



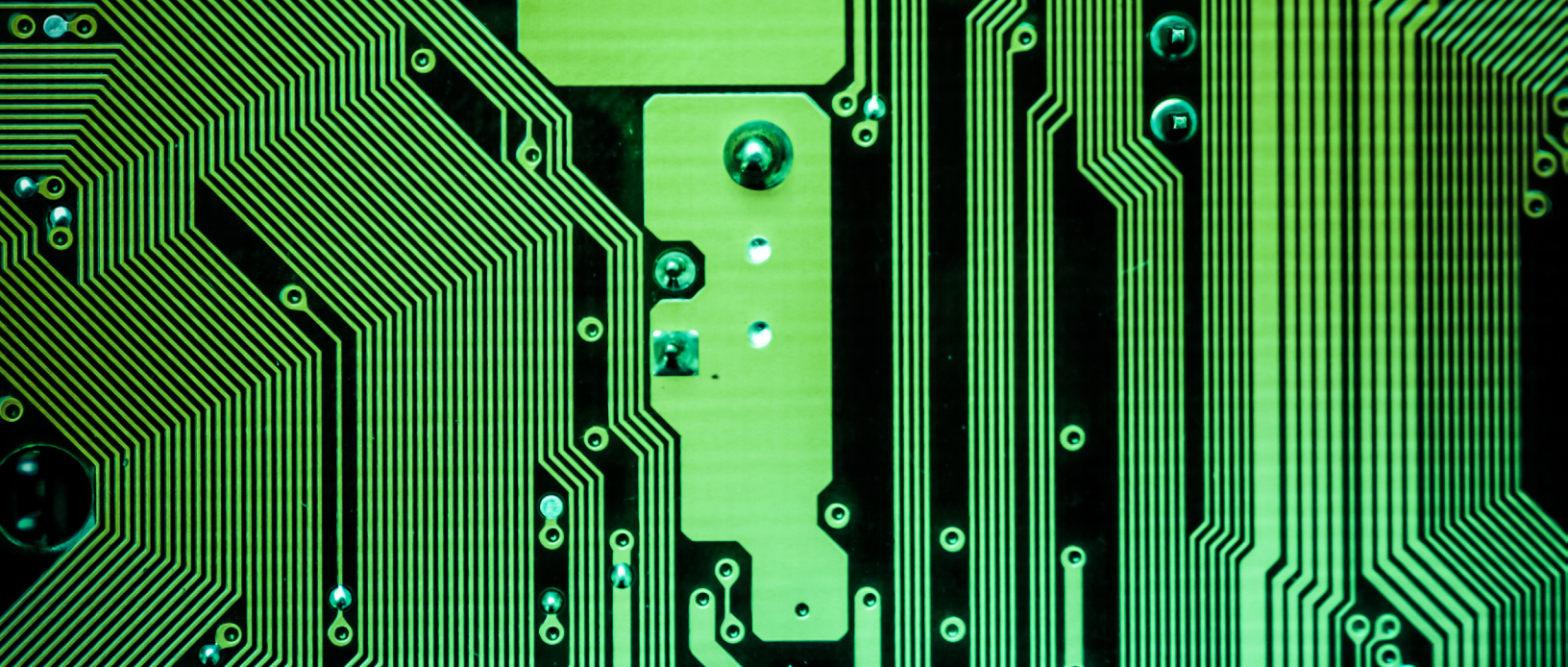
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## Aerospace & Defense:

Biden Administration issues long-awaited executive order on outbound investment screening & solicits public input on rulemaking process

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Through Aerospace & Defense Insights, we share with you the top legal and political issues affecting the aerospace and defense (A&D) industry. Our A&D industry team monitors the latest developments to help our clients stay in front of issues before they become problems, and seize opportunities in a timely manner.

**The Biden Administration has issued its long-awaited outbound investment screening executive order (“EO”), which broadly describes the scope of the program and directs the U.S. Department of the Treasury (“Treasury”) to issue implementing regulations. Alongside the EO, Treasury issued an Advance Notice of Proposed Rulemaking (“ANPRM”) that details the potential scope and implementation plans and requests public comment on various aspects of the outbound investment screening program (“outbound investment program”) in order to inform the final program. Once Treasury issues final implementing regulations, the outbound investment program will impose on U.S. persons notification requirements for certain transactions and will outright prohibit U.S. persons from engaging in other transactions—in both cases related to certain Chinese parties that are engaged in subsets of three advanced technology sectors. More than 60 stakeholders have submitted public comments on the ANPRM, and our team is reviewing these comments in order to analyze how they might shape the final implementing regulations.**

## What key facts should A&D companies know about the EO and ANPRM?

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On August 9, 2023, the Biden Administration issued its **long-awaited EO** granting Treasury the authority to establish and enforce the outbound investment program that will be administered by Treasury in consultation with other agencies, including the U.S. Department of Commerce.

In the EO, President Biden declared a national emergency under the International Emergency Economic Powers Act and determined the need for action due to the policies and actions of countries of concern that seek to, among other things, exploit U.S. outbound investments to develop sensitive technologies and products critical for military, intelligence, surveillance, and cyber-enabled capabilities.

The outbound investment program, pursuant to forthcoming implementing regulations, is expected to (1) require U.S. persons to notify Treasury of certain transactions and (2) prohibit U.S. persons from engaging in other transactions, in both cases related to certain Chinese parties that are engaged in subsets of three advanced technology sectors: (a) semiconductors and microelectronics; (b) quantum information technologies and (c) certain artificial intelligence (“AI”) systems. In

particular, the outbound investment program will be focused on investments that could result in the advancement of sensitive technologies critical to China's military modernization.

Importantly, while the EO articulates the broad contours of the outbound investment program and the ANPRM proposes some preliminary details, the specifics of the program, including precisely which entities and investments will be covered, remain in flux. It will be critical for U.S. and foreign stakeholders to actively engage in the rulemaking process to shape the program. Below is a summary of the key details of the outbound investment program, as set forth in the EO and ANPRM.

## Which investors will be covered by the outbound investment program?

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The outbound investment program will cover U.S. persons that engage in transactions involving certain persons from a "country of concern" (defined below) that are engaged in certain advanced technology sectors. The EO defines U.S. persons as "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 branches of any such entity, and any person in the United States."

## Which foreign countries will the outbound investment program target?

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The EO identifies China (including Hong Kong and Macau) as the "country of concern" that will be subject to the outbound investment program regulations, once issued.

## What kinds of foreign persons will be covered by the outbound investment program?

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Treasury anticipates that the outbound investment program will define "person of a country of concern" as:

- any individual that is not a U.S. citizen or permanent resident and is a citizen or permanent resident of a country of concern;
- any entity organized under the laws of, or with a principal place of business in, a country of concern;
- the government of any country of concern and any person owned, controlled, or directed by or acting for or on behalf of such government; or
- entities that are 50% or more owned, directly or indirectly, by persons described above.

Treasury anticipates defining a "covered foreign person" as (i) a "person of a country of concern" that is engaged in certain defined activities involving "covered national security technologies and products" or (ii) a person whose direct or indirect subsidiaries or branches are described in (i) and that, individually or in the aggregate, comprise more than 50 percent of that person's consolidated revenue, net income, capital expenditure, or operating expenses.

## Which sectors will be covered by the outbound investment program?

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Treasury anticipates that the outbound investment program will target “covered national security technologies and products,” which relate to three categories of advanced technologies: (1) semiconductors and microelectronics, (2) quantum information technologies, and (3) certain AI systems. As discussed in further detail below, Treasury is considering imposing outright prohibitions on U.S. investments in certain of these sectors, whereas it is considering notification requirements in others.

## What types of transactions will be outright prohibited under the outbound investment program?

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Treasury is considering imposing an outright prohibition on U.S. person investments in “covered foreign persons” engaged in:

- *certain activities within the semiconductors and microelectronics sector* (e.g., developing electronic design automation software or semiconductor manufacturing equipment; designing, fabricating, or packaging advanced integrated circuits; and installing or selling supercomputers);
- *certain activities within the quantum information technologies sector* (e.g., producing quantum computers and certain components; developing certain quantum sensors; and developing quantum networking and quantum communication systems); and
- *certain activities within the AI sector* involving the development of software that incorporates AI and that is designed to be exclusively used (or perhaps “primarily used”) for military, government intelligence, or mass-surveillance end-uses.

## What types of transactions will be covered by the outbound investment program?

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According to the ANPRM, Treasury anticipates focusing the outbound investment program on these types of transactions:

- certain acquisitions of equity interests (e.g., via mergers and acquisitions, private equity, venture capital, and other arrangements);
- greenfield investments;
- joint ventures; and
- certain debt financing transactions that are convertible to equity.

## What types of transactions will be excepted from the outbound investment program?

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According to the ANPRM, Treasury is considering excepting from coverage of the program certain types of transactions that may pose a lower likelihood of conveying intangible benefits to “covered foreign persons.” Specifically, Treasury is currently contemplating carving out certain passive and other types of investments, including:

- certain U.S. investments into publicly-traded securities, index funds, mutual funds, exchange-traded funds;
- certain investments made as a limited partner;
- committed but uncalled capital investments; and
- intracompany transfers of funds from a U.S. parent company to its subsidiary.

Treasury also noted that it does not intend to capture certain other transactions, including university-to-university research collaborations, intellectual property licensing arrangements, and others, as long as such transactions do not separately meet the definition of a transaction that is covered by the program.



## What types of transactions must be notified under the outbound investment program?

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Treasury is considering imposing a notification requirement for U.S. investments in “covered foreign persons” engaged in (1) the design, fabrication, and packaging of less advanced integrated circuits and (2) activities related to the development of software that incorporates an AI system and is designed to be used exclusively (or perhaps “primarily used”) for cybersecurity applications, digital forensics tools, and penetration testing tools; the control of robotic systems; surreptitious listening devices that can intercept live conversations without the consent of the parties involved; non-cooperative location tracking; or facial recognition. Treasury does not appear to be considering a notification requirement for the quantum information technologies sector at this time.

## Will the outbound investment program apply retroactively?

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Treasury is not proposing that the program apply retroactively; thus the program will likely apply to new investments — not to existing investments. Treasury notes, however, that it may nonetheless request information about transactions that were completed or agreed to after the effective date of the EO for the purposes of informing the development and implementation of the outbound investment program.

## When will the outbound investment program go into effect?

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The outbound investment program will go into effect following a rulemaking period that is expected to include the issuance of a proposed draft set of implementing regulations and, after that, final implementing regulations. Given the complexity of the outbound investment program and the need to propose implementing regulations, the program likely will not take effect until 2024.

## EO as inspiration for an EU outbound investment screening mechanism?

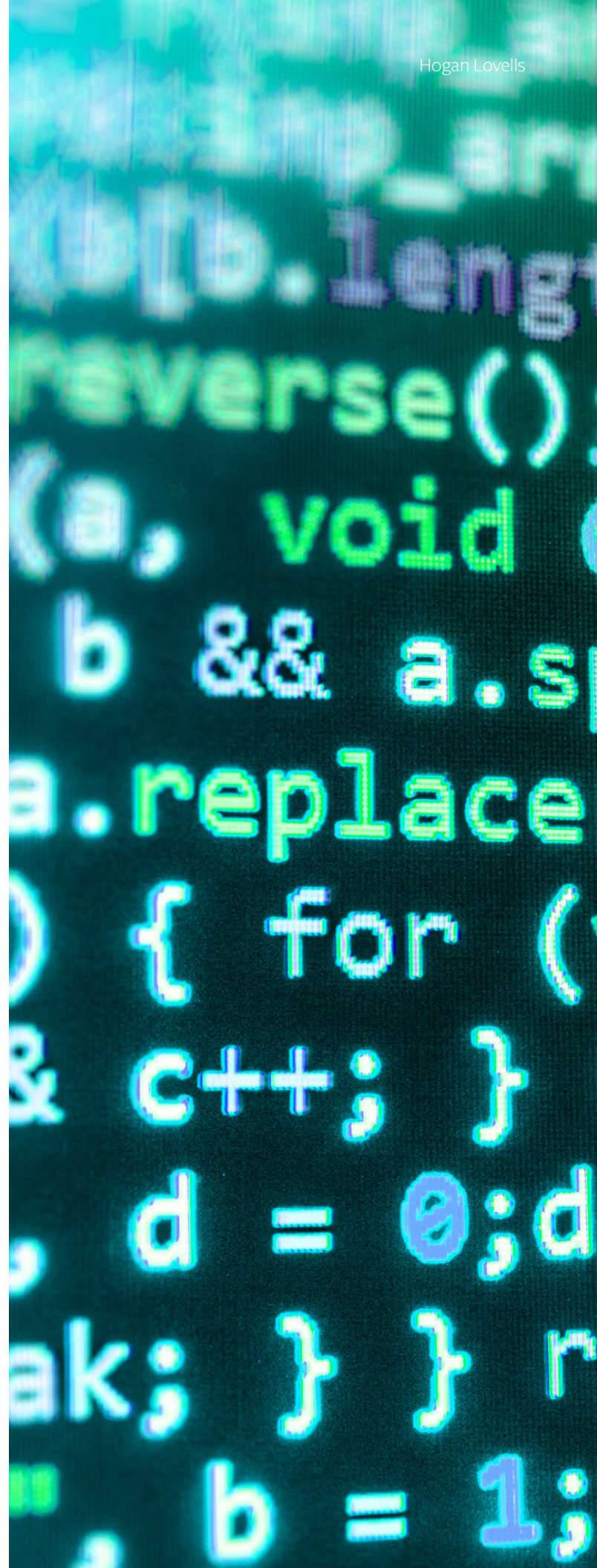
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On June 20, 2023, the European Commission and the EU High Representative for Foreign Affairs and Security Policy published a **Joint Communication on “European Economic Security Strategy”** (“Communication”) announcing their intention to explore possible measures to address security risks related to outbound investments. As part of the EU’s overall security strategy, Member States must first agree on a list of critical technologies – which is expected to be released on October 3, 2023 and would include cutting edge microchips and quantum computing – where excessive reliance on foreign suppliers poses a security risk. Based on this list, the European Commission plans to review the existing rules on inbound FDI and explore new measures on outbound investment screening in critical technology areas. While so far the scope of such outbound screening mechanism remains to be defined, the Communication refers to a “narrow set of technological advances that are core to enhancing military and intelligence capabilities of actors who may use them to undermine international peace and security”. The European Commission, together with a newly established dedicated group of Member States’ experts, will aim to put forward a legislative proposal for outbound investment screening by the end of 2023.

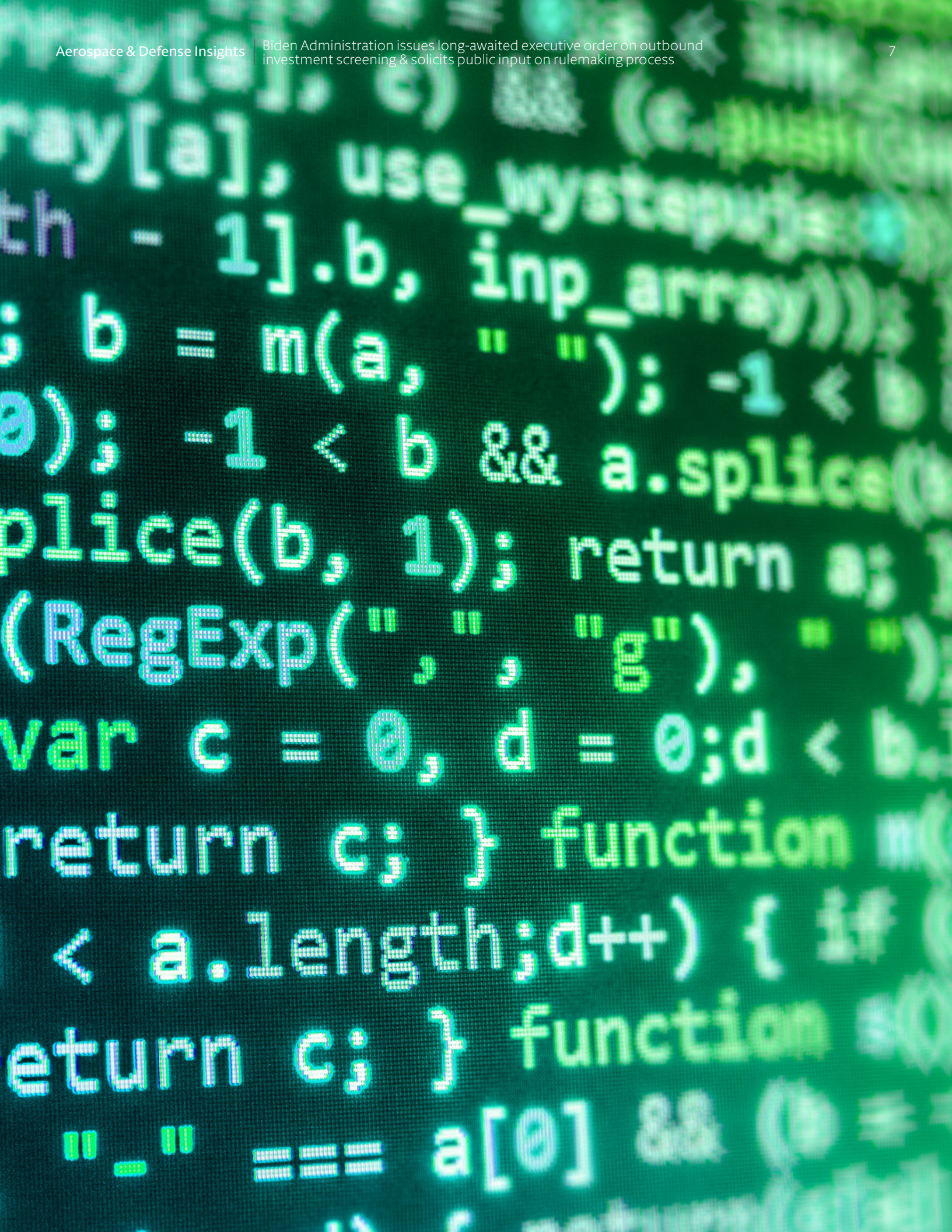
## Conclusion

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A&D companies should consider the potential impact of the EO and ANPRM on their businesses and operations, particularly given the widespread use throughout the A&D sector of semiconductors and microelectronics and the increasing adoption of or potential applications of AI systems and quantum information technologies in the sector. A&D companies should also take note of the broad scope of the outbound investment program, which could prohibit or require notifications even of some U.S. person investments in non-Chinese companies, including U.S. and European companies. They also should take into account the possibility that U.S. allies and partners may adopt similar outbound investment restrictions, as the EU has already announced earlier this year its intention to explore outbound investment screening. Please contact any of the Hogan Lovells lawyers listed below if you have questions on how to prepare your company for the outbound investment program.





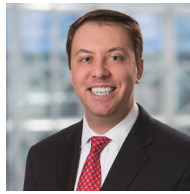






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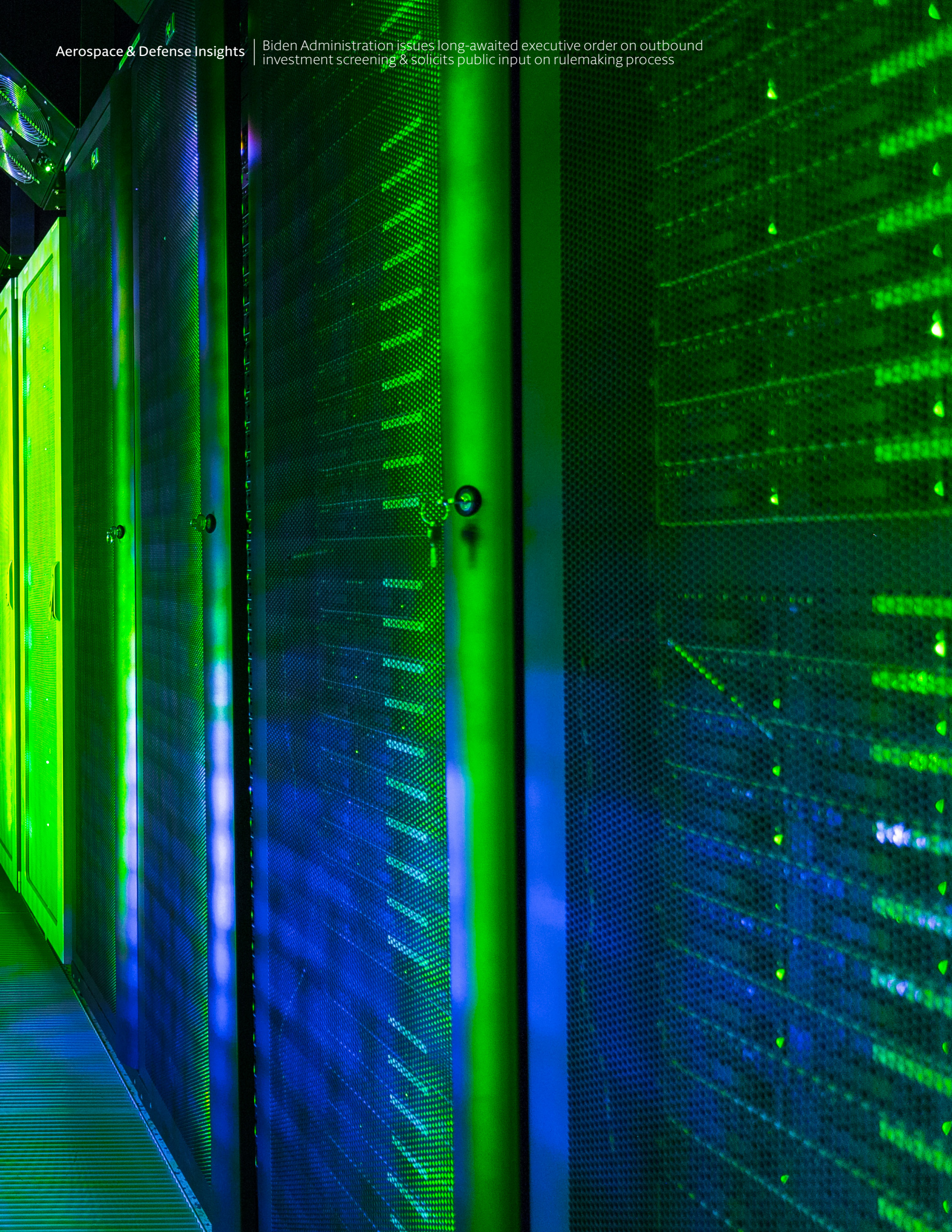














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