

U.S. Government Unveils Proposal for Outbound Investment Regime Targeting China

August 15, 2023

On August 9, 2023, the Biden Administration issued the long-awaited [Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern](#) (the “[EO](#)”) and accompanying [Advance Notice of Proposed Rulemaking](#) (the “[ANPRM](#)”) setting forth the proposed contours of an outbound investment regime targeting China.¹ Under the proposed regime, U.S. persons would be prohibited from making, or required to notify the U.S. government regarding, certain investments in entities engaged in certain activities relating to semiconductors and microelectronics, quantum information technologies, and artificial intelligence (“[AI](#)”) in “countries of concern” (presently limited to China, Hong Kong, and Macau). The United States currently has the authority to review inbound foreign investment through the Committee on Foreign Investment in the United States (“[CFIUS](#)”).

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors.

WASHINGTON

Chase Kaniecki
+1 202 974 1792
ckaniecki@cgsh.com

Samuel Chang
+1 202 974 1816
sachang@cgsh.com

William Dawley
+1 202 974 1771
wdawley@cgsh.com

Stephanie Gullo
+1 202 974 1671
sgullo@cgsh.com

¹Department of the Treasury, Advanced Notice of Proposed Rulemaking, “Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern” (August 9, 2023), <https://home.treasury.gov/system/files/206/Treasury-ANPRM.pdf>.
clearygottlieb.com



Although previously referred to informally as “Reverse CFIUS” in industry circles, the ANPRM makes clear that the U.S. Department of the Treasury does not contemplate a case-by-case review of outbound investments. Instead, the proposed regime would require parties to determine whether a given transaction is either prohibited, subject to notification, or permissible without notification. This would require that parties determine whether (i) a “U.S. person” is making or directing (ii) a “covered transaction” with (iii) a “covered foreign person”—*i.e.*, a “person of a country of concern” engaged in certain defined activities involving “covered national security technologies and products.” Each of these elements are discussed below.

The ultimate scope and burden of the program will largely depend on how forthcoming rulemakings address a number of potential ambiguities and uncertainties left open in the ANPRM and how targeted sectors are defined going forward. Parties seeking to submit written comments to the ANPRM must do so by September 28, 2023.

I. U.S. Persons

The EO authorizes the Treasury Secretary to prohibit, or require notification for, covered transactions by any “United States person,” defined as any U.S. citizen, lawful permanent resident, entity organized in the United States (including foreign branches of such entities), and any person (regardless of nationality) located in the United States.

In addition, the ANPRM would prohibit U.S. persons from “knowingly directing transactions” if such transactions would be prohibited if engaged in by a U.S. person. “Directing” would mean that a U.S. person “orders, decides, approves, or otherwise causes to be performed” a covered transaction. The ANPRM provides as examples of “directing”: (i) a U.S. general partner managing a non-U.S. fund undertaking a prohibited transaction, (ii) a U.S.-person officer or senior-level employee directing a non-U.S. fund to undertake a prohibited transaction, (iii) and U.S.-person venture partners launching a non-U.S. fund focused on prohibited transactions. However,

“directing” would not include secondary, wraparound, or intermediary services such as third-party investment advisory services, underwriting, debt rating, prime brokerage, global custody, payment processing, or legal, investigatory, or insurance services.

The proposed regime also could require that U.S. persons “take all reasonable steps to prohibit and prevent” transactions by non-U.S. entities controlled by such U.S. persons that would be prohibited if engaged in by a U.S. person and to require U.S. persons to provide notification of any transaction by a foreign entity controlled by such U.S. person that would be a notifiable transaction if engaged in by a U.S. person. The ANPRM proposes defining non-U.S. entities controlled by a U.S. person as a non-U.S. entity directly or indirectly owned 50% or greater by a U.S. person. “All reasonable steps” may include factors such as binding agreements between the U.S. parent and foreign subsidiary, internal policies and procedures, training and reporting requirements, testing and auditing, and exercise of applicable governance or shareholder rights.

II. Covered Transactions

The ANPRM proposes defining the term “covered transaction”—which would apply to both notifiable and prohibited transactions—to mean a U.S. person’s direct or indirect:

- acquisition of an **equity interest** or **contingent equity interest** in a covered foreign person;
- provision of **debt financing** to a covered foreign person where such debt financing is convertible to an equity interest;
- **greenfield investment** that could result in the establishment of a covered foreign person; or
- **establishment of a joint venture**, wherever located, that is formed with a covered foreign person or could result in the establishment of a covered foreign person.

The proposed regime is intended to be forward looking and would not apply retroactively to the fulfillment of prior binding capital commitments with cancellation

consequences made prior to issuance of the EO, nor would it cover university-to-university research collaborations, contractual arrangements or the procurement of material inputs (even if for covered national security technologies or products), intellectual property licensing, bank lending, the processing, clearing, or sending of payments by a bank, underwriting services, debt rating services, prime brokerage, global custody, equity research or analysis, or other secondary services to a transaction.

Notably, the ANPRM proposes carving out from the “covered transaction” certain “excepted transactions,” defined to include investments (i) into publicly traded securities (as defined in section 3(a)(10) of the Exchange Act),² (ii) into index funds, mutual funds, ETFs, or similar instruments (including associated derivatives) offered by investment companies (as defined in section 3(a)(1) of the Investment Company Act) or by a private investment fund, or (iii) made as a passive limited partner into a pooled investment fund (including venture capital, private equity, and fund of funds) below a to-be-determined *de minimis* threshold. Investments affording rights beyond standard minority shareholder protections would not constitute “excepted transactions.”

The ANPRM also proposes excepting 100% buyouts of entities owned by covered foreign persons and located outside of a country of concern; intracompany transfers from a U.S. parent to a subsidiary in a country of concern; and transactions made pursuant to pre-existing binding, uncalled capital commitments.

III. Covered Foreign Person

The proposed regime would prohibit or require notification of covered transactions with any “covered foreign person,” defined as (i) a “person of a country of concern” (ii) that is engaged in certain specified activities involving “covered national security technologies and products.”

Under the proposed rules, a “person of a country of concern” would be defined as (i) a citizen or permanent resident of a country of concern (*i.e.*, China, Hong Kong, or Macau) who is not also a U.S. citizen or permanent resident, (ii) an entity with a principal place of business in, or organized under the laws of, a country of concern, (iii) the government of a country of concern or any person owned, controlled, directed by, or acting on behalf of such government, or (iv) any entity directly or indirectly owned 50% or greater by one or more of the foregoing parties. Item (iv) is important as it would cover subsidiaries and portfolio companies of Chinese companies, wherever located.

Determining whether a person of a country of concern is engaged in specified activities may potentially raise significant compliance and diligence burdens. The ANPRM proposes a knowledge standard such that a “covered foreign “person” includes (i) any person of a country of concern that is engaged in, or that a U.S. person “knows or should know will be engaged in” (based on publicly available information and “other information available through a reasonable and appropriate amount of due diligence”), an identified activity, or (ii) a person deriving 50% or more consolidated revenue, net income, capital expenditure, or operating expense, from one or more subsidiaries or branches of a party described in (i). However, the ANPRM leaves open questions that may significantly impact the scope (and ultimate chilling effect) of the proposed regime, including how to determine that a company (particularly for early-stage companies or greenfield investments) “will foreseeably be engaged in” targeted activities, the relevant time period to calculate a company’s revenue, income, expenditures, or expenses, and what would constitute a “reasonable and appropriate amount of due diligence.”

The ANPRM proposes potential prohibitions or notifications for transactions involving “covered

²Transactions in publicly traded securities relating to certain listed Chinese companies are restricted under an existing sanctions program for “Chinese Military-Industrial Complex” companies. *See* 31 C.F.R. Part 586.

foreign persons” engaged in certain activities relating to the following:

— **Advanced semiconductor and microelectronic technologies and products.**

- Prohibitions for covered foreign persons engaged in activities involving the: (i) development or production of electronic design automation software designed to be exclusively used for integrated circuit design; (ii) development or production of front-end semiconductor fabrication equipment designed to be exclusively used for the volume fabrication of integrated circuits; (iii) design of integrated circuits that exceed the thresholds in Export Control Classification Number 3A090 under the Export Administration Regulations, or integrated circuits designed for operation at or below 4.5 Kelvin; (iv) fabrication of integrated circuits³ that meet any of the following criteria: (a) logic integrated circuits using a non planar transistor architecture or with a technology node of 16/14 nanometers or less, including but not limited to fully depleted silicon-on-insulator (FDSOI) integrated circuits, (b) NOT-AND (NAND) memory integrated circuits with 128 layers or more, (c) dynamic random-access memory (DRAM) integrated circuits using a technology node of 18 nanometer half-pitch or less, (d) integrated circuits manufactured from a gallium-based compound semiconductor, (e) integrated circuits using graphene transistors or carbon nanotubes, or (f) integrated circuits designed for operation at or below 4.5 Kelvin; (v) packaging of integrated circuits⁴ that support

³ “Fabrication of integrated circuits” is defined as the process of forming devices such as transistors, poly capacitors, non-metal resistors, and diodes, on a wafer of semiconductor material.

⁴ “Packaging of integrated circuits” is defined as the assembly of various components, such as the integrated circuit die, lead frames, interconnects, and substrate materials, to form a complete package that safeguards the semiconductor device and provides electrical connections between different parts of the die.

the three-dimensional integration of integrated circuits, using silicon vias or through mold vias; and (vi) installation or sale to third-party customers of a supercomputer, which are enabled by advanced integrated circuits, that can provide a theoretical compute capacity of 100 or more double-precision (64-bit) petaflops or 200 or more single-precision (32-bit) petaflops of processing power within a 41,600 cubic foot or smaller envelope.

- Notification requirements for covered foreign persons engaged in activities involving the: (i) design of integrated circuits; (ii) fabrication of integrated circuits; and (iii) packaging of integrated circuits, in each case, for which transactions involving U.S. persons are not otherwise prohibited.

— **Quantum information technologies.**

- Prohibitions for covered foreign persons engaged in activities involving the: (i) production of a quantum computer,⁵ dilution refrigerator, or two-stage pulse tube cryocooler; (ii) development of a quantum sensing platform designed to be exclusively used for military end uses, government intelligence, or mass surveillance end uses; and (iii) development of a quantum network or quantum communication system designed to be exclusively used for secure communications, such as quantum key distribution.

— **AI systems.**

- Prohibitions for covered foreign persons engaged in the development of software that

⁵ “Quantum computer” is defined as a computer that performs computations that harness the collective properties of quantum states, such as superposition, interference, or entanglement.

incorporates an AI system and is designed to be exclusively [or primarily] used for military, government intelligence, or mass-surveillance end uses.

- Notification requirements for covered foreign persons engaged in the development of software that incorporates an AI system and is designed to be exclusively [or primarily] used for: (i) cybersecurity applications, digital forensics tools, and penetration testing tools; (ii) the control of robotic systems; (iii) surreptitious listening devices that can intercept live conversations without the consent of the parties involved; (iv) non-cooperative location tracking (including international mobile subscriber identity (IMSI) Catchers and automatic license plate readers); or (v) facial recognition.

IV. National Interest Exemption

The ANPRM also contemplates a “national interest exemption” for transactions in “exceptional circumstances” where the Treasury Secretary determines that an otherwise prohibited transaction should be permitted because it provides an “extraordinary benefit” to U.S. national security or the U.S. national interest in a way that “overwhelmingly outweighs” relevant U.S. national security concerns. The Secretary may request detailed documentation from the relevant U.S. person(s) to determine whether to grant the exemption.

V. Notification Contents

The ANPRM proposes a requirement of filing notifications no later than 30 days following the closing of a covered transaction through an electronic portal hosted on the Treasury Department’s website. The notification would require (i) the identity of the transaction parties, including nationality or place of incorporation, as applicable; (ii) basic business information about the transaction parties; (iii) the expected date of the transaction; (iv) the nature of transaction, including the business rationale; (v) a description of the basis for determining the transaction

is a covered transaction; (vi) additional transaction information (including transaction documents and other agreements); (vii) additional detailed information about the covered foreign person; (viii) a description of due diligence conducted; (ix) information about previous or contemplated future transactions made by the U.S. person into the covered foreign person; and (x) additional information about the U.S. person.

VI. Penalties and Enforcement

The EO authorizes the Treasury Secretary to “take such actions and to employ all powers granted to the President by the International Emergency Economic Powers Act (“IEEPA”) as may be necessary to carry out the purposes” of the EO and enumerates a variety of authorized enforcement actions, including investigative powers, unwinding prohibited transactions, imposing civil penalties, and making criminal referrals.

The Treasury Secretary will have broad investigative powers. The EO states that the Treasury Secretary may investigate and make requests for information relating to notifiable or prohibited transactions from any relevant persons, including through the use of civil administrative subpoenas.

When the Treasury Secretary determines that a transaction is prohibited, the Secretary will have the power to nullify, void, or otherwise require divestment of the transaction.

The EO also instructs the Treasury Secretary to pursue available civil penalties for violations of the EO or its implementing regulations. The ANPRM contemplates penalizing with a civil penalty up to the maximum allowed under IEEPA: (i) material misstatements made in or material omissions from information or documentary material submitted or filed with the Treasury Department; (ii) the undertaking of a prohibited transaction; or (iii) the failure to timely notify a transaction for which notification is required.

Finally, the EO authorizes the Treasury Secretary to refer potential criminal violations of the EO or the regulations issued under it to the Attorney General.

VII. Looking Forward

Outbound investment screening is still relatively rare. However, there are signs of support for similar programs in other countries. This latest action by the Biden Administration follows the May 2023 [G7 Leaders' Statement on Economic Resilience and Economic Security](#) indicating that “appropriate measures designed to address risks from outbound investment could be important to complement existing tools of targeted controls on exports and inbound investments, which work together to protect our sensitive technologies from being used in ways that threaten international peace and security.”⁶ Additionally, in June 2023, the European Commission published a [Joint Communication on a European Economic Security Strategy](#) that includes an action to examine security risks resulting from outbound investments and to propose an initiative by the end of 2023.⁷

The EO and ANPRM were developed after extensive industry consultation and the ANPRM now requests public input on the outbound investment regime. Once the comment period closes on September 28, 2023, the Treasury Department will draft and publish the proposed regulations, likely followed by an additional notice and comment period after the regulations are released. The precise timeline for these next steps is presently uncertain, though it is only after the effective date of the regulations that transactions will be subject to the new regime.

The Treasury Department is required to evaluate the new outbound investment regime no later than one

year after the effective date of the implementing regulations to consider whether further adjustments to the regulations are warranted.

...

CLEARY GOTTLIB

⁶White House, “G7 Leaders’ Statement on Economic Resilience and Economic Security” (May 20, 2023), <https://www.whitehouse.gov/briefing-room/statements-releases/2023/05/20/g7-leaders-statement-on-economic-resilience-and-economic-security/>.

⁷Further, European Commission President Ursula von der Leyen stated in June 2023, “Outbound investment means that we need to ensure that European companies' capital, their knowledge, their expertise, their research is not abused by countries of concern for military application. So, we are working on how best to build such an instrument and we will propose an initiative before the end of the year.” Press Release, European Commission, “President von der Leyen presents the European economic security strategy and the revised multiannual EU budget” (June 20, 2023), https://ec.europa.eu/commission/presscorner/detail/en/AC_23_3401.