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As US-China Rivalry Intensifies, Congress Pushes to Further Decouple – Outbound Screening and the NCCDA

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Longstanding concerns on Capitol Hill about certain “outbound” activities conducted by U.S. companies and investors, particularly in the technology sector, both in China as well as outside of China with a China nexus, have given rise to significant legislative developments this year.

Background

Last summer, a bipartisan group of seven senators, led by Senators Bob Casey (D-PA) and John Cornyn (R-TX), introduced a bill called the National Critical Capabilities Defense Act (NCCDA), and a House companion bill was then introduced by a similar bipartisan group of members last December. At its core, the NCCDA would create a new federal interagency screening process, with mandatory notifications to a committee, for certain types of transactions and other activities by US companies that pose major risks to US “critical capabilities.” Some of the concerns behind the legislation are the same ones that Congress considered in recent years during the debate on the Foreign Investment Risk Review Modernization Act, which was enacted in 2018 and represented the most sweeping overhaul of the CFIUS process since its creation in 1975.

After an unsuccessful attempt by the Senate authors to add the NCCDA as an amendment to the Senate’s version of a large China-focused competitiveness bill called the US Innovation and Competition Act (USICA), the House sponsors and their allies were able to tuck the NCCDA into the House’s rival bill on competition with China, the America COMPETES Act, before that broader package was passed this past February. Now, Senate and House negotiators are ironing out the differences between the two packages in conference negotiations, with over a hundred congressional committee leaders and other members having been appointed to lead the unwieldy discussions. Without question, the NCCDA is one of the most active areas of debate, perhaps because of its direct relevance to the aims of USICA and the COMPETES Act, which include strengthening crucial US supply chains, spurring innovation in areas of emerging technology, bolstering economic competitiveness with China, and incentivizing domestic manufacturing and production of certain high-demand technologies such as semiconductors.

On June 13, the bicameral, bipartisan sponsors of the NCCDA floated an updated, more focused "discussion draft" of the provisions to stakeholders in an effort to address specific concerns that had been raised about the original bill, including its broad scope, imprecise definitions, feasibility of implementation, and impacts on industry.

Jurisdictional Scope and Definitions

As the NCCDA's name suggests, the updated legislation aims to strengthen the United States' "national critical capabilities" – namely by regulating certain "covered activities" that involve "countries of concern" or "entities of concern." Below is an explanation of some of the draft legislation's key terms.

Covered Activity

The discussion draft creates a new key term – "covered activities" – to lay out the scope of the new interagency committee's jurisdiction, with each activity requiring a nexus with either a country of concern or an entity of concern. Initially, there are three specific jurisdictional buckets, which include any activity by a US person, a "foreign entity," an "affiliate" of a US person, or an affiliate of a foreign person that:

1. "builds, develops, produces, manufactures, fabricates, refurbishes, expands, shifts, services, manages, operates, utilizes, sells, or relocates a national critical capability to or in a country of concern;"

2. "shares, discloses, contributes, transfers, or licenses to an entity of concern any design, technology, intellectual property, or know-how, including through open-source technology platforms or research and development, that supports, contributes to, or enables a national critical capability by an entity of concern or in a country of concern; or"

3. "invests in, provides capital to, or consults for, or gives any guidance, related to enhancing the capabilities or facilitating access to financial resources for a national critical capability for an entity of concern or a country of concern."

The first jurisdictional bucket above is driven principally by concerns over the long-term future of the US industrial base, especially in the areas of technology and manufacturing, and the potential for additional offshoring to China. The second is driven mainly by congressional frustrations based on the view that our dual-use export control system has not done enough to stop the transfer of US intellectual property and related "know-how" to China. And the third bucket is motivated by the ongoing flows of US capital into Chinese companies in key technology areas.

The term "covered activities" would also create two other areas of jurisdiction for the interagency committee. First, since the broader bills elsewhere would provide billions of dollars of funding to incentivize the domestic manufacture of semiconductors, the discussion draft also covers any activity in a country of concern by a recipient of such federal funding, even those activities not directly dealing with national critical capabilities. Finally, the updated bill covers activities undertaken in countries of concern by companies that do contract work (above a yet-undefined monetary threshold) with any US national security agency, which presumably includes all major U.S. defense and intelligence contractors.

The updated bill makes a slew of other changes and clarifications to the legislation, and many (though not all) of them have been quietly applauded by stakeholders. A series of new jurisdictional exceptions, labeled “ordinary business transactions,” has been added to the bill to carve out routine, benign commercial activity. Similarly, the draft proposes to add a “de minimis” threshold to avoid ensnaring smaller transactions that presumably would involve reduced risks. As the debate over the NCCDA continues, the proper scope of these exceptions is one key topic of discussion.

Country of Concern

As mentioned, the updated bill covers only activities in “countries of concern,” which it defines by reference to another law, the Secure and Trusted Communications Networks Act of 2019. That law defined “foreign adversary” as any foreign government or entity “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 updated bill adopts that definition in its entirety to define “countries of concern,” and it also specifically categorizes China, Russia, Iran, North Korea, Cuba, and Venezuela as such countries.

Entity of Concern

The discussion draft also targets some outbound activities involving “entities of concern.” This term is defined as any entity influenced by or affiliated (directly or indirectly) with a country of concern. Notably, the definition of “affiliated” has caused some confusion and concern for stakeholders due to its breadth and ambiguity. Under the updated NCCDA, an entity is considered “affiliated” with a country of concern if it meets any of the following criteria:

- Five percent or more of voting stock or shares is owned or controlled by the country or by an entity influenced by that country.
- It is substantially influenced by a country of concern, or by an entity that is itself influenced by that country.
- It is located in a country of concern and shares a high-level employee with an entity influenced by that country.
- High-level decisions can be made by a country of concern or by an entity influenced by that country.
- It is part of an entity headquartered in a country of concern.
- It is domiciled in a country of concern and either receives or divulges the following types of information to an entity influenced by a country of concern: US trade secrets, intelligence information, national security information, controlled unclassified information, or sensitive information.
- It is entirely domiciled in a country of concern and influenced by a national of that country; or,
- The Committee on National Critical Capabilities (described below) designates it as an entity of concern.

National Critical Capabilities

Another central definition in the updated bill is “national critical capabilities,” which now includes:

- supply chains in sectors identified pursuant to Executive Order, but specifically including semiconductors, large-capacity batteries, critical minerals and materials, pharmaceuticals, and active pharmaceutical ingredients;
- technologies identified by the Director of National Intelligence as critical, including in the fields of artificial intelligence, bioeconomics, and quantum science;
- sectors identified in the White House National Science and Technology Council’s February 2022 Critical and Emerging Technologies List; and
- any other “industries, technologies, and supply chains” identified in the future by the Committee on National Critical Capabilities, which the NCCDA establishes.

Ordinary Business Transactions

As mentioned, the discussion draft also creates a series of carve-outs under the term, “ordinary business transactions,” which include:

- “the sale or license of a finished item” along with associated support to the customer;
- the sale or license of a product “if the United States person generally makes such services available to all of its customers”;
- the transfer of any equipment that “could not result in a foreign person using the equipment to produce critical technology”; and
- the acquisition by an American of any good or service from a non-US person who has “no rights to exploit any intellectual property contributed by” US persons.

The updated bill also gives the interagency committee the ability to carve out additional ordinary business transactions in the future.

Federal Review Process for Covered Outbound Activities

Establishment of Committee on National Critical Capabilities

The updated bill would create the interagency committee – the Committee on National Critical Capabilities – with the authority to review and, if needed, block covered outbound activities that fall under the definition of “covered activity.” While the draft proposal does not specify which agency would serve as chair, the Committee would comprise one representative each from the Departments of Commerce, State, Treasury, Homeland Security, Defense, Justice, Energy, Health and Human Services, Agriculture, and Labor, as well as the Office of the United States Trade Representative and the White House Office of Science and Technology. There would also be nine other federal agencies as non-voting ex officio members of the Committee.

Notification and Interagency Review Process

Were the updated bill to become law, any US person or foreign entity that plans to engage in a covered activity would have to give written notice to the Committee at least 45 days before the activity commences. Once notice is received, the Committee would have the discretionary authority to conduct a review of the activity to screen for any unacceptable risks to national critical capabilities. The Committee would be required to conduct a review upon Congress' request. It could also initiate a review on its own authority.

Section 1005 of the draft bill contains a non-exhaustive list of five factors that the Committee must consider in the review process:

1. US economic, national security, intelligence, military, health, and agricultural interests;
2. The history of distortive or predatory trade practices in each country in which a covered activity occurs;
3. Control and beneficial ownership of each foreign person that is a party to the transaction;
4. Impact on the domestic industry and resulting resiliency; and
5. Whether the activity could, directly or indirectly, support, enhance, or enable the capabilities of a country of concern or entity of concern.

Addressing Risks to National Critical Capabilities

The updated bill contemplates three main ways that the Committee may address risks to national critical capabilities. First, if the Committee determines through its review process that a covered activity poses unacceptable risk, it can recommend that the President take certain actions. The President would have a 15-day window after the review process concludes to announce his/her intended actions, which could include mitigating, prohibiting, or suspending the covered activity. The President could also direct the Attorney General to seek appropriate relief in a federal court. Further, the President could exercise existing authorities granted under laws such as the Export Control Reform Act, International Emergency Economic Powers Act, or Defense Production Act.

Second, the Committee could make legislative proposals to Congress to establish or expand federal programs which bolster national critical capabilities within the United States. And third, the Committee would be authorized to negotiate, enter into, and enforce agreements with parties involved in covered activities in order to mitigate risks to national critical capabilities. These negotiations should involve the lead agency under whose jurisdiction the covered activity falls. The Committee's authority to enter negotiated agreements would extend to covered activities that are pending, voluntarily abandoned, or completed.

Other Powers and Obligations of the Committee

The updated bill would require the Committee to prescribe implementing regulations for the new law. Notably, the Committee would be authorized to impose civil penalties of up to $250,000 for violating any provision of the statute (including failure to give timely, complete, and truthful notice of a covered activity) or an agreement negotiated by the Committee.

The Committee would be required to study and identify supply chain sensitivities for national critical capabilities. As part of this analysis, the Committee would categorize goods, materials, and technology according to whether their sourcing is of least concern (supply chains housed wholly within US-allied countries), greater concern (supply chains involve countries or entities of concern, but substitute production is available elsewhere), or greatest concern (supply chains, in part or in whole, involve countries or entities of concern, with no available substitute production).

Finally, the Committee chair would be charged with engaging with representatives from US-allied countries to develop tools that address covered activities with countries or entities of concern in a coordinated, multilateral, and strategic fashion.

Key Takeaways and the Big Picture

The new NCCDA discussion draft represents a good-faith effort by key members of Congress – eager to assert their relevance on international trade, national security, and geoeconomics as a constitutionally co-equal branch of government – to address real and legitimate concerns by stakeholders in industry, the executive branch, and elsewhere. Nonetheless, US companies and investors that currently conduct covered outbound activities should closely monitor the progress of the NCCDA. The evolving bill's language, though narrowed and clarified in key places, has been read by many to still capture a large swath of activities abroad. The scope of the term "covered activity" is particularly broad, for example, considering the enumerated ways in which an entity may be deemed "affiliated" with a country of concern. Many US enterprises may be unknowingly engaged in covered activities, potentially creating both uncertainty and regulatory risk. If the NCCDA is enacted in its current form, businesses might need to comprehensively review all of their current and future foreign transactions and supply chains, so as to minimize the risk of noncompliance.

Lastly, while the legislative outlook for the NCCDA (as well as the broader USICA and the COMPETES Act) is cloudy, stakeholders can be assured that the issues underlying this bipartisan bill are unlikely to go away anytime soon. The US-China rivalry continues to heat up, and it is likely to last decades. And both the COVID pandemic and Russia's invasion of Ukraine have turned up the spotlight on supply chain problems and challenging economic inter-dependencies involving foreign adversary nations. As a result, the regulatory processes and tools of the US Government will continue to evolve, and US companies' and investors' economic activities involving those nations will be under the microscope more than ever.

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