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As National Security Concerns Mount, the U.S. Government Announces Proposal to Regulate Emerging Technologies

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On November 19, 2018, the U.S. Department of Commerce, Bureau of Industry and Security ("BIS"), issued an advanced notice of proposed rulemaking initiating the process to regulate exports of "emerging" technologies in areas such as artificial intelligence, biotechnology, navigation and surveillance. The move represents the first step in what could be a marked and meaningful expansion of U.S. export controls and stands to materially impact many types of transactions involving technology companies, including M&A, investments, joint ventures, strategic alliances, and services and licensing arrangements. Industry has until December 19, 2018, to express its views to try to shape the debate before the rulemaking process moves forward and restrictions potentially start to take root.

> **The move stands to materially impact many types of transactions involving technology companies**

The View from Washington

BIS's announcement represents the latest front in the Trump administration's whole-of-government effort to safeguard technologies that "*are essential to the national security of the United States*." The recently enacted National Defense Authorization Act ("NDAA") contained the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"), which significantly expanded the scope of foreign investment transactions subject to review by the Committee on Foreign Investment in the United States ("CFIUS"). The NDAA also contained the Export Control Reform Act of 2018 ("ECRA"), which required BIS to upgrade and modernize U.S. export controls.

> **These BIS export controls, once fully implemented, will factor significantly into the CFIUS national security review process**

These laws enhance measures to prevent foreign parties from gaining access to sensitive U.S. technology both when they seek to acquire ownership interests in U.S. companies, as well as outside the acquisition context via the variety of activities that can constitute exports. These BIS export controls, once fully implemented, will factor significantly into the CFIUS national security review process, in particular under its recently enacted "pilot program" regulations regarding investments in U.S. "critical technology" companies.

Major Features of the Proposal

There are five key reasons why the proposed rulemaking is noteworthy:

1. The emerging technologies include those that have been the focus of intense investor interest, particularly among venture capital and private equity funds.

BIS has identified 14 proposed "*representative general categories of technolog*y" for which it currently seeks to assess whether there should be enhanced export controls. The categories implicate technologies with applications in, for example, autonomous driving, cloud computing, facial recognition, neural networks and 3D printing. The technology categories are:

- Additive manufacturing
- Advanced computing
- Advanced materials
- Advanced surveillance
- Artificial intelligence

- Biotechnology
- Brain-computer interfaces
- Data analytics
- Hypersonics
- Logistics
- Microprocessors
- Position, Navigation and Timing (PNT)
- Quantum information and sensing
- Robotics

The complete list is available here.

Export controls extend far beyond the physical shipment of goods out of the U.S.

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2. Export controls can sweep broadly and capture many sorts of commercial activities.

Export controls extend far beyond the physical shipment of goods out of the U.S. Under U.S. law, an "export" can also include electronic transfers of technical information such as code and specifications; outsourcing of design and production; and technical training. For example, though merely using software in a cloud currently may not be captured for these purposes, an "export" can include foreign remote access to source code and technical data such as algorithms on servers located in the U.S. and the release of technical information to foreign nationals, including in the U.S.

These restrictions can prompt companies to implement significant security measures, such as access restrictions for electronic data stored on shared drives and other systems. Export controls can mandate U.S. government licensing without which activities implicating access to controlled technology may not commence or continue. They can also mean that sales and the provision of services to certain customers or markets, or the employment of or contracting with certain foreign nationals, all are prohibited without prior authorization.

The regulations likely will place restrictions on a variety of business arrangements

> 3. The proposed regulation should be viewed within the larger effort to counter China's "whole-of-government" effort to acquire "bleeding-edge" U.S. technologies.

While the controls over "emerging" technologies, once fully implemented, would apply to all exports regardless of the country or foreign nationals involved, as a practical matter it should be viewed in the context of U.S.-China strategic competition. Notably, while ECRA affords BIS discretion in what licensing requirements to impose in this area, it generally requires at a minimum that BIS restrict exports to countries subject to a U.S. embargo, including an arms embargo — a category that includes China.

More generally, the U.S. government is concerned about China's Made in China 2025 initiative to gain a competitive edge in advanced technologies such as 5G, and it has imposed tariffs on half of China's imports to the United States on the basis that the Chinese government and its companies force U.S. companies to transfer to them technology and engage in theft of U.S. intellectual property. BIS's effort is one more prong of a wider strategy to try to blunt China's progress.

> 4. BIS will also be issuing a rulemaking proposing to control "foundational" technologies.

In addition to "emerging" technologies, ECRA requires the Department of Commerce to identify, and impose export controls on, "foundational" technologies, on which BIS has indicated it will separately issue a similar proposed rulemaking at a later date. Under the current regulatory architecture, "technology" is controlled on the basis it constitutes information that is "necessary," for example, to develop, produce, or use a particular item identified on the export control lists. Now there is an impetus mandated by Congress to increase the reach of regulation to nascent technologies at earlier stages of creation, even before they may be connected with identified items.

> 5. The public has less than 30 days to comment.

The advanced notice of proposed rulemaking provides until December 19, 2018, to submit comments, which the U.S. government will use to identify and describe emerging technologies. BIS has indicated that it welcomes comments on, for example, "*the impact specific emerging technology controls would have on U.S. technological leadership*"and"*the stage of development or maturity level of an emerging technology that would warrant consideration for export control*." Accordingly, the comment period provides interested parties a short window of opportunity to try to help shape the contours of the technologies at issue and the rules that will apply to them.

Key Takeaways

- Private equity and other investors should consider how this potential forthcoming new regulatory landscape may impact both prospective and current investments, as well as potential exits.
- If implemented, the regulations likely will place restrictions on a variety of business arrangements where foreign parties may be considered to gain access to controlled U.S. technology, including on early-stage technology ventures.
- Though the exact timing is unclear, after the comment period BIS will proceed with the rulemaking process and may do so in a manner that ultimately results in more restrictive export rules and more complex compliance requirements.
- Even before the regulations are finalized, these efforts signal how U.S. policymakers and government agencies already are apt to scrutinize technology investments and acquisitions, particularly from China.

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Suggested Reading

- 15 February 2019 Article Economic Sanctions and Export Controls Review Q4 2018
- 23 January 2019 Press Release Kirkland Represents Nordic Capital in its Acquisition of Orchid Orthopedic Solutions
- 22 January 2019 Kirkland Alert EU Poised to Enact a “European CFIUS”: Four Considerations for Cross-Border M&A