

# Memorandum

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## BIS Further Targets Chinese Firms by Amending the Foreign Direct Product Rule to Restrict Flow of Certain Foreign Produced Items to Huawei and Its Non-U.S. Affiliates and by Adding Thirty-Three Entities to the Entity List

June 4, 2020

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### Executive Summary

Over the last few weeks, the Department of Commerce's Bureau of Industry and Security ("BIS") has taken two sets of actions further targeting Chinese firms. First, on Friday, May 15, BIS announced new rules further tightening export controls targeting Huawei Technologies and its non-U.S. affiliates.<sup>1</sup> Second, on Friday, May 22, BIS announced that it would add thirty-three China-related entities, including certain entities in the United Kingdom and in Hong Kong, to the Entity list, including twenty-four "governmental and commercial organizations"<sup>2</sup> for "supporting procurement of items for military end-use in China" and nine entities "complicit in human rights violations and abuses" in Xinjiang.<sup>3</sup> The additions to the Entity List will be published in the Federal Register on June 5, 2020.<sup>4</sup> Once the additions to the Entity List become effective on June 5, 2020, it will be prohibited to export, reexport, or transfer items "subject to the EAR" to any of the designated entities, without authorization from BIS. In light of these two developments, foreign firms with Huawei dealings should review those dealings to ensure that they comply with the amended Foreign Direct Product Rule and businesses with international operations should carefully review their counterparts to ensure that they are not providing any items "subject to the EAR" to any of the entities that will be included on the Entity List.

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<sup>1</sup> Huawei was first added to the Entity List on May 16, 2019. Subsequent BIS rulemaking has increased the number of Huawei affiliates designated on the Entity List. As of the publication of this interim rule, 114 non-U.S. affiliates of Huawei are listed on the Entity List.

<sup>2</sup> <https://www.commerce.gov/news/press-releases/2020/05/commerce-department-add-two-dozen-chinese-companies-ties-wmd-and>

<sup>3</sup> <https://www.commerce.gov/news/press-releases/2020/05/commerce-department-add-nine-chinese-entities-related-human-rights>

<sup>4</sup> <https://www.federalregister.gov/documents/2020/06/05/2020-10869/addition-of-entities-to-the-entity-list-revision-of-certain-entries-on-the-entity-list>

<https://www.federalregister.gov/documents/2020/06/05/2020-10868/addition-of-certain-entities-to-the-entity-list-revision-of-existing-entries-on-the-entity-list>

## Amendment to the Foreign Direct Product Rule to Target Huawei Supply Chains

The BIS action concerning Huawei takes the form of an interim final rule amending General Prohibition Three (the Foreign Direct Product Rule) of the Export Administration Regulations (“EAR”).<sup>5</sup> Prior to the new rulemaking, the Foreign Direct Product Rule made foreign produced items subject to the EAR if they were the direct product of U.S. technology or software controlled under the EAR for national security reasons, or produced at a plant where the plant or a major component of the plant were the direct product of technology or software controlled for national security reasons. The interim rule expands the scope of technologies and software covered by the Foreign Direct Product Rule, when applied to Huawei and its non-U.S. affiliates, by adding new categories of controlled technology and software.<sup>6</sup>

The new rulemaking expands the scope of the Foreign Direct Product Rule, to include certain additional technologies and software, when foreign produced items are to be provided to Huawei and its designated affiliates in circumstances where Huawei and its designated affiliates were involved in the development or production of the foreign made item.

Under the new rulemaking, it is prohibited to export, reexport, or transfer items to Huawei and its designated affiliates without a BIS license where:

1. The item is produced or developed by Huawei or its designated affiliates;
2. The item is the direct product of specified U.S. electronics (including semiconductors), computer, and telecommunications technologies and software,<sup>7</sup> or is produced by a plant or major component of a plant outside the U.S. which is itself a direct product of the specified technologies and software; and
3. The transferor or exporter has knowledge that item is “destined” for Huawei or a designated affiliate on the Entity List.

Secretary of Commerce Wilbur Ross stated that the purpose of these new restrictions concerning Huawei is to “prevent U.S. technologies from enabling malign activities contrary to U.S. national security and foreign policy interests.” This action is part of a U.S. strategy targeting Huawei’s supply chains, specifically Huawei’s access to semiconductors which are manufactured abroad using products and processes based on U.S. technology.<sup>8</sup> Foreign

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<sup>5</sup> The BIS interim rule became effective immediately on May 15, 2020 and was published to the Federal Register on May 19, 2020. BIS is accepting public comment on the interim rule through July 14, 2020.

<sup>6</sup> The rule also includes a savings clause for previously-unregulated items subject to the interim rule which were already in shipment or production—these items are not subject to the EAR and do not require a license so long as they have been exported, reexported, or transferred before September 14, 2020.

<sup>7</sup> Three categories of technologies are controlled under this rule: (1) electronics, such as semiconductors, microprocessors, and microcircuits (ECCNs 3D001, 3D991, 3E001, 3E002, 3E003, 3E991); (2) digital computer and data processing (ECCNs 4D001, 4D993, 4D994, 4E001, 4E992, 4E993); and (3) telecommunications technologies, including channel switching and signal routing (5D001, 5D991, 5E001, 5E991).

<sup>8</sup> On May 15, 2020, BIS also extended the temporary general license for U.S. telecommunications carriers maintaining Huawei equipment and networks through August 13, 2020.

producers, especially those operating in the semiconductor space, will now have to review their operations to determine if a BIS license is needed before providing items to Huawei or its non-U.S. affiliates.

### **New Entity List Designations**

On Friday, May 22, BIS also announced it will add thirty-three new Chinese governmental and non-governmental organizations to the Entity List. The additions target entities determined by the U.S. Government to be acting contrary to the foreign policy or national security interests of the United States. Specifically, the designations respond to two categories of conduct. First, BIS has targeted nine entities for being “implicated in human rights violations and abuses in the implementation of China’s campaign of repression, mass arbitrary detention, forced labor and high-technology surveillance against Uighurs, Kazakhs, and other members of Muslim minority groups in the Xinjiang Uighur Autonomous Region.” The second group includes twenty-four entities in China, Hong Kong, and the United Kingdom which have been determined to be involved in procurement of commodities and technology for military end-use in China or to be engaged in development of weapons of mass destruction in China. A complete list of the newly designated entities may be found in Appendix A.

A BIS license will be required to export, reexport, or transfer any items “subject to the EAR” to a designated entity. Entity-specific licensing review policies differ entity by entity, but generally a presumption of denial applies to these license requests.

### **Implications for International Businesses**

Non-U.S. businesses, especially those in semiconductor, electronics, telecommunications, and related sectors, will need to review operations to determine if they involve transactions with any Huawei or Huawei affiliates which are subject to the new amendment to the Foreign Direct Product Rule. Businesses will need to determine which, if any, of these transactions involve foreign-produced products derived from the newly specified U.S. electronics, computer, and telecommunications technologies and software, even when those technologies and software did not previously trigger the Foreign Direct Product Rule because they are not controlled by the EAR for national security reasons. Overseas manufacturers, especially those in the semiconductor and related electronics space, may previously have taken the position that their foreign made items, even if derived from certain U.S. technologies or produced with certain equipment derived from U.S. technology, were not “subject to the EAR.” Under the new rule, these manufacturers may need to reevaluate whether such products are now subject to the EAR, as the categories of technology that are covered by the Foreign Direct Product rule have been expanded for items destined for Huawei and its affiliates. U.S. semiconductor and electronics firms may also want to take this opportunity to review the operations of their non-US affiliates and evaluate if any dealings with Huawei are impacted by the new rule making. All businesses, both U.S. and foreign, should also review their operations for transactions with any of the thirty-three Chinese entities newly added to the Entity List.

## Appendix A – New Entity List Additions

### ENTITIES RELATED TO HUMAN RIGHTS ABUSES IN CHINA'S XINJIANG UIGHUR AUTONOMOUS REGION

- PRC Ministry of Public Security – Institute of Forensic Science
- Aksu Huafu Textiles Co.
- CloudWalk Technology
- FiberHome Technologies Group
- Nanjing FiberHome Starrisky Communications Development
- NetPosa
- SenseNets
- Intellifusion
- IS'Vision

### ENTITIES WITH TIES TO WMD AND MILITARY ACTIVITIES

- Beijing Cloudmind Technology Co., Ltd.
- Beijing Computational Science Research Center
- Beijing Jincheng Huanyu Electronics Co., Ltd.
- Center for High Pressure Science and Technology Advanced Research
- Chengdu Fine Optical Engineering Research Center
- China Jiuyuan Trading Corporation
- Cloudminds (Hong Kong) Limited
- Cloudminds Inc. (operating in the United Kingdom)
- Harbin Chuangyue Technology Co., Ltd.
- Harbin Engineering University
- Harbin Institute of Technology
- Harbin Yun Li Da Technology and Development Co., Ltd.
- JCN (HK) Technology Co. Ltd.
- K Logistics (China) Limited
- Kunhai (Yanjiao) Innovation Research Institute

- Peac Institute of Multiscale Science
- Qihoo 360 Technology Co. Ltd. (operating in the United Kingdom)
- Qihoo 360 Technology Company
- Shanghai Nova Instruments Co., Ltd.
- Sichuan Dingcheng Material Trade Co., Ltd.
- Sichuan Haitian New Technology Group Co. Ltd.
- Sichuan Zhonghe Import and Export Trade Co., Ltd.
- Skyeye Laser Technology Limited
- Zhu Jiejin

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