

INTERNATIONAL BUSINESS ALERT

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US outbound investment screening: Overview and key potential impacts

The Biden Administration issued an Executive Order (E.O.) on Aug. 9, 2023, entitled “Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern.” The E.O. creates a new framework for forthcoming regulations on U.S. investments in designated countries, presently focused on China. The U.S. Department of the Treasury (Treasury) concurrently issued an Advance Notice of Proposed Rulemaking (ANPRM) describing the proposed scope of the regulations and requesting public comment, prior to issuance of regulations. Together, these actions have the potential to impact a range of U.S. business activities in high technology sectors, including greater due diligence for investors.

Key elements of the E.O.

The new E.O. directs Treasury to issue regulations that:

1. require U.S. persons to notify the U.S. government of specified transactions involving “covered foreign persons” that “may contribute to the threat to the national security of the United States” (notifiable transactions) and
2. prohibit U.S. persons from engaging in other specified transactions involving covered foreign persons that “pose a particularly acute national security threat because of their potential to significantly advance the military, intelligence, surveillance, or cyber-enabled capabilities of countries of concern” (prohibited transactions).

As noted above, a *covered foreign person* is defined as any “person of a country of concern” engaged in activities involving one or more “covered national security technologies and products.” The only country of concern

currently listed is the People's Republic of China (including Hong Kong and Macau), although additional countries may be added.

Covered national security technologies and products are defined as including "sensitive technologies and products in the semiconductors and microelectronics, quantum information technologies, and artificial intelligence sectors that are critical for the military, intelligence, surveillance, or cyber-enabled capabilities of a country of concern." The E.O. indicates additional technologies and products could be added in the future.

Key elements of the ANPRM

The ANPRM further describes the proposed process and scope of Treasury regulations and provides a number of potential key definitions. The ANPRM requests comments on these various proposed process and scope requirements, with comments due by Sept. 28, 2023.

United States persons

Similar to economic sanctions regulations, the definition includes any United States citizen, lawful permanent resident, entity organized under the laws of the United States or any jurisdiction in the United States (including any foreign branches of such entity), and any person in the United States.

Covered transactions

Transactions impacted by the order would include those that involve:

1. a person of a country of concern that is engaged in, or a person of a country of concern that a U.S. 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 above and which, individually or in the aggregate, comprise more than 50% of that person's consolidated revenue, net income, capital expenditure or operating expenses.

Covered foreign persons

The ANPRM proposes a broad definition that includes:

1. any individual that is not a U.S. citizen or lawful permanent resident of the United States and is a citizen or permanent resident of a country of concern;
2. an entity with a principal place of business in, or an entity incorporated in or otherwise organized under the laws of a country of concern;
3. the government of a country of concern, including any political subdivision, political party, agency or instrumentality thereof, or

any person owned, controlled or directed by, or acting for or on behalf of the government of such country of concern; or

4. any entity in which a person or persons identified in items 1 through 3 above holds individually or in the aggregate, directly or indirectly, an ownership interest equal to or greater than 50%.

Covered transactions

1. Acquisition of an equity interest or contingent equity interest in a covered foreign person;
2. Provision of debt financing to a covered foreign person where such debt financing is convertible to an equity interest;
3. Greenfield investment that could result in the establishment of a covered foreign person; or
4. 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 ANPRM proposes that this definition include “indirect transactions involving intermediary entities who are not ‘U.S. persons’ or ‘covered foreign persons’” to cover any instances of U.S. persons knowingly investing in a third-country entity engaged in a transaction that would otherwise be subject to notification or prohibition if engaged in by the U.S. person directly. The ANPRM also proposes prohibiting U.S. persons from knowingly directing prohibited transactions.

Covered national security technologies and products

The ANPRM proposes covering the following:

- semiconductors and microelectronics
- quantum information technologies
- AI systems

For each category, the ANPRM defines types and/or uses of technology that will be considered prohibited and those that will only require notification.

Proposed review process and enforcement

The ANPRM proposes requiring parties to file notifications no later than 30 days following closing of a transaction, with notifications required to include details regarding the persons involved in the transaction (including beneficial ownership), the basis for determining that the transaction is a covered transaction, prior investments made by the U.S. person in the covered foreign person, information regarding planned future investments, as well as associated transaction documentation and other information.

The E.O. requires Treasury to investigate violations of the E.O. or implementing regulations and pursue civil penalties. The E.O. also

authorizes Treasury to “nullify, void, or otherwise compel the divestment of any prohibited transaction entered into after the effective date” of the implementing regulations and/or refer potential criminal violations to the Department of Justice for potential prosecution.

Key outstanding questions and impact

Scope of covered technologies

As currently proposed, the ANPRM is targeted to require reporting and/or prohibiting transactions in a fairly narrow band of industries and technologies. That said, the E.O. provides the ability to further expand the regulations. In this vein, we note that there has been extensive recent reporting on China creating a government funded program to attract investments in biotechnology — which could become a future industry sector targeted under the E.O.

Excepted transactions

The ANPRM proposes a number of transaction types that would be excepted from coverage, including but not limited to any of the following, provided the investment does not afford the U.S. person rights beyond standard minority shareholder protections:

- Investments in publicly traded securities, index funds, mutual funds, etc.;
- Certain investments, below a de minimis value, made by a limited partner into a VC fund, private equity fund, fund of funds, or other pooled investment funds where the limited partner has limited rights and influence;
- Acquisition of equity or other interest of covered foreign person in an entity or assets located outside of a country of concern; and
- Transfers of funds from a U.S. parent to a subsidiary located in a country of concern.

Other key exemptions may involve certain academic research, procurement transactions, IP licensing, and various financial and consulting services. The ANPRM specifically requests additional comments on scoping of exempted and restricted transactions.

Scope of covered foreign persons

The E.O. and ANPRM both contemplate application to various indirect ownership structures, whereby transaction parties may be deemed as “covered” and subject to reporting and/or prohibition provisions even where a non-U.S. party is not located in/or directly majority owned by a Country of Concern. This has the potential to impact a broader set of transactions, where it may not be initially apparent that the investment involves a party that is considered a “covered foreign person.” The ANPRM also specifically requests additional comments on the scope of “covered foreign persons.”

Conclusion

Although the E.O. and ANPRM appear to be more narrowly tailored than initially reported over the past year, there is still a potential for significant impact on a number of industries and investors in the high-technology space. In particular, the outbound investment program will add yet another layer of due diligence for U.S. investors to consider when looking at potential investment opportunities in targeted sectors. Companies and individuals potentially impacted should consider submitting comments to the ANPRM, which are permitted until Sept. 28, 2023.

For more information on the U.S. outbound investment screening program, please contact [Matt Lapin](#) or any member of Porter Wright's [International Business & Trade Practice Group](#).