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Export Controls Alert

November 18, 2024

The new US Outbound Investment Security Program

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US investors who completed, agreed upon, or intend to engage in relevant transactions should act now to ensure full compliance by the effective date.



What's the impact?

- The Treasury Department has finalized regulations underlying its new Outbound Investment Security Program.
- The regulations take effect January 2, 2025 and will directly impact US persons seeking to invest in the semiconductor, quantum computing, and artificial intelligence sectors in China or in related greenfield, brownfield, or joint venture investments.
- Driven by national security concerns, the regulations impose significant due diligence obligations, prohibit certain transactions altogether, and require government notification for others. Violations carry potential civil and criminal consequences, including divestment.

On October 28, 2024, the Department of the Treasury (Treasury) issued a Final Rule to implement Executive Order 14105, "Addressing United States Investments in Certain National Security

Technologies and Products in Countries of Concern,” issued by President Biden, on August 9, 2023 (the “Outbound Order”). The Final Rule completes the rulemaking process marked by Treasury’s August 2023 [Advance Notice of Proposed Rulemaking](#) (ANPRM) and its July 2024 [Notice of Proposed Rulemaking](#) (NPRM).

The Final Rule was published November 15, 2024, and will become effective January 2, 2025.

The Final Rule sets forth new regulations captioned “Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern,” which can be found in the new Title 31, Code of Federal Regulations, Part 850 (the “Outbound Regulations”).

The Outbound Regulations “complement existing authorities and tools of the U.S. Government, such as export controls and inbound investment reviews” and are based on findings in the Outbound Order “that countries of concern are ‘engaged in comprehensive, long-term strategies that direct, facilitate, or otherwise support advancements in sensitive technologies and products that are critical to such countries’ military, intelligence, surveillance, or cyber-enabled capabilities.” Although nominally addressing “countries of concern,” the Outbound Order’s Annex, which the new regulations expressly adopt, currently targets only one country—the People’s Republic of China, along with Hong Kong and Macau (collectively, “China”).

The government’s goal is to prevent US investment from advancing the development of sensitive technologies and products in China. In the government’s view, certain investments by US persons would provide investees not only with funds but also with intangible benefits, such as enhanced standing and prominence, managerial assistance, access to investment and talent networks, market access, and enhanced access to additional financing. The new regulations, therefore, prohibit a US person from engaging in certain “covered” investment transactions with “covered foreign persons” engaged in “covered activities” primarily involving three technology fields—semiconductors and microelectronics, quantum computing, and artificial intelligence—that the government has determined pose a particularly acute national security threat as they could significantly advance a country of concern’s—i.e., China’s—military, intelligence, surveillance, or cyber-enabled capabilities. For other transactions determined to contribute to a threat to US national security, the Outbound Regulations require US persons to notify Treasury of key facts regarding the transactions.

While the Final Rule does not prohibit all investment activity in China, it provides no mechanism for parties to submit transactions for review and clearance by Treasury or even obtain an advisory opinion. Instead, the new regulations impose significant due diligence burdens on US investors to refrain from engaging in prohibited transactions or provide the requisite notice when US investors have knowledge of certain triggering facts regarding certain non-prohibited transactions. Further, the duty to provide notice continues even after a transaction is complete.

The Final Rule

SCOPE OF THE REGULATIONS—COVERED TRANSACTIONS

Section 850.210 of the Outbound Regulations defines which transactions are covered transactions under the rules. In essence, a covered transaction is a specific investment by a US person in a foreign (i.e., Chinese) person that is involved in a “covered activity.”

The types of investments targeted by the regulations are detailed in § 850.210. If a transaction does not fall within one of the specified categories, the regulations do not apply. Investments covered by the scope of the regulations include the following:

- / The acquisition of an equity interest or contingent equity interest in a person that the US person knows at the time of the acquisition is a covered foreign person, including a US person’s use of an intermediary to engage in a transaction that would be a covered transaction if engaged in directly by a US person;
- / The provision of a loan or a similar debt financing arrangement to a person that the US person knows at the time of the provision is a covered foreign person, where such debt financing affords or will afford the US person an interest in profits of the covered foreign person, the right to appoint members of the board of directors (or equivalent) of the covered foreign person, or other comparable financial or governance rights characteristic of an equity investment but not typical of a loan;
- / The conversion of a contingent equity interest into an equity interest in a person that the US person knows at the time of the conversion is a covered foreign person, where the contingent equity interest was acquired by the US person on or after January 2, 2025;
- / The acquisition, leasing, or other development of operations, land, property, or other assets in China that the US person knows at the time of such acquisition, leasing, or other development will or shall result in (i) The establishment of a covered foreign person or (ii) the engagement of a Chinese person in a covered activity;
- / The entrance into a joint venture, wherever located, that is formed with a Chinese person, and that the US person knows at the time of entrance into the joint venture that the joint venture will engage or plans to engage in a covered activity;
- / The 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 a US person knows at the time of the acquisition likely will invest in a Chinese person 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.

The Final Rule also identifies transactions that, even if they would fall within the above categories, would not be considered a covered transaction—namely, an excepted transaction pursuant to § 850.501 (see below) and transactions conducted for the official business of the US Government.

Parties scope

US PERSONS

The Final Rule places obligations on US persons, including the requirement to review relevant transactions to determine whether the transaction is either a prohibited or notifiable transaction (as explained below). A US person includes any US 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.

Section 850.303(a) of the new regulations prohibits a US person from knowingly directing transactions by non-US entities that the US person knows at the time of the transaction would be prohibited if engaged in by a US person. This is important to note for US nationals working at foreign entities. A US person “knowingly directs” a transaction when the US person has authority, individually or as part of a group, to make or substantially participate in decisions on behalf of a non-US person and exercises that authority to direct, order, decide upon, or approve a transaction. Such authority exists when a US person is an officer, director, or senior advisor or otherwise possesses senior-level authority at a non-US person entity. Section 850.303(b) requires a US person’s recusal from participation in certain activities to avoid violating this prohibition. The Final Rule does not restrict a US person from generally working at any entity that receives investment, nor does it restrict a US person from working at an entity making such an investment.

US-PERSON-CONTROLLED ENTITIES

The obligations placed on US persons are not restricted to the US person itself. Section 850.302 of the new regulations also requires US persons to take all reasonable steps to prohibit and prevent foreign entities that they control from undertaking a transaction that would be prohibited if undertaken by a US person and to notify Treasury if the controlled foreign entity undertakes a transaction that would be a notifiable transaction if undertaken by a US person.

The term controlled foreign entity means any entity incorporated in or otherwise organized under the laws of a country other than the United States of which a US person is a parent. A parent is defined as (a) a person who or which directly or indirectly holds more than 50% of (1) the outstanding voting interest in the entity, or (2) the voting power of the board of the entity; (b) the general partner, managing member, or equivalent of the entity; or (c) the investment adviser to any entity that is a pooled investment fund.

COVERED FOREIGN PERSONS

The Final Rule's scope applies to transactions involving so-called "covered foreign persons." Pursuant to § 850.221, a foreign person of a country of concern is:

- / Any individual that is a citizen or permanent resident of a country of concern (i.e., China, Hong Kong, or Macau), not a US citizen, and not a permanent resident of the United States;
- / An entity with a principal place of business in, headquartered in, or incorporated in or otherwise organized under the laws of, China, Hong Kong, or Macau;
- / The government of China, Hong Kong, or Macau, including any political subdivision, political party, agency, or instrumentality, any person acting for or on behalf of such government, or any entity with respect to which such government holds individually or in the aggregate, directly or indirectly, 50% or more of the entity's outstanding voting interest, voting power of the board, or equity interest, or otherwise possesses the power to direct or cause the direction of the management and policies of such entity;
- / Any entity in which one or more of the aforementioned persons, individually or in the aggregate, directly or indirectly, own at least 50% of the outstanding voting interest, voting power of the board, or equity interest; and
- / Any entity in which one or more persons identified above, individually or in the aggregate, directly or indirectly, at least 50% of the outstanding voting interest, voting power of the board, or equity interest.

Any such foreign person is a covered foreign person if the additional requirements of § 850.209 are met. Pursuant to § 850.209, covered foreign persons are:

- / A Chinese person (i.e., an individual that is a citizen or permanent resident of a China, is not a US citizen, and is not a permanent resident of the US) that engages in a covered activity (see below);
- / A person that, directly or indirectly, holds a board seat on, a voting or equity interest (other than through securities or interests that would be excepted if held by a US person) in, or any contractual power to direct or cause the direction of the management or policies of any person of a country of concern that engages in a covered activity if certain additional requirements pertaining to this person's revenue, net income, capital expenditure, or operating expenses—as detailed in § 850.209(a)(2)(i)-(iv)—are met; and
- / A Chinese person that participates in a joint venture. Such person is deemed to be a covered foreign person by virtue of its participation in the joint venture.

Treasury does not intend to publish a list of entities designated as covered foreign persons. Instead, Treasury expects a US person to conduct a reasonable and diligent inquiry to determine

whether a transaction is covered under the Final Rule, including whether any covered foreign persons are involved.

KNOWLEDGE

A US person's knowledge of certain facts or circumstances is generally a prerequisite for the obligations under the Final Rule to apply.

During the rulemaking process, Treasury received several comments regarding the proposed knowledge requirements. The new regulations address the issue in two sections. Section 850.104 discusses the knowledge standard generally. Section 850.216 defines "knowledge," specifying that a US person has knowledge if such person has 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, i.e., if the US person could have possessed such information through a reasonable and diligent inquiry (no "self-blinding").

The Final Rule identifies specific factors that Treasury will take into consideration when assessing whether a US person undertook a reasonable and diligent inquiry to determine whether the relevant transaction is covered under the regulations. Under § 850.104, such factors include the inquiry a US person has made regarding an investment target or other relevant transaction counterparty, the contractual representations or warranties the US person has obtained or attempted to obtain, efforts by the US person, as of the time of the transaction, to obtain and consider available non-public information, the US person's consideration of available public information, and the use of available public and commercial databases to identify and verify relevant information of an investment target or other relevant transaction counterparty.

Technology scope — "covered activities"

The Final Rule targets specific technologies and products that the US government considers sensitive or critical for military, intelligence, surveillance, or cyber-enabled capabilities. The relevant technologies fall into three categories: semiconductors and microelectronics, quantum information technologies, and artificial intelligence (AI). The rules apply only if the investment target is concerned with such technologies or products. Instead of establishing a specific technology scope, the Outbound Regulations define specific activities concerned with sensitive technologies and products as "covered activities," as set forth in §§ 850.208, 850.217, and 850.224. The respective covered activity is critical for determining whether a transaction is prohibited (§ 850.217) or notifiable (§ 850.224).

SEMICONDUCTORS AND MICROELECTRONICS

The covered activities in the semiconductor and microelectronics sector are as follows:

Activities that result in a prohibited transaction:

- / The development or production of any electronic design automation software for the design of integrated circuits or advanced packaging;
- / The development or production of any of the following:
 - Front-end semiconductor fabrication equipment designed for performing the volume fabrication of integrated circuits, including equipment used in the production stages from a blank wafer or substrate to a completed wafer or substrate (i.e., the integrated circuits are processed but they are still on the wafer or substrate),
 - Equipment for performing volume advanced packaging, or
 - Commodity, material, software, or technology designed exclusively for use in or with extreme ultraviolet lithography fabrication equipment;
- / The design of any integrated circuit that meets or exceeds the performance parameters in Export Control Classification Number (ECCN) 3A090.a or is designed for operation at or below 4.5 Kelvin;
- / The fabrication of:
 - Logic integrated circuits using a non-planar transistor architecture or with a production technology node of 16/14 nanometers or less, including fully depleted silicon-on-insulator (FDSOI) integrated circuits;
 - NOT-AND (NAND) memory integrated circuits with 128 layers or more;
 - Dynamic random-access memory (DRAM) integrated circuits using a technology node of 18 nanometer half-pitch or less;
 - Integrated circuits manufactured from a gallium-based compound semiconductor;
 - Integrated circuits using graphene transistors or carbon nanotubes; or
 - Integrated circuits designed for operation at or below 4.5 Kelvin;
- / The packaging of any integrated circuit using advanced packaging techniques (The term advanced packaging means 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, sale, 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.

Activities that result in a notifiable transaction:

- / The design of any integrated circuit that does not meet or exceed the performance parameters in ECCN 3A090.a and/or is not designed for operation at or below 4.5 Kelvin;
- / The fabrication of any integrated circuit that is not described above; and

/ The packaging of any integrated circuit that is not advanced packaging.

QUANTUM INFORMATION TECHNOLOGIES

The covered activities in the quantum information technology sector are as follows:

Activities that result in a prohibited transaction:

- / The development of a quantum computer; Section 850.225 defines the term quantum computer as a computer that performs computations that harness the collective properties of quantum states, such as superposition, interference, or entanglement;
- / The production of any of the critical components required to produce a quantum computer, such as a dilution refrigerator or two-stage pulse tube cryocooler;
- / The development or production of any quantum sensing platform designed or intended to be used for or that the relevant covered foreign person intends to be used for any military, government intelligence, or mass-surveillance end use;
- / The development or production of any quantum network or quantum communication system designed or intended to be used for networking to scale up the capabilities of quantum computers, such as for the purposes of breaking or compromising encryption, secure communications, such as quantum key distribution, or any other application that has any military, government intelligence, or mass-surveillance end use.

There are no activities that would result in a notifiable transaction in the quantum information technologies sector. Transactions involving entities active in quantum information technologies are, therefore, either allowed or prohibited.

CERTAIN ARTIFICIAL INTELLIGENCE (AI) SYSTEMS

Pursuant to § 850.202 an AI system is (a) a machine-based system that can, for a given set of human-defined objectives, make predictions, recommendations, or decisions influencing real or virtual environments—i.e., a system that (1) uses data inputs to perceive real and virtual environments; (2) abstracts such perceptions into models through automated or algorithmic statistical analysis; and (3) uses model inference to make a classification, prediction, recommendation, or decision; or (b) any data system, software, hardware, application, tool, or utility that operates in whole or in part using a system described in (a).

It is important to note that different versions of an AI system, including adaptations, derivatives, subsequent generations, or successor systems, should be assessed as distinct AI systems since the designed end-use or capabilities of a successor system could vary from a prior version.

In the AI-sector, the covered activities are as follows:

Activities that result in a prohibited transaction:

- / The development (meaning, e.g., design, assembly and testing of prototypes, or substantive modification, see § 850.211) of any AI system designed to be exclusively used or is intended to be used for any military end use or government intelligence or mass-surveillance end use (e.g., through incorporation of features such as mining text, audio, or video; image recognition; location tracking; or surreptitious listening devices);
- / The development of any AI system trained using a quantity of computing power greater than:
 - 10^{25} computational operations (e.g., integer or floating-point operations); or
 - 10^{24} computational operations (e.g., integer or floating-point operations) using primarily biological sequence data.

Activities that result in a notifiable transaction:

The development of any AI system that is not covered under the provisions for a prohibited transaction and is designed to be used for any military, government intelligence, or mass-surveillance end use or is intended by the covered foreign person or joint venture to be used for cybersecurity applications, digital forensics tools, penetration testing tools, the control of robotic systems, or trained using a quantity of computing power greater than 10^{23} computational operations is a notifiable transaction.

For both, prohibited and notifiable transactions in the AI-sector, the Final Rule in Note 3 to § 850.217 provides the exception that if a person customizes, configures, or fine-tunes a third-party AI model or machine-based system strictly for its own internal, non-commercial use (e.g., not for sale or licensing), this would not trigger a prohibition or notification requirement solely on that basis unless the person's internal, non-commercial use is for government intelligence, mass-surveillance, or military end use or for digital forensics tools, penetration testing tools, or the control of robotic systems.

Additional prohibited transactions

In addition to the technology-specific prohibited transactions, the regulations include prohibitions for covered transactions specific to the relevant covered foreign person or the relevant joint venture.

Such prohibited transactions are:

- / The foreign person is a covered foreign person pursuant to § 850.209(a)(2) because of its relationship to one or more covered foreign persons engaged in any covered activity that results in a prohibited transaction as described above;
- / The covered person or joint venture engages in a covered activity (irrespective of whether this results in a prohibited or notifiable transaction) and:

- Is designated on the Bureau of Industry and Security's (BIS) Entity List or Military End User List;
- Meets the definition of a "Military Intelligence End-User" in 744.22(f)(2) of the EAR;
- Is designated on Treasury's list of Specially Designated Nationals and Blocked Persons (SDN List), or is an entity in which one or more individuals or entities included on the SDN List, individually or in the aggregate, directly or indirectly, own a 50% or greater interest;
- Is designated on Treasury's list of Non-SDN Chinese Military Industrial Complex Companies (NS-CMIC List); or
- Is designated as a foreign terrorist organization by the Secretary of State under 8 USC. 118.

Excepted transactions

The Final Rule excepts some types of transactions from its scope, provided that such transactions do not afford a US person certain rights that are not standard minority shareholder protections. Under § 850.501, such transactions include:

- / **Publicly traded securities:** An investment by a US person in a publicly traded security or a security issued by a registered investment company, such as an index fund, mutual fund, or exchange-traded fund;
- / **Certain LP investments:** A US person's investment made as an LP in a venture capital fund, private equity fund, fund of funds, or other pooled investment fund if such investment is \$2,000,000 or less or if the US person has received a contractual assurance that its capital will not be used by the fund to engage in what would be a prohibited or notifiable transaction;
- / **Derivatives:** A US person's investment in certain derivative securities;
- / **Buyouts of country of concern ownership:** A US person's full buyout of all country of concern ownership of an entity, such that the entity does not constitute a covered foreign person following the transaction;
- / **Intracompany transactions:** An intracompany transaction between a US person and its controlled foreign entity to support operations that are not covered activities or to maintain ongoing operations with respect to covered activities that the controlled foreign entity was engaged in prior to January 2, 2025;
- / **Certain pre-Final Rule binding commitments:** A transaction fulfilling a binding, uncalled capital commitment entered into prior to January 2, 2025;
- / **Certain syndicated debt financings:** Where the US person, as a member of a lending syndicate, acquires a voting interest in a covered foreign person upon default and the US person cannot initiate any action vis-à-vis the debtor and is not the syndication agent;
- / **Equity-based compensation:** A US person's receipt of employment compensation in the form of an award or grant of equity or an option to purchase equity in a covered foreign person, or the exercise of such option; 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 related to outbound investment and the transaction is of a type for which associated national security concerns are likely to be adequately addressed by the actions of that country or territory.

What happens when the rules apply?

Different from other controls on the relevant technologies covered by the Final Rule, the Outbound Regulations do not establish a case-by-case review of or a licensing process for transactions. Rather, US persons undertaking a transaction have an obligation to determine whether the given transaction is prohibited, permissible but subject to notification, or not covered by the regulations because either it is an excepted transaction or it is not a covered transaction. If a transaction would be covered under the regulations, a US person can also seek a national interest exemption from the notification requirement or prohibition pursuant to § 850.502 on the basis that a transaction is in the national interest of the United States. Treasury will provide additional information on this process on its [Outbound Investment Security Program website](#).

If the US person determines that its transaction is subject to a notification requirement, § 850.405 of the new regulations requires the US person to file a notification form with Treasury that includes information related to the transaction, such as details about the US person, the covered foreign person, the covered transaction, and the relevant national security technologies and products. Such notification must be filed no later than 30 days after the relevant covered transaction is completed or, where a US person acquires actual knowledge after the completion date of a transaction that the transaction would have been a covered transaction if such knowledge had been possessed at the time of the transaction, no later than 30 days after the US person's acquisition of such knowledge (§ 850.403). Notification procedures are set forth in § 850.404.

Legal consequences for non-compliance

Subpart G of the Final Rule authorizes the Secretary of the Treasury to investigate violations of the regulations (as detailed in Subpart F of the Final Rule), including pursuing civil penalties available under the International Emergency Economic Powers Act (IEEPA) and referring criminal violations to the Attorney General. The Secretary of the Treasury may also, as appropriate, take action authorized under IEEPA to nullify, void, or otherwise compel the divestment of any prohibited transaction. Under IEEPA, currently, the maximum civil penalty for a violation is the greater of \$368,136 or twice the value of the transaction that is the basis for the violation.

The Final Rule gives a US person the ability to voluntarily self-disclose any violation of the regulations. For this, a US person may submit a voluntary self-disclosure if they believe their conduct may have resulted in a violation of any part of the Final Rule. Such self-disclosure will be taken into consideration during Treasury's determination of the appropriate response to the self-disclosed activity.

Practical impact

Given the extent of the rule and the fact that it establishes an entirely new regime of controls in the (high) technology sector, whether the Outbound Investment Security Program will achieve its goals, cause unintended consequences, or both remains to be seen. Some parties that submitted comments to Treasury during the rulemaking process feared the new regime will chill US investments in the relevant technology sectors abroad. Others thought the program was overdue.

The current political situation may also give some investors pause but likely not for long as new opportunities continue to arise. Whether the regulations will evolve after the pending change in administration also remains to be seen, but US investors should not be surprised if Treasury expands the program given its underlying national security and foreign policy objectives.

As a result, we recommend that all US investors who either completed or agreed on relevant transactions since August 9, 2023, or intend to engage in relevant transactions going forward take steps now to ensure full compliance by the regulations' January 2nd effective date. Investors who fail to do so risk potential divestment orders and other significant civil and criminal consequences.

Before January 2, 2025, Treasury intends to publish on its [Outbound Investment Security Program website](#) instructions on how to file a notification and how to request a national interest determination. Treasury also anticipates publishing further information to help facilitate compliance by US persons and engaging in stakeholder outreach and education on the new outbound investment requirements.

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