

# New NPRM Augments Executive Order 14105 Affecting Outbound U.S. Investment into China

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The U.S. Department of the Treasury (“*Treasury*”) issued a Notice of Proposed Rulemaking (“*NPRM*”) to implement Executive Order 14105 (“*EO 14105*”) “*Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern*” (the “*Outbound Order*”). The NPRM builds on the Advance Notice of Proposed Rulemaking (“*ANPRM*”) issued by Treasury in August 2023. (See [here](#) for more information on the NPRM; see also our previous report on EO 14105 and the ANPRM [here](#)).

EO 14105 significantly reshapes U.S. outbound investment policy towards the People’s Republic of China and its Special Administrative Regions of Hong Kong and Macau (collectively, “*China*”) by providing a new framework for restricting investments in China, and to other countries that may be designated as “countries of concern” in the future. Specifically, EO 14105 tasks Treasury, in consultation with the Secretary of Commerce and other Cabinet members, to devise a new two-part program with respect to “*covered national security technologies and products*.” That key term is defined to mean: (a) semiconductors and microelectronics; (b) quantum information technologies; and (c) artificial intelligence (“*AI*”) sectors that are critical for military, intelligence, surveillance, or cyber-enabled capabilities, though the list may be expanded at a later date.

The NPRM offers a full draft of, and explanatory discussion regarding, the intent of the proposed rule required by EO 14105. The NPRM reflects Treasury’s consideration of the comments received on the ANPRM and provides the public an additional opportunity to submit comments on the new program. Written comments on the NPRM may be submitted by August 4, 2024 [here](#). The NPRM will be followed by final implementing regulations later.

## NPRM

At its core, the proposed rule would place certain obligations upon any *U.S. person* in connection with a *covered transaction*. These obligations may include prohibiting a

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## Related Capabilities

- National Security Law
- China

*covered transaction* from taking place or requiring submission of specified information about a transaction to Treasury. Treasury has been explicit that the program “is not intended to impede all U.S. investments into [China] or impose sector-wide restrictions on United States person activity.” Treasury will also not engage in case-by-case review of transactions but will instead place the burden on the transaction parties to determine whether their transactions are subject to applicable notification requirements or a prohibition. This is similar to existing practice under the jurisdiction of the Committee on Foreign Investment in the United States (“CFIUS”) over inbound foreign investments and private parties’ compliance with U.S. economic sanctions programs.

Below we outline some of the key aspect of the NPRM and provide more detail on: (a) which parties the rule would cover; (b) the types of transactions the rule would cover; (c) exceptions to the rule; and (d) compliance obligations.

#### ***a. Covered Parties***

The proposed rule would place certain obligations on *U.S. persons*, including a notification requirement for certain transactions and a prohibition of certain other transactions. The proposed rule defines a *U.S. person* broadly to include any U. S. citizen or lawful permanent resident, as well as any entity organized under the laws of the United States or any jurisdiction within the United States, including any foreign branch of any such entity, and any person in the United States. The term *person* captures both individuals and entities.

#### ***b. Covered Transactions***

The proposed rule would apply to certain transactions or covered activities – activities that have a strategic national security nexus – between a *U.S. person* and a *covered foreign person*. The NPRM defines a *covered foreign person* as a person of a country of concern that is engaged in a covered activity related to defined sub-sets of technologies and products. Additionally, this defined term includes persons that hold any voting interest, board seat, or equity interest in a covered foreign entity, or any person that holds any power to direct or cause the direction of the management of the covered foreign entity; and where more than 50 percent of one of several key financial metrics of the entity is attributable to such *covered foreign person*. This would also include any joint venture with a foreign entity from a country of concern.

Under the proposed rule, a person of a country of concern would include an individual who is a citizen or permanent resident of a country of concern (and not a U.S. citizen or permanent resident of the United States); an entity that is organized under the laws of a country of concern, headquartered in, incorporated in, or with a principal place of business in a country of concern; the government of a country of concern; or an entity that is directly or indirectly majority-owned by any persons or entities in any of the aforementioned categories. Again, in EO 14105, the President identified China as a country of concern.

Examples of types of *covered transactions* would include:

- the acquisition of an equity interest or contingent equity interest;
- certain debt financing that is convertible to an equity interest or that affords certain rights to the lender;
- the conversion of a contingent equity interest;
- a greenfield investment or other corporate expansion;
- a joint venture; and
- certain investments as a limited partner (LP) or equivalent in a non-U.S. person pooled investment fund. U.S. persons engaged in one of these types of activities with a covered foreign person, would be subject to the proposed rules and would be obligated to comply with the notification or prohibition requirements.

### ***c. Excepted Transactions***

Despite the broad net the definition of *covered transactions* casts in the proposed rule, Treasury has explicitly proposed excepting certain types of transactions from the rule's coverage, as summarized below:

- **Publicly traded securities:** An investment by a *U.S. person* in a publicly traded security or a security issued by an investment company, such as an index fund, mutual fund, or exchange-traded fund;
- **Certain LP investments:** A *U.S. person's* investment of a certain size made as a limited partner or equivalent in a venture capital fund, private equity fund, fund of funds, or other pooled investment fund;
- **Buyouts of country of concern ownership:** A *U.S. person's* full buyout of all country of concern ownership of an entity, such that the entity would not constitute a covered foreign person following the transaction;
- **Intracompany transactions:** An intracompany transaction between a U.S. parent and a majority-controlled subsidiary to support ongoing operations or other noncovered activities;
- **Pre-Outbound Order binding commitments:** A transaction fulfilling a binding, uncalled, capital commitment entered into before August 9, 2023;
- **Certain syndicated debt financings:** Where the *U.S. person*, as a member of a lending syndicate, acquires a voting interest in a covered foreign person upon default and the *U.S. person* cannot initiate any action vis-à-vis the debtor and does not have a lead role in the syndicate; and
- **Third country measures:** Certain transactions involving a person of a country or territory outside of the United States may be excepted transactions where the Secretary of the Treasury determines that the country or territory is addressing national security concerns posed by outbound investment and the transaction is of a type for which associated national security concerns are likely to be adequately addressed by the actions of that country or territory.

In addition, there is a general national interest exemption under the proposed rule, whereby a *U.S. person* could seek an exemption from the application of the prohibition or

notification requirement on the basis that a transaction is in the national interest of the United States.

#### ***d. Compliance Obligations***

Treasury provided a breakdown of the types of transactions in the targeted industries that may be either *prohibited transactions* or *notifiable transactions*:

- **Semiconductors and microelectronics:**
  - *Prohibited transactions:* Treasury proposes a prohibition on covered transactions related to electronic design automation software; certain fabrication and advanced packaging tools; the design, fabrication, or packaging of certain advanced integrated circuits; and supercomputers.
  - *Notifiable transactions:* Treasury proposes a notification requirement for covered transactions related to the design, fabrication, or packaging of integrated circuits not otherwise covered by the prohibited transaction definition.
- **Quantum information technologies:**
  - *Prohibited transactions:* Treasury proposes a prohibition on covered transactions related to the development of quantum computers and production of critical components; the development or production of certain quantum sensing platforms; and the development or production of quantum networking and quantum communication systems.
- **Certain AI systems:**
  - *Prohibited transactions:* Treasury proposes a prohibition on covered transactions related to the development of any AI system designed to be exclusively used for, or intended to be used for, certain end uses. The NPRM also proposes alternatives for a prohibition on covered transactions related to the development of any AI system that is trained using a specified quantity of computing power and trained using a specified quantity of computing power using primarily biological sequence data.
  - *Notifiable transactions:* Treasury proposes a notification requirement for covered transactions related to the development of any AI system not otherwise covered by the prohibited transaction definition, where such AI system is designed or intended to be used for certain end uses or is trained using a specified quantity of computing power (set below the levels in the prohibited transaction definition).

If the transaction is deemed a *notifiable transaction* under the proposed rule, the *U.S. person* involved with the transaction would be required to file a notification form with Treasury that includes information related to the transaction such as details about the U.S. person, the covered transaction, relevant national security technologies and products, and the *covered foreign person*. The NPRM proposes that a notification must be filed no later than 30 days after a transaction is completed or, where a U.S. person acquires actual *knowledge* after the completion date of a transaction that the transaction would have been a covered transaction if such knowledge had been possessed at the time of the transaction, no later than 30 days after the U.S. person's acquisition of such knowledge. The proposed rule also contains a ten-year record keeping requirement for notifiable events. Parties that fail to comply with the proposed rule may be subject to both

civil and criminal penalties.

## **Key Takeaways**

When taken in broader context, the proposed rules should still not affect most transactions with China. For now, the new prohibitions and notification requirements target only certain investments involving advanced computing, quantum technology, and AI systems. However, there is still a significant amount of discretion that Treasury holds, in consultation with other executive agencies, in determining the types of transactions that will be *covered transactions*. For instance, Treasury is seeking comments to further refine its definition of AI systems. Nevertheless, given this specific subjective uncertainty baked into the proposed rules, this may cause companies in these high-tech sectors to reconsider any new ventures and investments involving China to mitigate risk immediately. And, of course, Treasury could add additional types of technologies and transactions in the coming years.

Stakeholders should look for opportunities to provide input to Treasury to further refine the proposed rules. Input in the form of written comments is due to Treasury by August 4, 2024 on [Regulations.gov](https://www.regulations.gov). There is ample opportunity to refine the NPRM. We encourage anyone that would like to be involved in the comment process or anyone with questions to please reach out.