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PRIMER ON BIS DE MINIMIS RULE

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US Export Control Laws

- ❖ The US Government manages a complex system of export control laws and regulations designed to protect US national security and foreign policy interests
- ❖ Among the regulations, the Department of Commerce/Bureau of Industry and Security (BIS) administers the Export Administration Regulations (EAR), which control dual use and some military items (which include products, equipment, materials, software and technology)
- ❖ The EAR establish a licensing, reporting and recordkeeping framework that includes a detailed list of dual use and some military items – the Commerce Control List (CCL)
- ❖ The EAR apply to any person (entity or individual) who is subject to US jurisdiction and:
 - Exports
 - Reexports
 - Transfers or Retransfers; and/or
 - Releases

Dual use or some military items

Export Administration Regulations

- ❖ The EAR utilize a “catch-and-release” approach to the licensing of items on the CCL
 - Items are subject to licensing unless released from controls – which means that persons subject to US jurisdiction do not need to obtain a license from BIS but may use pre-authorized approvals known as License Exceptions
 - If permitted under the EAR, license exceptions may be used for any exports, reexports, transfers, retransfers or releases, unless otherwise prohibited
- ❖ In addition to the License Exception authorization, which releases CCL items from the requirements to obtain licenses from BIS, the EAR also incorporate a release from control through the ‘*de minimis*’ rule
- ❖ The *de minimis* rule is designed to grant persons the ability to determine that the nexus between the US and foreign content is sufficiently distant or “minimal” that the EAR requirements no longer apply
- ❖ Part 734, Supplement 2 and EAR 734.3 and 734.4 outline the requirements for the use of the *de minimis* rule

De Minimis Rule Explained

- ❖ The *de minimis* rule has been part of the EAR for over 20 years
- ❖ It is designed to limit or eliminate the reach of the EAR to certain foreign manufactured items that incorporate US origin products, materials, equipment, software or technology (collectively, “items”)
- ❖ The rule established percentage thresholds for US content – if the US content incorporated into the foreign manufactured product falls below or equals the percentage thresholds, then the foreign produced product is not subject to the EAR
 - The EAR identify two specific thresholds
 - US content that falls below or equals 25%
 - US content that falls below or equals 10%
 - Calculating the content requires a detailed analysis of the controlled US origin items when compared to the overall value of the foreign produced product

De Minimis Rule Explained

- ❖ Supplement 2 of Part 734 indicates that a *de minimis* calculation takes into account
 - Hardware
 - Software; and
 - Technology
- ❖ Value of US Origin Content
 - Fair market price in the market where the foreign product is being produced (EAR 734, Supp. 2)
 - Method used to calculate value must be consistent with the business practice where the foreign item is produced
- ❖ Determining how many parts are included in an item may be more straightforward than assessing the value of the item given the technology on which it is based
- ❖ Applying the *de minimis* rule requires an understanding of several key EAR definitions and the licensing requirements that apply to the US origin items that are exported, reexported, transferred, or released to a foreign destination for purposes of producing a foreign manufactured item

Key Terms

- ❖ Important definitions
 - Export
 - Reexport
 - Transfer
 - Foreign manufactured item
 - The “second incorporation rule”
- ❖ The *de minimis* rule takes on enhanced importance, not only when producing items in countries where the US has mixed or adverse national security or foreign policies but when dealing with parties who are included on any of several BIS denied, unverified, or entity lists
- ❖ These lists establish restrictions on when items “subject to the EAR” may not be exported, reexported, transferred, or released to parties included on any of the lists
- ❖ Restrictions can include license requirements for all ECCN items or for all items “subject to the EAR” which would include any item on the CCL (ECCN items) as well as EAR99 items

SECTION 01

DEFINITIONS IMPORTANT TO THE *DE MINIMIS* RULE

Definitions Important to the *De minimis* Rule

Export

- ❖ An actual shipment or transmission out of the United States, including the sending or taking of an item out of the United States, in any manner
- ❖ Releasing or otherwise transferring “technology” or source code (but not object code) to a foreign person in the United States (a “deemed export”)
- ❖ Exports that transit through a country or countries to a destination identified in the EAR
- ❖ (Special definitions for transferring spacecraft)

Definitions Important to the *De minimis* Rule

Reexport

- ❖ An actual shipment or transmission of an item subject to the EAR from one foreign country to another foreign country, including the sending or taking of an item to or from such countries in any manner
- ❖ Releasing or otherwise transferring “technology” or source code subject to the EAR to a foreign person of a country other than the foreign country where the release or transfer takes place (a deemed reexport)
- ❖ Any release outside of the United States of “technology” or source code subject to the EAR to a foreign person of another country is a deemed reexport to the foreign person's most recent country of citizenship or permanent residency, except as described in § 734.20
- ❖ The reexport of an item subject to the EAR that will transit through a country or countries to a destination identified in the EAR

Definitions Important to the *De minimis* Rule

Release

- ❖ Technology and software are released through:
 - Visual or other inspection by a foreign person of items that reveals “technology” or source code subject to the EAR to a foreign person; or
 - Oral or written exchanges with a foreign person of “technology” or source code in the United States or abroad.
 - Any act causing the “release” of “technology” or “software,” through use of “access information” or otherwise, requires an authorization to the same extent an authorization would be required to export or reexport such “technology” or “software” to that person.

Definitions Important to the *De minimis* Rule

Transfer

- ❖ A change in end use or end user of an item within the same foreign country. Transfer (in-country) is synonymous with In-country transfer.
- ❖ All of these definitions are subject to section 734.18 and 734.20, which are carve-outs or “releases” in the catch-and-release mode of what constitutes an export, reexport or transfer

SECTION 02

THE *DE MINIMIS* RULE

25% *De minimis* Rule

- ❖ Re-exports of foreign (non-US) made:
 - Commodity incorporating controlled US-origin commodities or bundled with US-origin software,
 - Software incorporating controlled US-origin software, or
 - Technology commingled with or drawn from controlled US-origin technology
- ❖ Are not subject to the EAR
- ❖ If the US-origin controlled content, software, or technology is valued at **25% or less** of the total value of the foreign-made item, software, or technology
- ❖ And the re-export is made to any country except Iran, North Korea, Sudan, or Syria

10% *De minimis* Rule

- ❖ Re-exports of foreign (non-US) made:
 - Commodity incorporating controlled US-origin commodities or bundled with US-origin software,
 - Software incorporating controlled US-origin software, or
 - Technology commingled with or drawn from controlled US-origin technology
- ❖ Are not subject to the EAR
- ❖ If the US-origin controlled content, software, or technology is valued at **10% or less** of the total value of the foreign-made item, software, or technology
- ❖ And the re-export is made to any country in the world (including Iran, North Korea, Sudan, or Syria)

De minimis Rule – Summary

- ❖ Effectively this means that unlicensed reexports of (most) foreign items can have up to 25% controlled US content without violating the EAR except for those four (4) countries, which can only have up to 10% controlled US content
- ❖ Cuba was removed from this list in 2015 (but impact was minimal due to comprehensive embargo)
- ❖ Some exceptions – see next slide

No *de minimis* level

- ❖ Foreign produced encryption technology that incorporates US origin encryption technology controlled by ECCN 5E002
- ❖ Foreign-made items that incorporate US-origin 9x515 or “600 series” items described in paragraphs .a through .x of a 9x515 or “600 series” ECCN when destined for Country Group D:5 (US Arms Embargoed Countries)
- ❖ Foreign-made items that incorporate US-origin 9x515 or “600 series” items described in paragraph .y of a 9x515 or “600 series” ECCN when destined for Country Group E:1 or E:2 (currently Cuba, Iran, North Korea, Sudan, and Syria) **or for China**
 - **Thus no foreign-made items that incorporate ANY amount of US-origin 9x515 or 600 series items can be sent to China**
- ❖ Other exceptions to *de minimis* include certain foreign-made computers containing US-origin controlled semiconductors (to certain destinations); certain US-origin technology related to gas turbine engine parts when redrawn, used, consulted or commingled abroad; and certain foreign-made military commodities incorporating US content (to certain destinations).

SECTION 03

CALCULATING *DE MINIMIS* VALUES

US-Origin Controlled Content Value

1. Determine the ECCN of each US-origin item incorporated into the foreign-made product
2. Identify which of those US-origin items would require an export license to the destination country where the foreign made product will be exported or transferred
 - EAR99 items are considered controlled content for Cuba, North Korea, Syria, Crimea
3. Determine the fair market price of the controlled US-origin content in the market where the foreign product is being produced
 - Usually the same as the cost to the foreign manufacturer if arms length
 - If the parties are related, use the fair market price that would normally be charged to unaffiliated customers in the same foreign market

Foreign-Made Product Value

4. Determine the fair market price of the foreign-made product in the market where it is sold
 - Usually the same as the actual cost to a buyer of the product in an arms-length transaction
 - If the parties are related, use the fair market price that would normally be charged to unaffiliated customers in the same foreign market
 - For foreign-made software, the total value will be: the value of actual sales of that software based on orders received at the time the foreign software incorporates US-origin content PLUS, if applicable, an estimate of all future sales of that software

Calculate Percentage Value of US-Origin Content

5. Divide the total value of the US-origin controlled content by the foreign-made item value, then multiply the resulting number times 100
6. If the percentage value is equal to or less than the *de minimis* level, then the foreign-made item is not subject to the EAR

Additional Considerations

- ❖ Include only controlled content in the *de minimis* calculation
 - Content is controlled based on the destination of the foreign made product
 - Results for same product can differ based on license requirements
- ❖ EAR99 items are considered “controlled content” for embargoed countries
- ❖ If your non-US item is subject to the EAR pursuant to the *de minimis* rules, then all of the EAR policies must be considered (including end use and end user license requirements)
- ❖ One-time report required for technology subject to *de minimis* rule

SECTION 04

CASE STUDIES

Case Study #1

U.S.-origin steam wand with
fair market price of \$55 = EAR99

Italian-manufactured espresso
machine with fair market price of \$500

Orders from: Syria, UAE

De minimis percentage to Syria = $.11 \times 100\% = 11\%$

De minimis percentage to UAE = 0%



Value for *De Minimis* Purposes

- ❖ If the buyer and seller are related parties and the price is reduced based on that relationship, then you still must use fair market price in the *de minimis* calculation (*i.e.*, not the actual / reduced price)
- ❖ If the espresso machine is a product that has never been sold before, use a comparable fair market price for a similar product, or the production cost of the item

Case Study #2

U.S. origin content:

- ❖ power supply with fair market price of \$150 = EAR99
- ❖ microprocessor chip with fair market price of \$200 = 3A001

German-manufactured computer with fair market price of \$1000

Orders from Cuba, Brazil

De minimis percentage for Cuba = $.35 \times 100\% = 35\%$

De minimis percentage for Brazil = $.2 \times 100\% = 20\%$



Questions?

Biography



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Giovanna M. Cinelli is the leader of the international trade and national security practice. As a practitioner for more than 30 years, she counsels clients in the defense and high-technology sectors on a broad range of issues affecting national security and export controls, including complex export compliance matters, audits, cross-border due diligence, and export enforcement, both classified and unclassified. She handles complex civil and criminal export-related investigations and advises on transactional due diligence for regulatory requirements involving government contracts, export policy, and compliance, as well as settlement of export enforcement actions before the US departments of State, Commerce, Treasury, and Defense, and related agencies. Giovanna has conducted dozens of export investigations and has negotiated six consent agreements before the Department of State. She advises clients on matters before the Committee of Foreign Investment in the United States (CFIUS), and addresses mitigation requirements that may apply as part of CFIUS clearances for cross-border transactions. Additionally, Giovanna has developed and assisted clients with the implementation of business-related strategies with adherence to strict requirements addressing US government national security and critical infrastructure concerns, as well as Foreign Agents Registration Act (FARA) requirements. She has addressed the challenging issues associated with the extraterritorial application of US export laws and regulations within litigations and arbitrations, and has assisted clients when navigating the conflicting requirements these may laws create. Giovanna regularly speaks and writes on international arms trade, technology transfer, national security cross-border requirements, and export issues. She has participated in panel discussions related to CFIUS and technology transfer hosted by the Center for Strategic and International Studies and the Council on Foreign Relations. She has appeared on CNN's "Burden of Proof" and MSNBC's "Hardball with Chris Matthews" as an expert in international technology transfer, arms exports, and related national security issues. As a member of the Defense Trade Advisory Group for nearly two decades, Giovanna engages regularly with the Department of State on matters affecting defense trade. She was a member of the Regulations and Procedures Technical Advisory Committee and is in her third term as a member of the Department of Commerce's Virginia/DC District Export Council.

Biography



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Kenneth J. Nunnenkamp represents buyers and sellers in transactions before the Committee on Foreign Investments in the United States (CFIUS), and counsels parties to transactions regarding CFIUS risks, applicability and solutions. His experience includes representation of buyers and sellers in public and private transactions in all value ranges, from small transactions in the millions to large matters in the billions, public and private. Ken's experience with CFIUS includes almost every industry and transactions involving entities from more than 35 countries, including Japan, China, Germany, the United Kingdom, Canada, Switzerland, Norway, Sweden, Indonesia, Australia, South Korea, Luxembourg, France, and many more. Ken chairs the Morgan Lewis CFIUS Working Group, which brings together the Firm's attorneys who practice in the area and who are interested in its developments. Ken's expertise encompasses trade and regulatory fields dealing with or implicating national security issues, including: US economic sanctions; Trade remedies (§§ 201, 232 and 301, and related matters, including exclusion requests, hearing testimony and Congressional involvement); Export controls and compliance/investigations under the ITAR, EAR and other regulations; US Customs regulations governing imports and exports; Customs and Census issues arising under the Foreign Trade Regulations, Endangered Species Act and Lacey Act issues with imports and exports of exotic and controlled items; C-TPAT; and Trade Agreements/Buy American issues. Ken also represents clients in matters relating to classified activities and before the Justice Department's Foreign Agent Registration Act (FARA) division. He brings more than 30 years of litigation and investigation experience, including time as a JAG Officer in the US Marine Corps. As an experienced entrepreneur, Ken applies business acumen to legal solutions, while assessing risk in user-friendly terms. He serves on the Wake Forest University Business School Board of Visitors, and publishes and presents frequently on topics relating to national security law, trade and business.

Biography



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Katelyn M. Hilferty helps clients navigate US export controls and customs laws, sanctioned country regulations, anti-money laundering regulations, and national security issues. She has experience with classification/jurisdiction analyses, license applications, compliance counseling, investigations, and voluntary disclosures under the International Traffic in Arms Regulations (ITAR), Export Administration Regulations (EAR), and Office of Foreign Assets Control (OFAC) regulations. Additionally, she has counseled clients on transactions before the Committee on Foreign Investment in the US (CFIUS).

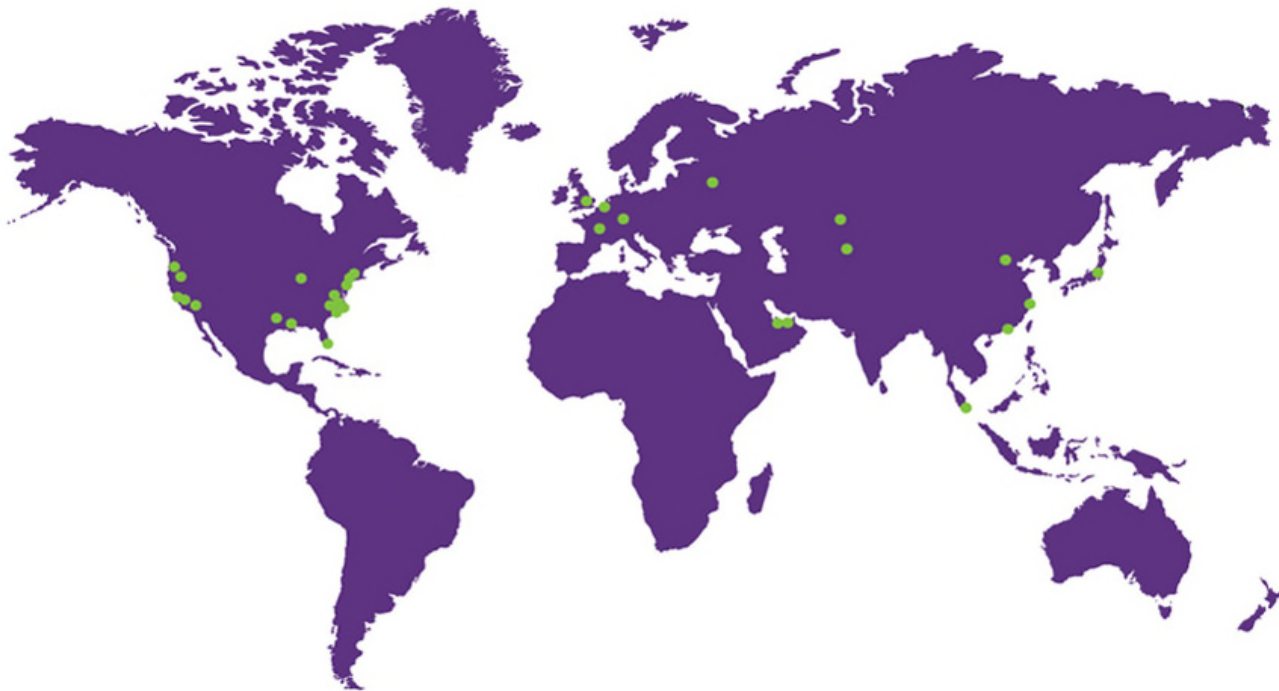
Katelyn also has experience with import-related matters under the jurisdiction of US Customs and Border Protection (CBP), including ruling requests, prior disclosures, protests of Customs seizures, and focused assessments.

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