

2008

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### Recommended Citation

Andrew F. Diamond, *Dueling Over Dual-Use Goods: The U.S. Department of Commerce's Misguided Attempt to Promote U.S. Security and Trade with China through Restrictive Export Controls*, 3 Brook. J. Corp. Fin. & Com. L. (2008).

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## **DUELING OVER DUAL-USE GOODS: THE U.S. DEPARTMENT OF COMMERCE’S MISGUIDED ATTEMPT TO PROMOTE U.S. SECURITY AND TRADE WITH CHINA THROUGH RESTRICTIVE EXPORT CONTROLS**

On July 6, 2006, the U.S. Department of Commerce’s Bureau of Industry and Security (BIS) published in the *Federal Register* a proposed version of what has come to be known as the “China Military Catch All Rule.”<sup>1</sup> The rule proposed not only to tighten U.S. export licensing policy for certain goods destined for China but also to create a program for trusted Chinese end-users to facilitate trade.<sup>2</sup> The published notice requested public comment on the proposed rule “in order to obtain the benefit of a variety of viewpoints before publishing any final rule.”<sup>3</sup>

And comment the public did. During the ensuing months, in which BIS extended the comment period an additional month,<sup>4</sup> over fifty individual comments were submitted, totaling nearly 1,000 pages.<sup>5</sup> For just under twelve months, this public and often contentious debate unfolded over what final form, if any, the rule should take.<sup>6</sup> Generally, the debate pitted American businesses and exporters—proponents of liberalized trade controls on China—against the United States government and, more specifically, the Commerce Department, which view such trade controls as effective tools of foreign policy and national security.<sup>7</sup> Ultimately, the United States government and the Commerce Department prevailed and heavy restrictions were placed on trade.

The publication of the final version of the China Military Catch All Rule<sup>8</sup> on June 19, 2007 has been hailed by the government as embodying “one of the most important changes to export control policy in many

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1. Revisions and Clarifications of Export and Reexport Controls for the People’s Republic of China (PRC); New Authorization Validated End-User, 71 FED. REG. 38313 (July 6, 2006) [hereinafter Proposed Rule].

2. *Id.* at 38313–14.

3. *Id.* at 38316.

4. R.G. Edmonson, *Comment period on dual-use export rules extended*, JOURNAL OF COM., Oct. 19, 2006.

5. Assistant Secretary of Commerce for Export Administration Christopher A. Padilla, *The Future of U.S. Export Controls on Trade with China*, STATES NEWS SERVICE, Jan. 29, 2007, available at <http://www.bis.doc.gov/news/2007/padilla02012007.htm> [hereinafter Padilla 1/29/07].

6. *See, e.g., Exporters Urge BIS to Reconsider China ‘Catch-All’ Rule*, MANAGING IMPORTS AND EXPORTS, April 2007, available at LEXIS (describing the publishing of the proposed rule as “kicking up a veritable storm among U.S. exporters”).

7. Padilla 1/29/07, *supra* note 5.

8. Revisions and Clarifications of Export and Reexport Controls for the People’s Republic of China (PRC); New Authorization Validated End-User; Revision of Import Certificate and PRC End-User Statement Requirements, 72 FED. REG. Vol. 33646 (June 19, 2007) [hereinafter Final Rule].

years.”<sup>9</sup> In an op-ed in the *San Jose Mercury News*, Under Secretary of Commerce for Industry and Security Mario Mancuso argued that the new rule “strike[s] the right balance in our complex relationship with China” by “support[ing] U.S. companies in competing successfully in China while restricting the export of technologies that would contribute to China’s military modernization.”<sup>10</sup>

In reality, the new rule will most likely do quite the opposite. The China Military Catch All Rule will not only negatively impact American business interests in China, but will also do little to slow China’s military modernization and may even undermine U.S. national security. Part I of this note provides a brief overview of U.S. dual-use<sup>11</sup> export controls and then specifically addresses those with direct application to China in order to place the new regulations in the proper context. Part II examines the final incarnation of the China Military Catch All Rule in detail, highlighting both the changes between the proposed and final versions and the major changes to current U.S. dual-use export control policy.

Part III provides an evaluation of the immediate and long-term consequences of the rule’s implementation, both in the United States and in China, and addresses three specific implications. This note will first argue that the rule unnecessarily expands liability for U.S. exporters, as well as for entities throughout the supply chain. The specter of harsh penalties requires greater due diligence efforts to ensure that these newly controlled items do not end up bolstering China’s military. These developments make the costs (administrative or otherwise) of doing business for U.S. exporters in China greater,<sup>12</sup> while making their foreign counterparts more attractive to Chinese buyers,<sup>13</sup> thereby further fueling the political time bomb that is America’s ballooning trade deficit with China.<sup>14</sup> Second, the rule will undermine U.S. business competitiveness in China and in other markets. The final rule is strictly unilateral in nature as the United States has been unable to convince a single ally to adopt similar restrictions.<sup>15</sup> With many

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9. Padilla 1/29/07, *supra* note 5.

10. Mario Mancuso, *Securing our Exports to China: New Rules Can Limit Military’s Access to High Technology*, SAN JOSE MERCURY NEWS, June 18, 2007, available at [http://www.bis.doc.gov/news/2007/oped06\\_18\\_07.htm](http://www.bis.doc.gov/news/2007/oped06_18_07.htm).

11. The term “dual-use” is defined as “[i]tems that have both commercial and military or proliferation applications.” See 15 C.F.R. § 772.1 (2007).

12. Letter from 23 Organizations to Stephen Hadley, (Sept. 21, 2005), available at [http://www.usaengage.org/storage/usaengage/Publications/2005\\_09\\_nftc\\_catchall.pdf](http://www.usaengage.org/storage/usaengage/Publications/2005_09_nftc_catchall.pdf).

13. William Reinsch, “Future of Export Controls,” Remarks to the Practicing Law Institute (Dec. 11, 2006), available at <http://www.nftc.org/newsflash/newsflash.asp?Mode=View&articleid=1843&Category=All>.

14. Li Ruogu, *Real Issues in China-US Trade Imbalance*, CHINA DAILY, May 9, 2008.

15. Memorandum from Paul Freedenberg, Ass’n for Mfg. Tech., on Overview of the China Military Catch-All Regulation to the Interested Parties (June 19, 2007), available at [http://www.amtonline.org/document\\_display.cfm/document\\_id/55349/section\\_id/103/overviewofthechinamilitarycatch-allregulation](http://www.amtonline.org/document_display.cfm/document_id/55349/section_id/103/overviewofthechinamilitarycatch-allregulation).

of these items available elsewhere, Chinese firms are likely to turn to foreign competitors for their products.<sup>16</sup> Likewise, due to the rule's extraterritorial application through its reexport provisions,<sup>17</sup> foreign companies will increasingly "design out" U.S. components in their products, damaging U.S. economic interests in other markets as well.<sup>18</sup> Third, this new economic reality will mean that U.S. businesses are competitively disadvantaged in their dealings in the hyper-competitive Chinese market. This will reduce the profits they have to re-invest in cutting edge research and development (R&D). Because the Pentagon now relies primarily on commercial technology to equip America's military,<sup>19</sup> a reduction in private sector R&D for high-technology will only serve to jeopardize U.S. military superiority,<sup>20</sup> a result fundamentally contrary to the stated goal of the rule itself.<sup>21</sup>

## I. U.S. DUAL-USE EXPORT CONTROLS

### A. A BRIEF HISTORY OF U.S. DUAL-USE EXPORT CONTROLS<sup>22</sup>

The United States emerged from the wreckage of World War II as the undisputed leading economic power in the world, even though, paradoxically, international trade was an insignificant component of America's economic prowess.<sup>23</sup> Despite playing the preeminent role in international trade and global financial markets, the domestic market was the United States' primary concern after the war.<sup>24</sup> Faced with the onset of the Cold War and the division of nations into ideological blocs,<sup>25</sup> the key objective at the core of U.S. export controls—and those of its allies<sup>26</sup>—was

16. *Id.*

17. Reexport is "an actual shipment or transmission of items subject to the [Export Administration Regulations] from one foreign country to another foreign country." 15 C.F.R. § 772.1 (2007).

18. THE COALITION FOR SECURITY AND COMPETITIVENESS, RECOMMENDATIONS FOR MODERNIZING EXPORT CONTROLS ON DUAL-USE ITEMS 7 (Mar. 6, 2007), available at [http://www.securityandcompetitiveness.org/files/dual-use\\_recommendations.pdf](http://www.securityandcompetitiveness.org/files/dual-use_recommendations.pdf).

19. Michael Hirsh, *The Great Technology Giveaway?; Trading with Potential Foes*, FOREIGN AFFAIRS 2 (1998).

20. Robert L. Paarlberg, *Knowledge as Power: Science, Military Dominance, and U.S. Security*, INTERNATIONAL SECURITY 122, 129–30 (Summer 2004).

21. "In general, however, this rule proposes certain revisions and clarifications to licensing requirements and policies with regard to the PRC and more precisely reflect U.S. foreign policy and national security interests." Final Rule, *supra* note 8, at 33646.

22. For a much more expansive and detailed look at the history of U.S. export controls, see WILLIAM J. LONG, U.S. EXPORT CONTROL POLICY 13-68 (1989); *Dual-Use Export Controls in Historical Perspective*, in RICHARD T. CUPITT, RELUCTANT CHAMPIONS: U.S. PRESIDENTIAL POLICY AND STRATEGIC EXPORT CONTROLS 31–50 (2000).

23. U.S. EXPORT CONTROL POLICY, *supra* note 22, at 14.

24. *Id.*

25. *E.g.*, the North Atlantic Treaty Organization (NATO) and the Warsaw Pact.

26. At this time, America's allies were in the process of rebuilding after the war and "were little concerned about export policy." However, the United States was able to secure "allied

to restrict the ability of the Soviet Union and its satellites to acquire key items that would aid their military development,<sup>27</sup> as well as to “inflict [upon them] the greatest economic injury” possible.<sup>28</sup> The establishment of the Coordinating Committee for the Control of Multinational Trade (CoCom)<sup>29</sup> in 1949 embodied this strategy,<sup>30</sup> seeking to prevent the West from fulfilling Lenin’s prediction that “the capitalists will sell [the communists] the rope with which we will hang them.”<sup>31</sup>

CoCom, an informal agreement among like-minded states,<sup>32</sup> sought to control three categories of goods: conventional arms, nuclear-related items, and dual-use items.<sup>33</sup> Of the three, the dual-use restrictions were the most controversial as they inevitably restricted normal commerce, limiting the trade of goods and technologies that had both civilian and military applications.<sup>34</sup> This impact primarily fell on U.S. exporters for a number of reasons.<sup>35</sup> First, even though all CoCom members pledged to restrict controlled dual-use technology, “the United States was the most zealous export controls enforcer.”<sup>36</sup> Second, U.S. businesses had a virtual monopoly in dual-use technologies for much of the Cold War.<sup>37</sup> Thus, due to CoCom restrictions, large and potentially lucrative markets overseas were simply

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cooperation through the enormous economic leverage the U.S. trade and aid policies exerted in the years immediately following the Second World War . . . .” LONG, *supra* note 22, at 17–18.

27. Christopher F. Corr, *The Wall Still Stands: Complying with Export Controls on Technology Transfers in the Post-Cold War, Post-9/11 Era*, 25 HOUS. J. INT’L L. 441, 450 (2003); DOUGLAS E. MCDANIEL, UNITED STATES TECHNOLOGY EXPORT CONTROL 97 (1993).

28. LONG, *supra* note 22, at 15.

29. For an in-depth study of CoCom, see MICHAEL MASTANDUNO, *ECONOMIC CONTAINMENT: COCOM AND THE POLITICS OF EAST-WEST TRADE* (Cornell Univ. Press 1992) (noting that “export control policies and their coordination in CoCom have been an integral part of the postwar international system [and that] to understand them is to understand more fully the dynamics of that system.”).

30. LONG, *supra* note 22, at 17.

31. Corr, *supra* note 27, at 449–50.

32. THE HENRY L. STIMSON CENTER, STUDY GROUP ON ENHANCING MULTILATERAL EXPORT CONTROLS FOR US NATIONAL SECURITY, FINAL REPORT 16 (Apr. 2001).

33. Corr, *supra* note 27, at 451.

34. *Id.* at 451–52.

35. One expert has characterized export controls as a structural cost “paid primarily by the United States to maintain a liberal international economic order during a time of severe U.S.-Soviet rivalry.” See LONG, *supra* note 22, at 14. See also, MASTANDUNO, *supra* note 29, at 28 (noting that “the history of U.S. export control policy has been one of subordination of business interests to the pursuit of national security and foreign policy goals by the state. American firms have been consistently frustrated by the Byzantine nature of the U.S. control system, their variable access to it, and their inability to influence decisively the substance of policy.”).

36. Corr, *supra* note 27, at 452; William J. Long, *Global Security, Democratization, and Economic Development after the Cold War: New Goals for U.S. Export Control Policies*, in GARY BERTSCH, ET AL., INTERNATIONAL COOPERATION ON NONPROLIFERATION EXPORT CONTROLS 67–68 (1994) [hereinafter Long, *Global Security*]. See also MASTANDUNO, *supra* note 29, at 13, 18 (arguing that during 1949–58 and 1980–84, the United States, through the use of CoCom controls, sought to engage in “economic warfare” against the communist bloc).

37. Corr, *supra* note 27, at 452.

off-limits to U.S. exporters.<sup>38</sup> This de facto monopoly on dual-use technologies actually had the somewhat surprising effect of ameliorating potential American business displeasure at these broad controls, as “it was quite unlikely that another country, particularly a non-CoCom country, was in a position to supply the technology” to these closed markets.<sup>39</sup> This potential discontent was further placated by the seemingly endless Pentagon budget, which showered U.S. companies with lucrative contracts for the domestic military market.<sup>40</sup> Additionally, in line with widespread public anti-communism, many business groups actively voiced their opposition to trade liberalization with the Soviet Union and its satellites.<sup>41</sup>

This honeymoon was not to last, however, as by the mid- to late-1970s foreign companies had begun to close the technological gap, prompting U.S. companies to face greater competition.<sup>42</sup> As business leaders and the export community pushed for liberalized export controls, especially in light of uneven enforcement among CoCom members,<sup>43</sup> the U.S. government took the opposite approach and pressured CoCom to become even more restrictive, so that by the end of the 1980s, “the United States presided over an increasingly restrictive CoCom alliance.”<sup>44</sup>

With the end of the Cold War and the dissolution of the Soviet Union, the rationale underlying CoCom was no more and CoCom was disbanded in 1994.<sup>45</sup> It was replaced in 1996 with the establishment of the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies (Wassenaar Arrangement),<sup>46</sup> a voluntary, loose association of thirty-three like-minded countries.<sup>47</sup> The Wassenaar

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38. *Id.*

39. Corr, *supra* note 27, at 452.

40. Jeff Gerth & Eric Schmitt, *The Technology Trade: A Special Report; Chinese Said to Reap Gains In U.S. Export Policy Shift*, N.Y. TIMES, Oct. 19, 1998, at A1.

41. LONG, *supra* note 22, at 13–24; CUPITT, *supra* note 22, at 82; MASTANDUNO, *supra* note 29, at 28.

42. Corr, *supra* note 27, at 452; MCDANIEL, *supra* note 27, at 97; Long, *Global Security*, *supra* note 36, at 65.

43. U.S. allies in CoCom long favored more narrowly tailored strategic control on East-West trade, given their “relatively greater economic interest in East-West trade and their preference for a less confrontational political relationship with the Soviets.” MASTANDUNO, *supra* note 29, at 13.

44. Corr, *supra* note 27, at 452–4 (highlighting the key role played by the “Toshiba-Kongsberg incident,” where two Japanese and Norwegian companies transferred advanced milling machines and related technology to the Soviet Union in violation of CoCom).

45. *Id.* at 455; see also Michael Lipson, *The Reincarnation of COCOM: Explaining Post-Cold War Export Controls*, THE NONPROLIFERATION REVIEW 34 (Winter 1999) (arguing that the decision to disband CoCom “was driven by increased sensitivity to national economic competitiveness in a globalizing economy, concerns that controls were inhibiting market reforms in former communist states, and a sense that CoCom was overly dominated by the United States.”).

46. For a detailed history on the transition between CoCom and the Wassenaar Arrangement, see Lipson, *supra* note 45, at 33.

47. Corr, *supra* note 27, at 455 n.35.

Arrangement's primary goal is to "promot[e] transparency and greater responsibility in transfers of conventional arms and dual-use goods and technologies."<sup>48</sup> The Wassenaar Arrangement essentially requires members to notify each other of transfers of listed exports after the transfer has taken place and when licenses for similar transfers are denied.<sup>49</sup> Under the Wassenaar Arrangement, unlike with CoCom, members no longer have veto power over another member's exports, there is no requirement for pre-shipment notification of exports and members are left to implement the Wassenaar controls solely at their own discretion.<sup>50</sup> This has prompted one security specialist to describe the Wassenaar Arrangement as a "'chat society' with no teeth,"<sup>51</sup> while others have noted that it "is proving to be mostly a paper tiger."<sup>52</sup> Indeed, one former U.S. defense official has said that the United States destroyed CoCom "in a reckless way, before there was a replacement regime" and that the Wassenaar Arrangement "doesn't control anything" and is "basically a reporting society."<sup>53</sup> These lax requirements apparently have done little to boost compliance, as a 2002 U.S. government study found that many members were delinquent in their reporting requirements.<sup>54</sup>

The dissolution of CoCom and its replacement with a weaker regime reflected the policies of the Clinton administration and many of its key officials, most notably William Perry, a Silicon Valley executive who was tabbed to be the deputy defense secretary.<sup>55</sup> At his 1993 Senate confirmation hearing, Perry stated that controlling dual-use exports was a "hopeless task."<sup>56</sup> He further stated that dual-use controls "only interfere[] with our companies' ability to succeed internationally."<sup>57</sup> Perry concluded that efforts to control dual-use technologies in the post-Cold War era would be futile, and that export promotion was the way to bolster America's industries in the increasingly globalized economy.<sup>58</sup>

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48. See The Wassenaar Arrangement, *Guidelines and Procedures, Including the Initial Elements*, July 2004, available at [http://www.wassenaar.org/2003Plenary/initial\\_elements\\_2003.htm](http://www.wassenaar.org/2003Plenary/initial_elements_2003.htm).

49. Corr, *supra* note 27, at 455.

50. *Id.*

51. Richard Read, *U.S. Trade, Security Interests Clash Over Tech Exports to China*, THE OREGONIAN, Feb. 3, 2003, at A07 (quoting James Mulvenon).

52. Hirsh, *supra* note 19, at 2.

53. Peter H. Stone, *High-Tech's High Anxiety*, NATIONAL JOURNAL, Vol. 30, No. 50, Dec. 12, 1998, at 2926 (quoting Peter Leitner).

54. U.S. GENERAL ACCOUNTING OFFICE, NONPROLIFERATION: STRATEGY NEEDED TO STRENGTHEN MULTILATERAL EXPORT CONTROL REGIMES, GAO-03-43, 10, 13-4 (2002).

55. Stone, *supra* note 53.

56. *Id.*

57. Gerth & Schmitt, *supra* note 40.

58. Hirsh, *supra* note 19.

With some exceptions, the Clinton years were generally marked by the systematic easing of dual-use export controls.<sup>59</sup> However, the terrorist attacks of September 11, 2001 “changed the focus of the Bush Administration and Congress from liberalization and streamlining to tightening controls and increasing scrutiny of export transactions and technology transfer.”<sup>60</sup> This shift can be seen most superficially in the name change of the Commerce Department bureau in charge of dual-use export controls from the Bureau of Export Administration to the Bureau of Industry and Security.<sup>61</sup> It can be seen more substantively from the recent comments of Bush administration officials that economic policies and national security policy are becoming “increasingly intertwined”<sup>62</sup> and that “[e]xport controls do not exist in a policy vacuum, isolated from broader issues of national or international concern [but] . . . are guided by and reflect larger U.S. foreign policy and national security imperatives.”<sup>63</sup>

#### **B. U.S. DUAL-USE EXPORT CONTROLS ON CHINA**

In line with this shift in focus, it is now “a clear and unwavering principle” that U.S. export controls must be subservient to broader U.S. strategic aims, “reflect[ing] and support[ing] America’s larger foreign policy toward China.”<sup>64</sup> That such a security-dominant mantra was advanced by the assistant secretary of Commerce for export administration—ostensibly a position concerned with the promotion of expanded trade—aptly demonstrates how the agency primarily responsible for U.S. export control administration views its primary purpose with regard to China.<sup>65</sup> However, there must be a balance between security and trade, especially with regard to China and its much-ballyhooed market of

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59. Gerth & Schmitt, *supra* note 40; Stone, *supra* note 53; Thomas Friedman, *U.S. Ending Curbs on High-Tech Gear to Cold War Foes*, N.Y. TIMES, Mar. 31, 1994, at A1.

60. Corr, *supra* note 27, at 459.

61. *Id.*

62. Assistant Secretary of Commerce for Export Administration Christopher A. Padilla, *The Future of Export Controls*, STATES NEWS SERVICE, May 15, 2007, available at <http://www.bis.doc.gov/news/2007/padilla05152007.htm> [hereinafter Padilla 5/15/07].

63. Padilla 1/29/07, *supra* note 5.

64. *Id.*; see also Mario Mancuso, Technology Leadership, Economic Power, and U.S. National Security: U.S. Dual-Use Trade with China, Keynote Address to the Heritage Foundation, Feb. 20, 2008, available at <http://www.bis.doc.gov/news/2008/mancusoheritage02202008.htm> (stating that U.S. “export controls do not, in a strict sense, ‘balance’ trade and security . . . . As a national security bureau within an economic agency, our most solemn obligation is to protect the security of the nation. And there is nothing of comparable (or near comparable) worth against which we ‘trade-off’ U.S. security.”).

65. It could very well be argued that this security-dominated view is not confined only to China. See Corr, *supra* note 27, at 461 (noting that after September 11, 2001, “BIS shifted its posture somewhat, emphasizing security and tougher export controls. It has been more reluctant to promote the interests of U.S. exporters when faced with opposition from the traditionally tougher agencies such as the Defense and State Departments.”).



1.3 billion people.<sup>66</sup> Consequently, “export controls must also take into account our complex relationships with emerging powers and economies. Nowhere is this more evident than in the case of China.”<sup>67</sup>

On the one hand, Bush administration officials talk of promoting “China’s peaceful economic development”<sup>68</sup> and encouraging Beijing’s role as a “responsible stakeholder”<sup>69</sup> in the international system. Export controls, they argue, support this policy by “facilitat[ing] hundreds of millions of dollars of civilian high-technology trade annually,”<sup>70</sup> thus expanding trade and increasing economic interdependence between China, the United States and the global marketplace.<sup>71</sup>

On the other hand, China’s continued military modernization, characterized by its rising military budget, is making Washington nervous.<sup>72</sup> The Department of Defense estimates that China’s military spending has increased by double-digit percentages each of the past fifteen years, with China’s officially announced 2008 military budget rising to approximately \$58.8 billion.<sup>73</sup> However, both the U.S. government<sup>74</sup> and non-government

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66. The notion of a single market of 1.3 billion people is actually rather illusory. The reality of China’s domestic market is that no such unity exists so as to tie together the divergent tastes, needs and proclivities of China’s population. Often, markets exist solely within cities or certain economic zones. See *Getting Past the Hype of China’s 1.3 Billion Customers*, China Law Blog, Aug. 15, 2007, available at [http://www.chinalawblog.com/2007/08/chinas\\_13\\_billion\\_customers\\_an.html](http://www.chinalawblog.com/2007/08/chinas_13_billion_customers_an.html).

67. Padilla 5/15/07, *supra* note 62.

68. Padilla 1/29/07, *supra* note 5; China itself used to refer to its own “peaceful rise” but the implications contained therein made many of its neighbors nervous. It has since begun referring to its “peaceful development.” See Evan S. Medeiros, *China Debates its ‘Peaceful Rise’ Strategy*, YALEGLOBAL ONLINE, June 22, 2004, available at <http://yaleglobal.yale.edu/display.article?id=4118>; *China Committed to Peaceful Development*, CHINA DAILY, Apr. 30, 2006, available at [http://www.chinadaily.com.cn/china/2006-04/30/content\\_581391.htm](http://www.chinadaily.com.cn/china/2006-04/30/content_581391.htm).

69. Robert B. Zoellick, *Whither China: From Membership to Responsibility? Remarks to the National Committee on United States-China Relations*, Sept. 21, 2005, available at [http://www.ncuscr.org/files/2005Gala\\_RobertZoellick\\_Whither\\_China1.pdf](http://www.ncuscr.org/files/2005Gala_RobertZoellick_Whither_China1.pdf) (“[I]t is time to take our policy beyond opening doors to China’s membership into the international system: We need to urge China to become a responsible stakeholder in that system.”).

70. Padilla 1/29/07, *supra* note 5.

71. Under Secretary of Commerce for Industry and Security Mario Mancuso, *Enhancing Secure Trade with China*, Remarks to the U.S.-China Business Council, June 18, 2007, available at <http://www.bis.doc.gov/news/2007/mancuso06182007.htm>.

72. David Lague, *China Plans Steep Increase in Military Spending*, N.Y. TIMES, Mar. 5, 2008, available at <http://www.nytimes.com/2008/03/05/world/asia/05china.html?n=Top/News/World/Countries%20and%20Territories/China>.

73. Assistant Secretary of Defense for International Security Affairs Peter W. Rodman, *The Military Power of the People’s Republic of China*, Testimony before the House Armed Services Committee, June 22, 2006, available at [http://www.globalsecurity.org/military/library/congress/2006\\_hr/060622-rodman.pdf](http://www.globalsecurity.org/military/library/congress/2006_hr/060622-rodman.pdf); Lague, *supra* note 72 (reporting that China’s 2008 military budget is to increase by 17.6 percent to approximately \$58.8 billion).

74. See, e.g., OFFICE OF THE SECRETARY OF DEFENSE, ANNUAL REPORT TO CONGRESS ON THE MILITARY POWER OF THE PEOPLE’S REPUBLIC OF CHINA 25 (2007), available at <http://www.defenselink.mil/pubs/pdfs/070523-China-Military-Power-final.pdf> (noting that China’s official budget leaves out many large expenditures, and therefore China’s total military

experts<sup>75</sup> estimate actual military expenditures to be two to three times the official Chinese government budget.<sup>76</sup> Still, even using the high-end of these credible estimates, the Chinese defense budget pales in comparison to what the Pentagon spends annually.<sup>77</sup> Additionally, while China has certainly become more transparent regarding its military buildup,<sup>78</sup> much uncertainty remains.<sup>79</sup> Indeed, even if the United States or the international community knew more about China's command and control structure, its nuclear posture or its submarine capabilities, such knowledge would provide no insight into Chinese motivations or intentions. The fundamental question is not whether China is going to become a world power, but what will China do once it has that power.<sup>80</sup>

In response to this and other uncertainties, the Bush administration's foreign policy towards China has been to "prudently hedge against . . . [China's] rapid military buildup."<sup>81</sup> The term "hedging" in this context is manifested by "pursuing policies that, on one hand, stress engagement and integration mechanisms and, on the other, emphasize realist-style balancing in the form of external security cooperation with Asian states and national military modernization programs."<sup>82</sup> This "delicate balancing act" allows one state "to maintain its extensive and mutually beneficial economic ties

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budget for 2007 is between \$85 billion and \$125 billion, 1.9 and 2.8 times, respectively, the officially announced figure of \$45 billion) [hereinafter CHINA MILITARY POWER REPORT].

75. See, e.g., Keith Crane, et al., MODERNIZING CHINA'S MILITARY: OPPORTUNITIES AND CONSTRAINTS 243 (2005), available at [http://www.rand.org/pubs/monographs/2005/RAND\\_MG260-1.pdf](http://www.rand.org/pubs/monographs/2005/RAND_MG260-1.pdf) (estimating that China's military expenditures for 2003 should be 1.4 to 1.7 times the officially announced number).

76. Lague, *supra* note 72.

77. The Pentagon's budget for Fiscal Year 2007 was \$439.3 billion. See Office of Management and Budget, Department of Defense, available at <http://www.whitehouse.gov/omb/budget/fy2007/defense.html>. The Pentagon's budget for Fiscal Year 2009 is \$515.4 billion, a 7.5% increase over the previous year's budget. U.S. Department of Defense, *News Release: Fiscal 2009 Department of Defense Budget Released*, Feb. 4, 2008, available at [http://www.defenselink.mil/comptroller/defbudget/fy2009/2009\\_Budget\\_Rollout\\_Release.pdf](http://www.defenselink.mil/comptroller/defbudget/fy2009/2009_Budget_Rollout_Release.pdf).

78. China recently committed to provide previously undisclosed military figures to the United Nations in an effort to assuage international concerns regarding the transparency of its military modernization effort. See *China promises more military transparency*, SPACE WAR, Sept. 2, 2007, available at [http://www.spacewar.com/reports/China\\_promises\\_more\\_military\\_transparency\\_999.html](http://www.spacewar.com/reports/China_promises_more_military_transparency_999.html).

79. Padilla 1/29/07, *supra* note 5.

80. Variations of this question are posed in Evan S. Medeiros, *Strategic Hedging and the Future of Asia-Pacific Stability*, 29 WASHINGTON QUARTERLY 145, 147 (Winter 2005–06) (raising the following questions: "even if China is currently a rising power with limited aims, will it evolve into a revolutionary power with revisionist goals that challenges the regional or even the global order? Will China's diplomatic and military propensities change over time as it accumulates material power and status?").

81. Padilla 5/15/07, *supra* note 62. The term "hedging" vis-à-vis China is also used in other official U.S. government publications. For example, see OFFICE OF THE SECRETARY OF DEFENSE, QUADRENNIAL DEFENSE REVIEW REPORT 30–31 (2006), available at <http://www.defenselink.mil/qdr/report/Report20060203.pdf>.

82. Medeiros, *supra* note 80, at 146.

with” the other state and its neighbors “while addressing uncertainty and growing security concerns about the other.”<sup>83</sup>

As a key component of this strategy, it is stated U.S. policy to use export controls to deny the export, reexport or transfer of any items “that would make a direct and significant contribution to China’s military.”<sup>84</sup> Keeping in mind the potential economic cost, Assistant Secretary of Commerce Padilla has noted that U.S. “export controls must reflect the duality inherent in this policy and must distinguish between different kinds of customers within a large and diverse economy.”<sup>85</sup> Indeed, China, like almost any other trading partner, “contain[s] an assorted and varying mix of attractive trade opportunities and security risks.”<sup>86</sup>

Being able to differentiate between legitimate civilian end-users and those posing as fronts for the military has become an increasingly important task for Washington, given that no other country in the world makes “more organized efforts to obtain and illegally export controlled U.S. technology” than China.<sup>87</sup> Such efforts are highlighted by a number of export control cases brought in the United States in recent years for attempts to export controlled technology to China.<sup>88</sup> These cases underpin the rationale behind

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83. *Id.* at 146.

84. Padilla 1/29/07, *supra* note 5.

85. Padilla 5/15/07, *supra* note 62.

86. Mancuso, *supra* note 71. Indeed, one commentator has called China the “poster child for the double-edged nature of the globalization of technology.” Adam Segal, *New China worries*, INTERNATIONAL ECONOMY, Sept. 22, 2007.

87. Padilla 1/29/07, *supra* note 5.

88. For example, seven people were arrested in New Jersey in July 2004 for the illegal export of components for electronic warfare systems, smart weapons, radar systems, and communication equipment to China in violation of the federal *Arms Export Control Act*. Noting that past shipments were believed to have ended up with the Chinese military or institutions affiliated with the military, authorities said that the arrests were the latest in a crackdown on what they believed to be “a covert network in the United States that purchases sensitive weapons technology.” *Seven Arrested for Illegal Transfers of Weapons to China*, ASIAN EXPORT CONTROL OBSERVER 7, Aug./Sept. 2004, available at [http://cns.miis.edu/pubs/observer/asian/pdfs/aeco\\_0408.pdf](http://cns.miis.edu/pubs/observer/asian/pdfs/aeco_0408.pdf); see also *Four New Jersey Residents Sentenced for Illegal Exports to China*, INTERNATIONAL EXPORT CONTROL OBSERVER 9, May 2006, available at [http://cns.miis.edu/pubs/observer/pdfs/ieco\\_0605e.pdf](http://cns.miis.edu/pubs/observer/pdfs/ieco_0605e.pdf). Four months later, the California-based Interaero Inc. was fined \$500,000 and placed on five-year probation for illegally exporting six shipments of missile and jet fighter equipment worth \$40,000 to a Chinese entity. See *U.S. and German Companies Accused of Illegally Exporting Military Parts to China*, ASIAN EXPORT CONTROL OBSERVER 16, Dec. 2004/Jan. 2005, available at [http://cns.miis.edu/pubs/observer/asian/pdfs/aeco\\_0412.pdf](http://cns.miis.edu/pubs/observer/asian/pdfs/aeco_0412.pdf). In February 2005, BIS placed a Temporary Denial Order on the Wisconsin-based Wen Enterprises, its president Ning Wen, and his wife Hailin Lin for “conspiring to sell electronic components controlled under U.S. Export Administration Regulations (EAR) to [a Chinese entity] without the proper licenses over thirty times from June 2002 through September 2004.” *Temporary Denial Order Issued for Unauthorized Transfers of Electronic Components*, ASIAN EXPORT CONTROL OBSERVER 9–10, Feb./Mar. 2005, available at [http://cns.miis.edu/pubs/observer/asian/pdfs/aeco\\_0502.pdf](http://cns.miis.edu/pubs/observer/asian/pdfs/aeco_0502.pdf). Ning Wen was found guilty by a jury and sentenced to 5 years in jail. His conviction was upheld by the U.S. Court of Appeals for the Seventh Circuit. *U.S. v. Ning Wen*, 477 F.3d 896 (7th Cir. 2006). In February 2006, Ko-Suen Moo, a Taiwanese national, was charged in U.S. federal court with being a Chinese covert agent and attempting to acquire and

U.S. Immigration and Customs Enforcement<sup>89</sup> deeming “China’s aggressive and wide-ranging espionage as the leading threat to U.S. technology.”<sup>90</sup> It would appear, however, that the effort to acquire sensitive dual-use items is not confined to the United States.<sup>91</sup>

These attempts to procure U.S. high-technology dual-use items come as little surprise given that China’s continued military modernization is increasingly reliant on commercial technologies.<sup>92</sup> This reality might be more directly related to cost-efficiency rationales than weaknesses in China’s military industries, though that remains an unsettled point.<sup>93</sup> The Department of Defense’s annual report on China’s military power states

export military components and weapons to China. *Taiwan National Charged with Plotting Illegal Export of Engines, Missiles to China*, INTERNATIONAL EXPORT CONTROL OBSERVER 10–11, Mar. 2006, available at [http://cns.miis.edu/pubs/observer/pdfs/ieco\\_0603e.pdf](http://cns.miis.edu/pubs/observer/pdfs/ieco_0603e.pdf). On May 17, 2006, Moo pled guilty in the Southern District of Florida to export violations, as well as bribery and conspiracy violations and acting as an agent of a foreign government. See U.S. Immigration and Customs Enforcement Factsheet, *Select Arms & Strategic Technology Investigations (ASTI)*, Nov. 2006, available at <http://www.fas.org/asmp/iceasti.htm> [hereinafter ICE Factsheet].

89. A Department of Defense report states that since 2000, U.S. Immigration and Customs Enforcement officials have “initiated more than 400 investigations involving the illicit export of U.S. arms and technologies.” See CHINA MILITARY POWER REPORT, *supra* note 74, at 29. For a partial list of recent ICE investigations relating to arms and strategic technology investigations, see ICE Factsheet, *supra* note 88.

90. CHINA MILITARY POWER REPORT, *supra* note 74, at 29.

91. E.g., *Head of Russian Space Company Arrested for Allegedly Transferring Dual-Use Technologies to Chinese Entity*, INTERNATIONAL EXPORT CONTROL OBSERVER 22–24, Dec. 2005/Jan. 2006, available at [http://cns.miis.edu/pubs/observer/pdfs/ieco\\_0512e.pdf](http://cns.miis.edu/pubs/observer/pdfs/ieco_0512e.pdf); *Illegal Export of Unmanned Helicopters to China Reveals Gaps in Export Control Awareness in Japan*, INTERNATIONAL EXPORT CONTROL OBSERVER 4–5, Feb. 2006, [http://cns.miis.edu/pubs/observer/pdfs/ieco\\_0602e.pdf](http://cns.miis.edu/pubs/observer/pdfs/ieco_0602e.pdf); *Sensitive Machine Tool Exports from Taiwan to China*, INTERNATIONAL EXPORT CONTROL OBSERVER 6–7, May 2006, available at [http://cns.miis.edu/pubs/observer/pdfs/ieco\\_0605e.pdf](http://cns.miis.edu/pubs/observer/pdfs/ieco_0605e.pdf); *Yamaha Motor Receives Fine for Attempted Unlicensed UAV Transfer to China*, INTERNATIONAL EXPORT CONTROL OBSERVER 7–8, Mar./Apr. 2007, available at [http://cns.miis.edu/pubs/observer/pdfs/ieco\\_10e.pdf](http://cns.miis.edu/pubs/observer/pdfs/ieco_10e.pdf).

92. Padilla 1/29/07, *supra* note 5; see also Adam Segal, *The Civilian High-Technology Economy: Where is it heading?* Testimony before the U.S.-China Economic and Security Review Commission, Mar. 16, 2006, available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_03\\_16\\_17wrts/06\\_03\\_16\\_17\\_segal\\_greenberg.php](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_03_16_17wrts/06_03_16_17_segal_greenberg.php); Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy Beth M. McCormick, Testimony before the U.S.-China Economic and Security Review Commission, Mar. 17, 2006, p. 2, available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_03\\_16\\_17wrts/06\\_03\\_16\\_17\\_mccormick.php](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_03_16_17wrts/06_03_16_17_mccormick.php).

93. Roger Cliff, Testimony before the U.S.-China Economic and Security Review Commission, Mar. 16, 2006, p. 5, available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_03\\_16\\_17wrts/06\\_03\\_16\\_17\\_cliff.php](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_03_16_17wrts/06_03_16_17_cliff.php) (noting that to the extent that certain designs and technologies are available from foreign sources, “it probably has not made sense for China to attempt to develop completely new types of weapons” due to cost-efficiency). However, Richard Bitzinger has argued that from this same trend, “one may infer that the Chinese military remains dissatisfied with the quality and capabilities of weapon systems coming out of domestic arms factories” or that these factories cannot produce the requested weapons in sufficient amounts. See Richard A. Bitzinger, *Modernizing China’s Defense Industries: How Effective Have Been Recent Reforms?* Testimony before the U.S.-China Economic and Security Review Commission, Mar. 16, 2006, available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_03\\_16\\_17wrts/06\\_03\\_16\\_17\\_bitzinger.php](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_03_16_17wrts/06_03_16_17_bitzinger.php).

that “[m]any dual-use technologies, such as software, integrated circuits, computers, electronics, semiconductors, telecommunications, and information security systems, are vital for the [Chinese People’s Liberation Army’s] transformation into an information-based, network-centric force.”<sup>94</sup> Given that China lacks the capability to indigenously produce many of these and other key dual-use technologies, Beijing has had “to obtain from abroad through legal and illegal commercial transactions”<sup>95</sup> items for use in such high-value systems as submarines,<sup>96</sup> missiles,<sup>97</sup> and, potentially, an aircraft carrier.<sup>98</sup> U.S. officials expect these efforts to continue.<sup>99</sup>

## II. THE CHINA MILITARY CATCH ALL RULE

It is in this context that BIS announced the final China Military Catch All Rule on June 19, 2007.<sup>100</sup> This rule amended the Export Administration Regulations (EAR),<sup>101</sup> the export control provisions of which “are intended to serve the national security, foreign policy, nonproliferation, and short supply interests of the United States . . . [by] restrict[ing] access to dual use items by countries or persons that might apply such items to uses inimical to U.S. interests.”<sup>102</sup> The EAR is the implementation mechanism of the Export Administration Act of 1979,<sup>103</sup> under which Congress granted the

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94. CHINA MILITARY POWER REPORT, *supra* note 74, at 29.

95. *Id.*

96. QUADRENNIAL DEFENSE REVIEW REPORT, *supra* note 81, at 29–30; CHINA MILITARY POWER REPORT, *supra* note 74, at 29; Bitzinger, *supra* note 93 (noting that China’s dependence on foreign technology is “especially acute” concerning jet engines, marine diesel engines, avionics, and submarines); Bernard D. Cole, Testimony before the U.S.-China Economic and Security Review Commission, Mar. 16, 2006, available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_03\\_16\\_17wrts/06\\_03\\_16\\_17\\_cole.php](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_03_16_17wrts/06_03_16_17_cole.php) (stating that the “most effective military capabilities being acquired by China . . . is its already capable and growing submarine force”).

97. QUADRENNIAL DEFENSE REVIEW REPORT, *supra* note 81, at 29–30; CHINA MILITARY POWER REPORT, *supra* note 74, at 29.

98. See Andrew F. Diamond, *Dying with Eyes Open or Closed: The Debate over a Chinese Aircraft Carrier*, KOREAN JOURNAL OF DEFENSE ANALYSIS, Vol. XVIII, No. 1, Spring 2006, available at <http://cns.miis.edu/other/diamond060426.pdf>.

99. McCormick, *supra* note 92, at 1–2 (noting that the United States “expect[s] China to continue making a concerted effort to acquire asymmetric and ‘leap ahead’ technologies from the U.S. through legal and illegal means.”).

100. Final Rule, *supra* note 8, at 33646.

101. 15 C.F.R. § 730-774 (2007).

102. 15 C.F.R. § 730.6.

103. The Export Administration Act of 1979 actually expired in 1989. Since then, due to an inability to forge consensus on a new version of the Act, the president has been forced to issue a series of executive orders under the International Emergency Economic Powers Act (IEEPA) to maintain the U.S. export control system. See, Ian F. Ferguson, et al., *Export Administration Act of 1979 Reauthorization*, CRS REPORT FOR CONGRESS 3–4 (Mar. 11, 2002); *Bush Extends Emergency Export Control Act*, ASIAN EXPORT CONTROL OBSERVER 19, Oct./Nov. 2004, available at [http://cns.miis.edu/pubs/observer/asian/pdfs/aeco\\_0410.pdf](http://cns.miis.edu/pubs/observer/asian/pdfs/aeco_0410.pdf).

executive branch the authority to regulate foreign commerce.<sup>104</sup> Section 5 of the Act maintains the executive's authority to develop lists of controlled items for export and proscribed countries.<sup>105</sup> The President's designee—the Commerce Department—has the responsibility of composing the dual-use control list, known as the Commerce Control List (CCL), as well as identifying those proscribed countries.<sup>106</sup> Items included on the CCL, which itself is within the EAR, are “subject to the export licensing authority of BIS.”<sup>107</sup>

In amending the EAR, the final China Military Catch All Rule does four things. First, it places new restrictions on the export, reexport, or transfer<sup>108</sup> of approximately twenty products and associated technologies<sup>109</sup> that have both civilian and military applications when the exporter has “knowledge” or “is informed” that the items are destined for “military end-use” in China.<sup>110</sup> Second, the final rule establishes a presumption of denial for export license applications that would make “a direct and significant contribution” to China's military capabilities,<sup>111</sup> or for items going to China that are controlled for reasons of chemical and biological weapons proliferation,<sup>112</sup> nuclear nonproliferation,<sup>113</sup> and missile technology.<sup>114</sup> Third, the final rule creates a “Validated End-User” program, which allows specified items to be exported without a license to certain pre-approved Chinese entities.<sup>115</sup> Finally, the rule raises the total dollar threshold to \$50,000 or greater for transactions requiring an End-User Statement as issued by China's Ministry of Commerce.<sup>116</sup> To properly understand what obligations the final China Military Catch All Rule places upon U.S. exporters, it is first necessary to examine these provisions in closer detail.

#### A. NEW LICENSING REQUIREMENTS

The China Military Catch All Rule amended section 744.21 of the EAR to state that an exporter may not export, reexport, or transfer any of the approximately twenty specified products or associated technologies without a license if, at the time of the transaction, the exporter either has

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104. Ferguson et al., *supra* note 103, at 2.

105. Long, *Global Security*, *supra* note 36, at 59.

106. *Id.*

107. 15 C.F.R. § 738.1(a) (2007).

108. Transfer is “[a] transfer to any person of items subject to the EAR either within the United States or outside of the United States with the knowledge or intent that the items will be shipped, transferred, or transmitted to an unauthorized recipient.” 15 C.F.R. § 772.1 (2007).

109. Supplement No. 2 to § 744 (2007).

110. 15 C.F.R. § 744.21; Final Rule, *supra* note 8, at 33647.

111. 15 C.F.R. § 742.4(b)(7) (2007).

112. 15 C.F.R. § 742.2(b)(4).

113. 15 C.F.R. § 742.2(b)(4).

114. 15 C.F.R. § 742.2(b)(4).

115. 15 C.F.R. § 748.15 (2007).

116. 15 C.F.R. § 748.10.

“knowledge” or has “been informed” by BIS that the item is intended for a “military end-use” in China.<sup>117</sup> “Knowledge” is defined by the EAR as including:

not only positive knowledge that the circumstance exists or is substantially certain to occur, but also an awareness of a high probability of its existence or future occurrence. Such awareness is inferred from evidence of the conscious disregard of facts known to a person and is also inferred from a person’s willful avoidance of facts.<sup>118</sup>

An exporter may also possess knowledge if it has “been informed” “either individually by specific notice” or through the publishing of an amendment or a separate notice in the *Federal Register* that informs the exporter “that a license is required for specific exports, reexports, or transfers of any item because there is an unacceptable risk of use in or diversion to ‘military end-use’ activities in the PRC.”<sup>119</sup> Such specific notice is to be given at the direction of the Deputy Assistant Secretary for Export Administration.<sup>120</sup>

Supplement 2 to section 744, entitled “Restrictions on Certain Military End-Uses in the People’s Republic of China (PRC),” contains the list of items that are subject to the military end-use license requirement as defined in section 744.21.<sup>121</sup> The list controls items in nine of the ten categories contained in the CCL. No items on the list fall into “Category 0 - Nuclear Materials, Facilities and Equipment and Miscellaneous,” the lone unaffected category.<sup>122</sup> Included in the list of items subject to the final rule are: depleted uranium,<sup>123</sup> certain oscilloscopes,<sup>124</sup> high performance computers,<sup>125</sup> telecommunications equipment operating outside normal

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117. 15 C.F.R. § 744.21(a) (2007).

118. 15 C.F.R. § 772.1 (2007).

119. 15 C.F.R. § 744.21(b).

120. 15 C.F.R. § 744.21(b).

121. Supplement No. 2 to 15 C.F.R. § 744 (2007).

122. The other nine CCL categories are: 1-Materials, Chemicals, Microorganisms, and Toxins; 2-Materials Processing; 3-Electronics; 4-Computers; 5-Telecommunications and Information Security; 6-Lasers and Sensors; 7-Navigation and Avionics; 8-Marine; and 9-Propulsion Systems, Space Vehicles and Related Equipment. 15 C.F.R. § 738.2(a) (2007).

123. Defined as any uranium containing less than 0.711% of the isotope U-235. See Supplement No. 2 to 15 C.F.R. § 744.

124. “Limited to digital oscilloscopes and transient recorders, using analog-to-digital conversion techniques, capable of storing transients by sequentially sampling single-shot inputs at great than 2.5 giga-samples per second,” and related technology. See Supplement No. 2 to 15 C.F.R. § 744.

125. “Limited to computers . . . with an Adjusted Peak Performance (‘APP’) exceeding 0.5 TeraFLOPS (WT),” and software “specially designed or modified for the ‘development’, ‘production’, or ‘use’ of equipment controlled by 4A101.” See Supplement No. 2 to 15 C.F.R. § 744.

temperatures,<sup>126</sup> phased array antennae,<sup>127</sup> certain airborne communications and inertial navigation systems,<sup>128</sup> and aero gas turbine engines.<sup>129</sup>

Initially, in the proposed rule published in July 2006, forty-seven items were to be subject to the military end-use control.<sup>130</sup> However, responding to concerns raised in public comments, BIS “conducted a structured military and economic impact review” which used three criteria, “no one of which being solely determinative,” to determine which items were to remain on the list: “(1) the military applicability of each item; (2) the relative foreign availability of each item; and (3) the level of U.S. commercial exports of each item” to China.<sup>131</sup> Of the three, BIS accorded military applicability the greatest weight, while indigenous Chinese production of an item was given greater weight than “evidence of foreign availability from countries that cooperate with the United States in multilateral export control regimes.”<sup>132</sup> In conducting this review, “[w]hen BIS found limited evidence of foreign availability and significant military applicability, the item remained on the list, even if it was a major commercial export.”<sup>133</sup>

Between the proposed rule and its ultimate form, items affecting sixteen Export Control Classification Numbers (ECCNs) were removed from the list, including items containing low-level encryption.<sup>134</sup> The export, reexport and transfer to China of the remaining twenty items and related technologies is now subject to this new licensing requirement if the exporter knows or is informed that the item is intended for a “military end-use” in China.<sup>135</sup> Section 744.21(f) defines “military end-use” as meaning:

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126. “Limited to telecommunications equipment designed to operate outside the temperature range from 219K (-54 °C) to 397K (124 °C)” and related software and technology. *See* Supplement No. 2 to 15 C.F.R. § 744 (2007).

127. Specific to phased array antennae “operating above 10.5 Ghz . . .” and related software and technology. *See* Supplement No. 2 to 15 C.F.R. § 744.

128. “Other navigation direction finding equipment, airborne communication equipment, all aircraft inertial navigation systems not controlled under 7A003 or 7A103, and other avionic equipment, including parts and components, n.e.s.,” and related software and technology. *See* Supplement No. 2 to 15 C.F.R. § 744.

129. “Limited to ‘aircraft’, n.e.s., and gas turbine engines not controlled by 9A001 or 9A101,” and related software and technology. *See* Supplement No. 2 to 15 C.F.R. § 744.

130. Proposed Rule, *supra* note 1, at 383138.

131. “Q&As on the Bureau of Industry and Security’s China Policy Rule,” 2007, available at [http://www.arentfox.com/publications/pdfs/export/QAs\\_bis\\_finalrule.pdf](http://www.arentfox.com/publications/pdfs/export/QAs_bis_finalrule.pdf); *see also* Final Rule, *supra* note 8, at 33647–8.

132. “Q&As on the Bureau of Industry and Security’s China Policy Rule,” *supra* note 131; *see also* Final Rule, *supra* note 8, at 33647–8.

133. “Q&As on the Bureau of Industry and Security’s China Policy Rule,” *supra* note 131, at 4–5; Final Rule, *supra* note 8, at 33647.

134. Petra A. Vorwig, *New Export Control Rule for Exports to China Released by Commerce Department*, Steptoe & Johnson, LLP Publications, June 22, 2007, available at <http://www.steptoel.com/publications-4590.html>.

135. 15 C.F.R. § 744.21(e)(1) (2007).



incorporation into a military item described on the U.S. Munitions List . . . [or] the Wassenaar Arrangement Munitions List . . . ; incorporation into items listed under ECCNs ending in ‘A018’ on the CCL in Supplement No. 1 to part 774 of the EAR; or for the ‘use’, ‘development’, or ‘production’ of military items described on the USML or the IML, or items listed under ECCNs ending in ‘A018’ on the CCL. ‘Military end-use’ also means ‘deployment’ of items classified under ECCN 9A991 as set forth in Supplement No. 2 to Part 744.<sup>136</sup>

If an item proposed for export is found to meet this definition of “military end-use,” the export license applications “will be reviewed on a case-by-case basis to determine whether the export, reexport, or transfer would make a *material contribution* to China’s military capabilities and would result in advancing the country’s military activities contrary to the national security interests of the United States.”<sup>137</sup> This “material contribution” standard is more rigorous than the “direct and significant contribution” standard employed in section 742.4(b)(7), which is addressed in Part II.B herein.<sup>138</sup> However, for now, it is important to note that BIS determined that “items subject to the ‘military end-use’ control were . . . more sensitive when destined for a ‘military end-use’ than when they are simply controlled for national security reasons” as in section 742.4.<sup>139</sup> Therefore, BIS determined these items should be “subject to a different licensing review standard, consistent with U.S. foreign and related export control policies for the PRC.”<sup>140</sup>

## B. PRESUMPTION OF DENIAL

The second major change to the EAR ushered in by the final China Military Catch All Rule is to make it U.S. policy to deny exports of CCL items that are controlled for national security reasons if their export would make a “direct and significant contribution” to China’s military capabilities.<sup>141</sup> These national security licensing requirements are based on the goal of restricting the export, reexport or transfer of items “that would make a significant contribution to the military potential of any other country or combination of countries that would prove detrimental to the national security of the United States.”<sup>142</sup> These targeted countries include, among others, Azerbaijan, Belarus, China, Iraq, Libya, North Korea, Russia,

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136. 15 C.F.R. § 744.21(f) (2007). A new note to paragraph (f) also defines the terms “use,” “development,” “production,” “operation,” “maintenance,” and “deployment.”

137. 15 C.F.R. § 744.21(e)(1) (2007) (emphasis added).

138. Section 742.4(b)(7) reads, in pertinent part: “There is a presumption of denial for license applications to export, reexport, or transfer items that would make a direct and significant contribution to the PRC’s military capabilities. . . .” 15 C.F.R. § 742.4(b)(7).

139. Final Rule, *supra* note 8, at 33648–49.

140. *Id.* at 33649.

141. 15 C.F.R. § 742.4(b)(7); Final Rule, *supra* note 8, at 33646–47.

142. 15 C.F.R. § 742.4(a) (2007).

Uzbekistan, and Vietnam.<sup>143</sup> Section 742.4(b)(5) notes that Kazakhstan, Mongolia, and Russia should be “accorded enhanced favorable consideration licensing treatment” in recognition of their efforts to establish export and reexport safeguard measures.<sup>144</sup>

China, however, receives no such consideration. It is true section 742.4(b)(7) states that there is a presumption to approve license applications to export, reexport or transfer items to China for bona fide civil end-uses.<sup>145</sup> However, the final rule also established a “presumption of denial” for items that would make a “direct and significant contribution” to China’s military capabilities.<sup>146</sup> To illustrate what might be considered to constitute China’s military capabilities, the final rule included as a supplement to section 742 a “Description of Major Weapons Systems”<sup>147</sup> whose advancement “would prove detrimental to the national security of the United States.”<sup>148</sup> The list is not exhaustive, but it includes such items as: battle tanks; armored combat vehicles; large-caliber artillery systems; combat aircraft; attack helicopters; warships, missiles and missile launchers, including Man-Portable Air-Defense Systems and Unmanned Aerial Vehicles; offensive space weapons; command, control, communications, computer, intelligence, surveillance, and reconnaissance; precision guided munitions including “smart bombs;” and night vision equipment.<sup>149</sup>

In the proposed version of the rule, BIS sought to deny items controlled for national security reasons that would have made a “material contribution” to China’s military capabilities, the same standard that is used for “military end-use” control described above in Part II.A.<sup>150</sup> Such a change in the review standard would have drastically changed U.S. policy in place since 1983, which states that BIS must either conduct “an extended review” or deny applications for the export or reexport of items that would make a “direct and significant contribution” to “a series of listed PRC military activities.”<sup>151</sup> In the final rule, BIS decided to maintain the “direct and significant” standard, as it judged the “material contribution” standard “too broad” to be used to review national security-controlled items.<sup>152</sup> However, in a slightly smaller policy shift, for the final rule, BIS decided “to apply it to PRC military capabilities as a whole, rather than a limited list of military activities.”<sup>153</sup>

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143. See “Country Group D:1,” Supplement No. 1 to 15 C.F.R. § 740 (2007).

144. 15 C.F.R. § 742.4(b)(5).

145. 15 C.F.R. § 742.4(b)(7); Final Rule, *supra* note 8, at 33646.

146. 15 C.F.R. § 742.4(b)(7).

147. “Description of Major Weapons Systems,” Supplement No. 7 to 15 C.F.R. § 742 (2007).

148. 15 C.F.R. § 742.4(a) (2007).

149. “Description of Major Weapons Systems,” Supplement No. 7 to 15 C.F.R. § 742.

150. Proposed Rule, *supra* note 1, at 38313; Final Rule, *supra* note 8, at 33647.

151. Final Rule, *supra* note 8, at 33647.

152. *Id.*

153. *Id.*

Finally, for the export and reexport of items to China that are controlled for reasons of chemical and biological proliferation,<sup>154</sup> nuclear nonproliferation,<sup>155</sup> and missile technology,<sup>156</sup> the final rule imposes the same “presumption of denial” that is employed for license applications for export of national security-controlled items.<sup>157</sup> This is done by stating that license applications covered by a particular section (i.e., “missile technology”) “when destined to the People’s Republic of China, will be reviewed in accordance with the licensing policies in both paragraph (b) of [that particular] section and §742.4(b)(7).”<sup>158</sup>

### C. VALIDATED END-USER PROGRAM

The first two elements of the China Military Catch All Rule as described above involve tightening U.S. export licensing policy for specific items that would be exported, reexported, or transferred to China. The third and fourth elements of the final rule are more liberalizing in nature, as they comprise the “carrots” to go along with the aforementioned “sticks.”

The third change brought about by the final rule is the creation of the Validated End-User (VEU), a new program that “permits the export, reexport, and transfer to validated end-users of any eligible items<sup>159</sup> that will be used in a specific eligible destination.”<sup>160</sup> A validated end-user is an end-user<sup>161</sup> that has been approved by the End-User Review Committee pursuant to the requirements laid out in section 748.15 of the EAR.<sup>162</sup> The End-User Review Committee is made up of representatives of the Departments of Commerce (which also chairs the Committee), Defense, Energy, and State, as well as other appropriate agencies.<sup>163</sup> The Committee’s unanimous vote is necessary to authorize VEU status for a potential candidate or to include additional eligible items in the pre-existing authorization.<sup>164</sup> However, a majority vote will suffice to remove VEU authorization from an end-user or to remove a previously eligible item from a pre-existing authorization.<sup>165</sup> The End-User Review Committee has thirty

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154. 15 C.F.R. § 742.2 (2007).

155. 15 C.F.R. § 742.3.

156. 15 C.F.R. § 742.5.

157. 15 C.F.R. § 742.2(a)(f); Final Rule, *supra* note 8, at 33646.

158. 15 C.F.R. § 742.3(b)(4). *See also* 15 C.F.R. § 742.2(b)(4); 15 C.F.R. § 742.5(b)(4).

159. It should be noted that “[i]tems controlled under the EAR for missile technology (MT) and crime control (CC) reasons may not be exported or reexported under [VEU] authorization.” 15 C.F.R. § 748.15(c) (2007).

160. 15 C.F.R. § 748.15.

161. An “end-user” is defined in the EAR as “[t]he person abroad that receives and ultimately uses the exported or reexported items. The end-user is not a forwarding agent or intermediary, but may be the purchaser or ultimate consignee.” 15 C.F.R. § 772.1 (2007).

162. 15 C.F.R. § 748.15.

163. “End-User Review Committee Procedures,” Supplement No. 9 to 15 C.F.R. § 748.

164. Supplement No. 9 to 15 C.F.R. § 748.

165. Supplement No. 9 to 15 C.F.R. § 748.

days to complete its review and make determinations whether to grant VEU authorization to the candidate once the candidate's complete application in the form of an advisory opinion request<sup>166</sup> has been "circulated to all [End-User Review Committee] agencies."<sup>167</sup>

This request for VEU authorization, in order to be approved by the End-User Review Committee, must contain certain information about the prospective validated end-user.<sup>168</sup> This information must include, among other details, the name of the proposed VEU candidate and its contact information, "an overview of the structure, ownership and business of the prospective validated end-user," a "list of the items proposed for VEU authorization approval and their intended end-uses," "the physical address(es) of the location(s) where the item(s) will be used," any plans for the reexport or transfer of the item, and a description of the record keeping system that is in place and how it will ensure compliance with VEU requirements.<sup>169</sup> Finally, the request must include, on the original letterhead of the prospective VEU, "an original statement . . . signed and dated by a person who has authority to legally bind the prospective [VEU]" certifying that the prospective VEU will comply with all VEU requirements, "including the requirement that items received under authorization VEU will only be used for civil end-uses," and that the candidate "agrees to allow on-site reviews by U.S. Government officials to verify the end-user's compliance with the conditions of the VEU authorization."<sup>170</sup>

Once the End-User Review Committee receives all necessary materials, it will then consider the prospective VEU's application, taking into account a number of factors. These factors include: the candidate's past compliance with U.S. export controls, its record of "exclusive engagement in civil end-use activities," its capability to comply with VEU requirements, the necessity of "on-site review prior to approval" and its agreement to further on-site reviews to ensure compliance, and the candidate's "relationship with U.S. and foreign companies."<sup>171</sup> Additionally, the Committee will consider the "status of export controls"<sup>172</sup> and "the support and adherence to multilateral export control regimes"<sup>173</sup> of the government of the eligible

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166. Supplement No. 9 to 15 C.F.R. § 748 (2007).

167. Supplement No. 9 to 15 C.F.R. § 748.

168. 15 C.F.R. § 748.15(a)(1) (2007). *See also* "End-User Review Committee Procedures," Supplement No. 9 to 15 C.F.R. § 748.

169. "Information Required in Requests for Validated End-User (VEU) Authorization," Supplement No. 8 to 15 C.F.R. § 748.

170. Supplement No. 8 to 15 C.F.R. § 748.

171. 15 C.F.R. § 748.15(a)(2).

172. For information on the status of China's export controls, see EVAN S. MEDEIROS, CHASING THE DRAGON (2005) available at [http://www.rand.org/pubs/monographs/2005/RAND\\_MG353.sum.pdf](http://www.rand.org/pubs/monographs/2005/RAND_MG353.sum.pdf); JONATHAN DAVIS, EXPORT CONTROLS IN THE PEOPLE'S REPUBLIC OF CHINA, (2005) available at <http://www.uga.edu/cits/documents/pdf/CITS%20China%20Final.pdf>.

173. Of the four multilateral export control regimes, China is a member of the Nuclear Suppliers Group. *See* <http://www.nsg-online.org/member.htm>. It is not a member of the

destination.”<sup>174</sup> Currently, the only two eligible destinations are China and, most recently, India.<sup>175</sup> Supplement 7 to section 748 provides a list of “validated end-users, respective eligible items and eligible destinations.”<sup>176</sup> As of October 3, 2008, the list contained only five validated Chinese end-users.<sup>177</sup>

If approved for VEU status, an eligible end-user may only use the items obtained under VEU for civil end-uses.<sup>178</sup> Additionally, the validated end-user may only use the item “at the end-user’s own facility located in an eligible destination or at a facility located in an eligible destination over which the end-user demonstrates effective control.”<sup>179</sup> Finally, exporters and reexporters who utilized VEU are required to submit annual reports to BIS detailing the name and address of each validated end-user that received items, the quantity and value of such items, and the ECCNs of these items.<sup>180</sup>

#### D. END-USER STATEMENTS<sup>181</sup>

The fourth and final change implemented by the final China Military Catch All Rule is to revise the situations in which a PRC End-User Statement must be obtained. Previously, pursuant to the end-use visit understanding of April 2004 between China’s Vice Minister of Commerce and the U.S. Under Secretary of Commerce for Industry and Security, exporters were required to obtain PRC End-User Statements from China’s Ministry of Commerce “for all exports [to China] of items on the CCL requiring a license” valued at over \$5,000.<sup>182</sup> The final rule raises the dollar threshold triggering the requirement of obtaining a PRC End-User Statement when “the total value of [the] transaction exceeds \$50,000.”<sup>183</sup>

Wassenaar Arrangement. See <http://www.wassenaar.org/participants/index.html>. It is not a member of the Missile Technology Control Regime. See <http://www.mtrc.info/english/index.html>. It is not a member of the Australia Group. See <http://www.australiagroup.net/en/participants.html>.

174. 15 C.F.R. § 748.15(a)(2) (2007).

175. 15 C.F.R. § 748.15(b).

176. “Authorization Validated End-User (VEU): List of Validated End-Users, Respective Eligible Items and Eligible Destinations,” Supplement No. 7 to 15 C.F.R. § 748.

177. Supplement No. 7 to 15 C.F.R. § 748; George Leopold, *Four chip industry players in China ‘validated’ as U.S. export users*, ELECTRONIC ENGINEERING TIMES, Oct. 29, 2007, at 16. A report from the Wisconsin Project on Nuclear Arms Control called into question the vetting process for these Chinese VEUs, stating that some of them had close ties with the Chinese military. See WISCONSIN PROJECT ON NUCLEAR ARMS CONTROL, IN CHINA WE TRUST? Jan. 2008, available at <http://www.wisconsinproject.org/pubs/reports/2007/inchinawetrust.pdf>.

178. 15 C.F.R. § 748.15(d) (2007).

179. 15 C.F.R. § 748.15(d)(1).

180. 15 C.F.R. § 748.15(f)(1)(i).

181. Prior to the publication of the final rule, the EAR used the term “PRC End-User Certificates.” However, “to conform with nomenclature that is recognized by [China’s Ministry of Commerce],” the final rule amended the EAR to now refer to these documents as “PRC End-User Statements.” See Final Rule, *supra* note 8, at 33650.

182. Final Rule, *supra* note 8, at 33650.

183. 15 C.F.R. § 748.10(b)(3) (2007).

This does not apply to the export of any computer to China that requires a license<sup>184</sup> or items classified under ECCN 6A003 (cameras),<sup>185</sup> as these items, regardless of dollar value, require a PRC End-User Statement due to U.S. national security concerns.<sup>186</sup>

If the export of an item necessitates that a PRC End-User Statement be obtained from China's Ministry of Commerce, it is incumbent upon the importer in China to obtain the PRC End-User Statement<sup>187</sup> signed by an official in the Department of Mechanic, Electronic and High Technology Industries, Export Control Division I of China's Ministry of Commerce with the Ministry's seal affixed to the Statement.<sup>188</sup> Additionally, the PRC End-User Statement must include the title of contract, the names of the exporter and importer, the end-user and end-use, and a description of the item, dollar value and quantity, along with the importer's signature.<sup>189</sup>

### III. IMPACT OF THE CHINA MILITARY CATCH ALL RULE

The aforementioned changes to U.S. export control policy vis-à-vis China will have widespread implications for U.S. exporters, U.S. competitiveness abroad, and U.S. national security. The final rule unnecessarily undermines U.S. economic interests abroad by expanding the potential liability for U.S. exporters and increasing their administrative burdens, disproportionately affecting small and medium business.<sup>190</sup> This expanded liability is not limited just to exporters, as businesses throughout the supply chain will now be subject to nebulous provisions and stiff penalties.<sup>191</sup> Additionally, the extra-territorial impact of the rule by including "reexports" within its scope further expands the potential liability to foreign suppliers, creating an incentive for them to "design-out" U.S. products so as to escape this liability trap.<sup>192</sup> The ultimate effect of these realities will be to place further requirements on already burdened American businesses<sup>193</sup> to the detriment of U.S. competitiveness in the

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184. 15 C.F.R. § 748.10(b)(3).

185. 15 C.F.R. § 748.10(b)(3).

186. Final Rule, *supra* note 8, at 33650.

187. 15 C.F.R. § 748.10(c)(1).

188. 15 C.F.R. § 748.10(c)(3).

189. 15 C.F.R. § 748.10(c)(3) (2007).

190. Letter from 23 Organizations to Stephen Hadley, *supra* note 12.

191. Donald A. Weadon, Jr., & Carol A. Kalinoski, *US blunders on with China military-export rule*, ASIA TIMES ONLINE, Sept. 22, 2006, available at [http://www.atimes.com/atimes/China\\_Business/HI22Cb01.html](http://www.atimes.com/atimes/China_Business/HI22Cb01.html); Letter from 24 Organizations to Sheila Quarterman, Nov. 30, 2006, available at [http://www.aeanet.org/GovernmentAffairs/gakm\\_ExportCoalitionChinaRegCommentLetter.asp](http://www.aeanet.org/GovernmentAffairs/gakm_ExportCoalitionChinaRegCommentLetter.asp); Donald A. Weadon, Jr., & Carol A. Kalinoski, *New US export controls threaten China trade*, ASIA TIMES ONLINE, Jan. 11, 2006, available at [http://www.atimes.com/atimes/China\\_Business/HA11Cb01.html](http://www.atimes.com/atimes/China_Business/HA11Cb01.html).

192. THE COALITION FOR SECURITY AND COMPETITIVENESS, *supra* note 18, at 7; Freedenberg, *supra* note 15.

193. Mark Foulon & Christopher A. Padilla, *In Pursuit of Security and Prosperity: Technology Controls for a New Era*, WASHINGTON QUARTERLY, Vol. 30, Spring 2007, at 83, available at

hyper-competitive Chinese market, as other foreign suppliers are not so burdened.<sup>194</sup>

The unilateral nature of the rule further undermines its potential efficacy, as no U.S. allies or major trading partners are willing to undertake similar restrictions on their trade with China.<sup>195</sup> This will further compound the damage to U.S. business competitiveness in the Chinese marketplace, the access to which is increasingly vital to American businesses.<sup>196</sup> These losses will result in reduced profits for many cutting edge commercial enterprises in the United States, which will ultimately mean lower levels of investment in vital R&D.<sup>197</sup> Such reductions in private R&D will only serve to undermine U.S. national security, as the Pentagon and America's military superiority is increasingly reliant on private sector R&D.<sup>198</sup> Thus, the final China Military Catch All Rule may very well exacerbate the very problems it was designed to solve.

#### A. INCREASED LIABILITY

In the 1990s, the Clinton administration began to shift the burden for policing export control compliance from the government to the private sector.<sup>199</sup> Industry became more responsible for ensuring compliance with applicable export rules and regulations.<sup>200</sup> From a practical standpoint, such a shift makes sense. Intuitively, exporters tend to have much more technical understanding of their own items intended for export than the government.<sup>201</sup> Additionally, as the government tends to be predominantly focused on national security concerns, an increased governmental role might lead to overly conservative reviewing policies, especially with respect to high-technology items, potentially prompting delays and rising denial rates.<sup>202</sup>

However, this burden-shifting also means that companies are required to determine when end-users in China are likely to use dual-use items for a military end-use.<sup>203</sup> Under the final rule, U.S. exporters are required to obtain a license when they have "knowledge" that their item for export is destined for a "military end-use" in China. Under the EAR, "knowledge is

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[http://www.twq.com/07spring/docs/07spring\\_foulon-padilla.pdf](http://www.twq.com/07spring/docs/07spring_foulon-padilla.pdf) (noting that "U.S. firms face an ever-growing challenge to operate profitably in a hypercompetitive global marketplace").

194. See discussion *infra* Part III.B.

195. Freedenberg, *supra* note 15.

196. THE COALITION FOR SECURITY AND COMPETITIVENESS, *supra* note 18, at 5.

197. See Paarlberg, *supra* note 20, at 129–30.

198. See discussion *infra* Part III.C.

199. Gerth & Schmitt, *supra* note 40.

200. Corr, *supra* note 27, at 491–92.

201. Gregory W. Bowman, *E-mails, Servers, and Software: U.S. Export Controls for the Modern Era*, 35 GEO. J. INT'L L. 319, 365–66 (Winter 2004).

202. *Id.*

203. Gerth & Schmitt, *supra* note 40.

broader than actual knowledge, and would include constructive knowledge where the exporter had reason to know or believe, based on the circumstances, that there was a military end-use, or intentionally blinded itself to the facts.”<sup>204</sup> Thus, for BIS to establish a violation of export regulations, “it is sufficient for BIS to show that the exporter should have been aware that the transaction would be a violation of the EAR without hard evidence of actual knowledge.”<sup>205</sup> While it is true that BIS used the previously existing definition of “knowledge” in the EAR and thus did not modify the definition with respect to the final rule,<sup>206</sup> it is the subject (Chinese end-users) about which exporters must have knowledge that creates the potential for drastically expanded liability.<sup>207</sup>

Private sector officials have been complaining to the government for the last decade that they are not in a position to make informed determinations on Chinese end-users.<sup>208</sup> This is because the Chinese military is a notoriously nebulous entity and “has long played a role in commercial ventures” and it is often “difficult to distinguish between military officers’ personal and professional dealings.”<sup>209</sup> Despite the rapid growth of privately-owned businesses in China, state-owned enterprises are still a key element in the Chinese economy.<sup>210</sup> Some of these state-owned enterprises are owned or controlled by the Chinese military.<sup>211</sup> Furthermore, there are a number of universities and supposedly private enterprises that have direct or indirect ties to the Chinese military.<sup>212</sup> This has prompted one export control specialist to state that “[e]xporters should rightly fear a high risk of liability under such a broad definition of knowledge since it is frequently difficult for exporters to determine the ultimate use of products shipped to China.”<sup>213</sup> Indeed, Under Secretary Mancuso has stated that it is

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204. Jonathan M. Epstein, *U.S. Department of Commerce Poised to Impose New Restrictions On Exports to China*, THE METROPOLITAN CORPORATE COUNSEL, Dec. 2006, Vol. 14, at 64, available at <http://www.metrocorpcounsel.com/current.php?artType=view&artMonth=November&artYear=2008&EntryNo=5984>.

205. Corr, *supra* note 27, at 513.

206. For a brief explanation of the evolution of the knowledge standard used in the final rule, see *China Export Control Reg to be Clarified in BIS Web Posting*, INSIDE US-CHINA TRADE, Vol. 6, No. 36, Sept. 13, 2006, available at LEXIS.

207. Paul Luther & Matt West, *Export of Dual-Use Items to China Addressed by The Department of Commerce*, BAKER BOTTS INTERNATIONAL TRADE UPDATE, June 27, 2007, available at [http://www.bakerbotts.com/file\\_upload/templates/docamendsexportadministrationregulationsonexportofdual-useitemstochina.htm](http://www.bakerbotts.com/file_upload/templates/docamendsexportadministrationregulationsonexportofdual-useitemstochina.htm).

208. Gerth & Schmitt, *supra* note 40.

209. *Id.*

210. William Armbruster, *Export Controls: Bush administration proposals would tighten restrictions on China trade*, SHIPPING DIGEST, Oct. 2, 2006.

211. *Id.*

212. *Id.*

213. Cliff Burns, *The Chinese ‘Catch-All’ Saga Continues*, MONDAQ BUSINESS BRIEFING, Sept. 1, 2006, available at LEXIS.



“impossible” to trade with Chinese entities without dealing with the government to some extent, due to China’s economic structure.<sup>214</sup>

Thus, in order to avoid liability, exporters must engage in much greater due diligence to ensure, to the best of their ability, that their items for export are not destined for a military end-use in China.<sup>215</sup> Currently, exporters are required not only to review various U.S. government lists such as the Denial List and the Entity List,<sup>216</sup> but they will have to conduct increased customer screening of, and investigation into, Chinese end-users who are not on such lists.<sup>217</sup> Furthermore, it is quite possible that the “presumption of denial” of certain licenses ushered in by the final China Military Catch All Rule will, “as a matter of practice, ‘bleed over’ to applications for commercial uses in China, requiring exporters to go to great lengths to demonstrate the bona fide commercial use of its Chinese customers.”<sup>218</sup> These increased due diligence measures will especially burden small- and medium-sized firms, as they will have to divert limited resources to meet these rising administrative costs.<sup>219</sup> The ironic twist is that, by shifting the compliance burden on to private companies, the government has freed up resources to bolster its enforcement activities.<sup>220</sup>

However, the chain of liability does not end with the exporter. The final rule explicitly applies to reexports as well, resulting in the extra-territorial extension of liability to firms outside the United States who reexport U.S.-origin items.<sup>221</sup> Such extraterritorial controls can complicate transactions, serving as a disincentive for foreign buyers to choose U.S. exporters.<sup>222</sup>

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214. *Mancuso Rejects Criticism of VEU Export Control Program*, INSIDE U.S.-CHINA TRADE, Vol. 8, Feb. 22, 2008, available at LEXIS.

215. Vorwig, *supra* note 134; *Industry Will Push OMB to Re-Examine China Export Control Rule*, INSIDE US-CHINA TRADE, Vol. 6, Dec. 6, 2006, available at LEXIS; Jonathan M. Epstein & Antonia I. Tzinova, *Exporting Commercial Goods and Technology to China Under the New Military End-Use Restrictions*, THE METROPOLITAN CORPORATE COUNSEL, Vol. 15, Dec. 2007, at 69, available at LEXIS (stating that “[t]he hardest part of compliance will be assessing what steps need to be taken to be reasonably assured the item is not going to a military end-use”).

216. As of October 3, 2008, twenty-two Chinese entities were on the Entity List, which identifies certain foreign entities that are subject to license requirements for specific items. See Supplement No. 4 to Part 744, 15 C.F.R. § 744 (2007).

217. Corr, *supra* note 27, at 517–18; Epstein, *supra* note 204 (noting that “the new rule will create additional compliance costs and uncertainty for U.S. exporters, and may have a chilling effect well beyond its stated scope”).

218. Epstein & Tzinova, *supra* note 215.

219. Letter from 23 Organizations to Stephen Hadley, *supra* note 12.

220. Corr, *supra* note 27, at 491–2; see also Donald Weadon, Jr. & Carol A. Kalinoski, *BIS Stumbles with ‘China Rule’*, JOURNAL OF COM., Jan. 24, 2008, available at LEXIS (noting that President Bush recently “signed into law a significant enhancement of penalties for infringement or violation of current U.S. export laws, making infractions of this new and untested export [VEU] authorization problematic”).

221. See, e.g., 15 C.F.R. § 742.4(b)(7) (2007) (stating that “[t]here is a presumption of denial for license applications to export, reexport, or transfer items that would make a direct and significant contribution to the PRC’s military capabilities”).

222. Corr, *supra* note 27, at 473.

This is especially true when the controls—as here—are unilateral in nature and when the items in question are available from vendors in other countries.<sup>223</sup> The liability for U.S. exporters is daunting in such transactions as “the overseas re-exporter typically lacks information as to whether the U.S. technology, product, or component is subject to re-export licensing requirements, and the U.S. exporter often does not provide sufficient information.”<sup>224</sup>

Noting that the United States is one of only a few countries that impose reexport controls, the Coalition for Security and Competitiveness has highlighted the significant compliance burden reexport controls impose on both U.S. companies and their foreign trading partners.<sup>225</sup> Foreign companies are often discouraged by the complexity of these reexport controls from procuring U.S.-origin products, resulting in these same foreign companies “designing out” U.S. components “in favor of components from countries without stringent re-export controls.”<sup>226</sup> Japanese companies in particular are known to be especially careful not to violate U.S. export control regulations, prompting them to redesign their products to eliminate U.S. components.<sup>227</sup> Reexporters in other countries are likely to view the extraterritorial effect of the China Military Catch All Rule as confirmation that American firms are unreliable suppliers.<sup>228</sup> Allied nations are likely to further respond by using their blocking statutes<sup>229</sup> to limit the extraterritorial impact of this rule on their domestic businesses.<sup>230</sup> With respect to Chinese companies, they already view the United States to

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223. *Id.*; see also Segal, *supra* note 86.

224. Corr, *supra* note 27, at 473.

225. THE COALITION FOR SECURITY AND COMPETITIVENESS, *supra* note 18, at 7; R.G. Edmonson, *U.S. issues new rule for dual-use China exports*, JOURNAL OF COM., June 20, 2007, available at <https://www.joc.com/articles/Printable.asp?sid=42376> (quoting William Reinsch, president of the National Foreign Trade Council, arguing that the Final Rule would render U.S. companies liable for sanctions if their dual-use items were reexported to China).

226. THE COALITION FOR SECURITY AND COMPETITIVENESS, *supra* note 18, at 7.

227. R.G. Edmonson, *Duel over dual-use goods; Industry opposes proposed rules for exports that could benefit Chinese military*, JOURNAL OF COM., Aug. 21, 2006, at 36, available at LEXIS.

228. Reinsch, *supra* note 13.

229. “Blocking statutes” preclude or limit the ability of U.S. litigants to obtain information, witnesses, or documents located in countries with such statutes. See, e.g., the United Kingdom’s Protection of Trading Interests Act, 1980, ch. 11 (Eng.), amended by Civil Jurisdiction and Judgments Act, 1982, ch. 27, and Statute Law (Repeals) Act, 1993, ch. 50, Sch. 1, pt. XIV; Canada’s Foreign Extraterritorial Measures Act, R.S.C., ch. F-29, § 3 (1984) (Can.), as amended by Department of External Affairs Act, 1995, ch. 5, 1994-1995 S.C.; France’s Law concerning the Communication of Economic, Commercial, Industrial, Financial or Technical Documents or Information Law No. 80-538, 1980 J.O. 1799 (July 16, 1980); Australia’s Foreign Proceedings (Excess of Jurisdiction) Act, No. 3 (1984) (Austl.), as amended by Foreign Judgments Act, No. 112 (1991); and South Africa’s Protection of Business Act, No. 99, § 1 (1978) (S. Afr.), as amended by Protection of Business Act Amendment, No. 114 (1979), and Protection of Business Act Amendment, No. 71 (1984), and Protection of Business Act Amendment, No. 87 (1987).

230. *BIS Stumbles with ‘China Rule,’ supra* note 220.

be the least reliable and most restrictive of their major trading partners.<sup>231</sup> The final rule “can only serve to reinforce in the Chinese that negative perception.”<sup>232</sup>

This “remarkable liability chain” extends even further. The final rule also applies to the “transfer”<sup>233</sup> of controlled items, which implicates entities throughout the supply chain.<sup>234</sup> These entities include shippers, freight forwarders, banks, accountants and consultants.<sup>235</sup> Additionally, “when viewed through the lens of the corporate-knowledge doctrine, the opportunities for serious liability exposure abound for service providers as well.”<sup>236</sup> The language of section 744.6 of the EAR ensures their liability, by stating that:

No U.S. person shall, without a license from BIS, knowingly support an export, reexport, or transfer that does not have a license as required by this section. Support means any action, including financing, transportation, and freight forwarding, by which a person facilitates an export, reexport, or transfer without being the actual exporter or reexporter.<sup>237</sup>

It is this language that prompted one export control specialist to state that “with higher penalties under the Patriot Act, fines for even minor infractions skyrocket, creating an exposure umbrella resembling a mushroom cloud.”<sup>238</sup>

## B. REDUCED U.S. COMPETITIVENESS

Statistics clearly demonstrate the reasons why U.S. companies are so enamored with the Chinese market. In 2006, the United States exported \$17.7 billion worth of high-tech goods to China, an increase of forty-four percent and more than the total value of U.S. exports to India, Russia and Thailand combined.<sup>239</sup> Since 2000, U.S. exports to China have risen 240 percent, more than to any other market.<sup>240</sup> Applied Materials, a leading Silicon Valley semiconductor company, predicted in 2002 that over the next ten years, approximately twenty percent of its revenues could come from

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231. Freedenberg, *supra* note 15.

232. *Id.*

233. A “transfer” is “[a] transfer to any person of items subject to the EAR either within the United States or outside of the United States with the knowledge or intent that the items will be shipped, transferred, or transmitted to an unauthorized recipient.” 15 C.F.R. § 772.1 (2007).

234. *US blunders on with China military-export rule*, *supra* note 191.

235. *Id.*; Letter from 24 Organizations to Sheila Quarterman, *supra* note 191.

236. *US blunders on with China military-export rule*, *supra* note 191.

237. 15 C.F.R. § 744.6(a)(1)(ii) (2007).

238. Donald A. Weadon, Jr., *America must relax weapons controls*, THE FINANCIAL TIMES LIMITED, Aug. 1, 2006, at 11, available at LEXIS.

239. Mancuso, *supra* note 71.

240. *BIS Finalizes 9 Key Provisions of New China Export Rule*, MANAGING IMPORTS AND EXPORTS, Vol. 2007, No. 9, Sept. 2007, available at LEXIS.

trade with China.<sup>241</sup> Additionally, China is on track to overtake Japan as the third-largest destination for U.S. exports sometime in the immediate future.<sup>242</sup> Statistics such as those make it easy to see why James Sasser, U.S. Ambassador to China during the Clinton administration, once remarked that “[t]he Chinese really don’t do any lobbying. The heavy lifting is done by the American business community.”<sup>243</sup>

For the American business community, the Final China Military Catch All Rule could prove to be the perfect storm, combining with a number of external factors to undermine U.S. competitiveness. First, the rule and its restrictions are unilateral in nature.<sup>244</sup> Not one U.S. Wassenaar Arrangement ally has agreed to enact similar provisions.<sup>245</sup> Up until the 1980s, unilateral U.S. export controls were still somewhat effective, as most other nations in the world could not compete technologically with the United States.<sup>246</sup> However, globalization has leveled the technological playing field to the point that such unilateral controls are doomed to failure.<sup>247</sup> Technologically advanced countries like Taiwan, South Korea, Japan, and Malaysia are more than capable of supplying dual-use technology to China.<sup>248</sup> Second, European companies are also more than willing to trade with China, a fact that stems from a very different view of Beijing’s ascendancy.<sup>249</sup> The U.S. view is best encapsulated by a 2006 Pentagon report on China which stated that “China has the greatest potential to compete militarily with the United States and to field disruptive military technologies that could over time offset traditional U.S. military advantages absent U.S. counter strategies.”<sup>250</sup> Europe tends not to view China as an emerging threat and regards engagement, as opposed to containment, as the proper way to “minimize any risks associated with Beijing’s emergence as a global player.”<sup>251</sup> In the export control context, most Wassenaar Arrangement

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241. Craig S. Smith, *China Finds Way to Beat Chip Limits*, N.Y. TIMES, May 6, 2002, at C4.

242. *BIS Finalizes 9 Key Provisions of New China Export Rule*, *supra* note 240.

243. William R. Hawkins, Testimony before the U.S.-China Economic and Security Review Commission, Mar. 17, 2006, available at [http://www.uscc.gov/hearings/2006hearings/written\\_testimonies/06\\_03\\_16\\_17wrts/06\\_03\\_16\\_17\\_hawkins.pdf](http://www.uscc.gov/hearings/2006hearings/written_testimonies/06_03_16_17wrts/06_03_16_17_hawkins.pdf) (quoting James Sasser).

244. Freedenberg, *supra* note 15; Segal, *supra* note 86.

245. *Id.*

246. Corr, *supra* note 27, at 508.

247. Stone, *supra* note 53, at 9.

248. R. Aylan Broadbent, *U.S. Export Controls on Dual-Use Goods and Technologies: Is the High Tech Industry Suffering?* 8 CURRENTS INT’L TRADE L.J. 49, 53 (Summer 1999).

249. Corr, *supra* note 27, at 456.

250. QUADRENNIAL DEFENSE REVIEW REPORT, *supra* note 81, at 29–30. However, “[q]uestioning inflated Pentagon claims of Chinese strength and resisting the trend toward a harsher anti-Chinese military stance are essential, therefore, if we want to avert a costly and dangerous cold war in Asia.” Michael T. Klare, *Revvng Up the China Threat*, THE NATION, Oct. 24, 2005, available at <http://www.thenation.com/doc/20051024/klare>.

251. STUDY GROUP ON ENHANCING MULTILATERAL EXPORT CONTROLS FOR US NATIONAL SECURITY, *supra* note 32, at 13.

members, including much of Europe, “simply do not share the U.S. view of China as a restricted destination.”<sup>252</sup>

These divergent viewpoints toward China further undermine the efficacy of U.S. export controls and American business competitiveness, because U.S. policy implicitly assumes cooperation from Wassenaar Arrangement members.<sup>253</sup> In determining whether a certain product is available outside the United States (i.e. “foreign availability”), the Coalition for Security and Competitiveness states that the Commerce Department assumes countries that participate in the same multilateral export control regimes as the United States have adopted the same dual-use controls as the United States.<sup>254</sup> The Commerce Department’s process for determining “foreign availability” ignores the differences in these countries’ export controls, which is even more important in the context of the Wassenaar Arrangement where members are not obligated to harmonize their control lists.<sup>255</sup> Thus, “many items restricted by the United States are available in Wassenaar member countries because of differences, for example, in licensing administration, compliance and enforcement procedures, technical interpretation of the lists and application of re-export rules.”<sup>256</sup> One of the most fundamental differences between the now defunct CoCom and the Wassenaar Arrangement is the absence of authority for a state to veto an export by a fellow member, thus preventing the sale altogether.<sup>257</sup> Thus, “items subject to U.S. controls are now more readily available in other countries, including members of international regimes.”<sup>258</sup>

Craig Barrett, the CEO of Intel, equated these unilateral U.S. export controls on goods going to China to “fighting with one hand tied behind my back.”<sup>259</sup> Barrett’s comment underscores the fundamental importance of multilateral approaches to export controls if they are to be effective.<sup>260</sup> However, the final China Military Catch All Rule is not only unilateral in nature; it seeks to control goods that are widely available from foreign companies.<sup>261</sup> Thus, delays in the export licensing process can be deadly. It

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252. Corr, *supra* note 27, at 456.

253. THE COALITION FOR SECURITY AND COMPETITIVENESS, *supra* note 18, at 6.

254. *Id.*

255. *Id.*

256. *Id.*

257. *Id.*

258. *Id.*

259. Mark LaPedus, *Intel’s Barrett cries foul over export controls in China*, EE TIMES, Nov. 2004, available at <http://www.eetimes.com/showArticle.jhtml?articleID=51202676>.

260. Vago Muradian, *Better Export Controls Needed to Check Dual-Use Technologies*, DEFENSE DAILY, January 22, 1998, Vol. 198, No. 14, available at Lexis; Stone, *supra* note 53 (quoting Ashton B. Carton, former Clinton administration Assistant Defense Secretary and now Harvard professor, as saying “[t]here’s no point in [the United States] controlling things if our partners don’t. For dual-use exports, it’s crucial to have international consensus.”).

261. *Exporters Urge BIS to Reconsider China ‘Catch-All’ Rule*, *supra* note 6; Letter from 24 Organizations to Sheila Quarterman, *supra* note 191, at 2; Jim Puzanghera, *Controls tightened on*

can take more than six months for U.S. companies to secure an export license for goods going to China.<sup>262</sup> James Jochum, the Commerce Department's Assistant Secretary for Import Administration, has said that the U.S. government "take[s] a longer time reviewing licenses to China than to any other destination."<sup>263</sup> In 2003, an export application for China took, on average, seventy-two days, longer than for any other country.<sup>264</sup> Such delays inevitably force the foreign buyer to look elsewhere.<sup>265</sup> For example, in 2002, Semiconductor Manufacturing International Corporation (SMIC), one of China's largest semiconductor producers, planned to purchase high-tech items from Silicon Valley-based Applied Materials, but after waiting months for license approval, SMIC instead placed its order with a Swedish company, costing Applied Materials a multi-million dollar deal.<sup>266</sup> As Joseph Xie of SMIC said, "We love to do business with the U.S., but we can't wait forever. Europe and Japan are getting the business."<sup>267</sup>

### C. REDUCED U.S. NATIONAL SECURITY

As U.S. exporters go, so goes American military superiority.<sup>268</sup> This is due to a fundamental shift in the way the Pentagon constitutes U.S. military hegemony. During the Cold War, the U.S. defense industry spent billions of dollars specially designing complex, top-secret weapons systems for the Pentagon.<sup>269</sup> That is no longer the case, as "a revolution has turned the U.S. defense industry upside down."<sup>270</sup> Nowadays, it is the private sector that increasingly supplies the Pentagon, as very little is custom-made for the military anymore.<sup>271</sup> Thus, the products from the private sector are "increasingly used to supply off-the-shelf technology for military applications, as government entities find that higher quality and lower prices are available on the open market."<sup>272</sup>

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*exports to China*, L.A. TIMES, June 16, 2007, at C1, available at <http://articles.latimes.com/2007/jun/16/business/fi-china16>.

262. Smith, *supra* note 241.

263. Read, *supra* note 51.

264. *Id.*

265. Smith, *supra* note 241.

266. *Id.*

267. *Id.*

268. Segal, *supra* note 86 (noting the following "paradoxical outcome for the Pentagon: U.S. national security is tied to the same global process of innovation through global competition and integration that indirectly contributes to the improvement of Chinese military capabilities").

269. Hirsh, *supra* note 19, at 2.

270. *Id.*

271. *Id.*; Stone, *supra* note 53.

272. Michael Beck, et al., STRENGTHENING MULTILATERAL EXPORT CONTROLS 11 (Sept. 2002); see also Segal, *supra* note 86 (quoting the U.S. Defense Science board as stating that the Pentagon "relies 'increasingly on the U.S. Commercial advanced technology sector to push the technological envelope and enable the Department to 'run faster' than its competitors'").

However, these private sector companies increasingly rely on exports to generate a profit, with no bigger market than China.<sup>273</sup> The profits are then reinvested in R&D to generate the next generation of cutting edge goods.<sup>274</sup> The private sector shares of total R&D in the United States have increased from fifty percent in the mid-1980s to more than sixty-six percent of total R&D in 2003.<sup>275</sup> Overall, total U.S. R&D is greater than \$250 billion annually, and while vital in promoting U.S. economic growth and international competitiveness, “[it is] also at the foundation of U.S. military superiority.”<sup>276</sup> Private R&D also has the added advantage of being “unhampered by bureaucratic and security restrictions,” making it “more flexible, more innovative, and better organized.”<sup>277</sup> By reinvesting their profits, which are substantially derived from exports, U.S. private sector companies can further solidify America’s technological superiority.<sup>278</sup> Maintaining this technological superiority, given the Pentagon’s increasing reliance on the commercial sector, is the foundation of American military hegemony.<sup>279</sup>

There is potentially an additional adverse impact on U.S. national security that must be noted. It is clear that China will continue to seek high-tech dual-use items despite the unilateral U.S. controls contained in the China Military Catch All Rule.<sup>280</sup> To secure its access to these increasingly vital items, China, with its surging foreign currency reserves, “will either partner with, or purchase outright, capable non-U.S. suppliers.”<sup>281</sup> This will provide China at some point thereafter with the capability to domestically produce these goods, and once its own domestic demand is met, global prices can be expected to drop.<sup>282</sup> These Chinese producers will then turn their sights to exporting to the U.S. market, causing prices to drop further, and potentially driving out of business many of the U.S. suppliers for these dual-use goods, “essentially gutting the U.S. defense industrial base.”<sup>283</sup>

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273. Stone, *supra* note 53.

274. Padilla 5/15/07, *supra* note 62.

275. Paarlberg, *supra* note 20, at 130.

276. *Id.* at 129–30.

277. Rod Smith & Bernard Udis, *New Challenges to Arms Export Control: Whither Wassenaar?* NONPROLIFERATION REVIEW 81, 87 (Summer 2001).

278. Padilla 5/15/07, *supra* note 62.

279. Susan Mora & Jennifer Cummings, *NFTC President Bill Reinsch Says Tightened Export Controls Endanger U.S. Competitiveness and Add Little to National Security Efforts*, December 11, 2006, available at <http://www.nftc.org/newsflash/newsflash.asp?Mode=View&articleid=1840&Category=All>; Laura D’Andrea Tyson, *Washington Can’t Keep High Tech to Itself, so Why Try?* BUSINESS WEEK 18 (July 6, 1998).

280. *BIS Stumbles with ‘China Rule’*, *supra* note 220.

281. *Id.*

282. *Id.*

283. *Id.*; see also Alan M. Field, *Bush administration seeks to reform export controls*, SHIPPING DIGEST, Feb. 11, 2008, available at LEXIS (noting that, for example, strict unilateral U.S. export controls “had crippled U.S. exports of night-vision devices,” as Chinese competitors had taken

**IV. CONCLUSION**

The focus of U.S. export policy should be to maintain American dominance in high-technology goods. This is the best path to protecting U.S. national security and American business interests, both at home and abroad. Instead, the final China Military Catch All Rule attempts to shift the focus to the potential for China's military to rival that of the United States. It seeks to do this by placing unilateral restrictions on dual-use goods that China can easily purchase from our foreign competitors. By denying China access to our dual-use technology, the United States is sending Beijing a clear message that Washington views China much more as a strategic competitor than a strategic partner. Such messages only serve to undermine efforts to bring China more into the international system as a "responsible stakeholder." However, by treating China as a strategic adversary, this current U.S. policy will unfortunately only make conflict between the United States and China more likely. Absent real multilateral efforts on the part of the United States, in such a conflict, China will most certainly have access to these dual-use items through our allies, a tragic twist of fate indeed.

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advantage of the opening created by these controls and eliminated the previous U.S. monopoly on such items).

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