

## **U.S. RAISES THE STAKES FOR DOING BUSINESS IN CHINA**

### **How companies can avoid getting caught in the middle of the U.S.-China trade war**

What a week it has been for the export control world. First, the Bureau of Industry and Security ("**BIS**") of the U.S. Department of Commerce finalized two major amendments to the Export Administration Regulations ("**EAR**") that significantly tighten export controls to China. Second, the Commerce Department and the U.S. State Department suspended regulations that provided preferential treatment to Hong Kong concerning export controls, including access to certain export license exceptions. These game changing developments significantly increase the level of expected counterparty due diligence for companies and related risks of non-compliance, particularly those currently doing business in Hong Kong or mainland China. Pending receipt of further guidance on the practical impact of these changes from U.S. authorities, companies should take steps now to assess how these changes impact their compliance risk and overall risk tolerance.

### **FINAL RULES NOW EFFECTIVE – TIGHTENED U.S. EXPORT CONTROL RULES WITH CHINA**

On June 29, 2020, BIS imposed more rigid end-use and end-user controls in the EAR, especially regarding exports to China pursuant to a rule issued on April 28, 2020. (See previous alert [here](#)). Specifically, these updated rules expand military end use and end user restrictions (the "**MEU Rule**") and remove a commonly used license exception for civil end-uses of certain controlled items.

#### **Expansion of Restrictions on Military End-Use and End-User**

The definition of Military End Use in Section 744.21(f) of the EAR now includes "any item that supports or contributes to the operation, installation, maintenance, repair, overhaul, refurbishing, 'development,' or 'production,' of military items." This

significantly expands the scope of Military End User controls as additional licensing requirements will now be required for certain items when the items are exported to a Military End User in China. This new language expands the scope of Military End Use such that any one of the listed activities is sufficient to trigger the licensing requirement for exporting to certain end users, now considered Military End Users, in China. The MEU Rule also broadened the scope of the items subject to license requirements and changed the license review policy to a presumption of denial for exports for Military End Use and End Users.

Finally, the MEU Rule requires exporters to make an Electronic Export Information ("EEI") filing for items destined to China, Russia, or Venezuela unless the shipment is eligible for License Exception GOV – even if no license is required to ship an item to those destinations.

BIS also issued FAQs on the MEU Rule on June 29, 2020. The FAQs memorialize much of the comments that accompanied the MEU Rule's publication. The FAQs also emphasized that determining whether a counterparty is a "Military End User" is reliant on effective due diligence and a fact-specific evaluation of the intended end user's activities to determine whether they are caught by the new language.

### **Elimination of License Exception Civil End Users (CIV)**

Further, the Civil End Users ("CIV") License Exception has been removed from the EAR. Exporters who previously relied on CIV now must request licenses from BIS for exporting such EAR-controlled items to China, among other countries.

### **SUSPENSION OF PREFERENTIAL U.S. EXPORT CONTROL REGULATIONS FOR HONG KONG**

On June 29, 2020, the U.S. State Department suspended regulations under the International Traffic in Arms Regulations ("ITAR") that allowed for the export of U.S. defense articles to Hong Kong without the need for certain licenses that would be needed if the articles were exported to mainland China. Similarly, the Commerce Department also suspended regulations that allowed for the export to Hong Kong of EAR-controlled items without the need of licenses that would be required if exporting the same items to mainland China.

These changes come on the heels of the U.S.' determination that Hong Kong no longer enjoys a high degree of autonomy from China, which allowed for favorable treatment under U.S. export control regulations – in particular due to a recent national security law passed by China's legislature that is specifically directed towards Hong Kong. The U.S. has long been concerned with diversion risk – that items lawfully exported to Hong Kong would be unlawfully diverted to mainland China and reach unauthorized end users such as the Chinese government.

While both State and Commerce Departments issued statements regarding this change to Hong Kong's privileged status, there has not been an update to the Federal Register – for example to formally change Hong Kong's Country Group designation to match the rest of China. In the absence of Federal Register notices to provide regulatory clarity, companies should act with caution as the U.S. government may deem that companies have been given constructive notice of the regulatory changes.

## **WHAT TO EXPECT NEXT AND HOW TO PREPARE NOW**

These changes to U.S. export controls toward China and Hong Kong have a major impact for companies. The MEU Rule increases due diligence requirements for companies doing business with Chinese counterparties, as the expansion of "Military End Use" increases the scope of potentially captured entities. The Chinese government's stated strategy of Civil-Military fusion increases the likelihood that Chinese counterparties could have activities that are captured by the definition of Military End User. Meanwhile the elimination of the CIV license exception increases licensing costs for companies who previously relied on the exception.

Further, the elimination of Hong Kong special status under U.S. export controls may cause significant disruption to the ways companies do business in the region. While the exact scope of the regulatory changes are not known at this time, companies should consider assessing their current exposure risk: for example to what extent does your current trade compliance function rely on EAR license exceptions that are only authorized to Country Group B?

Companies should assess whether their compliance mechanisms are properly situated to deal with this new reality – particularly with respect to counterparty due diligence and licensing. The risks of non-compliance, given the U.S. policy priorities, are considerable.

## CONTACTS

**David DiBari**  
Managing Partner  
T +1 202 912 5098  
E david.dibari  
@cliffordchance.com

**Joshua Berman**  
Partner  
T +1 202 912 5174  
E joshua.berman  
@cliffordchance.com

**Michelle Williams**  
Partner  
T +1 202 912 5011  
E michelle.williams  
@cliffordchance.com

**Laurence Hull**  
Associate  
T +1 202 912 5560  
E laurence.hull  
@cliffordchance.com

**Carol Lee**  
Associate  
T +1 202 912 5194  
E carol.p.lee  
@cliffordchance.com

**Holly Bauer**  
Associate  
T +1 202 912 5132  
E holly.bauer  
@cliffordchance.com

**Michael Press**  
Associate  
T +1 202 912 5214  
E michael.press  
@cliffordchance.com

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Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

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