Tech Outbound Investment Is Target of National Security Scrutiny

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Gibson Dunn's Stephenie Gosnell Handler, Amanda Neely and Chris Mullen analyze recent federal and congressional moves to ramp up scrutiny of outbound investments in technology and other sectors impacting national security.

After years of speculation and thwarted efforts to regulate US foreign investments in critical technologies, the White House and Congress took unprecedented steps the last two weeks to safeguard national security by regulating outbound investments.

Organizations will soon face new transaction disclosure requirements and prohibitions on transactions in certain sectors implicating national security.

The Biden administration's August 9 executive order brings clarity and uncertainty alongside efforts in Congress to include the Outbound Investment Transparency Act as an amendment to the must-pass National Defense Authorization Act.

The executive order establishes controls on certain outbound US investments in countries of concern. To date, this includes only China, along with Hong Kong and Macau. It doesn't impose any immediate obligations or restrictions.

Instead, it directs the Treasury to issue regulations banning a small set of transactions—those that "pose a particularly acute national security threat"—and requiring notification to the federal government for others that may implicate national security.

As anticipated, targeted sectors are semiconductors and microelectronics, quantum information technologies, and artificial intelligence systems.

At the same time the order was issued, the Treasury issued an advance notice of proposed rulemaking seeking public comment about the outbound investment regulatory regime.

This was an unusual step given that Biden issued the order under the International Emergency Economic Powers Act, which allows the executive branch to dispense with notice-and-comment rulemaking to implement rules quickly in response to national emergencies.

The notice provides further details about the contours of the forthcoming potential requirements and restrictions, but seeks significant public input to assist in crafting the regulatory text, which could be many months away from actual implementation.

In response to growing concerns about China's threats, Congress also recently took action on outbound investments. Two weeks before the order's release, the Senate voted 91 to 6 to include Senator John Cornyn's (R-TX) and Senator Bob Casey's (D-PA) Outbound Investment Transparency Act as an amendment to the annual defense authorization bill.

The amendment would require US entities to notify the federal government of investments in sensitive technologies in countries of concern. While it wouldn't give the administration authority to block transactions, its notification requirements include a broader set of covered sectors and more types of transactions than the order.

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Those disclosures would give the federal government substantially more information about relevant transactions and could lay the groundwork for future legislation to establish a comprehensive outbound investment regime. Disclosure of covered investments may cause companies to reconsider some covered transactions in light of potential negative publicity and shareholder concerns.

The release of the EO muddies the forecast for the Outbound Investment Transparency Act. Key House Democrats, as well as House Select Committee on the Chinese Communist Party Chairman Mike Gallagher (R-WI), advocated for stronger measures that would explicitly authorize the administration to block transactions outright.

House Foreign Affairs Committee Chairman Michael McCaul's response to the executive order advocates for the inclusion of existing technology investment and sectors like biotechnology and energy.

Importantly, based on the advance notice's terms, it appears the order and OITA have been designed to work concurrently.

Authority to implement both measures is currently delegated to the Treasury secretary—who should be able to simultaneously implement the order's notification and prohibition requirements for the smaller subset of technology sectors, alongside the OITA's notification requirements for the broader set of technology sectors and transactions.

There's evidence that Treasury may already be looking ahead to implementing both the order and the OITA. For example, the advanced notice's definition of "covered transaction" mirrors the OITA text.

And the unusual use of an advance notice of proposed rulemaking in conjunction with an executive order based on the International Emergency Economic Powers Act may indicate the Treasury's desire to gather sufficient stakeholder input to ensure regulations are properly scoped to implement both measures.

One potential area of tension between the order and the OITA relates to the treatment of active versus passive investments. The OITA's requirements appear to implicate both, while the proposed rule indicates the Treasury is weighing an exception for certain types of passive investments.

This tension may ultimately be resolved through the rulemaking process, since the OITA permits the secretary to exclude from the definition of "covered activity" "any category of transactions that the secretary determines is in the national interest."

In light of these recent developments, organizations contemplating outbound investments in sensitive technologies should continue to closely watch Congress and consider participating in the rulemaking process by offering a public comment.

It remains crucial for organizations investing in countries of concern to be aware of gaps and overlaps between the executive order, the proposed rulemaking, and the OITA to navigate the evolving regulatory environment.

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