

Locke Lord QuickStudy: Final Rule Issued Regarding U.S. ?Outbound Investments in ?Certain Chinese National Security ?Technologies and Products

Locke Lord LLP

WRITTEN BY

Ryan Last

On October 28, 2024, the U.S. Department of the Treasury (the Treasury) released [final regulations](#) (the Final Rule) to implement Executive Order 14105, titled “Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern” (EO 14105 or the “Outbound Order”), issued by President Biden on August 9, 2023.

The Outbound Order is intended to restrict U.S. investments that could enhance the development of sensitive technologies deemed to threaten U.S. national security. The Final Rule prohibits or requires notification regarding certain investments in entities within or otherwise connected to “countries of concern” listed on Annex A to the Outbound Order. Currently, Annex A lists only the People’s Republic of China, along with the Special Administrative Region of Hong Kong and the Special Administrative Region of Macau (collectively, China); the President may in the future update the Annex to the Outbound Order to add additional countries of concern. Please also see our August 15, 2023 QuickStudy titled “[President Biden Issues Executive Order Banning Certain Technology Sharing with China](#).”

Executive Summary

The Final Rule, which takes effect on January 2, 2025, requires U.S. persons to provide notification to the Treasury regarding, or in some cases prohibits, certain types of investment transactions involving Chinese businesses that develop or produce quantum technologies (including quantum computing, sensing, and networking/communications), semiconductors or related products, certain types of AI systems, or supercomputers.

The Final Rule also introduces new requirements for U.S. persons to conduct certain due diligence, cause their “controlled foreign entities” to comply with the prohibitions and notification requirements, and meet other new compliance expectations.

The overarching goal of the Outbound Order and related Final Rule is to prevent both capital and the intangible benefits that often accompany U.S. investments, from flowing to Chinese businesses that develop or produce the listed technologies, while preserving the U.S.’s commitment to open and secure investments. The Treasury anticipates making additional information available on its Outbound Investment Security Program (the Program) [website](#).

The Final Rule

The Final Rule has two core requirements. First, the Final Rule requires U.S. persons to notify the Treasury no later than 30 days following the closing of specified types of investments in a Covered Foreign Person or joint venture that designs, fabricates, or packages integrated circuits not meeting the prohibited standard, or that develops certain types of AI systems. Second, the Final Rule prohibits U.S. persons from investing in a Covered Foreign Person or joint venture that develops or produces (or in some cases installs or sells) specified types of semiconductors or related products, supercomputers, quantum technologies, or certain AI systems.

In certain instances, the Final Rule introduces a due diligence requirement based on a knowledge standard. U.S. persons are required to take action in such cases if they are aware, or should have been aware, of facts indicating a transaction is covered by the Final Rule. The Final Rule imposes recordkeeping and other ancillary requirements as well.

Prohibited Transactions

Subpart C of the Final Rule prohibits U.S. persons from engaging in a Prohibited Transaction unless an exemption for that transaction has been granted under section 850.502. It also requires U.S. persons to take all reasonable steps to prohibit and prevent any transaction by their Controlled Foreign Entities that would be prohibited if engaged in by a U.S. person. Finally, it prohibits U.S. persons from knowingly directing a transaction by a non-U.S. person that the U.S. person knows at the time of the transaction would be a prohibited transaction if engaged in by a U.S. person.

Notifiable Transactions

Subpart D of the Final Rule requires U.S. persons to notify the Treasury in any of the following circumstances:

- If it undertakes a Notifiable Transaction (section 850.401);
- If its Controlled Foreign Entity undertakes a transaction that would be notifiable if undertaken by a U.S. person (section 850.402); or
- If the U.S. person acquires actual knowledge following the completion date that the transaction would have been either prohibited or notifiable if the U.S. person had known of the relevant facts or circumstances as of the completion date (section 850.403).

When one of these notification requirements applies, a U.S. person is required to follow the Treasury's procedures to timely submit detailed information to the Treasury and to certify as to the completeness and accuracy of the submission. In addition, the U.S. person has an ongoing duty to promptly (and no later than 30 days after learning of the issue) update any submission if it later discovers a material omission or inaccuracy about any information so provided.

Exceptions and Exemptions

While the Final Rule imposes many restrictions, it also includes several exceptions for specific types of transactions. These include investments in publicly traded securities, certain limited partner investments in venture or private equity funds, and intracompany transactions. Additionally, U.S. persons may apply for a national interest

exemption if they believe a transaction is critical to U.S. interests.

Importance of Compliance and the Final Rule's Impact

The Final Rule marks a significant shift in U.S. foreign investment policy, and is a direct response to growing national security concerns about foreign adversaries leveraging U.S. investments to accelerate or enhance their development of sensitive technologies. As compliance requirements come into effect in January 2025, U.S. businesses and investors with exposure to transactions covered by the Final Rule may want to develop compliance programs and conduct due diligence on certain transactions to avoid potential violations.

Key Defined Terms

Controlled Foreign Entity means an entity incorporated in, or organized under the laws of, a country other than the United States of which a U.S. person is a parent.

Covered Activity means, in the context of a transaction, any of those activities included in the definition of Notifiable Transaction in section 850.217 or Prohibited Transaction in section 850.224.

Covered Foreign Person. The Final Rule describes three sets of circumstances that will cause a person to be a Covered Foreign Person:

- Under section 850.209(a)(1), a person is a Covered Foreign Person if it is a person of a country of concern that is engaged in a Covered Activity;
- Under section 850.209(a)(2), a person is a Covered Foreign Person even if it is not itself a person of a country of concern or engaged in a Covered Activity but has a particular relationship with a person of a country of concern that is engaged in a Covered Activity; or
- Under section 850.209(a)(3), a person of a country of concern will be a Covered Foreign Person by virtue of its participation in a joint venture with a U.S. person if such joint venture is engaged in a Covered Activity.

Covered Transactions are transactions that are either notifiable or prohibited, and include a U.S. person's direct or indirect:

- Acquisition of an equity interest or contingent equity interest (including convertible debt) in a Covered Foreign Person;
- Provision of debt financing that affords the lender an interest in profits or certain management or governance rights in a Covered Foreign Person that are characteristic of an equity investment but not typical of a loan;
- Conversion of a contingent equity interest (including convertible debt) in a Covered Foreign Person where the contingent equity interest was acquired on or after the effective date of the Final Rule;
- Acquisition, leasing, or other development of land, property or other assets in a country of concern that will result in or the U.S. person plans to result in the establishment of a Covered Foreign Person, or the engagement of a person of a country of concern in a Covered Activity;
- Entering into a joint venture with a person of a country of concern when the U.S. person knows that the joint venture plans to engage in a Covered Activity; or
- Acquisition of an LP or equivalent interest in a pooled investment fund that is not a U.S. person but that the U.S. person knows at the time likely will invest in a person of a country of concern that is in the semiconductor/microelectronics, quantum information technologies, or artificial intelligence sectors, and such

fund undertakes a transaction that would be a Covered Transaction if undertaken by a U.S. person.

Excepted Transaction. Below is a summary of ten categories of Excepted Transactions, which are treated as not being Covered Transactions (subject to conditions in some instances, e.g., that the U.S. person investor cannot gain rights beyond standard minority shareholder protections):

- An investment by a U.S. person in a publicly traded security;
- An investment by a U.S. person in a security issued by a registered investment company, such as an index fund, mutual fund, or exchange traded fund, or issued by a company that is or has elected to be regulated as a business development company;
- An investment by a U.S. person as a limited partner in a pooled investment fund where the committed capital is not more than \$2 million or a binding contractual assurance has been secured that the capital will not be used to engage in Prohibited or Notifiable Transactions;
- An investment by a U.S. person in a derivative that does not confer the right to acquire equity, any rights associated with equity, or any assets in or of a Covered Foreign Person;
- A U.S. person's full buyout of all interests of any person of a country of concern in an entity, such that the entity is not a Covered Foreign Person following the transaction;
- An intracompany transaction between a U.S. person parent and its Controlled Foreign Entity that supports new operations that are not Covered Activities or that maintains pre-existing operations, including Covered Activities that were ongoing prior to the effective date of the Final Rule;
- Fulfillment of a U.S. person's binding, uncalled capital commitment entered into prior to the effective date of the Final Rule;
- The acquisition of a voting interest in a Covered Foreign Person upon default or other condition involving a loan, where the loan was made by a lending syndicate and a U.S. person participated passively in the syndicate;
- The receipt of employment compensation by an individual in the form of stock or stock options, or the exercise of such options; and
- Certain transactions with or involving a person of a country or territory outside the U.S. that has been designated by the Secretary in accordance with provisions set forth in section 850.501(g) of the Final Rule. No such designations have yet been made.

Knowledge. A U.S. person is responsible for knowledge the U.S. person had or could have had through a "reasonable and diligent inquiry." The Treasury expects a U.S. person to make a reasonable effort, taking into account the context of a given transaction and any warning signs, among other factors.

The Final Rule also requires a U.S. person to provide prompt notice to the Treasury upon (and no later than 30 calendar days after) acquiring actual knowledge after the completion date of a transaction of facts or circumstances that would have caused the transaction to be a Covered Transaction if the U.S. person had such knowledge on the completion date.

Parent means a U.S. person that, directly or indirectly, (1) holds more than 50% of the outstanding voting interest or voting power of the board of the entity; (2) is a general partner, managing member, or equivalent of the entity; or (3) if the entity is a pooled investment fund, is an investment adviser to any such fund.

U.S. person means any U.S. citizen, lawful permanent resident, entity organized under the laws of the U.S. or any jurisdiction within the U.S., including any foreign branch of any such entity, or any person in the U.S.

The Final Rule provides the Secretary with authority to pursue civil penalties for violations and to refer criminal violations to the U.S. Department of Justice for prosecution. U.S. persons that believe they may have violated the Final Rule can submit a voluntary self-disclosure, which the Treasury may take into account when determining whether to pursue an enforcement action and if so any penalties.

Conclusion

This paper is intended as a guide only and is not a substitute for specific legal or tax advice. Please reach out to the authors for any specific questions. We expect to continue to monitor the topics addressed in this paper and provide future client updates when useful.

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