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# Export Control Reform Act Introduced in Congress

March 8, 2018

International Trade

On February 15, 2018, House Foreign Affairs Committee Chairman Ed Royce (R-CA) introduced bipartisan legislation—the Export Control Reform Act of 2018 ("ECRA")—to modernize U.S. export control regulation of commercial and dual-use items. The bill is co-sponsored by the committee's ranking Democratic member, Eliot Engel (D-NY). The proposed legislation seeks to establish a permanent statutory basis for export control of commercial, dual-use, and less sensitive defense items.

Introducing the ECRA, Chairman Royce emphasized that the need for export control reform is dictated by aggressive Chinese government policies that have increasingly forced U.S. companies to hand over sensitive technology as a cost of doing business in China. In response, the ECRA establishes a framework to protect critical and emerging U.S. technology and know-how. The same issue also has been taken up through the Foreign Investment Risk Review Modernization Act ("FIRRMA"), a bipartisan effort to control outbound technology transfers (among other issues) through the expansion of the authority and operation of the Committee on Foreign Investment in the United States ("CFIUS"). It remains to be seen whether Congress will proceed with the ECRA or FIRRMA, or potentially combine the two efforts.

## Key Aspects of the Export Control Reform Act

If enacted as introduced, the potential impact of the ECRA on export controls would be far-reaching:

- The ECRA on its face would significantly expand U.S. jurisdiction to regulate the transfer abroad by U.S. and foreign persons of commodities, software, or technology regardless of any U.S. content.
- The ECRA would for the first time apply U.S. deemed export controls to transfers of controlled technology to U.S. companies unless they are majority-owned by U.S. natural persons.
- The ECRA would establish control over release of technology that includes information at any stage of its creation, such as "foundational information" and "know-how," in order to protect emerging technology and sensitive intellectual property. To that extent, the bill would require the president to establish an interagency process to identify emerging technologies that are not identified in any U.S. or multilateral control list, but nonetheless could be essential to U.S. national security.

Key aspects of the export control reform legislation are set forth in more detail below.

**Permanent Statutory Basis for U.S. Export Controls**

Currently, the Bureau of Industry and Security ("BIS") in the U.S. Department of Commerce administers the Export Administration Regulations ("EAR") to regulate the export, reexport, and in-country transfer abroad of commercial, dual-use, and less sensitive military commodities, software, and technology. Since the lapse of the Cold War-era Export Administration Act of 1979 ("EAA") in 2001, presidential executive orders under the International Emergency Economic Powers Act ("IEEPA") have authorized the continuation of the EAR.

The ECRA would repeal the EAA, as continued in effect by IEEPA, and provide a statutory basis for all delegations, rules, regulations, determinations, or licenses issued under the EAA, IEEPA, or the EAR. Additionally, the ECRA would codify statutory language underlying the EAR's antiboycott provisions that prohibit United States persons from providing support to foreign boycotts, such as the boycott of Israel, that are not supported by the U.S. government. Finally, the bill would carry over sanctions from the EAA against U.S. and foreign persons who engage in commercial transactions that violate missile proliferation or chemical and biological weapons controls.

**Expansion of U.S. Export Control Jurisdiction**

- **Expansion of U.S. export controls to non-U.S. items**: The bill on its face seeks to expand U.S. export control jurisdiction to cover exports, reexports, or transfers of items which are currently not subject to the EAR and may include non-U.S. commodities, software, or technology that do not contain U.S. content and are not manufactured from U.S. technology. Under the existing regulations, "items subject to the EAR" consist of items listed on the Commerce Control List ("CCL") or classified as EAR99, and include (i) items in the United States; (ii) U.S.-origin items wherever located; (iii) foreign-made items that incorporate controlled U.S. content in quantities exceeding the *de minimis* levels; and (iv) certain foreign-made direct products of U.S.-origin technology or software. 15 C.F.R. Section 734.3. The proposed definition of "item" that is subject to the ECRA includes "a commodity, software, or technology" and does not require that the item be located in the United States, be of U.S. origin, contain any U.S. content, or be a direct product of U.S. technology or software. Sec. 2(6). Such a broad definition of "item" would extend U.S. jurisdiction to control items that are not currently subject to the EAR. Without a link to the United States in the definition of "item" or limitations in other terms of the bill, U.S. export controls jurisdiction would potentially apply to any non-U.S. items.

  While the broadened definition of "item" would not affect exports from the United States (which are already subject to control), it would have significant implications on shipments between two foreign countries or within a foreign country. Given the broad ECRA definitions of "reexport" and "transfer," which include "the shipment or transmission of the item from a foreign country to another foreign country" and "a change in the end use or end user of the item within the same foreign country," the ECRA would appear to extend U.S. control over reexports and transfers of non-U.S. items outside of the United States, without regard to whether the non-U.S. item incorporates any U.S. content or was produced using U.S. technology. Any such attempted expansion of U.S. jurisdiction is likely to be highly controversial and difficult to enforce.
- **Expanded definition of "technology"**: The ECRA expands the definition of "technology" subject to U.S. export controls to include "information at whatever stage of its creation, such as foundational information and know-how, as further defined by regulations." Sec. 2(9). While the criteria for information subject to this definition are yet

to be defined, it appears from Chairman Royce's statement that the new definition aims to extend the current export control regime to protect emerging technology and sensitive intellectual property, particularly as these are targeted by Chinese acquisitions. This expansion dovetails with FIRRMA, which proposes to expand the scope of CFIUS jurisdiction to review any non-passive investment by a foreign person in a U.S. critical technology company, with an updated definition that similarly focuses on capturing emerging technologies within the scope of "critical technology."

As under the current EAR, the "technology" subject to control under the ECRA would exclude "published information" and technology that "arises during, or results from, fundamental research and is intended to be published." Sec. 2(9). Likewise, the ECRA would not regulate items that are subject to Section 203(b) of IEEPA (i.e., communications not involving a transfer of anything of value, certain donations, and exchange of "any information or informational materials," not including those otherwise controlled). Sec. 104(b).

- **Controlling release of technology to U.S. entities unless they are owned more than 50 percent by U.S. natural persons**: The bill would further expand export control jurisdiction with respect to transactions involving U.S. legal entities that are majority-owned by non-U.S. natural persons. The bill proposes a more narrow definition of "U.S. person" that would apply to a legal entity organized under U.S. law only if natural persons who are U.S. citizens or permanent residents "own, directly or indirectly, more than 50 percent of the outstanding capital stock or other beneficial interest in such legal entity." Sec. 2(12)(B). The term "foreign person" is defined as "not a U.S. person." Sec. 2(5). Therefore, under the proposed bill, only those U.S. companies that are majority-owned by natural U.S. persons would qualify as "U.S. persons" for export control purposes, while U.S. companies owned less than 50 percent by natural U.S. persons would be considered "foreign persons." This is significant because the ECRA defines "export" broadly, consistent with the current EAR, to include "the release or transfer of technology or source code relating to the item to a foreign person in the United States." Sec. 2(3). Therefore, the ECRA could require obtaining export authorization for any transfer of technology or source code that is subject to export control between two U.S. companies, where the ultimate natural person shareholding of the recipient company does not meet the criteria in the bill for that company to be a "U.S. person." It would be particularly difficult to assess whether certain U.S. public companies that are owned by international investors should be considered U.S. persons or foreign persons for purposes of export controls, given the difficulty of determining the identity of natural person shareholders.
- **Expanded jurisdiction over control of U.S. persons' activities relating to "foreign intelligence services"**: Under the EAR, BIS has the authority to regulate certain activities of U.S. persons, including activities related to the proliferation of nuclear explosive devices, chemical or biological weapons, and missile technology. The bill would expand these controls to require regulation of activities of U.S. persons, wherever located, relating to specific "foreign intelligence services." Sec. 103(a)(2). The mandated control of U.S. persons' activities involving foreign intelligence services is not further defined and, as such, could have a broad impact on any dealings with particular foreign intelligence services outside the scope of those limited activities that are excluded from control under section 203(b) of IEEPA discussed above. Sec. 104(b).

**Requirement to Identify Critical Technologies**

The bill would require the president to establish a regular and robust interagency process to identify the "emerging and other types of critical technologies that are not identified on any list of items controlled for export," but nonetheless could be essential for maintaining or increasing U.S. technological advantage. Sec. 109(a). The ECRA states that this interagency process should regulate "critical technology" as defined in U.S. foreign direct investment laws, and its release to foreign persons should be regulated "as warranted regardless of the nature of the underlying transaction." Sec. 102(10). This definition of "critical technology" could be established by FIRRMA, as described further below.

**Potential Availability of License Exception for Missile Technology**

By repealing the overall EAA, the ECRA would repeal the EAA requirement for a license for any export of dual-use items or technology related to the design, development, production, or use of missiles, to any country. In 1991, the EAA was amended to conform with the Missile Technology Control Regime ("MTCR"), which the United States and allied nations founded in 1987 to limit the proliferation of rocket and unmanned vehicle systems capable of delivering nuclear, biological, and chemical weapons of mass destruction and their associated equipment and technology. The amended EAA established a statutory requirement for "an individual validated license for any exports of goods or technology" listed in the MTCR annex "to any country." 50 U.S.C.A. § 4605(l)(1). BIS has historically exempted from licensing missile technology items for use in Canada, but has otherwise required specific licensing of such items worldwide in accordance with the statute. Under the ECRA, BIS would no longer be prohibited from applying license exceptions to exports, reexports, and transfers of missile technology items subject to its jurisdiction. Of course, BIS may decide to retain its current practice. Moreover, the ECRA would still require U.S. persons to obtain BIS licensing for exports, reexports, and transfers of missiles and the performance of missile-related services, and exports, reexports, and transfers of missile technology controlled on the U.S. Munitions List would still require specific licensing from the State Department.

**Relationship to FIRRMA**

The ECRA was introduced at the same time that Congress is considering another bill to address national security concerns related to sensitive technology in the form of FIRRMA. Senator John Cornyn (R-TX) introduced FIRRMA last November with a bi-partisan group of co-sponsors, and Rep. Robert Pittinger (R-NC) introduced an identical companion bill in the House. FIRRMA represents the most significant effort to reform the CFIUS process since the passage of the Foreign Investment and National Security Act of 2007, which has governed CFIUS for a decade. The effort to reform CFIUS is being driven by a concern that CFIUS needs greater authority to address national security risks arising from a foreign investment, especially from China. For our full analysis of FIRRMA, please see our client alert "CFIUS Reform Legislation Introduced in Congress."

FIRRMA would expand CFIUS jurisdiction in a number of ways, but most relevant here, it would permit CFIUS to review any contribution by a U.S. critical technology company, other than through an "ordinary customer relationship," of intellectual property and associated support to a foreign person through any type of arrangement (including joint ventures) regardless of whether the transaction results in any control over the U.S. business. CFIUS historically has focused exclusively on *inbound* investments, so this expansion to permit CFIUS to review *outbound* contributions of IP would represent a significant departure from CFIUS's traditional role. Recent

congressional hearings on FIRRMA have focused on this intersection of CFIUS and export controls, and there has been some criticism that FIRRMA would duplicate controls that are already in place through the export control regime. For more information, see our client alert "CFIUS Developments: Senate Committee on Banking, Housing, and Urban Affairs Hearing to Examine CFIUS Reform."

If FIRRMA were enacted, it would also establish a new definition of "critical technology" that could be cross-referenced in the ECRA in the context of the interagency process to identify and protect critical technologies, as described above. The FIRRMA definition of "critical technology" (subject to further definition in regulation) is "technology, components, or other technology items that are essential or could be essential to national security" and include "[o]ther emerging technologies that could be essential for maintaining or increasing the technological advantage of the United States over countries of special concern with respect to national, defense, intelligence, or other areas of national security, or gaining such an advantage over such countries in areas where such an advantage may not currently exist." *See* FIRRMA Section 3(a)(8)(A)&(B)(vi).

## Legislative Prospects for the Export Control Reform Act

The ECRA is fundamentally a bill to restore a statutory basis for U.S. export controls, and such bills—traditionally styled as reauthorizations of the Export Administration Act of 1979—have fared poorly over the last two decades. The ECRA also faces a challenging path to enactment. The interaction of the bill with the pending FIRRMA legislation, however, creates an unusual legislative opportunity.

FIRRMA was referred to the Committee on Banking, Housing and Urban Affairs in the Senate, and that committee has jurisdiction over both CFIUS and export controls. Accordingly, the fact that FIRRMA mandates significant changes to both the CFIUS and export control processes poses no difficult jurisdictional issues in the Senate. In the House, however, CFIUS is within the jurisdiction of the Committee on Financial Services, while export controls are within the jurisdiction of the Committee on Foreign Affairs. In the House, consequently, FIRRMA was referred primarily to the Committee on Financial Services, and in addition to five other committees, including the Committee on Foreign Affairs. It is clear that the Committee on Foreign Affairs is determined to defend its jurisdiction over export controls, and the ECRA needs to be seen as part of its effort to do so. The fact that Chairman Royce of the Committee on Foreign Affairs is also a senior member of the Committee on Financial Services should strengthen the hand of his committee in this regard.

It is anticipated that the Committee on Foreign Affairs will hold a hearing on the ECRA in mid-March, and mark it up and report it out of committee thereafter. The House Committee on Financial Services also plans another hearing on FIRRMA, and likely will seek to mark it up thereafter. The Committee on Foreign Affairs can be expected to seek to persuade the Committee on Financial Services to pare back the pending FIRRMA bill before reporting it out of committee to deconflict its provisions from the provisions of the ECRA. This would probably translate to deleting from FIRRMA those provisions that have the effect of regulating exports from the United States. Procedurally, the Committee on Foreign Affairs could insist on marking up the FIRRMA text reported by the Committee on Financial Services, so this provides Foreign Affairs leverage in protecting its jurisdiction (and avoiding any overlap between FIRRMA and the ECRA). To avoid the delays attendant on such a process, the staffs of the two committees can

be expected to work together to resolve any differences between the committees over the two bills.

If both the ECRA and FIRRMA are reported by their respective committees of primary jurisdiction, the question will then arise whether to pass them through the House of Representatives separately, or in a combined form that would serve as a House alternative to the FIRRMA bill moving through the Senate. This is a question that will be decided by the two committees in consultation with the House Republican Leadership.

Once the ECRA reaches the Senate, either as a free-standing measure or in combination with the House version of FIRRMA, its prospects are uncertain. The Senate Committee on Banking appears intent on passing the Senate version of FIRRMA, and consequently there appears to be little interest there in passing an export control bill that will in some ways be inconsistent with the Senate version of FIRRMA. Should the Senate pass FIRRMA free-standing, a House-passed bill combining FIRRMA and the ECRA would be the natural House counterpart to the Senate bill in a House-Senate conference committee. However, it appears increasingly likely once FIRRMA is approved by the Senate Committee on Banking, an effort will be mounted to add it to the annual National Defense Authorization Act ("NDAA"). This would not only preclude the risk of contentious trade-related amendments should FIRRMA be scheduled for consideration on the Senate floor, but it would also preclude any need to conference FIRRMA with the House.

Of course, there will be a House-Senate conference on the NDAA, and the House conferees could seek to lay down the House-passed FIRRMA and ECRA language next to the Senate language on FIRRMA in that conference. However, unless the House passed-language has also been added to the NDAA in the House, the House passed-language will technically be out of scope in the conference, giving the Senate an advantage in pressing for adoption of its FIRRMA language (and stymieing prospects for the ECRA). To guard against this, the House Committees on Foreign Affairs and Financial Services may well seek to incorporate their language into the NDAA as well. Should they do that, the ultimate fate of the ECRA will be in the hands of the House and Senate conferees on the NDAA.

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Covington has deep experience advising clients on the legal, policy, and practical dimensions of U.S. trade controls. We will continue to monitor developments in this area, and are well-positioned to assist clients in understanding how these recent announcements may affect their business operations.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our International Trade Controls, CFIUS, and Public Policy and Government Affairs practices:


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