

US Treasury Department Issues Notice of Proposed Rulemaking on Implementation of Outbound Investment: 5 Key Takeaways

The proposed regulations would implement President Biden’s Executive Order that restricts certain outbound investments from the US.

On June 21, 2024, the US Department of the Treasury (Treasury) issued a Notice of Proposed Rulemaking ([NPRM](#)) that would implement [Executive Order 14105](#) on “Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern” (August 9, 2023) (the Order). The Order, which we discussed in our [Client Alert](#) in August 2023, directed Treasury to issue regulations aimed at addressing the national security threat posed by certain US investments that may accelerate the development of sensitive technologies and products in “countries of concern.” The NPRM addresses public comments received to the [Advance Notice of Proposed Rulemaking](#) (ANPRM), which Treasury published concurrently with the Order, and offers an opportunity for the public to provide comments to inform the development of the final regulations. Comments are due by August 4, 2024, and — [according to](#) US Commerce Department Secretary Gina Raimondo — final regulations are expected to be in place by the end of 2024.

Consistent with the Order and the ANPRM, the proposed regulations are expected to apply to US persons investing in a “country of concern” (currently, the People’s Republic of China, Hong Kong, or Macau) in three key sectors: semiconductors and microelectronics, quantum information technologies, and artificial intelligence (AI). US persons will be prohibited from engaging in certain transactions that present a “particularly acute” national security threat, while other transactions will require notification to Treasury within 30 days of the completion date. The obligations apply to a US person with “knowledge” of the relevant facts and circumstances related to a transaction. The Order and the draft implementing regulations focus on the “intangible benefits” that often accompany US investments and consequently Treasury proposes excepting certain types of transactions that would not generally raise such concerns. As expected, the NPRM does not establish a case-by-case review for outbound investment transactions, but it does include the penalty and disclosure framework for violations, which may be subject to civil and criminal penalties, as set forth in the International Emergency Economic Powers Act (IEEPA).

This Client Alert sets out five key takeaways from the NPRM and its associated [Fact Sheet](#), and highlights some key differences from the ANPRM.

1. The proposed regulations impose legal obligations on US persons with “knowledge”

Consistent with the definition of “US person” in US sanctions programs implemented under IEEPA (and also consistent with the definition in the ANPRM and the Order), the NPRM defines a “US person” as a US citizen (wherever located), a lawful permanent resident (a so-called “green card holder”) (wherever located), an entity organized under the laws of the US (including a foreign branch), and persons (regardless of nationality) physically present in the US.

The US person definition does not include foreign subsidiaries of US entities, but the NPRM requires that US persons take “all reasonable steps to prohibit and prevent” transactions by their controlled foreign entities (as defined below) that would be a prohibited if engaged in by a US person. Similar to anti-“facilitation” provisions under most US sanctions programs, the proposed regulations prohibit US persons from “knowingly directing” transactions by non-US entities that would be prohibited if undertaken by US persons. The NPRM indicates that if a US person has decision-making authority over a non-US person and recuses themselves from an investment decision, the US person will not be considered to have knowingly directed the transaction. Notably, Treasury explained that it is soliciting comments regarding this approach, particularly as to what stage of an investment the recusal carveout should apply, such as at the time of negotiation of a transaction, the decision to undertake the transaction, or overseeing the investment after the completion date.

The NPRM defines “controlled foreign entity” as a foreign entity of which a US person is a “parent,” which in turn is defined as (i) a person who directly or indirectly holds more than 50% of the outstanding voting interest or voting power of the board, (ii) the general partner, managing member, or equivalent, or (iii) the investment adviser in a pooled investment fund. In determining whether a US person took “all reasonable steps” to prevent a controlled foreign entity from engaging in a prohibited transaction, Treasury will consider factors that include agreements with respect to compliance with the proposed regulations, governance or shareholder rights by the US person with respect to the controlled foreign entity, training and internal reporting requirements, and internal policies, procedures, and guidelines.

Under the NPRM, the obligations on US persons with respect to prohibited and notifiable transactions will apply if a US person has *knowledge* of the relevant facts or circumstances at the time of the transaction. “Knowledge” is defined to mean:

- actual knowledge that a fact or circumstance exists or is substantially certain to occur;
- an awareness of a high probability of a fact or circumstance’s existence or future occurrence; or
- reason to know of a fact or circumstance’s existence.

This definition is similar to the definition of “knowledge” found in the US Export Administration Regulations at [15 CFR § 772.1](#).

In response to comments on the knowledge standard discussed in the ANPRM, the NPRM indicates that Treasury will determine whether a US person had knowledge of the relevant facts and circumstances at the time of the transaction based on information the US person had or could have had through “reasonable and diligent inquiry.” The NPRM identifies several factors that Treasury will consider relevant to a reasonable and diligent inquiry, including questions asked of the investment target or counterparty, contractual representations or warranties, efforts by the US person to review available public information and obtain available non-public information, whether the US person “purposefully avoided” learning

information, and the use of public and commercial databases to identify and verify relevant information of an investment target or counterparty.

US persons should therefore conduct diligence prior to engaging in a transaction that may be prohibited or notifiable under the program, maintain records of such diligence for 10 years, and require certain contractual representations and warranties from the investment target or counterparty when appropriate. According to the NPRM, if a US person has undertaken a reasonable and diligent inquiry and still does not have knowledge of a fact or circumstance relevant to whether a transaction is a covered transaction, Treasury would generally not, absent other circumstances, attribute knowledge of that fact or circumstance to such US person.

2. The proposed rule would apply to specific categories of covered transactions that involve a covered foreign person

As previewed in the ANPRM, the proposed regulations apply to certain types of investments, each a “covered transaction,” involving certain entities, each of which is referred to as a “covered foreign person.”

Covered transactions are defined to include a US person’s direct or indirect:

- acquisition of an equity interest or contingent equity interest in a covered foreign person;
- provision of a loan or debt to a covered foreign person, if such financing is convertible to equity or will afford the US person the right to make management decisions on behalf of the covered foreign person or to appoint members of the board of directors of the covered foreign person;
- conversion of a contingent equity interest or conversion of debt to an equity interest in a covered foreign person (including a lender’s foreclosure on collateral);
- certain acquisitions, leases, or development of operations, land, property, or assets (“greenfield investment”) that result in the establishment of a covered foreign person or the engagement of a person of a country of concern in a “covered activity”;
- entrance into a joint venture with a person of a country of concern that will engage in a covered activity; or
- acquisition of a limited partner or equivalent interest in a venture capital fund, private equity fund, fund of funds, or other pooled investment fund (in each case where the fund is not a US person) that the US person knows likely will invest in a person of a country of concern that is in the semiconductors and microelectronics, quantum information technologies, or artificial intelligence sectors, and such fund undertakes a transaction that would be a covered transaction if undertaken by a US person.

Covered foreign persons are defined to include:

- a person of a country of concern that engages in a covered activity; or
- a person that directly or indirectly holds a voting interest, board seat, equity interest, or power to direct the management or policies of a covered foreign person; if the person derives more than 50% of its revenue or net income from or incurs more than 50% of its capital expenditure or operating expenses through, the covered foreign person.

A person of a country of concern that participates in a joint venture that is a covered transaction will be deemed to be a covered foreign person.

“Countries of concern” are listed in the Annex to the Order, which currently only includes the People’s Republic of China, along with the Special Administrative Regions of Hong Kong and Macau, although additional countries may be added in the future. “Covered activity” includes any of the activities referred to in the definitions of notifiable transactions or prohibited transaction (as further discussed below).

Notably, Treasury explained why it declined to address several comments to the ANPRM, including:

- Setting a *de minimis* threshold below which a person of a country of concern’s activity involving a covered technology or product would not trigger the definition of covered activity, meaning the person would not be a covered foreign person. Treasury explains that a *de minimis* threshold based on the level of activity involving a covered technology or product would be challenging and would not effectively respond to the national security objectives of the Order; and
- Publishing a list of covered foreign persons. Treasury explains that compiling a list of covered foreign persons would be challenging given that such list would likely be subject to frequent changes and underinclusive, which would undermine the national security goals of the Order. Treasury also notes that a list of covered foreign persons could result in attempts to evade the rule through corporate restructuring and would be overly burdensome to maintain.

The NPRM indicates that whether a person is a covered foreign person should be determined based on the most recent available annual financial statement, or if that is not available, the most recent unaudited financial statement. Therefore, US persons should review the financial statements from the target company or counterparty to confirm whether an investment may be a covered transaction. The definition of covered foreign persons reflects the program’s broad application to entities that may not engage in covered activities themselves, but that are nevertheless significantly connected to a covered activity. The NPRM indicates that Treasury will expect a US person to conduct a reasonable and diligent inquiry to determine whether a transaction is covered under the proposed rule, including whether any covered foreign person is involved.

3. Covered transactions that pose an acute national security threat will be prohibited; those that may contribute to a national security threat will require notification

As directed by the Order, the NPRM targets “covered activities” relating to the development or production of “covered national security technologies and products” in three key sectors identified as posing a “particularly acute” national security threat due to their critical role in advancing the military, intelligence, surveillance, or cyber-enabled capabilities of countries of concern:

- semiconductors and microelectronics;
- quantum information technologies; and
- artificial intelligence (AI).

Prohibited Transactions

The NPRM proposes to prohibit covered transactions that involve covered foreign persons engaging in the following “covered activities”:

- Advanced integrated circuit design and equipment
 - The development or production of electronic design automation software for the design of integrated circuits or advanced packaging. “Advanced packaging” is defined as “to package integrated circuits in a manner that supports the two-and-one-half-dimensional (2.5D) or three-dimensional (3D) assembly of integrated circuits, such as by directly attaching one or more die or wafer using through-silicon vias, die or wafer bonding, heterogeneous integration, or other advanced methods and materials.”
 - The development or production of certain front-end semiconductor fabrication equipment designed for performing the volume fabrication of integrated circuits, equipment for performing volume advanced packaging, or other items designed exclusively for use in or with extreme ultraviolet lithography fabrication equipment.
- Advanced integrated circuit design and production
 - Designing or fabricating integrated circuits that meet or exceed certain advanced technical thresholds identified by the Bureau of Industry and Security of the Department of Commerce (BIS), or integrated circuits designed for operation at or below 4.5 Kelvin.
 - Packaging of integrated circuits using advanced packaging techniques.
- Supercomputers
 - The development, installation, selling, or production of any supercomputer enabled by advanced integrated circuits that can provide a theoretical compute capacity of 100 or more double-precision (64-bit) petaflops or 200 or more single-precision (32-bit) petaflops of processing power within a 41,600 cubic foot or smaller envelope.
- Quantum computers and components
- Development or production of a quantum computer or its critical components
- Quantum sensors
 - The development or production of any quantum sensing platform designed or intended for military, government intelligence, or mass-surveillance end uses.
- Quantum networking and quantum communication systems
 - The development or production of quantum networks or communications systems designed or intended to be used for (1) networking to scale up the capabilities of quantum computers; (2) secure communications, such as quantum key distribution; or (3) other applications with a military, government intelligence, or mass-surveillance end use.
- AI Systems
 - The development of AI systems designed to be exclusively used for, or intended to be used for, a military end use or government intelligence or mass surveillance end use.

- The development of AI systems that are trained using certain quantities of computing power.

In addition to the covered activities identified above, the NPRM proposes prohibiting transactions involving a “covered foreign person,” even if the relevant covered activity would otherwise be a notifiable transaction, if the covered foreign person is:

- included on the [BIS Entity List](#) or [Military End User List](#);
- a “Military Intelligence End-User” as defined by BIS in [15 C.F.R. § 744.22\(f\)\(2\)](#);
- included on Treasury’s list of [Specially Designated Nationals and Blocked Persons](#) (SDN List) or owned 50% or more by one or more SDNs;
- included on Treasury’s [Non-SDN Chinese Military-Industrial Complex Companies List](#); or
- designated as a foreign terrorist organization by the Secretary of State under [8 U.S.C. § 1189](#).

Notifiable Transactions

The NPRM does not propose to require notification of covered activities in the quantum information technologies sector. The following “covered activities” would be notifiable to Treasury no later than 30 days after completion of a covered transaction:

- Integrated circuit design and production
 - The design, fabrication, or packaging of integrated circuits that is not otherwise covered as a prohibited transaction.
- AI Systems
 - The development of an AI system that is not otherwise a prohibited transaction, and (i) is designed to be used for a military end use or government intelligence or mass surveillance end use, (ii) is intended to be used for cybersecurity applications, digital forensic tools, and penetration testing tools, or the control of robotic systems, or (iii) is trained using a certain threshold of computing power.

If a US person acquires knowledge of a “covered transaction” after the completion date, the US person must notify Treasury of the transaction within 30 days of the acquisition of such knowledge. When providing such notification, the US person will be required to describe any pre-transaction diligence undertaken and explain why the US person either did not possess or obtain such knowledge at the transaction’s completion date.

The NPRM indicates that notifications will be submitted electronically to Treasury and must include a certification by the US person and certain information, including:

- a description of the US person (including a post-closing organizational chart);
- the commercial purpose of the transaction;
- the basis for determining that the transaction is a covered transaction;

- transaction information, such as current status, completion date, and value;
- aggregate equity interest, voting interest, and board seats being acquired by the US person;
- information regarding the covered foreign person; and
- a description of the covered activities.

After providing the notification, the US person will have a continuing obligation to supplement the notification if it subsequently learns of a material omission or inaccuracy. The US person must maintain a copy of the filed notification and supporting documentation for 10 years.

Similar to the review process by the Committee on Foreign Investment in the United States (CFIUS), Treasury reserves the right to submit questions or request additional information regarding the notification. However, unlike the CFIUS review process, Treasury will not “clear” or approve covered transactions.

4. Less sensitive transactions will be excluded from the scope of the program

Consistent with the ANPRM, the NPRM includes exceptions for certain covered transactions that Treasury believes are less likely to confer “intangible benefits” to a covered foreign person, such as enhanced standing and prominence, managerial assistance, investment and talent networks, market access, and enhanced access to additional financing. These excepted transactions include the following:

- Investments in publicly traded securities (including securities traded on non-US exchanges) or securities issued by an investment company that is registered with the Securities and Exchange Commission or a business development company.
- Certain passive investments made as a limited partner (LP) in a venture capital fund, private equity fund, fund of funds, or other pooled investment funds. Treasury is considering defining a passive investment as one with limited rights and where the committed capital is either less than 50% of the total assets of the fund or does not exceed \$1 million.
- The acquisition of all of the interests in an entity held by one or more person of a country of concern such that the entity would no longer be considered a covered foreign person.
- Intercompany transactions to support ongoing operations that would not be considered covered activities.
- A transaction made pursuant to a binding capital commitment entered into prior to the date of the Order (August 9, 2023).
- The acquisition of an interest in a covered foreign person due to default on a debt financing made by a syndicate of banks, where the US person cannot initiate action vis-à-vis the debtor and does not have a lead role.

Similar to the concept of “excepted investors” in the CFIUS regime, Treasury also proposes an exception for transactions with or involving persons of countries or territories outside the US that Treasury determines are addressing national security concerns posed by outbound investment. Treasury has not

yet identified countries or territories that will fall within this designation. Under the CFIUS rules, the excepted countries currently include the United Kingdom, Canada, Australia, and New Zealand.

The NPRM also indicates that a US person could seek an exemption from the restrictions on the basis that a covered transaction is in the national interest of the United States, and that such exemptions may be subject to binding conditions. Treasury anticipates that this exemption of a covered transaction would be granted by the Secretary of the Treasury (Secretary) only in “exceptional circumstances.”

5. Violations will be subject to penalties under IEEPA and Treasury will have the authority to nullify, void, or otherwise require divestment of a prohibited transaction

The proposed regulations identify the following violations that could result in penalties:

- engaging in a prohibited transaction;
- failing to timely submit the information required for a notifiable transaction;
- making materially false or misleading representations, statements, or certifications to Treasury, as well as falsifying or concealing any material facts; and
- taking action to evade or avoid or cause a violation of the program.

The NRPM also describes the process for US persons to make a voluntary self-disclosure if they obtain knowledge of actual or potential violations. Such voluntary self-disclosures must be in writing and include sufficient detail to afford a complete understanding of the conduct that may constitute the violation. Consistent with voluntary self-disclosures made in connection with US sanctions and export controls violations, Treasury will consider a voluntary self-disclosure as a mitigating factor when determining the appropriate response to a violation.

Violations will be subject to the civil and criminal penalties set forth in IEEPA. The current statutory maximum civil penalty under IEEPA is approximately \$368,000 per violation or twice the amount of the transaction, whichever is greater. A person who willfully commits, willfully attempts to commit, or willfully conspires to commit, or aids or abets in the commission of, a violation may be fined up to \$1 million or, if a natural person, imprisoned for up to 20 years (or both). Persons may also be subject to civil and criminal penalties under 18 U.S.C. § 1001 if they make fraudulent or false statements to the US government.

In addition to penalties, the Order provides authority for the Secretary, in consultation with the heads of relevant agencies, to nullify, void, or otherwise compel the divestment of a prohibited transaction after the effective date of the regulations. The NPRM notes that the Secretary will delegate all authority under the Order to the Assistant Secretary of the Treasury for Investment Security, who is also the Treasury official who oversees the CFIUS process.

Conclusion

The NPRM largely aligns with the ANPRM issued in August 2023, and further cements the US government’s new approach to outbound investment and the protection of US national security. US investors should establish appropriate diligence and compliance procedures and begin considering

transaction structures and contractual terms that may be impacted by implementation of the outbound investment program.

Treasury is inviting written comments by August 4, 2024. Final regulations are expected to be in place by the end of the year. Notably, the Chairman of the House Financial Services Committee, Patrick McHenry, [criticized](#) the NPRM as a “multi-year process,” in contrast to the “existing, time-tested sanctions regime that can have an immediate impact.” Meanwhile, China’s commerce ministry [claimed](#) the NPRM is “politicising and weaponising economic and trade issues” and reserved the right to take corresponding measures.

Latham & Watkins will continue to monitor and report on developments related to the Order and NPRM.

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