COVINGTON

Treasury Department Issues Proposed Rule to Implement Outbound Investment Executive Order

June 25, 2024

CFIUS

On June 21, 2024, the Department of the Treasury ("Treasury") published its long-awaited Notice of Proposed Rulemaking ("NPRM") setting forth proposed regulations (the "Proposed 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"). As we described in our analysis last August, the Outbound Order marks the first time that the United States, or any other major Western democratic economy, has sought to regulate and control outbound capital flows and other investments for national security reasons.

In certain areas, including the overall framework for implementing the Outbound Order, the NPRM largely adheres to the broad contours of the Advance Notice of Proposed Rulemaking ("ANPRM") that Treasury issued on August 11, 2023. In other areas, however—including the scope of covered foreign persons, the scope of activities in countries of concerns, the extent to which the rule would apply to foreign subsidiaries and affiliates of U.S. persons, the scope of exceptions for certain limited partner ("LP") investments, and the knowledge requirements—the NPRM answers questions left open in the ANPRM in a more expansive manner. Consequently, assuming that the final rule will largely track the NPRM, it will have implications for a broad range of stakeholders, including private equity, venture capital, and other investment funds; institutional investors, including pension funds, university endowments, and family offices; lenders; companies that have existing business or operations in China; and U.S. persons who work for foreign parties and are involved in considering or approving investment decisions, among others.

Consistent with the ANPRM, the NPRM targets investments in three key sectors: semiconductors and microelectronics, quantum information technologies, and artificial intelligence ("AI"). The NPRM proposes a two-tiered approach whereby: (1) certain transactions require only notification ("Notifiable Transactions"); and (2) certain other transactions are subject to outright prohibition ("Prohibited Transactions," and together with Notifiable Transactions, "Covered Transactions"). Specifically, the transactions subject to the notification requirements and prohibitions would include any transaction by a "U.S. person" or "controlled foreign entity" with a "covered foreign person"—i.e., a "person of a country of concern" that is engaged in certain defined activities involving "covered national security technologies and products"—subject to certain exceptions ("Excepted Transactions"). Below we address key questions

regarding the scope and application of the Proposed Rule and highlight some of the notable changes by comparison to the ANPRM.

The deadline for submitting comments in response to the NPRM is August 4, 2024. Treasury is expected to finalize the implementing regulations thereafter, though the exact timing of the final rule and its effective date remain unspecified.

Questions and Answers Regarding the NPRM

What is the scope of "U.S. persons" subject to the Outbound Order's restrictions?

The Outbound Order's restrictions and obligations would apply to any "U.S. person," defined broadly to include United States citizens, lawful permanent residents, entities organized under the laws of the United States or any jurisdiction within the United States (as well as foreign branches of any such entity), and persons present in the United States—regardless of nationality.

How does the Proposed Rule apply to foreign subsidiaries or affiliates of U.S. persons?

U.S. persons would also have certain obligations with respect to their subsidiaries, or "controlled foreign entities" (i.e., controlled by the U.S. person). The NPRM seeks to propose a "bright line" rule defining a "controlled foreign entity" as any entity in which a U.S. person directly or indirectly holds more than 50 percent of the outstanding voting interest or voting power of the board; serves as a general partner, managing member, or the equivalent; or is an investment advisor (with respect to a pooled investment fund). Certain examples included in the NPRM, however, appear expansive, and we expect that this will be an area of comment and focus for refinement in any final rule. For example, the NPRM explains that a U.S. person's direct and indirect holdings in the same entity would be aggregated, and that with respect to a tiered ownership structure, the voting interest or power of the board of a subsidiary would be fully attributed to the ultimate U.S. parent if the parent entity holds a greater than 50 percent voting interest or meets the other requirements identified above (e.g., serves as a general partner, etc.).

The obligation to comply with the Proposed Rule would fall on the U.S. person—i.e., the parent company, controlling shareholder, general partner, etc.—and not on the controlled foreign entity; U.S. persons would be obligated to take "all reasonable steps" to ensure that their controlled foreign entities comply with the Outbound Order. The NPRM notes that Treasury will consider certain factors, including the "size and sophistication of the [U.S.] parent" and the "existence and implementation of periodic training and reporting requirements with respect to compliance with the proposed regulations and the implementation of internal controls" to assess whether the U.S. parent took "all reasonable steps."

The knowledge standard—what investigation and diligence must investors undertake to determine whether a proposed transaction is notifiable or prohibited?

The NPRM introduces a "knowledge standard" outlining the level of awareness a U.S. person must have regarding certain facts and circumstances related to a particular transaction to trigger obligations under the Proposed Rule. It provides that the 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) could have obtained such information through a reasonable and diligent inquiry.

The Proposed Rule effectively imposes an obligation on U.S. persons and controlled foreign entities to conduct diligence to a reasonable degree to ascertain whether the transaction is prohibited or notifiable. This standard, of course, may create friction with the increasing limitations in China on the ability to conduct due diligence on transaction counterparties. In that regard, it is notable that the Proposed Rule also proposes certain factors that Treasury would consider in assessing whether a U.S. person undertook a reasonable and diligent inquiry, including the following:

- The inquiry a U.S. person, its legal counsel, or its representatives have made on behalf of the U.S. person regarding an investment target or relevant counterparty, including questions asked of the investment target or relevant counterparty, as of the time of the transaction;
- The contractual representations or warranties the U.S. person has obtained or attempted to obtain from the investment target or relevant counterparty with respect to the determination of a transaction's status as a covered transaction and an investment target or relevant counterparty's status as a covered foreign person;
- The effort by the U.S. person at the time of the transaction to obtain available non-public information relevant to the determination of a transaction's status as a covered transaction and an investment target or relevant counterparty's status as a covered foreign person, and the efforts undertaken by the U.S. person to obtain and review such information;
- Available public information, the efforts undertaken by the U.S. person to obtain and review such information, and the degree to which other information available to the U.S. person at the time of the transaction is consistent or inconsistent with such publicly available information;
- Whether the U.S. person, its legal counsel, or its representatives have purposefully avoided learning or sharing relevant information;
- The presence or absence of warning signs, which may include evasive responses or non-responses from an investment target or relevant counterparty to questions or a refusal to provide information, contractual representations, or warranties; and
- The use of public and commercial databases to identify and verify relevant information of an investment target or relevant counterparty.

What else is covered by the knowledge standard?

U.S. persons also would be prohibited from "knowingly directing" a transaction that would be prohibited if undertaken by a U.S. person. The NPRM specifies that this obligation would apply when the U.S. person has the "authority to make or substantially participate in decisions on behalf of a non-U.S. person entity and exercises that authority to direct, order, decide upon, or approve a transaction that would be a prohibited transaction if engaged in by a U.S. person." The NPRM indicates that officers, directors, senior advisors, and certain other senior-level decisionmakers would be deemed to have such authority. The NPRM suggests that this clarification is intended to "minimize the potential impact on non-senior U.S. person employees,

including administrative staff and individuals not playing a substantial role in an investment decision." The NPRM also would exempt those who recuse themselves from such investment decisions.

The NPRM further clarifies that third-party services such as banking services and "routine administrative work" performed by a U.S. person who lacks substantial involvement in an investment decision will not be covered by the knowledge standard.

What transactions are covered?

The following transactions would be "covered transactions":

- Acquisition of an equity interest or contingent equity interest in a person that the U.S. person knows at the time of the acquisition is a covered foreign person;
- Provision of a loan or a similar debt financing arrangement to a person that the U.S. person knows at the time of the provision is a covered foreign person, where such debt financing is (i) convertible to an equity interest, or (ii) affords the U.S. person the right to make management decisions with respect to or on behalf of the covered foreign person, or the right to appoint members of the board of directors (or equivalent) of the covered foreign person;
- Conversion of a contingent equity interest or convertible debt in a person that the U.S. person knows at the time of the conversion is a covered foreign person;
- Acquisition, leasing, or other development of operations, land, property, or other assets in a country of concern (i.e. greenfield or brownfield investment) 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 intends 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 where it was not previously engaged in such covered activity;
- Entrance into a joint venture, wherever located, with a person of a country of concern and that the subject U.S. person knows at the time of entrance into the joint venture will engage in or the U.S. person intends to engage in a covered activity;
- Acquisition of an LP 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 U.S. person) that a U.S. person knows at the time of the acquisition likely will invest in a person of a country of concern that is in the semiconductors and microelectronics, quantum information technologies, or AI sectors, and such fund undertakes a transaction that would be a covered transaction if undertaken by a U.S. person.

The application of this definition to expansions of existing operations or joint ventures is a significant evolution from the ANPRM. The ANPRM made clear that Treasury intended to cover greenfield investment—i.e., the establishment of a new business in China that would be a covered foreign person—but it was not clear how the rules would apply to brownfield investments or expansions of existing businesses. Treasury appears to have answered that question by confirming that those activities would be covered, too. The NPRM provides that the "[a]cquisition, leasing, or other development of operations, land, property, or other assets in a country of concern" would be covered if it results in "the engagement of a person of a country of concern in a covered activity where it was not previously engaged in such covered activity (in the case of a business pivot)."

> This change is notable because it appears to mean that U.S. persons will be prohibited from expanding existing operations in China to engage in a new covered activity involving a prohibited technology or product, and will be required to provide notice with respect to new operations related to notifiable technologies or products. We expect that this will be another active area of commentary in response to the Proposed Rule.

Additionally, relative to the ANPRM, the Proposed Rule broadens the scope of greenfield investments and joint ventures that could be covered by adopting an "intent" standard, in addition to the "knowledge" standard. Specifically, Treasury notes that for a greenfield/brownfield investment or joint venture, a "U.S. person's intent (as distinct from mere knowledge) would be sufficient for coverage in the joint venture context because a U.S. person may not know at the time of the transaction that the joint venture will engage in a covered activity, yet the Department of the Treasury seeks to capture transactions likely to convey intangible benefits to a covered foreign person."

What is the scope of "covered foreign persons" with whom transactions would be prohibited or notifiable?

A covered foreign person is defined to mean (1) a "person of a country of concern" that engages in a "covered activity" (defined further by reference to subsets of technologies and products in the semiconductors and microelectronics, quantum information technologies, and AI sectors), and (2) any person that directly or indirectly holds any voting interest, board seat or observer right, or equity interest, or holds any power to direct or cause the direction of the management or policies of a "person of a country of concern" that engages in a "covered activity" if more than 50 percent of the first person's revenue, net income, capital expenditure, or operating expenses is attributable to such "person of a country of concern," individually or in the aggregate with other persons of a country of concern engaged in covered activities. Accordingly, covered foreign persons can include not only Chinese entities, but also entities in other jurisdictions that hold substantial interests in Chinese companies engaged in covered activities.

The Proposed Rule defines a "person of a country of concern" to mean:

- an individual who is a citizen or permanent resident of a country of concern (defined to mean the People's Republic of China including the Special Administrative Region of Hong Kong and the Special Administrative Region of Macau) and not a U.S. citizen or permanent resident of the United States;
- an entity that is organized under the laws of a country of concern, headquartered in, incorporated in, or with a principal place of business in a country of concern;
- the government of a country of concern, or any entity with respect to which the government of such country holds individually or in the aggregate, directly or indirectly, 50 percent 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 activity;

- an entity that is directly or indirectly majority-owned (i.e., 50 percent or more of the outstanding voting interest, voting power of the board, or equity interest) by any persons or entities in any of the aforementioned categories; or
- any entity in which one or more persons identified in the above category holds at least 50 percent of the outstanding voting interest, voting power of the board, or equity interest.

What are the "covered activities"?

"Covered activity" is defined by reference to certain "covered national security technologies or products" in the semiconductors and microelectronics, quantum information technology, and AI sectors. Each covered activity corresponds either to a prohibition or mandatory notification. Many covered activities are defined according to highly technical parameters.

Semiconductors and microelectronics	
Prohibited	**Notification Required**
▪ Develop or produce any electronic design automation software for the design of integrated circuits or advanced packaging; ▪ Develop or produce any (1) 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); (2) Equipment for performing volume advanced packaging; or (3) Commodity, material, software, or technology designed exclusively for use in or with extreme ultraviolet lithography fabrication equipment; ▪ Design 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; ▪ Fabricate any integrated circuit that meets any of the following criteria: (1) Logic integrated circuits using a non-planar	▪ Design any integrated circuit that is not described in the prohibited category; ▪ Package any integrated circuit that is not described in the prohibited category.

transistor architecture or with a production technology node of 16/14 nanometers or less, including fully depleted silicon-on-insulator (FDSOI) integrated circuits; (2) NOT-AND (NAND) memory integrated circuits with 128 layers or more; (3) Dynamic random-access memory (DRAM) integrated circuits using a technology node of 18 nanometer half-pitch or less; (4) Integrated circuits manufactured from a gallium-based compound semiconductor; (5) Integrated circuits using graphene transistors or carbon nanotubes; or (6) Integrated circuits designed for operation at or below 4.5 Kelvin; ■ Package any integrated circuit using advanced packaging techniques; ■ Develop, install, sell, or produce 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.	
Quantum information technologies	
Prohibited	**Notification Required**
■ Develop a quantum computer or produce any of the critical components required to produce a quantum computer such as a dilution refrigerator or two-stage pulse tube cryocooler; ■ Develop or produce any quantum sensing platform designed for, or which the relevant covered foreign person intends to be used for, any military, government intelligence, or mass-surveillance end use; ■ Develop or produce any quantum network or quantum communication system designed for, or which the relevant covered foreign person intends to be used for: (1) Networking to scale up the capabilities of quantum computers, such as for the purposes of breaking or compromising encryption; (2) Secure	None.

communications, such as quantum key distribution; or (3) Any other application that has any military, government intelligence, or mass-surveillance end use. **Definition of "quantum computer" remains unchanged from the ANPRM as "a computer that performs computations that harness the collective properties of quantum states, such as superposition, interference, or entanglement."*	
Artificial intelligence systems	
Prohibited	**Notification Required**
▪ Develop any AI system that is designed to be exclusively used for, or which the relevant covered foreign person intends to be used for, any: (1) military end use (e.g., for weapons targeting, target identification, combat simulation, military vehicle or weapon control, military decision-making, weapons design, or combat system logistics and maintenance); or (2) government intelligence or mass surveillance end use (e.g., through mining text, audio, or video; image recognition; location tracking; or surreptitious listening devices); ▪ Develop any AI system that is trained using a quantity of computing power greater than: • Proposal 1: 10^24 computational operations • Proposal 2: 10^25 computational operations; ▪ Develop any AI system that is trained using a quantity of computing power greater than: • Proposal 1: 10^23 computational operations using primarily biological sequence data • Proposal 2: 10^24 computational operations using primarily biological data.	▪ Develop any AI system that is not in the prohibited category and that is: • Designed to be used for any government intelligence or mass-surveillance end use (e.g., through mining text, audio, or video; image recognition; location tracking; or surreptitious listening devices) or military end use (e.g., for weapons targeting, target identification, combat simulation, military vehicle or weapons control, military decision-making, weapons design, or combat system logistics and maintenance); • Intended by the covered foreign person to be used for cybersecurity applications, digital forensics tools, and penetration testing tools, or the control of robotic systems; or • Trained using a quantity of computing power greater than 10^23 computational operations (alternative proposals for 10^24 and 10^25 computational operations).

**AI System defined as (1) 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 uses data inputs to: Perceive real and virtual environments; abstract such perceptions into models through automated or algorithmic statistical analysis; and use model inference to make a classification, prediction, recommendation, or decision, or (2) any data system, software, hardware, application, tool, or utility that operates in whole or in part using a system described above.*	

An important change since the ANPRM is that a transaction would be prohibited, even if it falls in the notifiable category, if the transaction involves a party identified on certain restricted party lists[1] maintained by the U.S. government, including the Entity List maintained by the Department of Commerce's Bureau of Industry and Security, or that meets the definition of "military intelligence end-user" under 15 C.F.R. § 744.22(f)(2).

What transactions are exempted?

Consistent with the approach in the ANPRM, Treasury is proposing a category of "excepted transactions" that would be excluded from the mandatory notification requirement or prohibition. Those include:

- **Publicly traded securities:** An investment by a U.S. person in a publicly traded security or a security issued by an investment company, such as an index fund, mutual fund, or exchange-traded fund;
- **Certain LP investments:** Certain U.S. person investments made as an LP or equivalent in a venture capital fund, private equity fund, fund of funds, or other pooled investment fund that do not result in the acquisition of certain specific governance rights (with certain conditions for participation on an advisory board or committee of such investment

[1] Restricted lists include: Bureau of Industry and Security's Entity List (15 CFR part 744, supplement no. 4); Bureau of Industry and Security's Military End User List (15 CFR part 744, supplement no. 7); Department of the Treasury's list of Specially Designated Nationals and Blocked Persons (SDN List); Department of the Treasury's list of Non-SDN Chinese Military-Industrial Complex Companies (NS–CMIC List); Foreign terrorist organization list under 8 U.S.C. 1189

fund) provided that the LP's committed capital is not more than 50 percent of the total assets under management and the LP has secured a binding contractual assurance that its capital will not be used in a prohibited transaction. Alternatively, Treasury is considering a different construct that would exempt certain LP investments so long as they do not afford the U.S. person rights beyond "standard minority shareholder protections," *provided that* the committed capital, aggregated across any investment and co-investment vehicles that comprise the fund, does not exceed $1,000,000;

- **Buyouts of country of concern ownership:** A U.S. person's full buyout of all country of concern ownership of an entity, provided that the entity would not constitute a covered foreign person following the transaction;
- **Intracompany transactions:** An intracompany transaction between a U.S. parent and a controlled foreign entity to support ongoing operations or other non-covered activities, provided that such transaction would not be a greenfield investment or joint venture investment that meets the definition of a covered transaction;
- **Pre-Outbound Order binding commitments:** A transaction fulfilling a binding, uncalled, capital commitment entered into prior to August 9, 2023;
- **Certain syndicated debt financings:** Where the U.S. person, as a member of a lending syndicate, acquires a voting interest in a covered foreign person upon default and the U.S. person cannot initiate any action vis-à-vis the debtor and does not have a lead role in the syndicate; 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 posed by outbound investment and the transactions are of a type for which associated national security concerns are likely to be adequately addressed by the actions of that country or territory.

Additionally, while they are not considered excepted transactions, the NPRM suggests in the preamble to the text of the Proposed Rule that certain other transactions are not within the scope of covered transactions because they would not meet the elements in the definition of a "covered transaction," namely: university-to-university research collaborations; the sale of goods and services; the purchase, sale, and licensing of intellectual property; and a variety of financial and non-financial services ancillary to a transaction such as the processing, clearing, or sending of payments by a bank.

Can parties request a waiver or prior authorization for a covered transaction?

While declining to adopt a formal licensing process where a U.S. person could seek prior authorization for a covered transaction, the NPRM affirms that a U.S. person could still seek a "national interest exemption" for a covered transaction on a case-by-case basis, and that Treasury will in the future detail the process and required information for any national interest exemption request on its website.

For transactions that are required to be notified, when must the notification be made and what information is required to be provided in the notification?

A U.S. person subject to the notification requirement under the Proposed Rule would be required to file a notification with Treasury that includes information related to the transaction

such as details about the U.S. person, the covered transaction, relevant national security technologies and products, and the covered foreign person, including as applicable, "pitch decks, marketing letters, offering memorandums, and due diligence materials related to the transaction." The NPRM proposes that a notification must be filed no later than 30 calendar days after a transaction is completed. Other required information for notifications include: the full legal names and titles of each officer, director, and other member of management of the covered foreign person and a brief description of the known end use(s) and end user(s) of the covered foreign person's technology, products, or services.

For any required information the U.S. person is not able to provide, the U.S. person is required to provide sufficient explanation for why the information is unavailable or otherwise cannot be obtained and explain the U.S. person's efforts to obtain such information. If such information subsequently becomes available, the U.S. person shall provide such information to the Department of the Treasury promptly, and in no event later than 30 calendar days following the availability of such information.

The Proposed Rule also requires the U.S. person to maintain copies of the notification filed, along with supporting documentation (including due diligence materials, pitch decks, marketing letters, etc.) for a period of ten years from the date of the filing.

Once a notification has been submitted, the NPRM adds that Treasury may follow up with additional questions or document requests with deadlines specified by Treasury. The NPRM also notes that once a notification has been submitted, it is possible the U.S. person will receive no communication from the Treasury Department other than an electronic acknowledgement of receipt.

What happens if parties find out after the fact that a transaction was notifiable or prohibited?

The Proposed Rule would require a U.S. person to submit a notification to Treasury if the U.S. person "acquires actual knowledge after the completion date of a transaction of a fact or circumstance such that the transaction would have been a covered transaction if such knowledge had been possessed by the relevant U.S. person at the time of the transaction." This requirement would apply to both notifiable and prohibited transactions. The U.S. person would be required to submit the "post-transaction knowledge" notification no later than 30 calendar days after acquiring such knowledge, and it would be required to include:

- Identification of the fact or circumstance of which the U.S. person acquired knowledge post-transaction;
- The date upon which the U.S. person acquired such knowledge;
- A statement explaining why the U.S. person did not possess or
- obtain such knowledge at the time of the transaction; and
- A description of any pre-transaction diligence undertaken by the U.S. person, including, as applicable, any steps described in § 850.104(c).

How will LP investments be treated?

The NPRM also clarifies the scope of LP investments that would be covered by the Proposed Rule and those that would be excepted, including by addressing the "knowledge" and timing considerations. Regarding the application of the knowledge standard, the NPRM notes that an LP investment will only be covered when the U.S. persons knows (or has reason to know) at the time of the investment that the pooled fund likely will invest in a covered foreign person. The NPRM acknowledges that when a pooled fund is soliciting investments, it may not yet have identified specific targets in which it seeks to make investment, and it may not be practicable for an LP to know where its investment is going, via the pooled fund, in terms of a specific target entity even following a reasonable and diligent inquiry at the time of its LP investment. However, the NPRM notes "it is possible for an LP to know, through a reasonable and diligent inquiry, where a pooled fund is likely to invest at a higher level in terms of geography and sector," for example by researching "past investments made by a pooled fund's manager, engaging with the pooled investment fund's general partner, or reviewing such fund's prospectus or other documentation."

The NPRM clarifies that in order to be a covered transaction, (1) the U.S. person LP would need to invest in a pooled fund that the U.S. person knows is likely to invest in a person of a country of concern that is in any of the three specified sectors in the Outbound Order; and (2) such pooled fund would need to actually undertake a transaction that would be a covered transaction if undertaken by a U.S. person. The NPRM does not address whether the capital committed by the U.S. person LP must be called by the fund for the transaction, or if it is sufficient that the U.S. person LP has committed capital to the fund generally. The NPRM explains that, under these circumstances, if the transaction undertaken by the fund is a notifiable transaction, the U.S. person LP would be required to submit a notification to Treasury no later than 30 calendar days following the date of the transaction. On the other hand, if the transaction undertaken by the fund is a prohibited transaction, the U.S. person LP will be deemed to have engaged in a prohibited transaction in violation of the Proposed Rule. With that said, the NPRM reiterates that both prongs (1) and (2) above must met in order for there to be a covered transaction under the Proposed Rule—i.e., "a U.S. person's investment as a limited partner into a pooled fund would not be a covered transaction if the U.S. person does not know at the time of its investment that the pooled investment fund likely will invest in a person of a country of concern that is in any of the three relevant sectors, even when such fund subsequently undertakes an investment that would be a covered transaction if made by a U.S. person."

What are the penalties for engaging in a prohibited transaction or failing to make a required notification?

The penalties for non-compliance include both civil and criminal penalties, as well as a divestment order. A violation (e.g., missed notification) would be subject to civil penalties not to exceed $368,136 (adjusted regularly for inflation) or twice the amount of the transaction, whichever is greater, as set forth in the International Economic Emergency Powers Act ("IEEPA"). A violation could also be subject to criminal penalties not to exceed $1,000,000 and/or 20 years in imprisonment as set forth in IEEPA. The NPRM indicates that the Secretary of the Treasury could take any action authorized under IEEPA to nullify, void, or otherwise require divestment of any prohibited transaction. The NPRM also provides greater details on the process for a U.S. person to submit a voluntary self-disclosure, including that in determining the appropriate response to any violation, Treasury will consider the submission and the timeliness of the voluntary self-disclosure of such non-compliance.

Congressional Response

Several Members of Congress have praised the NPRM as an important step forward, while suggesting more needs to be done to counter China's technological capabilities, and touting congressional proposals, such as the Outbound Investment Transparency Act (S.2678) and the Chinese Military and Surveillance Company Sanctions Act (H.R.760), as appropriate next steps.

Senator Bob Casey (D-PA) said that he "will keep pushing to pass [his] bipartisan legislation to make permanent an outbound investment screening program." The NPRM follows the U.S. Senate's bipartisan 91-6 vote to add Senator Casey's legislation—the Outbound Investment Transparency Act, which he introduced with Senator John Cornyn (R-TX)—to the FY2024 NDAA. Clients should expect Senators Casey and Cornyn to once again attempt to use the NDAA amendment process to advance this legislation.

Meanwhile, House Financial Services Committee Chair Patrick McHenry (R-NC-10) suggested expanding sanctions would have a more immediate impact and said that "[a]ny effort to block global funding for the Chinese military-industrial complex must include the full blocking sanctions in Congressman Andy Barr's Chinese Military and Surveillance Company Sanctions Act." As we previously reported, the Chinese Military and Surveillance Company Sanctions Act would expand sanctions on certain companies based in China by "harmonizing" the U.S. government's various sanctions lists. McHenry's Committee advanced the bill earlier this Congress, but it has not seen Floor action and was not included in the House NDAA this year or last.

Covington will continue to monitor these important developments. In the meantime, If you have any questions concerning the material discussed in this client alert, please contact the members of our CFIUS and PPGA practices.

David Fagan	+1 202 662 5291	dfagan@cov.com
Holly Fechner	+1 202 662 5475	hfechner@cov.com
Heather Finstuen	+1 202 662 5823	hfinstuen@cov.com
Mark Plotkin	+1 202 662 5656	mplotkin@cov.com
Jonathan Wakely	+1 202 662 5387	jwakely@cov.com
Ingrid Price	+1 202 662 5838	iprice@cov.com
Janine Slade	+1 202 662 5239	jslade@cov.com
Brian Williams	+1 202 662 5270	bwilliams@cov.com
Lawrence Barker	+1 202 662 5437	lbarker@cov.com
Ian Carrico	+1 202 662 5238	icarrico@cov.com
Corinne Cook	+1 202 662 5077	ccook@cov.com
Jacob Crump	+1 202 662 5591	jcrump@cov.com
Irina Danescu	+1 202 662 5556	idanescu@cov.com
Samuel Karson	+1 202 662 5341	skarson@cov.com
Fiza Khan	+1 202 662 5690	fkhan@cov.com
Brian Kim	+1 202 662 5703	bkim@cov.com
Monty Roberson	+1 202 662 5903	mroberson@cov.com
Madeline Sanderford	+1 202 662 5408	msanderford@cov.com
Morgan Schreurs	+1 202 662 5362	mschreurs@cov.com