SULLIVAN & CROMWELL LLP

S&C memo

November 11, 2024

Treasury Issues Final Rule Establishing Outbound Investment Security Program

New Program Effective January 2, 2025 Prohibits or Requires Notification of Certain Outbound Investments, Targeting Sensitive Industry Sectors in Countries of Concern (Currently, Only China)

SUMMARY

On October 28, 2024, the U.S. Department of the Treasury ("Treasury") issued a Final Rule (the "Final Rule")[1] implementing Executive Order 14105 of August 9, 2023, "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern" (the "Executive Order").[2] The Final Rule addresses and is informed by 49 public comment letters received from interested parties in response to Treasury's Notice of Proposed Rulemaking (the "NPRM") issued on June 21, 2024.[3] Consistent with the NPRM, the Final Rule requires U.S. persons to notify Treasury of certain outbound investment transactions and prohibits certain outbound investment transactions, in each case that involve persons of "countries of concern" that engage in "covered activities" involving certain sensitive technologies and products in the semiconductors and microelectronics, quantum information technologies and artificial intelligence ("AI") sectors. These "covered transactions" are the types of U.S. person investments that, according to Treasury, are most likely to convey "both capital and intangible benefits that can be exploited to accelerate the development of sensitive technologies or products critical for military, intelligence, surveillance, or cyber-enabled capabilities of countries of concern in ways that threaten the national security of the United States."[4] The People's Republic of China, including the Special Administrative Regions of Hong Kong and Macau, is the sole identified "country of concern," though the President may identify additional countries in the future.[5] The Final Rule will take effect on January 2, 2025.

THE OUTBOUND INVESTMENT SECURITY PROGRAM

A. Scope of the Program

The Final Rule requires U.S. persons to notify Treasury of—or in some cases prohibits—"covered transactions," which are specified types of outbound investments in or involving "covered foreign persons." "Covered foreign persons" are "person[s] of countries of concern" that engage in certain "covered activities" involving certain specified sensitive technologies and products in the semiconductors and microelectronics, quantum information technologies, and AI sectors. This section discusses these and other key concepts and defined terms that establish the scope of the Final Rule.

1. Knowledge Standard

In order for a particular investment transaction to be subject to the Final Rule, the participating U.S. person must have "knowledge" that it is engaging in a covered transaction, including knowledge that the transaction involves a covered foreign person. Similar to its use in other regulatory contexts,[6] "knowledge" is defined as having (1) actual knowledge that a fact or circumstance exists or is substantially certain to occur, (2) awareness at the time of a transaction of a high probability of a fact or circumstance's existence or future occurrence, or (3) reason to know of a fact or circumstance's existence.

Treasury's assessment of whether a U.S. person had the requisite knowledge at the time of a particular transaction "will be made based on information a U.S. person had or could have had through a reasonable and diligent inquiry."[7] The Final Rule includes a non-exhaustive list of factors Treasury will consider in assessing whether a U.S. person undertook a reasonable and diligent inquiry, including, among other things, the U.S. person's review of publicly available information, pursuit and review of non-public information, and efforts to obtain contractual assurances. In response to comments on the NPRM, Treasury declined to include a requested safe harbor provision or to prescribe specific due diligence obligations in the Final Rule, but added a new paragraph to the definition of "knowledge" to clarify that its assessment will be made based "on a consideration of the totality of relevant facts and circumstances."[8] According to Treasury, this new language accounts for circumstances where a U.S. person may face obstacles to conducting due diligence (which commenters noted is a particularly relevant concern in the context of transactions involving Chinese companies), while preserving the necessary flexibility for Treasury to consider the individual facts and circumstances of a transaction.

2. U.S. Persons and Controlled Foreign Entities

The Final Rule's obligations and prohibitions apply to "U.S. persons." Consistent with the NPRM, the Final Rule defines U.S. persons to include U.S. citizens, lawful permanent residents, entities organized under the laws of the United States or any jurisdiction within the United States, including any foreign branch of any such entities, or persons in the United States. Notably, this determination is made without regard to where the person currently resides—that is, a U.S. citizen or lawful permanent resident currently living in a

country of concern is still a U.S. person under the Final Rule, even if such person is also a citizen of the country of concern.

Also consistent with the NPRM, U.S. persons are required to "take all reasonable steps to prohibit and prevent" their "controlled foreign entities" from engaging in a transaction that would be a prohibited transaction if undertaken by a U.S. person.[9] Treasury will assess compliance with this requirement again "based on a consideration of the totality of relevant facts and circumstances," including factors such as the existence and implementation of periodic training and internal reporting requirements, internal controls and testing and/or auditing processes.[10]

Finally, U.S. persons are prohibited from knowingly directing a transaction that would be prohibited if undertaken by a U.S. person. Under the Final Rule, a U.S. person "knowingly directs" a transaction when such U.S. person has authority, individually or as part of a group, to make or substantially participate in decisions on behalf of a non-U.S. person, and exercises that authority to direct, order, decide upon, or approve a transaction that would be a prohibited transaction if engaged in by a U.S. person. The Final Rule specifies that such authority exists if the U.S. person is an officer, director, or otherwise possesses executive responsibilities in a non-U.S. person. Taking into account comments on the NPRM, the Final Rule provides that a U.S. person with the requisite authority will *not* be deemed to have knowingly directed a transaction when the U.S. person is recused from (1) participation in formal approval and decision-making processes related to the transaction, including making a recommendation, (2) reviewing, editing, commenting on, approving and signing relevant transaction documents, *and* (3) engaging in negotiations with the investment target (or, as applicable, the relevant transaction counterparty, such as a joint venture partner).

3. Covered Transactions

Under the Final Rule, "covered transactions" include any of the following transactions by a U.S. person, directly or indirectly:[11]

- **Equity interests.** The acquisition of an equity interest or contingent equity interest[12] in a person that the U.S. person knows is a covered foreign person.
- **Debt financing.** The provision of debt financing[13] to a person that the U.S. person knows is a covered foreign person if such debt financing affords the U.S. person an interest in the covered foreign person's profits, the right to appoint members of the board of directors (or equivalent) of the covered foreign person, or other comparable financial or governance rights characteristic of an equity investment but not typical of a loan.
- **Conversion.** The conversion of a contingent equity interest into an equity interest in a person that the U.S. person knows at the time of the conversion is a covered foreign person, where the contingent equity interest was initially acquired by the U.S. person on or after the effective date of the Final Rule.[14]
- **Greenfield or brownfield investments.** The acquisition, leasing or other development of operations, land, property or other assets in a country of concern that the U.S. person knows will result in, or that the U.S. person plans[15] to result in, (1) the establishment of a covered foreign person or (2) the engagement of a person of a country of concern in a covered activity.[16]

- **Joint ventures.** The entry into a joint venture,[17] wherever located, with a person of a country of concern where the U.S. person knows that the joint venture will engage, or plans to engage, in a covered activity.
- **Fund investments.** An investment as a limited partner or equivalent in a non-U.S. pooled investment fund where (1) the U.S. person knows the fund is likely to invest in a person of a country of concern that operates in one or more of the relevant industry sectors and (2) the fund in fact undertakes a transaction that would be a covered transaction if undertaken by a U.S. person.

4. Covered Foreign Person

As described above, an outbound investment transaction is not a "covered transaction" subject to the Final Rule unless it involves (or may establish) a "covered foreign person." The Final Rule defines a "covered foreign person" to include:

- a person of a country of concern that is engaged in a covered activity;[18]
- a person that is not otherwise a covered foreign person but:

  1. has, directly or indirectly, a voting or equity interest in, a board seat (voting or observer) on, or any contractual power to direct or cause the direction of management or policies of, a covered foreign person, and
  2. more than 50% of the person's annual revenue, net income, capital expenditure, or operating expenses[19] are attributable to covered foreign persons (either individually, or aggregated across all such covered foreign persons from which the person derives or incurs (as applicable) at least $50,000 of the relevant metric);[20] or

- with respect to a joint venture transaction that constitutes a covered transaction, the person of a country of concern that participates in such joint venture.

Treasury declined a request by some commenters to provide and maintain a list of covered foreign persons, noting that such a list would likely be subject to frequent change and under-inclusive, and could result in attempts to evade the regulations through corporate restructuring. Rather, consistent with the knowledge standard discussed above, Treasury expects U.S. persons to conduct a "reasonable and diligent inquiry" into whether a covered foreign person is involved in a particular transaction.

5. Person of a Country of Concern

Consistent with the NPRM, the Final Rule defines a "person of a country of concern" to include:

- any individual that is a citizen or permanent resident of a country of concern (unless they are also a U.S. citizen or permanent resident);
- 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 of a country of concern, any person acting for or on behalf of such government, and any entity with respect to which such government holds individually or in the aggregate, directly or indirectly, 50% or more of the entity's outstanding voting interest, voting power of the board, or equity interest, or otherwise possesses the power to direct or cause the direction of the management and policies of such entity; and

- any entity in which one or more of the persons identified above, individually or in the aggregate, directly or indirectly, holds at least 50% of such entity's outstanding voting interest, voting power of the board, or equity interest.

6. Covered Activities

The Final Rule categorizes covered transactions (that are not excepted transactions) as either "notifiable" or "prohibited" depending on the type of "covered activity" in which the covered foreign person is (or in the case of a brownfield or greenfield investment or joint venture, will be or plans to be) engaged. Consistent with the Executive Order, the "covered activities" identified in the Final Rule are certain activities that relate to specifically identified technologies and products in the semiconductors and microelectronics, quantum information technologies or artificial intelligence sectors. A chart detailing the Final Rule's division of covered transactions into notifiable and prohibited categories, based on the relevant covered activity in which the person of a country of concern engages, is attached as **Annex A**.

Transactions with a covered foreign person that engages in *any* covered activity—whether referred to in the definition of "prohibited transaction" or in the definition of "notifiable transaction"—are prohibited transactions if the covered foreign person is included on one of several U.S. Government lists, including the Entity List or the Military End User List maintained by the Department of Commerce's Bureau of Industry and Security or the list of Specially Designated Nationals and Blocked Persons or list of Non-SDN Chinese Military-Industrial Complex Companies maintained by Treasury's Office of Foreign Assets Control.

B. Exceptions and Exemptions

1. Excepted Transactions

Consistent with the NPRM, the Final Rule establishes categories of "excepted transactions" that, although covered, are not notifiable or prohibited transactions. Under the Final Rule, an excepted transaction would include an investment by a U.S. person:

- in publicly traded securities that trade on a securities exchange or over-the-counter in any jurisdiction;
- in securities issued by any investment company registered with the Securities and Exchange Commission or any business development company under the Investment Company Act of 1940;
- made as a limited partner or equivalent in an investment fund not otherwise covered by the prior exception, where (A) the limited partner or equivalent's committed capital is not more than $2,000,000, aggregated across any investment and co-investment vehicles of the fund or (B) the limited partner or equivalent has secured a binding contractual assurance that its capital in the fund will not be used to engage in a transaction that would be a prohibited or notifiable transaction if engaged in by a U.S. person; or
- in a derivative, so long as such derivative does not confer the right to acquire equity, any rights associated with equity, or any assets in or of a covered foreign person.

In each of the above circumstances, the covered transaction would cease to qualify as an excepted transaction if it would afford the U.S. person "rights beyond standard minority shareholder protections with

respect to the covered foreign person."[21] The Final Rule includes a list of minority protections that would *not* disqualify the covered transaction from being an excepted transaction.[22]

Additional excepted transactions include:

- the full buyout by a U.S. person of all interests in an entity held by one or more persons of a country of concern, such that the entity does not constitute a covered foreign person following the transaction;
- an intracompany transaction between a U.S. person and its controlled foreign entity that supports operations that are not covered activities or that maintains covered activities that the controlled foreign entity was engaged in prior to January 2, 2025;
- fulfillment of a U.S. person's binding capital commitment to a fund or similar investment entity entered into prior to January 2, 2025;
- the acquisition by a bank of a voting interest in a covered foreign person upon default or other condition involving a loan, where the loan was made by a lending syndicate and the U.S. person lender (1) cannot on its own initiate any action vis-à-vis the debtor and (2) is not the syndication agent;
- the receipt of employment compensation in the form of an equity grant or option to purchase equity in a covered foreign person, or the exercise of such option; and
- certain transactions with or involving a person of a country or territory outside the United States that has been designated by the Secretary of the Treasury in accordance with certain criteria (to be developed) that relate to that country or territory's own measures to address the national security risk related to certain outbound investment.[23]

2. National Interest Exemption

In addition to the categories of excepted transactions specified in the Final Rule, the Final Rule also provides for a national interest exemption from the applicable prohibition or notification requirement. The Secretary of the Treasury (in consultation with the Secretary of Commerce, the Secretary of State, and the heads of other relevant agencies, as appropriate) will consider requests for such an exemption on a case-by-case basis, taking into account "the totality of the relevant facts and circumstances."[24] The Final Rule indicates that Treasury anticipates that the national interest exemption would be granted "in exceptional circumstances."[25] Treasury will provide more information related to the exemption application process on its Outbound Investment Security Program website.[26]

C. Notification Process

1. Timing Requirements

Notifications with respect to notifiable transactions must be filed no later than 30 calendar days following the completion date of the transaction and in accordance with electronic filing instructions that will be posted on Treasury's Outbound Investment Security Program website. If a U.S. person acquires actual knowledge that a previously completed transaction would have been a covered transaction (whether notifiable or prohibited) if the U.S. person had known of relevant facts or circumstances as of the completion date of the transaction, the U.S. person must submit a notification no later than 30 calendar days following the acquisition of such actual knowledge.

2. Notification Content

Notifications are required to include information similar in scope to what is currently required in filings with the Committee on Foreign Investment in the United States ("CFIUS"), including a description of the transaction and why it is a covered transaction; descriptions of the U.S. person and the covered foreign person, including in each case the identity of such person's ultimate owner; with respect to the covered foreign person, the names and titles of each officer, director, and other members of management; a post-transaction organization chart of each of the U.S. person and the covered foreign person; and, if the notification relates to actual knowledge acquired with respect to a previously completed transaction, an explanation as to why the U.S. person did not possess or obtain such knowledge at the time of the transaction and a description of any pre-transaction due diligence undertaken by the U.S. person. Also consistent with the CFIUS filing process, the U.S. person would be required to certify as to the completeness and accuracy of the information submitted.

Where any required information is unavailable, the notification must include "sufficient explanation" for why the information is unavailable, along with an explanation of the U.S. person's efforts to obtain the information. If any missing information subsequently becomes available, the U.S. person is required to provide such information to Treasury no later than 30 calendar days thereafter. U.S. persons would be required to retain a copy of any notification and supporting documentation for 10 years.[27]

D. Enforcement

1. Violations

A U.S. person violates the Final Rule if it:

- takes any action prohibited by the Final Rule;
- fails to take any action required by the Final Rule within the timeframe and in the manner specified in the Final Rule;
- makes materially false or misleading representations when submitting any information required by the Final Rule; or
- takes any action that evades or avoids, or has the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions of the Final Rule.

Treasury may require any person to provide information under oath regarding any act or transaction subject to the Final Rule. Treasury may conduct investigations, hold hearings, administer oaths, examine witnesses, receive evidence, take depositions, and subpoena witnesses and documents with respect to any act or transaction subject to the Final Rule.

2. Penalties

Potential penalties for violations of the Final Rule include civil and criminal penalties[28] up to the maximum amount set forth in section 206 of IEEPA (for civil violations, the greater of $250,000 (currently $368,136, as adjusted pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended) or twice

the amount of the transaction, and for criminal violations, $1,000,000, 20 years in prison (if a natural person), or both). The Secretary of the Treasury may refer potential criminal violations to the Attorney General. In addition, in the case of a prohibited transaction, the Secretary of the Treasury, in consultation with the heads of other relevant agencies, is authorized to nullify or void the transaction or otherwise compel divestment. Similar to the U.S. economic sanctions and export control regimes, the Final Rule establishes a voluntary self-disclosure process, and Treasury would take any such voluntary disclosure into account as a mitigating factor in determining the appropriate response to any violation, including the potential imposition of penalties.

OBSERVATIONS

Compliance Implications

The Final Rule is nuanced and complex in many respects. Both U.S. and foreign persons that regularly engage in investment activities should familiarize themselves with the scope of the Final Rule, and should remain cognizant of the fact that transactions that may not on their face appear to implicate the Final Rule may nevertheless be covered transactions. The Final Rule confirms, for example, that a party may be both a U.S. person *and* a covered foreign entity by virtue of the way those terms are defined—meaning that, in some cases, a U.S. person's investment *in another U.S. person* could potentially implicate the Final Rule.[29] Similarly, the scope of the Final Rule is broad—particularly with respect to transactions involving a covered foreign person that engages in activities relating to integrated circuits. In essence, the Final Rule requires at least a notification for nearly all such investments.[30]

In addition, given the importance of "knowledge" and the associated "reasonable and diligent inquiry" standard in defining the scope of the Final Rule, investing parties should review their existing standard due diligence requests and processes to ensure that they are seeking all the information reasonably needed to assess the applicability of the Final Rule (and to support that assessment in the future, should questions later arise). Parties should pay particular attention to, and update as necessary, their internal reporting requirements, internal policies, procedures, guidelines, and auditing processes to ensure their corporate compliance programs adequately address the Final Rule.[31]

Legislative Response

Even as Treasury has moved relatively quickly to develop and issue the Final Rule, outbound investment screening has remained a topic of interest for the U.S. Congress, and it is possible that additional laws regarding outbound investment are enacted. Several congressional leaders have voiced their support for the Final Rule, but have also suggested that it should be augmented—for example, to address a broader set of technologies and transactions.[32] These statements follow a bipartisan amendment to the FY 2025 National Defense Authorization Act ("NDAA") proposed in the Senate in October that would cover additional sectors and would require an alternative, though in many respects similar, regulatory framework.[33] This amendment is largely unchanged from the amendment proposed to the FY 2024 NDAA, which, though it

passed the Senate by a wide margin, was dropped by House Republican leadership. However, the Chair of the Select Committee on the Chinese Communist Party, Representative John Moolenaar (R-MI), recently stated that an outbound investment notification measure is "probably our [number one] priority right now," and indicated that House Speaker Mike Johnson (R-LA) would like to have outbound investment legislation by the end of the year.[34] However, according to reports, there is still some disagreement within the House Republican caucus as to the regulatory framework, and the Chairman of the House Financial Services Committee has stated that he "remain[s] skeptical of a sectoral approach to regulating outbound investment."[35] While potential legislation still has significant hurdles to overcome before any bills are passed, the continuing congressional interest in outbound investment screening suggests that the framework established by the Final Rule could be subject to change and enhancement in the future.

* * *

ENDNOTES

1 U.S. Department of the Treasury, Final Rulemaking, *Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern* (October 28, 2024), *available at* https://home.treasury.gov/system/files/206/TreasuryDepartmentOutboundInvestmentFinalRuleWEBSITEVERSION_0.pdf.

2 The White House, *Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern* (Aug. 9, 2023), *available at* https://www.whitehouse.gov/briefing-room/presidential-actions/2023/08/09/executive-order-on-addressing-united-states-investments-in-certain-national-security-technologies-and-products-in-countries-of-concern/. For additional information regarding the Executive Order, *see* our prior memo, *New Executive Order Directs Establishment of Outbound Investment Regime* (Aug. 15, 2023), *available at* https://www.sullcrom.com/insights/memo/2023/August/New-Executive-Order-Directs-Establishment-of-Outbound-Investment-Regime.

3 U.S. Department of the Treasury, Proposed Rule, *Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern* (June 21, 2024), *available at* https://www.federalregister.gov/documents/2024/07/05/2024-13923/provisions-pertaining-to-us-investments-in-certain-national-security-technologies-and-products-in.

4 Final Rule at 14.

5 Note that this differs from the "countries of concern" identified in the Department of Justice's ("DOJ") recent Notice of Proposed Rulemaking relating to data transactions, which would prohibit or otherwise restrict certain transactions involving Americans' bulk sensitive personal data and certain U.S. government-related data. The "countries of concern" identified in the DOJ's Notice of Proposed Rulemaking are: China, Russia, Iran, North Korea, Cuba, and Venezuela.

6 *See, e.g.*, the Department of Commerce's Export Administration Regulations, 15 CFR Subchapter C, at § 772.1. In the economic sanctions context, Treasury's Office of Foreign Assets Control typically similarly interprets "knowledge" to mean that a person "has actual knowledge or should have known of specific conduct, a circumstance, or a result." *See, e.g.*, 31 CFR §§ 561.314; 589.322.

ENDNOTES (CONTINUED)

7 31 CFR § 850.104(b).

8 31 CFR § 850.104(d).

9 A "controlled foreign entity" is defined as any foreign entity (1) in which the U.S. person directly or indirectly holds more than 50% of the outstanding voting interest or voting power of the board, (2) for which the U.S. person is a general partner, managing member, or equivalent, or (3) in the case of an investment fund, for which the U.S. person serves as investment adviser. Direct and indirect holdings of the U.S. person's voting interest or voting power of the board, as applicable, would be aggregated. For tiered ownership structures, where the relationship between an entity and another entity is a parent-subsidiary relationship (*i.e.*, greater than 50% of the voting interest or voting power of the board), the voting interest or voting power of the board of the subsidiary would be fully attributed to the parent. If the relationship is not a parent-subsidiary relationship (*i.e.*, 50% or less of the voting interest or voting power of the board), then the indirect downstream holdings of voting interest or voting power of the board attributed to the first entity would be determined proportionately. 31 CFR §§ 850.206, 850.219.

10 31 CFR § 850.302; Note 1 to 31 CFR § 850.302.

11 The Final Rule emphasizes that an indirect transaction by a U.S. person, regardless of the number of intermediary entities involved, is a covered transaction if it meets the elements of the definition. In response to comments on the NPRM, the Final Rule includes a note clarifying that a U.S. person is not considered to have acquired an indirect equity interest or contingent equity interest in a covered foreign person when the U.S. person acquires a limited partnership interest in a pooled investment fund and that fund then acquires an equity interest or contingent equity interest in a covered foreign person—though that circumstance may be covered by the investment fund-related provision in the "covered transaction" definition. Final Rule at 91; Note 1 to 31 CFR § 850.210.

12 The Final Rule defines a "contingent equity interest" to mean a financial interest (including debt) that currently does not constitute an equity interest but is convertible into, or provides the right to acquire, an equity interest upon the occurrence of a contingency or defined event or at the discretion of the *U.S. person* that holds the financial interest. 31 CFR § 850.205.

13 In response to comments on the NPRM, the Final Rule clarifies that neither the issuance of secured debt for which equity is pledged as collateral, nor the acquisition of such secured debt on the secondary market, is an acquisition of an equity interest. However, "foreclosure on collateral where the debtholder takes possession of the pledged equity is an acquisition of an equity interest." Note 2 to § 850.210. The Final Rule further clarifies, however, that foreclosure on collateral where the U.S. person does not know at the time of issuing or acquiring the secured debt that the pledged equity was in a covered foreign person does not constitute a covered transaction. *Id*. Thus, foreclosure on equity pledged as collateral will constitute a covered transaction only when a U.S. person has knowledge at *both* the time of the issuance or acquisition of the secured debt *and* at the time of foreclosure that the equity is that of a covered foreign person. Final Rule at 79.

14 The Final Rule added the qualification regarding the date of the acquisition of the contingent equity interest in recognition of the fact that the activities of an investment target in which a U.S. person holds a contingent equity interest could change during the period between the initial acquisition and conversion such that the U.S. person may be unable to convert the existing contingent interest. With respect to contingent equity interests acquired after the effective date of the Final Rule, Treasury noted that "an investor that acquires a contingent equity interest in an investment target may be able to obtain contractual assurances from the investment target as to the nature of its future activities, addressing a situation where the activities of the investment target change such that the U.S. person would be unable to convert its interest and the target could obtain a windfall." Final Rule at 75. Including such contractual assurances would be particularly important in certain mandatorily convertible instruments (such as Standard Agreements for Future Equity (SAFEs)) that are common in early stage venture capital investments.

ENDNOTES (CONTINUED)

15 The Final Rule notes that, "[i]n assessing whether a U.S. person 'plans' for its actions to result in the establishment of a covered foreign person or to shift an existing entity's operations into a covered activity, the U.S. person is responsible for the information it had or could have had through a 'reasonable and diligent inquiry' at the time of the transaction. Indicators relevant to what the U.S. person plans include, for example, correspondence with the investment target or relevant government, business plans, and presentations to potential investors." Final Rule at 82-83.

16 Notably, it is not necessary that a greenfield or brownfield transaction ultimately result in the establishment of a covered foreign person for the transaction to be covered, "so long as the specified action coupled with the specified plan is present at the time of the transaction." Final Rule at 97.

17 Treasury declined to define the term "joint venture" in the Final Rule, and instead references the plain English meaning of the term—that is, "involving the contribution of capital and/or assets by two parties and the sharing of profits and losses." Final Rule at 85-86.

18 Treasury declined to define the term "engages in" in response to comments on the NPRM, but emphasized in the Final Rule that present tense phrasing is intentional and it does not cover past activity that is no longer occurring at the time of the transaction (though the prohibition on evading or avoiding the provisions of the Final Rule remains applicable). Treasury also declined to include a de minimis exception with respect to the "engages in" language, instead reiterating that "any amount of a covered activity by a person of a country of concern is sufficient for such person to be defined as a covered foreign person in the Final Rule." Final Rule at 49.

19 The Final Rule specifies that calculations are to be based on an audited financial statement from the most recent year. If an audited financial statement is not available, the most recent unaudited financial statement is to be used instead. If no financial statement is available, an independent appraisal is to be used instead. If no independent appraisal is available, a good-faith estimate is to be used instead. 31 CFR § 850.209(b)(1).

20 The Final Rule clarifies that Treasury intends the threshold of more than 50 percent of any of the financial metrics to be evaluated independently, not in combination. That is, "if a person holds a specified interest in a person of a country of concern and such person of a country of concern represents 20 percent of the first person's revenue and 31 percent of its capital expenditure, these metrics will be evaluated independently and not combined to equal 51 percent." Final Rule at 67.

21 31 CFR § 850.501(a)(2).

22 The list of minority protections are identical to the list of minority protections that are deemed not to confer control over an entity for CFIUS purposes. *See* 31 CFR § 800.208(c). These protections include:

(1) the power to prevent the sale or pledge of all or substantially all of the assets of an entity or a voluntary filing for bankruptcy or liquidation;

(2) the power to prevent an entity from entering into contracts with majority investors or their affiliates;

(3) the power to prevent an entity from guaranteeing the obligations of majority investors or their affiliates;

(4) the right to purchase an additional interest in an entity to prevent the dilution of an investor's pro rata interest in that entity in connection with the issuance of additional interests in the entity;

(5) the power to prevent the change of existing legal rights or preferences of the particular class of stock held by minority investors, as provided in the relevant corporate documents governing such stock; and

(6) the power to prevent the amendment of the organizational documents of an entity with respect to the forgoing matters.

23 Similar to the "excepted foreign state" concept in the CFIUS regulations, this exception would grant favorable treatment to select allied jurisdictions that are similarly working to address risks posed by outbound investment in countries of concern. Treasury anticipates making available on its Outbound Investment Security Program website more information on the factors it will consider when making a designation including, among others, "the extent to which the country or territory has in place and effectively utilizes a mechanism to regulate outbound investment involving sensitive technologies and products in the semiconductors and microelectronics, quantum information technologies, and AI sectors." Final Rule at 191.

24 The determination may be "informed by, among other considerations, the transaction's effect on critical U.S. supply chain needs, domestic production needed for projected national defense requirements, the United States' technological leadership globally in areas affecting U.S. national security, and the impact on national security from prohibiting a given transaction." Final Rule at 196.

25 Final Rule at 63.

26 *See* https://home.treasury.gov/policy-issues/international/outbound-investment-program.

27 This is consistent with the 21st Century Peace through Strength Act of 2024 (Sec. 3111, Pub. L. 118-50), which amended section 206 of IEEPA and extended the statute of limitations for violations of IEEPA from five years to ten years.

28 Criminal violations of the Final Rule include willful commissions, willful attempts to commit, willful conspiracies to commit, or aiding or abetting in the commission of, a violation, attempt to violate, conspiracy to violate, or causing of a violation of any order, regulation, or prohibition issued under IEEPA. Final Rule at 291.

29 This is the case because, as discussed in Section A.4 above, a "covered foreign entity" is defined to include certain parent (or other controlling) entities of covered foreign entities. *See* Final Rule at 52-53.

30 The Final Rule includes as a notifiable transaction, "*any* covered transaction in which a relevant covered foreign person or joint venture designed, fabricated, or packaged any integrated circuit that was not described in the definition for prohibited transaction." In response to commenters' concerns regarding such an expansive definition, Treasury responded in the Final Rule that "[t]he potential intangible benefits of U.S. investment are particularly relevant in the semiconductor industry given the complex and resource-intensive nature of semiconductor research, development, manufacturing, and scaling, as well as the importance of the semiconductor supply chain to national security applications." Final Rule at 102.

31 Both DOJ and Treasury (OFAC) have published guidance on developing satisfactory corporate compliance programs. *See* Department of Justice, Criminal Division, *Evaluation of Corporate Compliance Programs* (March 2023), *available at* https://www.justice.gov/criminal-fraud/page/file/937501/download; OFAC, *A Framework for OFAC Compliance Commitments* (May 2, 2019), *available at* https://ofac.treasury.gov/media/16331/download?inline. *See also* our memoranda *DOJ Updates Guidance on the Evaluation of Corporate Compliance Programs* (June 3, 2020), *available at* https://www.sullcrom.com/insights/memo/2020/June/DOJ-Updates-Guidance-on-the-Evaluation-of-Corporate-Compliance-Programs and *OFAC Issues Compliance Commitments Framework* (May 10, 2019), *available at https://www.sullcrom.com/insights/memo/2019/May/OFAC-Issues-Compliance-Commitments-Framework.*

32 *See* Press Release, *Moolenaar: Biden Regulations on Outbound Investment to China a Good Step, Congress Must Strengthen* (October 29, 2024), *available at* https://selectcommitteeontheccp.house.gov/media/press-releases/moolenaar-biden-regulations-outbound-investment-china-good-

ENDNOTES (CONTINUED)

step-congress-must; *see also* Press Release, *DeLauro Statement on Final Outbound Investment Rule* (October 28, 2024), *available at* https://delauro.house.gov/media-center/press-releases/delauro-statement-final-outbound-investment-rule.

33 *See* S.Amdt.3284 to S.4638, *available at* https://www.congress.gov/amendment/118th-congress/senate-amendment/3284/text. The House passed a version of the 2025 NDAA in June 2024 that did not include any outbound investment provisions.

34 *See* Gopal Ratnam (Roll Call), *China hawks prep tech investment screening measure* (October 1, 2024), *available at* https://rollcall.com/2024/10/01/china-hawks-prep-tech-investment-screening-measure/.

35 *See* Press Release, *McHenry Statement on Treasury's Outbound Investment Final Rule* (October 28, 2024), *available at* https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=409401.

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 900 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

ANNEX A

NOTIFIABLE AND PROHIBITED COVERED TRANSACTIONS – COVERED ACTIVITIES

Sector	Notifiable	Prohibited
	Covered Activities	
Semiconductors and Microelectronics	**Design, fabrication, or packaging** of **any** integrated circuit that is not covered by the prohibited transaction definition.	**Development or production** of (1) any electronic design automation software for the design of integrated circuits or advanced packaging; (2) certain front-end semiconductor fabrication equipment designed for performing the volume fabrication of integrated circuits; (3) equipment for performing volume advanced packaging; or (4) commodity, material, software, or technology designed exclusively for use in or with extreme ultraviolet lithography fabrication equipment. **Design** of any integrated circuit that meets or exceeds the performance parameters in Export Control Classification Number 3A090.a in supplement No. 1 to 15 CFR part 774, or integrated circuits designed for operation at or below 4.5 Kelvin. **Fabrication** of (1) logic integrated circuits using a non-planar transistor architecture or with a production technology node of 16/14 nanometers or less; (2) NOT-AND memory integrated circuits with 128 layers or more; (3) dynamic random-access memory integrated circuits using a technology node of 18 nanometer half-pitch or less; (4) integrated circuits manufactured from a gallium-based compound semiconductor; (5) integrated circuits using graphene transistors or carbon nanotubes; or (6) integrated circuits designed for operation at or below 4.5 Kelvin. **Packaging** of any integrated circuit using advanced packaging techniques. **Development, installation, sale, or production** of any supercomputer enabled by advanced integrated circuits that can provide a theoretical compute capacity of 100 or more double-precision (64-bit) petaflops or 200 or more single-precision (32-bit) petaflops of processing power within a 41,600 cubic foot or smaller envelope.

Sector	Notifiable	Prohibited
	Covered Activities	
Quantum Information Technologies	**N/A**	**Development** of a quantum computer or **production** of any of the critical components required to produce a quantum computer such as a dilution refrigerator or two-stage pulse tube cryocooler. **Development or production** of any quantum sensing platform designed for, or which the relevant covered foreign person intends to be used for, any military, government intelligence, or mass-surveillance end use**.** **Development or production** of any quantum network or quantum communication system designed for, or which the relevant covered foreign person intends to be used for: (1) networking to scale up the capabilities of quantum computers; (2) secure communications, such as quantum key distribution; or (3) any other application that has military, government intelligence, or mass-surveillance end use.
AI Systems	**Development**[*] of an AI system that is not covered by the prohibited transaction definition AND is (1) designed to be used for any military or government intelligence or mass-surveillance end use; (2) intended by the relevant covered foreign person or joint venture to be used for cybersecurity applications, digital forensics tools, and penetration testing tools, or the control of robotic systems; or (3) trained using a quantity of computing power greater than 10^23 of computational operations.	**Development**[*] of any AI system that is designed to be exclusively used for, or which the relevant covered foreign person intends to be used for any: (1) military end use (*e.g.*, for weapons targeting, target identification, combat simulation, military vehicle or weapons control, military decision-making, weapons design (including chemical, biological, radiological, or nuclear weapons), or combat system logistics and maintenance); or (2) government intelligence or mass surveillance end use (*e.g.*, through incorporation of features such as mining text, audio, or video; image recognition; location tracking; or surreptitious listening devices). **Development**[*] of an AI system that is trained using a quantity of computing power greater than: (1) 10^25 computational operations (*e.g.*, integer or floating-point operations) or (2) greater than 10^24 when using primarily biological sequence data.

[*] In response to commenters' requests for clarification, the Final Rule provides that a person customizing, configuring, or fine-tuning a third-party AI model or machine-based system strictly for its own internal, non-commercial use (*e.g.*, not for sale or licensing) would not implicate a prohibition for related transactions solely on that basis unless the person's internal, non-commercial use is for government intelligence, mass-surveillance, or military end use, or for digital forensics tools, penetration testing tools or the control of robotic systems. Note 3 to 31 CFR §§ 850.217 and 850.224.