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Regulatory Update

BIS Extends Export Control Restrictions to Transactions Involving Subsidiaries of Listed Parties

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On September 29, the U.S. Department of Commerce's Bureau of Industry and Security (BIS) issued an Interim Final Rule (the Rule) extending export controls applicable to transactions involving parties restricted pursuant to the Export Administration Regulations (EAR). Following the posting of the Rule, restrictions on the provision of items subject to the EAR now extend to transactions involving non-U.S., 50%-or-more-owned affiliates of listed parties.

BIS has long applied a "legally distinct" standard for applying restrictions to subsidiaries and other foreign affiliates of entities restricted under the EAR, such that export-control restrictions did not reach the provision of items to legally distinct entities of listed parties. The Rule thus marks a major expansion of existing export control regulations with far-reaching impacts on private sector compliance. The new standard, which BIS refers to as the "Affiliates Rule," represents the latest in a series of tools implemented by the U.S. government to address the risk of diversion of goods and technology for national security purposes.

The Affiliates Rule

The Affiliates Rule expands existing export-control restrictions to apply to transactions involving an entity 50% or more owned by one or more parties designated on one of three lists identifying individuals, organizations and addresses subject to export, reexport and transfer (in-country) restrictions involving items subject to the EAR: (1) the BIS Entity List; (2) the BIS Military End-User (MEU) List; or (3) certain U.S. Department of the Treasury Office of Foreign Assets Control (OFAC)-listed Specially Designated Nationals (SDNs) subject to export restrictions as specified in Part 744.8 of the EAR.[1]

The Affiliates Rule functions to impose the same restrictions applicable to these listed parties on their subsidiaries and affiliates. Indeed, it operates similarly to OFAC's well-established 50% rule, in which entities owned 50% or more, directly or indirectly, individually or in aggregate, by one or more relevant listed parties are subject to the same restrictions applicable to their listed owners. The Rule employs the exact same language as OFAC has put forth in its own guidance, emphasizing and repeating that the new restrictions "apply to any foreign entity that is owned, directly or indirectly, individually or in aggregate, 50 percent or more by one or more listed entities or unlisted entities that are subject to [the relevant export controls] restrictions based upon their ownership." (15 C.F.R. 744.11.)

In the export controls context, the Rule makes clear that if a subsidiary entity caught by these criteria is owned by multiple entities that are the target of differing export restrictions (for example, one owner is

listed on the Entity List and another is an SDN included in Part 744.8, or two owners are listed on the Entity List but have differing license requirements), the relevant subsidiary is subject to the most restrictive license requirements, license exception eligibility and license review policy applicable to one or more of its owners under the EAR regardless of ownership percentage.

Temporary General License and Savings Clause

While the Rule and its obligations are effective as of its posting in the Federal Register on Sept. 29, BIS has issued a temporary general license (TGL) authorizing certain export, reexport or transfer transactions involving entities caught by the Affiliates Rule for 60 days (i.e., until Nov. 28). The TGL effectively authorizes: (1) exports involving now-caught entities to or within any destination in Country Group A:5 or A:6, pursuant to Supplement No. 1 to Part 740 of the EAR; or (2) exports involving now-caught entities to or within any destination other than Cuba, Iran, North Korea or Syria only if those entities are a joint venture with a non-listed entity headquartered in the United States or Country Group A:5 or A:6 that is not itself subject to the Affiliates Rule. Additionally, a savings clause confirms that shipments of items that were en route aboard a carrier on September 29 can proceed under previous eligibility provided the export, reexport or transfer is completed no later than 30 days from the effective date of the rule (i.e., until October 29).

Significantly Expanded Compliance Obligations

The drastic extension of the applicability of certain export restrictions requires parties to expand counterparty and third-party screening and ownership due diligence efforts, as ownership by any Entity List or MEU List parties (and certain SDNs) may carry newly applicable licensing requirements or other controls. As a reminder, the relevant list-based export restrictions apply if a listed entity is a party to the transaction as defined in the EAR (15 C.F.R. 748.5.), which includes not only the purchaser or end user but also, among others, any intermediate consignee. For example, though, pursuant to the new standard, the subsidiary of a listed freight forwarder may now no longer be permitted to serve as an intermediate consignee of shipments involving export-controlled items. As has always been the case, requirements are enforceable on a strict liability basis, meaning knowledge about ownership is not required to trigger end-user requirements under the EAR.

Significantly, BIS has articulated an additional onerous obligation in the Rule. Through new Red Flag 29, if an exporter, reexporter or transferor has “knowledge” that a foreign-entity party to a transaction has one or more owners listed on the Entity or MEU Lists (or that are unlisted but otherwise subject to license requirements or other restrictions based upon their ownership), there is an “affirmative duty” to determine full ownership information. If a party cannot determine ownership, it must submit a license application to BIS or identify an available license exception based on the restrictions applicable to the listed party. BIS further indicated in the Rule that if BIS has information in its possession to resolve the uncertainty, it will return the application without action and confirm that no license is required.

While recognizing the additional compliance burden associated with this new standard, BIS indicates in the Federal Register notice promulgating the Rule that it believes companies’ previous experience complying with OFAC’s 50% rule should ease the adoption of appropriate measures. While companies may be able to leverage certain practices they already employ to comply with the OFAC 50% rule, it is important to consider that the scope of activities captured under OFAC and EAR requirements differ, as the EAR captures all *items* subject to U.S. jurisdiction while OFAC regulations apply to U.S. *persons*. This means that restrictions under the EAR will reach transactions and suppliers wherever originated or located regardless of any other U.S. nexus that would bring transactions in-scope for OFAC jurisdiction. Compliance with the Rule may therefore require a vendor procurement overhaul for persons who deal in items subject to the EAR to account for ownership, as well as significantly increased due diligence efforts.

In addition, companies that have carefully built relationships with minimally engaged affiliates of listed parties that are now caught under the Affiliates Rule will likely have to significantly alter their current

operations. BIS asserts that the Rule will address diversionary efforts as BIS previously faced too high an administrative burden to add all relevant subsidiaries to the relevant lists, allowing transactions with certain subsidiaries to fall through the cracks. However, the eschewing of BIS' previously methodical approach to adding subsidiaries of companies perceived by the U.S. government to be risks to national security significantly circumscribes currently permissible commercial activity and will require companies to critically examine their ongoing operations.

Conclusion

On October 9, BIS added 29 entries to the Entity List in the first revisions to the Entity List since the promulgation of the Rule. In the Federal Register notice revising the Entity List to account for these new entries, BIS explicitly reminds readers that "Entity List license requirements and other Entity List restrictions also apply to any foreign entity that is owned, directly or indirectly, individually or in aggregate, 50 percent or more by one or more listed entities" — repeating and emphasizing the scope of the Rule. (90 Fed. Reg. 48,193 (Oct. 9, 2025).) To assist with questions of application, BIS has issued new and revised guidance in the form of FAQs, and the Federal Register notice will certainly be parsed for insight into BIS' intent in certain aspects of the Rule.

In sum, the Rule will not only require heightened screening with more sophisticated vendors accounting for entity ownership, but also increased due diligence efforts for a wide range of parties involved in the export of U.S.-origin goods and technology. Even the most sophisticated companies will likely need to update internal compliance processes for screening counterparties and review their existing counterparty relationships and pending export activity for compliance with the new standard.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] The Entity List identifies parties reasonably believed to be involved, or to pose a significant risk of being or becoming involved, in activities contrary to the national security or foreign policy interests of the United States. (Supplement No. 4 to Part 744, Title 15.) The MEU List identifies foreign parties as military end users that are subject to license requirements. (Supplement No. 7 to Part 744, Title 15.) Part 744.8 of the EAR imposes export restrictions on SDNs identified under certain OFAC sanctions programs.

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