

The scope and coming expansion of US outbound investment controls



The United States has a robust screening process for inbound foreign investment. In contrast, existing US controls on outbound investment are fragmented and focused on restricting transfers of export-controlled items, prohibiting investments in Chinese military-industrial complex companies and sanctioned countries, and reviewing transactions that may undermine the purpose of federal funding. Marking a major shift in US foreign policy, proposed legislation seeks to establish a committee that would review a relatively broad scope of outbound investments.

There is a groundswell of evolving bipartisan support for action on the issue but no consensus on the proper approach. Matthew Goldstein and Matthew Moedritzer set out the status quo – and direction of travel.



EXISTING OUTBOUND INVESTMENT CONTROLS

US export controls on outbound investment

Outbound investment in the development and production of industry in other countries takes many forms, to include transfers of articles, materials, software, technology, and services (collectively ‘items’), such as production machinery, engineering know-how, and testing and inspection equipment.

US export controls regulations administered by the Department of Commerce under the Export Administration Regulations (‘EAR’), the Department of State under the International Traffic in Arms Regulations (‘ITAR’), and by other federal agencies, restrict exports, reexports, and transfers (in-country) of items described on agency control lists.

EAR licence requirements are generally based on an item’s export classification under the EAR Commerce Control List and the destination, end use, and end-user of the item. The EAR

IF INTRODUCED, HR 760 WOULD REQUIRE THE BIDEN ADMINISTRATION TO BLOCK AND PROHIBIT TRANSACTIONS IN PROPERTY AND INTERESTS IN PROPERTY OF CHINESE COMPANIES IDENTIFIED ON THE DEPARTMENT OF DEFENSE LIST OF CHINESE MILITARY COMPANIES.

end use restrictions prohibit US persons from providing support for certain nuclear, missile, chemical, and biological weapons end uses and various other activities of concern without US government authorisation. For the purpose of these controls, ‘support’ is broadly defined to include shipping or transmitting controlled items, facilitating such shipments or transmissions, or performing any contract, service, or financing that a US person knows may assist or benefit a prohibited end use or end-user. The Commerce Department has also implemented end use restrictions that, among other things, prohibit US persons from exporting, reexporting, or transferring any item for the development or production of integrated circuits at a facility that fabricates certain advanced node integrated circuits in the People’s Republic of China (‘China’) or the Macau Special Administrative Region.

The ITAR requires a licence for any export, reexport, or transfer of articles and defense services described on the ITAR US Munitions List. Among other things, the ITAR also requires US persons and certain foreign persons who act as deal makers or otherwise facilitate the manufacture, export, permanent import, transfer, reexport, or retransfer of US or foreign defense articles or defense services for third parties to register with the Department of State as brokers, and the ITAR requires advanced government approval before the proposal or provision of certain brokering activities.

Chinese Military-Industrial Complex Sanctions

Although greater access for US financial services firms was part of the Trump administration’s 2020 trade deal with China, several executive actions by the Trump and Biden administrations in 2020 and 2021 imposed controls on capital market investments in certain Chinese companies involved in Chinese military, intelligence, and security research and development programmes, weapons, and related equipment production under China’s Military-Civil Fusion strategy. These restrictions prohibit US persons from engaging in the purchase or sale of any publicly traded securities of companies designated by the US government on the non-SDN Chinese Military-Industrial Complex List (‘NS-CMIC’) List.

For the purposes of the Chinese Military-Industrial Complex (‘CMIC’) Sanctions, ‘publicly traded securities’ has the meaning of the term defined under the Securities Exchange Act of 1934, which includes any note, stock, index fund, mutual fund, swaps, bond, debenture, transferable share, voting-trust certificate, and many other types of investments, denominated in any currency that trades on a securities exchange or through over-the-counter transactions, in any jurisdiction. The controls also prohibit US person investments in any publicly traded securities that are derivative of such securities or that are designed to provide investment exposure to such securities.

The Treasury Department's Office of Foreign Assets Control ('OFAC') administers the NS-CMIC List. At present, the list contains 68 companies, to include Huawei Technologies Co., Ltd., China National Offshore Oil Corporation, China Telecommunications Corporation, Semiconductor Manufacturing International Corporation (a/k/a 'SMIC'), and Aviation Industry Corporation of China, Ltd. (a/k/a 'AVIC').

The Treasury Department is authorised to designate additional NS-CMIC entities where it determines such entities operate or have operated in the Chinese defense or surveillance technology sectors or are owned or controlled, directly or indirectly, by a party who operates or who has operated in such sectors. The executive actions also authorise the Treasury Department to publish regulations implementing the CMIC Sanctions, which are found at 31 CFR part 586.

Proponents of expanding outbound investment controls recommend cross-listing companies on the NS-CMIC List with the Commerce Department Entity List, which imposes added licence requirements to engage in certain transactions subject to the EAR, as specified in an Entity List entry. Proponents also recommend revising the NS-CMIC List to include additional sectors, such as Artificial Intelligence ('AI').

Relatedly, Representative Andy Barr (R-KY) recently introduced HR 760, the Chinese Military and Surveillance Company Sanctions Act of 2023, which would require the Biden administration to block and prohibit transactions in property and interests in property of Chinese companies identified on the Department of Defense list of Chinese Military Companies (a/k/a the 'Section 1260H List') and the NS-CMIC List.

Other sanctions programmes OFAC implements various other sanctions programmes to include those that block financial dealings with persons designated on OFAC's Specially Designated Nationals and Blocked Persons ('SDN') List. These measures prohibit US persons from transferring, paying, exporting,

withdrawing, or otherwise dealing in property and interests in property of an SDN that are in the United States, that come within the United States, or that are or come within the possession or control of any US person. Among other things, these sanctions prohibit any contribution of funds for the benefit of an SDN.

OFAC further administers comprehensive sanctions against Cuba, Iran, North Korea, Syria, and the Crimea Region of Ukraine. The comprehensive sanctions against Cuba prohibit US persons from directly

INDUSTRY OPPOSITION TO THE PROPOSED OUTBOUND INVESTMENT CONTROLS PRIMARILY FOCUSES ON SUPPLY CHAIN DISRUPTION, INADVERTENT CONSEQUENCES, LACK OF ADMINISTRATIVE FEASIBILITY, AND THE ADEQUACY OF EXISTING OUTBOUND INVESTMENT CONTROLS UNDER US EXPORT CONTROLS AND SANCTIONS LAWS.

engaging in a commercial activity in or with Cuba and from taking any ownership interest in any property in which Cuba or a Cuban national has an interest, unless authorised by OFAC or exempt from regulation. These restrictions effectively prohibit US persons from doing business or investing in Cuba unless authorised by OFAC.

The comprehensive sanctions also prohibit new investments in Iran, North Korea, Syria, and the Crimea region of Ukraine by US persons. For purposes of these sanctions programmes, the term 'new investment' means a transaction that constitutes a commitment or contribution of funds or other assets, or a loan or other extension of credit. 'Loans or other extensions of credit,' in turn, are defined to mean any transfer or extension of funds or credit on a basis of an obligation

to repay, or any assumption or guarantee of the obligation of another to repay an extension of funds or credit.

As implemented by OFAC, the comprehensive programmes also prohibit US persons from purchasing equity interests in or funding a company in a non-sanctioned country that predominantly does business with a country subject to comprehensive sanctions.

As part of the sanctions against Russia for its invasion in Ukraine, the Obama and Biden administrations issued multiple executive orders to prohibit new investments in Russia as well as in Crimea and the so-called Donetsk People's Republic and Luhansk People's Republic regions of Ukraine, by any US person. For the purpose of the Russia sanctions, what constitutes a 'new investment' is broadly defined as a commitment of capital or other assets for the purpose of generating returns or appreciation, which includes purchases of new and existing debt and equity securities issued by a Russian entity and lending funds to, or purchasing an equity interest in, entities located outside Russia where such funds are specifically intended for new projects or operations in Russia.

Investments subject to the CHIPS Act expansion clawback Signed into law on 9 August 2022, the Creating Helpful Incentives to Produce Semiconductors and Science Act of 2022 (the 'CHIPS Act') is a multi-billion-dollar funding package designed to boost the US semiconductor industry. Recipients of federal funds under the act must enter into an agreement with the Secretary of Commerce that includes an 'expansion clawback' whereby recipients agree:

- that neither they nor their affiliated companies will engage in any 'significant transaction,' as defined in the agreement, involving the material expansion of semiconductor manufacturing capacity in China or any other 'foreign country of concern' for ten years from the date of an award; and
- during the term of the agreement, they must notify the Commerce Department

of any prospective significant transaction involving the material expansion of semiconductor manufacturing capacity in China or any other foreign country of concern.

China, Iran, North Korea, and Russia are presently designated as foreign countries of concern under the CHIPS Act. The act authorises Commerce to designate additional foreign countries of concern where such countries are engaged in conduct that is detrimental to the national security or foreign policy of the United States. The act also authorises Commerce to publish regulations implementing the outbound investment screening process.

Upon notification of a planned significant transaction, the Commerce Department will conduct a review to determine whether the transaction would violate an agreement and will either approve, mitigate, or block the transaction. If a recipient fails to remedy or otherwise cease activities related to a significant transaction, the Commerce Department may recover the full amount of federal financial assistance provided under the act.

AN OUTBOUND INVESTMENT REVIEW PROCESS?

Proposed legislation

The concept of outbound investment reviews is nothing new. China and other countries have outbound investment review processes, the United States maintained an outbound investment regime from 1968 to 1986 (with reportedly poor results), and a previous proposal for a process in the United States was raised in the 2017 version of the Foreign Risk Review Modernization Act ('FIRMA'). The final version of FIRMA, which was enacted with overwhelming bipartisan support in 2018, expanded the scope of US inbound investment reviews performed by the Committee on Foreign Investment in the United States ('CFIUS') but it did not include any outbound investment controls.

With the supply chain crisis experienced during the Covid-19 pandemic, an outbound investment controls process was again proposed in May

2021 with introduction of the National Critical Capabilities Defense Act of 2021 ('NCCDA') in the Senate. The measure was also introduced in the House in December 2021. These bills seek to amend the Trade Act of 1974 to establish the Committee on National Critical Capabilities ('CNCC') as an interagency panel to review certain outbound investments that could result in an unacceptable risk to national critical capabilities. As proposed, the CNCC would make recommendations to the President regarding covered transactions that pose an unacceptable risk to US national critical capabilities, and the President would be authorised to mitigate, suspend, or block such transactions.

There were reportedly attempts to roll the NCCDA into the CHIPS Act, and the February 2022 House-passed version of the America Creating Opportunities for Manufacturing, Pre-Eminence in Technology, and Economic Strength Act of 2022 ('COMPETES Act') contained the NCCDA provisions. Amid significant industry opposition to the proposed outbound investment controls, the CHIPS Act was enacted without the NCCDA provisions and they were not included in the Senate version of the COMPETES Act. The COMPETES Act is now in conference and sponsors of the NCCDA have circulated a revised version of their bill (the 'Revised NCCDA').

Key provisions of the Revised NCCDA include the following:

- Establishment of the CNCC as an interagency panel comprised of the heads, or designees of the heads, of over ten US government agencies, to include the Departments of Treasury, Commerce, State, and other agencies presently involved in the CFIUS review process.
- The initial NCCDA version was criticised for designating the Office of the US Trade Representative ('USTR') as Chair of the CNCC, primarily because the USTR handles trade disputes and is not ordinarily involved in investment screening. In response to this criticism, the Revised NCCDA leaves the

decision on who will lead the CNCC to the President.

- Instead of the broad definition of 'covered transaction' used in the previous draft of the bill, the Revised NCCDA focuses on 'covered activity,' which is defined to mean a broad scope of ongoing or proposed activities by a US person or foreign entity in a country of concern or that benefit a country of concern or an entity of concern related to a national critical capability. Covered activities may also include activities related to certain US government funding and contracts.
- A definition of the term 'entity of concern' as an entity headquartered, domiciled, affiliated with, or influenced by, a country of concern – with 'country of concern' having the meaning given the term 'foreign adversary' in Section 8(c)(2) of the Secure and Trusted Communications Networks Act of 2019. Section 8(c)(2) includes China, Cuba, Iran, North Korea, Russia, and Venezuela.
- An open-ended definition of 'national critical capability' that includes:
 - semiconductor manufacturing, large-capacity batteries, critical minerals and materials, pharmaceuticals, and certain other supply chains identified under Executive Order 14017 on America's Supply Chains;
 - technologies identified by the Director of National Intelligence as critical and emerging technologies, to include AI, bioeconomy, and quantum information science and technology;
 - manufacturing and other capabilities necessary to produce certain critical goods and materials; and
 - other industries, technologies, and supply chains identified by the CNCC as national critical capabilities.
- A provision mandating that a US person or foreign entity that engages in or plans to engage in a covered activity submit a written notification of the activity to the Committee 45 days before engaging in the covered activity. The

CNCC will review notices, can seek mitigation measures, and can refer an activity to the President with a recommendation to mitigate, suspend, or prohibit an activity.

- A limited exclusion from the scope of review for transactions below a specified de minimis threshold and for certain 'ordinary business transactions,' as defined by the act.
- A requirement for the CNCC to publish regulations with specific examples of the types of activities that are considered covered activities, and of the supply chains, technologies, goods, materials, sectors, and industries that are considered national critical capabilities.
- A civil penalty of up to \$250,000 for failing to make a mandatory notification of a covered activity, providing a material misstatement or omission to the CNCC, or violating the terms of a mitigation agreement.

The Revised NCCDA also contains provisions requiring the CNCC Chair to coordinate efforts with US allies and partners to develop comparable outbound investment controls in other countries. Given this emphasis on multilateral cooperation, the proposed committee structure, and various other provisions of the Revised NCCDA that mirror the process followed by CFIUS in reviews of inbound foreign investment, the proposed CNCC outbound investment review process is referred to by many as a 'reverse CFIUS' review process.

Arguments in favour of expanding outbound investment controls

Proponents of the NCCDA focused on two fundamentally different goals: (1) to protect national security by preventing US persons from providing funds, technology, and other material support to the Chinese Communist Party and other US adversaries; and (2) to limit the ability of US companies to offshore operations, which adversely impacts domestic jobs and other economic interests.

- On the first concern, proponents note China's

Civil-Military Fusion approach to achieving military and governmental ambitions that blurs the line between commercial trade and defense research, development, and acquisition.

- On the second concern, proponents note China's Made in China 2025 strategy and other initiatives, which seek to move the country away from merely assembling products for other countries to self-sufficient indigenous production and market dominance. For these and related reasons, the NCCDA has bipartisan support and key administration officials have expressed support for the bill. Moreover, the Biden administration's National Security Strategy, released 12 October 2022, announced the administration's intent to pursue new approaches to protecting national security that include outbound investment screening.

Proponents also claim that the particular investments targeted by the proposed outbound investment controls are not captured by existing national security controls. They especially seek controls on outbound investments that do not involve technology transfers, such as business advice and the development of managerial and operational skills that would better enable Chinese firms to make strategic products. They also seek enhanced controls on investments that would transfer technology on emerging technologies that are not yet subject to export controls.

Arguments against expanded controls

Industry opposition to the proposed outbound investment controls primarily focuses on supply chain disruption, inadvertent consequences, lack of administrative feasibility, and the adequacy of existing outbound investment controls under US export controls and sanctions laws.

Supply chain disruption

In a 23 June 2022 letter to members of Congress, the US Chamber of Commerce, National Foreign Trade Council, and other US industry groups warned that

the Revised NCCDA is 'extremely broad in scope and would create unworkable compliance concerns for businesses of all sizes.'¹ Underlying these concerns is the complex network of intertwined supply chains that depend on suppliers in China. The industry groups explained that the proposed expansion of outbound investment controls would inject great uncertainty and chill investment necessary to maintain these supply chains. This criticism is consistent with the actions of many risk-adverse companies that over-comply with US trade controls by, for instance, carving out US products and technology from their inventories. Expanding controls will increase this over-compliance, further increasing the adverse impacts on US industry and global supply chains.

Inadvertent consequences

Unilateral controls are known to suppress US innovation and competitiveness by diverting foreign investment, sales, and other economic opportunities to Europe, Asia, and other US competitors. This risk is ever more present when national security authorities are used to protect industries unrelated to military and intelligence affairs. Here, opponents argue that expanding outbound investment controls would discourage otherwise desired foreign investment in the United States by global companies that have operations in countries of concern. New outbound investment controls may also lead other countries to develop similar controls in a way that creates regulatory barriers to cross-border market access by US companies. This means that expanding outbound investment controls could harm domestic industries that policy makers seek to protect.

Lack of administrative feasibility

The Departments of Treasury and Commerce, each a likely

candidate to administer the proposed outbound investment controls, already face challenges in garnering the staff, expertise and other resources necessary to effectively administer the post-FIRRMA CFIUS process, enhanced controls on exports of semiconductor items to China, sanctions against Russia for its invasion of Ukraine, the information and communications technology and services ('ICTS') rule, and other national security controls. Opponents warn that adding another layer of bureaucracy will divert limited agency resources and reduce the effectiveness of these other controls.

Adequacy of existing protections

Opponents further note that, to the extent policy makers truly intend to narrowly tailor controls, it is not clear why their concerns are not adequately addressed by established US export controls and sanctions laws. For instance, if an investment requires an export controlled technology transfer, such transfer will require authorisation from the cognisant US government agency. In addition, given the scope of countries of concern identified in the Revised NCCDA, many activities that would be covered under the proposed controls are already prohibited by the OFAC CMIC sanctions and comprehensive sanctions programmes. Moreover, to the extent national security concerns are not addressed by existing export controls and sanctions laws, it seems easier to modify the existing controls than to create an entirely new bureaucratic regime.

The Senate Committee on Banking, Housing and Urban Affairs held a hearing on the proposed outbound investment controls on 29 September 2022, in which some committee members and industry witnesses echoed the criticisms noted above. During the hearing, Senator Pat Toomey (R-PA), a ranking member of the

Matthew A. Goldstein is a partner and Matthew S. Moedritzer is an associate at Akerman LLP's Washington DC office where they specialise in international trade with a focus on export controls, sanctions, foreign investment, and related national security controls.

WWW.AKERMAN.COM

committee at the time, expressed concerns on the need for a new outbound investment screening process and cautioned that any such controls should be limited to requiring US persons to notify the government of investments in China relating to technology that would require a licence for export. Senator Toomey filed an amendment to the National Defense Authorization Act of 2023 ('NDAA') articulating this approach but the amendment was not included in the final version of the NDAA.

The Treasury Department also circulated its own version of a bill on outbound investment. This draft legislation would establish a pilot programme that would allow policy makers to better assess risks to national security by requiring notices of certain outbound investment transactions, but it would not provide authority to mitigate, suspend, or prohibit any specific transactions.

Potential executive action

On 27 September 2022, a bipartisan group of House members sent a letter to President Biden, urging him to take executive action on outbound investment controls. Thereafter, President Biden signed the Consolidated Appropriations Act of 2023, an explanatory statement to which encourages the Commerce Department to work with the Department of Treasury in considering respective roles 'to address the national security threats emanating from outbound investments from the United States in certain sectors that are critical for US national security.'² The explanatory statement also required the Department of Commerce to submit a report to Congress within 60 days of the Act 'identifying the resources that would be required to establish and implement an outbound investment review program.'³

Critics of executive action warn that an executive order would be premature given the lack of consensus on how

to approach the issue and would improperly decide significant issues outside the open and deliberative legislative process. However, the Biden administration has been crafting an executive order on outbound investment that reportedly prioritises the review of transactions involving AI, quantum computing, and semiconductor technology. This indicates that executive action is likely, and the 60-day Department of Commerce report, as recently issued to Congress, reportedly states that the administration expects to finalise its policy soon.

CONCLUSION

There is continued bipartisan support in the new Congress for action and the Revised NCCDA may still be modified before being rolled back into the COMPETES Act or other more China-specific legislation. More recently, on 7 February 2023, the House Financial Services Committee held a hearing in which former officials and Committee leadership acknowledged the urgent need for outbound investment controls but urged caution on the scope of any new controls.

While it remains unclear at the time of writing whether an executive order will precede legislative action and what precise form either or both will take, new outbound investment controls are coming. To prepare, companies should consider potential impacts on their supply chains and contracts with foreign partners, as well as on their non-US management, shareholders, affiliates, and investment targets to ensure they can timely implement appropriate due diligence measures. US investment firms, fund managers, and others with foreign investments will face heightened risks and can begin identifying potential impacts through assessments of investment portfolios for holdings in Chinese companies implicated by the pending proposals.

LINKS AND NOTES

- 1 Business Coalition Letter, 23 June 2022.
- 2 Senate Explanatory Statement to Consolidated Appropriations Act, 2023.
- 3 Id.