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# US Restrictions on Outbound Foreign Investment

## U.S. TECH LAW UPDATE<sup>1</sup>

September 27, 2023

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On August 9, 2023, President Joe Biden issued a highly anticipated Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern (the “Executive Order”). The Executive Order declares a national emergency related to the development of sensitive technologies by “countries of concern” and directs the Secretary of the US Department of the Treasury (“Treasury”), in cooperation with the US Department of Commerce (“Commerce”), to establish a program regulating certain US investments in entities involved in semiconductors and microelectronics, quantum information technologies, and artificial intelligence if such entities are located in or are owned by nationals from the People’s Republic of China, including the Special Administrative Region of Hong Kong and the Special Administrative Region of Macau (together, “China”).

On August 14, 2023, in conjunction with the Executive Order, Treasury issued an Advance Notice of Proposed Rulemaking (the “ANPRM”) to provide transparency and clarity about the intended scope of the program and to solicit input on facets of the Executive Order’s implementation, such as key definitions, notification requirements, and penalty processes. The ANPRM does not itself implement the Executive Order and is not draft regulatory text; the ANPRM will be followed by draft regulations at a later stage in the process.

This legal update outlines key takeaways from the Executive Order and ANPRM, sources of international and domestic support for outbound investment screening, and investment implications for companies, investors, and individuals who, moving forward, will be restricted in their ability to directly or indirectly contribute to China’s efforts to develop sensitive technologies with military, intelligence, surveillance, or cyber-enabled capabilities.

### **I. Scope of the Executive Order**

President Biden issued the Executive Order under the authority vested in the President to regulate international commerce, including the International Emergency Economic Powers Act (“IEEPA”).<sup>2</sup> Under Section 203 of IEEPA, once the President declares that a national

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<sup>2</sup> IEEPA, enacted in 1977, authorizes the President to regulate international commerce after declaring a national emergency in response to any unusual and extraordinary threat to the national security and foreign policy of the United States originating in



emergency<sup>3</sup> exists, he may investigate, regulate, or prohibit foreign exchange transactions, transfers of credit, transfers of securities, and payments, and may take specified actions relating to property in which a foreign country or person has interest— such as freezing assets, blocking property and interests in property, and prohibiting US persons from entering into transactions related to frozen assets and blocked property. While IEEPA nominally applies only to foreign transactions, the breadth of the governing language, “any interest of any foreign country or a national thereof,”<sup>4</sup> and the interconnectedness of the global economy allows for expansive executive discretion.<sup>5</sup>

In addition to the requisite declaration of a national emergency, the Executive Order directs the Secretary of the Treasury to issue regulations that:

- i. **Prohibitions.** **Prohibit** US Persons, as defined by the ANPRM below, from engaging in transactions with certain individuals and entities located in or subject to the jurisdiction of China involving certain sensitive technologies and products that pose a particularly acute national security threat because of their potential to significantly advance the military, intelligence, surveillance, or cyber-enabled capabilities of China; and
- ii. **Notification Requirements.** Require US Persons to **notify** the US government of information related to transactions with certain individuals and entities located in or subject to China involving certain sensitive technologies and products that may contribute to the threat to national security informing the emergency declaration.

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whole or substantial part outside the United States. 50 U.S.C. §1701. Although Congress enacted IEEPA to limit the emergency economic powers that Congress had delegated to the President during the First World War, IEEPA has become a source of expansive executive economic authority, including during peacetime. “The International Emergency Economic Powers Act: A Congressional Attempt to Control Presidential Emergency Power,” Harvard Law Review 96, no. 5 (March 1983), p. 1120. IEEPA has served as an integral part of the postwar international sanctions regime, and the President, either through a declaration of emergency or via statutory direction, has used IEEPA to limit economic transactions in support of administrative and congressional national security and foreign policy goals. Barry E. Carter, *International Economic Sanctions: Improving the Haphazard US Legal Regime*, CAMBRIDGE UNIVERSITY PRESS (1988), p. 201. For example, Presidents have increasingly declared national emergencies, in part, to respond to human and civil rights abuses, slavery, denial of religious freedom, political repression, public corruption, and the undermining of democratic processes. See Christopher A. Casey, Dianne E. Rennack, Jennifer K. Elsea, [The International Emergency Economic Powers Act: Origins, Evolution, and Use](#), CONGRESSIONAL RESEARCH SERVICE (March 25, 2022); see also [Executive Order 13067](#).

<sup>3</sup> Neither the National Emergencies Act (“NEA”) (50 U.S.C. 1601 *et seq.*), which authorizes the President to declare national emergencies, nor IEEPA define what constitutes a “national emergency.” Casey, Rennack, Elsea, *The International Emergency Economic Powers Act*. IEEPA conditions its invocation in a declaration on its necessity for dealing with an “unusual and extraordinary threat to the national security, foreign policy, or economy of the United States,” but “unusual” and “extraordinary” are also undefined. 50 U.S.C. §1701. Presidents have interpreted these terms broadly and, since the 1980s, used IEEPA to implement trade restrictions against foreign adversaries. Casey, Rennack, Elsea, [The International Emergency Economic Powers Act](#). Even when Congress has not given explicit approval, no Member of Congress has ever introduced a resolution to terminate a national emergency citing IEEPA. *Id.*

<sup>4</sup> 50 U.S. Code § 1702(a)(1).

<sup>5</sup> Between 1977 and March 25, 2022, Presidents have invoked IEEPA in 67 new declarations of national emergency under the NEA. On average, these emergencies last nearly nine years. Casey, Rennack, Elsea, [The International Emergency Economic Powers Act](#). Most emergencies have been geographically specific, targeting a specific country or government. *Id.* However, since 1990, Presidents have declared non-geographically specific emergencies in response to issues like weapons proliferation, global terrorism, and malicious cyber-enabled activities. *Id.*



The Executive Order also identified three categories of sensitive technologies and products constituting “Covered National Security Technologies and Products.” (i) semiconductors and microelectronics, (ii) quantum information technologies, and (iii) artificial intelligence (“AI”) sectors critical for the military, intelligence, surveillance, or cyber-enabled capabilities of China, as determined by the Secretary of Treasury in consultation with the Secretary of Commerce and, as appropriate, the heads of other relevant agencies. Where applicable, Covered National Security Technologies and Products may be limited by reference to certain end-uses of those technologies or products. The contours of Covered National Security Technologies and Products are further elucidated by the ANPRM, as described below.

## II. Advanced Notice of Proposed Rulemaking

Pursuant to the Executive Order, the Secretary of Treasury is authorized to take such actions and to employ all powers granted to the President by IEEPA as may be necessary to carry out the purposes of the Executive Order, including:

- i. *Rulemaking*. Promulgate rules and regulations, including elaborating on the definitions contained in the Executive Order and further prescribing definitions of other terms as necessary to implement the Executive Order;
- ii. *Conducting Investigations*. Investigate and make requests for information relative to notifiable or prohibited transactions from parties to such transactions or other relevant persons at any time, including through the use of civil administrative subpoenas as appropriate;
- iii. *Unwinding Prohibited Transactions*. Nullify, void, or otherwise compel the divestment of any prohibited transaction entered into after the effective date of the regulations issued under the Executive Order; and
- iv. *Referring Criminal Violations*. Refer potential criminal violations of the Executive Order or the regulations issued under this order to the Attorney General.

In connection with Treasury’s rulemaking authority, the ANPRM reflects the framework that Treasury anticipates proposing for the implementation of the Executive Order and defines key terms governing who and what kind of transactions would be subject to outbound investment screening.

### A. Investments Subject to Screening

Under the framework proposed by the ANPRM, investments subject to screening are those by “US persons” in certain “covered transactions” relating to Covered National Security Technologies and Products and involving “covered foreign persons,” each as defined below.

#### i. *Requirements on US Persons*

The Executive Order and ANPRM suggest that US persons, wherever they are located, will be responsible for adhering to the prohibition and the notification requirement. A “US Person” includes any US. 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. Under the Executive Order, the Secretary of Treasury may also place certain obligations on US Persons with respect to foreign entities that they control and in certain situations when US Persons knowingly direct transactions by non-US Persons.

ii. *Covered Transactions*

Screening is anticipated to focus on US Persons undertaking certain types of transactions that could convey intangible benefits related to Covered National Security Technologies and Products, specifically a US Person's direct or indirect:

- a. *Equity Acquisitions*. Acquisition of equity interests (e.g., via mergers and acquisitions, private equity, venture capital, and other arrangements);
- b. *Greenfield Investments*. Greenfield investment<sup>6</sup> that could result in the establishment of a "covered foreign person," as defined below,
- c. *Joint Ventures*. Establishment of a joint venture, wherever located, that is formed with a "covered foreign person" or could result in the establishment of a "covered foreign person;" and
- d. *Debt Financing*. Provision of debt financing to a "covered foreign person" where such debt financing is convertible to an equity interest.

iii. *Covered Foreign Persons*

The ANPRM defines a "Covered Foreign Person" as a "person of a country of concern" that is engaged in, or that a US Person knows or should know will be engaged in, a Covered Transaction, or their direct or indirect subsidiaries or branches which, individually or in the aggregate, comprise more than 50% of that person's consolidated revenue, net income, capital expenditure, or operating expenses. A "person of a country of concern" is further defined as:

- i. *Individuals*. Any individual who is not a US citizen or lawful permanent resident of the US **and** is a citizen or permanent resident of a "country of concern;"
- ii. *Entities*. An entity with a principal place of business in, or an entity incorporated in or otherwise organized under the laws of a "country of concern;"
- iii. *Governments*. The government of a "country of concern;" or
- iv. *Ownership Interests*. Any entity in which a person or persons identified above holds individually or in aggregate, directly or indirectly, an ownership interest equal to or greater than 50%.

Presently, China is the only identified "country of concern." Because of the often-complicated corporate structures of offshore holding companies, the expansive definition of Covered Foreign Person may require additional due diligence and Know Your Customer

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<sup>6</sup> A greenfield investment is a form of foreign direct investment where a company establishes new operations in a different country, as opposed to acquiring or investing into existing operations.



precautions from US Persons, although to what extent remains to be seen based on the draft regulatory text that will follow the ANPRM.

iv. *Excepted Transactions*

Treasury is considering excepting the following transactions from any restrictions under the Executive Order (such transactions, “Excepted Transactions”):

- i. *Certain Securities*. Investments into publicly traded securities, index funds, mutual funds, or exchange-traded funds;
- ii. *Investments by Limited Partners*. Investments made as a limited partner into venture capital, private equity, or other pooled investment funds where the investor does not participate in the fund’s management or operations **and** the investment falls below a yet-defined *de minimis* threshold;
- iii. *Intracompany Transfers*. Intracompany transfers of funds from a US parent company to its China subsidiary;
- iv. *Interests in Entities and Assets Outside of China*. Acquisition of all the equity or other interests held by a Covered Foreign Person in an entity or assets located outside of China; or
- v. *Preexisting Commitments*. The completion of binding capital commitments made prior to the Executive Order.

Notwithstanding (ii), any investment that affords the US Person rights beyond those reasonably considered to be standard minority shareholder protections will not constitute an Excepted Transaction. Such rights include, but are not limited to:

- i. Membership or observer rights on, or the right to nominate an individual to a position on, the board of directors or an equivalent governing body of the Covered Foreign Person; or
- ii. Any other involvement, beyond the voting of shares, in substantive business decisions, management, or strategy of the Covered Foreign Person.

The above-proposed exceptions are designed to carve out certain transactions that are unlikely to involve the transfer of both capital and additional benefits to a Covered Foreign Person and buyouts of China ownership that eliminate the opportunity and incentive for a US Person to lend support to a Covered Foreign Person. Treasury also seeks to avoid unintended interference with the ongoing operation of a US subsidiary in China when that US subsidiary meets the definition of a Covered Foreign Person, although it is Treasury’s position that the contemplated definition of Covered Transaction already excludes most intracompany actions (such as the sale or purchase of inventory, the provision of paid services, the licensing of technology, or the provision of loans guarantees or other obligations).

The ANPRM also contemplates a potential “national interest exemption” for “exceptional circumstances” through which Treasury may determine that an otherwise prohibited transaction should be permitted because it provides an “extraordinary benefit” to US national security or the US national interest that “overwhelmingly outweighs” US national security concerns. Treasury



may request detailed documentation from the relevant US Persons to determine whether to grant the exemption.

These definitions and exceptions are under consideration and subject to further refinement. Depending on how Treasury clarifies the scope of the ANPRM, the US outbound investment screening program could significantly expand US jurisdiction over certain transactions involving China nationals and China-based companies.

B. Covered National Security Technologies and Products.

The ANPRM provides initial details on the subsets of Covered National Security Technologies and Products within the three categories identified in the Executive Order that will be subject to prohibition or notification requirements.

i. *Semiconductors and Microelectronics.*

Treasury is considering **prohibiting** US investments in China entities engaged in the development of electronic design automation software or semiconductor manufacturing equipment; the design, fabrication, or packaging of advanced integrated circuits; and the installation or sale of supercomputers.

Treasury is also considering requiring **notification** for US investments in China entities engaged in the design, fabrication, and packaging of less advanced integrated circuits.

ii. *Quantum Information Technologies*

Treasury is considering **prohibiting** US investments in China entities engaged in the production of quantum computers and certain components; the development of certain quantum sensors; and the development of quantum networking and quantum communication systems. Treasury is **not** currently considering a separate notification requirement for quantum information technologies.

iii. *Certain Artificial Intelligence Systems.*

Treasury is considering requiring **notification** for US investments in China entities engaged in activities related to software that incorporates an AI system and that is designed for certain end-uses that may have military or intelligence applications and pose a national security risk, such as cybersecurity applications, digital forensics tools, or “surreptitious listening devices that can intercept live conversations without the consent of the parties involved,” and noncooperative location tracking.

Treasury is also requesting comments on how to shape a **prohibition** on US investments in China entities engaged in a narrow set of activities related to software that incorporates an AI system and is designed for military, government intelligence, or mass surveillance end uses.



US Investments in China Entities Engaged In...		
<i>Technology</i>	<i>Notification</i>	<i>Prohibition</i>
<b>Semiconductors &amp; Microelectronics</b>	The design, fabrication, and packaging of all other integrated circuits.	<ul style="list-style-type: none"> <li>• The development of electronic design automation software or front-end semiconductor manufacturing equipment designed to be exclusively used for the volume fabrication of integrated circuits;</li> <li>• The design of integrated circuits that exceed the thresholds in Export Classification Number 3A090;</li> <li>• The fabrication of certain advanced integrated circuits, including advanced logic, NAND memory, and DRAM chips;</li> <li>• The packaging of integrated circuits that support three-dimensional integration; and</li> <li>• The installation or sale of supercomputers enabled by certain advanced chips.</li> </ul>
<b>Quantum Information Technologies</b>	None under consideration.	<ul style="list-style-type: none"> <li>• The production of quantum computers and certain components;</li> <li>• The development of quantum sensing platforms designed to be exclusively used for military, government intelligence, or mass surveillance end uses; and</li> <li>• The development of quantum networking and quantum communication systems designed to be exclusively used for secure communications, such as quantum key distribution.</li> </ul>
<b>Certain AI Systems</b>	Activities related to software that incorporates an AI system and is exclusively or primarily designed for certain end-uses that may have military or intelligence applications and pose a national security risk, such as: <ul style="list-style-type: none"> <li>• cybersecurity</li> <li>• digital forensic tools</li> <li>• penetration testing tools</li> <li>• control of robotic systems</li> <li>• surreptitious listening devices</li> <li>• non-cooperative location tracking</li> <li>• facial recognition.</li> </ul>	Activities related to software that incorporates an AI system and is designed for military, government intelligence, or mass surveillance end-uses.

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The ANPRM also seeks public comment on a range of other, related definitions and elements of the program. The public will have until September 28, 2023, to provide comments that will inform Treasury’s development of the draft regulatory text.



### III. Congressional Support for Restrictions on Outbound Investment

#### A. The Outbound Investment Transparency Act.

On July 25, 2023, the Senate voted to add a bipartisan amendment, the Outbound Investment Transparency Act (the “OITA”), to the 2024 National Defense Authorization Act in a 91 to 6 vote.<sup>7</sup> Similar to the Executive Order and the ANPRM, the OITA, cosponsored by Senate Finance Committee members Sens. Bob Casey (D-Pa.) and John Cornyn (R-Texas), would require U.S. entities to notify Treasury about covered outbound investments, acquisitions, and other business activities.<sup>8</sup> Unlike the Executive Order and ANPRM, the OITA (i) would function as an information-gathering tool to obtain a fuller picture of US investments in China, Russia, North Korea, and Iran; (ii) would cover a wider range of technology sectors, adding hypersonics, dual-use networked laser scanning systems, and satellite-based communications; and (iii) would not ban investments in these sector but requires notification 14 days prior to the conclusion of a covered transaction.<sup>9</sup> The Senate vote signals a resounding bipartisan consensus to address outbound investment as a national security matter.

#### B. Letter to President Biden on Restrictions on US Investments to China.

On July 18, 2023, the House Select Committee on the Chinese Communist Party (the “CCP”) launched an investigation into US outbound investment in China-based companies, sending letters each to GGV Capital, GSR Ventures, Walden International, and Qualcomm Ventures, asking for information on their investments in China and requiring a response by August 1, 2023.<sup>10</sup> In the letters, the House Select Committee on the CCP alleged that investments by US firms into China-based companies contributed to China's human rights abuses, military modernization and efforts to supplant US technological leadership.

On August 3, 2023, Chairman Mike Gallagher of the House Select Committee on the CCP wrote to President Biden ahead of the highly anticipated Executive Order requesting that in drafting the Executive Order President Biden prioritize transparency, including obtaining a full accounting of total US risk exposure and the beneficiaries of US investment in China to improve investors’ ability to make informed decisions. Further, Chairman Gallagher suggested that President Biden adopt several core principles in the Executive Order, namely that the Executive Order should:

- i. Include both private and public market investments flowing to China in new restrictions;
- ii. Restrict US capital from flowing to organizations connected to the CCP’s Xijiang policies, the CCP’s technological rise, and China’s military;

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<sup>7</sup> [Amendment SA 931](#) to [S.2226](#), the National Defense Authorization Act for Fiscal Year 2024 (July 25, 2023).

<sup>8</sup> *Id.*

<sup>9</sup> Thibault Denamiel, Eric Meyers, and William Alan Reinsch, [Insight into the Senate's Outbound Investment Mechanism](#), CSIS (August 2, 2023).

<sup>10</sup> Press Release, [Select Committee Launches Investigations into U.S. Venture Capital Firms Funding Problematic PRC Companies](#), HOUSE SELECT COMMITTEE ON THE CCP (July 19, 2023).





- iii. Protect shareholder rights by forcing China companies to meet the same due diligence standards as US companies;
- iv. Ensure investment restrictions are predictable and provide certainty to investors;
- v. Avoid creating an onerous, case-by-case screening process;
- vi. Consult with allies and partners before implementing new restrictions and urge them to adopt parallel restrictions on investing in China.<sup>11</sup>

## V. European Union Outbound Investment Regime

On June 20, 2023, the European Commission published its Joint Communication on a European Economic Strategy (the “Joint Communication”), setting out its plan for developing a framework for the assessment and management of security risks raised by certain economic activities.<sup>12</sup> Of particular interest is the Joint Communication’s proposed approach to investment screening, with commitments made by the European Commission to both strengthen the existing Foreign Direct Investment Screening Regulation and develop an outbound investment review mechanism. For the latter, the Joint Communication indicates that the European Commission will:

- i. Set up a dedicated group of European Union Member States’ experts, building a new structured, confidential cooperation mechanism;
- ii. Conduct outreach and consultations with businesses and other stakeholders, and partner countries, as appropriate; and
- iii. Aim to propose an outbound screening initiative by the end of 2023.

Signaling support for the US, European Commission president Ursula Von der Leyen has urged the European Union to introduce similar measures, although European Union Member States remain reluctant about submitting to the authority of a European Union-wide screening process. It remains unclear whether an instrument similar to the process proposed in the Executive Order and the ANPRM will attract sufficient political support.<sup>13</sup>

## IV. Implications for US Investment in China

Although the outbound investment screening process proposed by the Executive Order and the ANPRM is not the reverse CFIUS<sup>14</sup> that analysts anticipated, the new rules are being drafted amid intensifying geopolitical tensions that have already slowed US investment into China. According to the Rhodium Group, direct US investment into China hit a 10-year low of US\$8.2 billion in 2022. Also in 2022, US venture capital investment into China hit US\$1.3 billion, the lowest value since 2014 (see below figures, also from the Rhodium Group).<sup>15</sup>

<sup>11</sup> [Letter to President Biden on Restrictions on US Investments to China](#), The Select Committee on the CCP (August 3, 2023).

<sup>12</sup> [Joint Communication to the European Parliament, The European Council And The Council On “European Economic Security Strategy”](#) (June 20, 2023).

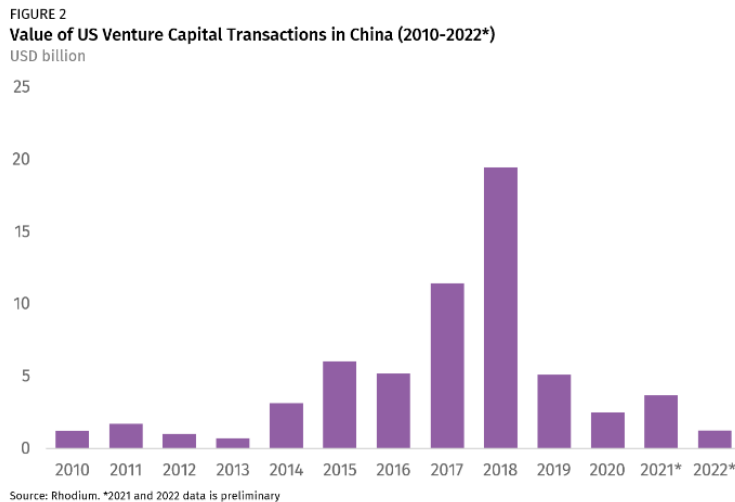
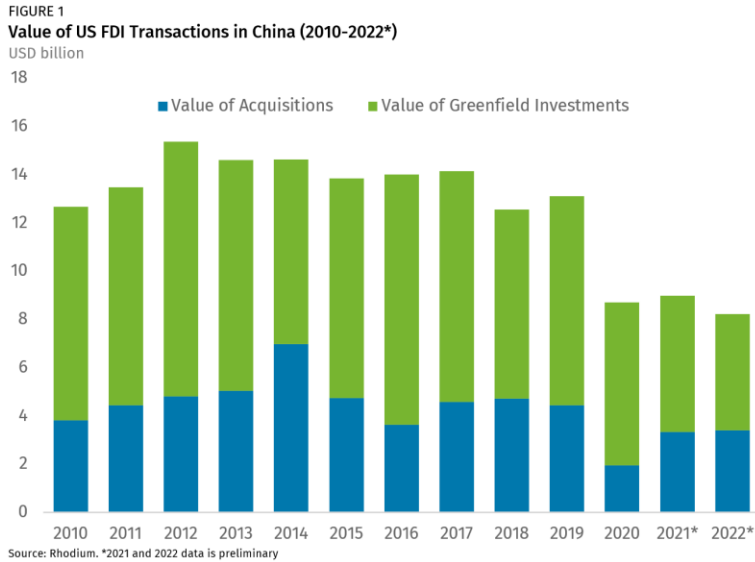
<sup>13</sup> Emily Benson, Gregory C. Allen, [A New National Security Instrument: The Executive Order on Outbound Investment](#), CSIS (August 10, 2023).

<sup>14</sup> Referencing the Committee on Foreign Investment in the US, which reviews certain foreign investments in US businesses.

<sup>15</sup> Andrew Duehren, [Biden Restricts US Investment in China](#), WALL STREET JOURNAL (August 9, 2023). Reva Goujon, Charlie Vest, and Thilo Hanemann, [Big Strides in a Small Yard: The New US Outbound Investment Screening Regime](#), RHODIUM GROUP (August 11, 2023).



According to PitchBook, in the second quarter of 2023, US venture capital involvement in China deals dropped such that US investors participated in only 30 deals amounting to approximately \$200 million. This represents the smallest number of quarterly deals since at least 2016.<sup>16</sup> Many venture capitalists had anticipated the Executive Order for a long time.<sup>17</sup> They also expressed that exposure to China would make it challenging for them to attract investors or limited partners to invest in their funds.<sup>18</sup> Thus, the Executive Order and the ANPRM will likely continue the chilling effect that deteriorating US – China relations have already had on investment from the US and other countries into China generally and China’s high-tech sector in particular.



<sup>16</sup> Yuliya Chernova, Angus Loten, *American VCs Still Have a Lot at Stake in China*, WALL STREET JOURNAL (August 10, 2023).  
Michelle Toh, *US Investment Curbs Deal “Major Blow” to Chinese Startups*, CNN (August 10, 2023).

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*



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China may attempt to retaliate with its own economic measures against the US, particularly by imposing more export restrictions over materials like rare earths that China has significant control over. However, China's ability to implement effective countermeasures may be limited by several, emerging economic challenges, including China's slowing GDP growth, high youth unemployment rate, falling exports, prolonged real estate slump, factory slow-down and underwhelming consumer spending.<sup>19</sup>

Still, the proposed outbound investment measures have not been introduced in a vacuum and are but one tool in a trend of intensifying hostility between the US and China. For now, there are no currently effective restrictions and interested stakeholders have the opportunity to influence the draft regulations by submitting comments to the ANPRM, which Treasury is accepting until September 28, 2023.

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<sup>19</sup> Brian Spegele, [How Bad is China's Economy](#), WALL STREET JOURNAL (July 26, 2023).