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President Biden Creates a National Security Program That Will Impact Outbound U.S. Investments Involving “Countries of Concern”

Shawn B. Cooley, Timothy C. Welch, Nathan Cunningham, Christina Carone, and William Looney*

In this article, the authors discuss measures taken by the Biden administration intended to restrict the flow of significant capital from the United States to aspects of the Chinese technology sector.

President Biden has issued an executive order (the EO)¹ establishing a new but narrowly targeted national security program that will restrict certain outbound U.S. investments to address national security threats posed by countries of concern that seek to develop and exploit sensitive or advanced technologies and products for military, intelligence, surveillance, or cyber-enabled capabilities.

Concurrently therewith, the U.S. Department of the Treasury issued an Advance Notice of Proposed Rulemaking (ANPRM),² elaborating on certain concepts set out in the EO (both the EO and the ANPRM, the Measures). The Measures applicable to transacting parties are not yet in effect. Rather, the Measures contemplate regulations that will function as outbound U.S. investment controls.

The purpose of this new program is to restrict the flow of significant capital from the United States to aspects of the Chinese technology sector and to withhold benefits frequently provided by a contribution of significant capital, such as managerial assistance, access to investment and talent networks, market access, and enhanced access to additional financing. Aspects of the Measures anticipate or consider varying degrees of extraterritorial application and application to certain Chinese interests located outside of China.

The National Security Program Proposed in the EO

The EO directs Treasury to implement and administer a new national security program in consultation with other agencies (e.g., U.S. Department of Commerce). The program will, pursuant to the yet-to-be-issued implementing regulations, (1) prohibit U.S. persons from engaging in certain covered transactions involving enumerated categories of highly advanced technologies and products, and (2) require U.S. persons to notify the Secretary of the Treasury of other similar but less sensitive covered transactions.

Focused on China, the EO targets only outbound investments by U.S. persons into entities located in or subject to the jurisdiction of a specifically listed country of concern, and certain other entities owned by persons of a country of concern. A “country of concern” includes any country or territory listed in the Annex to the EO that the administration has identified as posing a national security threat due to such country engaging in military modernization activities that support advancements in sensitive technologies and products. The Annex to the EO currently only identifies, collectively, the People’s Republic of China and the Special Administrative Regions of Hong Kong and Macau as a country of concern.

The two components (i.e., prohibition and notification) of the program center on investments that could advance a country of concern’s activities related only to three categories of national security technologies and products—semiconductors and micro-electronics, quantum information technologies, and artificial intelligence. The administration selected these technologies due to their critical role in accelerating the development of advanced military, intelligence, surveillance, and cyber-enabled capabilities that pose national security threats (e.g., the breaking of cryptographic codes and development of cutting-edge weapons). The EO also directs the Secretary to issue regulations that detail the scope and requirements of the program, and it authorizes the Secretary to investigate violations of the EO and related regulations, and impose penalties for such violations.

The EO appears to be narrowly targeted and designed to find an appropriate balance between the oft-competing goals of protecting U.S. national security and maintaining an open investment policy in the United States. The EO program represents an interagency coordinated approach that will subject a limited subset of transactions

for additional scrutiny based on evolving national security threats. Under existing statutory authorities, including the International Emergency Economic Powers Act and the National Emergencies Act, the administration could prohibit U.S. persons from making outbound investments involving a broader range of technologies or countries of concern that might increase national security risks to the United States; however, the contemplated program will specifically target certain outbound U.S. investments involving China and sensitive technologies and products that are critical to military advancement. Notably, the program will only impact transactions involving certain activities, capabilities, or end uses of covered national security technologies and products with cutting-edge military, surveillance, cyber, or espionage applications.

What the National Security Program Anticipates and Does Not Anticipate

Treasury concurrently issued an ANPRM in the Federal Register to provide transparency and clarity about the intended limited scope of this program.³ The ANPRM contains proposed definitions or guidance on Treasury’s intent regarding the scope of coverage for U.S. persons, covered foreign persons, categories of covered transactions, excepted transactions, and covered technologies and products. The process of Treasury drafting regulations likely will extend into 2024.

Requirements on U.S. Persons

The Measures anticipate that U.S. persons will have the obligation to determine whether a given transaction is prohibited, subject to notification, or permissible without notification since the Measures do not contemplate an administrative approval process. This is important because the Measures do not establish a more aggressive “reverse CFIUS” (Committee on Foreign Investment in the United States) process, although Treasury’s Office of Investment Security will manage both CFIUS and the new program. The Measures are silent as to whether Treasury will issue advisory opinions or interpretive guidance. A “U.S. person” includes any “United States citizen, lawful permanent resident, entity organized under the laws of the United States or any jurisdiction within the United

States, including any foreign branches of any such entity, and any person in the United States.” Treasury expects the regulations to apply to U.S. persons wherever they are located.

Treasury intends to limit certain activities of a foreign fund (1) managed by a U.S. general partner; (2) of which a U.S. person is an officer, senior, manager, or equivalent senior-level employee and where a U.S. person directs the transaction (but not where the U.S. person recuses themselves from the particular transaction); and (3) a foreign fund started by U.S. venture partners. The Measures are silent regarding a U.S. entity controlled or owned by a foreign person. Treasury is considering limiting certain transactions that a U.S. person orders, decides, approves, or otherwise causes to be performed as well as the actions of a foreign entity in which a U.S. person has a 50 percent or greater interest or that the U.S. person otherwise controls. Treasury does not intend to capture, however, activity by a U.S. person such as mere financial processing or clearing or certain lower-level duties such as signing routine paperwork.

In-Scope and Out-of-Scope Transactions

Treasury is considering using the term “covered transaction” that would apply to the definition of both prohibited and notifiable transactions. Treasury anticipates that transactions covered by this program would include certain acquisitions of equity interests (e.g., mergers and acquisitions, private equity, venture capital, and other arrangements), certain debt-financing transactions that are convertible to equity, greenfield investments, and joint ventures. A covered transaction could depend on exceeding a monetary threshold (such as the size of the U.S. limited partner’s transaction and/or the total assets under management of the U.S. limited partner) or obtaining rights no more significant than typical minority shareholder protections.

In addition, Treasury is considering whether to exclude from the scope of its new regulations certain U.S. investments into publicly traded instruments (e.g., securities, index funds, mutual funds, and exchange-traded funds), a U.S. person’s acquisition of 100 percent of a Chinese entity or asset located outside of China, intracompany transfers from U.S. parents to subsidiaries, and satisfying a preexisting and binding capital call.

Treasury intends for the new regulations to be forward-looking only, without retroactive application.

Covered Foreign Persons

The EO requires Treasury to prohibit or require notification of certain transactions by a U.S. person into a “covered foreign person.” The EO defines a “covered foreign person” as a person of a country of concern who is engaged in defined activities involving one or more covered national security technologies and products (discussed in detail below). Treasury also is considering expanding upon the definition of a “covered foreign person” to include a knowledge standard and to encompass both (1) an entity majority owned by one or more (individually or collectively) Chinese persons as well as (2) that entity’s subsidiaries or branches that individually or collectively contribute a majority of the entity’s revenue, income, capital expenditure, or operating expenses.

Covered National Security Technologies and Products

The ANPRM provides details on the three categories of technologies and products covered by the new program.

1. *Semiconductors and Microelectronics.* Treasury is considering that this sector will trigger both prohibitions as well as notification requirements. A prohibition may attach to a transaction with a Chinese entity that develops, designs, fabricates, packages, installs, or sells certain advanced integrated circuits, semiconductors, or supercomputers or their associated manufacturing equipment or software. A notification could be required for a transaction involving a Chinese entity that designs, fabricates, or packages certain less-advanced integrated circuits.
2. *Quantum Information Technologies.* Treasury is considering only a prohibition on transactions in this sector, which could encompass a Chinese entity that produces or develops quantum computers, components, or sensors, or networking or communication systems.
3. *Artificial Intelligence (AI) Systems.* For this sector, Treasury is considering imposing both prohibitions and notification

requirements that are specific to a particular end use (such as cybersecurity applications, digital forensics tools, the control of robotic systems, facial recognition, or surreptitious listening devices) that implicates national security considerations because of military, government intelligence, or mass-surveillance applications.

The aims of the program contemplated by the EO and ANPRM are consistent with and are expected to complement the U.S. Department of Commerce's recently enhanced export controls that restrict the export and reexport to, and transfer within, the People's Republic of China of certain advanced computing-integrated circuits, semiconductors, and related items that are of U.S. origin or otherwise subject to U.S. export controls.

Key Takeaways

- The new program will govern certain direct or indirect transactions by U.S. persons in a portion of the Chinese technology sector.
- The focus of the Measures is significant capital and the attendant benefits provided by U.S. persons that could augment China's military modernization and advancement.
- The EO distinguishes prohibited transactions from those transactions that require only a notification. Specifically, the EO requires a higher standard for prohibited transactions involving advanced covered technologies and products that the Secretary determines "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." In contrast, the EO applies a lower standard for the notification requirement in transactions involving other covered technologies and products that the Secretary determines "may contribute to the threat to the national security of the United States."
- The Measures cover transactions such as acquisitions of equity interests, certain debt financing, greenfield investments, and joint ventures in the following sectors:
 - Semiconductors and microelectronics,
 - Quantum information technologies, and
 - Artificial intelligence.

- Treasury intends to implement exceptions related to certain small passive-only interests, public shares, preexisting capital commitments, intracompany transfers, and 100 percent acquisitions outside China.

Notes

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1. See Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern, <https://www.whitehouse.gov/briefing-room/presidential-actions/2023/08/09/executive-order-on-addressing-united-states-investments-in-certain-national-security-technologies-and-products-in-countries-of-concern/>.

2. <https://public-inspection.federalregister.gov/2023-17164.pdf>.

3. See <https://public-inspection.federalregister.gov/2023-17164.pdf>.