August 10, 2023

President Biden Issues Executive Order Creating Unprecedented Outbound Investment Review Prohibitions Targeting China

On August 9, 2023, President Biden issued an executive order entitled "Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern" (the "Order") creating the first-ever outbound investment review mechanism in the United States.[1] This Order has been widely expected for months and is narrower and has a longer implementation period than many had predicted. In a concurrent action on the same day, the Department of the Treasury issued an advance notice of proposed rulemaking (the "ANPRM") to begin to implement the Order.[2]

The initial rules will only apply to three sectors in the PRC: (i) semiconductors and microelectronics, (ii) quantum information technologies, and (iii) certain artificial intelligence ("AI") systems. The ANPRM also contemplates both a prohibition on a targeted subset of proposed investments in these sectors and a separate notification and review requirement for a broader set of proposed investments involving these sectors.

Neither the Order nor the ANPRM has any immediate effect—the ANPRM solicits comments from U.S. industry and other stakeholders within 45 days of its publication in the Federal Register, after which Treasury will issue a notice of proposed rulemaking, to be followed by another notice and comment period, after which Treasury will ultimately issue a final rule. As a result, it is unlikely that a final rule will take effect for at least a year and perhaps longer depending upon, among other things, the volume of comments that the Treasury Department receives.

The Order and ANPRM are a cautious first step in the creation of "reverse CFIUS" reviews for certain U.S. person investments in China and occurs amid continuing tension in the U.S.-China relationship. The Treasury Department is also considering incorporating a number of exceptions to the requirements of the initial rules, largely focused on U.S. person investments in publicly traded securities and certain passive investments made as a limited partner.

Key Aspects of the ANPRM and the Order

In the ANPRM and a related fact sheet,[3] the Treasury Department describes its initial view of the framework of the regulations it will ultimately issue to implement the Order. The ANPRM's framework includes the following with respect to the outbound investment review program:

- **Broad Definition of "U.S. Persons**." The program anticipates that U.S. persons, wherever they are located, will be responsible for adhering to the prohibition and the notification requirements. A U.S. person includes any U.S. citizen, lawful permanent resident, entity organized under the laws of the United States or any jurisdiction within the United States and any person in the United States. Under the Order, the Secretary of the Treasury may also place certain obligations on U.S. persons with respect to foreign entities that they control and in certain situations where U.S. persons knowingly direct transactions by non-U.S. persons.

- **Only Covers Specific Categories of Covered Transactions**. The program is anticipated to focus on U.S. persons undertaking certain types of transactions that could convey "intangible benefits," specifically: the acquisition of equity interests (*e.g.*, via mergers and acquisitions, private equity, venture capital, and other arrangements); greenfield investments; joint ventures; and certain debt financing transactions that are convertible to equity.

- **Narrowly Targeted Prohibitions**. Investments prohibited by the program are intended to be narrowly targeted to a subset of investments in these sectors, as follows:

    - *Semiconductors and Microelectronics*. PRC companies engaged in activities related to: (i) technologies that enable advanced integrated circuits; (ii) advanced integrated circuit design and production; and (iii) supercomputers.

    - *Quantum Computers and Components*. PRC companies engaged in activities related to: (i) quantum computers and components (the production of a quantum computer, dilution refrigerator, or two-stage pulse tube cryocooler); (ii) quantum sensors (quantum sensing platforms designed to be exclusively used for military end uses, government intelligence, or mass surveillance end uses); and (iii) quantum networking and quantum communication systems (a quantum network or quantum communication system designed to be exclusively used for secure communications, such as quantum key distribution).

    - *AI*. According to the ANPRM: "[i]f the Treasury Department were to pursue a prohibition in this category, a potential approach is to focus on U.S. investments into [PRC companies] engaged in the development of software that incorporates an AI system and is designed to be exclusively used for military, government intelligence, or mass-surveillance end uses. Alternatively, 'primarily used' could take the place of 'exclusively used.'"

- **Broader Notification Requirement**. The Treasury Department is currently considering a notification requirement for a broader set of investments in the PRC semiconductors and microelectronics and AI sectors (notably, the ANPRM does not currently contemplate a notification requirement in the quantum computing sector), as follows:

    - *Semiconductors and Microelectronics*. PRC companies engaged in activities related to: (i) integrated circuit design, (ii) integrated circuit fabrication, and (iii) integrated circuit packaging.

    - *AI*. From the ANPRM: "[t]he Treasury Department is considering a requirement for U.S. persons to notify the Treasury Department if undertaking a transaction with a [PRC] person engaged in the development of software that incorporates an artificial intelligence system and is designed to be exclusively used for: cybersecurity applications, digital forensics tools, and penetration testing tools; the control of robotic systems; surreptitious listening devices that can intercept live conversations without the consent of the parties involved; non-cooperative location tracking (including international mobile subscriber identity (IMSI) catchers and automatic license plate readers); or facial recognition. Alternatively, 'primarily used' could take the place of 'exclusively used.'"

- **Only Covers Investments in Certain PRC Persons**. The restrictions are anticipated to apply to investments in entities that are engaged in activities related to the defined sub-sets of technologies and products, and that are organized under the laws of a country of concern, have a principal place of business in a country of concern, or are majority-owned by country of concern individuals or entities. Presently, the Order only lists the PRC (including Hong Kong and Macau) as a "country of concern."

- **Potential for a Range of Excepted Transactions**. The Treasury Department is considering creating exceptions to the rule for certain types of passive and other investments "that may pose a lower likelihood of conveying intangible benefits or in an effort to minimize unintended consequences." For example, the Treasury Department is considering excepting from the program's coverage certain U.S. person investments into 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 U.S. parent company to its PRC subsidiary. The scope and nature of each of these potential exceptions is under consideration as detailed in the ANPRM.

The Order also requires the Secretary of the Treasury to perform an assessment, within one year of the issuance of the regulations implementing the Order (and on an annual basis thereafter), to determine whether it is advisable to amend the regulations, including whether to expand or adjust the definition of "covered national security technologies." The Order also requires the Secretary of the Treasury to provide annual reports to the President regarding the effectiveness of the regulations, including "aggregate sector trends evident in notifiable transactions and related capital flows" and to provide recommendations as to whether additional U.S. government actions should be taken with respect to outbound investment reviews.

Implications

The Order and ANPRM are the latest in a long line of recent U.S. government actions[4] targeting China, including the targeting of Chinese entities for sanctions and export control restrictions, increasing export licensing requirements on a wide variety of U.S. goods and technology to be shipped to China, and various U.S. government rules targeting the use of China-origin information and communications technology in the United States. Given that U.S. export controls already prohibit the export of many higher technology U.S.-origin goods, software, and technology to Chinese companies in these sectors, the initial outbound investment rules appear targeted to further cut off these Chinese companies from U.S. financial support and other "intangible benefits" that could be conveyed by U.S. person investors.

The Order and ANPRM represent an unprecedented expansion of the ability of the U.S. government to review outbound investment from the United States and should be carefully reviewed by U.S. fund managers (and non-U.S. fund managers with significant U.S. limited partners or co-investors) as well as companies considering investments in Chinese companies in or adjacent to the Chinese quantum computing, semiconductor, or artificial intelligence sectors.

Fund managers and companies considering investments in China would also be well-advised to monitor and consider submitting comments during the Department of the Treasury's notice and comment rulemaking activities pursuant to the Order and ANPRM (including reviewing and potentially responding to further questions that the Treasury Department may pose to the public regarding the scope of its proposed regulations). This Order, along with other recent U.S. government actions targeting China, may also make it advisable to consider future compliance obligations under the to-be-issued Treasury regulations implementing the Order.

We will continue to monitor developments in U.S. inbound and outbound investment reviews and will provide further updates as appropriate.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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1 The White House, "Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern: (Aug. 9, 2023), available here.

2 U.S. Dep't of the Treasury, "Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern" (Aug. 9, 2023), available here.

3 U.S. Dep't of the Treasury, "FACT SHEET: President Biden Issues Executive Order Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern; Treasury Department Issues Advance Notice of Proposed Rulemaking to Enhance Transparency and Clarity and Solicit Comments on Scope of New Program" (Aug. 9, 2023), available here.

4 *See, e.g.*, Paul, Weiss "First Cases from DOJ's Disruptive Technology Strike Force Cover Export Control Evasion and Trade Secret Theft" (Jun. 5, 2023), available here; Paul, Weiss, "BIS Imposes $300 Million Penalty Against Seagate for Export Control Violations and Makes Controversial Changes to Voluntary Self-Disclosure Program (May 1, 2023), available here; Paul, Weiss, "President Biden Revamps Communist Chinese Military Companies (CCMC) Sanctions Program (Jun. 7, 2021), available here; Paul, Weiss, "Commerce Publishes Information and Communications Technology and Services (ICTS) Interim Rule in the Final Days of the Trump Administration (Jan. 27, 2021), available here.