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10 Key Takeaways: Biden Administration Sets the Stage for Regulation of U.S. Investments in China

President Biden recently issued an [executive order](#) (“EO”) establishing a framework to regulate certain U.S. investments with a nexus to China, taking initial steps towards what eventually could be unprecedented regulation of outbound U.S. investment. Specifically, the order directs the U.S. Department of the Treasury (“Treasury”) to issue regulations requiring notification of, and in some cases outright prohibition of, certain U.S. investments in Chinese and Chinese-owned companies relating to semiconductors, quantum technology, and artificial intelligence. The EO also covers investments in Hong Kong and Macau.

Concurrent with the August 9, 2023, executive order, Treasury unveiled an [“Outbound Investment Program”](#) website, along with a [fact sheet](#) and an [Advance Notice of Proposed Rulemaking](#) (“ANPRM”).

In the months ahead, it will be critical for observers to keep apprised of Congress’s reaction to President Biden’s EO and Treasury’s ANPRM, especially among members who have been particularly involved in advancing legislation on outbound investment. Congress may yet legislate on the issue, and such legislation could differ in scope from the Biden Administration’s executive action.

This alert provides background regarding the Biden Administration’s executive action, along with 10 key takeaways.

BACKGROUND

Geopolitical risk commentators have anticipated an EO relating to U.S. outbound investment for some time, based on policymakers’ stated concerns around the role of U.S. investment capital in developing sensitive technologies in China. Proposals in this context have tended to focus on the establishment of a multi-agency body (akin to the Committee on Foreign Investment in the United States) to review outbound investment in sensitive technologies or “critical capabilities” with a nexus to certain countries of concern, including China.

Key milestones in this process have included:

- Passage of the [National Critical Capabilities Defense Act](#) by the House of Representatives in February 2022;
- A bipartisan group of lawmakers, including former House Speaker Nancy Pelosi (D-CA), Senate Majority Leader Chuck Schumer (D-NY), and Senator John Cornyn (D-TX) publishing a [letter](#) in September 2022 urging President Biden to issue an EO on outbound investment; and
- Senate passage of the [Outbound Investment Transparency Act](#), by a vote of 91-6, on July 25, 2023.

Against this backdrop, observers had expected the Biden Administration to take executive action, with interest intensifying leading up to the G-7 summit in May 2023 and over the summer.

KEY TAKEAWAYS

Here are 10 key takeaways regarding the Biden Administration's executive action:

1. The EO Establishes a Framework for Future Regulatory Action, but Does Not Directly Regulate Any Investments as of This Time

At its core, the EO is a directive to Treasury to develop, in consultation with other federal agencies, regulations providing for the notification or (in certain cases) prohibition of certain U.S. person investments in Chinese and Chinese-owned companies involved in certain activities relating to semiconductors, quantum technology, and artificial intelligence.

The EO delegates various items for Treasury to decide, including:

- Which technologies trigger the requirements
- What types of investments are covered
- Which investments are:
 - Prohibited outright due to their posing “a particularly acute national security threat”
 - Subject to a notification requirement that may “contribute to the threat to the national security of the United States”
- Whether the requirements apply to:
 - Foreign entities owned or controlled by U.S. persons
 - U.S. persons
- Prescribed form and content of notifications to Treasury
- Which types of investments are exempt from the requirements

Therefore, while the EO establishes a framework, it leaves the heavy lifting to Treasury, which will ensue over the course of a potentially lengthy regulatory process (see below). In fact, Treasury has already taken steps to address these issues in the ANPRM described below.

It is important to note that, as currently envisioned, the notification requirement for non-prohibited transactions, unlike the related CFIUS review for inbound investments, is not intended to be a first step in a review that could lead to prohibiting a notified transaction. Instead, the ANPRM explains that the purpose of notification will be

to increase the government's visibility into U.S. person transactions that could contribute to threats to national security and that could inform future U.S. government policy development.

2. The EO Includes a Notable Policy Statement

Extensive commentary, proposed legislation, and statements by members of Congress have elaborated on the “why” of regulating outbound investment, but the EO description of the policy is particularly noteworthy. The EO provides that while the United States overall is committed to open investment, “countries of concern are exploiting or have the ability to exploit certain United States outbound investments, including 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.”

This is noteworthy as a succinct statement of why the U.S. government is regulating in this area and could inform future developments.

3. Treasury's ANPRM Sets Out Key Details, but Is Not a Fully Formed Proposal, with a Comment Period Open Through September 28

The ANPRM is essential reading for anyone interested in understanding the specifics of the executive action. As described below, the ANPRM covers the types of investments that Treasury proposes to cover, the specific technologies at issue, the contours of the notification requirement and the prohibitions, and other discretionary points.

However, it is important to note that the ANPRM, as an “advance notice,” is the **most preliminary** form of administrative rulemaking that Treasury can initiate. As such, the ANPRM does not include a fully formed set of proposed regulations.

Rather, the ANPRM covers a number of interpretational points, as noted above, and informs the public as to how Treasury intends to act, inviting the public's comment.

Comments are due by September 28, 2023.

It is not clear exactly how Treasury will proceed after the closing of the comment period, but it would be reasonable to expect some period of time in which Treasury reviews and synthesizes comments, potentially followed by the issuance of a proposed rule setting out proposed regulations. There is a good chance the regulatory process will continue into next year. Proposed regulations, when issued, will likely be subject to further opportunities for comment.

4. The ANPRM Specifies the Types of China-Related Persons and Entities Triggering the Requirements, Including Parents with Subsidiaries Engaged in Covered Activity

According to the ANPRM, Treasury proposes that certain investments by a U.S. person into a “covered foreign person” would be prohibited or require notification. A “covered foreign person” would include:

- (a) a “person of a country of concern” that is engaged in, or a U.S. person knows or should know will be engaged in, the specified activity involving a covered technology, or
- (b) a person whose direct or indirect subsidiaries or branches are described in (a) above and which subsidiaries comprise more than 50 percent of the parent’s consolidated revenue, net income, capital expenditure, or operating expenses.

The following persons and entities would be considered a “person of a country of concern”:

- (a) any individual that is not a U.S. citizen or lawful permanent resident of the U.S. and is a citizen or permanent resident of China;
- (b) entities that are organized or with a principal place of business in China;
- (c) the Chinese government and entities owned or controlled by the Chinese government; or
- (d) any entity in which a person or persons described in (a)-(c) holds individually or in the aggregate, directly or indirectly, an ownership interest of 50 percent or greater.

Notably, in all cases, this regime will apply to entities that are engaged in, or that the U.S. person investor “knows or should know” will be engaged in, specified activities involving covered technologies.

5. The ANPRM Specifies the Types of Investments That Would Be Covered and Those That Would Be Specifically Excluded

Treasury proposes to define the following *direct or indirect* investments in a covered foreign person as “covered transactions” subject to outright prohibition or the notification requirements:

- Acquisition of an equity interest or contingent equity interest
- Provision of debt financing that is convertible to equity
- Greenfield investment that could result in the establishment of a covered foreign person
- Establishment of a joint venture, *wherever located*, that is formed with a covered foreign person or that could result in the establishment of a covered foreign person

Furthermore, the ANPRM provides that the following would be **excluded from the new outbound investment regime**:

- University-to-university research collaborations
- Contractual arrangements for procurement of material inputs for technologies at issue (e.g., raw materials)
- IP licensing arrangements
- Bank lending
- Bank processing, clearing, or sending of payments
- Underwriting services
- Debt rating services
- Prime brokerage
- Global custody
- Equity research or analysis
- Other services secondary to a transaction

6. Treasury Intends for the Regulations to Be Forward-Looking

The ANPRM notes that Treasury intends for the definition of “covered transaction” to be “forward-looking, and not to cover transactions and the fulfillment of uncalled, binding capital commitments with cancellation consequences made prior to the issuance of the Order.”

7. The ANPRM Establishes a Category of “Excepted Transactions”

Treasury, exercising discretion provided by the EO, proposes to carve out certain “*excepted transactions*” that otherwise would be covered, based on a determination that they pose a lower national security risk. This includes U.S. person investments:

- In publicly traded securities
- In index funds, mutual funds, or exchange-traded funds
- As a limited partner in a venture capital fund, private equity fund, or fund of funds, where:
 - the limited partner’s investment is passive (*i.e.*, the limited partner only contributes capital, cannot make managerial decisions, is not responsible for debts beyond the investment, and does not have the ability to influence the fund’s or a covered foreign person’s decision making); and
 - the investment is below a “*de minimis*” threshold set by Treasury.

The ANPRM goes on to explain that, notwithstanding the above, an investment will not be considered “excepted” where the U.S. person gains rights beyond standard minority shareholder protections, including board or observer rights or involvement in substantive business decisions.

The ANPRM provides that the following U.S. person transactions also are excepted transactions:

- Acquisition of an entity or assets outside of China when acquiring all of a covered foreign person’s equity or assets (which may include assets in China)
- Intracompany transfer of funds to a subsidiary in China
- A transaction made pursuant to a binding, uncalled capital commitment entered into before the date of the EO

8. The ANPRM Specifies the Technologies Subject to Investment Prohibition or Notification

As noted above, the EO directs Treasury to identify technologies relating to semiconductors/microelectronics, quantum information, and artificial intelligence warranting investment controls. Specifically, this includes the following (note that the ANPRM sets out detailed parameters for all of the below):

• Semiconductors/microelectronics:

- *Prohibition*: Certain technologies that enable advanced integrated circuits; certain advanced integrated circuit design and production; and supercomputers
- *Notification*: Certain integrated circuit design, fabrication, and packaging

• Quantum information:

- *Prohibition*: Quantum computers and components; quantum sensors; quantum networking and communication systems
- *Notification*: None

• Artificial intelligence:

- *Prohibition*: Software incorporating AI and designed to be exclusively or primarily used for military, government intelligence, or mass-surveillance end uses
- *Notification*: Software incorporating AI and designed to be exclusively or primarily used for cybersecurity, digital forensics, and penetration testing; control of robotic systems; surreptitious listening devices; and non-cooperative location tracking (including IMSI catchers and automatic license plate readers)

Treasury’s initial regulations will focus on investments in these three areas involving China. However, the EO also holds open the possibility that both the covered technologies and countries could be expanded in the future.

9. The ANPRM Proposes Application of the Rules to (a) U.S. Persons Directing Activities of Non-U.S. Entities, and (b) Non-U.S. Entities Owned or Controlled by U.S. Persons

Pursuant to authority set out in the EO, Treasury is proposing to apply the regulations to certain transactions not involving U.S. person investments.

First, the ANPRM proposes prohibiting U.S. persons from “*knowingly directing*” transactions by non-U.S. persons that would be prohibited for the U.S. person, similar to the “*facilitation*” concept in sanctions regulations. This would include, *e.g.*, a U.S. person general partner managing a foreign fund that engages in a transaction prohibited for the U.S. person, but would exclude secondary or intermediary services (*e.g.*, a bank processing a payment).

Second, the ANPRM notes that Treasury *“is considering rules that would place certain obligations on U.S. persons related to foreign entities that they control.”* Treasury does not describe what these potential “obligations” are, inviting comment from the public on this point.

10. Congress Still May Take Action Regarding Outbound Investments

As noted above, each house of Congress has passed a bill on outbound investments over the last 18 months, with the Senate recently passing the Outbound Investment Transparency Act as a proposed amendment to the National Defense Authorization Act for Fiscal Year 2024, which could set up further consideration of the bill later this year.

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