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Proposed Export Control Legislation Would Place New Restrictions on Technology Transfer, Even Within the U.S.

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On February 15, 2018, U.S. House of Representatives Foreign Affairs Committee Chairman Ed Royce (R-CA) introduced the Export Control Reform Act of 2018 ("the Act"), which could have a significant impact on restricting access to U.S. technology, even within the U.S.[1] The Act responds to bipartisan concerns regarding the transfer and use of domestic technology and expands the scope of U.S. export controls. Companies should be aware that the Act would increase compliance complexity and heighten enforcement risk.

The View from Washington

Introduction of this proposed legislation comes at a time when Congress and the administration are grappling with how to address concerns that the U.S. may be beginning to lose its global competitive edge in leading-edge technologies, particularly to China. Chairman Royce stated, "[i]n recent years, the government in Beijing has increasingly forced U.S. companies to hand over sensitive technology as a cost of doing business in China," adding that such policies "are undermining our national security and our economy."[2] In August 2017, the Trump Administration initiated an investigation under Section 301 of the Trade Act in response to allegations of such practices, the results of which are expected in the coming months.

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The Act places export control reform squarely within the broader Congressional debate over CFIUS reform and how to balance foreign direct investment with preservation of U.S. technological leadership. The proposed Foreign Investment Risk Review Modernization Act ("FIRRMA") would expand the jurisdictional ambit of the Committee on Foreign Investment in the United States ("CFIUS") to capture licensing arrangements, certain joint ventures, and investments in U.S. technology companies — with no de minimis "safe harbor" exception for passive minority investments.[3] Last week, CFIUS ordered Qualcomm to postpone its shareholder meeting to prevent a vote on Broadcom's hostile bid, stating, "China would likely compete robustly to fill any void left by Qualcomm as a result of this hostile takeover."[4]

In light of growing global concerns over how to strike the right balance between foreign direct investment and national security interests, the Act seeks to bolster the U.S. export control architecture itself, forcing prospective foreign investors in U.S. technology companies to face greater regulatory headwinds.

Features of the Export Control Reform Act

The Export Control Reform Act would expand the scope of what is controlled and potentially subject to export licensing. Following are some of its major features:

- **Restrictions on Foreign-Owned U.S. Companies.** Companies organized in the U.S. but owned by foreign persons very well could first have to be approved under an export license in order to receive U.S. technology. This is because such corporations or other legal entities — such as U.S. subsidiaries — would be considered a "United States person" only if U.S. citizens or U.S. nationals "own, directly or indirectly, more than 50 percent of the outstanding capital stock or other beneficial interest in such legal entity."[5] Otherwise, transactions with U.S.-based subsidiaries of foreign parent companies would be considered "exports," even though those companies are located in the U.S.
- **Capture of Broader Forms of Technology.** What constitutes "technology" would also be construed more broadly, specifically to include "information at whatever stage of its creation, such as foundational information and know-how."[6] Currently, "technology" is defined within the parameters of that information which is "necessary" for certain identified activities specifically in connection with an "item."[7]

Diluting that definition to also include information while an item is in the development stage, or information more generally, broadens the scope of what is covered and in turn what may trigger the need for an export license. This focus on "know-how" tracks the rising importance of potential transfers of know-how in CFIUS reviews and presidential actions, including in President Trump's decision to block the acquisition of Lattice Semiconductor Corp. in September 2017.

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- **Addition of Items to be Controlled.** There would be an "ongoing interagency process to identify emerging critical technologies that are not identified in any list of items controlled for export under U.S. law or regulations, but that nonetheless could be essential for maintaining or increasing the technological advantage of the U.S."[8] This would include requiring agencies such as the Commerce Department Bureau of Industry and Security ("BIS") to "publish proposed regulations for public comment that would control heretofore unlisted emerging critical technologies."[9] Doing so could result in greater export license requirements in areas such as artificial intelligence, surveillance and cybersecurity.
- **Expansion of Reasons for Control.** The concept of "dual-use" would be expanded to include terrorism and weapons of mass destruction-related applications to modernize export controls in response to newer forms of threats.[10] There would also be express recognition of the importance of human rights and of protection of the nation's critical infrastructure. The Act emphasizes that export controls should be coordinated with multilateral export regimes, as "[e]xport controls that are multilateral are most effective."[11] In this respect, the Act tracks FIRRMA's focus on coordinating CFIUS reviews with allies' national security review regulators to better protect against adversaries.

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balance foreign direct investment with preservation of U.S. technological leadership.

Impacts of the Proposed Legislation

Jurisdiction: The Export Control Reform Act would have a significant impact on BIS's jurisdiction. A fairly unique feature of U.S. export controls is that the controls continue to travel with the items extraterritorially, such that even when non-U.S. persons seek to reexport such items from one foreign country to another, those items are still subject to U.S. export controls. By raising the bar for when a company is considered a U.S. person, the Act would broaden the scope of what transactions are considered exports, potentially imposing licensing requirements even when transactions occur within the U.S.

Enforcement: The Act would also have a meaningful impact on enforcement. Currently, U.S. companies have to obtain export licenses, e.g., when providing access to controlled technology to foreign national employees in the U.S. as doing so is a "deemed export" to that individual's most recent country of citizenship or permanent residency.[12] However, for the U.S. government to verify compliance with those rules requires penetrating into an enterprise to understand what foreign national employees the entity has, what countries they are from, and what technology they have access to. By treating the enterprise itself as a foreign person and simply knowing what foreign-owned companies are in the U.S. and who is doing business with them, BIS and other agencies will more readily be able to check whether applicable licenses for transfer of controlled technology have been obtained.

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Penalties: Under the Export Control Reform Act, civil penalties for each export violation may be up to $250,000 or twice the value of the transaction, consistent with the current rules. Criminal penalties for each "knowing" violation would be codified at

$500,000 or five times the value of the export, as well as the possibility of imprisonment up to five years. Those for each "willful" violation would be set at $1 million or five times the value of the export, as well as the possibility of imprisonment up to 10 years. In all cases, penalties can also be non-financial, including revocation of export licenses and a bar on export privileges.[13]

Key Takeaways

- The U.S. government is actively looking at what tools can be deployed to stave off transfer of U.S. technology, particularly to China, to try to protect a competitive advantage and U.S. military technological superiority.
- One option is to bolster the export control architecture itself, by expanding the definition of export to include certain transactions within the U.S. and to capture more types of emerging technologies.
- Operating companies and private equity sponsors will need to assess the impact that increased export license requirements will have on their current and prospective value chain, and prepare to navigate more complex compliance requirements.
- Enforcement risk in what heretofore has been a fairly discrete area of export controls could very well increase, as BIS and other agencies more readily will be able to track what foreign-owned companies exist in the U.S. and who is doing business with them.

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1. Export Control Reform Act of 2018, H.R. 5040, 115th Cong. (2018).↩

2. Press Release, Foreign Affairs Committee, Royce Introduces Bipartisan Export Control Reform Bill (Feb. 15, 2018).↩

3. Foreign Investment Risk Review Modernization Act of 2017, H.R. 4311, 115th Cong. (2017).↩

4. Letter from Aimen N. Mir, Deputy Assistant Secretary of Investment Security, U.S. Department of the Treasury (Mar. 5, 2018) (https://www.sec.gov/Archives/edgar/data/804328/000110465918015036/a18-7296_7ex99d1.htm#Exhibit99_1_081114).↩

5. Export Control Reform Act of 2018 § 2.12.B.↩

6. Id. at § 2.9.A.ii.↩

7. 15 C.F.R. § 772.1.↩

8. Export Control Reform Act of 2018 § 109.a.↩

9. Id. at § 109.b.2.↩

10. Id. at § 2.2.↩

11. Id. at § 102.4.↩

12. 15 C.F.R. § 734.13 (b).↩

13. Export Control Reform Act of 2018 §110.↩

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