

Locke Lord QuickStudy: Further Examination Into President Biden's Outbound Investment Controls in Certain Chinese Technology Sectors

Locke Lord LLP

WRITTEN BY

Ryan Last

Expanding upon our initial [QuickStudy](#) published on August 15, 2023, this QuickStudy explores certain implications of President Biden's August 9, 2023 [Executive Order](#) ("EO") that introduced a new "Outbound Investment Program" ("OIP") aimed at prohibiting U.S. investments in companies that support military, intelligence, surveillance, or cyber-enabled capabilities in "countries of concern." The EO was issued pursuant to powers granted to the President under the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.) (IEEPA), the National Emergencies Act (50 U.S.C. 1601 et seq.) (NEA), and section 301 of title 3, United States Code.

Concurrently with the release of the EO, the U.S. Department of the Treasury ("U.S. Treasury") issued an [Advanced Notice of Proposed Rulemaking](#) ("ANPRM"). Both the EO and the proposed rules in the ANPRM outline a program with two key objectives: (1) to prohibit U.S. persons from engaging, either directly or indirectly, in certain types of transactions with a "covered foreign person" who are involved in the activities related to specified "covered national security technologies and products"; and (2) to mandate that U.S. persons notify the U.S. Treasury when they engage, either directly or indirectly, in the same types of transactions involving a broader range of defined "covered national security technologies and products."

In an Annex to the EO, the President identified only one country, the People's Republic of China ("PRC"), along with the Special Administrative Region of Hong Kong and the Special Administrative Region of Macau, as a country of concern.

In the ANPRM, the U.S. Treasury states that the basis for the EO is that "U.S. investments are often more valuable than capital alone because they can also include the transfer of intangible benefits. Investors from the United States often lend support to the companies in which they invest, and these could include PRC entities that are developing technology with military end uses. Intangible benefits that often accompany U.S. investments and help companies succeed include enhanced standing and prominence, managerial assistance, access to investment and talent networks, market access, and enhanced access to additional financing. Certain investments from the United States into a country of concern can be exploited to accelerate the development of sensitive technologies or products in ways that negatively impact the strategic military position of the United States."

The ANPRM proposes to define a "covered foreign person" as "(1) a person of a country of concern that is engaged in, or a person of a country of concern that a US person knows or should know will be engaged in, an

identified activity with respect to a covered national security technology or product; or (2) a person whose direct or indirect subsidiaries or branches are referenced in item (1) and which, individually or in the aggregate, comprise more than 50 percent of that person's consolidated revenue, net income, capital expenditure, or operating expenses."

The EO defines categories of "covered national security technologies and products" as (1) semiconductors and microelectronics; (2) quantum information technologies; and (3) artificial intelligence. Where applicable, "covered national security technologies and products" may be limited by reference to certain end uses of those technologies or products.

"Covered transactions," which apply equally to both prohibited transactions and those requiring notification to the U.S. government, encompass various scenarios involving a U.S. person's direct or indirect engagement in: (1) the acquisition of an equity interest or contingent equity interest in a covered foreign person; (2) the provision of debt financing to a covered foreign person, where such debt financing has the potential to be converted into an equity interest; (3) a Greenfield investment that might lead to the creation of a covered foreign person; and (4) the establishment of a joint venture, regardless of its location, either formed with a covered foreign person or with the potential to result in the formation of a covered foreign person.

As stated in the ANPRM, the U.S. Treasury expects that the restrictions and notification mandates will apply to U.S. persons' investments in companies involved in the covered national security technologies and products with companies that are legally organized or headquartered in China or under Chinese ownership, whether by Chinese citizens, the Chinese government, or Chinese parent companies. Additionally, the proposed regulations may extend to companies outside of China if they are at least 50% owned, whether individually or collectively, directly or indirectly, by Chinese citizens, Chinese parent companies, or the Chinese government.

The U.S. Treasury is considering broad categories of transactions that would carry a lower likelihood of raising concern and would be exempted from the definition of "covered transactions." These excluded transactions would encompass: (1) investments in publicly traded securities, such as stocks, index funds, mutual funds, ETFs, or similar investments offered by an investment company or private investment fund; (2) purely passive investments made by a limited partner into pooled investment funds (e.g., venture capital funds or private equity funds), provided they fall below a threshold determined by the U.S. Treasury; (3) acquisitions of equity or other interests held by a covered foreign entity in an entity or asset located outside of a country of concern, where the U.S. person is acquiring all interests held by the covered foreign entity; (4) an intra-company transfer of funds from a U.S. parent company to a subsidiary situated in a country of concern; and (5) transactions conducted in accordance with a binding, uncalled capital commitment made prior to the date of the EO. Any investment that provides rights to U.S. persons beyond ordinary minority shareholder protections would not be considered an excluded transaction (e.g., membership or observer rights on the board of directors of the covered foreign person).

Currently, the ANPRM targets application only to U.S. persons. The U.S. Treasury, however, has proposed extending the restrictions to U.S. persons' subsidiaries organized outside the U.S. by requiring U.S. persons to take appropriate action to cause non-U.S. organized subsidiaries under their control to comply with the proposed requirements.

Unlike the strict liability standard employed under U.S. sanctions administered by the U.S. Treasury, the ANPRM

suggests the potential adoption of a “knowledge standard” throughout the program. This would mean that a U.S. persons should be “aware, or reasonably expected to be aware” through a reasonable level of due diligence, that they are engaging in a transaction involving a covered foreign entity, and that this transaction falls within the category of a covered transactions. Importantly, knowledge could also be inferred when there is a deliberate avoidance of facts or a willful disregard of pertinent information.

The EO and ANPRM are part of a comprehensive economic diplomatic strategy employed by the U.S. and a continuing feature of its national security approach. While this program does introduce some distinct elements, setting it apart from traditional U.S. trade controls such as export restrictions on goods, software and technology, sanctions programs targeting specific parties, countries or regions, and inbound foreign direct investment oversight through the Committee on Foreign Investment in the United States, the proposed rules for outbound investments largely incorporate aspects from each of these existing regulatory frameworks. The EO and ANPRM establish an additional layer and avenue of control, with a specific focus on the movement of capital. The 45-day period for public input on the ANPRM ended on September 28, 2023. Following, the U.S. Treasury will issue a Proposed Notice of Rulemaking with what is expected to be a nearly finalized version of the regulations and permit one more opportunity for public comment.

The U.S. Treasury also advises that the U.S. benefits from an open investment climate and believes that the OIP will not change that. U.S. Treasury believes that the OIP is narrowly targeted at investments in highly sensitive technologies and products which is limited to protecting U.S. national security. The U.S. Treasury anticipates that the rules will exempt certain transactions, including potentially those in publicly-traded instruments and intracompany transfers from U.S. parents to subsidiaries.

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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