UNITED STATES DEPARTMENT OF COMMERCE
Bureau of Industry and Security
Washington, D.C. 20230

September 14, 2009

A = Company A, which is located outside the United States

B = Company B, which is also located outside the United States

Dear

I am writing in response to your email dated June 16, 2009 requesting advice concerning the application of the "secondary incorporation rule" in calculating the *de minimis* ratio of controlled U.S.-origin parts at the aircraft level. In your email, you explain that A provides avionics equipment, which often incorporates controlled U.S.-origin parts, to its customer B, for incorporation into the civil aircraft that company manufactures. In your email, you specifically ask the Bureau of Industry and Security (BIS) to confirm that B does not need to consider the amount of U.S.-origin components incorporated into A's equipment in order to compute the *de minimis* ratio at the aircraft level, and you also ask whether BIS intends to modify the Export Administration Regulations (EAR) to better document the "secondary incorporation rule". In a second e-mail dated July 8, 2009, you described the products that A supplies to B by stating "As part of our package we provide cockpit avionics." Based on the information that you provided, we are unable to determine whether an aircraft manufacturer located outside the United States would have to include the amount of U.S.-origin components in the equipment that it purchases from A when determining the amount of U.S.-origin content of the aircraft. We can, however, provide you with more detailed guidance regarding the criteria that BIS would apply in evaluating such equipment.

When determining whether an item made outside the United States is subject to the EAR because it contains more than a *de minimis* level of U.S.-origin content, BIS has historically followed a practice often referred to as the "second incorporation principle". Although the EAR generally apply to foreign-made items that incorporate more than a *de minimis* level of controlled U.S.-origin content, the second incorporation principle excepts from EAR control certain U.S.-origin components of the foreign-made items.

The second incorporation principle generally states that U.S.-origin components that are incorporated into a foreign-made discrete product will not be counted in *de minimis* calculations when the foreign-made discrete product of which they are part is itself incorporated into a subsequent foreign-made item (*i.e.*, after the second foreign incorporation). This principle may be employed only if a "first" incorporation has actually been completed, resulting in a foreign-made discrete product. In other words, the U.S.-origin components must be incorporated into a "first" discrete product before a

"second" incorporation can occur, and the level of U.S.-origin content in the "first" discrete product must be considered until that product's "second" incorporation is complete.

The purpose of the second incorporation principle is to minimize the burden on foreign parties who purchase foreign-made products and typically have little or no means to determine how much, if any, U.S.-origin content those foreign-made products contain. Whether a particular foreign-made item incorporating U.S.-origin components is a discrete product depends on the facts of a particular case, and it is helpful to keep the purpose of the second incorporation principle in mind when evaluating a particular situation. Evidence that a foreign-made item was purchased in an arm's length transaction or evidence that the item is regularly sold by itself, either as a stand alone product or as an identifiable replacement for a particular product, would tend to indicate that the item is a discrete product. For example, if B purchased a flight data recorder regularly sold by itself as a stand alone product through an arm's length transaction before incorporating the recorder into an aircraft, the U.S.-origin components of that recorder would not need to be taken account of when determining the amount of U.S. content in the aircraft. Alternatively, if the purchaser of a foreign product in contemplation of further manufacturing operations participated in the design or manufacture of the product or chose the parts that were to go into the foreign product, then that indicates that the foreign-made product was in fact part of a larger manufacturing or production process and therefore not a discrete or completed product when further processing or manufacturing commenced. For example, if B helped A design a flight data recorder specifically for a B aircraft or chose the components that were to go into the recorder, then those actions by B would be indications that the flight data recorder is not a discrete product.

The second incorporation principle may not be applied to exempt from EAR control those U.S.-origin components for which there is no *de minimis* level. One group of such components is directly relevant to avionics and aircraft. In accordance with § 734.4(a)(3) of the EAR, there is no *de minimis* level for foreign-made commercial primary or standby instrument systems that integrate QRS11-00100-100/101 Micromachined Angular Rate Sensors, for commercial automatic flight control systems that integrate QRS11-00050-443/569 Micromachined Angular Rate Sensors, or for aircraft incorporating any of these QRS11 sensors.

We hope that the above explanation will help A and its customers better understand how to apply the second incorporation principle. We do not currently have plans to amend the EAR to highlight the second incorporation principle, but we are evaluating the possibility of publishing an advisory opinion concerning it on our Web site.

Should you have any questions regarding this issue, please contact the Regulatory Policy Division at (202) 482-2440, or at rpd2@bis.doc.gov

Sincerely,

/Hillary Hess/

Hillary Hess
Director, Regulatory Policy Division
Office of Exporter Services