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NATIONAL SECURITY REGULATIONS 2023 YEAR IN REVIEW (TAYLOR'S VERSION)

Wilson Sonsini is pleased to present the National Security Regulations 2023 Year in Review, *that we've dubbed as "Taylor's Version." We hope you enjoy the references to songs by American singer-songwriter Taylor Swift that are mentioned throughout this Report for your reading pleasure.*

Dear Reader:

With headlining developments across the board, 2023 was another year for the books. Far from there being nothing new, last year saw everything from the announcement of a brand-new regulatory regime (outbound screening) to amped-up supercomputing and semiconductor export controls, to still more sanctions on Russia. Altogether, these record-breaking volumes of promulgation, regulation, and enforcement kept practitioners of National Security law quite busy and repeatedly asking, is it over now?

We noted in last year's report that over the last several years, parties interested in acquiring, investing in, licensing from, or collaborating with U.S. businesses—particularly those working with exciting and novel technologies—have been forced to grapple extensively with a wide range of regulations concerning national security. And this did not change in 2023, as the Committee on Foreign Investment in the United States (CFIUS or the Committee), export controls, sanctions, anti-money laundering (AML), and government contracts matters affected companies, investors, and their partners far and wide.

Tensions new and old—from the Middle East to the Taiwan Strait to the Donbas front—brought continued focus on the arsenal of national security regulatory tools available to further the economic, policy, and defense interests of the U.S., UK, EU, and their allies. In an attempt to attain peace, government regulators continued to act assertively to combat major geopolitical rival China, contain Russia as it embarks upon its third year of aggression in Ukraine, repel Houthi attacks in the Red Sea corridor, and respond to the atrocities of the conflict in Israel and Gaza.

This report recounts the most significant developments in national security regulation in 2023 and discusses our expectations for the rest of this year—changes that will assuredly affect how technology companies, life sciences companies, and their partners and investors will interact [for]evermore.

CFIUS and Foreign Direct Investment (FDI) Review

Last year saw CFIUS and its foreign counterparts attain new heights of regulatory scrutiny and searching enforcement. Abroad, a number of countries in the EU and elsewhere continued to establish and activate their own foreign investment review regimes. Domestically, a new U.S. outbound foreign investment regime was unveiled, and announcements embedded in FAQ changes that initially looked to be sweet nothing ended up severely disrupting previously settled norms.

In addition, we continued to see sparks fly in the discourse between the U.S. Department of the Treasury, the U.S. Department of Justice (DOJ), and the U.S. Department of Defense over the appropriate government response to myriad geopolitical threats. Throughout 2023, the traditionalist call for an open investment environment was drowned out by a more protectionist trend that is set to accelerate as the contentious U.S. presidential election season nears.

Outbound Screening: …Ready for It?

For the past couple of years, we have reported on the numerous pushes in Congress for the creation of an *outbound* foreign investment review regime in the United States. National Security Advisor Jake Sullivan had long signaled that the Biden Administration would fashion its own outbound screening regime (sometimes also referred to as "reverse CFIUS," but feel free to call it what you want) through executive action alone if Congress could not pass legislation to create its own outbound foreign investment review regime. So when Congress still did not take any affirmative steps toward creating any such statutorily authorized body in 2023, the White House leveraged its executive authorities to begin developing its own version of this regime, as we predicted last year.

President Biden's August 2023 Executive Order (the EO) directed the Treasury Department to coordinate with other U.S. government agencies to establish an interagency body to review—and in some cases, prohibit—investments of U.S. persons benefiting the People's Republic of China. Initially, under the terms of the EO, this body will focus on regulating investments relating to the semiconductors and microelectronics, artificial intelligence, and quantum information technologies industries—i.e., some of the sectors venture capital has been most enchanted with over the last year.

The White House EO was accompanied by an initial notice (an "Advance Notice of Proposed Rulemaking") seeking public comments regarding the proposed scope of the new reverse CFIUS regime through September 2023. In 2024, we anticipate additional draft regulations will clarify the scope of this outbound screening regime.

The "Tortured Filers Department"

In May 2023, CFIUS issued a surprisingly significant new FAQ on its website. In the FAQ, CFIUS introduced an updated interpretation of the "completion date" for a transaction, upending the ability of companies and investors to initiate closings in the "two-step" manner that had previously allowed companies to first receive an initial, passive investment, and later to deliver any "CFIUS triggering rights" to an investor following the Committee's closure of its monthslong standard review process.

Prior to the FAQ, companies, investors, legal advisors, and CFIUS itself had generally accepted the two-step model, which was especially critical for EC/VC fundraising during the post-2018 period when CFIUS reviews began to considerably expand in scope and length. This model worked to balance competing interests in the delicate balance between national security, on the one hand, and venture-backed firms' insatiable need for investor funding on the other.

Wilson Sonsini attorneys Stephen Heifetz and Josh Gruenspecht wrote last summer of their fear that CFIUS's new interpretation would result in significant negative consequences for companies with controlled technologies dependent on EC/VC funding. Of course, the investments that have since failed to materialize because of this change—or other investment-unfriendly policies adopted by CFIUS outside of the normal notice-and-comment regulation model—will never be directly captured in CFIUS's, policymakers', or think tanks' annual reports.

The technical impact of the FAQ, though not immediately apparent when released, gained bite when CFIUS followed through on the technical change with prompt private communications to parties signaling its intent to follow through on its new interpretation. Within two months of the May 2023 FAQ, CFIUS affirmed to non-filers that it was about to be a cruel summer when it quickly began issuing non-notified enforcement letters probing transactions that had previously adopted the two-step structure.

Altogether, these changes set more companies up for a particularly mean filing process before a Treasury Department agency that has long demonstrated it is not a typical rule-bound regulator.

The Story of [CFI]Us: Next Chapter

Since the outbound foreign investment regime EO, the national security and investment communities have continued to await release of the draft regulations implementing the outbound foreign investment review regime, which remain pending as of the beginning of 2024. Arrival of these draft regulations before the presidential election in November appears to be a safe bet. Whether other U.S. allies will establish similar screening regimes remains less clear.

More broadly, we expect scrutiny by CFIUS (and its foreign counterparts) to continue as geopolitical tensions with China and Russia remain fraught. In the U.S., this will likely arrive via enhanced diligence into the rights and attributes of limited partners—a focus asserted by CFIUS in the *other* FAQ update it delivered back in May 2023. Investors and companies alike should therefore be prepared for treacherous, protracted, and deep-searching reviews into all parties touching a transaction, regardless of how far up, down, or across the ownership chain an affiliate may be.

Export Controls and Sanctions

2023 looked a lot like '22 for the export controls and sanctions bar: (more) supercomputing and semiconductor manufacturing export controls on China; (more) sanctions prohibiting the supply of certain items, funds, and services to Russia; and (more) designations on actors in the Middle East engaged in terrorism and disrupting global supply chains. In other words, 2023 was a kind of year that we know all too well.

Export Controls: More Bad Blood with Russia and China

The first significant update occurred in May 2023, when the Bureau of Industry and Security (BIS), the Office of Foreign Assets Control (OFAC), and the State Department simultaneously announced a new slate of measures to counter Russian aggression in Ukraine, implementing additional export controls on a broader swath of items to Russia and Belarus, expanding the scope of services that U.S. persons are prohibited to provide to Russia and Belarus, and designating additional Russian individuals and entities operating in Russia's energy, defense, primary resources, tech, and financial services sectors.

Then, BIS apparently decided that autumn 'tis the damn season for China-focused export control rules after releasing its (now, second annual) October controls on the export of advanced computing chips and semiconductor manufacturing equipment to China. Among other changes, the October 2023 rules reorganized the labyrinthine Export Control Classification Number (ECCN) classifications of high-performance threshold chips, expanded the list of countries subject to these heightened export controls on advanced computing and semiconductor manufacturing items to include China, Macau, Russia, Belarus, Venezuela, and various nearby other countries in Asia, Africa, and the Middle East determined to present diversion risks. This measured tightening of export controls remains consistent with BIS's slow (but steady) mission of ensuring such items stay [stay stay] out of the hands of entities in China so they are not able to circumvent the agency's marquee controls on advanced computing chips used commonly in large data centers and AI-related applications that have piqued investors'—and regulators'—interest lately.

Throughout 2023, BIS's Entity List—which records thousands of parties who are unable to receive exports from the U.S., of U.S. goods, or of foreign goods derived from U.S. content or technology without explicit BIS authorization—was also supplemented with a number of designations. Over the course of the year, BIS filled in the List's blank space with hundreds more Chinese, Russian, Belarusian, and other entities and individuals—including, in particular, a number of ascendant companies operating with genomic and genetic data. As is generally the case with parties named on the Entity List, a BIS license is required for any transaction involving EAR-controlled items and a listed party.

Sanctions Never Go Out of Style

Western countries' love story with sanctions continued in high gear in 2023, featuring another year with multiple rounds of sanctions on Russia and Belarus. By the time the war in Ukraine closed its second year, thousands of additional entities had been named to OFAC's "List of Specially Designated Nationals" and to its counterpart asset freeze lists maintained by regulators in the EU and UK.

All in all, the EU, UK, U.S., Canada, and other allied nations participated in implementing even more rounds of sanctions on Russian entities and key Russian politicians, businessmen, and government figures. These include additional sanctions announced or adopted by the UK and the EU in 2023 restricting Russian-origin imports diamonds and metals and expanding export controls on dual use tech and industrial goods. Already in 2024, a 13th EU sanctions package responding to the death of Alexei Navalny has been adopted by the European Council.

The 1 most significant sanctions narrative of the year was the increased enforcement that we've also observed throughout the CFIUS, export controls, anti-corruption, AML, crypto, government contracts, and related practice areas, both in the U.S. and the UK, which made headlines multiple times over the past year:

- two massive OFAC settlements—one for $958 million and a second with for $508 million—catapulted OFAC enforcement to collecting record amounts of fines for the second consecutive year, notching revenue exceeding OFAC's wildest dreams;
- OFAC, BIS, and the DOJ released a joint Tri-Seal Compliance Note discussing the merits of private sector actors filing voluntary self-disclosures to report actual or potential violations of sanctions, export controls, and other national security laws;
- last February, the DOJ and the Department of Commerce announced the establishment of a Disruptive Technology Strike Force to investigate and respond to national security risks associated with the distribution of sensitive technologies to adversaries in locations such as China, Iran, Russia, and North Korea;
- the multilateral crude oil price cap originally introduced more than a year ago (if you can think back to December 2022) received iterative updates in 2023 and has already been the subject of enforcement efforts, demonstrating continued novelty in sanctions targeting; and
- on both sides of the Atlantic, regulators doubled down into initiating investigations and enforcement inquiries into activities related to Russian oligarchs having a less than stellar reputation.

The story of sanctions enforcement appears to be heading along a familiar trajectory, however. After the Deputy Attorney General announced earlier in 2023 that "sanctions are the new FCPA," we briefly recounted the historical narrative of anticorruption enforcement and what that presages for sanctions going forward if that trend is to begin again: more enforcement, more penalties, more multilateral coordination, more multijurisdictional investigations, and a *much* more prominent stature for sanctions issues in the boardroom.

AML

2023 was *not* a good year to have your white-collar crimes told to the FBI (or identified by the U.S. Treasury). We noted last year that 2022 appeared to be an AML enforcement set-up year, and set up it was. Like OFAC, the Financial Crimes Enforcement Network (FinCEN), too, attained new record collections after reaching the largest settlement in the history of the U.S. Treasury—approximately $3.4 billion for violations of AML laws and regulations.

Illicit Affairs

We also continued to see increased enforcement leveraging traditional AML rules and regulations against nontraditional financial services companies. These efforts demonstrate that, despite the types of services offered or protections afforded to customers (e.g., anonymity), if a company falls within the ambit of AML laws, it is required to comply with those AML laws, and will be expected to comply with such laws.

The federal government continues to successfully rely on already existing AML laws for enforcement purposes, as it has done recently in telling decentralized finance companies that FinCEN won't tolerate it when they fail to stand up adequate programs to comply with these laws. Having a robust compliance program continues to be essential for any company operating in the regulated financial services or alternative financial services industries to guard against significant fines, sanctions, and other penalties.

Instead of being caught saying you would've, could've, should've had an adequate AML compliance program in place, be sure to follow our Focus on Fintech newsletter to receive more regular and in-depth updates and developments from financial services regulators that may affect your company.

Can FinCEN Ask You a Question…?

While *technically* an update for 2024 rather than 2023, we'd be remiss not to remind parties of FinCEN's new regulations on the Beneficial Ownership Information (BOI) Reporting Requirement ("BOI Rule") that came into effect on New Year's Day.

The BOI Rule, which we've written about more in depth here and here, requires millions of legal entities to file information with FinCEN disclosing their beneficial owners or potentially be subject to civil and criminal penalties. For entities in existence prior to January 1, 2024, this information must be furnished to FinCEN no later than January 1, 2025, while newly formed entities have 90 calendar days to furnish their beneficial ownership information to FinCEN.

Government Contracting

Government contracting similarly experienced a chiefly evolutionary year in 2023. Among other developments, we continued to witness gradual tightening of the government's approach to contractors' cybersecurity requirements and saw increased sensitivity to the foreign activities of its contractors in certain foreign jurisdictions. For 2024, we expect much of the same, including through the upcoming implementation of the long-awaited Cybersecurity Maturity Model Certification by the U.S. Department of Defense.

CHIPS and Semiconductor Funding: I Know Places You Can (and Can't) Manufacture Leading Edge Chips

We also continued to see incremental drafting and sculpting of the CHIPS ("Creating Helpful Incentives to Produce Semiconductors") and Science Act subsidies for semiconductor companies. These funds are still scheduled for distribution over the next few years to jumpstart what we perceive to be a renaissance of a federal industrial policy to regain (and maintain) technological independence and leadership in the semiconductor industry in the years ahead.

In particular, 2023 saw everything from the release of the first Funding Opportunity Announcement (FOA) under the CHIPS and Science Act, to the posting of informative materials guiding applicants about how to prepare materials for submission, to a Notice of Proposed Rulemaking implementing new clawback mechanisms on funding recipients who should've said no to impermissibly engaging with certain entities of concern or enabling a material expansion of semiconductor manufacturing capabilities in China, Russia, or North Korea.

By June 2023, an expanded FOA permitted applications for projects beyond front- and back-end fabrication of leading-edge, current-generation, and mature-node semiconductors to include wafer manufacturing and capital-intensive ($300 million-plus) semiconductor materials and manufacturing equipment. And in September 2023, a still-further expanded FOA opened to applications for less capital-intensive semiconductor materials and manufacturing equipment projects, requiring less than $300 million of capital investment.

These strong pushes by the Department of Commerce to get funds into the hands of companies and projects across the country are consistent with the Biden Administration's simple message to semiconductor manufacturers: "Come Back…Be Here."

The Energy and Climate Funding Gold Rush

This is no hoax: new funding opportunities enabled by sizable grants authorized under the bipartisan Inflation Reduction Act from 2022 continue to be regularly posted by various U.S. offices and agencies, including those associated with the Department of Energy and the Environmental Protection Agency. Attorneys in Wilson Sonsini's energy and climate solutions practice are continuing to track those federal funding opportunities for you here.

Conclusion

Long story short, 2023 was the latest in a series of blockbuster busy years for CFIUS, FDI, sanctions, export controls, and other related practice areas, and although 2024 is well underway we don't appear to be out of the woods yet. On the near horizon are forthcoming rules focused on AI models as well as a number of legislative, regulatory, and/or administrative actions that have already been introduced—and it's likely not the last time a new rule will be introduced to address perceived threats in the biotechnology and pharmaceutical sectors.

But fear not: you're [not] on your own, kid. Whether the year to come will be one where everything has changed, or still more installments of iterative executions of longstanding trends, it'll be nice to have a friend in Wilson Sonsini's national security practice who will be sure to keep you abreast of the latest developments in the year to come.

In the meantime, please feel free to contact Josephine Aiello LeBeau (jalebeau@wsgr.com), [Hey] Stephen Heifetz (sheifetz@wsgr.com), Joshua Gruenspecht (jgruenspecht@wsgr.com), Mike Casey (mcasey@wsgr.com), Anne Seymour (aseymour@wsgr.com), Seth Cowell (scowell@wsgr.com), Jahna Hartwig (jhartwig@wsgr.com), Tim Kobes (tkobes@wsgr.com), or any member of the national security practice at Wilson Sonsini Goodrich & Rosati with any questions or additional information about the developments noted in this *National Security Regulations 2023 Year in Review*.

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