

Biden Administration Releases Executive Order Proposing Outbound Investment Regime

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On August 9, 2023, the Biden Administration released a long-awaited Executive Order (“EO”) establishing an outbound investment review program (the “Program”) for investments by U.S. companies and investors in China-based entities that are engaged in certain activities involving a defined set of sensitive technologies and products. As described more fully below, the program is designed to prohibit certain outbound equity investments altogether and to require notification of certain other outbound equity investments, in each case with a focus on advanced semiconductors and microelectronics, quantum information technologies, and artificial intelligence systems.

The EO directs the U.S. Department of the Treasury (the “Treasury Department”) to promulgate regulations implementing the Program, in consultation with the U.S. Department of Commerce and other U.S. government agencies. As part of this effort, the Treasury Department issued an accompanying Advanced Notice of Proposed Rulemaking (“ANPRM”) seeking public comment on various proposals and questions regarding how to implement the Program. Issuance of the EO and ANPRM commences a months-long regulatory rulemaking process that will formally establish the Program. The EO does not prescribe a date by which the regulations must be finalized, but comments to the ANPRM must be submitted within 45 days.

Issuance of the EO culminates a years-long, bipartisan U.S. government effort to restrict U.S. businesses and investors from making outbound investments that could advance adversarial nations’ development of certain military and dual-use technologies. The EO manifests the widely held view among U.S. policymakers that advanced technologies and products that may be developed and funded with the support of the U.S. private sector increasingly serve as the basis for next-generation military, intelligence, and cyber-enabled capabilities of such adversarial nations—especially China. Indeed, the EO states that the Program is necessary because continued advancement in sensitive technologies and products that are critical to military, intelligence, and cyber-enabled capabilities “constitutes an unusual and extraordinary threat to the national security of the United States.” In addition to restricting the provision of economic

support by U.S. persons, the Program is designed to deny China-based entities the other benefits and advantages that may come with U.S. investments, including transfer of know-how, managerial and implementation assistance, and broader access to talent and markets. The EO also follows other legislative and regulatory reforms aimed at preserving America's leading role in certain industry sectors, and in particular, advanced technologies.

Key highlights from the EO and ANPRM include the following:

Transactions and Investments Subject to the Program. The EO does not specify the types of transactions that would be subject to the program. However, the ANPRM proposes to include transactions that would result in the acquisition of an equity interest or contingent equity interest in a China-based entity that is engaged in activities involving relevant technologies and products (any such entity being a "covered foreign person"). This could include a variety of transactions undertaken by U.S.-based companies and private equity or venture capital firms, such as mergers and acquisitions; asset purchases; equity investments or financings; convertible debt financing arrangements; greenfield investments; and joint ventures (each, a "covered transaction").

Importantly, the Treasury Department noted in the ANPRM that it is considering scoping the Program to cover both direct and indirect investment transactions. The Treasury Department also stated, however, that it would create a carveout for specific types of transactions, including certain investments in publicly traded securities or exchange-traded funds, as well as passive limited partner investments in private equity and venture capital funds. It also clarified that other types of commercial arrangements (e.g., IP licensing, procurement of goods and services, etc.) would not be subject to the Program.

Covered Technologies and Products. The EO identifies three high-level categories of technologies and products that are subject to the Program: advanced semiconductors and microelectronics, quantum information technologies and artificial intelligence systems (collectively, "covered national security technologies and products"). The ANPRM proposes to include the following requirements for each category:

- **Advanced Semiconductors and Microelectronics.** Certain technologies and products in this category would be subject to a broad prohibition on investment, while others would be subject only to a prior notification requirement. The investment prohibition would apply to covered transactions with China-based entities that are engaged in activities involving: (i) technologies and equipment that enable the design and production of advanced integrated circuits; (ii) advanced integrated circuit design, fabrication, and packaging capabilities; and (iii) installation or sale to third-party customers of supercomputers. The prior notification requirement would apply to China-based entities that deal in technologies and products related to the design, fabrication, and packaging of other integrated circuits for advanced semiconductors and microelectronics.
- **Quantum Information Technologies.** Certain technologies and products in this category would be subject to a broad prohibition on investment, but the Treasury Department noted that it is not considering a separate notification requirement for this industry sector. The investment prohibition would apply to covered transactions with China-based entities that produce or develop: (i) quantum computers and related components; (ii) quantum sensing platforms exclusively for military, intelligence, or mass surveillance purposes; and (iii) quantum network or certain other communications systems.

- **Artificial Intelligence Systems.** As with semiconductors and microelectronics, certain technologies and products in this category would be subject to a broad prohibition on investment, while others would be subject only to a prior notification requirement. The investment prohibition would apply to covered transactions with China-based entities that engage in the development of software that incorporates an artificial intelligence system and is designed exclusively for military, intelligence, or mass-surveillance purposes. The prior notification requirement would apply to China-based entities that develop software for artificial intelligence systems used for other sensitive purposes, including cybersecurity, digital forensics, and penetration testing.

Importantly, the ANPRM notes that the Treasury Department is considering including a knowledge standard in the regulations that would apply across the Program. According to the ANPRM, this would mean that, in order to be covered by the Program, an investment transaction would have to be conducted under circumstances where the U.S. investor knows, “or reasonably should know based on publicly available information and other information available through a reasonable and appropriate amount of due diligence” that it is undertaking a transaction that is subject to the Program. Inclusion of this knowledge standard would provide a level of protection for U.S. investors, though the ANPRM makes clear that U.S. investors would be expected to carry out thorough due diligence reviews of China-based entities that are the target of contemplated investment. As required by the EO, the ANPRM notes that the Treasury Department will review the Program after one year to determine whether additional categories of industries or transactions should be incorporated into the regulations.

Covered Countries. The EO includes an Annex specifying that the investment prohibitions under the Program are directed at companies based in the People’s Republic of China, including the Special Administrative Regions of Hong Kong and Macau. While other countries could be impacted by this regime in the future, at this time the Annex identifies only China as a “country of concern” subject to the Program. The pending 2023 National Defense Authorization Act identifies additional countries of concern that are the subject or target of U.S. sanctions and export controls (e.g., Russia, Iran, etc.), and Russia is currently the subject of a broad ban on new investment under U.S. sanctions, so it is possible that these countries and others may be incorporated into the Program at some point in the future in furtherance of a more cohesive or robust policy toward limiting outbound investment by U.S. persons.

Penalties and Prospective Application. Failure to comply with the requirements of the Program could subject U.S. businesses and investors to financial penalties and other enforcement actions, including divestiture of ownership interests acquired in violation of the EO. The ANPRM specifically notes that the prohibitions to be implemented pursuant to the regulations will apply on a forward-looking basis, not retroactively. This confirms that pre-existing investments in the impacted countries and industries will not be subject to the Program.

Oversight and Implementation. The ANPRM was released by the Office of Investment Security of the Treasury Department, which also leads the Committee on Foreign Investment in the United States (“CFIUS”) review process. On this basis, and given the proposed structure of the Program in the ANPRM, it is reasonable to assume that the Program will be overseen and implemented in a manner similar to the CFIUS process. The Biden Administration already has provided \$20 million to the Treasury Department to begin development of the Program. Recent legislation also requires the Treasury Department and the U.S. Department of Commerce to submit a report within one year of the EO describing the effectiveness and parameters of the Program, as well as the resources needed to implement it over the next three years.

Key Takeaways

Several questions regarding the scope of the Program remain, and we expect that the Treasury Department will need to clarify a number of key issues during its rulemaking process. These include how the Program will be enforced and what penalties may apply; what other technologies or industry sectors will be added to the Program in coming years; and what would happen in a context involving the acquisition of a U.S. business with legacy Chinese subsidiaries operating in industry sectors covered by the Program.

The EO makes clear that, in addition to limiting capital outflows to China, the U.S. government is increasingly focused on restricting the transfer of advanced technologies to China and other countries viewed as adversaries by U.S. policymakers. It also signals that, in an increasingly competitive and unstable geopolitical environment, U.S. policymakers are committed to denying China-based entities in critical industries the potential benefits and advantages that flow from U.S. investment, including the know-how, strategic direction, and access to talent and markets, that would promote their competitive interests, and the interests of the Chinese government.

Finally, it will be interesting to track whether U.S. allies adopt similar review programs as they did after the U.S. Congress enhanced the CFIUS review program in 2018.

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