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September 28, 2023

U.S. Department of the Treasury
Attention: Meena R. Sharma, Acting Director
Office of Investment Security Policy and International Relations
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern TREAS-DO-2023-0009

Dear Ms. Sharma:

Thank you for the opportunity to comment on the advance notice of proposed rulemaking on Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern ("Outbound Investment ANPRM").[1] The Outbound Investment ANPRM proposes rules to establish a regulatory program to either prohibit or require notification concerning certain types of outbound investments by United States persons into certain defined entities from a country of concern (the "Outbound Program").

We provide the following comments based on our experience working with national security focused regulatory regimes and representing participants in industries likely to be impacted by the Outbound Program. The overarching theme of these comments concerns the need for objective criteria to assess the scope and application of the proposed rule, as well encourage a multilateral approach with allies and partners. We submit these comments to facilitate the goal of "narrowly tailored restrictions"[2] to prevent unwanted economic outcomes that could negatively impact U.S. industry and technology development.

1) **An Outbound Program needs to be characterized by objective standards that allow predictable and consistent application. The following comments relate to the establishment of more objective criteria for "covered national security technologies and products" so that U.S. investors can practically carry out self-assessments to determine compliance obligations.**

   a) **"Covered national security technologies or products" should be defined using objective criteria based on technical and performance parameters**

The Outbound Investment ANPRM would prohibit covered transactions involving covered foreign persons engaged in certain defined activities defined as covered national security technologies or products.[3] Based on the criteria of the term covered national security technologies or products, the

[1] Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern, 88 Fed. Reg. 54961 (proposed Aug. 14, 2023).
[2] *Id.*, 54967 Part 3(F).
[3] *Id.* 54963 Part 3(C)-(D).

covered transaction could be prohibited or notifiable.[4] Assessing whether the activities of a covered foreign person meets the criteria of covered national security technologies or products will fall on the U.S. person investor (or possibly its foreign controlled subsidiary).[5] It is thus essential that the criteria be objective and practicable to apply. Using the technical parameters of the Commerce Control List ("CCL") is one option that was used, in part, in the Outbound Investment ANPRM and we would encourage the reference to export control classification numbers ("ECCNs") where possible given their clear technical parameters and familiarity among compliance professionals. We recognize that emerging technologies may not have entries on the CCL, but clear technical or performance parameters could still be used to describe the criteria, as was done for certain descriptions in the Outbound Investment ANPRM.[6]

b) We specifically caution against the use of a standard that is based on the original design intent of an item as proposed in the Outbound Investment ANPRM for certain activities.

The Outbound Investment ANPRM would prohibit covered transactions involving certain activities defined in covered national security technologies or products.[7] Some of the proposed definitions are based on whether the relevant activity was "designed to be exclusively used for" certain end uses (e.g., military or intelligence end uses).[8] The following types of activities fall within the prohibited category of covered national security technologies or products and the determinative criteria is how the relevant technology, software, or product was originally designed:[9]

Semiconductor and Microelectronic

- The development or production of electronic design automation software ***designed to be exclusively used for*** integrated circuit design.

- The development or production of front-end semiconductor fabrication equipment ***designed to be exclusively used for*** the volume fabrication of integrated circuits.

Quantum Information

- The development of a quantum sensing platform ***designed to be exclusively used for*** military end uses, government intelligence, or mass surveillance end uses.

- The development of a quantum network or quantum communication system ***designed to be exclusively used for*** secure communications, such as quantum key distribution.

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[4] *See id*.
[5] *See generally id.* at 54963-64 Part 3 (B)-(C).
[6] *See id.* at 54966-69 Part 3 (F) (As discussed further in this comment, definitions for some technologies such as "Advanced Integrated Circuit Design" are more detailed in comparison to others, such as the definition of "Quantum Networking").
[7] *See generally id.* at 54964-69 Part 3 (C) – (I).
[8] *See generally id.*
[9] *Id.* (emphasis added).

AI Systems

- **Prohibition:** The development of software that incorporates an AI system and is ***designed to be exclusively used for*** military, government intelligence, or mass-surveillance end uses.

- **Proposed for Notification:** The development of software that incorporates an artificial intelligence system and is ***designed to be exclusively used for***: cybersecurity applications, digital forensics tools, and penetration testing tools; the control of robotic systems; surreptitious listening devices that can intercept live conversations without the consent of the parties involved; non-cooperative location tracking (including international mobile subscriber identity (IMSI) Catchers and automatic license plate readers); or facial recognition

The intention about how an item was originally designed may not be practically discoverable to a U.S. person investor or even to the foreign person counterparty. For example, a U.S. person may know how a product is marketed, or its current applications, but an investor is unlikely to have positive knowledge about the intent surrounding the original design of an item. Similarly, an item might have been developed by former employees or a predecessor company of a business and the original intent might not be known even to the foreign person counterparty. Parties (and Treasury to the extent it is reviewing a transaction under the Outbound Program) will need to use their judgment to assess the original design intention of an item based on what circumstantial information can be collected about the original design. This process will be inherently flawed and inconsistently applied, creating uncertainties for business and administrative issues for the Government (*i.e.*, how can the Government make this determination with any certainty in practice). Importantly, the inherent subjectivity will disincentivize a broader range of transactions as risk adverse business decisions will seek to avoid investments if the relevant item *could have been* originally designed for a prohibited end use, regardless of whether it was designed for, or is used in, that end use.

Instead of using the original design intent of an item, we would propose objective criteria, such as performance or technical specifications and parameters relating to items that are important to national security. This objective approach can be updated by Treasury as new items develop or policy focus shifts. It would also facilitate assessments by U.S. persons who are unlikely to be able to determine the original design intentions. Without clear standards on the intended technology and covered transactions, larger sections of the targeted industries could be inadvertently disrupted.

2) The Outbound Investment ANPRM is the first of its kind globally. If only the U.S. adopts outbound restrictions, it risks prejudicing U.S. investors and U.S. technical development. The final Outbound Program should have a mechanism to encourage and help allies and partners establish similar processes and except cross-border investment with allies and partners that meet certain criteria.

a) Any Outbound Program should involve outreach to allies and partners similar to that exercised under FIRRMA.

Restrictions applicable only in the U.S. or to U.S. businesses will isolate and handicap the country's ability to remain competitive and innovate in the same emerging technology areas that the Outbound Program seeks to protect.[10] For this reason, the Outbound Program should incorporate a formal process

[10] *See e.g.*, A. MacCormack, et. al., *Innovation through Global Collaboration: A New Source of Competitive Advantage*, Harvard Business School Working Paper 07-080, Aug. 14, 2007 (available at:

encouraging other countries to adopt similar restrictions so that U.S. firms are not competitively disadvantaged.

In 2018, the U.S. Congress recognized a similar concern when it passed the Foreign Investment Risk Review Modernization Act ("FIRRMA").[11] In that legislation, Congress stated that "the President should conduct a more robust international outreach effort to urge and help allies and partners of the United States to establish processes that are similar to the Committee on Foreign Investment in the United States to screen foreign investments for national security risks and to facilitate coordination," and mandated that CFIUS develop a formal process for "cooperation with allies and partners." A similar approach for the Outbound Program would be consistent with the President's requirement in the authorizing Executive Order 14105, which requires the Departments of Treasury, Commerce, and State to engage with allies and partners about the "risks posed by countries of concern advancing covered national security technologies and products." That mandate to engage with allies and partners should be capitalized upon to spearhead a FIRRMA-like multilateral approach.

b) Incentives for a multilateral approach could involve an "excepted investor" like approach similar to FIRRMA for investments in countries that meet certain criteria.

The Outbound Investment ANPRM proposes a number of exceptions based on the type or character of the investment,[12] but it does not propose an exception for investment targets located in key allies and partners that might have adopted regulatory regimes that also address the national security concerns associated with technology development by countries of concern. Were an ally or partner to adopt and coordinate with U.S. on regulatory measures to address the policy concerns underlying the Executive Order 14105, applying the Outbound Program rule to investments in those jurisdictions should be unnecessary. We recommend that Treasury consider an additional exception to the Outbound rule for certain foreign states that meet defined criteria, analogous to its approach in implementing FIRRMA.

Under the implementing regulations of FIRRMA, certain "excepted investors" from "excepted foreign states" were excepted from parts of the expanded scope of FIRRMA, such as mandatory filing requirements. Treasury chose countries for "excepted foreign states" based on whether the "foreign state has established and is effectively utilizing a robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security."[13]

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https://www.hbs.edu/ris/Publication%20Files/07-079.pdf) (". . . innovations are increasingly brought to the market by networks of firms, selected for their unique capabilities, and operating in a coordinated manner."); *see also* Kristalina Georgieva, *From Fragmentation to Cooperation: Boosting Competition and Shared Prosperity*, Keynote Address at the OECD Global Forum on Competition, Dec. 6, 2021 (available at: https://www.imf.org/en/News/Articles/2021/12/06/sp120621-keynote-address-at-the-oecd-global-forum-on-competition) (explaining that healthy competition boosts innovation and "global competition depends on domestic policy action and global cooperation.").

[11] Effective August 13, 2018, *amending* Section 721 of the Defense Production Act of 1950, codified at 50 U.S.C. 4565.

[12] 88 Fed. Reg. at 54965-66 Part 3 (E).

[13] 31 C.F.R. § 800.1001.

Treasury should consider a similar approach for the Outbound Program. The following criteria, taken in part from the criteria used in Part 800 of the CFIUS regulations implementing FIRRMA, could form the basis for an applicable exception:

(1) the foreign state effectively utilizes a robust process to analyze foreign investments and coordinates with the U.S. on matters relating to investment security. This is the criteria used by Treasury to determine expected foreign states under FIRRMA. This would ensure that investments by foreign persons of concern in the jurisdiction have been vetted by a "robust process" that met the requirements of Treasury to be an "excepted foreign state"; and

(2) the foreign state maintains a robust and comparable export control restrictions and coordinates with the U.S. on matters relating to export control policies. This would ensure that items exported from the jurisdiction to countries of concern, maybe by a covered foreign person subsidiary in that jurisdiction, would be controlled similar to the controls applicable in the United States.

The purpose of providing for such an exception would be to expand the yard in which U.S. firms can invest and collaborate in emerging technology areas, thereby facilitating innovation and development among allies and partners, while also maintaining a common "high fence" through comparable investment security and export control policies.

3) The obligations on "U.S. Persons" should be clear and definitive. Imposing requirements on controlled foreign entity(ies) without a multilateral approach (or excepted foreign state exception) could incentivize shifting global ownership structures outside the United States, which would harm both the U.S. economy and the Outbound Program's policy goals.

U.S. persons are clearly defined and are the parties responsible for compliance under the Outbound Investment ANPRM.[14] However, the Outbound Investment ANPRM proposes unclear liability for U.S. persons relating to its "controlled" foreign subsidiaries.[15] It requires U.S. persons to take "reasonable steps" to push Outbound Program compliance to its "controlled" foreign subsidiaries. The Outbound Investment ANPRM proposes the following as potential "reasonable steps":[16]

(i) relevant binding agreements between a U.S. person and the relevant controlled foreign entity or entities;

[14] 88 Fed. Reg. at 54965 Part 3 (D) (prohibiting U.S. persons from "knowingly directing" covered transactions and requiring they take "all reasonable steps" to prevent covered transactions by foreign subsidiaries).
[15] *See generally id.* at 54965-66 Part 3 (D) – (E) (explaining the objectives for the included definitions. As proposed by question 24, "parent-subsidiary relationship" should be defined "as one in which a U.S. person's ownership interest is equal to or greater than 50 percent." We generally agree, however, would recommend that this test be of the ownership of "voting interest" rather than equity because voting interest is a better indicator of control. That is the test that is partially used by the implementing regulations of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 16 C.F.R. 801.1(b). In addition to 50% or more of the voting interest, the Outbound Rule could adopt the remainder of the bright line "control" test used 16 C.F.R. 801.1(b), which would also include the contractual ability to appoint 50% or more of the board of directors of corporate entities, or the right to remove and replace 50% or more trustees of trust entities.)
[16] *Id.* at 54971 Part 3 (M).

(ii) relevant internal policies, procedures, or guidelines that are periodically reviewed internally;

(iii) implementation of periodic training and internal reporting requirements;

(iv) implementation of effective internal controls; (v) a testing and auditing function; and

(v) the exercise of governance or shareholder rights, where applicable.

The result of this will be extra-territorial application to all non-U.S. operations that have a U.S. parent, whether it is an intermediate or ultimate parent. This will also require the implementation of dedicated compliance policies for any business that has a U.S. entity in its upstream ownership chain, regardless of the purpose of that U.S. entity (e.g., shell company or ultimate parent/headquarters).

The additional compliance obligations could discourage the use of U.S. entities as part of global ownership chains, particularly for businesses involved in covered national security technologies or products. For example, a U.S. subsidiary of a foreign based global business would require the global business to impose compliance obligations on all the entities directly/indirectly owned by its U.S. subsidiary, regardless of the operational reality of the organizations (e.g., the U.S. entity may be in a different business division from entities underneath it in the ownership chain or may be a minor operation compared to the non-U.S. subsidiaries). Depending on the "reasonable steps" ultimately adopted, this effect could have the unintended consequence of having global companies move U.S. entities from their ownership chains or isolate them within their organizational structure, which would impact the growth of business in the United States and also impact the ability of U.S. regulatory schemes to apply in general.

We recommend that Treasury consider omitting the requirement that a U.S. person take reasonable steps to push down compliance and instead rely upon the proposed rule that prohibits a U.S. person from "knowingly directing" a transaction that would be prohibited transactions pursuant to the Order if engaged in by a U.S. person.[17] The prohibition on "knowingly directing" together with other national security policy tools (export controls, sanctions) could provide an alternative that does not burden U.S. ownership chains with new compliance structures. Alternatively, the Outbound Program could apply to any foreign controlled subsidiary of a U.S. person that was acting on behalf of or for the benefit of a U.S. person (similar to the jurisdictional reach of the certain sanctions programs administered by OFAC and of the Foreign Corrupt Practices Act[18]).

4) In addition to adopting the "EAR" knowledge standard, the Outbound Program should adopt the reasonable diligence requirements and practices of the EAR, which would avoid an unachievable strict liability standard.

We agree with the Outbound Investment ANPRM that "knowledge" should be defined consistent with EAR.[19] This would provide a definition that is well-established and understand by trade compliance professionals. In addition to the Outbound Investment ANPRM's use of "know" or "knowingly" in

[17] *Id.*, at 54971 Part 3 (L).
[18] *See* Foreign Corrupt Practices Act of 1977, 15 U.S.C. § 77dd-2 (h)-(i).
[19] 88 Fed. Reg. at 54969 Part 3 (J).

selected provisions,[20] the following additional provisions in the Outbound Investment ANPRM require diligence and analysis by the U.S. person that should also be held to a "knowledge" standard consistent with the diligence requirements under the EAR.

- Whether a company in a third country (i.e., not in a country of concern) is 50% or more, in the aggregate, owned by persons of a country of concern. This assessment will involve details about upstream ownership that will be impracticable for a U.S. person to know with complete certainty (similar to how U.S. persons often do not have complete information to confirm the application of the OFAC 50% rule). This will be even more true after the Outbound Program comes into effect and ownership connections to countries of concern will be intentionally obfuscated.

- Whether a parent entity has covered foreign person subsidiaries or branches that individually or in the aggregate, comprise more than 50 percent of that parent's consolidated revenue.[21] Again, this assessment will involve details that will be impracticable for a U.S. person to know with complete certainty, such as the confidential financials of potentially unrelated affiliated entities of a target investment.

Anticipating the issues associated with U.S. person compliance the Outbound Investment ANPRM asked commenters to consider "[w]hat contractual or other methods might a U.S. person employ to ***enhance certainty*** that a transaction they are undertaking is not a covered transaction?"[22] This implicitly recognizes that methods will be needed to achieve better confidence on compliance. The adoption of the EAR knowledge standard and compliance practices will provide a practicable and well-established solution in this regard.

As with the EAR, the Outbound Program should only require U.S. persons to exercise reasonable due diligence to determine whether "knowledge" (as defined under the EAR) exists that a transaction could violate the Outbound Program. This would not require a new compliance standard, but can use the compliance standards and practices of the EAR, similar to the "Know Your Customer Guidance" issued by the Bureau of Industry and Security of the Department of Commerce.[23] In this process, the use of contractual representations/restrictions and compliance certifications are typical tools used to resolve potential red flags and give U.S. persons better confidence that an undertaking is permissible. Without this knowledge standard and diligence practice, both U.S. persons seeking to comply, and Treasury seeking to administer, will not have access to all the information necessary to assess compliance with certainty. This will result in an inherently flawed process, which will disincentivize potential collaboration and investment opportunities as parties seek to avoid the risk associated with regulatory uncertainty.

[20] *See id.* at 54969-70 Part 3 (J); *see also id.* at 54964 Part 3 (C), 70-71 Part 3 (L) (defining "covered foreign person and "knowingly directing transactions").
[21] *See id.* at 5964 Part 3 (C)(2) (defining "Covered Foreign Person").
[22] *Id.* at Part 3 (C) (question 7).
[23] *Know Your Customer Guidance,* Bureau Indus. And Sec., https://www.bis.doc.gov/index.php/all-articles/23-compliance-a-training/47-know-your-customer-guidance (last visited Sept. 28, 2023).

5) Terms used in Outbound Program rule, and specifically the technical terminology used in the covered national security technologies or products, should be consistent with definitions in the EAR where possible

We note that many terms used in the Outbound Investment ANPRM are not defined.[24] We recommend that Treasury not adopt new definitions for terms applicable to the criteria defining covered national security technologies or products when those terms are already defined in the EAR. Consistency of technical terminology with the EAR will minimize confusion and facilitate compliance implementation as trade compliance professionals will already be familiar with terminology under the EAR. For example, the term "technology" is not defined in the Outbound Investment ANPRM but it has a well-established definition under the EAR.[25] Similarly, the EAR has definitions for technical terms used for the criteria defining covered national security technologies or products, such as "Quantum cryptography" and "Hybrid integrated circuit," which should be incorporated into the Outbound Program rule.[26] In this regard, we recommend that BIS participate to assess how existing EAR definitions could be used to provide clarity and objectivity to the Outbound Program rule.

6) The notification filings should be the obligation of the U.S. person triggering jurisdiction, be a post-closing notification, and have a straightforward process to facilitate compliance and minimize burdens.

The Outbound Program is intended to apply to acquisitions of any amount of equity. Although the Outbound Investment ANPRM proposes a *de minimis* threshold for certain passive limited partner investments,[27] other types of covered transactions would apply regardless of the size of the deal or whether control is acquired. In addition, Outbound Investment ANPRM proposes certain types of covered transactions that might not have a covered foreign person counterparty at the time of notification, such as with the establishment of a new greenfield investment or joint venture when those new activities "***could*** result in the establishment of a covered foreign person."[28] For smaller deals captured by the Outbound Program, such as small minority investments, a foreign counterparty may not be willing to incur the burden and exposure of a regulatory process. For deals captured by the Outbound Program in which a covered foreign person counterparty is not yet in existence (e.g., new joint venture), a foreign counterparty may not exist to participate in the process.

The obligation to file a notification should be solely on the U.S. person that created the jurisdiction for the Outbound Program to apply. This would facilitate compliance by putting the filing burden on the party that is in the best position to comply. The use of a joint filing process, as contemplated by the Outbound Investment ANPRM,[29] could (1) create administration issues resulting from the lack of participation of the foreign person, and (2) disadvantage U.S. person investment to the advantage of investors from third countries that would not have the same regulatory burdens associated with the subject investment.

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[24] Terms such as "Electronic design automation software", "front-end semiconductor fabrication", "quantum sensors", and "quantum networking".
[25] *See* 15 C.F.R. § 772.1.
[26] *See id.*
[27] *See* 88 Fed. Reg. at 54965 Part 3 (E)(1.a.)(iii)(B) (proposing a carve out for investments by limited partners below a certain threshold and considering how to define the threshold based on transaction size, total assets managed, and like factors without unduly enriching the covered foreign person).
[28] *See id.* at 54964 Part 3 (D).
[29] *See id.* at 54970 Part 3 (K) (question 56).

For similar reasons, the notification requirement should be post-closing within a reasonable period after closing.[30] Imposing a pre-closing notification requirement in a competitive market will disadvantage U.S. person investments to the advantage of investors from third countries. It would also interject regulatory uncertainty into the process that would further disadvantage U.S. person investment. Even if the U.S. person conducted reasonable diligence to confirm the notification requirement (*i.e.*, that the investment is not prohibited), parties will naturally view the pre-closing notification as involving risks, which will be associated with deal uncertainty, ultimately to the detriment of U.S. person investors.

Finally, the Outbound Investment ANPRM includes the topics proposed to be included in any notification filing.[31] Many are logically related to the investment that triggered the notification requirement: details of the parties involved; [32] details about the covered transaction, all side agreements, and the deal's business rationale;[33] and a description of the basis for determining that the transaction is a covered transaction.[34] However, the following topics would involve proprietary information about U.S. person and/or foreign person that would frustrate compliance:

- "[D]etailed information about the covered foreign person, which could include products, services, research and development, business plans, and commercial and government relationships with a country of concern."[35] This information would be proprietary to a foreign person counterparty and could be unrelated to the investment. As such, the U.S. person would not be able to provide such information, nor would a foreign person be interested in disclosing information, particularly for smaller investments or collaborations.

- "[A] description of due diligence conducted regarding the investment."[36] This information could implicate privileged communications under U.S. law and would nonetheless involve sensitive internal information about the U.S. person's business decisions. The topic of "deal rationale" is already proposed, which directly relates to the covered transaction. U.S. persons may be hesitant to file with Treasury if they suspect their deal diligence might be questioned or subject the business entity to potential liability if their diligence were found to be lacking.

In summation, the filing should request information directly related to the purpose of the notification: to "increase the U.S. Government's visibility into U.S. person transactions involving the defined technologies and products that may contribute to the threat to the national security of the United States" and to "be helpful in highlighting trends with respect to related capital flows as well as inform future policy development."[37] To satisfy these goals, the notice should provide "visibility" into the transaction and be helpful to identify "trends" for policy development. As such, we recommend that the notification filing content be limited to the topics logically related to the covered transaction, as listed in Part K, subparts (i) to (vi).[38]

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[30] *See id.* at 54970 Part 3 (K) (question 57).
[31] *See id.* at 54970 Part 3 (K).
[32] *Id.* at 54970 Part 3 (K) (i)-(ii).
[33] *Id.* at (iii)-(iv), (vi).
[34] *Id.* at (v).
[35] *Id.* at (vii).
[36] *Id.* at (viii).
[37] *Id.* at 54970 Part 3 (F).
[38] *Id.* at 54970 Part 3 (K)(i)-(vi).

Respectfully,

Squire Patton Boggs (US) LLP

For any questions concerning these comments, please feel free to contact either of the following attorneys from our International Trade and National Security Practice.

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