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U.S. Department of the Treasury Releases Final Rule Implementing Executive Order on Outbound Foreign Investments into China

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Under the Final Rule, certain types of transactions either require a notification or are prohibited when a U.S. person or controlled foreign entity would acquire interests in a covered foreign person, due to that covered foreign person's activities in certain critical technology sectors. The meanings of the terms "U.S. person" and "covered foreign person" are expansive. For example, the term covered foreign person includes entities organized in China, Hong Kong and Macao, as well as entities outside of China, including those located in the United States, which are subsidiaries of Chinese entities or which derive substantial revenue from Chinese subsidiaries in the Targeted Sectors. The Final Rule is crafted such that U.S. persons cannot avoid application of the Final Rule by routing investments through offshore funds or entities.

Several notable exceptions to the Final Rule's prohibitions include those transactions involving (1) publicly traded securities; and (2) LP investments by U.S. investors in non-U.S. pooled investment funds of $2 million or less, or when an LP investment is subject to binding contractual assurances that its capital in the fund will not be used to engage in a prohibited or notifiable transaction if engaged in directly by a U.S. person. IPO underwriters are not exempt from the Program to the extent the underwriters acquire non-public securities, even if only temporarily or in furtherance of an eventual public listing. We summarize key aspects of the Program and provide related key takeaways below.

Introduction

On October 28, 2024 (the "Effective Date"), the U.S. Department of the Treasury ("Treasury") released a final rule (the "Final Rule"), implementing Executive Order 14105 (the "EO"), requiring notification of or prohibiting certain outbound foreign investments into mainland China, Hong Kong and Macao (collectively, "China"). *See* 89. Fed. Reg. 90398. The Final Rule took effect on January 2, 2025 (the "Effective Date"). It applies to prospective transactions in three identified sectors: **semiconductors and microelectronics**, **quantum information technologies** and certain **artificial intelligence** technologies (the "Targeted Sectors"). The Final Rule provides another tool for the upcoming Trump administration's expected hawkish approach to competition with China.

In response to its Advanced Notice of Proposed Rulemaking (the "ANPRM") and Notice of Proposed Rulemaking (the "NPRM"), Treasury received 112 comments from industry, Congress, think tanks, and private citizens on, among other things, the scope of key terms to be included in the Final Rule and the procedures Treasury would use to establish and administer the new outbound investment program (the "Program"). Treasury has provided additional clarification in its Frequently Asked Questions bulletin released December 13, 2024 and updated on January 17, 2025 (the "FAQ").

The Final Rule is the first time the U.S. or any of its allies have regulated outbound investments for national security purposes outside of investment bans in the sanctions context. In his testimony before the House Select Committee on the Chinese Communist Party, Ambassador Robert Lighthizer, President Trump's first-term U.S. Trade Representative and mentor to the presumptive U.S. Trade Representative Jamieson Greer, emphasized restrictions on outbound investment as an integral part of a mosaic of policy recommendations towards strategic decoupling from China. We expect President Trump to direct a whole-of-government approach to protecting American resources and industrial base, slowing China's technological advancement in sectors deemed critical to U.S. national security, and addressing perceived risks to U.S. supply chains, with outbound investment restrictions as a key instrument in this holistic approach. While the Program shares similarities with the Committee on Foreign Investment in the United States ("CFIUS") process, it does not establish a case-by-case process for reviews of specific transactions or permit negotiation with the U.S. government. Appendix A summarizes key differences between CFIUS and the Program.

Washington Context

Since before the enactment of the Foreign Investment Risk Review Modernization Act ("FIRRMA") in 2018, U.S. Congressional debates have explored the prospect of

restricting outbound investment. Ultimately, outbound restrictions were not included in FIRRMA. It was only at the direction of the Consolidated Appropriations Act of 2023 that the Departments of Commerce and Treasury reported on any outbound investment initiatives and the resources required to establish and implement them. Several Congressional efforts related to outbound investment restrictions have since stalled in Congress, leaving the EO and its rulemaking process as the initiative's foundation.

For example, the Outbound Investment Transparency Act ("OITA") passed the Senate in July 2023 as an amendment to the National Defense Authorization Act for Fiscal Year 2024 ("NDAA"). OITA did not include prohibitions on outbound investments. However, it required notification of transactions involving more technologies (e.g., hypersonics and satellite-based communications) and countries (i.e., Russia, Iran, and North Korea) than those covered by the Final Rule. OITA did not make it into the final version of the NDAA, but we anticipate there may be some appetite in the upcoming 119th Congress to expand the Program's coverage and/or further entrench it under novel legislation. While there is bipartisan political consensus supporting an outbound investment regime, concerns from Congress remain as to whether the regime established in the Final Rule has been appropriately scoped (or even, in some cases, whether it has a sound legal basis). Should it choose, the new Republican-controlled Congress will have the latitude to enact further legislation and/or the Trump Administration will be able to issue a new executive order amending the Program's contours.

Key Definitions

U.S. Person. The Final Rule defines a "U.S. person" as "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 branch of any such entity, or any person in the United States." U.S. persons are responsible for complying with the Final Rule. U.S. persons must also "take all reasonable steps" to prevent prohibited transactions by any affiliated controlled foreign entity are responsible for notifying Treasury of any notifiable transactions.

Controlled Foreign Entity. A "controlled foreign entity" is an "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." A U.S. person is a parent if it is (a) the beneficial owner of greater than 50% of outstanding voting interest or board seats; (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, with 'investment adviser' as defined in the

Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)).

Covered Foreign Person. The Final Rule defines "covered foreign person" as a person of a country of concern (i.e., China, Hong Kong and Macao) that (1) engages in a "covered activity"; or (2) derives more than 50% of its revenue, net income, capital expenditures or operating expenditures from a person of a country of concern that engages in a covered activity (e.g., a Chinese subsidiary or joint venture).

Person of a Country of Concern. A "person of a country of concern" is defined as (1) an individual who is a citizen or permanent resident of China and not a U.S. citizen or permanent resident; (2) an entity headquartered or with its principal place of business in China, or incorporated or organized under Chinese law; (3) the Chinese government and any party, agency or instrumentality thereof; or (4) any entity, wherever located, where, individually or in the aggregate, directly or indirectly, 50% or greater voting, board, or equity interests are held by persons described in (i)-(iii). Investors should understand that many U.S.-organized subsidiary entities of Chinese companies, through ownership stake and/or commercial ties, will thus be considered covered foreign persons.

Covered Transactions

The Final Rule is focused on discrete investments in country-of-concern entities which are related to sensitive technologies and products critical for military, intelligence, surveillance or cyber-enabled capabilities. "Covered transactions" (i.e., transactions that are subject to regulation) under the Final Rule are broken into two categories driven by the nature of the investment covered activity conducted within Targeted Sectors: "Prohibited Transactions," which are more serious due to the investment target's work within the Targeted Sectors, and "Notifiable Transactions," which cover some types of residual activities in those Targeted Sectors.

Indirect Investment. The Program is designed such that a U.S. person cannot, through an intermediary (e.g., a special purpose vehicle), engage in a covered transaction. Thus, the covered transactions definition includes "indirect" transactions.

Types of Transactions. Appendix B summarizes both Prohibited Transactions and Notifiable Transactions and the covered activities associated with each, including, for example, with respect to investment targets designing integrated circuits:

> Prohibited Transaction per § 850.224(c): Designs any integrated circuit that meets or exceeds the performance parameters in Export Control Classification Number 3A090.a in supplement No. 1 to 15 CFR part 774, or integrated circuits designed for operation at or below 4.5 Kelvin.
>
> Notifiable Transaction per § 850.217(a): Designs any integrated circuit that is not described in § 850.224(c).

Any direct or indirect prospective investment by a U.S. person not meeting exemption criteria warrants close scrutiny against the definitions in the Final Rule. While recognizing whether a Targeted Sector is implicated may be clear in many cases, intensive diligence will often be necessary to support the fact-heavy analysis required to distinguish between Prohibited Transactions and Notifiable Transactions. Some assessments will require reasoned analysis, as uncertainty remains around the definition of several key terms. For example, engineers and other subject matter-experts may have very different views of what might constitute "control of robotic systems" in the notifiable transactions definition. Treasury's commentary to the Final Rule and the FAQ provide some guidance (e.g., FAQ Items 16 and 22 clarify some ambiguity around the term "AI systems"), and Treasury has indicated that it is amenable to releasing additional clarifications as it receives further feedback from industry.

Additionally, the FAQ clarified that otherwise Notifiable Transactions would instead be Prohibited Transactions if the relevant covered foreign person also appears on any of the following lists:

- The Department of Commerce Bureau of Industry and Security's ("BIS") Entity List (15 CFR part 744, supplement no. 4);
- BIS's Military End User List (15 CFR part 744, supplement no. 7);
- The definition of "Military Intelligence End-User" established by BIS in 15 CFR § 744.22(f)(2);
- 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;
- Treasury's list of Non-SDN Chinese Military-Industrial Complex Companies; or
- List of foreign terrorist organizations as designated by the Secretary of State under 8 U.S.C 1189.

Knowledge Standard. The Final Rule includes a "knowledge" definition to provide guidance on sufficiency of due diligence efforts for determining whether a transaction

involves a covered foreign person engaging in a covered activity. Treasury left the definition vague for the purpose of being able to assess individual cases by the totality of the relevant facts and circumstances. Under the Final Rule, a U.S. person may be deemed to possess knowledge if the person: (1) has actual knowledge that a fact or circumstance exists or is substantially certain to occur, (2) is aware of a high probability of a fact or circumstance's existence or future occurrence, or (3) has reason to know, judged through whether a reasonable and diligent inquiry was undertaken. The Final Rule provides a list of factors against which diligence efforts will be judged. We recommend U.S. persons, among other diligence efforts: (i) seek representations and warranties from an investment target concerning whether it engages in activities that would be captured by the Final Rule; (ii) seek access to non-public information concerning the investment target; and (iii) ensure that the U.S. person has accounted for available public information about the investment target. While the Final Rule does not provide any safe harbor, for example, for obtaining representations and warranties, Treasury states in the FAQ that doing so would support an assessment by Treasury that an investor conducted "reasonable and diligent inquiry."

Types of Investments. The Final Rule covers the below direct and indirect types of transactions: (1) acquisition of equity or a contingent equity interest; (2) debt financing affording U.S. person equity investment-type economics or control benefits; (3) conversion of contingent equity interest into equity interest acquired after the Effective Date; (4) involvement in greenfield or brownfield investment; (5) entrance into a joint venture; or (6) acquisition of a limited partner interest in a non-U.S. fund.

Prohibition on Greenfield Investments, Brownfield Investments, and Joint Ventures. The scope of the covered transactions definition includes a prohibition on the acquisition, leasing, or other development of operations, land, property, or other assets in a country of concern that the U.S. person knows at the time of such acquisition, leasing, or other development will result in, or that the U.S. person plans to result in (i) the establishment of a covered foreign person or (ii) the engagement of a person of a country of concern in a covered activity. Given the predominance of these types of investments for international growth, internal compliance measures will be critical to assessing risk of missteps. In the Final Rule commentary, it noted that objective indicators (e.g., correspondence) would be used to assess a U.S. person's knowledge and plans at the time of a transaction. We note that the Final Rule is ambiguous in what constitutes a joint venture. Treasury refers to the "plain English meaning of the term, i.e., as involving the contribution of capital and/or assets by two parties and the sharing of profits and losses" and notes that pure licensing agreements or commercial contracts would not be considered prohibited joint

ventures. While we understand that Treasury is aware of existing disagreements within industry concerning how to interpret the term, Treasury has not yet provided clarity on this point.

Process, Penalties, Recusal, Excepted Transactions and the National Interest Exemption

Notification Process. U.S. persons with knowledge of a Notifiable Transaction have the affirmative obligation to report such transaction to Treasury within 30 calendar days post-closing through the recently established Outbound Notification System ("ONS") online portal. The Final Rule gives Treasury the discretion to request additional information be provided. If the relevant U.S. person only obtains knowledge of the transaction after it is completed, the notification must be submitted to Treasury via ONS within 30 calendar days of the acquisition of such knowledge. The Final Rule also clarifies that a submission beyond 30 calendar days after the transaction does not preclude a determination by Treasury, as a factual matter related to subsequent litigation, that such U.S. person had relevant knowledge at the time of the transaction.

Penalties. The program authorizes civil money penalties of up to the greater of $377,700 (adjusted at least annually for inflation) or twice the value of the relevant transaction in case of violations. It also authorizes criminal penalties for willful violations up to $1 million and/or up to 20 years imprisonment. The Final Rule authorizes Treasury to force divestment of any prohibited transaction. Additionally, voluntary self-disclosure will be accounted for as a mitigating factor in Treasury's determination of the appropriate response to violations.

Recusal. A U.S. person cannot "knowingly direct" any non-U.S. person to complete a transaction that would be prohibited if completed by a U.S. person. This includes U.S. persons who hold influence or the authority to participate in decisions (e.g., officers and directors) at non-U.S. person entities, including, for example, founders and partners of non-U.S. funds who hold U.S. passports. However, U.S. persons at non-U.S. person entities can recuse themselves from all of the following activities, in which case Treasury will consider them not to have "knowingly directed" a prohibited transaction: (1) Participating in formal approval and decision-making processes related to the transaction, including making any investment recommendation; (2) Reviewing, editing, commenting on, approving and signing relevant transaction documents; and (3) Engaging in negotiations with the investment target (or, as applicable, the relevant transaction counterparty, such as a joint venture partner). This will require partners or founders, including individuals captured by "key man" provisions, who are U.S. Persons

at non-U.S. entities (e.g., non-U.S. private equity funds) to recuse themselves from all negotiation and decision-making processes related to prohibited transactions.

Excepted Transactions. The Final Rule codifies exceptions where notification requirements or prohibitions do not apply:

- Investments in publicly traded securities in any jurisdiction (*but excluding participation in IPOs – see below*);
- Certain investments that U.S. persons may undertake as LPs, where (i) the LP's committed capital is not more than $2 million, aggregated across any investment and co-investment vehicles of the fund; or (ii) the LP has obtained a binding contractual assurance that its capital in the fund will not be used to engage in a transaction that would be a prohibited transaction or a notifiable transaction if engaged in by a U.S. person (note that U.S. LP investors and non-U.S. funds courting U.S. LP investors are grappling with how to memorialize these commitments in limited partner agreements and side letters);
- Derivatives;
- Buyouts of ownership interests held by persons of a country of concern;
- Certain intracompany transactions;
- Acquisitions of an equity interest in a covered foreign person based on such person's default, and where the loan was made by a syndicate of banks in a loan participation where the U.S. person lender(s) in the syndicate (i) cannot by itself initiate any action vis-à-vis the debtor; and (ii) is not the syndication agent; and
- Equity-based employment compensation.

Transactions made after the Effective Date pursuant to a binding, uncalled capital commitment entered into before the Effective Date are also excepted. Additionally, the Final Rule provides Treasury with discretion to except persons of certain nationalities as a matter of policy, if the relevant government takes adequate measures to address the national security risks addressed by the program. We expect, similar to the CFIUS Excepted Foreign States list, that this carve-out will eventually cover close U.S. allies such as the UK if they adopt similar outbound investment control programs.

IPO Underwriting Arrangements – Not Exempt. Despite comments advocating that it do so, Treasury declined to include an exception for IPO underwriting where a U.S. person acquires a non-public equity interest, even in the short term, in a covered foreign person. Treasury is concerned about the combination of acquisition of an equity interest with the transfer of intangible benefits, including enhanced standing and prominence, managerial assistance, access to investment and talent networks, market access and enhanced access to additional financing. However, the provision of

underwriting services that do not entail acquiring equity interests (e.g., a "short term residual position in the issuer's shares in the event of a shortfall in demand") would not be a covered transaction.

National Interest Exemption. The Final Rule references to the process, outlined more substantively in a subsequent bulletin (the "NID Guidelines"), for covered transactions to be approved by Treasury. The Secretary, in consultation with counterparts at the Department of State, the Department of Commerce and other relevant agencies, has the authority to determine it is in the in the national interest of the United States to do so. These exemptions are likely only to be granted in exceptional circumstances, but considerations that may inform such a determination include:

- The transaction's effect on critical U.S. supply chain or critical infrastructure needs;
- Domestic production needs in the United States for projected national defense requirements;
- The United States' technological leadership globally in areas affecting U.S. national security; and
- The impact on U.S. national security from prohibiting a given transaction.

Key Takeaways

The Final Rule is not retroactive. The restrictions discussed here took effect on January 2, 2025. They do not cover binding, uncalled capital commitments entered into before this date, but will apply to transactions initiated or negotiated prior to January 2, but completed thereafter. This new cutoff deviates from the EO and ANPRM initial proposal to retroactively cover all commitments entered into after the EO's issuance date of August 9, 2023.

The Program's compliance burden falls on U.S. persons, and due diligence for prospective investments in the Targeted Sectors will be even more critical than before. Affected investors should begin formulating compliance strategies and procedures as soon as possible. Determining whether a counterparty is a covered foreign person, and whether a contemplated transaction is a covered transaction, will require a technical, fact-specific analysis by the U.S. person involved. Investors should be careful in assessing whether the Department of the Treasury Office of Investment Security has jurisdiction, as certain definitions and technical thresholds are not perfectly aligned with the Export Administration Regulations and International Traffic in Arms Regulations. The Final Rule previews additional forthcoming compliance information posted to the Outbound Investment Security Program website. Thus far,

this guidance has included the FAQ and NID Guidelines.

The Program's confidentiality standard is markedly lower than that of CFIUS. The Program allows for non-public information to be disclosed when doing so is "important" to the national security analysis or in "the national interest." This standard would permit Treasury to release lists of companies receiving notifiable investments from U.S. persons or which have sought to have U.S. investors engage in prohibited investments in order to deter future investment with these companies.

Expect the Program to expand. In order to create an advantageous negotiation position, President Trump will likely seek to grow the number of bargaining chips in order to extract concessions from Beijing. Given prior legislative debate and the growing set of technologies perceived as critical to U.S. national security, we anticipate more Targeted Sectors to be included in the Program (including, potentially, biotechnology, hypersonics and satellite-based communications).

Appendix A

	CFIUS	*Outbound Investment Controls*
Intent	Regime concerns U.S. investment in certain sectors within "countries of concern" (currently limited to China, Hong Kong and Macao)	Regime concerns foreign investments in U.S. businesses
Scope	Applies only to certain transactions involving specified countries	Applies to certain transactions with any non-U.S. person/investor
Compliance Burden	Compliance burden on U.S. person investor to engage in sufficient due diligence before engaging in covered transaction to determine if prohibited or notifiable	Compliance burden on target and investor to determine if a transaction may trigger a mandatory CFIUS filing (or if a filing is otherwise warranted)
Mitigation	Covered transactions are either notifiable or prohibited;	Transactions may be approved without conditions ("mitigation

	there is no “mitigation” process	measures”), approved subject to mitigation measures or referred to the president for prohibition
Implementation	Implemented by newly formed OGT within the Department of the Treasury, which sits within the Office of Investment Security	Inter-agency implementation (Nine Executive Branch departments/offices and five “observer” members)
Disclosure	Allows for information to be publicly disclosed if it is “important” to the national security analysis or in the “national interest”	Confidential and subject to FOIA, with limited exceptions (only to the extent “necessary” for national security purposes)

Appendix B

	PROHIBITED (Full Text Here)	***NOTIFIABLE (Full Text Here)***

SEMICONDUCTORS AND MICROELECTRONICS	Covered transactions related to: • certain electronic design automation software; • certain fabrication or advanced packaging tools; • the design or fabrication of certain advanced integrated circuits; • advanced packaging techniques for integrated circuits; and • supercomputers	Covered transactions related to the **design**, **fabrication** or **packaging** of integrated circuits not otherwise covered by the prohibited transaction definition
QUANTUM INFORMATION TECHNOLOGIES	Covered transactions related to the development or production of: • quantum computers or critical components required to produce a quantum computer; • certain quantum sensing platforms (military, government intelligence or mass surveillance end uses); and • certain quantum networks or quantum communication systems	N/A
ARTIFICIAL INTELLIGENCE	Covered transactions related to the development of any AI system:	Covered transactions related to the development of any AI system not otherwise covered by the prohibited transaction

	• designed to be exclusively used for, or intended to be used for, **certain end uses**; or • that is trained using a quantity of computing power greater than 10^{25} computational operations, or trained using primarily biological sequence data and a quantity of computing power greater than 10^{24} computational operations. **End uses include**: military, government intelligence, mass surveillance, as well as internal, non-commercial use for digital forensics, penetration testing and the control of robotic systems.	definition, where such AI system is designed or intended to be used for **certain end uses** or applications, or trained using a quantity of computing power greater than 10^{23} computational operations **End uses include**: military, government intelligence, mass-surveillance, cybersecurity applications, digital forensics, penetration testing and ***control of robotic systems***

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Suggested Reading

- 19 February 2025 Kirkland Alert Court Order Restores Corporate Transparency Act Reporting Obligations — Most Filings Now Due by March 21, 2025
- 13 February 2025 Award Chambers Global 2025: 82 Kirkland Practice Areas and 145 Attorneys Ranked
- 12 February 2025 Press Release Kirkland Advises Richards Manufacturing Co. on Sale to TE Connectivity