

# National Security Update - Department of Commerce Releases Interim Final Rule to Implement the Information and Communications Technology Supply Chain Executive Order

January 21, 2021

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## I. Overview

On January 19, 2021, the Department of Commerce (“Commerce”) [published](#) an Interim Final Rule to implement provisions of Executive Order 13873, “Executive Order on Securing the Information and Communications Technology and Services Supply Chain” (May 15, 2019) (the “ICTS Order”). Unless suspended by the Biden Administration, the Rule will go into effect 60 days from the publication, on March 20, 2021. The Interim Final Rule represents yet another action arising from the ongoing concern across the U.S. Government that foreign adversaries may be able to expropriate U.S. technologies, intellectual property, or sensitive Government or commercial information, and implement or exploit vulnerabilities in information and communications technology or services. It follows on the heels of other notable efforts, including the Foreign Investment Risk Review Modernization Act, which altered the jurisdiction and authorities of CFIUS, and the prohibitions on “use” of certain covered telecommunications equipment and services under Section 889 of the John S. McCain National Defense Authorization Act for Fiscal Year 2019.

The ICTS Order (initially discussed in a [May 16, 2019 Client Alert](#)) grants the Secretary of Commerce the authority to prohibit certain transactions, including commercial transactions, involving information and communications technology and services (“ICTS”) that have been “designed, developed, manufactured, or supplied by persons owned by, controlled by, or subject to the jurisdiction or direction of foreign adversaries” and that pose an “undue or unacceptable risk to the national security of the United States.” The Interim Final Rule outlines the specific processes and procedures by which the Secretary of Commerce will implement the ICTS Order.

The Interim Final Rule follows a [Proposed Rule](#) published by Commerce on November 27, 2019 that we discussed in a [November 27, 2019 Client Alert](#). The Interim Final Rule contains a number of notable differences from the Proposed Rule. Among other additions, the Interim Final Rule incorporates several new definitions of key terms and further details the procedures that the Secretary of Commerce must follow when reviewing ICTS Transactions. The Interim Final Rule also outlines the particular government and non-government persons that are considered to be “foreign adversaries” within the scope of the regulations.

The Interim Final Rule was published in the Federal Register the day before the end of the Trump administration and will not be effective until 60 days after publication. Shortly after the Inauguration on January 20, 2021, the White House Chief of Staff Ron Klain instructed executive departments and agencies to consider postponing for 60 days the effective dates of rules that have been published in the Federal Register but have not yet taken effect to allow the new Administration to review questions of fact, law, and policy that the rules may raise. The dates and timelines referenced in this alert reflect those stated in the Interim Final Rule, which are subject to revision or suspension.

## II. Definitions, Scope, and Processes

### 1. Key Definitions

Section 7.2 of the Interim Final Rule sets forth a number of definitions that are critical for determining the scope and implications of the regulations. A brief overview of the most important terms is below.

- **Foreign adversary.** The Interim Final Rule defines a foreign adversary as “any foreign government or foreign non-government person determined by the Secretary to have engaged in a long-term pattern or serious instances of conduct significantly adverse to the national security of the United States or security and safety of United States persons.” The Interim Final Rule identifies a list of governments and non-government persons that will be treated as foreign adversaries for the purpose of the Rule. These are:
  - The People’s Republic of China, including the Hong Kong Special Administrative Region (China);
  - the Republic of Cuba (Cuba);
  - the Islamic Republic of Iran (Iran);
  - the Democratic People’s Republic of Korea (North Korea);
  - the Russian Federation (Russia); and
  - Venezuelan politician Nicolás Maduro (Maduro Regime).

The Interim Final Rule states that Commerce may change this list any time, based on sources including “threat assessments and reports from the U.S. Intelligence Community, the U.S. Departments of Justice, State, and Homeland Security.” It also provides that the Secretary will periodically review the list in consultation with other agencies. Any changes to the list will be announced in the Federal Register without advance notice, and Commerce maintains the authority to review any transactions involving persons owned by, controlled by, or subject to the jurisdiction or direction of foreign adversaries not identified in the Interim Final Rule. The Rule also notes that the list of foreign adversaries is not intended for any purpose other than implementing this process.

- **ICTS Transaction.** The Interim Final Rule defines an ICTS Transaction broadly as “any acquisition, importation, transfer, installation, dealing in, or use of any information and communications technology or service, including ongoing activities, such as managed services, data transmission, software updates, repairs, or the platforming or data hosting of applications for consumer download.” The Rule additionally provides that an ICTS Transaction may also include “any other

transaction, the structure of which is designed or intended to evade or circumvent the application of the Executive Order.”

- **Party or Parties to a Transaction.** The Interim Final Rule defines a party or party to a transaction as a “person engaged in an ICTS Transaction, including the person acquiring the ICTS and the person from whom the ICTS is acquired,” with “person” including both individuals and entities. As with the definition of an ICTS Transaction, parties to a transaction broadly includes “entities designed or intended to evade or circumvent application of the Executive Order.” Notably, the definition of “party” provides an exclusion for common carriers, except to the extent that the common carrier “knows, or should have known” that it was transporting ICTS to parties to a transaction that had been adjudicated by Commerce under the Rule and ICTS Order.
- **Persons owned by, controlled by, or subject to the jurisdiction of a foreign adversary.** To further clarify the Interim Final Rule, Commerce defined persons owned by, controlled by, or subject to the jurisdiction of a foreign adversary to mean (1) “any person, wherever located, who acts as an agent, representative, or employee, or any person who acts in any other capacity at the order, request, or under the direction or control, of a foreign adversary or of a person whose activities are directly or indirectly supervised, directed, controlled, financed, or subsidized in whole or in majority part by a foreign adversary;” (2) “any person, wherever located, who is a citizen or resident of a nation-state controlled by a foreign adversary;” (3) “any corporation, partnership, association, or other organization organized under the laws of a nation-state controlled by a foreign adversary;” and (4) “any corporation, partnership, association, or other organization, wherever organized or doing business, that is owned or controlled by a foreign adversary.”

## 2. ICTS Transactions Covered by the Interim Final Rule

Transactions may be subject to review under the Rule where they meet four conditions:

- *First*, the transaction must be conducted by any person subject to the jurisdiction of the United States or must involve property subject to the jurisdiction of the United States.
- *Second*, the transaction must involve property in which any foreign country or a national thereof has an interest (including through an interest in a contract for the provision of the technology or service).
- *Third*, the ICTS Transaction must be “initiated, pending, or completed” on or after January 19, 2021. Notably, this date applies regardless of when the underlying contract relating to the transaction was actually entered into, as Commerce considers any act or service provided pursuant to the contract to be a new “transaction” that is subject to the Rule.
- *Fourth*, the transaction must involve one or more of the following broad categories of ICTS:
  - Certain ICTS that will be used by a party to a transaction in a sector designated as “critical infrastructure” by Presidential Policy Directive 21. Notably, there are 16 such sectors, including energy, emergency services, the defense industrial base, critical manufacturing, and many sub-sectors within those categories;
  - Software, hardware, or any other product or service integral to:

- Wireless local area networks;
- Mobile networks;
- Satellite payloads;
- Satellite operations and control;
- Cable access points;
- Wireline access points;
- Core networking systems; or
- Long- and short-haul networks;
- Software, hardware, or any other product or service integral to data hosting or computing services that uses, processes, or retains, or is expected to use, process, or retain, sensitive personal data on greater than one million U.S. persons at any point over the twelve months preceding an ICTS Transaction, including:
  - Internet hosting services;
  - Cloud-based or distributed computing and data storage;
  - Managed services; and
  - Content delivery services;
- Internet-enabled sensors, webcams, end-point surveillance or monitoring devices, modems and home networking devices, or drones or any other unmanned aerial system, if greater than one million units have been sold to U.S. persons at any point over the twelve months prior to an ICTS Transaction;
- Software designed primarily for connecting with and communicating via the Internet that is in use by greater than one million U.S. persons at any point over the twelve months preceding an ICTS Transaction, including desktop applications; mobile applications; gaming applications; and web-based applications; **or**
- ICTS integral to: artificial intelligence and machine learning, quantum key distribution, quantum computing, drones, autonomous systems, or advanced robotics.

The Rule only excepts a narrow set of ICTS Transactions, including those that are: (1) authorized under a U.S. government-industrial security program or (2) transactions that have been reviewed or are undergoing review by the Committee on Foreign Investment in the United States (“CFIUS”). However, a transaction involving ICTS that is separate from, and subsequent to, a transaction reviewed by CFIUS may still be reviewed by Commerce under the Interim Final Rule “if and to the extent that such transactions are separate from the transaction reviewed by CFIUS.”

For the three categories that require a twelve month threshold, no guidance is provided in the Rule to assist a party to a transaction in discerning whether the ICTS in question would trigger the threshold and be subject to review. Further, the exact process by which Commerce will identify transactions for review continues to remain unclear. The Interim

Final Rule grants the Secretary with wide discretion to evaluate those transactions that the Secretary believes poses a risk within his or her discretion.

### 3. Procedures for Commerce's Review of ICTS Transactions

For transactions that are identified, the Interim Final Rule sets forth a multi-stage process for Commerce's initial review. *First*, upon receiving a referral, the Secretary "will assess whether the referral falls within the scope of the Rule and determine whether to accept the referral, request additional information from the referring entity, or reject the referral." As part of this assessment, the Secretary will consider whether there is any foreign adversary involvement. In doing so, the Secretary will consider: (1) whether the party or its component suppliers have headquarters, research, development, manufacturing, test, distribution, or service facilities or other operations in a foreign country, including one controlled by a foreign adversary; (2) personal and professional ties between the party—including its officers, directors or similar officials, employees, consultants, or contractors—and any foreign adversary; (3) laws and regulations of the foreign adversary in which the party is headquartered or conducts operations, including research and development, manufacturing, packaging, and distribution; and (4) "any other criteria the Secretary deems appropriate."

*Second*, upon accepting a referral, the Secretary "shall conduct an initial review of the ICTS Transaction" to assess whether it poses "an undue or unacceptable risk." In doing so, the Secretary may draw on a number of sources including various assessments, reports, and actions of U.S. government agencies and the new Federal Acquisition Security Council that is charged with assessing risks in the Government's supply chain. The Secretary may also consider any other source or information that the Secretary deems appropriate.

To determine whether undue or unacceptable risk exists, the Secretary may consider a number of criteria, including (1) the nature and characteristics of the ICTS, including technical capabilities, applications, and market share considerations; (2) the nature and degree of the ownership, control, direction, or jurisdiction exercised by the foreign adversary over the design, development, manufacture, or supply of the ICTS; (3) statements and actions of the relevant foreign adversary, persons involved in the design, manufacture, or supply of the ICTS, or the parties themselves; (4) whether the ICTS Transaction poses a discrete or persistent threat; (5) the nature of the vulnerability at issue; (6) whether there is an ability to otherwise mitigate the risks; (7) the severity of the harm posed by the Transaction on at least one of several sectors, including health, critical infrastructure, sensitive data, the economy, and foreign policy, among others; and (8) the likelihood that the Transaction will in fact cause harm.

*Third*, should the Secretary find that an ICTS Transaction likely meets the criteria set forth above, the Secretary must notify the appropriate agency heads "and, in consultation with them" determine whether the ICTS Transaction is subject to the Rule.

*Fourth*, if, after that consultation, the Secretary determines that the ICTS Transaction is subject to the Rule, the Secretary will make an initial written determination (1) explaining why the Transaction is subject to the Rule and (2) setting forth whether the Secretary has initially determined to block the Transaction or to propose mitigation measures. Commerce will notify the parties to the Transaction by service or through publication in the Federal Register.

#### 4. Procedures for Party Response and Final Determination

A party may respond to the initial determination from the Secretary within 30 days of service. It may do so either by challenging the basis for the initial determination or by proposing its own mitigation options. It may also request a meeting with Commerce, which Commerce may accept or decline at its discretion. If the parties to an ICTS Transaction do not submit a response to the Secretary's initial determination within 30 days following service of the initial determination, that initial determination will become final.

After receiving a submission from a party to an ICTS Transaction, the Secretary will consider whether the information affects the initial determination and then "consult with and *seek the consensus of* all appropriate agency heads" prior to issuing a final determination. If the Secretary cannot reach a consensus, the Interim Final Rule provides that the Secretary will notify the President of any opposition, and, after receiving direction from the President, the Secretary will issue a final determination.

The Secretary must issue a final determination as to whether a transaction is prohibited, not prohibited, or permitted pursuant to negotiated mitigation measures within 180 days of accepting a referral and commencing review. Among other information, the final determination must "consider and address" information received from a party to the Transaction.

#### 5. Procedures for Licenses

While the Proposed Rule indicated that a pre-clearance process would not be established, based on feedback received by Commerce, the Interim Final Rule states that within 60 days of publication, Commerce will publish procedures "to allow a party or parties to a proposed, pending, or ongoing ICTS Transaction to seek a license." The procedures "will establish criteria by which persons may seek a license to enter into a proposed or pending ICTS transaction or engage in an ongoing ICTS Transaction." The license process will be in effect within 120 days of publication of the Interim Final Rule (i.e., May 19, 2021). Persons who may seek a license will include "any parties to a proposed, pending, or ongoing ICTS Transaction." Commerce will review license applications within 120 days of acceptance, and a license is deemed granted if Commerce does not issue a decision within that timeframe.

### **III. Looking Ahead and Comment Period**

While finalized and published in the Federal Register at the end of the Trump Administration, the implementation of the Interim Final Rule will fall to the new Biden Administration. Because the Rule was published but not yet effective by the inauguration, its effective date may be postponed by the Commerce Department for further review. A [January 20, 2021 memorandum](#) from White House Chief of Staff Ronald Klain to the heads of executive departments and agencies instructs them to "consider postponing" the effective dates of rules that have been published but have not taken effect to allow for further review of for questions of fact, law, and policy that they may raise. It is uncertain at this point whether Commerce will choose to postpone the Rule, or, what, if any changes might result from further review by the Biden Administration.

Assuming the Rule is not suspended, Commerce has requested comments on the Interim Final Rule by March 22, 2021. Commerce's need to evaluate and adjudicate these comments,

coupled with the recent change of Administration, means this Rule could evolve further. Thus, it will be important to continue following these developments going forward to evaluate the potential risk in Commerce reviewing, and potentially prohibiting or requiring mitigation measures for a contemplated ICTS Transaction.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

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