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Client Alert: Key Questions Answered about the New US Outbound Investment Regime Targeting China

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On August 9, 2023, President Biden issued an executive order to regulate, for the first time, US outbound investments in key technologies in China that are critical to national security. The executive order directs the Treasury Department, in consultation with the Department of Commerce and other agencies, to issue regulations that will prohibit or require notification for specified transactions. These requirements will apply to investments in three sectors of the Chinese economy: semiconductors and microelectronics, quantum information technologies, and artificial intelligence. Further executive branch action is necessary to implement the executive order.

The Treasury Department provided additional details and solicited input about the future implementation of the investment restrictions in an Advanced Notice of Proposed Rulemaking (ANPRM) released alongside the executive order. The ANPRM provides for an initial 45-day public notice and comment period that will inform Treasury's development of implementation regulations. The next step will be for Treasury to draft regulations and to solicit comments on them, which will provide an additional opportunity for public input before the regulations are finalized.

This article answers 12 key questions about how the outbound investment regime will develop and function.

1. The executive order refers to certain investments in "countries of concern." Which countries are those?

An annex to the order lists "countries of concern." The only country the annex currently lists is China, which it identifies to include Hong Kong and Macau.

2. What types of restrictions does the executive order prescribe?

The restrictions will fall into two buckets – (a) a prohibition on US investments in certain Chinese "covered national security technologies and products" and (b) a notification requirement for US investments in other Chinese "covered national security technologies and products."

Treasury states in the ANPRM that it does not envision a case-by-case review of US outbound investments. Rather, it expects that parties to the transaction will have an obligation to determine whether a given transaction is prohibited or subject to notification.

3. Who will the investment restrictions regulate?

In the ANPRM, Treasury said it anticipates that US persons, wherever located, will be responsible for complying with the executive order's notification and prohibition requirements. A US person includes any US citizen, lawful permanent resident, entity organized under the laws of the United States or any jurisdiction within the United States, including any foreign branches of any such entity, and any person in the United States. Treasury is considering including "indirect" transactions within the scope of the regime, meaning that US persons could not circumvent the requirements by directing transactions through non-US person intermediaries.

4. Will all investments in "countries of concern" be subject to the restrictions?

No. The ANPRM states that restrictions would only apply to investments related to individuals or entities (a) that are engaged in activities related to defined subsets of technologies and products, and (b) with respect to (i) individuals, if the person is a Chinese citizen or lawful permanent resident and not a US citizen or lawful permanent resident, or (ii) entities, if the entity is organized under the laws of China, has a principal place of business in China, or is majority-owned by Chinese individuals or entities. Affected transactions may include certain acquisitions of equity interests, such as mergers and acquisitions, private equity, venture capital, greenfield, joint ventures, and certain debt financing. Certain types of investments, even in identified Chinese technologies and products, may be exempt. Similar to the inbound investment CFIUS context, Treasury is considering creating an exception for passive investments that it deems low-risk, such as investments in certain publicly traded securities, index funds, mutual funds, exchange-traded funds, certain investments made as a limited partner, committed but uncalled capital investments, and intracompany transfers of funds from a US parent company to its subsidiary.

5. Which technologies and products will the outbound investment regime cover?

The ANPRM identifies the following categories of technologies and products that the outbound investment regimes could capture. Additional details about these technologies and products, including, in some instances, particular specifications, are available in the ANPRM.

a. ***Semiconductors and microelectronics***.

- Investments in the following would be prohibited:

  – The development of electronic design automation software or semiconductor manufacturing equipment

  – The design, fabrication, or packaging of advanced integrated circuits

– The installation or sale of supercomputers

- Investments in the following would require notification:

  – The design, fabrication, and packaging of less advanced integrated circuits

b. ***Quantum information technologies***.

- Investments in the following would be prohibited:

  – The production of quantum computers and certain components

  – The development of certain quantum sensors

  – The development of quantum networking and quantum communication systems

- Treasury is not considering requiring notification of any investments in quantum information technologies.

c. ***Certain artificial intelligence systems***.

- Treasury is not currently considering prohibiting any AI-specific investments, but it is soliciting information about how to design a narrow prohibition on investments in AI products that have national security implications.

- Investments in the following would require notification:

  – Activities related to software that incorporates an AI system and is designed for end-uses that may have military or intelligence applications and pose a national security risk.

6. How would notification work?

Treasury is considering requiring notifications to include the following information:

- The identity of the person(s) engaged in the transaction and their nationality (for individuals) or place of legal organization (for entities)

- Basic business information about the parties to the transaction, including beneficial ownership

- The relevant or expected date of the transaction

- The nature of the transaction, including how it will be effectuated, the value, and the business rationale

- A description of the basis for determining that the transaction is a covered transaction, including the national security technologies and products involved

- Additional information about the transaction, including transaction documents and relevant side agreements

- Information about the covered foreign person

- A description of the due diligence conducted regarding the investment

- Information about previous transactions made by the US person into the covered foreign person that is the subject of the notification, and contemplated future investments into the foreign person

- Additional information about the US person, such as its primary business activities and plans for growth

Filings would be submitted electronically and Treasury is considering protecting information contained in notifications against disclosure, with certain exceptions.

Treasury is considering requiring that notifications be filed no later than 30 days following the closing of a covered transaction.

Treasury has solicited comments on the implementation of each of these elements.

7. I was thinking about making investments that might be covered by the new investment regime. Can I still do so?

The investment regime is not yet in effect. The executive order initiates the process of developing and promulgating the restrictions it identifies. And that process is likely to take many months. So, for now, investors do not face any new legal restrictions.

Still, investments in sensitive Chinese technologies, even before the investment regime takes legal effect, are likely to face government scrutiny. The ANPRM states that Treasury may, after the effective date of the regulations, request information about investments that were completed or agreed to after the issuance of the executive order.

Notably too, as recently as August 3, Rep. Mike Gallagher (R-WI), Chairman of the House Select Committee on the Chinese Communist Party, criticized the narrow scope of the White House efforts to restrict outbound US capital investment. The heightened focus on these issues by Chairman Gallagher and Congress underscores the high likelihood that clients with significant investments in these areas in China can expect Congressional inquiries into their investments.[1]

8. I expect to be impacted by the new regulations. Is there anything I should do?

Yes. Companies impacted by this new investment regime can help play a role in shaping it. Treasury issued the ANPRM “as a vehicle for obtaining early stakeholder participation in the rulemaking process" and seeks comment on specific topics that will inform the scope and application of the proposed rule. Only after the public has had an opportunity to offer its input will Treasury release draft regulations. Public reaction to the proposed investment regime, and the public's input, are likely to play an important role in the development of those draft regulations. Thus, we encourage interested parties to submit comments on the ANPRM. The public has until September 28, 2023, to provide comments. We are happy to work with any clients to prepare submissions to Treasury.

9. What are the issues on which Treasury seeks comments?

Treasury has identified 83 specific questions to guide the comments it receives. These questions fall into a number of categories, including the following:

- Definitions, including of "US person," "person of a country of concern," "covered transaction," and "investment"
- The scope of exceptions for transactions that would otherwise be covered
- Which national security technologies and products should be covered and how they should be identified
- Whether a person's obligations under the regulations should be conditioned on that person's knowledge of relevant circumstances
- The information notifications should require and how notifications should be filed
- Whether there should be a national interest exemption from the restrictions
- Compliance and record-keeping controls that will provide guidance
- Penalties for noncompliance

10. Will there be additional opportunities to amend the outbound investment regulations?

Yes. The executive order directs various means for review and revision. Within one year of when regulations become effective, which is still many months away, Treasury must assess the effectiveness of the regulations and decide whether to amend them. The executive order requires periodic review of the effectiveness of the regulations thereafter.

11. Does the US impose any other restrictions on trade with China?

While this would be the first outbound investment regime in the United States, there are already a number of controls that impact the provision of specified technologies to China. On October 7, 2022, for example, the US Commerce Department's Bureau of Industry and Security imposed export controls on China meant to deprive it of critical technologies related to high-end semiconductors and supercomputers. The Commerce Department also imposed export controls related to Chinese military end uses and end users, issued rules to restrict various Chinese entities' access to foreign-produced direct products of US technology or software, and designated numerous Chinese entities on its Entity List, subjecting them to heightened licensing requirements. Other restrictions on trade with China include the Uyghur Forced Labor Prevention Act (UFLPA), which restricts imports derived from products of Xinjiang or an entity on the UFLPA Entity List and sanctions on specified entities and individuals imposed under various sanctions programs. Building on these existing restrictions, the new outbound investment regime seeks to prevent China from exploiting "certain intangible benefits that often accompany United States investments and that help companies succeed, such as enhanced standing and prominence, managerial assistance, investment and talent networks, market access, and enhanced access to additional financing."

12. Why is this happening now?

The effort reflects the Biden administration's effort to strike a balance between advancing US national security interests and preventing relations with China—already near their worst in decades—from reaching a new low. The executive order describes US officials' concerns that China is exploiting US investments in critical technologies to accelerate and improve its efforts to use those technologies—and particularly their military, intelligence, surveillance, or cyber-related applications—against the United States and its allies. But the language of the order seems designed to preempt Chinese remonstrances that it is really designed to contain China's peaceful rise. The order's accompanying press release states that the restrictions are "narrowly targeted" to protect national security, and reiterates the United States' commitment to an otherwise liberal trade regime characterized by open investment and robust cross-border flows. Still, the executive order is likely to prompt China to seek out retaliatory measures that could disrupt US trade and supply chains.

[1] Jenner & Block's National Security, Sanctions, and Export Controls practice group, together with its Government Controversies and Public Policy Litigation practice group, are uniquely well positioned to help clients navigate the challenges that arise as a result of Congressional scrutiny of national security issues, particularly those related to the evolution of the US and China geopolitical relationship.

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