

# One Step Closer to a Limited 'Reverse CFIUS' Program

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On June 21, 2024, the U.S. Department of the Treasury announced a proposed rule (Proposed Rule) to impose limited restrictions on certain outbound U.S. investments in technology, as directed by Executive Order 14105.

The Proposed Rule, which creates notification requirements and prohibits U.S. persons from engaging in certain investments in mainland China, Hong Kong, and Macau (collectively, China) that involve semiconductors and microelectronics, quantum information technologies or artificial intelligence (AI) (together, Sensitive Sectors), makes good on Treasury's promise that this new "reverse CFIUS" program will be far more targeted than CFIUS itself.

We believe the program, as outlined in the Proposed Rule, will require attention from a relatively modest universe of U.S. investors:

- Those who continue to invest in Sensitive Sectors in China.
- U.S. limited partner investors in non-U.S. funds investing in Sensitive Sectors.
- U.S. persons who work for non-U.S. companies making Sensitive Sector investments.

The Proposed Rule also seeks to address U.S. multinational companies' fears that the rule would limit their ability to continue to invest in their operations in China.

## Covered Investment Transactions

As expected, the Proposed Rule generally applies to the following specified investment-related activities by U.S. persons with parties from China involved in a limited set of activities within the Sensitive Sectors:

- acquisition of equity,
- providing of certain debt financing,
- assistance with certain start-up work,
- entrance into a joint venture, or
- the establishment or expansion of operations.

Transactions covered by the rule are either "prohibited" or "notifiable," unless exempted by the Proposed Rule. U.S. persons would have the burden of complying with these requirements, with violations subject to civil or criminal penalties.

"Prohibited" covered transactions apply to covered investment-related activities involving:

- Specified high-end semiconductors and related manufacturing equipment, computers, software and technology.
- Quantum computers and systems.
- Advanced AI systems.

Transactions that would otherwise be only "notifiable" are prohibited if they involve parties on specified U.S. government sanctions and restricted party lists or involve other national security related activities in semiconductors and AI. "Notifiable" covered transactions are activities involving less-advanced semiconductors and AI systems, with notices required 30 calendar days following the transaction's completion date, or once a U.S. person learns that a transaction is a notifiable transaction after the fact.

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See our February 13, 2024, alert [“Know Your Cloud Customer: Commerce Department Proposes To Regulate Foreign Access to US IaaS Products,”](#) our October 25, 2023, alert [“BIS Updates October 2022 Semiconductor Export Control Rules”](#) and our November 3, 2023, alert [“Biden Administration Passes Sweeping Executive Order on Artificial Intelligence.”](#)

The restrictions apply to investment-related activities with individuals, entities and government agencies from China, defined broadly to include, for example, entities located outside of these jurisdictions in which persons from China hold 50% or greater voting interests, board interests or equity interests, or parties with other specified financial and governance ties to China.

## US Limited Partner Investments in Non-U.S. Funds

Under the Proposed Rule, restrictions on covered investments will apply to U.S. persons who are passive investors in non-U.S. funds if the U.S. person knew or should have known at the time of their initial investment in the fund that the fund’s investments, investment focus or likely or planned areas of investments included any of the Sensitive Sectors.

This provision is likely to require U.S. investors to gain greater clarity about, and perform more diligence on, fund objectives before agreeing to commit funds to a non-U.S. fund. Passive investments below a yet-to-be-determined de minimis amount will be exempt from this restriction.

Much like the CFIUS regulations, the Proposed Rule includes several criteria to be examined in determining whether a limited partner’s interest in a fund will qualify as “passive” under the rule. As a general matter, the Proposed Rule closely parallels CFIUS’ current standard for when an investor qualifies as “passive.”

## US Person ‘Direction’ of Non-U.S. Transactions

The Proposed Rule also prohibits U.S. persons from “knowingly directing” a transaction by a non-U.S. person that would be a prohibited transaction if engaged in by a U.S. person. The restrictions on “directing” prohibited transactions appear to be narrowly targeted at senior-level U.S. persons who are employed or engaged by non-U.S. firms.

For example, the Proposed Rule indicates that a company’s officers, senior advisers and others with senior-level authority have the authority to provide such direction. Activities considered “directing” include ordering, deciding upon, or approving to a transaction that would be a prohibited transaction if conducted by a U.S. person. The Proposed Rule would carve out a U.S. person who recuses themselves from an investment even if that person has the authority to make or substantially participate in such decisions on behalf of a non-U.S. person entity.

## Other Exceptions and Limitations

The Proposed Rule exempts all covered transactions undertaken prior to the effective date of the rule. Treasury may, however, request information about other transactions after August 9, 2023. Certain binding capital commitments that were entered into after August 9, 2023 are further subject to the regulations if all other criteria has been met.

As expected, the Proposed Rule excepts several categories of transactions that are unlikely to result in the transfer of “intangible benefits” by U.S. persons to parties of concern in China. For example, the rule would carve out investments in publicly traded securities, and investments in U.S.-registered index funds, mutual funds or exchange traded funds.

In addition, and critically for those with current operations in China, intracompany transactions by U.S. companies to support ongoing operations would also be excepted. On the other hand, greenfield or brownfield transactions involving covered activities would not be excepted.

Finally, the Proposed Rule would also permit U.S. persons to buy out interests held by persons of concern, fulfill certain binding capital commitments and, in some instances, default on outstanding loans. The Proposed Rule also authorizes Treasury to issue case-by-case national-interest exemptions, although we would expect them to be extremely rare.

While not in the text of the Proposed Rule, Treasury indicates that it eventually contemplates additional exemptions for covered transactions involving persons from partner or allied countries that have been assessed to have adequate security measures in place to address national security concerns arising from outbound investments of concern. Recent statements from the EU suggest that such developments will eventually be forthcoming from EU jurisdictions.

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## Conclusion

The Proposed Rule contains no surprises to those who have been following the administration's process for developing a "reverse CFIUS" program. We do not believe the Proposed Rule should have an impact on most outbound investment traffic from the

U.S., and we believe the largest compliance impact is likely to hit U.S. investors in non-U.S. funds. The Proposed Rule offers relatively clear (if nuanced) parameters and scope of coverage, and remains true to the commitments made by Treasury Secretary Janet Yellen that such restrictions would be "highly targeted and clearly directed at a few sectors."

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Summer associates **Viktoryia Bick** and **Zoe Owens** contributed to this article.