



ALERTS

New Executive Order Restricts U.S. Investments In China

September 6, 2023

Highlights

A recent executive order creates new prohibitions and notification requirements for U.S. investments in China, which can include investments involving Chinese subsidiaries, branches, or ownership

Proposed rules target national security technologies, such as advanced semiconductors and microelectronics, quantum information technologies, and artificial intelligence systems

The Treasury Department is seeking comments from interested parties by Sept. 28, 2023

In August 2023, President Joe Biden issued a much-anticipated executive order instructing the U.S. Department of the Treasury to establish a program restricting certain U.S. outbound investments in China, Hong Kong and Macau (collectively, China). The new restrictions will specifically target investments in certain categories of national security technologies and products.

In response to the executive order, the Treasury Department's Office of Investment Security published a Federal Register notice in the form of an

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Executive Order Creates New Prohibitions and Notification Requirements

The executive order will regulate U.S. outbound investments in China in two ways:

- 1. Prohibits investments in certain sub-sets of advanced technologies and products relating to:
 - Electronic design automation software; semiconductor manufacturing equipment; advanced integrated circuits; and supercomputers
 - Quantum computers and certain components; quantum sensors; and quantum networking and quantum communication systems
 - Software that incorporates an artificial intelligence (AI) system and is designed for end uses with national security implications, e.g., military surveillance end uses
- 2. Requires notifications to the Treasury Department of investments in:
 - Design, fabrication, and packaging of less advanced integrated circuits
 - Software that incorporates an AI system designed for certain end uses that have military or intelligence applications and pose a national security risk

Treasury Provides Some Answers and Leaves Many Questions

The advance notice provides a preview into how it intends to implement regulations on topics such as key definitions, emerging U.S. investment trends in target technology and products, notification requirements, national interest exemption, compliance and record-keeping controls, and potential penalties. The Treasury Department is seeking feedback from interested parties on at least 83 different questions involving these topics.

Here are four key questions and answers that will help companies work through this new advance notice.

1. Will the restrictions apply retroactively to past investments?

The Treasury Department does not intend to apply these restrictions retroactively to transactions occurring prior to the effective date of the regulations (currently unknown). To inform implementation of its program, it may request information about transactions completed after issuance of the executive order and before the effective date. However, interested

parties should be aware that these regulations are imminent, and thus, should consider the potential impact of these restrictions on upcoming transactions.

Investors should also be aware that while the Treasury Department is currently proposing post-closing notifications, it is soliciting comments on whether it should impose pre-closing notification requirements.

2. How can these restrictions apply to investments in countries outside of China?

The Treasury Department is contemplating at least two approaches that would extend to U.S. investments in countries beyond China:

- Restricting investments in companies outside of China that have direct or indirect subsidiaries and/or branches in China that comprise more than 50 percent of the parent's consolidated revenue, net income, capital expenditure or operating expenses
- Restricting investments in subsidiaries outside of China that directly or indirectly have Chinese ownership equal to or greater than 50 percent

To avoid potential surprises, investors should carefully review their investments to determine if they involve subsidiaries, branches or ownership in China.

3. What will be the scope of covered AI technology?

The Treasury Department is considering restrictions on investments involving software incorporating AI systems and designed for certain end uses, such as:

- Military, government intelligence, mass-surveillance
- Cybersecurity applications, digital forensics tools, and penetration testing tools
- Control of robotic systems
- · Certain surreptitious listening devices
- Facial recognition
- Non-cooperative location tracking (including international mobile subscriber identify) catchers and automatic license plate readers

Because AI is a fast-changing technology with widespread applications, the Treasury Department is seeking comments on the effects or consequences of taking this specific end-use approach.

4. What will be the penalties for non-compliance?

The executive order provides that the Treasury Department will have authority to unwind prohibited investments, impose civil monetary

penalties, and refer transactions for criminal investigation. The agency is considering civil penalties up to the maximum allowed under the International Emergency Economic Powers Act, which is currently the greater of \$356,579 per transaction or twice the transaction value.

Entities affected by this executive order should consider submitting comments to the Treasury Department by the Sept. 28 deadline and should consider taking proactive measures in preparation for the imminent regulations.

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