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Client Alert

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U.S. Outbound Investment Review Regime Moving Forward

New program may prohibit some U.S. investments in China

On March 3, 2023, the U.S. Departments of the Treasury ("Treasury") and Commerce ("Commerce") delivered to Congress separate confidential reports that confirm the Biden Administration is moving forward with establishing a regulatory system to screen outbound U.S. investments in advanced technologies that could pose national security risks. It has been speculated that this new outbound screening regime may prohibit or restrict certain outbound investments while collecting information about others for future consideration. Although the reports to Congress did not identify any specific country or sector target, the new regime is expected to focus largely on U.S. investments in China that impact the semiconductor, quantum computing, and artificial intelligence sectors. While the details of the new program are yet to be finalized, the Biden Administration may issue an Executive Order ("EO") establishing the program before the end of April.

Background

The idea of an outbound investment review system in the United States is not new. Legislative efforts to create such a review mechanism first arose during the 2018 congressional debate over the Foreign Investment Risk Review Modernization Act ("FIRRMA"). Most recently, after a failed attempt to revive this issue in 2021,[1] Senators Bob Casey (D-PA) and John Cornyn (R-TX) reintroduced the National Critical Capabilities Defense Act ("NCCDA") as a part of the Creating Helpful Incentives to Produce Semiconductors and Science Act of 2022 ("CHIPS Act"), which aimed to counter China's rise in the semiconductor industry. However, on August 9, 2022, President Biden signed into law a version of the CHIPS Act that again omitted the NCCDA provisions.

The Consolidated Appropriations Act of 2023, signed into law on December 29, 2022, includes an outbound investment review program. In addition to allocating $10 million each to Treasury and Commerce to "consider establishing a program to address the national security threats emanating from outbound investments from the United States in certain sectors that are critical for U.S. national security," the Act required Treasury and Commerce to each submit a report describing the program and the resources needed over the next three years to establish and implement it. The reports, provided to Congress on March 3, 2023, broadly describe the Biden Administration's consideration of such a program and needed resources.

The Biden Administration has been making ongoing efforts to shape an outbound investment review mechanism via an EO. The October 2022 National Security Strategy specifically mentioned the "screening of outbound investment" as a new approach being pursued to address national security threats, revealing that the White House already had decided to move ahead with the program. The Biden Administration also has been meeting with industry groups and allies to develop an appropriate approach, and National Security Advisor Jake Sullivan held discussions with key Cabinet secretaries on a draft EO in December 2022. The recent reports to Congress indicate that President Biden intends to request funding for the program in his fiscal 2024 budget, set to release on March 9, 2023, underscoring that the issuance of the EO may be imminent.

Key Takeaways

A great deal of uncertainty remains regarding the details of the new outbound investment screening regime. The Biden Administration appears to realize that getting these details right is crucial to the success of the overall policy goals of the program and is working to resolve any remaining issues. To be effective, the new outbound screening regime must prevent the exploitation of U.S. capital and expertise that may threaten U.S. national security while not stifling domestic growth by placing an undue burden on U.S. businesses. While the program specifics continue to be hammered out within the executive and legislative branches, there are several notable features that appear to be taking shape.

- ***The new screening regime initially will be aimed squarely at China.*** The March 3 reports did not specifically identify which countries would be subject to the new review system. Given the relative lack of U.S. investment in other "adversarial nations," however, it is expected that the new regulatory system will focus on U.S. investments in China. Nevertheless, it is noteworthy that President Biden's 2022 EO on factors for the Committee on Foreign Investment in the United States ("CFIUS") to consider in its reviews of foreign investments in the United States repeatedly cites as a concern the national security threats posed by third-party relationships with countries of concern (*i.e.,* China, Russia, North Korea, Iran, Cuba, and Venezuela). Depending on how broadly the Biden Administration applies the outbound investment restrictions, it is conceivable that U.S. investors could be restricted or prohibited from investing in entities outside the borders of adversarial nations (*i.e.*, entities not based in China) based on their extensive relationships with adversarial nation-based entities.
- ***The new screening regime restrictions initially will be very limited in scope.*** The screening regime will apply to certain entities involved in those sensitive technologies that are critical to U.S. national security and could advance adversarial nations' development of military and dual-use technologies. It is widely believed that the new program will apply to advanced semiconductors, quantum computing, and artificial intelligence, although the program likely will not treat them all the same. Semiconductors are tangible and more easily defined, making U.S. investments in them the most likely candidate for restriction or prohibition. Quantum computing and artificial intelligence are more conceptual and difficult to scope, which likely will result in the new rules requiring U.S. investors to report certain activities falling within delineated subsets of those sectors. Notably, the previous NCCDA provisions also covered biotechnology and critical minerals, and the CFIUS EO and other U.S. national security documents have identified multiple other sectors important to U.S. national security. Thus, whether accomplished through executive or legislative action, we expect that the scope of both

restrictions and reporting will be broadened eventually, particularly after Treasury and Commerce analyze any initial reporting data.

- ***The new screening regime will be permanent and robust, but it initially will not be "Reverse CFIUS."*** The outbound screening regime will be administered by Treasury in coordination with Commerce (and other federal agencies and authorities). It likely will be hosted within Treasury's Office of Investment Security, which is the same office that oversees CFIUS. Thus, the program likely will draw heavily upon the structure, processes, and experience of CFIUS. For example, the new program only will address investments not covered by other authorities, meaning that the screening regime will not overlap with sanctions, export controls, or other such measures. At the outset, it is further unlikely that the program will review individual transactions on a case-by-case basis, and therefore will not determine whether to approve, mitigate, or block them. Once an outbound investment screening office is established and staffed, regulations are written, and a monitoring and enforcement program implemented, the screening regime could become more granular in its approach, but that will take resources and time. The new program also will be subject to a public comment period, during which industry stakeholders may comment on the various issues involved. Additionally, the Biden Administration is working very hard to engage international partners and allies, which may result in similar regimes being replicated abroad. Outbound investment screening will not be temporary, and its impact will likely grow over time, both in the United States and abroad.

Looking Ahead

An outbound investment review system, whether established by Congress or shaped by an EO, turns a new page on the growing competition between the United States and China (and potentially other adversarial nations). In anticipation of a new regulatory system, U.S. and multinational businesses with investments in China should review their strategies and begin to screen new investments in companies operating in sectors deemed critical to U.S. national security, particularly in the semiconductor, quantum computing, and artificial intelligence industries. Such investors also should review their relevant operations and prepare to submit public comments to Treasury when appropriate to voice support, concern, or opposition.

Investors seeking to review their investment strategy, proactively screen their investments, or prepare comments for submission may benefit from counsel experienced in these areas. King & Spalding has a global footprint, substantial industry experience, and deep bench of former trade and national security government officials, including a former U.S. Department of Treasury official who recently helped lead the Office of Investment Security, which chairs CFIUS and likely will oversee any new outbound investment screening regime. King & Spalding is uniquely positioned to guide companies through preparing for the historic implementation of this new regulatory program.

ABOUT KING & SPALDING

Celebrating more than 130 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 1,200 lawyers in 23 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality, and dedication to understanding the business and culture of its clients.

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[1] In 2021, Senators Bob Casey (D-PA) and John Cornyn (R-TX) introduced the National Critical Capabilities Defense Act but failed to include it as a part of the United States Innovation and Competition Act, which passed the U.S. Senate in June 2021. *See* USICA, S. 1260, *available at:* https://www.congress.gov/bill/117th-congress/senate-bill/1260.