

December 6, 2024

Treasury Department Issues Final Rule Regulating Outbound Investment to Protect National Security

On October 28, 2024, the U.S. Department of Treasury (“Treasury”) issued a final rule regulating U.S. outbound investment (the “Final Rule”).¹ The Final Rule specifically targets U.S. investment in Chinese companies engaged in activities related to semiconductors and microelectronics, quantum information technologies and certain AI systems. The rule prohibits U.S. persons from engaging in certain Covered Transactions and requires those persons to notify Treasury of other Covered Transactions involving these technologies.² The Final Rule will become effective on January 2, 2025.

As discussed in our previous memorandum, the Final Rule implements President Biden’s August 2023 executive order on “Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern” (the “Outbound Order”). The President found in the Outbound Order “that the advancement by *countries of concern* in sensitive technologies and products critical for the military, intelligence, surveillance, or cyber-enabled capabilities of such countries constitutes an unusual and extraordinary threat to the national security of the United States.”³ (emphasis added). According to Treasury, the Final Rule helps address this threat by “tak[ing] targeted and concrete measures to ensure that U.S. investment is not exploited to advance the development of key technologies by those who may use them to threaten our national security.”⁴

Key Takeaways

- **High Fence, Small Yard.** The Final Rule creates a “high fence” around a relatively “small yard” of important, advanced technologies. Transactions that do not involve semiconductor, quantum or AI businesses are not subject to the Final Rule.
- **Uncertain but Broad Scope.** Unlike U.S. sanctions programs that list designated individuals and entities, the Final Rule does not define who are the “Covered Foreign Persons.” It requires U.S. companies and individuals to undertake a “reasonable and diligent inquiry” to determine whether a transaction is covered under the rule. To assess whether a “reasonable and

¹ Treasury Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern (Oct. 28, 2024), available [here](#). The Final Rule completes Treasury’s implementation of President Biden’s August 2023 Executive Order on “Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern,” available [here](#).

² We previously addressed Treasury’s Advanced Notice and Notice of Public Rulemaking. See Paul, Weiss, *President Biden Issues Executive Order Creating Unprecedented Outbound Investment Review Prohibitions Targeting China* (Aug. 10, 2023), available [here](#); Paul, Weiss, *Treasury Issues Notice of Proposed Rulemaking to Restrict U.S. Outbound Investment in National Security Technologies* (Jun. 26, 2024), available [here](#); see also Treasury, *Provisions Pertaining to U.S. Investments in Certain National Security Technologies and Products in Countries of Concern* (Jun. 21, 2024), available [here](#).

³ Outbound Order, available [here](#). That order defined “countries of concern” as the People’s Republic of China, including Hong Kong and Macau.

⁴ Treasury, *Press Release: Treasury Issues Regulations to Implement Executive Order Addressing U.S. Investments in Certain National Security Technologies and Products in Countries of Concern* (Oct. 28, 2024), available [here](#). The “Outbound Investment Security Program” will be administered by the Office of Global Transactions, which is a newly created office within Treasury’s Office of Investment Security.

diligent inquiry” occurred, Treasury will consider “the totality of relevant facts and circumstances,” including the U.S. person’s efforts to obtain available nonpublic information on the counterparty or target and review that information for consistency with any available public information about the counterparty or target. Treasury may also consider “the presence or absence of warning signs,” such as the counterparty’s or target’s evasive responses or a refusal to provide certain information.

- **No Country Off Limits.** Given the breadth of relevant definitions, the Final Rule may apply to transactions in any country, if there is a sufficient nexus between a U.S. person and a covered foreign person. For instance, the Final Rule obligates U.S. persons to ensure that subsidiaries in third countries do not engage in Covered Transactions. Further, the Final Rule could also apply to transactions between a U.S. person and entities that are either directly or indirectly controlled by Chinese nationals or entities, but are located outside of China, such as companies that are incorporated or headquartered in countries other than China but have significant ownership or control by Chinese entities or individuals., meaning U.S. persons’ due diligence obligations extend beyond investments directly into China.

Key Aspects of the Final Rule

- **To whom does the Final Rule apply?**
 - **U.S. Persons Are Broadly Defined.** U.S. persons, wherever they are located, will be required to adhere to the prohibitions and the notification requirements in the Final Rule. “U.S. persons” are defined broadly to include “any United States citizen, lawful permanent resident, entity organized under the laws of the United States or any jurisdiction within the United States, including any foreign branch of any such entity, or any person in the United States.”
 - **Executives and Directors of Non-U.S. Companies Are Potentially Implicated.** While the Final Rule would not apply to non-U.S. entities, a “U.S. person” would be prohibited “from knowingly directing a transaction” of a non-U.S. company. To “knowingly direct,” the U.S. person must both “have authority to make or substantially participate in decisions on behalf of the non-U.S. person and exercise that authority to direct, order, decide upon, or approve a transaction.” The Final Rule specifies that a U.S. person must recuse itself from specific activities, including participation in formal approval and decision-making processes, reviewing and signing relevant transaction documents and engaging in negotiations with the investment target, to avoid being considered as “knowingly directing” a transaction.
 - **Controlled Foreign Entities Are Also Potentially Implicated.** U.S. persons are required to “take all reasonable steps to prohibit and prevent” a controlled foreign entity from engaging in a transaction that would be prohibited if undertaken by a U.S. person, and in addition report to Treasury any notifiable transaction by the controlled foreign entity. A “controlled foreign entity” is one in which a U.S. person directly or indirectly controls a majority of the voting interest, acts as the general partner or managing member or acts as an investment advisor to a pooled investment fund.⁵
- **What transactions are covered?**
 - **Covered Transactions.** The Final Rule is applicable to certain transactions by U.S. persons that involve Covered Foreign Persons (“Covered Transactions”). Covered Transactions include “the acquisition of an equity interest or contingent equity interest; certain debt financing that affords certain rights to the lender; the conversion of a contingent equity interest; a greenfield investment or other corporate expansion; entrance into a joint venture; and certain investments as a limited partner or equivalent (LP) in a non-U.S. person pooled investment fund.”⁶

⁵ See 31 CFR § 850.206.

⁶ See 31 CFR § 850.210(a)

- **Covered Foreign Persons.** Covered Foreign Persons are individuals or entities associated with a Country of Concern (presently China, Hong Kong and Macau) that are engaged in covered activities.⁷
- **Covered Activities.** Covered activities include, for example, research, development and manufacturing involving covered national security technologies and products. An investment in a Covered Foreign Person is within the purview of the Final Rule if the Covered Foreign Person is engaged in *any* covered activity, regardless of whether the investment itself directly involves the technology associated with those covered activities.
- **Transactions Outside a Country of Concern.** A transaction can be covered even if it is an investment or joint venture *outside* a Country of Concern.
 - An entity outside a country of concern can be considered a covered foreign person if it “directly or indirectly holds a board seat on, a voting or equity interest . . . in, or any contractual power to direct or cause the direction of the management or policies of any person or persons” from which it derives significant financial benefits, such as more than 50% of its revenue, net income, capital expenditure or operating expenses.
 - A joint venture outside a country of concern can be a covered transaction if it involves a covered foreign person and the joint venture engages or plans to engage in a covered activity.
 - Notably, the use of intermediaries does not exempt a transaction from being a covered transaction, if the transaction otherwise meets the criteria of involving a covered foreign person.⁸
- **Which transactions are *prohibited* and which require *notification* under the Final Rule?**
 - **Prohibition:** The categories of prohibited transactions is relatively narrow, focusing on specific activities and relationships that pose acute national security risks.
 - **Notification:** The notification obligation applies broadly to a wide range of transactions involving Covered Foreign Persons and requires detailed information to be submitted to the Treasury. This includes information on the nature of the transaction, the parties involved and the relevant national security technologies and products.⁹
 - The table below defines the types of activities that are covered by the prohibition and the notification requirement:

Category	Prohibition Unless Subject to Exemption	Notification Requirement
<i>Semiconductors and microelectronics</i>	Developing or producing any electronic design automation software for the design and fabrication of advanced semiconductors; designing of advanced integrated circuits; fabricating advanced integrated circuits; packaging of advanced integrated circuits; developing, installing, selling or producing any supercomputer enabled by advanced integrated circuits.	Designing, fabricating or packaging of integrated circuits that are not otherwise prohibited are subject to a notification requirement to Treasury.

⁷ Covered foreign person also includes a person that has a voting or equity interest, board seat or other authorities concerning a person of a country of concern with more than 50% of certain financial metrics. See 31 CFR § 850.209.

⁸ See 31 CFR §§ 850.209(a)(2), 850.209(a)(3) and 850.210(a)(5). See also Note 1 to § 850.210.

⁹ See Annex: National Security Technologies and Products, *infra*.

Category	Prohibition Unless Subject to Exemption	Notification Requirement
Certain AI systems	Developing any AI system intended exclusively for specific end uses (specifically, military, government intelligence or mass-surveillance end uses), those trained with more than 10 ²⁵ computational operations or with biological sequence data and more than 10 ²⁴ computational operations.	Developing any AI system that is not prohibited but is either designated or intended for specific end uses or applications or trained with more than 10 ²³ computational operations is subject to a notification requirement to Treasury.
Quantum information technologies	Developing any quantum computers or producing any essential components necessary for creating a quantum computer, or the development or production of specific quantum sensing platforms and certain quantum networks or quantum communication systems.	None (entirely prohibited).

What types of transactions are excepted from the Final Rule’s coverage?

The Final Rule carves out specified categories of transactions:¹⁰

- **Investments in any publicly traded security.** The exception applies to pre-IPO investing, including with respect to the acquisition of pre-public shares that might be obtained in connection with certain underwriting activities.
- **Securities issued by an investment company.** This exception applies to the sale of securities issued by an investment company, as defined in Section 3(a)(1) of the Investment Company Act of 1940, that is registered with the SEC. This includes index funds, mutual funds and exchange-traded funds.
- **Certain limited partner investments.** This exception applies to investments made by a U.S. person as an LP or equivalent in a venture capital fund, private equity fund, fund of funds or other pooled investment fund; provided that certain conditions are met.
- **Buyouts of country of concern ownership.** This exception applies to the acquisition by a U.S. person of all equity or other interests in an entity held by one or more persons of a country of concern; provided that, following the acquisition, the entity does not constitute a covered foreign person. This exception aims to “eliminate the likelihood that intangible benefits of a U.S. person could transfer to a covered foreign person.”¹¹
- **Intracompany transactions.** This exception applies to transactions between a U.S. person and its controlled foreign entity that support operations not classified as covered activities or that maintain covered activities in which the controlled foreign entity was engaged prior to January 2, 2025. This exception is designed to “avoid unintended interference with the ongoing operations of a U.S. person’s controlled foreign entity, even if that entity meets the definition of a covered foreign person.”¹²
- **Pre-outbound order binding commitments.** This exception applies to transactions made in fulfillment of a binding capital commitment entered into prior to January 2, 2025.

¹⁰ These bullets synthesize these categories of transactions. The specific text of each exemption is set forth in 31 CFR § 850.501.

¹¹ See Final Rule at 152.

¹² See *Id.* at 153.

- **Certain syndicated debt financing.** This exception applies to the “acquisition 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 a U.S. person participated passively in the syndicate.”
- **Exemptions issued by Treasury.** Under the Final Rule, Treasury can issue exemptions (i) where the Secretary of the Treasury determines that the country or territory is addressing national security concerns related to outbound investment and the transaction is of a type for which associated national security concerns are likely to be adequately addressed by the actions of that country or territory or (ii) where the Secretary of the Treasury determines that there is a “national interest.”

What type of due diligence into transactions does the Final Rule require?

- **Reasonable and Diligent Inquiry.** The Final Rule requires investors to undertake a “reasonable and diligent inquiry” to determine whether a transaction is a covered transaction, evaluated based on the totality of relevant facts and circumstances.¹³ Such an inquiry is expected to involve several steps, including: inquiring with “investment targets or other relevant transaction counterpart[ies] (such as a joint venture partner)” to ascertain the status of the transaction and the counterparty; making efforts “to obtain and consider available non-public information”; reviewing “available public information” for consistency; avoiding purposeful blindness; identifying “warning signs” such as “evasive responses or non-responses” or “a refusal to provide information, contractual representations, or warranties”; using “available public and commercial databases [to] verify relevant information”; and conducting “periodic training and internal reporting requirements” with respect to compliance with the Final Rule.¹⁴
- **Contractual Provisions.** The Final Rule requires U.S. persons to confirm that no contractual provisions associated with the covered transaction enable restricted activities. The rule also requires investors to obtain or attempt to obtain contractual representations or warranties from the investment target or counterparty regarding the transaction’s status and the counterparty’s status as a covered foreign person. Specifically, for limited partner investments, the Final Rule requires investors to secure binding contractual assurances that their capital will not be used to engage in transactions that would be prohibited or notifiable if engaged in by a U.S. person, obtained prior to the investment.¹⁵

Does the Final Rule contain any continuing, post-transaction obligations?

- **Documentation and recordkeeping.** The Final Rule will require any U.S. person that files a notification with Treasury to maintain a copy of the notification and supporting documentation for 10 years from the date of the notification. If the U.S. person did not provide the information required, they must provide a “sufficient explanation” for why the information could not be obtained and describe the steps taken to try to obtain it.¹⁶
- **Post-transaction monitoring.** There is no requirement for ongoing monitoring after a transaction occurs, although the rule does require a U.S. person to notify Treasury within 30 days if it acquires actual knowledge post-transaction of facts that would have made the transaction a Covered Transaction.¹⁷

¹³ See 31 CFR § 850.104(d).

¹⁴ See 31 CFR §§ 850.104(c), 850.302(b).

¹⁵ See 31 CFR § 850.501(a)(1)(iii).

¹⁶ See 31 CFR §§ 850.405(c) (d).

¹⁷ See 31 CFR § 850.403.

What constitutes a violation of the Final Rule and what are the penalties?

Violations of the Final Rule include: taking action prohibited under the Final Rule; failing to take action required by the Final Rule; making “materially false or misleading” representations to Treasury when submitting any information required by the Final Rule; and taking any action that evades or avoids or has the purpose of evading or avoiding any of the prohibitions of the Final Rule.

- **Knowledge Requirement.** The Final Rule makes clear that its knowledge requirement is integral to determining whether a U.S. person is complying with the regulations, particularly in identifying covered transactions. The knowledge standard is defined as “actual knowledge, awareness of a high probability, or reason to know of a fact or circumstance’s existence.”¹⁸ This requirement is closely tied to the due diligence requirement that a U.S. person must conduct a “reasonable and diligent inquiry” to ascertain relevant facts or circumstances, discussed above. Failure to conduct such an inquiry may result in the U.S. person being deemed to have had reason to know of the relevant facts, thereby meeting the knowledge requirement.
- **Civil and Criminal Penalties.** A violation of the Final Rule is subject to civil penalties up to \$368,136, or an amount that is twice the amount of the transaction that is the basis of the violation, whichever is greater. Any person whose violation is willful is also subject to criminal penalties of up to \$1,000,000 and imprisonment of up to 20 years.¹⁹ Treasury is authorized to impose such civil penalties and refer criminal violations to the Department of Justice.
- **Divestment.** Treasury will be empowered to take action to “nullify, void, or otherwise compel divestment of any prohibited transaction entered into after the effective date” of the Final Rule, which is January 2, 2025.
- **Voluntary Self-Disclosures.** If a U.S. person elects to disclose voluntarily an actual or possible violation of the Final Rule to Treasury, then Treasury may “take such disclosure into account as a mitigating factor in determining the appropriate response, including the potential imposition of penalties, if [Treasury] determines that there was, in fact, a violation.”²⁰

Have other countries recently taken similar action on outbound investment?

- **United Kingdom.** In the United Kingdom, the National Security and Investment Act 2021 (“NSIA”) covers foreign investment into the United Kingdom.²¹ Earlier this year, the U.K. government confirmed in guidance that it considers the NSIA to extend to outbound investment as well.²² The new U.K. government has recently published its Green Paper on Industrial Strategy, calling for a reduction in regulatory red tape around investment. However, the Green Paper is largely silent on the NSIA, and the government has not yet given any indication how it intends to use its NSIA enforcement powers whether in relation to inwards, domestic or outbound investment.²³
- **European Union.** In January 2024, the EU Commission’s Directorate General for Trade published a White Paper²⁴ addressing outbound investment controls as a measure to protect EU economic security. The paper focuses on the concern that outbound investment could result in technology and know-how leakage that is not adequately protected through the export controls regime.

¹⁸ See 31 CFR § 850.216.

¹⁹ See Section 206 of the International Emergency Economic Powers Act, as amended (50 U.S.C. 1705).

²⁰ See 31 CFR § 850.704. See also Final Rule at 173.

²¹ Paul, Weiss, *UK NSIA Investment Controls: Insights for Dealmakers from the Latest Data* (Sep. 25, 2024), available [here](#).

²² UK Cabinet Office guidance, *How the National Security and Investment Act could affect people or acquisitions outside the UK* (updated May 21, 2024), available [here](#).

²³ See Nicole Kar, Global Co-Chair of the Paul, Weiss Antitrust Practice, to the Financial Times, *Labour cannot ignore national security in its pitch to investors* (Oct. 22, 2024), available [here](#).

²⁴ European Commission, *White Paper on Outbound Investments* (Jan. 24, 2024) (COM(2024) 24 final), available [here](#).

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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Our National Security Group

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Annex: National Security Technologies and Products

Semiconductors Fabrication and Semiconductors Advanced Packaging		
<p>Semiconductors Fabrication: forming devices such as transistors, poly capacitors, non-metal resistors and diodes on a wafer of semiconductor material.²⁵</p> <p>Semiconductors Advanced Packaging: the packaging of integrated circuits in a manner that supports the two-and-one-half-dimensional (2.5D) or three-dimensional (3D) assembly of integrated circuits, such as by directly attaching one or more die or wafer using through-silicon vias, die or wafer bonding, heterogeneous integration or other advanced methods and materials.²⁶</p>		
Category	Prohibited Transactions ²⁷	Notifiable Transactions ²⁸
Electronic Design Automation Software	Developing or producing any electronic design automation software for the design of integrated circuits or advanced packaging.	N/A
Semiconductor Fabrication Equipment	Developing or producing any front-end semiconductor fabrication equipment designed for performing the volume fabrication of integrated circuits, equipment for performing volume advanced packaging or items for extreme ultraviolet lithography fabrication equipment.	N/A
Integrated Circuit Design	Designing any integrated circuit that meets or exceeds the performance parameters in Export Control Classification Number 3A090.a or integrated circuits designed for operation at or below 4.5 Kelvin.	Any covered transactions not explicitly prohibited.
Integrated Circuit Fabrication	Fabricating any of the following: logic integrated circuits using a non-planar transistor architecture or with a production technology node of 16/14 nanometers or less, NAND memory integrated circuits with 128 layers or more, DRAM integrated circuits using a technology node of 18 nanometer half-pitch or less, integrated circuits manufactured from a gallium-based compound semiconductor, integrated circuits using graphene transistors or carbon nanotubes or integrated circuits designed for operation at or below 4.5 Kelvin.	Any covered transactions not explicitly prohibited.
Integrated Circuit Packaging	Packaging any integrated circuit using advanced packaging techniques.	Any covered transactions not explicitly prohibited.
Supercomputers	Developing, installing, selling or producing 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.	N/A

²⁵ See 31 CFR § 850.214.

²⁶ See 31 CFR § 850.201.

²⁷ See 31 CFR § 850.224.

²⁸ See 31 CFR § 850.217.

AI Systems		
An AI system is a machine-based system, which can be data system, software, hardware, application, tool or utility that operates in whole or in part using a system that can, for a given set of human-defined objectives, make predictions, recommendations or decisions influencing real or virtual environments—i.e., a system that: (1) uses data inputs to perceive real and virtual environments; (2) abstracts such perceptions into models through automated or algorithmic statistical analysis; and (3) uses model inference to make a classification, prediction, recommendation or decision. ²⁹		
Category	Prohibited Transactions	Notifiable Transactions
AI Systems for Military, Intelligence or Surveillance	Developing any AI system that is designed to be exclusively used for, or which the relevant covered foreign person intends to be used for, any military end use, government intelligence or mass-surveillance end use.	Developing any AI system that is not prohibited and is designed to be used for any military end use, government intelligence or mass-surveillance end use; or is intended by the covered foreign person or joint venture to be used for cybersecurity applications, digital forensics tools, penetration testing tools or the control of robotic systems.
AI Systems with High Computing Power	Developing any AI system that is trained using a quantity of computing power greater than 10 ²⁵ computational operations, or 10 ²⁴ computational operations if using primarily biological sequence data.	Developing any AI system that is trained using a quantity of computing power greater than 10 ²³ computational operations (e.g., integer or floating-point operations).
Quantum Computers		
The term quantum computer means a computer that performs computations that harness the collective properties of quantum states, such as superposition, interference or entanglement. ³⁰		
Category	Prohibited Transactions	Notifiable Transactions
Quantum Computers and Components	Developing a quantum computer or producing any of the critical components required to produce a quantum computer such as a dilution refrigerator or two-stage pulse tube cryocooler.	N/A
Quantum Sensing Platforms	Developing or producing 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.	N/A
Quantum Networks and Communication Systems	Developing or producing any quantum network or quantum communication system designed for, or which the relevant covered foreign person intends to be used for: networking to scale up the capabilities of quantum computers, secure communications or any other application that has any military, government intelligence or mass-surveillance end use.	N/A

²⁹ See 31 CFR § 850.202.

³⁰ See 31 CFR § 850.225.