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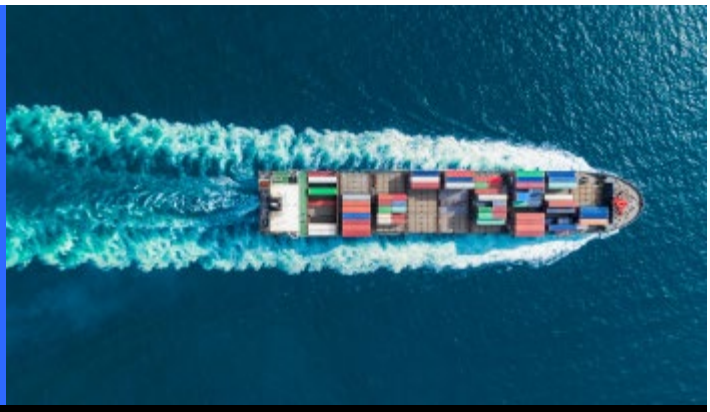

International Trade Update October 31, 2024

Much Ado About Outbound: Unpacking the Newest U.S. Regulatory Regime

On October 28, 2024, the U.S. Department of the Treasury issued final regulations implementing an outbound investment control regime targeting AI, semiconductors, and quantum computing investments involving China that raise national security concerns. The regulations' prohibitions and reporting requirements go into effect on January 2, 2025.

Outbound investment regulations have arrived, and with them the establishment of the newest U.S. regulatory regime concerning cross-border transactions.

While the regulations have effectively created a new regulatory regime out of whitespace—and indeed, there is much that is truly novel in the regulations—they nonetheless draw heavily on existing processes, definitions used, and potential penalties available in existing international trade regimes—namely, the Committee on Foreign Investment in the United States (CFIUS), sanctions, and export controls. The regulations are presently targeted to U.S. outbound investments in China and limited to a narrow group of critical technology sectors. The regime, however, could be expanded both with respect to target countries and the sectors of interest. Despite the limited scope of the regulations as they currently stand, the commercial importance of the targeted sectors and the potential for its expansion, makes it critical for U.S. investors to understand the contours of the regulations and potentially to de-risk potential investments. Effectively navigating these new regulations will require a thorough understanding of the nuances of the outbound requirements, the scope of additional due diligence of targets that includes detailed technical analysis, and the contours of guardrails that need to be implemented to achieve compliance.

While the regulations will come into force over a year after the President's Executive Order (EO)

14105 invoked the International Emergency Economic Powers Act (IEEPA) and the National Emergencies Act (NEA) to prohibit or restrict certain U.S. investments in China on the basis of national security,[1] the notion of an outbound investment regime has been the topic of discussion within the executive branch and Congress for a number of years—reflecting, in no small part, policy hesitations with restricting U.S. investors' ability to invest in foreign companies under national security auspices. Outbound investment was ultimately not included in the Foreign Investment Risk Review Modernization Act of 2018 and faltered again when the National Critical Capabilities Defense Act failed in the summer of 2022. That failure, however, spurred support for executive action. In the span of just two years, the outbound investment regime has developed from a few provisions included in the 2023 fiscal omnibus spending bill—the Senate explanations on that bill gave Treasury 60 days to "submit a report describing its efforts and identifying the resources that would be required to establish and implement" an outbound investment initiative[2]—into a new regulatory regime that will go into effect in the new year. The speed with which the regime has been developed through regulation—including proposed rules and public comment periods—demonstrates that outbound investment controls are an important national security priority for this Administration.

As outlined in the final regulations issued on October 28, 2024 (the "Final Rule"), the new outbound investment regime targets "covered transactions" involving U.S. persons and "covered persons" from, and certain persons affiliated with, the People's Republic of China (including the Special Administrative Regions of Hong Kong and Macau) (collectively "China") that involve specified national security technologies and products—which currently include semiconductors and microelectronics, quantum information technologies, and artificial intelligence (AI) systems. Beginning on January 2, 2025, some "covered transactions" will be prohibited outright, while others will require post-transaction notification to the newly created Office of Global Transactions within the U.S. Department of the Treasury (Treasury), which is charged with implementing and overseeing the outbound investment regime. While this office will sit under the same Investment Security bureau as CFIUS, unlike foreign direct investment review overseen by CFIUS, the outbound investment regime will not be implemented by either an inter-agency grouping or through a screening mechanism. Rather, the new Office of Global Transactions will have the lead, and instead of a governmental review, the new rule requires industry to conduct sufficient due diligence before engaging in "covered transactions" to assess if such transactions are prohibited or notifiable. In other words, the outbound investment regime will avoid the often-lengthy CFIUS review process—U.S. investments in China beginning in 2025 will fall under three categories: (i) prohibited; (ii) require notification; or (iii) permitted (with no further process required under the outbound investment regulation).

As with CFIUS, the proposed penalties for violations are steep. Specifically, Treasury may impose civil penalties of up to the greater of $368,136 (an amount adjusted annually for inflation) or twice the amount of the transaction that is the basis for the violation. Willful violations can result in criminal penalties of up to $1,000,000 or imprisonment of up to 20 years, or both.

We provide below: (1) a brief refresher on the outbound investment rulemaking process, (2) an outline of core provisions of the Final Rule, (3) an analysis of the Final Rule, focusing on key changes from the Notice of Proposed Rulemaking (NPRM) issued in June 2024,[3] (4) the status of congressional action on outbound legislation, and (5) our key takeaways for global companies and investment firms.

I. Background on the Outbound Investment Rule and Regulatory Process

In 2022, the Biden Administration's National Security Strategy (the "Strategy") identified China as "the only competitor with both the intent to reshape the international order and increasingly, the economic, diplomatic, military, and technological power to advance that objective."[4] To meet the "pacing challenge" of China, the Strategy emphasized the importance of a modern industrial strategy in which U.S. technological leadership is a key national security priority. In support of

that objective, in August 2023, President Biden issued EO 14105.[5] The EO outlined proposed regulatory controls on outbound U.S. investment in certain "countries of concern," namely China. The EO was accompanied by an Advance Notice of Proposed Rulemaking (ANPRM) issued by Treasury that provided the broad contours of the proposed outbound investment regime and sought input from industry across many areas of implementation.[6] For more details on the EO and ANPRM, please refer to our prior client alert. Nearly a year later, the Administration issued an NPRM responding to comments from industry and providing more detailed regulations for public review.

II. Core Contours of the Outbound Regulations

The Final Rule largely adopts the structure and most definitions included in the NPRM, and sets forth the following contours for this new regulatory regime:

Overview	
Scope	The Final Rule applies to U.S. persons, defined as any U.S. citizen or lawful permanent resident, U.S.-organized entities—including any foreign branch of any such entity—or any person in the United States (31 C.F.R. § 850.229).
Key Terms	
Country of Concern	Currently includes the People's Republic of China (inclusive of the Special Administrative Areas of Hong Kong and Macau) (31 C.F.R. § 850.205 and Annex to EO 14105). The Final Rule leaves open the possibility of adding additional countries of concern.
Covered Foreign Persons	(1) A person of a "country of concern" that engages in a covered activity; or (2) A person that has a voting or equity interest, board seat, or certain powers with respect to a person of a country of concern where more than 50% of one or more key financial metrics of the person is attributable to a person(s) of a country of concern (31 C.F.R. § 850.209).
Covered Transactions	Covered transactions include a U.S. person's direct or indirect: • Acquisition of an equity interest or contingent equity interest; • Certain debt financing that affords or will afford the U.S. person an equity interest or certain board rights; • Conversion of a contingent equity interest or equivalent; • Greenfield investments or other corporate expansion;

	• Entry into a joint venture; or • Acquisition of a limited partner or equivalent interest in a non-U.S. investment fund (31 C.F.R. § 850.210).
Excepted Transactions	Excepted transactions include certain: • Publicly traded securities (though, note that there are other sanctions-related restrictions on dealing in publicly traded securities issued by certain Chinese entities);[7] • Securities issued by investment companies or business development companies; • Limited partner investments; • Derivatives; • Buyouts of full country of concern ownership stake; • Intracompany transactions initiated before January 2, 2025; • Certain binding commitments entered into before January 2, 2025; • Certain syndicated debt financings; • Equity-based compensation; and • Transactions involving third countries designated by the Secretary of the Treasury that have adopted similar national security measures (31 C.F.R. §§ 850.213, 850.501).
Knowledge	Knowledge is defined to include: • Actual knowledge that a fact or circumstance exists or is substantially certain to occur; • An awareness of a high probability of a fact or circumstance's existence or future occurrence; or • Reason to know of a fact or circumstances existence (31 C.F.R. § 850.216).
National Security Technologies and Products Subject to the Final Rule	
Semiconductors and Microelectronics	• Prohibited: Covered transactions related to certain electronic design automation software; certain fabrication or advanced packaging tools; the design or fabrication of certain advanced integrated circuits; advanced packaging techniques for integrated circuits; and supercomputers (31 C.F.R. § 850.224). • Notifiable: Covered transactions related to the design, fabrication, or packaging of integrated circuits not otherwise covered by the prohibited transaction definition (31 C.F.R. §

	850.217).
Quantum IT	• Prohibited: Covered transactions related to the development or production of (i) quantum computers or critical components required to produce a quantum computer; (ii) certain quantum sensing platforms; and (iii) certain quantum networks or quantum communication systems (31 C.F.R. § 850.224). Quantum technologies are those that rely on the scientific principles of quantum mechanics to solve complex problems very quickly. • Notifiable: N/A

Certain AI Systems	• Prohibited: Covered transactions related to the development of any AI system:
	  ◦ designed to be exclusively used for, or intended to be used for, certain end uses,
	  ◦ that is trained using a quantity of computing power greater than 10^25 computational operations, or trained using primarily biological sequence data and a quantity of computing power greater than 10^24 computational operations (31 C.F.R. § 850.224).
	• Notifiable: Covered transactions related to the development of any AI system not otherwise covered by the prohibited transaction definition, where such AI system is designed or intended to be used for certain end uses or applications, or trained using a quantity of computing power greater than 10^23 computational operations (31 C.F.R. § 850.217).

As the structure and substance of the Final Rule did not change significantly from the NPRM, we refer our clients to our previous analysis of the NPRM for a more detailed explanation of the provisions of the Final Rule.

III. Key Differences From the NPRM

While the Final Rule largely tracks that of the NPRM, there are certain notable distinctions, which we analyze below.

1. ***The Final Rule expands the scope of covered transactions involving AI systems.***

The Final Rule combines the definitions of "artificial intelligence" and "AI system" from EO 14110 (the "AI Executive Order"), issued on October 30, 2023, outlining protections for the use and development of AI.[8] For consistency with the AI Executive Order, the Final Rule modifies the definition of AI system by moving the clause "uses data inputs" into 31 C.F.R. § 850.202(a)(1). This relatively minor definitional change indicates that Treasury is adopting this rule against the backdrop of the AI Executive Order and the recently released National Security Memorandum on AI and that the U.S. government is working to harmonize its approach to AI across agencies and regulatory programs.[9]

Throughout its rulemaking process, Treasury has grappled with where to set the computational thresholds for transactions involving AI systems that would trigger the Final Rule's notification requirements. The ANPRM did not propose any thresholds. In the NPRM, Treasury proposed

several thresholds for consideration ranging from greater than 10^23 to 10^25 computational operations. Computational operations are a measure of the compute power needed to train an AI system. The Final Rule selected greater than 10^23 computational operations (e.g., integer or floating-point operations) as the threshold for notifiable transactions involving the development of AI systems. Treasury explained that this threshold captures the lower end of large-scale AI models released to date and that the selection was based on the current number of publicly known AI models originating from China. Similarly, the Final Rule selected greater than 10^25 computational operations as the threshold for prohibited transactions involving an AI system (and at greater than 10^24 computational operations for an AI system using primarily biological sequence data). While some commenters noted (1) that a 10^26 threshold would better target AI systems that pose the most significant national security threats and (2) that widely-available commercial AI models have been trained at 10^25 computational operations, Treasury set the threshold at greater than 10^25, noting that it has identified greater than 10^25 models, including those trained on biological data, that originate from a country of concern and pose risks to national security. Treasury indicated that it relied on information from both public comments and U.S. government subject-matter experts to make its determination.

Treasury also noted that it considered how computing power may evolve as AI model development continues. Accordingly, the Final Rule acknowledges that computing power thresholds will need to be updated periodically to reflect developments in AI and directs that the Secretary of the Treasury, in consultation with the Secretary of Commerce, should assess and update the computing power threshold as appropriate. In our assessment, the notification process seems designed to help inform any future modifications to the thresholds—although the information collected extends well beyond technical specifications.

For companies, determining when a transaction involving an AI system is prohibited or notifiable based on the computational threshold may be challenging because of the limited amount of publicly available information and benchmarking about models using such thresholds. Thus, the Final Rule places a significant emphasis on effective due diligence for transactions involving AI systems.

2. ***The Final Rule provides clarity on the knowledge standard.***

The knowledge standard describes the knowledge a U.S. person must have about certain facts and circumstances related to a covered transaction to trigger obligations under the Final Rule. Importantly, the notification requirements and prohibitions apply when a U.S. person has actual knowledge, an awareness of a high probability, or reason to know of a fact or circumstance's existence such that the U.S. person knew or reasonably should have known that it was undertaking a covered transaction involving a covered foreign person. In other words, U.S. persons cannot ignore available information and must undertake sufficient due diligence before engaging in a transaction that may constitute a "covered transaction." This standard of knowledge has become very common across a full scope of economic tools deployed by the Departments of the Treasury and Commerce (e.g., General Prohibition 10 under the Export Administration Regulations is triggered by a similar "knowledge" standard).

An assessment of whether a U.S. person had reason to know of a fact or circumstance takes into consideration whether a U.S. person conducted a "reasonable and diligent inquiry" at the time of the transaction.

Section 850.104(c) of the Final Rule provides an illustrative list of factors Treasury will consider when assessing whether a U.S. person has undertaken a reasonable and diligent inquiry, including:

1. The inquiry a U.S. person has made regarding an investment target or other relevant transaction counterparty (such as a joint venture partner), including questions asked of the investment target or relevant counterparty, as of the time of the transaction;

2. The contractual representations or warranties the U.S. person has obtained or attempted to obtain from the investment target or other relevant transaction counterparty (such as a joint venture partner) with respect to the determination of a transaction's status as a covered transaction and status of an investment target or other relevant transaction counterparty (such as a joint venture partner) as a covered foreign person;

3. The efforts by the U.S. person as of the time of the transaction to obtain and consider available non-public information relevant to the determination of a transaction's status as a covered transaction and the status of an investment target or other relevant transaction counterparty (such as a joint venture partner) as a covered foreign person;

4. Available public information, the efforts undertaken by the U.S. person to obtain and consider such information, and the degree to which other information available to the U.S. person as of the time of the transaction is consistent or inconsistent with such publicly available information;

5. Whether the U.S. person purposefully avoided learning or seeking relevant information;

6. The presence or absence of warning signs, which may include evasive responses or non-responses from an investment target or other relevant transaction counterparty (such as a joint venture partner) to questions or a refusal to provide information, contractual representations, or warranties; and

7. The use of available public and commercial databases to identify and verify relevant information of an investment target or other relevant transaction counterparty (such as a joint venture partner).

While these questions are broad in scope, Treasury has acknowledged that some of the factors may be inapplicable or impracticable for a given transaction. Consequently, in line with Treasury's approach to enforcing sanctions, the Final Rule emphasizes that whether a U.S. person has conducted a reasonable and diligent inquiry will be based on consideration of the totality of relevant facts and circumstances. Still, the specific nature of the illustrated diligence arguably sets an expectations bar for investors. For example, Treasury's reference to public and commercial databases is arguably specific enough that Treasury will look to see whether an investor took time to review these kinds of resources for relevant information.

Additionally, whereas the NPRM explicitly stated that in assessing knowledge Treasury would consider diligence conducted by the U.S. person, as well as diligence conducted by legal counsel and representatives on its behalf, the Final Rule removes these additional parties. Nevertheless, Treasury will still take into account whether a U.S. person has undertaken a reasonable and diligent inquiry of the facts and circumstances surrounding the transaction.

3. ***The Final Rule delineates activities from which U.S. persons may withdraw to avoid "knowingly directing" transactions.***

The Final Rule prohibits U.S. persons from "knowingly directing" a transaction by a non-U.S. person when the U.S. person knows the transaction would be prohibited if made by a U.S. person. This is very similar to restrictions in U.S. sanctions which prohibit the referral by U.S. persons of business that would be sanctionable if undertaken by a U.S. person to a non-U.S. person.

A U.S. person "knowingly directs" a transaction when the U.S. person possesses authority to make or substantially participate in decisions made by the non-U.S. person, and exercises such authority to direct, order, or approve a transaction. U.S. persons who are officers, directors, or who otherwise possess executive responsibilities over a non-U.S. person are identified as having such authority.

However, the Final Rule states that if a U.S. person with such authority recuses themselves from specific activities, they will not be considered to have exercised their authority to direct a

transaction, which will help U.S. persons avoid running afoul of the regulations. Unlike the NPRM, the Final Rule specifically includes recusal steps that U.S. persons should take, including refraining from: (1) participating in formal approval and decision-making processes related to the transaction; (2) reviewing, editing, commenting on, approving, and signing transaction documents; and (3) engaging in negotiations with the investment target or relevant transaction counterparty. Again, this is very similar to the recusal expectations in similar contexts under U.S. sanctions.

4. ***The Final Rule Updates the definition of "covered foreign person."***

The Final Rule reorganizes and clarifies the definition of a "covered foreign person" to better articulate the individuals and entities captured by the new regulations.

"Covered foreign person" specifically includes individuals and entities who may not themselves be persons "of a country" of concern—it also includes those persons who have a relationship with a person of a country of concern that is in turn engaged in a covered activity. In order to be deemed a "covered foreign person" in this circumstance, that person must hold an interest, such as a voting interest or equity interest, in the natural or corporate person engaging in the covered activity such that the relevant person has power to direct or manage that person. And if there is such an interest, more than fifty percent of the relevant person's revenue or net income must be attributable to the person engaged in the covered activity.

Note the Final Rule defines a "person of a country of concern" in § 850.221 as an individual that is a citizen or lawful permanent resident of a country of concern (and also not a U.S. citizen or lawful permanent resident of the United States); an entity with a principal place of business in, headquartered in, or incorporated in or otherwise organized under the laws of, a country of concern; the government (and certain subdivisions and government owned enterprises) of a country of concern; persons acting on behalf of a government of a country of concern; and certain entities individually or in the aggregate, directly or indirectly, holding at least 50 percent of the outstanding voting interest, voting power of the board, or equity interest of any of the foregoing. We note that this definition is far broader than the definition of non-U.S. person in most U.S. sanctions programs.

5. ***The Final Rule modifies the treatment of certain debt and contingent equity transactions.***

The NPRM sought comments regarding the effect, if any, on the definition of "covered transaction" for the conversion of contingent equity interests or acquisition of limited-partnership interests. Based on responsive comments in connection with §§ 850.210(a)(1) and 850.210(a)(3) of the NPRM, the Final Rule changes how certain debt and contingent equity transactions are treated under the definition of covered transaction. We highlight three main changes from the NPRM:

- First, the Final Rule clarifies in Note 1 to § 850.210 that a U.S. person is not considered to have indirectly acquired an equity interest or contingent equity interest in a covered foreign person when the U.S. person acquires a limited partnership interest in a venture capital fund, private equity fund, fund of funds, or other pooled investment fund and that fund then acquires an equity interest or contingent equity interest in a covered foreign person. Thus, the U.S. person's limited partnership investment into the investment fund is not a covered transaction, absent other circumstances. However, to the extent that the fund is a U.S. person, its transactions with a covered foreign person would be covered by the Final Rule if it meets the definition of a covered transaction.

- Second, the Final Rule modifies the definition of contingent equity interest to (1) refer to a "financial interest" rather than a "financial instrument" to clarify that the Final Rule covers the acquisition or conversion of interests that are convertible into an equity interest and (2) clarify that debt can constitute a financial interest that is convertible into an equity interest.

This inclusion of debt and convertible interests builds on Treasury's focus on these instruments first seen in its Venezuela and Russia sanctions programs.

- Third, the Final Rule clarifies in Note 2 to § 850.210 that neither the issuance of debt financing secured by equity collateral nor the acquisition of such secured debt on the secondary market is an acquisition of an equity or contingent equity interest. Thus, such debt transactions will not constitute covered transactions. However, the Final Rule states that foreclosure on such collateral where the debtholder takes possession of the pledged equity constitutes an acquisition of an equity interest and is thus a covered transaction. In general, the Final Rule does not cover debt financing unless it has equity-like characteristics or is convertible into an equity interest.

6. ***The Final Rule exempts passive limited partner investments of $2,000,000 or less.***

The Final Rule does not cover any passive limited partner investments of $2 million or less, and also excepts limited partner investments that are accompanied by a binding contract that the capital invested would not be made to indirectly create a notifiable or prohibited transaction. Similar to CFIUS, the outbound regime enumerates in § 850.501(a)(2) a list of what it considers to qualify as passive minority shareholder protections.

7. ***The Final Rule clarifies and adds several exceptions.***

The Final Rule clarifies and adds to § 850.501 several types of excepted transactions that would otherwise constitute prohibited or notifiable transactions, including the following:

- Clarifies that derivative transactions are excepted so long as the derivative "does not confer the right to acquire equity, any rights associated with equity," or any assets related to a covered foreign person. This is in line with Treasury's general views on allowing derivatives without the receipt of the underlying asset that was developed in the context of Russia sanctions.
- Excepts employee compensation in the form of equity, an option to purchase equity, and the exercise of such option.
- Excepts transactions between a U.S. person and its controlling foreign entity that supports or maintains operations that are not covered activities *or* that maintains covered activities that the entity was engaged in prior to the Final Rule's effective date.

8. ***The Final Rule provides that Treasury may disclose non-public information when doing so is "important" to the national security analysis or in "the national interest."***

Generally, information or documentation submitted to Treasury pursuant to the Final Rule's requirements shall not be publicly disclosed if it is not otherwise publicly available, unless the parties to the notification consent to its disclosure. In certain instances, however, Treasury may disclose private information and materials to certain parties including Congress and congressional committees subject to appropriate confidentiality and classification requirements. Such information and materials may also be provided to other U.S. government entities or entities of allied foreign governments when such information is "important to the national security analysis or actions of such governmental entity or [Treasury]."[10] Despite this, our assessment remains that all such notifications should be marked confidential and, if possible, exempt from the Freedom of Information Act requests under one or more provisions concerning sensitive commercial information.

Additionally, the Final Rule provides that Treasury may disclose otherwise confidential information "when such disclosure of information is determined by the Secretary to be in the national interest."[11] While the Final Rule does not explain how the Secretary would make that determination, it specifies that the determination may not be delegated below the level of the Assistant Secretary of the Treasury. These exceptions to confidentiality are noteworthy, as they provide somewhat less protection than similar confidentiality protections in the CFIUS

regulations.[12]

IV. Congressional Outlook

While the outbound investment regime derives its authority from executive authorities, IEEPA, and the NEA, the prospect of additional congressional legislative action remains.

Momentum on an outbound investment regime first picked up steam in Congress, and while the executive branch firmly took the lead in establishing a regulatory regime, we will continue to watch as Congress works on its own outbound investment protocols—which may augment, conflict with, or overtake the executive's action depending on how Congress proceeds.

In 2023, the Senate voted 91 to 6 to include the Outbound Investment Transparency Act in the FY 2024 National Defense Authorization Act (NDAA), though the measure was ultimately stripped from the final bill. An amendment to the Senate draft of the FY 2025 NDAA similarly would require U.S. persons to notify Treasury when investing in a "covered foreign entity" and the investment involves "covered sectors" (i.e., advanced semiconductors and microelectronics, artificial intelligence, quantum information science and technology, hypersonics, satellite-based communications, and networked laser scanning systems with dual-use applications). Covered foreign entities would include entities incorporated in countries of concern (i.e., North Korea, China, Russia, or Iran), entities that are primarily traded on exchanges in a country of concern, and entities majority owned by entities that fall under one of the first two categories. We note that the bill's notification requirement would be in addition to existing restrictions on almost all transactions with Iran and DPRK, targeted restrictions on Russian transactions, and limitations on investments in publicly traded securities of certain Chinese companies. House Financial Services Committee Chairman Patrick McHenry opposed the FY 2024 provision, effectively blocking it from becoming law, and appears poised to do so again this year. He favors a sanctions regime, rather than limiting outbound investment. Consistent with that view, after the Final Rule was released, Chairman McHenry stated that he remains "skeptical of a sectoral approach to regulating outbound investment."[13]

That said, House Speaker Mike Johnson, Foreign Affairs Committee Chairman Michael McCaul, and Select Committee on Strategic Competition Between the United States and the Chinese Communist Party Chairman John Moolenaar strongly support addressing outbound investment in the FY 2025 NDAA and are seeking a compromise. The day after Treasury released the Final Rule, Chairman Moolenaar issued a statement "commending" the regulation but calling for Congress to "build on these rules and address a broader set of technologies and transactions that threaten our national security."[14]

Should such legislation pass, questions almost certainly will arise regarding harmonization with Treasury's Final Rule.

V. Key Takeaways for the Private Sector

Even though the Final Rule does not come into effect until next year, there are steps that clients can take now to prepare.

1. ***Companies and other investors with global operations should review and update their operations and investment processes now so that they can come into compliance with these rules once they become effective.***

The January 2, 2025 effective date will arrive quickly, especially with planning time lost to the upcoming end-of-year holidays. Companies and other investors should consider updating their approach to diligence and negotiating terms for investments now. In the comments to the NPRM, industry requested more guidance on what due diligence steps Treasury envisioned U.S. firms would take, with many asking for an illustrative list of proposed steps (e.g., a list of due diligence

questions or sample agreement representations). Treasury declined to provide this level of detail. However, companies will be well placed to develop their own diligence questions and terms for use in the investments and transactions that will be agreed to in 2025. In particular, companies will want to focus their due diligence process on ascertaining whether the technology and products of potential investments fall under the prohibited or notifiable categories. For example, determining whether an AI system was trained using a quantity of computing power greater than 10^23 computational operations may well fall outside the scope of existing due diligence questions.

Importantly, the Final Rule exempts certain intracompany transactions between U.S. persons and their controlled foreign entities that are instigated prior to the January 2, 2025 effective date. Transactions that would be covered transactions but that support the U.S. person's ongoing operations with respect to covered activities that the controlled foreign entity was engaged in prior to January 2, 2025 effective date will be excepted. Therefore, companies with global operations should review and assess their current activities in order to document them as part of their compliance plans and more clearly establish them as activities that are grandfathered for purposes of this exception.

2. ***Treasury will provide more information on the format for providing notifications.***

Clients subject to the Final Rule will need to determine which transactions are covered by the Final Rule (both prohibited and notifiable) and navigate the new process to notify Treasury of notifiable transactions. In a guidance document published simultaneously with the Final Rule, Treasury has committed to providing additional information before the effective date to facilitate compliance. Such guidance will include instructions on how to file a notification and how to request a national interest exemption. Treasury also indicates that it will engage in stakeholder outreach about the Final Rule's requirements. We will be closely engaging with Treasury about this and will be monitoring Treasury's Outbound Investment Security Program website for additional information. We urge our clients to do the same.

3. ***Non-U.S. private equity and investment funds must actively manage their investment in sensitive areas—U.S. limited partners may be excluded from certain investments.***

The Final Rule was modified in response to several comments about the low threshold for the passive investment exception. Treasury considered alternatives to limiting the Final Rule's impact on passive investment by U.S. limited partners in non-U.S. funds—considering a limit tied to a dollar amount versus a limit tied to a percentage of the fund's capital. Commenters preferred the percentage approach because the dollar limit was so low as compared with typical passive investment amounts. However, in the Final Rule, Treasury applied the dollar limit, modified by raising it from $1 million to $2 million. A $2 million limit on passive investment means that the Final Rule will impact many U.S. investors such that funds and their limited partners may instead need to rely on using contractual rights for U.S. investors to be excluded from transactions that implicate outbound investment restrictions. The responsibility (and cost) to effectively implement this approach is likely to be shared by general partners/managers and limited partners alike.

[1] Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern, 88 Fed. Reg. 54,867 (Aug. 11, 2023).

[2] Staff of S. Comm. on Appropriations, 117th Cong., Explanatory Statement, Division B—Commerce, Justice, Science, and Related Agencies Appropriations Act, 2023 at 59 (Dec. 19, 2022), https://www.appropriations.senate.gov/imo/media/doc/Division%20B%20-%20CJS%20Statement%20FY23.pdf.

[3] Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern, 89 Fed. Reg. 55,846 (July 5, 2024).

[4] The White House, National Security Strategy at 8 (Oct. 2022), https://www.whitehouse.gov/wp-content/uploads/2022/10/Biden-Harris-Administrations-National-Security-Strategy-10.2022.pdf.

[5] Exec. Order No. 14105, Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern, 88 Fed. Reg. 54,867 (Aug. 11, 2023).

[6] Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern, 88 Fed. Reg. 54,961 (Aug. 14, 2023).

[7] Client Alert, 2021 Year-End Sanctions and Export Controls Update, Gibson, Dunn & Crutcher LLP (Feb. 4, 2022), https://www.gibsondunn.com/2021-year-end-sanctions-and-export-controls-update/.

[8] Exec. Order No. 14110, Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence, 88 Fed. Reg. 75,191 (Nov. 1, 2023).

[9] *See* White House, Memorandum on Advancing the United States' Leadership in Artificial Intelligence; Harnessing Artificial Intelligence to Fulfill National Security Objectives; and Fostering the Safety, Security, and Trustworthiness of Artificial Intelligence (Oct. 2024), https://www.whitehouse.gov/briefing-room/presidential-actions/2024/10/24/memorandum-on-advancing-the-united-states-leadership-in-artificial-intelligence-harnessing-artificial-intelligence-to-fulfill-national-security-objectives-and-fostering-the-safety-security/.

[10] 31 C.F.R. § 850.801(b)(3).

[11] 31 C.F.R. § 850.801(d).

[12] *See* 31 C.F.R. § 800.802.

[13] Press Release, Chairman of the House Fin. Servs. Comm Patrick McHenry, McHenry Statement on Treasury's Outbound Investment Final Rule (Oct. 28, 2024) here.

[14] Press Release, Chairman of the Select Comm. on the Strategic Competition Between the U.S. and the Chinese Communist Party John Moolenaar, Moolenaar: Biden Regulations on Outbound Investment to China a Good Step, Congress Must Strengthen (Oct. 29, 2024), https://selectcommitteeontheccp.house.gov/media/press-releases/moolenaar-biden-regulations-outbound-investment-china-good-step-congress-must.

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