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# Executive Order Curbs China-Bound Tech Investment as Treasury Unveils New Rules

**August 23, 2023**

On August 9, 2023, President Biden signed Executive Order 14105 addressing investments by U.S. persons in certain identified national security technologies in "Countries of Concern," initially naming The People's Republic of China, The Special Administrative Region of Hong Kong and The Special Administrative Region of Macau. The Order, long anticipated, represents a further tightening of capital flows between the U.S. and China, following several years of increasing scrutiny on Chinese inbound investment into the U.S.

In the wake of several failed legislative efforts over the past12 plus months to restrict U.S. persons from participating in strategically sensitive market opportunities in China, the August 9 Executive Order directs Treasury and Commerce to lead efforts at a set of regulations to restrict such investments, relying on, among other authorities, the International Emergency Economic Powers Act. Concurrently with issuance of the E.O., the Secretary of the Treasury issued an Advanced Notice of Proposed Rulemaking (ANPR) outlining what the program would look like and seeking public comment and input by September 28 in advance of the anticipated issuance of a formal Notice of Proposed Rulemaking.

The ANPR sets out only broad concepts for how the program is expected to operate, and primarily poses questions around how to define key terms and the technologies that would be within the scope of the regulations. Still, several key points are worth noting.

- As proposed, the restrictions would be limited to semiconductors and microelectronics, quantum information technologies and artificial intelligence systems (to be defined), where the potential military, intelligence, surveillance and cyber-enabled applications pose risks to U.S. national security.
- The program, as proposed, would include certain outright prohibitions on investment with respect to the most sensitive technologies with direct military applications, along with notice requirements for a secondary set of nominally less

sensitive technologies.

- Covered transactions would include certain acquisitions of equity interests (e.g., mergers and acquisitions, private equity and venture capital), greenfield investment, joint ventures and certain debt financing transactions.
- It is not proposed or anticipated that the program would provide for retroactive application – i.e., it will not require divestment of existing investment.
- As proposed, there would be certain categories of exempted transactions, potentially including certain investments made as a limited partner into a venture capital fund, private equity fund, fund of funds or other pooled investment fund where an investor contribution is solely capital into a limited partnership and such limited partner cannot make managerial decisions, is not responsible for any debts of the fund beyond its investment and does not have the formal or informal ability to influence or participate in decision making or operations, *and where the investment is below a de minimis threshold to be determined by the Secretary*. Note though that while certain LP investments into a fund may not be within scope of the new prohibitions, the fund itself may face restrictions on how to deploy the LP contributed capital. This raises potential compliance issues for investing funds and diligence issues around ensuring fund compliance for investors and potentially changing the investment profile or thesis for certain funds, which will be a consideration for the fund's investors.
- Other potentially exempted transactions may include investments into publicly-traded securities or into index funds, mutual funds, exchange-traded funds or similar instruments (including associated derivatives); university-to-university research collaborations; contractual arrangements or the procurement of material inputs (raw materials); intellectual property licensing arrangements; bank lending; the processing, clearing or sending of payments by a bank; underwriting services; debt rating services; prime brokerage; global custody; equity research or analysis; or other services secondary to a transaction.
- The ANPR provides some initial detail on the sub-sets of technologies and products within the three categories identified in the E.O.:
    - Semiconductors and microelectronics: potentially to include prohibitions relating to investment into entities engaged in the development of electronic design automation software or semiconductor manufacturing equipment; the design, fabrication or packaging of advanced integrated circuits; and the installation or sale of supercomputers. Treasury is also considering requiring notification for U.S. person investments in entities within the countries of concern engaged in the design, fabrication and packaging of less advanced integrated circuits.

- Quantum information technologies: potentially to include prohibitions relating to investment into entities engaged in the production of quantum computers and certain components, the development of certain quantum sensors and the development of quantum networking and quantum communication systems. As presently contemplated, Treasury is not considering a category of less sensitive quantum information technologies that would be subject only to notification requirements.
- Certain artificial intelligence systems: potentially to include requiring notification with respect to investment into entities engaged in activities related to software that incorporates an artificial intelligence system and is designed for certain end-uses that may have military or intelligence applications and pose a national security risk.

While the specific rules remain to be adopted and will not come into force before 2024, we can say with good certainty that the intended effect of the order is to starve out certain investment into military application technologies in China and possibly elsewhere, and that we should expect the final rules to have that effect. There ultimately will be less investment opportunity with respect to certain key technologies, and U.S. investors should plan accordingly.

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