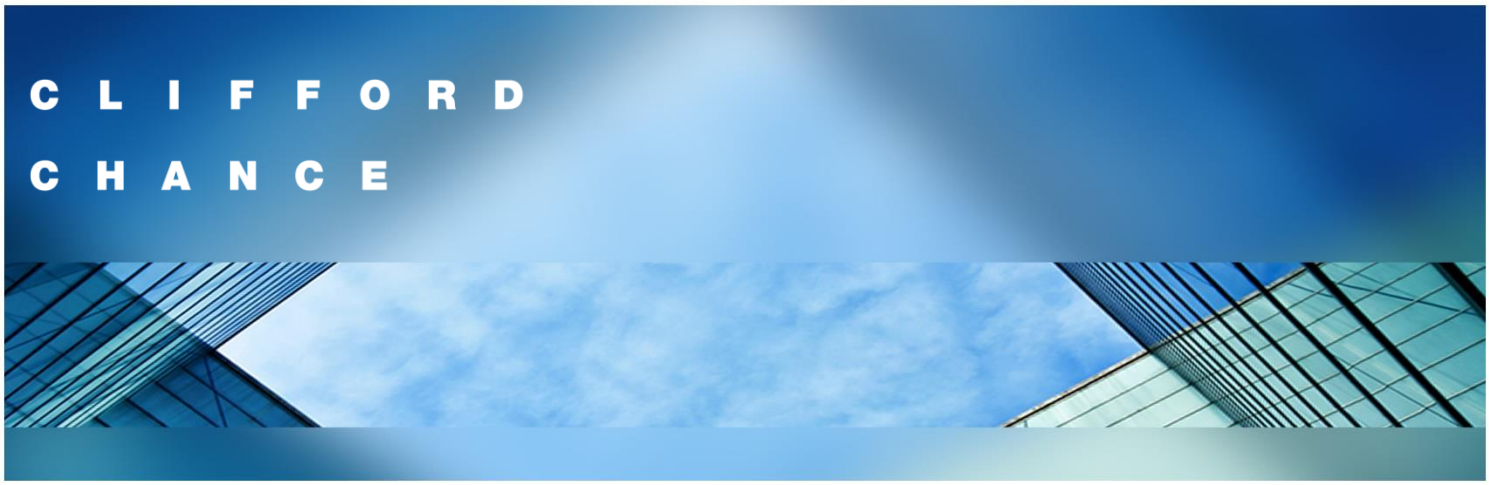


# THE EXPORT CONTROL REFORM ACT OF 2018: RISKS AND OPPORTUNITIES IN THE MODERNIZATION OF U.S. EXPORT CONTROLS

Perhaps as a treat for Chinese New Year, House Foreign Affairs Committee Chairman Ed Royce (R-CA) introduced a bill on Thursday, February 15, to renew the legislative basis for U.S. dual use export controls for the first time in nearly twenty years. The bill, entitled the "Export Control Reform Act of 2018" (ECRA), seeks to repeal the long-expired Export Administration Act of 1979 (EAA) and replace it with a legislative framework intended to modernize the U.S. dual use export control regime while addressing perceived threats to U.S. interests from non-U.S. competitors. The ECRA can be seen in some ways as a counterpoint to export control provisions contained in the "Foreign Investment Risk Review Modernization Act of 2017" (FIRRMA) currently working its way through Congress. (A summary of the FIRRMA bill can be found on our website.)

ECRA offers both risks and rewards for U.S. and non-U.S. companies with an interest in U.S. technology exports. U.S. subsidiaries of non-U.S. companies will need to watch the bill closely, as the current legislative text treats them as "foreign persons" and could restrict their ability to exchange technology with other U.S. companies. U.S. and non-U.S. companies involved in emerging technologies such as artificial intelligence, cyber, robotics, advanced aerospace, and similar fields could also be impacted by the bill's expanded controls on technology development in those sectors. On the other hand, ECRA promises to enhance both the stability and predictability of the U.S. export control system, to the benefit of U.S. exporters and their customers overseas, and provides an opportunity for interested parties to suggest improvement to U.S. dual use export controls.[1]

[1] The bill that contains ECRA, H.R. 5040, also has sections modernizing U.S. laws intended to counter third country boycotts of Israel and updating U.S. sanctions against missile and weapons of mass destruction (WMD) proliferation. The sanctions provisions require the President to deny export privileges to U.S. and non-U.S. persons determined to have engaged in proliferation of missile technologies, and to prohibit U.S. government procurement from any non-U.S. entity determined to be knowingly assisting any country of concern in the use, development, production, or acquisition of chemical or biological weapons.

## EXISTING U.S. EXPORT CONTROLS IN A NUTSHELL

Like many other governments around the world, the United States has laws and regulations intended to restrict the export of hardware, software, information, and services that could pose a risk to U.S. national security or foreign policy interests. These export controls apply to a wide range of products, including both military items and so-called "dual use" items that, while they may have civil applications, could nonetheless pose a threat to U.S. national security in adverse hands. Dual use items controlled by the U.S. government include everything from uranium enrichment technologies to encryption software to communications satellites.

In the United States, commercial exports of sensitive military products are controlled primarily by the U.S. Department of State under the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR). Dual use exports are controlled primarily by the U.S. Department of Commerce under the Export Administration Regulations (EAR).

U.S. export control laws regulate tangible exports from the United States, but they also control almost any other form of transfer from the United States to other countries, or from a U.S. person to a non-U.S. person. Postal shipments, email or phone calls, visual inspections, oral communications, and release of sensitive material or information are all controlled if they cross the U.S. border or involve a transfer of controlled information or services to a non-U.S. person, even within the United States. In addition, U.S. export controls can apply anywhere in the world to restrict transfers of U.S.-origin materials even after they have left the United States, and even after they have been incorporated into non-U.S. items overseas. Companies that fail to comply with applicable U.S. export control rules can be subject to severe penalties—exceeding $800 million in one case in 2017 involving a Chinese technology firm—and individuals can be imprisoned for up to 20 years for criminal violations.

The legislative underpinnings for U.S. export controls have been in need of modernization for some time. Historically, the Commerce Department relied on the Export Administration Act for legal authority to regulate dual use exports, but the EAA lapsed in 2001 and has not been renewed by Congress. Since that date, the Commerce Department has relied on authority delegated by the President under the International Emergency Economic Powers Act (IEEPA) to continue to apply the substantive provisions of the EAA. Moreover, while existing processes for identifying what needs to be controlled have been improved dramatically in recent years, they still do not easily capture emerging technologies such as cyber tools and artificial intelligence. Equally important, some aspects of current export control law impose significant compliance obligations and associated cost on industry without actually enhancing U.S. national security, and may restrict the U.S. export control system's ability to adapt to the new world of global supply chains and changing threats. Empowering the relevant government agencies to address these issues could both strengthen U.S. national security and improve industry's ability to focus compliance resources where they are most needed.

## ECRA: MODERNIZING AND EXPANDING U.S. DUAL USE CONTROLS

The ECRA proposed by Chairman Royce attempts to address the failings noted above in a number of ways. Most fundamentally, it permanently sunsets the EAA and replaces it with legislation that does not require regular re-approval by Congress. That simple act should win enthusiasm from industry, relevant federal agencies, and Congress. In place of the EAA, ECRA authorizes the President to permanently control the "export, reexport, and transfer of items" by U.S. and non-U.S. persons anywhere in the world.[2]

The bill also seeks to modernize the legislative basis for U.S. export controls in ways that could have significant implications for both U.S. and non-U.S. business. Probably the most substantive of these changes are aimed at countering the perceived threat—also reflected in the FIRRMA legislation—of countries such as China getting access to emergent critical technologies in the United States through acquisitions and collaborations with U.S. companies. The bill attempts to address this threat in a number of ways.

- ECRA expands the reach of U.S. export control law to cover transfers of controlled technology to U.S.-organized but foreign-owned companies within the United States. Under current law, transfers of EAR-controlled technology between U.S. companies in the United States are not subject to EAR restrictions, even if the receiving company is owned or controlled by non-U.S. persons.[3] Because ECRA currently redefines "U.S. Person" to exclude U.S. entities owned or controlled by non-U.S. persons, transfers of controlled technology or source code to such entities would now be considered a "deemed export" and therefore would be subject to licensing requirements under the EAR. **Were this provision to become law, many well-established U.S. companies ultimately owned by non-U.S. parents could find themselves needing export authorizations in order to receive EAR-controlled technical information or source code from other companies in the United States.**
- ECRA broadens the definition of "technology" controlled by the EAR to include "foundational information" and "know-how", thereby pushing EAR control further into developmental activities which may not currently trigger control. Companies engaged in such activities may require licensing for their exports and non-U.S. employees earlier in product development, and for a broader scope of information than previously.
- ECRA requires the President to establish an ongoing inter-agency process for identifying emergent critical technologies not yet subject to U.S. export control, and to establish controls over those technologies expeditiously through unilateral and multilateral means. The bill also establishes a legal requirement for regular updating of the lists of technologies subject to U.S. export controls.

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2 The EAR currently applies to items that are either of U.S. origin or contain a certain percentage of U.S.-origin content. Items with no connection to the United States are not subject to the EAR's rules. ECRA has no similar jurisdictional restriction, and could be read to apply to all transfers of "items" anywhere in the world. However, one would hope a narrow statutory construction would apply, suggesting that because Congress has not clearly indicated an intent to control all trade worldwide, ECRA should be read to cover only items that are of U.S. origin or have some other relevant U.S. connection.

3 Transfers of controlled material by the U.S. subsidiary to its non-U.S. employees or to its foreign parent are controlled under current rules.

These provisions attempt to improve the U.S. export control regime's ability to identify and control emergent technologies before they are acquired by potential U.S. competitors.

In addition to increased controls on U.S. technology exports, ECRA includes a number of provisions intended to modernize the U.S. dual use export control regime more generally. These provisions:

- Establish additional factors to be considered in granting authorizations for exports, including the likely impact of those exports on human rights, military interoperability, and the need to promote U.S. technological leadership;
- Update the criminal and civil penalties applied to dual use violations;
- Require U.S. and non-U.S. license applicants and other certifying parties for an EAR license to notify Commerce of any change in material facts affecting their applications;
- Encourage continued simplification and harmonization of the overall export control framework, including the EAR, ITAR, and government-to-government exports under the U.S. Foreign Military Sales (FMS) program;
- Require the President to notify Congress in advance of seeking any revisions to the EAR, and to submit an annual report to Congress on the implementation of EAR controls; and
- Expand controls on brokering (i.e., facilitating others' sales) of dual use items to include maritime nuclear propulsion and activities related to "specific… foreign intelligence services."[4] Brokering of most dual use items would remain non-controlled under the proposed legislation.[5]

It is not yet clear how ECRA's proposed reforms relate to the FIRRMA bill. As described in more detail on our website, FIRRMA proposes to create a "second line of defense" against outbound transfers of critical technologies by establishing jurisdiction to review such transactions within the Committee on Foreign Investment in the United States (CFIUS). By contrast, ECRA seeks to bolster export controls themselves, potentially undermining the argument for secondary jurisdiction in CFIUS. It is possible the ECRA and FIRRMA bills will be consolidated into another piece of legislation such as the National Defense Authorization Act likely up for consideration later in 2018. Whether such consolidation would result in removal of the "second line of defense" (CFIUS review) in favor of improvement to the first line of defense (export controls) remains to be seen.

## CONCLUSIONS

The Export Control Reform Act reflects an interest by Congress to put dual use export controls back on a solid statutory footing and improve the focus of U.S. export control law on emergent technologies. However, many U.S. companies

[4] The ECRA does not elaborate on what types of activities are intended for the Commerce Department to control under this provision. It may be intended as an alternative means for controlling U.S. persons assisting certain non-U.S. countries in cyber activities harmful to the United States.

[5] It may be worth noting that, with the apparently imminent shift of firearms and ammunition less than .50 caliber from ITAR to EAR control, brokering of such weapons will no longer be subject to ITAR control. If Congress is interested in continuing to control the brokering of AK-47s by U.S. persons, ECRA's proposed revisions to dual use brokering would be a good place to do it.

owned by non-U.S. parents may be disadvantaged by the bill's provisions treating them as foreign persons for export control purposes, and potentially subjecting them to licensing requirements in order to receive controlled technology or source code from other U.S. companies. Likewise, companies, academic institutions and others involved in early stage technology development not previously captured by U.S. export controls could potentially find themselves needing to apply for licenses to hire foreign person engineers or collaborate with non-U.S. companies.

Time will tell whether ECRA becomes law, and, if so, whether its provisions on emergent technologies become complementary to, or replacements for, the CFIUS-based "second line of defense" reflected in the FIRRMA bill. U.S. and non-U.S. companies contemplating technical collaboration with non-U.S. entities should assess both bills and existing law to understand how best to manage the export control risk and the potential impact on their commercial activities. Companies impacted by the bill's provisions or interested in improving U.S. dual use export controls generally should consider making their views known in the legislative process. An opportunity such as this may not present itself again for many years.

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