THE US-CHINA BUSINESS COUNCIL
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USCBC Comments Regarding the Proposed Rule Pertaining to US Investments in Certain National Security Technologies and Products in Countries of Concern

Department of the Treasury, Office of Investment Security

The US-China Business Council (USCBC) welcomes the opportunity to submit comments to the Department of the Treasury (Treasury) regarding the notice of proposed rulemaking (NPRM) preceding the implementation of regulations contemplated by the executive order (EO) of August 9, 2023, "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern."

USCBC represents more than 270 American companies that do business with China. Our membership includes some of the largest and most iconic American brands, in addition to small- and medium-sized enterprises. Our members represent a wide range of industries and sectors, including manufacturers, professional services firms, high-tech companies, investment funds, and others.

We greatly appreciate the administration's consultations with our organization and our member companies throughout the development of the Outbound Investment Security Program. Because of these discussions, many US companies have already created sophisticated due diligence mechanisms to ensure that their investments do not facilitate the development of national security technologies and products in countries of concern.

As a general matter, USCBC supports the Biden administration's efforts to protect US national security and promote a robust bilateral commercial relationship with China. However, USCBC has serious concerns about this proposed rule. If implemented as written, it will impose undue impediments on companies' ability to conduct global business.

Controls on outbound investments to a major trading partner are completely novel, and we believe certain elements of the proposed rule represent a departure from the United States' traditional support for free and open capital flows that undergird US companies' operations. USCBC did not reach this position with haste and only after determining that concerns raised in our ANPRM submission were not addressed. Urgent revisions, detailed below, are needed to ensure that the rule is clear, implementable, and does not impact a wider set of investments than needed to achieve the administration's national security objectives. The United States should not replicate China's system, which requires government approval or notification for overseas investments in a loosely defined range of sensitive areas.

The technologies and products covered by the NPRM all have complicated supply chains, and their inclusion in its scope followed rigorous consultation with the business community. Therefore, USCBC strongly urges the administration to act with restraint regarding any future expansions. If the scope of the proposed rule should eventually be expanded, the rule should follow a similarly rigorous consultation process and have a prospective application. Congress has also proposed alternative approaches to US outbound investment. To avoid unnecessary confusion, USCBC encourages the

administration and Congress to work to ensure there is one clear set of rules that will apply to US businesses. Any expansion of prohibited or notifiable activities should include a notice and comment period.

In our comments below, USCBC strives to act as a constructive partner to Treasury and the broader US government. Our submission provides specific feedback and suggestions on key definitions, concepts, and elements of the NPRM.

I. EXECUTIVE SUMMARY

To improve compliance with the final rule and any other future regulations under the outbound investment EO, and to address necessary questions and clarifications with Treasury, USCBC makes the following recommendations:

Specific Feedback on Key Definitions and Concepts:

- Treasury should provide greater detail about what due diligence is needed to satisfy the knowledge standard, such as by providing examples of red flags and examples of due diligence documentation. Treasury should also clearly define the term "relevant counterparty" in the context of investment targets and limit required knowledge diligence to parties participating in a transaction.
- Treasury should remove the inclusion of data systems, software, hardware, application, tool, or utility operating in whole or in part with covered AI systems from the definition of *AI system.*
- Treasury is encouraged to explain why a *US person's* mere intent to establish a *covered foreign person* would be sufficient in cases of greenfield and brownfield investments to constitute a *covered transaction,* and how requiring the establishment of a *covered foreign person* before triggering *covered transaction* obligations could undermine its national security goals. Treasury should ensure that such obligations are only triggered upon the fulfilment of clear and specified criteria.
- Treasury should define "joint venture" as a legal entity jointly owned by two or more independent persons and established to engage in a single-purpose project or an ongoing business in which the owners contribute certain resources and share the profits and losses associated with the legal entity. Treasury should publish guidance specifying that "joint venture" does not apply to a list of other routine business arrangements such as IP licensing agreements, which are already captured by US export controls and sanctions.
- The definition of integrated circuits (ICs) within *notifiable transactions* should only apply to ICs and IC manufacturing equipment listed on the Commerce Control List (CCL) in the Export Administration Regulations (EAR).
- Treasury should clarify the technical scope of *AI systems* within *notifiable transactions* to avoid unintentionally including diverse, non-military end uses. Treasury should clarify the meaning of "develops," "designed," and "intended" for use in areas of concern. As with *prohibited transactions*, Treasury should publish fact-based technical criteria that can be used to determine whether an *AI system* falls into a notifiable activity.
- Treasury should provide clear and explicit parameters for determining whether an investment target is a *person of a country of concern* and should clarify or provide specific examples of what

would constitute an action for or on behalf of the government of a country of concern and what would constitute an "instrumentality" of a political entity of a country of concern. Treasury should also revise the aggregation of various parties' ownership stakes in the investment target to apply only if attributable to a single entity. Alternatively, Treasury could remove said aggregation and establish a de minimis threshold that excepts small ownership investments.

- Within *prohibited transactions* for *AI systems*, Treasury should provide additional clarification on the meaning of "intended use" and "exclusive use." Treasury should provide specific examples of prohibited *AI systems* transactions to help companies craft compliance operations and should publish fact-based technical criteria that can be used to determine whether an *AI system* falls into a prohibited activity.
- Should Treasury adopt a threshold-based approach for defining *AI systems* within *covered transactions,* it should devise a mechanism whereby thresholds are re-evaluated to ensure that only the most advanced applications remain covered. We also suggest that a threshold-based approach establish a licensing system or other program to identify certain covered investment targets that satisfy non-diversionary requirements and provide for an approved investment process to these entities.
- Treasury should remove "any person in the United States" from the definition of *US person* or explicitly outline the criteria a non-US citizen or permanent resident individual in transit through the United States would need to meet to be considered a *US person*.
- Treasury should ensure that the final rule includes a clear demarcation of the stage of a transaction at which a carve out of a *US person* who recuses themselves from an investment would apply, such as the "decision to undertake a transaction," and should clarify what such a decision must entail.
- Treasury should adopt an alternative that minimizes the number of limited partner (LP) investments considered as *covered transactions*. Treasury should also utilize consistent language across both proposed alternatives for excepted LP investments if they are intended to be similarly applicable to both *prohibited transactions* and *notifiable transactions*.
- Treasury should clarify that the exception for intracompany transactions applies to a category of *covered activities* and is designed to allow *controlled foreign entities* to continue such activities without ending new development or tracing of funding to other activities. This exception should also apply to *covered transactions* between a *US person parent* and any of its affiliates, including any person that controls, is controlled by, or is under common control with the *US person*.
- Treasury should introduce an exception for scenarios in which a *US person* makes a small investment into an ecosystem to advance its competitive advantage and the investment carries a low risk of transferring intangible benefits.
- The national interest exemption should be fully developed before the publication of the final rule. This includes publishing the required information for an application and establishing binding conditions for the exemption, as well as a timeline for determining whether to grant an exemption, to provide certainty to US investors.

Notification Requirements:

- Treasury should remove the obligation that a *US person* update a notification submission until such *US person* is considering a subsequent investment in the target company. Treasury should also clarify that divestment will not be required for situations in which a target company later pivots into a *covered activity* in cases where the *US person* undertook reasonable due diligence at the time of the investment.
- Treasury should avoid requiring disclosure of the identities of third parties to a transaction and of the ultimate beneficial owner of a public company.

Additional Suggestions:

- Treasury should devise a mechanism for compliant enterprises to obtain a license for otherwise *prohibited transactions* if they can reasonably demonstrate that such transactions will not transfer intangible benefits to a military end use. Treasury should also consider publishing a list of authorized AI applications for investment regardless of computing power.
- Treasury should communicate its objectives with China's commercial regulators and Chinese businesses, providing a more permissive environment for US firms to conduct due diligence.
- The United States must continue to coordinate its approach to reviewing outbound investment with other countries. Treasury should develop the criteria for the proposed exception of certain transactions with or involving certain third countries prior to the issuance of a final rule.
- Treasury should adopt a prospective application of the proposed rule that commences on the effective date of the final rule, as opposed to the date of the issuance of the executive order of August 9, 2023.
- Treasury should assist companies in better understanding the concept of intangible benefits by publishing clear examples of investments by *US persons* that have transferred intangible benefits that allowed a *person of a country of concern* to accelerate the development a covered technology or product.

II. SPECIFIC FEEDBACK ON KEY DEFINITIONS AND CONCEPTS

850.104 Knowledge standard and 850.216 Knowledge

In the NPRM, section 850.216 defines *knowledge* as:

a. Actual knowledge that a fact or circumstance exists or is substantially certain to occur;
b. An awareness of a high probability of a fact or circumstance's existence or future occurrence; or
c. Reason to know of a fact or circumstance's existence.

Section 850.104 establishes criteria that Treasury believes are appropriate to determine whether a *US person* possessed or could have possessed such *knowledge*, stating that "a *U.S. person* that has failed to conduct a reasonable and diligent inquiry by the time of a given transaction may be assessed to have had reason to know of a given fact or circumstance," and provides several examples of reasonable due diligence. These examples include a review of due diligence questions asked by the US investor, efforts

to obtain non-public information, efforts to obtain open-source information, the use of public commercial databases, and whether any self-blinding occurred.

As written, such subjective evaluations to determine the level of "effort" and to assess due diligence reports create significant uncertainties for companies, particularly those engaged in M&A and venture capital activities. Before implementing a final rule, Treasury should clarify the specific record-keeping and due diligence obligations companies must undertake. Treasury should also publish examples of red flags and examples of due diligence documentation. Doing so will ensure that companies do not over-comply with the rule and that the rule does not restrict a broader-than-necessary set of business activities.

The proposed rule stipulates that a *US person* must conduct such diligence on an investment target or "relevant counterparty." However, the term "relevant counterparty" is not defined. In the venture capital and private equity context, "relevant counterparties" could include co-investors, the investment target's stockholders, and possible end users of the investment target's products and/or services, among others. The expectation that a *US person* will obtain detailed, complete responses from such third parties may negatively impact a *US person's* ability to participate in a transaction in a country of concern. USCBC recommends that Treasury clearly define this term and limit the required diligence to parties participating in the transaction. Treasury should consider adjusting the proposed rule to specifically state that a *US person* may rely on representations made in the investment agreement regarding "relevant counterparties." This would enable the parties to the transaction to negotiate and agree on reasonable representations and warranties. Any further diligence outside of the investment agreement should only be required of the target company, which is best positioned to provide information on its existing investors, ownership structure, products and services, and target markets.

850.202 AI system

The NPRM defines *AI system* to not only include the primary AI system itself, but also "any data system, software, hardware, application, tool, or utility that operates in whole or in part using" the AI system. While there may be a basis for implementing this broad definition within the context of the Executive Order on Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence, which is focused on safety and standards for AI, there is no clear reason to use this definition in the context of the proposed rule. As written, the definition would not only capture entities directly engaged in developing AI, but also any other entity that integrates AI into its own technology. This case is increasingly prevalent today as companies are incentivized to be "AI-driven," adopting various AI functionalities without the capability or intent to develop the underlying AI themselves. To minimize ambiguity regarding the scope of entities that should be covered and to ensure that the program is administrable, Treasury should remove 850.202(b) from the definition of *AI system*.

850.209 Covered foreign person

Section 850.209(a)(1) defines *covered foreign person* as "any person … that is engaged in a covered activity." While the proposed rule defines *covered activities*, such as developing *AI systems* above certain computing thresholds, it offers no guidance or direction on what it means for a particular entity to "engage" in *covered activities* (e.g., what it means for an entity to "engage" in the development of a covered *AI system*). US businesses are therefore expected to determine whether business processes constitute "engagement" in a *covered activity*. It is not clear whether IP ownership related to the

covered activity constitutes "engagement" or whether a board of directors that directs the activities of a subsidiary that performs a *covered activity* would be considered "engaged" in a *covered activity*. This ambiguity creates serious implementation challenges for US businesses regarding whether their transaction counterparts are a *covered foreign person.* USCBC recommends that Treasury adopt a de minimis threshold for what constitutes being "engaged" in a covered activity for the purposes of assessing whether an entity is a *covered foreign person.*

Section 850.209(a)(2)(i), (ii), (iii), and (iv) further define *covered foreign person* as any person that attributes more than 50 percent of its revenue, net income, capital expenditure, or operating expenses to a *person of a country of concern* that is engaged in a *covered activity*, either individually or in aggregate with other such persons. The term "engaged" remains undefined, making the 50 percent rule nearly impossible to implement for the reasons outlined above. In addition to clarifying "engaged," we also suggest that Treasury revise the 50 percent requirement to only apply if attributable to a single entity, rather than in the aggregate.

850.210 Covered transactions

850.210(a)(4) Greenfield or brownfield investment

In its commentary, the NPRM states that a *US person's* intent (as distinct from *knowledge*) to establish a *covered foreign person* would be sufficient for a greenfield or brownfield transaction to be deemed a *covered transaction*, regardless of whether a *covered foreign person* ultimately results from the investment. Treasury has assessed that requiring such an investment "to result in the establishment of a *covered foreign person* or a *person of a country of concern's* engagement in a new *covered activity* before triggering obligations associated with *covered transaction* status" could undermine the program's national security goals. USCBC urges Treasury to detail and justify this assessment, and to ensure that the obligations associated with *covered transaction* status are only triggered upon the fulfilment of clear and specified criteria, namely, the ultimate establishment of a *covered foreign person*.

Additionally, it is not clear at what point an exempted brownfield investment to support ongoing operations, excepted under 850.501(c), becomes a *covered activity* under 850.210(a)(4)(2), "[a]cquisition, leasing, or other development of operations, land, property, or other assets" if it results in "the engagement of a person of a country of concern in a covered activity." While the NPRM uses the term "business pivot" in its commentary to distinguish between ongoing operations versus expansions of operations, the term "business pivot" itself is not defined in the NPRM and is not an understood concept in other areas of law. Treasury should provide more clarity on what exactly would constitute a brownfield investment or expansion of an existing business that would trigger a notification obligation or prohibition as defined in section 850.210(a)(4). There are scenarios, such as the development of new generations of the same product, in which the boundary between existing and expanding operations is unclear.

850.210 (a)(5) Joint venture

The NPRM identifies "joint venture" (JV) as a type of *covered transaction* but does not define JV or explain how the proposed rule applies to investments that may evolve after the establishment of a JV, potentially covering any business relationship in which two parties are providing resources to support a common goal. This lack of definitional clarity may result in the unintentional inclusion of ordinary

business transactions that do not provide the kind of intangible benefits Treasury is targeting, ultimately hurting US businesses. To provide greater clarity to industry and ensure the rule targets the highest-risk transactions, USCBC suggests that Treasury define "joint venture" as:

a legal entity jointly owned by two or more independent persons and established to engage in a single-purpose project or an ongoing business in which the owners contribute certain resources and share the profits and losses associated with the legal entity.

Additionally, we suggest that Treasury specify that a covered JV does not include the following types of arrangements:

- Intellectual property licensing arrangements;
- Arrangements under which one party is paid by the other party for goods or services and the other party independently contributes to the development of such goods and services;
- Reselling arrangements of goods and services where product developments are made independently by the reseller; or
- Arrangements in which funding is provided to one or more independent persons for development purposes and the entity providing such funding is not involved in such development, i.e., a provision of funding without intangible benefits.

USCBC is concerned that the inclusion of joint ventures will prevent US companies from purchasing or taking a majority stake in their competitors in China. Absent this ability, US companies risk being excluded from certain business arrangements that are fundamental to their market access and competitiveness. Mergers, acquisitions, and JVs are essential for companies to achieve scale, pursue innovative business lines, and remain active participants in global value chains. It is crucial that Treasury define JV so that US firms retain these abilities. China also possesses regulatory mechanisms to review M&A and other significant investments. USCBC is concerned that the NPRM will increase the likelihood of double-sided regulatory exposure for US companies that compete in China.

850.211, 850.214, and 850.223 Meaning of 'develop,' 'fabricate,' and 'produce'

While Treasury defines the terms "develop, "fabricate," and "produce," the proposed rule does not explicitly state that these terms do not apply to a person supplying equipment or materials to a person engaging in a *covered activity*. It is also unclear if the definition of *covered activity* applies to the provision of customer support in connection with the sale of a product to a *covered foreign person.* The final rule should clarify that supplying equipment or materials or providing customer support to a *covered foreign person* as part of an arms-length transaction would not be considered as engaging in *the covered activity*. Although it is not Treasury's intention to cover supplier or customer service relationships, adding clarity within the definition of each supply-related subsection would significantly reduce business uncertainty. Without clarification, the proposed rule risks unintentionally expanding the definition of *covered foreign persons* to include entities that are providing incidental support to *covered activities*, which would create significant business uncertainty by capturing a broad swathe of supplier and administrative relationships that are unrelated to the investment activity.

Treasury also uses the term "design" to describe a *covered activity* but does not define it. USCBC therefore requests that Treasury define "design" as it has provided definitions for "develop,"

"fabricate," and "produce," and specify that supplier and customer service relationships within design are not considered *covered activities.*

850.217 Notifiable transactions

850.217(a)(b)(c) Notifiable integrated circuits (ICs)

USCBC suggests that, rather an imposing a catch-all notification requirement on all ICs, IC fabrication, and IC packaging not covered under section 840.224, Treasury align its notification requirements with the EAR. Specifically, Treasury should limit the scope of notifications to those ICs covered in the Notified Advanced Computing (NAC) section of the EAR and to the equipment covered in Section 744.23(a)(4) of the EAR, which provides license exceptions for certain ICs and identifies the critical equipment for IC fabrication and packaging. Doing so will help companies integrate future compliance obligations into existing EAR compliance mechanisms, such as the existing screening processes already in place on the ICs and equipment of concern.

850.217(d) Notifiable AI systems

Section 850.217(d)(2) identifies *AI systems* used in cybersecurity applications, digital forensics tools, and penetration testing tools, or the control of robotic systems as covered technologies for the purposes of *notifiable transactions*. As outlined in our comment on the ANPRM, Treasury should provide greater definitional detail to each of these applications to distinguish between systems that are offensive or defensive in nature, i.e., disrupting another computer network or protecting one's own network. As with our comments regarding *prohibited transactions* for *AI systems*, we recommend that Treasury provide concrete examples of notifiable *AI systems* and publish fact-based technical criteria that can be used to determine whether an *AI system* falls into the scope of notifiable activities.

Similarly, there are countless *AI systems* associated with various types of robotic technologies that do not constitute a national security risk and impact emerging areas of technologies where the United States is competing globally, such as potential applications for robotic-assisted surgery. This concern is further exacerbated by the inclusion of "hardware" that operates "in whole or in part" using an *AI system*. The technical scope of *AI systems* in robotics should be clarified to avoid unintentionally including diverse, non-military end uses. To help companies design their compliance operations, USCBC requests further clarification on the definitions of "develops," "designed," and "intended" within section 850.217(d). In particular, Treasury should clarify that these terms do not cover the provision of technical support or consulting services to a third party that is developing a covered *AI system*. Clarification is needed because many *AI systems* are not developed with discrete end uses and it may be unclear how investors can ascertain these end uses through due diligence.

850.221 Person of a country of concern

The NPRM defines *person of a country of concern* as:

1. Any individual that is not a United States citizen or permanent resident and is a citizen or permanent resident of a country of concern;
2. Any entity organized under the laws of a country of concern or with a principal place of business in a country of concern;

3. The government of a *country of concern*, including any political subdivision, political party, agency, or instrumentality thereof; any person acting for or on behalf of the government of such country of concern; or
4. Any entity in which a person or persons identified in items (1) through (3) holds individually or in the aggregate, directly or indirectly, an ownership interest equal to or greater than 50 percent.

USCBC supports Treasury in defining the term *person of a country of concern* but encourages further clarification to ease future compliance obligations. For example, it is difficult to discern if or how a person is acting for or on behalf of the government of a country of concern. It is also important to ensure that such a determination follows clear and explicit parameters and is not arbitrarily applied. Treasury is encouraged to clarify the specific actions "for or on behalf of" the government of a country of concern a person would have to take and be proven to have taken to be included in the scope of this definition. USCBC also recommends that Treasury clarify or provide specific examples of what would constitute an "instrumentality" of any political subdivision, political party, or agency of a government of a country of concern.

Entities in which a *person of a country of concern* holds individually or in the aggregate, directly or indirectly, an ownership interest of 50 percent or more are also included in the definition. The inclusion of "in the aggregate" and "direct and indirect" presents broad and impracticable diligence obligations for a *US person* when determining whether an investment target is a *person of a country of concern*, especially in the context of venture capital investments, where an investment target may have upward of 100 investors, all with de minimis ownership stakes. Consistent with our ask on *covered foreign person,* Treasury should revise the 50 percent rule to apply only if attributable to a single entity, rather than in the aggregate.

Absent this change, Treasury could consider removing the aggregation of various unrelated parties' ownership stakes in the investment target from the criteria and establishing a de minimis threshold, excepting small ownership investments in the investment target below 10 percent of the outstanding voting power or equity. Such a threshold would also serve to exclude most rank-and-file employees who may own stock or *contingent equity interest* in the investment target but who do not have decision-making authority.

850.224 Prohibited transactions

850.224(j) Intended use and exclusive use within AI systems

The NPRM uses several criteria to delineate between notifiable and prohibited AI-related transactions. Prohibited AI-related transactions identified in section 850.224(j) include *AI systems* designed to be exclusively used for or are intended to be used for military end uses and government intelligence or mass surveillance end uses. USCBC supports Treasury's efforts to prevent the proliferation of technologies with these end uses. However, as currently written, this language is unreasonably difficult to implement because it is challenging for investors to assess the meaning of "intended use" and "exclusive use." Many *AI systems* are end-use agnostic or are developed as individual modules of larger applications. In these scenarios, intended end use is not readily identifiable from an investor's perspective. Treasury should provide concrete examples of AI applications with these end uses and provide additional guidance on how companies can determine whether an *AI system* is prohibited, such as by publishing fact-based technical criteria that can be used to determine whether an *AI system* falls

into a prohibited activity. Doing so will help companies right-size their compliance operations, which will in turn make these programs more effective. Asking companies to determine a foreign entity's intent will only chill the investment climate in the AI sector in China and globally, where China is increasingly intertwined. Due to the subjectivity of the standard, companies may choose not to engage in a transaction at all rather than risk engaging in a *notifiable transaction* that is ultimately deemed to be prohibited.

Treasury should also synchronize its definition of *AI systems* within *prohibited transactions* with other regulations, such as by basing its definition of *AI systems* on the EAR, which already includes software used in the development of items on the CCL and technologies identified under section 1758 of the Export Controls Reform Act (ECRA). Doing so would better align with companies' existing compliance operations, facilitating implementation of the rule and minimizing business interruptions. It would also remove the need for companies to make subjective determinations about the intended use of *AI systems*.

850.224(k) Compute-based thresholds

Regarding the NPRM's contemplated threshold-based approach for *AI systems*, Treasury should seek to align the proposed rule with other national security policies on AI and choose to institute a threshold-based approach. USCBC recommends that the provisions target models trained on more than 10^26 FLOPs of compute. Should Treasury adopt a threshold-based approach to defining covered *AI systems*, it must also devise a mechanism for re-evaluating its thresholds to ensure that they remain focused on the most cutting-edge applications and that they do not encompass technologies that are available through domestic providers in China. We also suggest that a threshold-based approach institute a licensing system for transaction recipients that can demonstrate a lack of diversion to military, intelligence, or mass surveillance end users or end uses.

850.229 US person

The NPRM defines *US person* as "any United States citizen or lawful permanent resident, as well as any 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." It is important that the final definition of *US person* is as clear as possible and aligns with definitions found elsewhere in relevant US law. Clarity and consistency will make compliance easier for businesses as they navigate this new regulatory regime. USCBC recommends that Treasury remove "any person in the United States" from the definition of *US person*, or otherwise explicitly outline the criteria a non-US citizen or permanent resident individual in transit through the United States would need to meet to be considered a *US person*, such as duration in the United States or the "specific knowledge, experience, networks, and other intangible assets accrued while they are in the United States that could convey valuable benefits to a *covered foreign person*."

850.302 Actions of controlled foreign entity and 850.402 Notification of actions of a controlled foreign entity

The NPRM prohibits or requires notification of most transactions undertaken by a *controlled foreign entity* that the *US person parent* is also prohibited from undertaking or required to notify Treasury. Because of this language, *US persons* are required to understand the activities of all their *controlled*

foreign entities and ensure that they comply with the rule. While USCBC appreciates Treasury's examples illustrating the proposed definition of *controlled foreign entity*, this language still enables broad and extraterritorial application of the proposed rule. USCBC is concerned that this language will incentivize foreign entities to exit their partnerships with foreign subsidiaries of *US persons*, particularly in relationships where metrics for determining control are less apparent and in sectors such as AI where Treasury's proposed definitions are not as clear. We suggest that Treasury recalibrate its coverage of *controlled foreign entities* by removing prohibitions and only requiring notifications for *covered transactions*. Absent this change, we request that thresholds for establishing control be substantially revised upward.

850.303 Knowingly directing an otherwise prohibited transaction

The NPRM includes a prohibition on a *US person* that possesses authority at a non-*US person* entity from *knowingly directing* a transaction by that non-*US person* entity that would be a *prohibited transaction* if undertaken by a *US person*. According to the proposed rule, a *US person* "knowingly directs" a transaction when such *US person* has authority to make or substantially participate in decisions and exercises that authority to direct, order, decide upon, or approve a transaction that would be a *prohibited transaction* if engaged in by a *US person*. Such authority is stated to exist when a *US person* is an officer, director, or senior advisor, or otherwise possesses senior-level authority at a non-*US person*.

USCBC supports Treasury's further clarification of "substantial involvement" or "substantial participation" in an investment decision and its intent to avoid scoping in provision of third-party services such as banking services or routine administrative work. However, in its current form, the proposed rule appears to assume that the authority to make or substantially participate in transaction decisions is derived primarily from a *US person's* title within the non-*US person* entity, and that the ability to *knowingly direct* a transaction is derived solely from such authority. Treasury should clarify in the final rule that a *US person* officer, director, or senior advisor, or a *US person* who otherwise possesses senior-level authority at a non-*US person*, should not be considered as *knowingly directing* a transaction undertaken by a non-*US person* solely based on the *US person's* title or authority, but rather a *US person* must actually exercise their authority to direct, order, decide upon, or approve a transaction to be considered as *knowingly directing* it.

USCBC also supports the NPRM's proposed carve out for a *US person* who recuses themselves from an investment in its effort to avoid broad implications on the employment of *US persons*. However, it is important that the final rule includes a clear demarcation of the stage of a transaction at which such a carve out would apply. USCBC suggests the recusal carve out apply no earlier than the stage of a "decision to undertake a transaction," and that Treasury further clarify what such a decision to undertake a transaction must entail to be considered as such.

850.501 Excepted transactions

850.501 (a)(1)(iii) Excepted LP investments

The NPRM states that an investment by a *US person* limited partner (LP) under a specified threshold into a pooled fund that then invests in a *covered foreign person* would, subject to the specified criteria, constitute an *excepted transaction*. The proposed rule presents two alternative approaches for defining how such an investment would constitute an *excepted transaction*:

1. The LP's rights are consistent with a passive investment and the LP's committed capital is not more than 50 percent of the total assets under management of the pooled fund. Should the LP's committed capital constitute more than 50 percent of the fund's total assets under management, its investment would qualify as an *excepted transaction* if the *US person* secured a binding agreement that the pooled fund would not use its capital for a *prohibited transaction*.
2. The LP's committed capital is not more than $1 million.

The suggested rationale for these proposed alternative approaches is that if a *US person's* investment into a pooled fund is large enough, the *US person* would be able to guide the fund's investment decisions or interact with the fund's investment targets and potentially allow for the transfer of intangible benefits, such as "standing and prominence, managerial assistance, and enhanced access to additional financing." USCBC encourages Treasury to provide further justification for the proposed thresholds and its supposition that investments meeting such conditions would inherently involve the transfer of intangible benefits.

The threshold of $1 million in proposed alternative 2 is considerably low by institutional LP standards. Treasury acknowledges that this alternative may scope in a greater number of LP investments as *covered transactions* compared to alternative 1 but should be cognizant that this wide-reaching alternative may in fact have the potential to disqualify the majority of such investments, effectively making the exception meaningless. This approach would needlessly disadvantage *US person* LPs and facilitate the entrance of non-*US person* LPs into pooled funds in their place.

USCBC suggests that Treasury adopt an alternative that minimizes to the extent possible the number of LP investments considered as *covered transactions*. Between the two proposed alternatives, USCBC considers alternative 1 to be preferrable, as it is more realistic from an implementation and compliance standpoint. Regardless of which proposed alternative is ultimately adopted, investments for which a *US person* limited partner secures a binding agreement that the pooled fund would not use its capital for a *covered transaction* should qualify as excepted transactions.

Additionally, proposed alternative 1 condition (2) states that a *US person* LP's committed capital that exceeds 50 percent of the pooled fund's total assets under management would still qualify as an *excepted transaction* only if the *US person* secures a binding agreement that the pooled fund would not use its capital for a *prohibited transaction*. Whereas the specific term *prohibited transaction* is used in alternative 1, alternative 2 uses the broader term *covered transaction*. To ensure clarity and to maximize companies' ability to comply with the proposed provisions, USCBC requests that Treasury clarify whether this discrepancy is intentional and whether proposed alternative 1 could be applied differently to *notifiable transactions*. Treasury is advised to utilize consistent language across both proposed alternatives if they are intended to be similarly applicable to both *prohibited transactions* and *notifiable transactions*.

850.501(c) Exception for intracompany transactions

Section 850.501(c) offers an exception for transactions between a *US person* and its *controlled foreign entity* that support ongoing operations or other activities not defined in sections 850.208, 850.210(a)(4), or (a)(5). This appears to offer certain exceptions for *controlled foreign entities* to continue to engage in *covered activities*. However, the preamble states otherwise. It says that the exception is intended "to support ongoing operations or other activities that are not covered activities" and states that the

exceptions apply to "intracompany transactions that would be covered transactions but support activities that are not covered activities." The preamble later states that the goal of the exception is to "avoid unintended interference … even when the *controlled foreign entity* also meets the definition of *covered foreign person*," and that "the potential impacts … from covering intracompany transactions would likely outweigh the benefits in terms of the objectives of the Outbound Order." These contradictory statements create uncertainty for companies seeking to utilize section 850.501(c). It is not clear if the exception is only available to the extent that their China subsidiary freezes the *covered activity*, such as the development of *AI systems*, or if the *US person* must condition *covered transactions* as only for use in activities that are not *covered activities*.

USCBC suggests that the exception apply to the following:

- Categories of *covered activities*, such as the "development of *AI systems*" that allow *controlled foreign entities* to continue their activities within in a particular category without artificially ending new development in such category or tracing of funding to other activities;
- All intracompany transactions between a *US person* and a wholly owned subsidiary, irrespective of the nature of the transaction;
- Intracompany transactions between a *US person* and any other *controlled foreign entity* where such transaction is in support of ongoing activities.

The exception could also codify that this does not allow a company to engage in a new JV or greenfield investment. Doing so will minimize unintended interruptions to ongoing operations between *US persons* and their subsidiaries.

USCBC also suggests that Treasury consider revising the exception for intracompany transactions so that it applies not only to *covered transactions* between a *US person parent* and its *controlled foreign entity*, but also between a *US person* and any of its affiliates, including any person that controls, is controlled by, or is under common control with the *US person*. Such an exception should also apply to transactions involving affiliates that are knowingly directed by a *US person* or undertaken by a *controlled foreign entity* of a *US person*.

850.501 Exception for transactions with significant benefits and low national security risks

USCBC suggests that Treasury introduce an exception for scenarios in which a *US person* makes a small investment into an ecosystem to advance its competitive advantage and the investment meets the following criteria, which ensure that tangible benefits transferred to the *covered foreign person* are solely nominal:

- The investment amounts to no more than $10 million and the equity acquired is no more than five percent;
- The *US person* has no right to appoint a board director in the *covered foreign person*; and
- The *US person* has reason to believe that the investment would afford the *US person* significant business advantage beyond potential financial return.

This exception would mitigate unintended consequences of the proposed rule. If not added, the proposed rule would chill normal investment activities by *US persons* which benefit their businesses, technology, market development, and global competitiveness and where national security concerns are minimal.

The NPRM acknowledges potential ambiguities in the scope of *covered transactions*, noting that *covered transactions* would not usually apply to most routine intracompany activities, but stating that it is not necessary to specifically exclude a list of such activities by including them within the scope of *excepted transaction*. However, USCBC recommends that, in addition to applying a narrow definition to *covered transaction,* the final rule should explicitly include a non-finite list of *excepted transactions*, such as those that were previously enumerated in the ANPRM, including research collaborations, intellectual property licensing arrangements, and the sale of goods and services, which are not investments and which are necessary to ensure that US companies continue to derive revenue from foreign parties, including those that utilize US patented technology. Doing so will create clear lines for companies to craft compliance systems for the final rule.

850.502 National interest exemption

The proposed rule states that the Secretary of the Treasury, in consultation with other heads of relevant agencies, may determine that a *covered transaction* is in the national interest of the United States and is therefore exempt from applicable provisions. Once developed, Treasury anticipates detailing the process and required information for national interest exemption requests on its Outbound Investment Program website.

For full transparency, USCBC recommends that Treasury develop this proposed exemption before issuing a final rule. We encourage Treasury to develop its consideration for maintaining the United States' technological leadership globally in areas affecting US national security, as we are concerned that this rule will impact firms' global competitiveness and disincentivize investments that would be in the United States' national security interests. For example, there could be a scenario in which a US company needs to provide capital to its China JV partner to keep the firm afloat and to ensure that supply chains for covered technologies are not disrupted. There are also scenarios in which a US company could decide to buy out its Chinese competitor to acquire IP needed to develop a globally competitive product or process. There could also be circumstances in which a US company's investment is helping expand US access to critical technology, such as a semiconductor company with Chinese subsidiaries that seeks to provide components in the United States. Treasury should publish required information, including the explicit criteria for approval and timelines for responding to exemption requests, and establish the proposed binding conditions for the national interest exemption prior to the publication of the final rule.

III. NOTIFICATION REQUIREMENTS

850.403 Notification of post-transaction knowledge

The proposed rule requires a *US person* to submit a notification within 30 days of acquiring actual knowledge of a fact or circumstance that would have made a prior transaction either notifiable or prohibited. However, the proposed rule does not elucidate whether the responsibility only relates to the facts and circumstances in place at the time of the original transaction and fails to address a situation in which a target company subsequently pivots into a line of business that is a *covered activity*.

USCBC recommends that Treasury revise the proposed rule to remove the obligation that a *US person* update a notification submission made in connection with a transaction until such *US person* is considering a follow-on or other subsequent investment in the target company. Treasury should also

consider providing a clear exception from forced divestment for situations in which a target company later pivots into a *covered activity,* but the *US person* performed reasonable due diligence and the notification submission, if required, satisfied the requirements at the time of investment.

850.405 Content of notifications

Section 850.405(b)(8), (9) require notifications to disclose the identities of a *covered foreign person's* investors and the *US person's* co-investors in a transaction. The *US person* may not be able to obtain that information, but if it does, such information is typically confidential. In venture capital and private equity investments, parties are contractually bound from disclosing the identities of the parties. If other relevant parties are public companies, it can be difficult to identify the ultimate beneficial owner of the company. We suggest that Treasury remove the requirement in section 850.405 requiring the disclosure of the identities of third parties to a transaction and clarify that the disclosure of the ultimate owner of any public company is not required. Removing these requirements will enhance *US persons'* ability to conduct due diligence and obtain information from the target party about its investors.

IV. ADDITIONAL SUGGESTIONS

General authorizations

USCBC is concerned that the proposed rule neither entails a case-by-case review of *prohibited transactions* nor establishes a licensing process for a *US person* to seek prior authorization for a *covered transaction*. We propose that Treasury devise a mechanism for compliant enterprises to obtain a license for otherwise *prohibited transactions* to certain *covered foreign persons* that can reasonably prove that the investment would be consistent with US national security interests, e.g., intangible benefits from investments will not be redirected to a military end use. A license would help with situations such as JVs, in which ownership thresholds regularly shift. To create additional clarity around the definition of *AI systems*, Treasury should consider publishing a list of authorized AI applications for investment regardless of computing power.

At a minimum, the administration should create a process in which interested parties can submit a fact pattern and receive guidance on the applicability of the rule based on the facts presented. A similar solution is offered by the Securities and Exchange Commission (SEC), which offers non-binding guidance on certain fact-specific filings. Additionally, Treasury should establish an anonymous hotline for companies to submit questions regarding a proposed transaction to acquire guidance and clarity within a specific timeframe. Treasury should build on these conversations by publishing FAQs that the public can access for assistance.

Bilateral regulatory dialogue

To the extent that it has not already done so, it is crucial that the Office of Investment Security establish and maintain a dialogue with China's commercial regulators so that they are aware of Treasury's objectives. As part of these dialogues, Treasury should also communicate its objectives and compliance requirements to Chinese businesses. Doing so will provide for a more permissive environment for US firms to conduct due diligence, easing implementation of the proposed rule and minimizing impacts to out-of-scope investments.

Unilateral implementation

As the United States works to implement the proposed rule, it must continue to push other countries to implement similar policies. An uncoordinated or unilateral approach to reviewing outbound investment is unlikely to achieve its objectives and would disadvantage US firms and harm US competitiveness. Unilateral action would limit the ability of US companies to operate in large markets while their foreign competitors could maintain normal operations.

USCBC supports the potential exception of certain transactions with or involving a person of a country or territory outside of the United States designated to have adopted adequate measures to address the national security risk related to certain outbound investment. USCBC recommends that the criteria for this exception be fully developed and specified prior to the issuance of a final rule.

Prospective application

The NPRM does not propose a retroactive application of the provisions related to the prohibition of certain transactions and the notification of others, and instead proposes that the Treasury may, after the effective date of the regulations, request information about such transactions that were completed or agreed to after the date of the issuance of the Outbound Order. USCBC supports Treasury in adopting a prospective approach but strongly recommends that the application of the provisions commence after the effective date of the final rule, as opposed to the date of the issuance of the EO (August 9, 2023), as the parties to these transactions could not have foreseen the obligations to be imposed by the final rule. If the scope of the term "covered national security technologies and products" is expanded at any point in the future, the application of the expanded scope should similarly have a prospective application.

Intangible benefits

The NPRM states that Treasury has scoped the proposed rule to focus on US investments that present a likelihood of conveying 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 negatively impact the national security of the United States. Such intangible benefits include enhanced standing and prominence, managerial assistance, access to investment and talent networks, market access, and enhanced access to additional financing. To assist companies in better understanding the concept of intangible benefits, Treasury is encouraged to publish clear examples of investments by *US persons* that have transferred intangible benefits that subsequently allowed a *person of a country of concern* to accelerate the development a covered technology or product.

V. CONCLUSION

USCBC appreciates the opportunity to comment on this NPRM and hopes to continue to work with the administration to craft targeted policies that are effective, implementable, and promote the United States' national security and US companies' long-term global competitiveness. Providing more clarity and continuing regular consultations with US commercial stakeholders in the months ahead will aid the administration's goal of curbing investments that help countries of concern develop sensitive technologies and products critical for military, intelligence, and surveillance activities. Moreover,

coordinating efforts with US allies and partners will ensure that US competitiveness is not unnecessarily harmed.