

Tightened Global Enforcement of US Export Controls: The Significance for Israel

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The United States recently imposed a record fine on an overseas company that manufactures its products outside the borders of the United States, for violating US export controls. The incident demonstrates how the extraterritorial nature of the US rules of oversight over exports becomes a significant potential problem for Israeli companies, which could pay a hefty price for violating US export rules – even if they have not broken any Israeli laws. This case can also inform the conduct needed from Israeli oversight authorities to ensure that Israeli companies can continue doing business with China, while at the same time protecting these Israeli entities and avoiding stricter US oversight of the technological and economic activity on the Israel-US axis.

Overseeing the export of US dual-use commodities, technology, and software (i.e., civilian products that can also have defense applications) is the responsibility of the US Department of Commerce and is directed by the Bureau of Industry Security (BIS). BIS plays a key role in the trade war between the United States and China, especially in the battle of advanced technologies that are at the center of the microchip, semiconductor, and supercomputer industries.

In April 2023, BIS imposed a civilian fine of \$300 million on a company from Singapore and a US company, both of which belong to the Seagate Group. The fine was imposed as part of a settlement agreement, in light of accusations that between August 2020 and September 2021, the companies violated US export controls by selling 7.4 million hard drives that were manufactured outside the United States to the Chinese technology corporation Huawei – at a total cost of around \$1.1 billion.

This is the largest civil fine ever imposed by BIS. The sum is more than double Seagate's net profit from the prohibited deals, relegating the deals from highly profitable to outright losses. In addition, the compromise stipulates that Seagate will be subject to annual inspections regarding its conduct, and it was warned that if it violated export restrictions again in the next five years, its license to export goods under US oversight would be revoked.

Foreign Direct Product Rules

In August 2020, BIS began overseeing the export of certain goods manufactured outside of the United States to the Chinese Huawei group. The significance of this oversight was that any exporter wishing to sell these goods would need a BIS export license if Huawei were part of the deal and if the manufacture of the product (or any part of thereof) is based on US software or technology that is subject to export oversight by the United States.

These rules – which require an export license issued by the US administration, even for export from a third country, for products that were manufactured outside the United States, if they are the direct product of US technology that is under oversight – are known as the Foreign Direct Product (FDP) rules. To date, BIS has published 10 different FDP rules that prohibit the export of certain goods manufactured outside of the United States to certain countries, corporations, and end-users.

FDP rules have extraterritorial jurisdiction. They obligate companies that are not American to obtain a US export license for goods that have not been manufactured in the United States. The rules were set up to prevent sensitive US technology reaching problematic countries or users. The United States found that it was not enough just to oversee exports from the US or products that were manufactured in the US, since US interests were not represented by the export control laws of other countries. For example, Israel has a very different approach to China than the United States; Jerusalem has not imposed export restrictions on China similar to those

imposed by Washington. Therefore, FDP rules are designed to ensure that products manufactured using technology that is under US oversight – even those manufactured outside of the United States – are subject to US oversight.

The Violation of FDP Rules

The production of the hard drives that Seagate sold to Huawei used US technology and equipment that is under oversight by virtue of the FDP rule issued in August 2020. Therefore, the sale of these hard drives to Huawei required the approval of BIS. The two other companies that supply hard drives to Huawei announced that they would be suspending their dealings with the Chinese company until BIS issued them an export license.

Nonetheless, Seagate continued to sell huge quantities of the hard drives to Huawei, becoming the company's sole supplier of drives, at the expense of competitors that obeyed US law and stopped selling them. Subsequently, Seagate signed a strategic cooperation agreement with Huawei, making it the company's strategic supplier and giving it preferential status among Huawei's own suppliers. Seagate even provided Huawei with significant lines of credit, without which Huawei would not have been able to complete the purchases.

Israeli Companies Cannot Bury their Heads in the Sand

- The Seagate case is an example of extraterritorial enforcement of American export oversight: enforcement against a Singaporean company for goods that were manufactured outside the United States, in the context of technology that is neither in the vanguard of cutting-edge technology nor of the Chinese threat to the United States. The fine imposed is huge not only because of the sums involved, but also because it made profitable illegal deals into losing propositions. Moreover, the company is now subject to stricter oversight and the threat of heftier sanctions if it violates export restrictions in the coming years.

- The fine and the intensified oversight were imposed on Seagate for a violation that occurred before the significant tightening of export restrictions by the United States in the context of China, which were announced in October 2022, as part of the struggle between the superpowers over access to advanced technologies. Presumably any future violation of the new export restrictions would be met with an even harsher response.
- The case of Seagate is not the only time that the United States has exercised extraterritorial jurisdiction over exports – also in cases outside the context of the FDP rules – against individuals or entities that acted against the interests of the US. For example, BIS also imposed sanctions against two Israeli companies – the NSO Group and Candiru – for allegedly working against United States foreign policy and security interests.
- When it comes to the FDP rules, Israel is very much on the United States radar, since it is in the vanguard of technological advances – including regarding issues that are central to US oversight (such as semiconductors and advanced computing equipment). The Israeli hi-tech industry enjoys close connections with its US counterpart, thanks to research and development centers set up in Israel by US companies, US investment in Israel, and cooperation agreements between companies from both countries. At the same time, Israel also has commercial ties with countries and corporations that are targeted by United States export restrictions, including China. Since Israeli oversight of and restrictions on exports to these countries and corporations are far less strict than those of the United States, Israeli companies could find themselves in violation of FDP rules, even though they have not broken any Israeli laws.
- Israeli companies that viewed the gaps in Chinese and other markets as an opportunity, following the decision by other companies to withdraw from those markets or to significantly scale back their operations due to restrictions imposed by the United States or the European Union, would be well advised to rethink that approach. The US administration has stressed that it views with the utmost severity the fact that Seagate expanded its dealings with Huawei in order to grab the market share of

its competitors, who had obeyed FDP rules and curtailed all activity with Huawei.

A Lesson for Israel's Oversight Authorities

- Israel is entitled to determine its own export restrictions and not impose restrictions identical to those of the United States. At the same time, given the current regime of US export controls, and in light of bilateral strategic, economic, and technological relations, it is in Israel's interests not to be considered problematic territory that enables de facto the flow of US technology in violation of US export restrictions, while clearly harming US interests.
- The Israeli government must find the golden mean. It must enable trade with China while, at the same time stave off the danger of stricter enforcement vis-à-vis Israeli companies, limitations to the flow of technology, knowhow, and investments into Israel, and increased US pressure on Israel. When US House of Representatives Speaker Kevin McCarthy addressed the Knesset in May 2023, he made the connection between technological cooperation between Israel and the United States, and the need for Israel to tighten its oversight of investments by Chinese actors and Chinese access to Israeli technology and infrastructure. His cautionary tone was similar to messages relayed by previous US administrations – Republican and Democrat alike.
- Israel is already exercising restraint when it comes to issuing export licenses for China; it does not issue licenses for defense exports and issues civilian licenses sparingly. Indeed, the Ministry of Economy and Industry demands that all exporters declare in writing while applying for a license that no foreign country has imposed export restrictions on its goods for reexport at a later stage. With the encouragement of the United States, Israel also established and tightened its mechanism for the oversight of foreign investments, implicitly focusing on Chinese investments.
- Israel must inculcate in the local market the fact that Israeli export oversight is not the only oversight that is relevant, and that especially now, Israeli companies must ensure that they meet all the other relevant oversight rules, including those of the United States.

- It is important that Israel maintain open lines of communication with the authorities in the United States, and that it inform Israeli companies of messages relayed by the US about potential concern over activity that violates US oversight rules. It is far better to create a dynamic in which anyone violating these rules is quietly given the opportunity to stop this behavior and rectify the situation – rather than having to intervene retroactively on behalf of Israeli companies once they are already subject to US enforcement measures.
- Activity on the part of oversight authorities in Israel – in a manner that recognizes recent changes in US policy regarding exports of technology but does not bind Israel to it – will help prevent violations by Israeli companies, likely increase protection for companies violating these rules, and bolster US confidence that its technologies are safe in Israeli hands. This could help advance the easing of US export controls to Israel (as in the cases of Japan and Australia) and ease access to US security grants or security procurement from Israeli suppliers.

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