

Memorandum

BIS Imposes \$300M Fine, Largest Penalty Ever, Against Seagate for Violating Huawei Foreign Direct Product Rule

April 28, 2023

On April 19, 2023, the U.S. Department of Commerce's Bureau of Industry and Security ("BIS") issued the largest standalone administrative penalty in BIS history. BIS assessed a \$300 million civil penalty against Seagate Technology LLC and its Singapore subsidiary (together, "Seagate") for selling hard disk drives to Huawei Technologies Co. Ltd. ("Huawei") in violation of the foreign direct product ("FDP") rule. BIS's settlement with Seagate also includes a multi-year audit requirement and a five-year suspended Denial Order.

This action represents one of the first major enforcement actions taken by BIS for violating the FDP rule, a set of complex extraterritorial export control restrictions that target products manufactured entirely outside of the U.S. According to John Sonderman, Director of the Office of Export Enforcement, companies that "would violate [the] FDP rule are now on notice that these cases will be investigated and charged, as appropriate."

Case Background

Huawei and its affiliates were added to the Entity List in May 2019, when the U.S. imposed licensing requirements on exports, reexports, and transfers (in-country) of all items subject to the Export Administration Regulations ("EAR") destined to or involving listed Huawei entities. In August, 2020, BIS released a new FDP rule, further imposing a license requirement on any foreign-produced item when (1) there is knowledge that a listed Huawei entity is a party to the transaction and (2) the item is produced by an overseas plant or major component of a plant that is itself a direct product of certain controlled U.S.-origin technology or software.

According to the BIS Order and charging documents relating to Seagate, after BIS implemented the above export control measures, Seagate continued to do business with Huawei despite the fact that its only two competitors publicly stated they had stopped selling hard disk drives to Huawei. Seagate thus became Huawei's sole source provider of the drives. Although the hard disk drives Seagate provided to Huawei were manufactured in overseas plants, Seagate used several pieces of equipment during the production that were the direct products of controlled U.S.-origin technology. Seagate was alleged to have exported over 7.4 million foreign-produced hard disk drives over 429 transactions, valued at approximately \$1.1 billion in total, to Huawei entities in violation of U.S. export controls. BIS's \$300 million monetary penalty is more than twice of Seagate's estimated net profits from the alleged illegal exports.

Implications

This largest-to-date civil settlement in BIS history signals BIS's increasing focus on transactions outside of the U.S. in its enforcement of export controls targeting Huawei and other companies across the globe.

Companies should carefully evaluate its obligations under the EAR even when they manufacture their products entirely overseas. This is because the FDP rule is not unique to transactions involving Huawei and those on the Entity List. In addition, the scope of this rule is rapidly expanding. For example, in response to the Russian invasion of Ukraine, BIS imposed a comprehensive FDP rule on foreign-produced items destined to Russia or Belarus. More recently in October last year, BIS released a set of FDP rules targeting foreign-made products related to semiconductor manufacturing and supercomputer when destined to China.

These FDP rules are complex and contain many terms that are vague. For instance, there is no clear guidance on when a foreign-made item is considered the "direct product" of U.S. technology or software. Or, as was apparently the case in Seagate, it could be difficult to determine when a piece of equipment should be viewed as "major component of a plant." Based on the BIS Order, Seagate "incorrectly interpreted the FDP rule to require evaluation of only the last stage of its [hard disk drives] manufacturing process rather than the entire process." In-depth analysis is therefore needed to ensure that companies do not run afoul of the FDP rules when shipping foreign-made items to high risk countries and listed entities.

A significant factor behind the record fine is likely what BIS viewed to be repeated ignorance of red flags surrounding dealings with Huawei. BIS considers whether a violation was egregious when assessing the civil penalty, including whether there was willful or reckless violation of law or awareness of conduct at issue. In its Order, BIS stressed that Seagate continued its business with Huawei despite public statements from Seagate's competitors that they had ceased sales to Huawei, and despite notification from one of its equipment suppliers that a BIS license would be required if its equipment was used in any of the stages of production for a product destined for Huawei. By contrast, early detection of potential violations and self-disclosures to BIS would be a mitigating factor and may significantly reduce the potential penalty, according to the current BIS enforcement guidance.

Simpson Thacher & Bartlett LLP is experienced in navigating the complexities of export control rules across jurisdictions. If you have any questions regarding this memo, please reach out to any of the following attorneys in our global offices.

NEW YORK CITY

George S. Wang
+1-212-455-2228
gwang@stblaw.com

David H. Caldwell
+1-212-455-2612
dcaldwell@stblaw.com

Daniel S. Levien
+1-212-455-7092
daniel.levien@stblaw.com

PALO ALTO

Bo Bryan Jin
+1-650-251-5068
bryan.jin@stblaw.com

WASHINGTON, D.C.

Abram J. Ellis
+1-202-636-5579
aellis@stblaw.com

Mark B. Skerry
+1-202-636-5523
mark.skerry@stblaw.com

Malcolm J. (Mick) Tuesley
+1-202-636-5561
mick.tuesley@stblaw.com

Ryan D. Stalnaker
+1-202-636-5992
ryan.stalnaker@stblaw.com

Christine Tillema
+1-202-636-5559
christine.tillema@stblaw.com

BEIJING

Shuhao Fan
+86-10-5965-2987
shuhao.fan@stblaw.com

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