August 2, 2024

Meena Sharma
Acting Director
U.S. Department of the Treasury
Office of Investment Security
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

RE: "Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern" **RIN 1505-AC82**

Dear Ms. Sharma:

The National Foreign Trade Council (NFTC) appreciates this opportunity to respond to the Treasury Department's Notice of Proposed Rulemaking (NPRPM) "Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern" seeking comments on the Biden Administration's plan to establish an outbound investment security program. We appreciate and recognize that you and your staff have carefully considered our previous comments, which we provided on September 27, 2023, in response to Treasury's ANPRM implementing Executive Order (E.O.) 14105, "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern" (the Outbound Order), issued August 9, 2023. We are grateful that a number of our earlier recommendations have been adopted in this NPRM.

We divide our response to this NPRM into overarching comments on the outbound investment program set forth in this NPRM and offer observations on specific issues and definitions of concern.

General comments

NFTC reaffirms our strong recommendation that Treasury and other agencies involved in planning and implementing an outbound investment security program gain greater understanding of the resource commitments required to implement, administer, and enforce an outbound investment review process, gather real-time data on business impacts and understand the resources and effort required to comply with such a program. This program's effectiveness and thus national security impact of this program must not be degraded through unwarranted expansion of the substantive jurisdiction described in the Outbound Order.

NFTC is deeply concerned with expanding the outbound investment security program to include brownfield investments, particularly since these were not envisaged in the ANPRM. We are also disappointed that this proposed rule does not articulate how the government will use information reported by U.S. persons as part of a required notification, which had been one of the recommendations in responding to the ANPRM. Lastly, we reiterate our request for robust consultation and coordination with key allies, trading partners and other stakeholders. The U.S. must not continue to disadvantage its companies in key financial, manufacturing and technology sectors by standing alone in prohibiting investments, regardless of how narrowly tailored. Moreover, the U.S. must continue collaborating with allies and partners in this area. The U.S. must avoid the alternative route of attempting to circumvent those efforts by imposing new and expansive extraterritorial restrictions on non-U.S. persons.

We note that this proposed rule establishes a three-part mechanism for dealing with covered activities and transactions: prohibition, notification and exception. While we remain grateful for the opportunity to respond to questions in the ANRPM regarding notification, we urge further consultation with relevant stakeholders regarding all three elements of this outbound investment security program. We also note that Treasury has undertaken some analysis of the cost of implementing an outbound investment security program but reiterate our request for a comprehensive impact study of how this program will affect how U.S. investments in prohibited and notified sectors will be supplanted by investments from other countries.

Comments on specific issues of concern

NFTC appreciates the opportunity to comment on this NPRM and respond to the questions raised in the NPRM. We continue to press for greater clarity, consistency and consonance between this new outbound investment security program and existing national security regimes as described in the Export Administration Regulations (EAR) and the International Traffic in Arms Regulations (ITAR), particularly with regard to definitional clarity and alignment on compliance expectations and standards.

Knowledge standard - the ANPRM stated that Treasury was considering adopting a ***"knowledge standard"*** that U.S. persons would need to comply with in assessing whether a proposed transaction met the elements of a *covered transaction*. This NPRM requires a *U.S. person* to ascertain whether a proposed transaction is a *prohibited transaction, notifiable transaction* or not subject to the outbound investment security program and provides a series of examples of fact patterns that describe *covered activities* and *covered transactions* with a *covered foreign person.* The proposed ***"knowledge standard"*** encompasses actual knowledge, "awareness of a high probability of a fact or circumstance's existence **or future occurrence**" (emphasis added), or reason to know of a fact or circumstance's existence. In deciding whether to hold a U.S. person responsible, Treasury places great weight on the "reasonable and diligent inquiry" undertaken by a U.S. person.

We are concerned that despite Treasury's efforts to scope this ***"knowledge standard," the expectations described in the NPRM create a system of moving the goalposts*** rather than

objective criteria for reasonable due diligence efforts. The inclusion of the probability of **<u>future occurrence</u>** of a *covered transaction* is particularly troubling in this regard, and we respectfully request reconsideration of this concept as part of the ***"knowledge standard."*** For example, many greenfield and brownfield projects are, by their nature, **<u>future occurrences</u>** for which new facts come to light throughout the lifecycle of a project. How does Treasury envision applying the ***"knowledge standard"*** to greenfield and brownfield projects?

We also seek clarity on what it means for a U.S. person to "knowingly direct." Current work describes "knowingly directing" as a person having "the authority to make or substantially participate in the decision on behalf of a non-U.S. person." What criteria is Treasury applying to determine whether substantial participation in decision-making has occurred? For example, would this "knowledge standard" extend to due diligence and related activities undertaken by third parties such as attorneys, consultants, and other service providers? When does a third party "substantially participate in decision making"? We respectfully suggest that a U.S. person who recuses themselves from relevant decision-making processes be protected from this "knowledge standard."

Brownfield projects – this NPRM asserts that mere intent regarding a greenfield or brownfield project is sufficient to trigger a covered activity. This falls below and thus contradicts the ***"knowledge standard"*** currently described in the NPRM. We respectfully seek further clarification around Treasury's intention with respect to greenfield and brownfield projects; currently, these apply if there is an "acquisition, leasing or other development of operations, lands, property or other assets in a country of concern and which either (a) results in the establishment of a covered foreign person (greenfield investment) or (b) results in the engagement of a person in a country of concern in a covered activity and where that person was not previously engaged in such covered activity. Clarity is needed so that U.S. persons on the boards of existing Joint Ventures/investments can recuse themselves wherever necessary. Additionally*, "other development of operations"* creates additional ambiguity with respect to actions that may constitute a covered brownfield investment. Consistent with the example of a factory purchase to enter a new covered activity, Treasury should clarify that covered *"development of operations"* occurs only in the case of a significant new capital allocation and not mere payment of personnel salaries or similar use of ordinarily budgeted funds.

Covered foreign person(s) – Treasury notes that commenters on the ANPRM requested that Treasury publish a list of *"covered foreign persons"* and declined to do so because such a list could be overly restrictive and provide a means for evasion of the spirit and intent of the outbound investment security program through corporate restructuring. We respectfully disagree. Publication of a list of *"covered foreign persons"* can significantly improve compliance by reducing negative business impacts and setting forth clear "red flags" for due diligence. At the same time, the publication of a list of *"covered foreign persons"* is unlikely to dissuade intentional efforts to evade regulatory requirements, including prohibition and notification.

In addition, by including in "covered foreign person" even entities incorporated outside of China that have subsidiaries in China, the regulations may restrict U.S. companies from making investments that would be in the national security interests of the United States. For example, many non-Chinese semiconductor companies have facilities in China. U.S. investment in these companies could help expand access to critical semiconductor components in the U.S. and help these companies pivot away from the Chinese market. The regulations, however, will make it more difficult and costly for U.S. companies to consider such investments and, in many cases, may outright prohibit them. Treasury should consider making investments in these types of entities notifiable rather than prohibited and/or creating a licensing regime to make it easier for U.S. companies to obtain approval for investments in appropriate circumstances.

Controlled foreign entity – the NPRM applies a 50% voting interest standard to determine whether a U.S. person has controlling interest over a foreign entity and requires the U.S. person to prevent the *controlled foreign entity* from engaging in a prohibited transaction, and to notify Treasury if a *controlled foreign entity* were to enter a transaction that would be considered notifiable if undertaken by a U.S. person. We acknowledge that this deviates significantly from ANPRM, which had proposed basing the 50% calculation on revenue, income, expenditure and operating expense. However, given the complexity of business relationships within multinational companies as well as the often-speculative nature of frontier activities in the technologies of national security concern articulated in the Executive Order and this NPRM, we question whether a U.S. person with a 51% voting interest would be able to prevent a *controlled foreign entity* from entering into a prohibited transaction. This requirement would appear to impose an unrealistic knowledge standard on the part of the U.S. person, particularly if they are acting in a more proscribed role, such as an investment advisor.

Covered activity(ies) – The Executive Order and this NPRM specifically notes semiconductors and microelectronics, quantum information technologies, and Artificial Intelligence (AI) as "covered national security technologies and products" and this NPRM provides specific descriptions of AI systems. However, definitional discussion of these "covered national security technologies and products" remains broad. We respectfully request that the definitions of these technologies and products:

1. Conform to how they are enumerated on the Commerce Control List (CCL) in Supplement 1 to Part 774 of the EAR
2. Be limited to those items that are already controlled for National Security (NS) reasons
3. "Evergreened" in alignment with the corresponding CCL item, including any future decontrols. It is particularly important that the outbound investment security program treat integrated circuits (ICs) in a way that closely parallels how such ICs are controlled in the EAR.
4. Specifically exclude defense articles, technical data, and software described in the U.S. Munitions List, Part 122 of the ITAR, as the technologies and products targeted by this outbound investment security program are intrinsically dual-use,

5. Specifically exclude medical technologies used in clinical settings and direct patient care. For example, with respect to AI systems for "control of robotic systems", the currently proposed definition potentially covers a wide range of robots with medical applications used in hospital or clinical settings. This could hamper investments that support US and global public health as well as weaken U.S. economic leadership in the medical technology sector without creating national security benefits for the United States.

Joint Venture – the regulations do not define "joint venture" and the term could potentially cover almost any business relationship where two parties are providing resources to support a common goal. This would sweep in a large number of ordinary business transactions that do not present the national security concerns Treasury is targeting and would significantly increase the compliance burden for industry. To provide greater clarity to the industry and ensure the regulations are appropriately targeted to transactions raising the highest risks, recommend that Treasury define joint venture in the regulations as: "Joint Venture" means a legal entity jointly owned by two or more independent persons, established to engage in a single purpose project or an ongoing business in which the owners contribute certain resources and share the profits and losses associated with the legal entity.

Alternatively, we recommend that Treasury provide guidance that joint venture does not include the following types of transactions: (i) intellectual property licensing arrangements, (ii) arrangements under which one party is paid by the other party for goods or services and such other party independently contributes to the development of such goods or services, (iii) one party reselling goods or services of another party to such first party's own customers (with or without developments made independently by such first party), or (iv) arrangements in which funding is provided to one or more independent persons for development purposes and the entity providing such funding is not involved in such development. As stated above, clarity regarding the activities of U.S. persons in joint ventures is necessary so that company directors may recuse themselves as necessary.

Prohibited transactions – this NPRM proposes to include all *"covered foreign persons"* who have been designated on other government lists as prohibited. This proposal raises a number of conceptual concerns. As a general matter, the placement of entities on one or more U.S. Government lists is based on legal criteria specific to each of those lists, combined with entity-specific facts relevant to those criteria. "Cross-referencing" or "cross-designating" derogates from this practice and from the important general principle that a punitive U.S. Government action ought to correspond directly to factors that are specific to the legal standards applicable to that action. This ensures the integrity and credibility of such actions, protects against politicization or overbroad sanctions, and provides U.S. persons with a more predictable framework for market operations. The "cross-reference" proposed in the NPRM would mark a significant and concerning departure from this longstanding U.S. practice and dilute the specific purposes and effects of current list-based designations and associated controls.

Excepted transactions – we acknowledge Treasury's efforts to clarify the universe of *exemptions and excepted transactions* as well as to seek further input from stakeholders. We respectfully ask that transactions involving items and technologies that have been authorized for export to a covered foreign entity (e.g., through export licensing) be excluded from covered transactions and not subject to either prohibition or notification requirements.

Harmonization with other authorities – to avoid fragmentation and confusion, the Administration should seek to align the outbound investment restrictions on AI-related transactions to other national security-related AI policies. To that end, and consistent with thresholds set out in the Executive Order on AI, we recommend that investment restrictions target AI systems trained on more than 10^26 FLOPs of compute.

About NFTC

The NFTC, organized in 1914, is an association of U.S. business enterprises engaged in all aspects of international trade and investment. The NFTC supports open, rules-based trade, including a level and competitive playing field. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members value the work of the Treasury Department and other agencies in implementing the E.O. establishing outbound investment review mechanisms. Our goal is to always strengthen U.S. industries global supply chains and protect national security and economic security interests. Robust trade relationships are central to economic and national security. NFTC's National Security Policy Initiative brings the voice of business to policymakers on global security issues affecting international trade. Companies play a vital role in promoting American values, including human rights and democracy. Our data driven recommendations support American competitiveness and technology leadership that is central to our national security.

Thank you again for this opportunity to comment on this NPRM. We welcome the opportunity to discuss this important matter and answer any questions that you may have regarding these comments or recommendations. I can be reached at (202) 887-0278 or via email at jchu@nftc.org.

Sincerely,

Jeannette L. Chu
Vice President for National Security Policy