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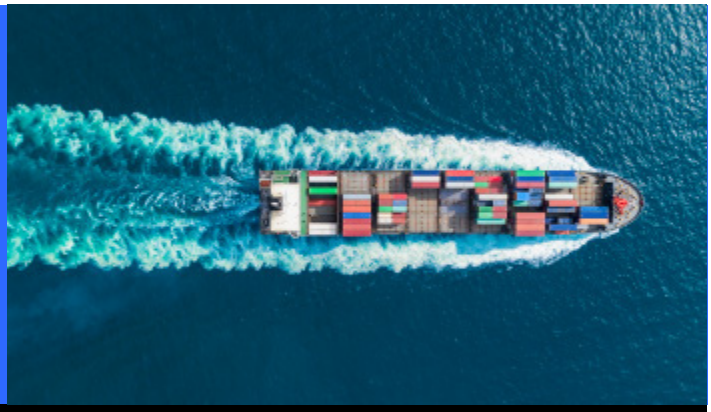

International Trade Update June 25, 2024

U.S. Outbound Investment Regime Nears Reality as U.S. Department of Treasury Solicits Public Comment on Proposed Rule

The proposed rule would significantly curtail U.S. investments in the People's Republic of China, Hong Kong, and Macau used to advance the development and production of semiconductors and microelectronics, quantum information technologies, and artificial intelligence systems.

Once finalized, this new regulatory framework will implement a notification regime for certain transactions while outright prohibiting others. Additionally, while transactions that occur prior to the effective date of the final rule are excepted, the U.S. Department of the Treasury reserves the right to request information about such transactions as needed. Comments on the proposed rule may be submitted until August 4, 2024.

This update provides (1) background of the outbound investment rulemaking process; (2) a refresher on the contours of the proposed rule; (3) changes from the August 2023 ANPRM in the June 2024 NPRM; (4) next steps in the regulatory process; and (5) Gibson Dunn's key takeaways.

I. Background of the Outbound Investment Rule

On June 21, 2024, the U.S. Department of the Treasury ("Treasury") advanced the Biden Administration's national security objective of regulating certain outbound investment by issuing a Notice of Proposed Rulemaking ("NPRM") pursuant to Executive Order ("EO") 14105, which was issued by President Biden on August 9, 2023. The EO and the NPRM address national security

risks posed by certain outbound investment activities involving "covered national security technologies and products" in "countries of concern," namely the People's Republic of China ("PRC"), Hong Kong, and Macau. The NPRM follows the Advance Notice of Proposed Rulemaking ("ANPRM") that was issued concurrently with the EO and was the subject of a previous Gibson Dunn client alert. Note that the NPRM does not itself impose any new requirements, and its proposed requirements are subject to change when Treasury issues the final rule.

An outbound investment regime would become another powerful tool in the U.S. government's efforts to counter the PRC's technological and military surge and reflects the Biden Administration's strategic priority of addressing the PRC as its "pacing challenge" in the global arena, particularly regarding critical technologies, as outlined in its 2022 National Security Strategy.

In line with the ANPRM, the NPRM proposes to prohibit some outbound investment transactions outright, and to require notifications for other investments. The categories of prohibited and notifiable investments address transactions with a "covered foreign person"—that is a person of a "country of concern" who engages in a "covered activity" related to the development or production of "covered national security technologies and products." The NPRM also provides exceptions and exemptions for certain transactions, outlines the procedures and penalties for compliance and enforcement, and invites further public comments on specific issues. The decision to issue the ANPRM and NPRM—administrative steps not required under the International Emergency Economic Powers Act ("IEEPA") under which EO 14105 was issued—indicates a concerted effort by Treasury to develop a rule informed by stakeholder input prior to issuing a final rule. The NPRM comment period ends on August 4, 2024, and Treasury is expected to issue a final rule thereafter.

Below, we provide a refresher on the basic contours of the rule, highlight changes introduced by the NPRM, and share key takeaways.

II. Refresher of Basic Contours of the Rule

A. To Whom Does the Rule Apply?

The NPRM adopts the definition of "U.S. person" set out in the EO, which 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."

The proposed rule would also apply to any "controlled foreign entity," defined as "any entity incorporated in, or otherwise organized under the laws of, a country other than the United States of which a U.S. person is a parent." The term "parent" would include any person or entity who or which (1) directly or indirectly holds more than 50 percent of the outstanding voting interest or voting power of the board of an entity, (2) is the general partner, managing member, or equivalent of an entity, or (3) is the investment adviser to any entity that is a pooled investment fund. The proposed rule would require such U.S. parents to take "all reasonable steps to prohibit and prevent any transaction by its controlled foreign entity" that would be prohibited or notifiable under

the proposed rule. The proposed rule provides a list of examples of "reasonable steps" U.S. parents should take to direct their controlled entities, such as using binding agreements, governance or shareholder rights, internal policies, procedures, or guidelines, periodic training and internal reporting requirements, effective internal controls, and testing and auditing functions.

In addition, the proposed rule would apply to U.S. personnel of foreign entities by prohibiting them from "knowingly directing" transactions that would be prohibited for a U.S. person to conduct itself. This is similar to the standard anti-"facilitation" provisions found in most U.S. sanctions regulations. The proposed rule would not restrict a U.S. person from working at any entity that receives investment, nor would it restrict a U.S. person from working at an entity making such an investment, as long as the U.S. person recuses themselves from the sensitive investment. Developing policies and procedures to ensure compliance with these requirements will be essential for U.S. and non-U.S. companies engaged in transactions that may involve the covered national security technologies and products.

B. What Types of Investments Would Be Restricted?

According to the proposed rule, a "covered transaction" is any transaction that a U.S. person knows (at the time of the transaction) involves a "covered foreign person." Such transactions include the following:

- Acquisition of an equity interest or contingent equity interest;
- Certain debt financing that is convertible to an equity interest or that affords certain management or board rights to the lender;
- The conversion of a contingent equity interest or equivalent;
- A greenfield investment or other corporate expansion;
- Entry into a joint venture; and
- Acquisition of a limited partner or equivalent interest in a non-U.S. investment fund.

A "covered foreign person" is defined as a person of a "country of concern" that engages in a "covered activity"—and certain parents and majority-owned subsidiaries of such entities. The initial "countries of concern" under the proposed rule are the PRC, Hong Kong, and Macau.

A "covered activity" is any activity related to the development or production of specific "covered national security technologies and products" in three key industries: semiconductors and microelectronics; quantum information technologies, and artificial intelligence ("AI") systems. As outlined in detail in the table below, certain "covered activities" will require notification to Treasury post-acquisition, while others will be prohibited outright.

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The following Gibson Dunn lawyers prepared this update: Chris Mullen, Mason Gauch, Michelle Weinbaum, Stephenie Gosnell Handler, Amanda Neely, Jayee Malwankar, Adam Smith, and David Wolber.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these issues. For additional information about how we may assist you, please contact the Gibson Dunn lawyer with whom you usually work, the authors, or the following leaders and members of the firm's International Trade practice group:

United States:
Ronald Kirk – Co-Chair, Dallas (+1 214.698.3295, rkirk@gibsondunn.com)
Adam M. Smith – Co-Chair, Washington, D.C. (+1 202.887.3547, asmith@gibsondunn.com)
Stephenie Gosnell Handler – Washington, D.C. (+1 202.955.8510, shandler@gibsondunn.com)
Christopher T. Timura – Washington, D.C. (+1 202.887.3690, ctimura@gibsondunn.com)
David P. Burns – Washington, D.C. (+1 202.887.3786, dburns@gibsondunn.com)
Nicola T. Hanna – Los Angeles (+1 213.229.7269, nhanna@gibsondunn.com)
Courtney M. Brown – Washington, D.C. (+1 202.955.8685, cmbrown@gibsondunn.com)
Amanda H. Neely – Washington, D.C. (+1 202.777.9566, aneely@gibsondunn.com)
Samantha Sewall – Washington, D.C. (+1 202.887.3509, ssewall@gibsondunn.com)
Michelle A. Weinbaum – Washington, D.C. (+1 202.955.8274, mweinbaum@gibsondunn.com)
Chris R. Mullen – Washington, D.C. (+1 202.955.8250, cmullen@gibsondunn.com)
Sarah L. Pongrace – New York (+1 212.351.3972, spongrace@gibsondunn.com)
Anna Searcey – Washington, D.C. (+1 202.887.3655, asearcey@gibsondunn.com)
Audi K. Syarief – Washington, D.C. (+1 202.955.8266, asyarief@gibsondunn.com)
Scott R. Toussaint – Washington, D.C. (+1 202.887.3588, stoussaint@gibsondunn.com)
Claire Yi – New York (+1 212.351.2603, cyi@gibsondunn.com)
Shuo (Josh) Zhang – Washington, D.C. (+1 202.955.8270, szhang@gibsondunn.com)

Asia:
Kelly Austin – Hong Kong/Denver (+1 303.298.5980, kaustin@gibsondunn.com)
David A. Wolber – Hong Kong (+852 2214 3764, dwolber@gibsondunn.com)
Fang Xue – Beijing (+86 10 6502 8687, fxue@gibsondunn.com)
Qi Yue – Beijing (+86 10 6502 8534, qyue@gibsondunn.com)
Dharak Bhavsar – Hong Kong (+852 2214 3755, dbhavsar@gibsondunn.com)
Felicia Chen – Hong Kong (+852 2214 3728, fchen@gibsondunn.com)
Arnold Pun – Hong Kong (+852 2214 3838, apun@gibsondunn.com)

Europe:
Attila Borsos – Brussels (+32 2 554 72 10, aborsos@gibsondunn.com)
Susy Bullock – London (+44 20 7071 4283, sbullock@gibsondunn.com)
Patrick Doris – London (+44 207 071 4276, pdoris@gibsondunn.com)
Sacha Harber-Kelly – London (+44 20 7071 4205, sharber-kelly@gibsondunn.com)
Michelle M. Kirschner – London (+44 20 7071 4212, mkirschner@gibsondunn.com)
Penny Madden KC – London (+44 20 7071 4226, pmadden@gibsondunn.com)
Irene Polieri – London (+44 20 7071 4199, ipolieri@gibsondunn.com)

Benno Schwarz – Munich (+49 89 189 33 110, bschwarz@gibsondunn.com)
Nikita Malevanny – Munich (+49 89 189 33 160, nmalevanny@gibsondunn.com)