

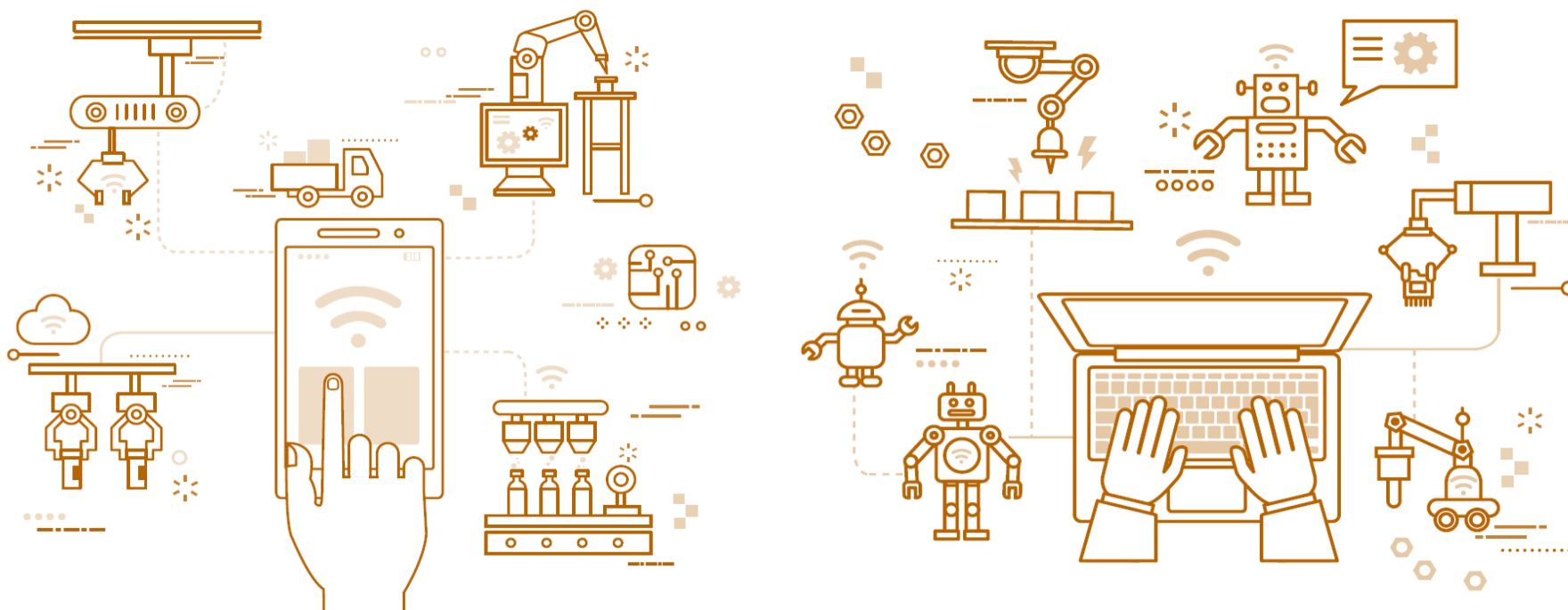
Practical Guidance On Managing New Foreign Investment Review Requirements and Export Controls on Emerging Technologies

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New and Emerging Restrictions on Foreign Access to U.S. Technology

Congress and the Trump administration have taken new and significant actions to limit foreign access to U.S. technology in response to perceived threats to U.S. national security posed by such transfers.

- Steps to stem the flow of U.S. technology abroad include, among others:
 - Review and restriction of non-immigrant visas;
 - Outreach to non-U.S. universities to encourage tighter controls on U.S. technology;
 - Procurement bans on technology from companies alleged to be involved espionage; and
 - Designation of particular non-U.S. companies (including JVs of U.S. companies) for special licensing requirements.
- The most far-reaching, significant changes to date include the Foreign Investment Risk Review Modernization Act (“**FIRRMA**”) and passage of Export Controls Reform Act (“**ECRA**”).

CFIUS: Overview and FIRREA

- The Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”) is an inter-agency committee authorized to review the national security implications of transactions that could result in control of a U.S. business by a foreign person.
- The Committee was established in 1975 and, before August 2018, was last reformed in 2007.
- CFIUS is authorized to block covered transactions or impose measures to mitigate any threats to U.S. national security.
- Many stakeholders, including those in U.S. national security agencies, saw CFIUS as antiquated and unable to reach a range of investments that resulted in foreign person access to critical technologies.
- Critically, **FIRREA** expanded the jurisdiction of CFIUS to review foreign person involvement in **non-controlling, non-passive** investments in U.S. businesses that deal with **critical infrastructure, critical technology**, or the **sensitive personal data** of U.S. citizens, and modified the process for reviewing these transactions.

Permanent CFIUS Member Agencies

1. Treasury (chair)
2. Commerce
3. Defense
4. Energy
5. Homeland Security
6. Justice
7. State
8. OSTP
9. USTR

Observer CFIUS Agencies

1. CEA
2. HSC
3. NEC
4. NSC
5. OMB

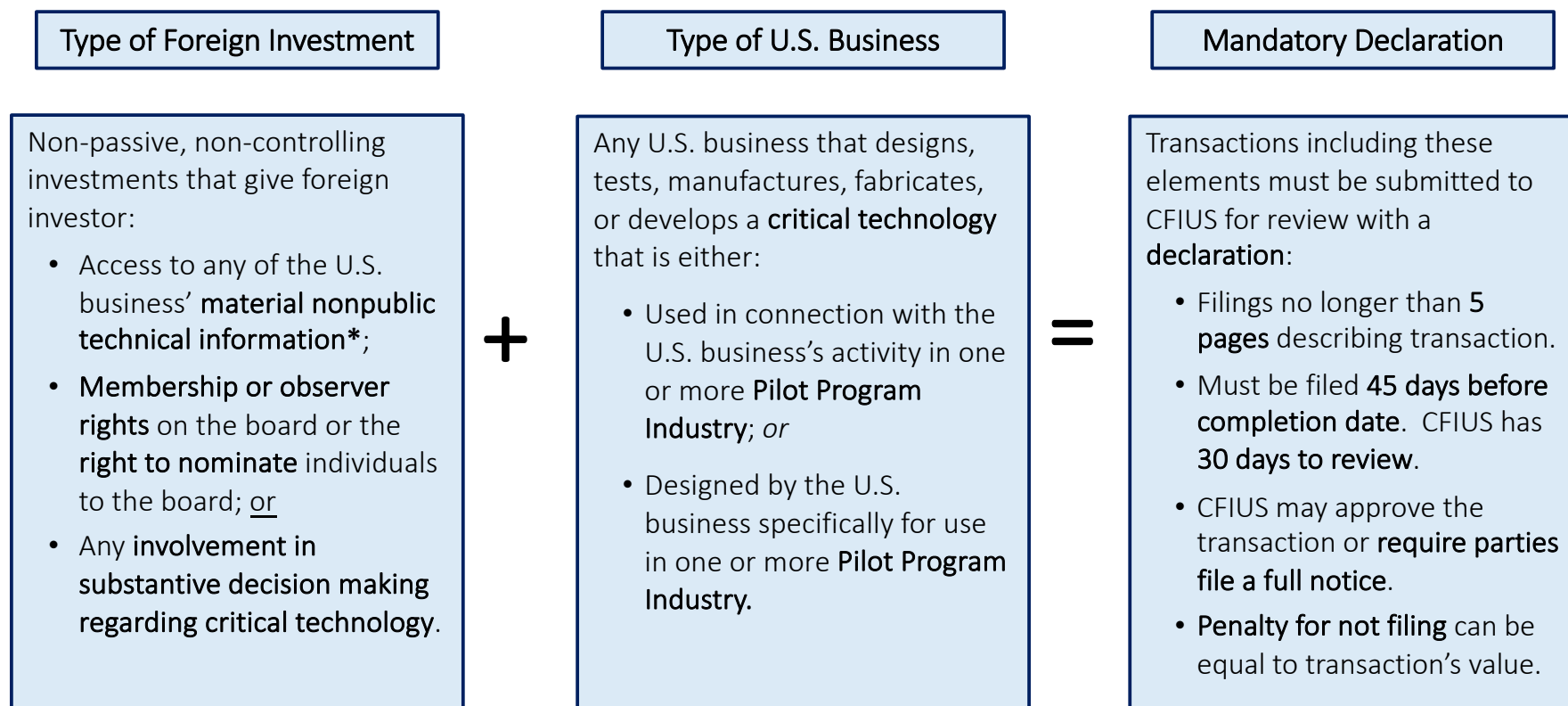
Other agencies may be added for specific reviews.

CFIUS: Pilot Program for “Critical Technology” Transactions

- FIRRMA granted CFIUS the authority to examine the national security implications of a foreign acquirer’s non-controlling investments in U.S. businesses that deal with “**critical technology**.”
- Critical technology includes technology subject to the EAR or the ITAR and the **emerging** and **foundational technologies** defined under ECRA.
- On November 10, CFIUS launched a pilot program implementing these new controls designed to review and restrict foreign technology transfers occurring through investments and other transactions.
- Under the program, non-U.S. investors seeking certain types of non-controlling investments in U.S. companies involved in making or designing certain critical technologies for use in **27 specific industries** will need to obtain CFIUS approval for transaction.
- CFIUS review of Pilot Program transactions are **mandatory**.

Pilot Program Industries	
1. Aircraft Manufacturing	15. Powder Metallurgy Part Manufacturing
2. Aircraft Engine and Engine Parts Manufacturing	16. Power, Distribution, and Specialty Transformer Manufacturing
3. Alumina Refining and Primary Aluminum Production	17. Primary Battery Manufacturing
4. Ball and Roller Bearing Manufacturing	18. Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing
5. Computer Storage Device Manufacturing	19. Research and Development in Nanotechnology
6. Electronic Computer Manufacturing	20. Research and Development in Biotechnology (except Nanobiotechnology)
7. Guided Missile and Space Vehicle Manufacturing	21. Secondary Smelting and Alloying of Aluminum
8. Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing	22. Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing
9. Military Armored Vehicle, Tank, and Tank Component Manufacturing	23. Semiconductor and Related Device Manufacturing
10. Nuclear Electric Power Generation	24. Semiconductor Machinery Manufacturing
11. Optical Instrument and Lens Manufacturing	25. Storage Battery Manufacturing
12. Other Basic Inorganic Chemical Manufacturing	26. Telephone Apparatus Manufacturing
13. Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing	27. Turbine and Turbine Generator Set Units Manufacturing
14. Petrochemical Manufacturing	

CFIUS: FIRMA Pilot Program Formulation



* information "not available in the public domain [that] is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods." 31 C.F.R. § 801.208(a)

Export Controls: Export Control Reform Act of 2018 (ECRA)

- Original goal of national security stakeholders was to expand CFIUS jurisdiction to also cover outbound flows of technology (e.g., IP licensing agreements, U.S. joint ventures in non-U.S. companies, and manufacturing outsourcing).
- In fact, many advanced technology exports are already regulated by the Departments of Commerce and State. Rather than create redundant controls, these stakeholders and Congress were persuaded to strengthen U.S. export control law - The Export Control Reform Act of 2018 (ECRA)
 - New law enforcement powers (e.g., wire taps)
 - Expansion of criteria to evaluate licenses (e.g., USG can dig deep into ownership of companies receiving U.S. technology; defense industrial base of the U.S.)
- The Export Control Reform Act of 2018 (ECRA) charged the Department of Commerce to lead an interagency review to identify **emerging** and **foundational technologies** that were not already subject to U.S. export controls.
- Once new technologies are identified, they will become CFIUS “**critical technologies**” and will trigger foreign investment review under certain circumstances.

CFIUS and Export Controls: What is a “critical technology”?

CFIUS Regulations, 31 C.F.R. 800.209 The term *critical technologies* means the following:

- (a) Defense articles or defense services included on the **United States Munitions List** set forth in the International Traffic in Arms Regulations (**ITAR**) (22 CFR parts 120-130).
- (b) Items included on the **Commerce Control List** set forth in Supplement No. 1 to part 774 of the Export Administration Regulations (**EAR**) (15 CFR parts 730-774), and controlled -
 - (1) Pursuant to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology; or
 - (2) For reasons relating to regional stability or surreptitious listening.

...

- (f) **Emerging** and **foundational** technologies controlled pursuant to section 1758 of the Export Control Reform Act of 2018.

Export Controls: Key Agencies



Dept. of Commerce **BIS** regulates exports of **dual-use** goods, technology, and software, and some military items, regulated by the **Export Administration Regulations** and described on the Commerce Control List (CCL).

- Items “**subject to the EAR**” include U.S.-origin items, items located in the U.S., foreign-made items incorporating more than a minimal amount of U.S.-origin content, and foreign-made direct products of certain U.S.-origin technology and software.



Dept. of State **DDTC** regulates exports of **defense articles**, including technical data, and **defense services** regulated by the **International Traffic in Arms Regulations (ITAR)** and described on the United States Munitions List (USML).

- Non-U.S. origin items incorporating ITAR-controlled items or produced from ITAR-controlled technology are also subject to the ITAR.

Key Export Control Concepts

- Generally, export controls can export or transfer of items located in the United States to foreign countries and the release of such items to foreign persons wherever located.
- U.S. export controls **follow the item (including technology)** and apply to:
 - U.S. persons, wherever located;
 - Non-U.S. persons receiving controlled items in the U.S.;
 - Non-U.S. persons receiving controlled U.S.-origin items outside of the U.S.;
 - The shipment or transmission of an item from the U.S. to another country
 - The re-export of controlled U.S.-origin items from one non-U.S. country to another;
 - The transfer of a controlled U.S.-origin item from one non-U.S. person to another.
- The most counterintuitive type of export is a **deemed export**. If you are a U.S. person working with a foreign person and you release or share technology or other controlled items the agencies *deem* this to be an export to the foreign person's home country.
- Deemed exports can also occur if you provide **visual access** (think facility tour) or oral access (think phone call) to a foreign person and she can glean technical information from what she sees.

What kinds of technology are subject to export licensing requirements?

- **“Technology”** Information necessary for the **“development,” “production,” “use,”** operation, installation, maintenance, repair, overhaul, or refurbishing (or other terms specified in ECCNs on the CCL that control “technology”) of an item.
- **“Development”** is related to all stages prior to serial production, such as: design, design research, design analyses, design concepts, assembly and testing of prototypes, pilot production schemes, design data, process of transforming design data into a product, configuration design, integration design, and layouts.
- **“Production”** means all production stages, such as: product engineering, manufacture, integration, assembly (mounting), inspection, testing, and quality assurance.
- **“Use”** means operation, installation (including on-site installation), maintenance (checking), repair, overhaul, and refurbishing.
- And sometimes other types of technology and data.

How do you know if export controls apply to your technology?

- Understand what is being shared and how.
- Review the Commerce Control List and United States Munitions List (“USML”) to determine whether the technology is specifically described:
 - Classification of items subject to the EAR is determined by matching the item to a description provided in the Commerce Control List (“CCL”).
 - Each item description has an Export Control Classification Number (“ECCN”) that indicates the controls applicable to the item’s export.
 - Classification of items subject to the ITAR is determined by matching the item description to a description provided on the USML.

Licensing Requirements for Certain Types of Technology

For example:

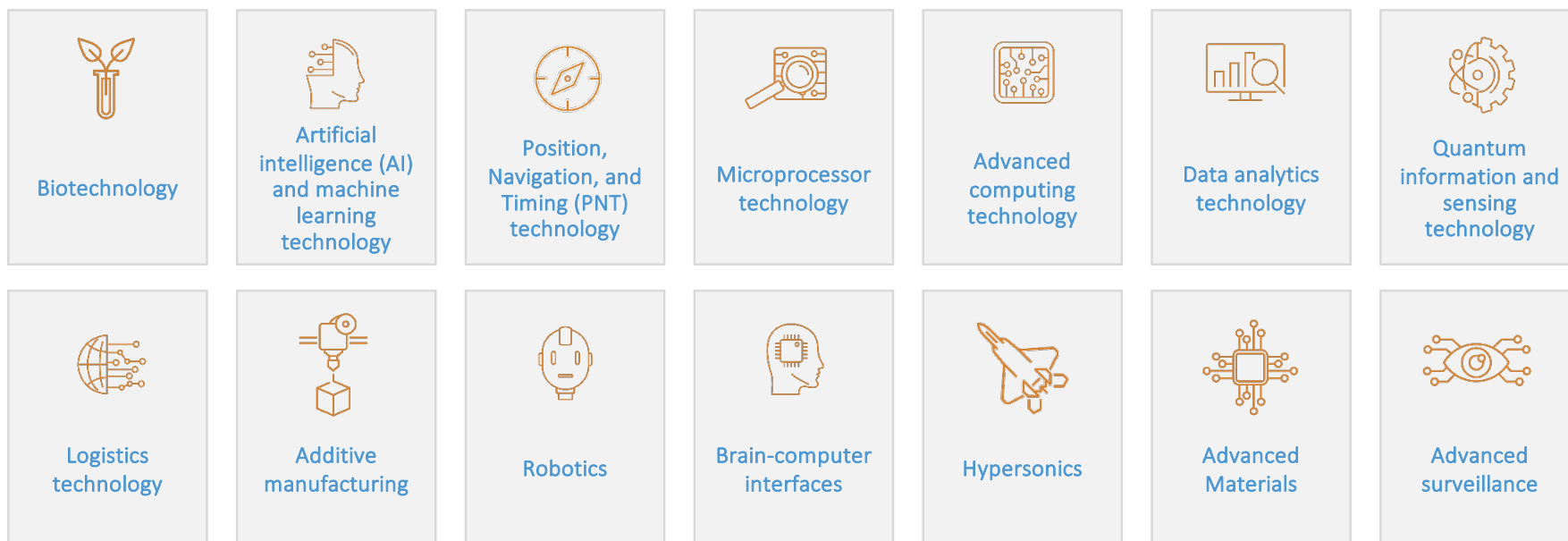
- 3E001 “Technology” according to the General Technology Note for the “**development**” or “**production**” of equipment or materials controlled by 3A (except 3A980, 3A981, 3A991, 3A992, or 3A999), 3B (except 3B991 or 3B992) or 3C (except 3C992).
 - a.1. Integrated circuits designed or rated as radiation hardened to withstand any of the following:
 - a.1.a. A total dose of 5×10^3 Gy (Si), or higher;
 - a.1.b. A dose rate upset of 5×10^6 Gy (Si)/s, or higher; or
 - a.1.c. A fluence (integrated flux) of neutrons (1 MeV equivalent) of 5×10^{13} n/cm² or higher on silicon, or its equivalent for other materials.

What is an “Emerging” Technology?

- None were specifically described in the legislation
- By definition, they must be “essential to the national security of the United States” and not already identified on Commerce Control List of the Export Administration Regulations
- ECRA requires interagency process led by Commerce, with participation from Defense, Energy, State, and other relevant agencies.
- Sources of information:
 - Technical Advisory Committees,
 - Classified information,
 - Publicly available information, and
 - Information gathered from CFIUS process.
- Department of Commerce is required to report to Congress every six months on its efforts to identify emerging technologies.

What Is An “Emerging” Technology?

A November 2018 Advanced Notice of Proposed Rule Making (ANPRM) Identified Fourteen Representative Technology Categories



New controls are coming, but many advanced technologies are already “critical technologies” for CFIUS purposes

Some Current AI Technology Controls

For example: Neural ICs and Neural Computers are already listed on the Commerce Control List, Supp. No. 1 to 15 C.F.R. 774, and specific applications of AI may be ITAR-controlled.

3A001 Electronic items as follows (see List of Items Controlled).

a.9. Neural network integrated circuits;

3E001 “Technology” according to the General Technology Note for the “development” or “production” of equipment or materials controlled by 3A ...

4A004 Computers as follows (see List of Items Controlled) and “specially designed” related equipment, “electronic assemblies” and “components” therefor.

b. ‘Neural computers’;

4D001 “Software” as follows (see List of Items Controlled).

a. “Software” “specially designed” or modified for the “development” or “production”, of equipment or “software” controlled by ... 4A004.

Other AI technologies might be controlled. *as applied:*

CATEGORY XI—MILITARY ELECTRONICS

*(b) Electronic systems, equipment or software, not elsewhere enumerated in this subchapter, specially designed for intelligence purposes that collect, survey, monitor, or exploit, or analyze and produce information from, the electromagnetic spectrum (regardless of transmission medium), or for counteracting such activities.

Practical Considerations: Preparing for New Controls

Map the technology being developed and used in your organization

Identify technologists who are good communicators to act as sounding boards and interlocutors with technology and business colleagues.



Work with technologists to help map the technologies being developed and used by your company. Especially for start-ups and for companies working with technologies that are not yet subject to control, this work may be especially time consuming, but is critical.



Mapping questions



Which business lines are using which technologies?



Which facilities are they used in if company has more than one facility?



Does the company have foreign national employees, and, what kinds of technology do they have access to?



How is technology managed in your IT network?



For technologies more likely to be deemed “emerging” what is your R&D supply chain?

Practical Considerations: Preparing for New Controls Rulemakings and Briefings

Participate in proposed rulemakings

- Commerce has authority to introduce new controls on emerging technologies without public comment, but Commerce is highly likely to request input on the identification of emerging technologies and on types of licensing requirements going forward.
- Approach proposed rule making constructively and with good information. Commerce may really want (and definitely needs) input to fashion better regulations and controls.
- Commerce regularly meets privately with companies and others that might have specific insight to share. **Key Tips:**
 - Commerce especially appreciates hearing from non-lawyers and lobbyists, so bring the lawyers and lobbyists, but make sure your technologists and business leads are ready to brief and respond to questions.
 - Information on foreign availability of technology and domestic competition is especially helpful.
 - If making a claim regarding the impact of controls on your business, be prepared to support the claim with concrete numbers.

Practical Considerations: Operating Under New Controls

Operating Under New Controls

- Export controls may limit technology transfer under a wide range of agreements, not just joint venture agreements – e.g., IP licensing-, sales-, and supplier agreements may all be impacted
 - In your drafting, clearly allocate responsibility/risk for evaluating controls and preparing licensing submissions, and the potential that licenses may not be granted
- Especially for emerging technologies, new export controls are likely to require companies to provide additional information in licensing submissions
 - Strengthen diligence procedures on potential counterparties: submissions may require detailed ownership information
 - Work with business teams to document information they have regarding foreign availability and domestic competitors
- Contingency plan for possibility that BIS will not grant licenses for certain foreign national employees or exports to countries subject to embargoes (e.g., China)

Practical Considerations: Deal Making - Structure

- Especially in competitive bidding/auction processes, foreign person status of investor and co-investors can be a deal-breaker for sellers.
 - Uncertainty of CFIUS outcome
 - Pilot Program timeline
 - Foreign person may be reluctant to open itself up to CFIUS scrutiny
- However, there may be ways to structure the deal to obviate need for mandatory declaration or notice
 - Deal documents can be drafted to explicitly prohibit foreign person access to material non-public technical information (MNPTI) and participation in substantive decision making.
 - Company processes to control foreign person access to MNPTI and participation in substantive decision making.
 - Staggered deal structure (Phase 1 – Truly passive; Phase 2 -- Control and Ownership)
- When CFIUS declaration or notifications are required, deal documentation needs to reflect allocation of risk and address possibility of CFIUS not clearing deal.

Practical Considerations: Deal Making – CFIUS Timeline

CFIUS Review Process Comparison

	Pilot Program Declaration	Joint Voluntary Notice
Deadline for Submission	45 days prior to close	No legal deadline. Submit prior to close.
Data Required	<ul style="list-style-type: none"> Identifying information for and descriptions of parties; Details regarding transaction; Catalogue of export controlled-items and industries for which they are produced; Org chart for the foreign buyer. 	
Review Period	30 Days: May be extended to longer CFIUS review/investigation process totaling 105 Days	20-30 Days: CFIUS Review of draft JVN 45 Days: Initial Review 45 Days: Investigation (if necessary) 15 Days: Investigation Extension (in "extraordinary circumstances") 15 Days: Presidential review (very rare)
Total time (including prep.)	Min: 35 days Max: 45 days	Min: 90 days Max: 185 days

Other relevant considerations include:

- 60 Day Pre-Close Notices for ITAR-registered companies
- Other agency policy wrt certain foreign persons
- Timing and coordination required for export license transfer

Practical Considerations: Deal Making - Diligence

Diligence on CFIUS and export controls issues is critical. If a target has not thought through trade compliance issues, this could present a host of issues.

- Successor liability for export violations (EAR \$300,000 or twice transaction value; ITAR \$1.1 million per violation)
 - CFIUS penalties – up to full value of transaction
 - Time-sensitive licensing and registration requirements, including, possible foreign national employee licensing may be required
 - Impact on expected ROI; poor compliance posture can impact ability to execute on planned technology transfers and international sales
-
- **Companies seeking investment should also diligence investors.** Not all investors, especially many investment funds, are savvy regarding the CFIUS process.
 - **Diligence findings should influence deal terms.**
 - Are any pre-close compliance disclosures required?
 - Does compliance risk warrant a special indemnity or discount on purchase price? Will new controls on emerging technologies impact ROI? Will R&W insurance cover breach?
 - How to ensure cooperation of Buyer/Seller in CFIUS and other filings?
 - Deal insurance? Deal break-up fee?

QUESTIONS?



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Thank You!