



## Outsourcing Manufacturing of Sensitive Items to Foreign Firms Presents Export Control Challenges

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Outsourcing the design and manufacturing of products, components and software to foreign contractors has become a significant part of manufacturing in the U.S. However, if the items involved are subject to U.S. export restrictions, outsourcing the design and/or manufacturing of these items to foreign firms can raise significant export control requirements - and potential legal liability - for the U.S. companies involved.

Export requirements in foreign manufacturing can arise in a number of ways. If the item being manufactured or its components require an export license for export to a particular country under the Export Administration Regulations (EAR) or the International Traffic In Arms Regulations (ITAR), transferring technical information related to such items to the foreign country frequently will also require an export license unless a license exception applies. Thus, if the U.S. company transfers technical drawings, blueprints or production specifications to the foreign vendor for use in producing the item overseas, the U.S. company will be required to review whether an export license is required prior to such transfer. Even if the foreign vendor is simply developing technology, intellectual property or software, if the U.S. company is sending specifications, product requirements or similar technical data to the foreign party, the transfer may require an export license ? even if no physical products are actually manufactured abroad. In certain cases the transfer of the technology alone can require a license even if the end product does not.

Similarly, if the U.S. company works collaboratively with the foreign company engineers and designers during the development process, including in phone calls and e-mails, conference calls, webinars, zoom calls or video conferences, the transfer of controlled technical data by the U.S. persons may require a license. Under the deemed export rule under the EAR and ITAR, even transfers to foreign persons<sup>[1]</sup> *in the U.S.* are considered an export and may require a license.

There are other ways in which requirements can arise as well. If the foreign company is subject to U.S. sanctions, such as being listed on the Office of Foreign Assets Control (OFAC) List of Specially

Designated Nationals and Blocked Persons (the "SDN List") (or is owned 50% or more by parties listed on the SDN List), U.S. persons are prohibited from entering most business transactions with such parties, including for designing or manufacturing items, unless a license is available. Similarly, if a party is listed on the Bureau of Industry and Security's (BIS) Entity list, U.S. companies are prohibited from exporting items subject to the EAR to such parties without a license or license exception - items subject to the EAR include physical products, technology and software[2]

Also, if the foreign manufacturer is located in a country subject to OFAC sanctions (such as Syria, Iran, Cuba, N. Korea or the Crimea, Donetsk and Luhansk regions of Ukraine) or subject to requirements listed under EAR Part 746, export restrictions may apply. Restrictions may also apply if the technical information being transferred abroad will be used in a "prohibited end use" as set forth in EAR Part 744, and/or transferred to a military or military-intelligence end user or used for a military or military-intelligence end use as set forth in EAR Part 744. Further, for transfers to countries such as Russia and designated regions of Ukraine, more restrictive export requirements may apply (See "U.S. Imposes Sweeping New Export Controls and Economic Sanctions Against the Russian Federation" available here).

BIS recently announced a significant enforcement case involving these issues. In this case, U.S. companies were outsourcing 3-D printing manufacturing for space, satellites, rockets and other controlled prototypes to companies in China. According to the BIS press release, a U.S. intermediary firm received export-controlled technical data and drawings from the U.S. companies and provided these to manufacturers in China to 3-D print the items without U.S. Government authorization. The manufactured items were then imported into the U.S. to be provided to the ordering customers. BIS issued a Temporary Denial Order to halt further transfers and is currently conducting an enforcement investigation of the transactions in question. Assistant Secretary of Commerce for Export Enforcement Matthew S. Axelrod provided the following statement related to the case:

Outsourcing 3-D printing of space and defense prototypes to China harms U.S. national security? By sending their customers' technical drawings and blueprints to China, these companies may have saved a few bucks?but they did so at the collective expense of protecting U.S. military technology.

In the release, BIS also reminded U.S. companies that they are prohibited from "taking any action that facilitates [the Chinese companies] taking possession or control of items subject to the EAR that are intended for export." Consequently the U.S. companies in this case could be liable for export violations as well for taking such actions "going through a middle-man does not automatically shield U.S. companies from liability. Failure to obtain the requisite export authorizations can result in significant penalties for U.S. companies " including up to \$1,000,000 in fines and 20 years' imprisonment for company employees per violation. A copy of the BIS release in this case is available here.

In dealing with today's supply chain issues, U.S. firms are subject to significant pressures to meet customers' price and delivery requirements. However, the export control laws continue to apply even during these challenging times. Dealing with export control requirements in foreign outsourcing is an important step on the checklist in a comprehensive export compliance effort.

This article contains general, condensed summaries of actual legal matters, statutes and opinions for

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[1] The term "Foreign Person" is defined in Part 772 of the EAR as follows: Foreign person. Any natural person who is not a lawful permanent resident of the United States, citizen of the United States, or any other protected individual as defined by 8 U.S.C. 1324b(a)(3). It also means any corporation, business association, partnership, trust, society or any other entity or group that is not incorporated in the United States or organized to do business in the United States, as well as international organizations, foreign governments and any agency or subdivision of a foreign government (e.g., diplomatic mission). "Foreign person" is synonymous with "foreign national," as used in the EAR, and "foreign person" as used in the International Traffic in Arms Regulations (22 CFR 120.16). This definition does not apply to part 760 of the EAR (Restrictive Trade Practices or Boycotts).

[2] Restrictions may also apply to transfers to parties on the EAR Denied Persons List, Military End User List and Unverified List.

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- International Trade and Business
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