

SCRUTINIZING OUTBOUND INVESTMENT: A CLOSER LOOK AT TREASURY'S PROPOSED RULE ON OUTBOUND U.S. INVESTMENTS

On June 21, 2024, the U.S. Department of the Treasury ("Treasury") issued a [Notice of Proposed Rulemaking](#) (the "Proposed Rule" or "NPRM") to implement the August 9, 2023 [Executive Order](#) ("EO") and address "the national emergency declared by the President with respect to the national security threat posed by countries of concern developing technologies that are critical to the next generation of military, intelligence, surveillance, or cyber-enabled capabilities."¹ As the [Treasury Press Release](#) and [Fact Sheet](#) describe, the Proposed Rule lays out draft regulations to establish a national security program. This program would either prohibit or require notification of certain types of outbound investments by "U.S. persons" into certain industries in so-called "countries of concern," currently defined as the People's Republic of China ("PRC"), Hong Kong, and Macau or otherwise involving "Covered Foreign Persons."

Comments on the Proposed Rule are due by August 4, 2024.²

I. WHO DOES THE PROPOSED RULE APPLY TO?

The Proposed Rule applies to all "U.S. persons," which includes "any United States 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."³

Key issues

- Who does the Proposed Rule apply to?
- What does the Proposed Rule require?
- Who will administer the Program?
- What are the possible penalties?
- Are there any exceptions?
- Next steps

¹ Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern (NPRM), at 79.

² [Fact Sheet and FAQs](#) (Fact Sheet), U.S. DEPARTMENT OF THE TREASURY (June 21, 2024).

³ *Id.*

II. WHAT DOES THE PROPOSED RULE REQUIRE?

Under the Proposed Rule, U.S. persons are **prohibited** from engaging in certain "*Covered Transactions*" involving specified national security technologies and products in three sectors—(i) semiconductors and microelectronics, (ii) quantum information technologies, and (iii) artificial intelligence—with "*Covered Foreign Persons*" and are required to **notify** Treasury of certain other transactions.

- "*Covered Transactions*" include certain acquisitions of equity interests, greenfield investments, and joint ventures by U.S. persons but not "excepted transactions," such as investments in publicly traded securities; a "U.S. person" would include any entity organized under the laws of the United States, including any foreign branch of any such entity; and a "covered foreign person" would include a person from a country of concern who is engaged in defined activities involving one or more of the covered national security technologies and products.⁴
- "*Covered Foreign Persons*" include a person of the PRC, Hong Kong, or Macau that is engaged in a covered activity. Under the Proposed Rule, such persons would include:
 1. An individual who is a citizen or permanent resident of the PRC, Hong Kong, or Macau (and not a U.S. citizen or permanent resident of the United States);
 2. An entity that is organized under the laws of the PRC, Hong Kong, or Macau, headquartered in, incorporated in, or with a principal place of business in the PRC, Hong Kong, or Macau;
 3. The government of the PRC, Hong Kong, or Macau; or
 4. An entity that is directly or indirectly majority-owned by any persons or entities in any of the aforementioned categories, regardless of location.⁵

Additionally, the Proposed Rule would include certain transactions involving an entity that has a voting interest, board seat, equity interest, or holds any power to direct or cause the direction of the management or policies in a covered foreign person where more than 50 percent of one of several key financial metrics of the entity is attributable to such covered foreign person.⁶

A summary of the prohibition and notification requirements in the Proposed Rule is included in the chart⁷ below:

Type of Technology	Prohibited Transactions	Notifiable Transactions
<i>Semiconductors and microelectronics</i>	Covered transactions related to electronic design automation software for the design of integrated circuits;	Covered transactions related to the design, fabrication, or packaging of integrated circuits not

⁴ NPRM, at 124 (§ 850.210).

⁵ NPRM, at 123 (§ 850.209).

⁶ *Id.*

⁷ Fact Sheet, at 4; NPRM, at 132 (§ 850.224).

	certain fabrication and advanced packaging tools; the design, fabrication, or packaging of certain advanced integrated circuits; and supercomputer.	otherwise covered by the prohibited transaction definition.
<i>Quantum information technologies</i>	Covered transactions related to the development of quantum computers and production of critical components; the development or production of certain quantum sensing platforms for certain designated uses; and the development or production of quantum networking and quantum communication systems.	None.
<i>Artificial intelligence (AI) systems</i>	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, including certain military end uses or government intelligence and mass surveillance end uses. The Proposed Rule 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.	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, such as certain cybersecurity applications, or is trained using a specified quantity of computing power (set below the levels in the prohibited transaction definition).

Treasury is requiring that notifications be filed no later than 30 days following the closing of a covered transaction. In its Fact Sheet, Treasury noted that the program will not entail a case-by-case review of U.S. outbound investments. Rather, transaction parties will have the obligation to determine whether a given

transaction is prohibited, permissible but subject to notification, or permissible without notification.

- For notifications, Treasury is requiring U.S. persons to provide information similar to that required during filings before the Committee on Foreign Investment in the United States ("**CFIUS**").
- The Proposed Rule requires that notifications shall provide, as applicable:
 1. The contact information of a representative of the U.S. person filing the notification, including the representative's name, title, email address, mailing address, phone number, and employer;
 2. A description of the U.S. person, including name, principal place of business and place of incorporation or legal organization, company address, website, and, if applicable, such U.S. person's ultimate owner;
 3. A post-transaction organizational chart of the U.S. person that includes, as applicable, its relationship with any controlled foreign entity or entities of the U.S. person and that identifies the covered foreign person and any other relevant persons involved in the transaction;
 4. A description of the commercial rationale for the transaction;
 5. A description of why the U.S. person has determined the transaction is a covered transaction that includes a discussion of the nature of the transaction, its structure, and other specific references describing the transaction type as well as the reason for submission;
 6. The status of the transaction, including the actual or expected completion date of the transaction;
 7. The total transaction value in U.S. dollars (or equivalent), an explanation of how the transaction value was determined, and a description of the consideration for the transaction;
 8. The aggregate equity interest, voting interest, board seats (or equivalent holdings) of the U.S. person and its affiliates in the covered foreign person (or joint venture) following the completion date of the transaction, including a description of any agreements or commitments for future investment or any options to make future investments in the covered foreign person (or joint venture);
 9. Information about the covered foreign person, including its name, and, as applicable, principal place of business and place of incorporation or legal organization, company address, website, and if the covered foreign person is an entity, such covered foreign person's ultimate owner, and the full legal names and titles of each officer, director, and other member of management of the covered foreign person, and a post-transaction organizational chart of the covered foreign person;
 10. Identification and description of the covered activity or activities undertaken by the covered foreign person that makes the transaction a covered transaction, as well as a description of the known end use(s) and

end user(s) of the covered foreign person's technology, products, or services;

11. A statement describing the attributes that cause the entity to be a covered foreign person, and any other relevant information about the covered foreign person or covered activity or activities;
 12. If a transaction involves a specified covered activity, identification of the technology node(s) or locations at which any applicable product is produced; and
 13. Certain additional information for a notification based on post-transaction knowledge.⁸
- As currently drafted, the Proposed Rule does not include a filing fee.

III. WHO WILL ADMINISTER THE PROGRAM?

The U.S. Department of the Treasury will administer this new national security program. According to the Proposed Rule, Treasury will use a portal on its website to collect electronic filings from U.S. persons.⁹ In making national interest exemption determinations and taking actions such as divestment, the Proposed Rule notes that the Secretary of the Treasury will consult with the Secretary of Commerce, the Secretary of State, and the heads of relevant agencies, including the heads of the Departments of Defense, Justice, Energy, Homeland Security, the Office of the Director of National Intelligence, and the Office of the National Cyber Director, among others.¹⁰

IV. WHAT ARE THE POSSIBLE PENALTIES?

Under the Proposed Rule, Treasury will have powers similar to those already held by CFIUS. Treasury would have the power to, among other things: (1) investigate and make requests for information from parties related to a notifiable or prohibited transaction "at any time," including through holding hearings, examining witnesses, receiving evidence, taking depositions, and requiring by subpoena the attendance and testimony of witnesses and production of documents; (2) nullify, void, or compel the divestment of a prohibited transaction entered into after the regulations issued under the EO take effect; and (3) refer potential criminal violations of the EO or the accompanying regulations to the U.S. Department of Justice for prosecution.¹¹ Given that the EO was issued under the authority provided by the International Emergency Economic Powers Act ("IEEPA"), penalties as set by IEEPA apply.¹²

V. ARE THERE ANY EXCEPTIONS?

The Proposed Rule includes exceptions for certain types of transactions, provided that such transactions "do not afford a U.S. person certain rights that are not standard minority shareholder protections." These transactions include:

⁸ NPRM, at 144-47 (§ 850.405).

⁹ NPRM, at 106.

¹⁰ NPRM, at 154, 159 (§ 850.502 and § 850.703).

¹¹ NPRM, at 159, 164 (§§ 850.702, 850.703, 850.904).

¹² NPRM, at 158 (§ 850.701).

- *Publicly traded securities*: An investment by a U.S. person in a publicly traded security or a security issued by an investment company registered with the Securities and Exchange Commission ("**SEC**"), 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 under certain specified conditions;
- *Buyouts of country of concern ownership*: A U.S. person's full buyout of all country of concern ownership, including equity or other interests, 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 foreign subsidiary to support ongoing operations or other non-covered activities;
- *Pre-Outbound Order binding commitments*: A transaction fulfilling a binding, uncalled, capital commitment entered into prior to 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 on its own 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 measures taken or that may be taken by the government of the relevant country or territory.¹³

The Proposed Rule also allows U.S. persons to 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, which Treasury will determine in consultation with other relevant agencies on a case-by-case basis.¹⁴ Treasury anticipates that it will grant exemptions of a *covered transaction* only in rare circumstances.¹⁵

When determining if a covered transaction is in the national interest of the United States and thus exempt from certain provisions, Treasury will conduct a holistic review of the transaction.¹⁶ Treasury expects to consider such factors as the transaction's effect on the U.S. supply chain, its relationship with national defense requirements, the potential impact of the transaction on U.S. technological

¹³ Fact Sheet, at 3; NPRM, at 148-54 (§ 850.501)

¹⁴ NPRM, at 68.

¹⁵ *Id.*

¹⁶ *Id.*

leadership, and any other security implications from blocking the transaction.¹⁷
Treasury does not plan to consider granting retroactive waivers or exemptions.¹⁸

VI. NEXT STEPS

As mentioned above, the Proposed Rule is currently a draft for public review and does not implement the EO requirements. That said, we anticipate significant engagement between the U.S. government and stakeholders as Treasury works to draft a final rule, and the public has until August 4, 2024 to submit any comments on this draft. It is also important to note that the EO mandates an assessment of the program one year after the effective date of the implementing regulations. This assessment will determine whether to amend the regulations or if any covered sectors or products should be added or removed from the scope of the regulations.

A timeline for implementation of a final rule had not been made public, but it is reasonable to expect that the new program will be effective by the end of 2024 or in Q1 of 2025.

CONCLUSION

The Proposed Rule is part of the U.S. Government's wider strategy to limit U.S. investments into China. This includes recent actions by the U.S. Senate to incorporate outbound screening mechanisms into the 2024 National Defense Authorization Act, which we previously discussed [here](#). While the Proposed Rule is not yet in force, the NPRM represents significant progress in the establishment of an outbound investment regime. Accordingly, it is critical for those affected – and potentially affected – to consider how a final rule might influence their investment plans, as U.S. persons undertaking certain transactions in countries of concern may soon need to determine if a transaction is prohibited or requires notification.

¹⁷ NPRM, at 154-55 (§ 850.502).

¹⁸ NPRM, at 68.

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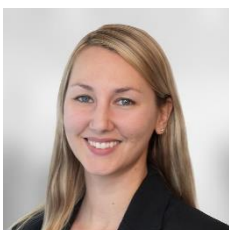
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