

Report on Supply Chain Compliance Volume 3, Number 11. May 28, 2020

US seeks to further isolate Huawei

By Sascha Matuszak

On Friday, May 15, the United States Department of Commerce, Bureau of Industry and Security amended the foreign-produced direct product rule and the Entity List^[1] in an attempt to further isolate Huawei Technologies Inc. from the U.S. semiconductor industry. The rule change pertains primarily to the non-U.S. manufacture of semiconductors where the product is manufactured using or based on specific types of U.S.-origin technology or software.

The amended rule^[2] maintains the scope and criteria of General Prohibition Three, also known as the foreign-produced direct product rule, and exercises existing authority under the Export Control Reform Act of 2018 by imposing a new control through 15 C.F.R. § 736.2(b)(3)(vi) of the Export Administration Regulations. The Bureau of Industry and Security described the move as a narrow and strategic targeting of Huawei's acquisition of semiconductors that are the direct product of certain U.S. software and technology. The impact is limited to a specific set of components and technology and the handful of companies that use them to manufacture chipsets and other electronics.

"Simply because a non-U.S. manufacturing facility uses some U.S.-origin equipment to manufacture products does not mean that those non-U.S. products cannot be sold, shipped, or otherwise transferred to Huawei," said Thad McBride, partner at Bass, Berry & Sims PLC. "It is only certain types of manufacturers—again, primarily in the semiconductor manufacturing space—that are impacted by the new rule."

Although the rule is merely a licensing requirement, it essentially gives the U.S. Department of Commerce a veto over Huawei obtaining certain types of technology manufactured outside of the United States. It is the latest in a long series of U.S. actions dating back more than two years to address alleged national security concerns posed by powerful Chinese tech giants.^[3]

Taiwan Semiconductor Manufacturing Co., the world's largest contract semiconductor maker, has reportedly already stopped taking orders from Huawei^[4] in response to the rule change.

Chinese retaliation

A greater risk to U.S. companies may be any retaliatory measures China decides to implement. The trade war between the two countries has already disrupted global supply chains, forcing companies to consider measures such as reshoring operations in order to escape tariffs.^[5] With the constant pressure on Huawei, it is only a matter of time before China targets U.S. technology companies that rely heavily on the Chinese market for sales.

The Chinese Ministry of Commerce, Ministry of Foreign Affairs, and Huawei issued statements criticizing the move.^[6] The Ministry of Commerce stated that the rule change was "'a violation of market principles and fair competition,'" while Huawei stated that "'it will have a serious impact on a wide number of global industries. In the long run, this will damage the trust and collaboration within the global semiconductor industry which many industries depend on, increasing conflict and loss within these industries.'"

David Goldman, in an article for *Asia Times Financial*, wrote, “If China retaliates by shutting US tech companies out of the Chinese market, the outcome will be a collapse of trans-Pacific technology trade, aggravating what already is the worst economic downturn since the Second World War.”^[7]

Not yet sanctioned

Despite media attention and harsh statements from Chinese authorities, the impact of the new rule change could be negligible. The rule does not prohibit U.S. companies from doing business with Huawei and does not carry the same strict penalties that come with doing business with sanctioned entities.

“This is an additional effort to push Huawei out of U.S. commerce, but it ultimately may not be hugely significant for most U.S. companies,” McBride said. “U.S. companies can still purchase goods from Huawei. U.S. companies can also still sell many non-U.S.-origin products to Huawei. And Huawei is not a prohibited party under U.S. sanctions, for example, like some of the large Russian companies that have been designated as Specially Designated Nationals (SDNs) of the United States. U.S. companies and individuals are prohibited from conducting virtually any transaction with an SDN. That is not the case with Huawei.”

An article in *The Wall Street Journal* echoed this view,^[8] with John Neuffer, president and CEO of the Semiconductor Industry Association, quoted as saying, “We are concerned this rule may create uncertainty and disruption for the global semiconductor supply chain, but it seems to be less damaging to the U.S. semiconductor industry than the very broad approaches previously considered.”

Regardless, the rule change adds more fuel to the trade war fire blazing between the two countries and presents the risk of Chinese retaliatory measures that could freeze U.S. companies out of the Chinese market or impose duties. The possibility also exists that the U.S. will add Huawei to its SDN list, which would have a much greater impact on the global semiconductor industry than any previous action.

¹ U.S. Department of Commerce, “Commerce Addresses Huawei’s Efforts to Undermine Entity List, Restricts Products Designed and Produced with U.S. Technologies,” news release, May 15, 2020, <https://bit.ly/2zhC7Q3>.

² Export Administration Regulations: Amendments to General Prohibition Three (Foreign-Produced Direct Product Rule) and the Entity List, 85 Fed. Reg. 29,849 (May 19, 2020) , <https://bit.ly/3gcjluK>.

³ Stu Woo and Asa Fitch, “The Great U.S.-China Tech Divide,” *The Wall Street Journal*, January 20, 2020, <https://on.wsj.com/36kVa8l>.

⁴ Cheng Ting-Fang, Lauly Li, “TSMC halts new Huawei orders after US tightens restrictions,” *Nikkei Asian Review*, May 18, 2020, <https://s.nikkei.com/2WOeI1F>.

⁵ Michael Schuman, “Trump’s Trade War With China Is Already Changing the World,” *The Atlantic*, June 25, 2019, <https://bit.ly/2Xifd3g>.

⁶ Nadeem Xu and Mark McCord, “China, Huawei decry toughened US blockade,” *Asia Times Financial*, May 18, 2020, <https://bit.ly/3cNIyZW>.

⁷ David Goldman, “Trump bets the farm on Huawei equipment ban,” *Asia Times Financial*, May 18, 2020, <https://bit.ly/3bQ4xOD>.

⁸ Bob Davis and Katy Stech Ferek, “U.S. Moves to Cut Off Chip Supplies to Huawei,” *The Wall Street Journal*, May 15, 2020, <https://on.wsj.com/3bPhh7V>.

This publication is only available to subscribers. To view all documents, please log in or purchase access.

[Purchase Login](#)