

# Export Control Reform Act Is Finalized in Congress

July 30, 2018

International Trade

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On July 23, the final text of the Export Control Reform Act of 2018 (“ECRA”) was released as part of the [Conference Report](#) to accompany the National Defense Authorization Act (“NDAA”) for fiscal year 2019. The NDAA is a must-pass piece of legislation that authorizes funding for the Department of Defense, and we expect it to be enacted and signed within the next two weeks. The ECRA would provide a permanent statutory basis for the U.S. government’s existing export controls on commercial, dual-use, and some military items. The bill also would expand U.S. export controls by establishing a process to impose new controls on certain emerging and foundational technologies that are essential to U.S. national security.

## Overview of the ECRA

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As we detail further below, the ECRA contains the following significant provisions:

- The ECRA would repeal most of the long-expired Export Administration Act of 1979 (“EAA”), and provide a permanent statutory authorization for the Export Administration Regulations (“EAR”), which have been kept in force by executive orders pursuant to the International Emergency Economic Powers Act (“IEEPA”) since the EAA expired. The EAR establish the core U.S. controls on exports, reexports, and in-country transfers of commercial, dual-use, and some military commodities, software, and technology.
- The ECRA would establish a new, interagency process to identify and impose additional controls on emerging and foundational technologies that are essential to U.S. national security, particularly with respect to potential threats posed by China. These provisions of the bill are designed to complement changes to the Committee on Foreign Investment in the United States (“CFIUS”) contained in the Foreign Investment Risk Review Modernization Act (“FIRRMA”), which is separate legislation included in the final NDAA (and discussed in our client alert dated [July 25, 2018](#)).
- The ECRA also contains additional measures relating to licensing requirements and licensing procedures.

## Permanent Statutory Basis for U.S. Export Controls

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As noted, the ECRA would provide a permanent statutory basis for the EAR, the existing export control regime administered by the U.S. Commerce Department’s Bureau of Industry and Security (“BIS”). The EAR regulate the export, reexport, and in-country transfer abroad of commercial, dual-use, and some military commodities, software, and technology that are subject to U.S. export jurisdiction as well as certain other activities on the part of U.S. persons in

connection with weapons proliferation. Items that have dual commercial and non-commercial/sensitive uses are usually classified in a specific Export Control Classification Number (“ECCN”) on the EAR’s Commerce Control List (“CCL”) and may require BIS licensing for export, reexport, or transfer, depending on their ECCN, destination, ultimate end user, and intended end use. Since the lapse of the EAA in 2001, Presidential executive orders under IEEPA have authorized the continuation of the EAR.

The ECRA would repeal most of the EAA and provide a new statutory basis for export control-related delegations, rules, regulations, determinations, or licenses issued under the EAA, IEEPA, or the EAR. The EAA, however, would remain in effect with respect to sanctions against foreign persons violating U.S. and certain non-U.S. partner countries’ export controls involving Russia and other “East bloc” countries and sanctions against U.S. and foreign persons who engage in commercial transactions that violate missile proliferation or chemical or biological weapons controls. These sections of the EAA would continue to be implemented under IEEPA.

In addition, the ECRA would provide a new statutory basis for the EAR's antiboycott provisions (at EAR Part 760) that prohibit United States persons from providing support to unsanctioned foreign boycotts, such as the boycott of Israel, and require reporting to the U.S. Commerce Department of requests to support such foreign boycotts.

## Emerging and Foundational Technologies

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### Identifying Covered Technologies

The most significant change resulting from the ECRA would be the creation of a formal interagency process to identify emerging and foundational technologies that “are essential to the U.S. national security” and are not otherwise controlled for export purposes. According to House Foreign Affairs Committee Chairman Ed Royce (R-CA), the chief architect of the bill, this process would counter strategic attempts to obtain these technologies through espionage by China and other unfriendly countries. While the ECRA does not identify any specific such technologies, we expect based on the FIRRMA debate and a prior Defense Department [report](#) from January 2018 that these technologies are likely to include areas such as artificial intelligence, robotics, augmented reality or virtual reality, and financial technology.

Under the current export controls regime, BIS has authority to impose temporary controls on previously unidentified technology because it provides a significant military or intelligence advantage to the United States or for foreign policy reasons. Under this process, the item is temporarily classified under [ECCN 0Y521](#) on the CCL for one year, which can be extended for up to two more one-year terms. For control to continue beyond that period, the technology must be permanently classified under a different ECCN.

The ECRA would establish a more regular process to identify emerging and foundational technologies warranting control. Through the process, and drawing on a range of sources (including information relating to reviews and investigations of transactions by CFIUS), the Departments of Commerce, Defense, Energy, State, and other relevant federal agencies would assess factors such as (1) the development of such technologies in other countries; (2) the effect U.S. export controls would have on the development of the technologies in the United States; and (3) the effectiveness of controls on limiting the proliferation of the technologies to foreign countries. The ECRA contains certain exceptions that would limit the range of technologies that can be designated as emerging and foundational. The process also would

include a notice and comment period for the proposed designation of emerging and foundational technologies to allow interested parties to provide their input prior to the designation taking effect.

### **Licensing Requirements**

Once the emerging and foundational technologies are identified, the ECRA would authorize the Department of Commerce to establish appropriate controls on exports, reexports or in-country transfers of these technologies. Importantly, the ECRA would require Commerce to impose a license requirement for the export, reexport or in-country transfer of such technology to or in any “country subject to an embargo, including an arms embargo imposed by the United States.” The scope of this license requirement is unclear, although it would include countries such as China that are subject to U.S. arms embargoes.

As under current EAR procedures, Commerce and the other relevant agencies—the Departments of Defense, State, and Energy—would review any license applications. In the event the reviewing agencies are not in agreement with respect to proposed exports of the emerging and foundational technologies, the ECRA authorizes the agencies to resolve the license application by majority vote. Under current procedures, a majority vote is required only for commercial communication satellites and hot-section technologies for commercial aircraft engines. When there are disagreements among the agencies with respect to export applications for other items, Commerce has authority as chair of the Operating Committee to make the decision after considering the recommendations made by other reviewing departments.

In addition to export licensing requirements, the designated emerging or foundational technologies would be subject to further government scrutiny and potential restrictions because they would be treated as “critical technologies” during a separate national security review of proposed foreign investments by CFIUS pursuant to FIRRMA.

## **Other Key ECRA Provisions**

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### **Expanded EAR Controls on Activities by U.S. Persons**

In addition to controlling items subject to U.S. jurisdiction, the EAR currently regulate certain activities of U.S. persons, without regard for whether the activity relates to an EAR-controlled item. The restricted activities involve proliferation of nuclear explosive devices, chemical or biological weapons, and missile technology. The ECRA would expand the EAR to control activities of U.S. persons, wherever located, relating to specific “foreign military intelligence services,” which could complicate dealings by U.S. companies or U.S. nationals with those services or impose new licensing requirements on such dealings.

### **Changes to Existing Export Licensing Procedures**

The ECRA also would impact the Commerce Department’s procedures for granting export licenses under the EAR. For example, regarding the processing of export license applications, the ECRA would require assessment of the proposed transfer’s impact on the U.S. defense industrial base, and would provide for the denial of an export license application that would have a significant negative impact on the U.S. defense industrial base. The factors to be considered as part of that assessment are broadly phrased including, for example, a reduction in U.S. production of an item that is the result of R&D funded by the Defense Department.

Notably, under certain circumstances, the ECRA would require license applicants operating as joint ventures, under joint development agreements, or in similar collaborative arrangements to identify any foreign person with a significant direct or indirect ownership interest in a non-U.S. party to the arrangement. If implemented broadly, this provision could require submissions detailing a wide range of non-U.S. passive investors in U.S.-incorporated, U.S.-controlled ventures.

### **Review Focused on Countries Subject to Arms Embargoes**

The ECRA also would require the Departments of Commerce, Defense, State, Energy and other agencies to review licensing requirements for exports, reexports and in-country transfers to or within countries subject to comprehensive U.S. arms embargoes, such as China. The review must assess (1) the scope of EAR controls that apply for military end uses and end users in such countries, and (2) potential controls on CCL-listed items that currently do not require licensing for export, reexport, or in-country transfer to or within arms-embargoed countries. Accordingly, the review could result in heightened restrictions on dealings with China and other such countries. The review must be completed and its results implemented within 270 days of the ECRA's enactment.

### **Increased Penalties for Violations**

The ECRA would increase the civil penalties for violations of the act and regulations promulgated thereunder from \$295,141 to up to \$300,000 per violation or the amount that is twice the value of the transaction, whichever is higher. The criminal penalties for willful violations would remain \$1,000,000 per violation or twice the value of the gain or loss from the transaction, whichever is greater, and up to 20 years in prison.

The ECRA would require the Commerce Department, in consultation with other appropriate agencies, to publish and update "best practices" guidelines to assist in the development of effective export control programs. The implementation of an effective export compliance program and a "high quality overall export compliance effort" would ordinarily be given weight as mitigating factors in a civil penalty action under the ECRA.

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Covington has deep experience advising clients on the legal, policy, and practical dimensions of U.S. trade controls. We will continue to monitor developments in this area, and are well-positioned to assist clients in understanding how these recent announcements may affect their business operations. For companies whose products may include emerging and foundational technologies, such as artificial intelligence, robotics, augmented reality or virtual reality, and cutting-edge financial technology, we would be glad to monitor and advise on the administration's policy with respect to their specific technologies and ensure that their perspectives are taken into account.

## International Trade

If you have any questions concerning the material discussed in this client alert, please contact the following members of our International Trade Controls and Public Policy practices:

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