

## United States Takes First Step Towards Regulations to Secure the Information and Communications Technology Services Supply Chain

December 11, 2019

On November 27, 2019, the United States Department of Commerce (the “**Department**”) issued an advance notice of proposed rulemaking seeking public comment on “regulations that would govern the process and procedures that the Secretary of Commerce (the “**Secretary**”) will use to identify, assess, and address certain information and communications technology and services transactions that pose an undue risk to critical infrastructure or the digital economy in the United States, or an unacceptable risk to U.S. national security or the safety of U.S. persons” (the “**Proposed ICTS Rule**”). The Proposed ICTS Rule was issued pursuant to [Executive Order 13873](#), “Securing the Information and Communications Technology and Services Supply Chain” (“**Supply Chain E.O.**”). As we previously discussed in a [client alert](#), the Supply Chain E.O. authorizes the Secretary to issue regulations that prohibit U.S. persons from acquiring information and communications technology or services (“**ICTS**”) designed, developed, manufactured, or supplied by persons owned by, controlled by, or subject to the jurisdiction or direction of a “foreign adversary.” The Supply Chain E.O. required the Secretary to publish implementing regulations within 150 days of May 15, 2019, and the Proposed ICTS Rule is a first step towards complying with this requirement. Comments on the Proposed ICTS Rule are due on or before **December 27, 2019**.

Despite the broad scope of the authority granted to the Secretary under the Supply Chain E.O., the Proposed ICTS Rule takes a targeted approach, providing a mechanism pursuant to which the Secretary can identify and review particular transactions to address national security risks, and prohibit or require mitigation in connection with such transactions as appropriate. This approach will likely prove less disruptive to U.S. and global business than would broader prohibitions on transactions involving certain countries or certain foreign companies. However, given the broad discretion granted to the Secretary to review particular transactions and the relatively opaque process the Proposed ICTS Rule would create, U.S. and global companies that engage in ICTS transactions are apt to face substantial uncertainty, potentially endangering deals.

### Summary of the Proposed ICTS Rule

#### *Scope and Purpose*

The Proposed ICTS Rule would create a new set of regulations located at 15 CFR part 7 that set forth a process by which the Secretary will apply a case-by-case, fact-specific approach to determine whether a particular transaction poses national security risks of the type addressed by the Supply Chain E.O. Specifically, the Proposed ICTS Rule gives the Secretary the discretionary authority to analyze any transaction that involves the “acquisition, importation, transfer, installation, dealing in, or use of any ICTS”<sup>1</sup> (“**Transaction(s)**”) provided that such Transaction:

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<sup>1</sup> ICTS is broadly defined in the Proposed ICTS Rule as “any hardware, software, or other product or service primarily intended to fulfill or enable the function of information or data processing, storage, retrieval, or communication by electronic means, including through transmission, storage, or display.”

- is conducted by any person or involves any property subject to the jurisdiction of the United States;
- involves any 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); and
- was initiated, is pending, or will be completed after May 15, 2019, regardless of when any contract applicable to the Transaction was entered into, dated, or signed or when any license, permit.

Notably, Transactions involving ongoing activities such as managed services, software updates, or repairs, constitute Transactions that “will be completed” on or after May 15, 2019, even if a contract was entered into prior to May 15, 2019. Accordingly, such Transactions will be subject to review by the Secretary and may require mitigation if the Secretary so determines.

According to the Proposed ICTS Rule, the Secretary will commence and conduct evaluations to determine what effect the reviewed Transaction will have on the “national security, foreign policy, and economy of the United States.” As discussed above, the Secretary will evaluate Transactions on a case-by-case, fact specific basis. The Secretary, in consultation with the relevant agency heads, will decide whether the Transaction warrants adjustment, which may include the imposition of mitigation measures, or an outright prohibition of the Transaction. Finally, though the Proposed ICTS Rule does not specifically identify a class of Transactions that will be presumptively subject to either prohibition or approval, the Secretary maintains the authority to do so. Any such determination would be published in the *Federal Register*, potentially along with additional guidance or request for comment.

## **Implementation**

The Secretary may initiate an evaluation in one of three ways:

- At the Secretary’s discretion;
- Upon the request of other Government departments, agencies, government bodies, or the Federal Acquisition Security Council;<sup>2</sup> or
- Based on credible information submitted by a private party to the Secretary.

As discussed above, the Proposed ICTS Rule also contemplates the Secretary determining the effect of a Transaction. In considering such effect, the Secretary will consider in particular whether the Transaction:

- is subject to the jurisdiction of the United States;
- involves any 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);
- was initiated, is pending, or will be completed after May 15, 2019;
- involves ICTS designed, developed, manufactured, or supplied, by persons owned by, controlled by, or subject to the jurisdiction or direction of a *foreign adversary*;<sup>3</sup> and

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<sup>2</sup> All requests must be submitted in writing provided from the head of the requesting agency, or his or her designee, to the Secretary.

<sup>3</sup> The Proposed ICTS Rule defines the term “foreign adversary” to mean 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 rule does not identify any particular government or person as a foreign adversary, or set forth any process by which such governments or persons will be identified or  
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- poses and undue or unacceptable risk of :
  - sabotage to or subversion of the design, integrity, manufacturing, production, distribution, installation, operation, or maintenance of ICTS in the United States;
  - catastrophic effects on the security or resiliency of United States critical infrastructure or the digital economy of the United States; or
  - other harm to the national security of the United States or the security and safety of United States persons.

To determine whether a Transaction involves an ICTS designed, developed, manufactured, or supplied, by persons “owned by, controlled by, or subject to the jurisdiction or direction of a foreign adversary,” the Secretary will consider a number of factors, such as:

- The laws and practices of the foreign adversary; and
- Equity interest, access rights, seats on a board of directors or other governing body, contractual arrangements, voting rights, and control over design plans, operations, hiring decisions, or business plan development.

### ***Determinations and Penalties***

If the Secretary determines a Transaction meets the criteria discussed above, the Secretary will provide a written notice to the parties of the Transaction:

- Advising that the Secretary has reached a preliminary determination;
- Explaining the basis for the preliminary determination, to the extent possible consistent with national security;<sup>4</sup> and
- Advising the affected party that it may, within 30 days after receipt of the notice, submit an opposition to the preliminary determination (the “**Opposition Period**”).

The Secretary will consider the opposing party or parties’ opposition, including supporting information submitted, prior to making a final determination. Within 30 days of receipt of an opposition, the Secretary will issue a final determination, and such final determination will be considered “final agency action.”<sup>5</sup> As described above, the Secretary may decide whether the Transaction is or is not prohibited, or otherwise require mitigation measures as conditions for an approval of the Transaction. The final determination will be issued in writing, and should include the penalties the parties will face if they fail to comply fully with either the prohibition or mitigation measures required by the Secretary. The Department will post summaries of final determinations on its website, and publish them in the *Federal Register*. Finally, if circumstances, technology or other available information have materially changed, the Secretary may initiate an evaluation and make a new determination.

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made public. The Proposed ICTS Rule states that such determinations are matters of executive branch discretion that will be made by the Secretary in consultation with other agency heads.

<sup>4</sup> Given the nature of the review contemplated by the Proposed ICTS Rule, it is likely that many determinations by the Secretary will be based in whole or in part on classified national security information, which will likely limit the amount of detail that can be included in such explanations and therefore also constrain the ability of parties to the Transaction to meaningfully respond.

<sup>5</sup> The ICTS Proposed Rule does not provide a timeline establishing when the Secretary will issue a final determination if neither party opposes the preliminary determination. However, the ICTS Proposed Rule affords the parties a 30-day period in which an opposition may be submitted, as discussed above. If the neither party submits an opposition within the Opposition Period, the Secretary will likely issue a final determination within 30 days of the end of the Opposition Period, particularly given the Secretary would have 30 days to do so if an opposition was submitted.

Regarding penalties, any person who violates, conspires to violate, or causes a violation of any determination issued by the Secretary under the Proposed ICTS Rule would be liable for a civil penalty up to \$302,584, or an amount that is twice the amount of the Transaction. Further, any person who violates a mitigation measure or material condition imposed by the Secretary would also be liable for a civil penalty up to \$302,584 or the value of the Transaction. The Proposed ICTS Rule provides that, upon receiving notice of the imposition of a penalty, the penalized party may submit a petition for reconsideration to the Secretary within 15 days of receipt of a penalty notice. The Secretary will review the petition and issue a final decision within 30 days of the petition.

## Topics for Comment

The Department is soliciting comments on or before December 27, 2019 on all aspects of the Proposed ICTS Rule, although the Proposed ICTS Rule expressly advises that the determination of a “foreign adversary” will be made by the Secretary in consultation with the heads of other executive departments and agencies, therefore suggesting that public comments on that topic are unlikely to affect the final regulations. In addition to general comments on the Proposed ICTS Rule, the Department is seeking input on the following:

- Are there instances where the Secretary should consider categorical exclusions? Are there classes of persons whose use of ICTS can never violate the Executive order?
- Are there Transactions involving types or classes of ICTS where the acquisition or use in the U.S. or by U.S. parties would fall within the terms of the Supply Chain E.O.’s prohibited Transactions because the Transaction could present an undue or unacceptable risk, but that risk could be reliably and adequately mitigated to prevent the undue or unacceptable risk? If the commenter believes the risks of a prohibited Transaction can be mitigated, what form could such mitigation measures take?
- If mitigation measures are adopted for a Transaction otherwise prohibited by the Supply Chain E.O., how should the Secretary ensure that parties to such Transaction consistently execute and comply with the agreed-upon mitigation measures that make an otherwise prohibited Transaction permissible? How could the Secretary best be made aware of changes in factual circumstances, including technology developments that could render mitigation measures obsolete, no longer effective, or newly applicable?
- Section 1(a) of the Supply Chain E.O. and the definition of “Transaction” that the Proposed ICTS Rule would implement refer to “acquisition, importation, transfer, installation, dealing in, or use of any information and communications technology or service.” How are these terms, in particular “dealing in” and “use of,” best interpreted?
- The Secretary expects persons engaged in Transactions will maintain records of those Transactions in the ordinary course of business. Should the Department require additional recordkeeping requirements for information related to Transactions?

## Proposed ICTS Rule Observations

Notably, the process established in the Proposed ICTS Rule appears to depend substantially on investigation, discovery and initiation by the U.S. Government, rather than voluntary submission by parties to a Transaction, as is customary in the context of other national security review processes, such as foreign investment reviews conducted by the Committee on Foreign Investment in the United States. This may suggest that the Department contemplates that the Proposed ICTS Rule will generally apply to large-scale transactions that are easily identifiable by the government. Additionally, if private entities are concerned that a proposed transaction could implicate the ICTS Rule but would prefer not to be entangled in mitigation measures, or otherwise prohibited from executing the proposed transaction there

is no mechanism by which the parties can obtain an advisory opinion. Instead, as discussed above, the parties may only initiate an evaluation by submitting information to the Secretary, provided the Secretary deems the parties “credible.”

It is also important to note that the Proposed ICTS Rule makes no specific reference to China or to particular Chinese companies, notwithstanding a widespread perception that the Supply Chain E.O. was aimed at that country. In general, it adopts a measured approach to implementation of the E.O., providing for case-by-case review of specific Transactions rather than across-the-board prohibitions on types of Transactions or dealings with particular countries or entities. Notwithstanding this, the Proposed ICTS Rule, if finalized in its current form, will likely create significant uncertainty for U.S. and non-U.S. companies that deal in ICTS, given the broad discretion the Secretary will possess to review Transactions and prohibit them or require mitigating measures. This uncertainty is compounded by what will likely be an opaque review process where the need for the Secretary to protect classified or sensitive information will limit the ability of participants to meaningfully respond to preliminary determinations. Further, the Proposed ICTS Rule does not provide any mechanism for requesting an advisory opinion regarding a Transaction in advance, and it is unclear whether the Department will be willing to informally consult with parties to a Transaction that may implicate the Proposed ICTS Rule. Accordingly, U.S. companies that frequently conduct Transactions that fall within the criteria discussed above should carefully monitor the development of the Proposed ICTS Rule to determine the exact impact on current Transactions. Similarly, non-U.S. companies that engage in ICTS transactions with U.S. entities should carefully consider their potential exposure to Department review.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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