ML STRATEGIES

Treasury Proposes Rule to Limit Outbound Investments in AI and Other Technologies — AI: The Washington Report

June 28, 2024 | Article | By **Bruce Sokler**, **Alexander Hecht**, **Christian Tamotsu Fjeld**, Matthew Tikhonovsky

VIEWPOINT TOPICS

- Artificial Intelligence
- AI: The Washington Report

1. Last week, the Secretary of the Treasury released a final proposed rule to implement the Biden administration's August 2023 Executive Order on outbound investments.
2. The proposed rule seeks to "prevent countries of concern from exploiting U.S. investments into" certain technologies, including AI and semiconductors for AI systems, that may pose risks to US national security.
3. The proposed rule would require notification of and prohibit certain investments involving US persons into countries of concern that develop sensitive technologies, including AI and semiconductors, building on existing requirements for certain foreign transactions.
4. While comments on the rule may be submitted until August 4, 2024, Treasury expects to finalize the rule by the end of the year.

On June 21, 2024, the Department of the Treasury (Treasury) issued a **Notice of Proposed Rulemaking** (NPRM) to implement the Biden administration's 2023 **Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern** ("Outbound Order").

According to **Treasury's fact sheet**, the proposed rule addresses US outbound investments into "countries of concern that seek to develop sensitive technologies," including AI systems and semiconductors for such systems, for "military, intelligence, surveillance, or cyber-enabled capabilities" that may threaten US national security. To this end, the rule would establish notification requirements for certain transactions and prohibit other certain transactions made by US persons involving certain foreign countries concerning sensitive technologies, including AI.

The proposed rule builds onto the existing framework for reviewing foreign transactions set by the Committee on Foreign Investment in the United States (CFIUS). The rule is subject to a comment period though August 4, 2024, and could change before it is finalized. We would expect that the final rule would hew closely to the proposed rule, and below we review its requirements for outbound investments involving semiconductors and AI.

Outbound Investments Executive Order

As AI has evolved in recent years — and its potential risks have become more apparent — lawmakers have become increasingly concerned about foreign countries of concern, including China, exploiting and benefitting from US investments into AI. **As we covered**, the Biden administration in October 2023 issued restrictions on exporting chips that are critical to AI systems to China. At that time, **Commerce Secretary Gina Raimondo indicated that** the purpose of the restrictions was to limit China's "access to advanced semiconductors that could fuel breakthroughs in artificial intelligence."

With a similar goal in mind, previously, on August 9, 2023, President Biden had signed an **Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern**. The Outbound Order aims to limit foreign countries of concern from exploiting US investments into certain technologies that may be used by these countries in ways that pose risks to US national security or to compete with the US in AI development and innovation. The Outbound Order specifically identifies artificial intelligence and semiconductors as two of the three

technology sectors that are involved in US outbound investments that may threaten US national security.

An **Annex to the Outbound Order** identifies as countries of concern the People's Republic of China (PRC), the Special Administrative Region of Hong Kong, and the Special Administrative Region of Macau.

The Outbound Order directed the Secretary of the Treasury to create specific notification and prohibition requirements for US outbound investments, including requiring US persons "to provide notification information relative to certain transactions involving covered foreign persons" as well as prohibit US persons "from engaging in certain other transactions involving covered foreign persons." While CFIUS currently requires that certain transactions involving foreign countries be reported to, and reviewed, and approved by the US government on a case-by-case basis, the Outbound Order's requirements would automatically apply, if finalized, to a certain set of outbound investments that have the potential to threaten US national security.

Advanced Notice of Proposed Rulemaking

Pursuant to the Outbound Order, the Department of the Treasury also issued on August 9, 2023, an **Advanced Notice of Proposed Rulemaking (ANPRM) on outbound investments**. Recognizing that "AI is a fast-changing technology area with novel aspects," the ANPRM sought comments on and posed several questions related to semiconductors and AI, including about the definition of AI systems.

The Proposed Rule's Scope

Incorporating comments made in response to the ANPRM, Treasury's NPRM expands on the notification requirements and prohibitions, previewed in the ANPRM, that would apply to US outbound investments concerning three types of technologies — semiconductors and microelectronics, quantum information technologies, and artificial intelligence.

The proposed rule would apply broadly to transactions made by US persons concerning the three types of technologies involving a covered foreign person, which would be defined as "a person of a country of concern" and would include:

- An individual who is a citizen or permanent resident of a country of concern and who is not a US citizen.
- An entity that is headquartered in, incorporated in, organized, or has its principal place of business in a country of concern.
- The government of a country of concern.
- An entity in which any of the above persons, entities, or governments directly or indirectly and individually or in the aggregate "holds at least 50 percent of any of the following interests of such entity: outstanding voting interest, voting power of the board, or equity interest."

The requirements would also extend to certain foreign entities of a US parent company.

The types of transactions covered by the rule are wide-ranging and would include certain acquisitions of equity interests; certain provisions of loans or similar debt financing arrangements; certain conversions of equity interests or debts; certain joint ventures; and certain acquisitions and leasing of operations, land, or other assets. The transaction types identified in the NPRM suggest that the rule is aimed at collecting more information on and restricting US private equity and venture capital investments, among other investments, involving foreign countries.

Prohibited Transactions Involving AI and Semiconductors

The proposed rule would prohibit transactions made by a US person involving a covered foreign person who develops the following AI systems, semiconductors, and microelectronics:

- AI systems "designed to be exclusively used for" or intended to be used for military end uses or government intelligence or mass surveillance end uses.
- AI systems trained using a computing power that exceeds a to-be-determined level and a computing power using primarily biological sequence data that exceeds a to-be-determined level. The NPRM includes multiple alternatives for the computing power thresholds for prohibited AI systems and invites comments on them.
- Electronic design automation software "for the design of integrated circuits."
- "Front-end semiconductor fabrication equipment designed for performing the volume fabrication integrated circuits."
- Integrated circuits that meet or exceed certain performance parameters, meet specific criteria, or are packaged according to advanced packaging techniques.
- Certain quantum information technologies.

Under the proposed rule, the responsibility would fall on US persons to determine if their transactions are prohibited. US persons who violate the prohibition may be subject to criminal and civil penalties, and any prohibited transactions that are completed may be subject to divestment and nullification.

Notifiable Transactions Involving AI and Semiconductors

Any US person that seeks to complete a transaction with a covered foreign person would be required to notify Treasury of the transaction if it involves any of the following technologies:

- AI systems designed to be used not exclusively for any military end use or government intelligence or mass-surveillance end use.
- AI systems "intended by the covered foreign person to be used for cybersecurity applications, digital forensics tools, and penetration testing tools, or the control of robotic systems."
- AI systems "trained using a quantity of computer power greater than a to-be-determined level. The NPRM includes multiple alternatives for the computing power thresholds for notifiable AI systems and invites comments on them.
- Integrated circuit design, fabrication, and packaging that are not otherwise prohibited.
- Certain quantum information technologies.

Treasury proposes that notification for transactions involving the above technologies must be filed "30 days after a transaction is completed." Furthermore, a US person who has knowledge of such notifiable transactions would also be required to notify Treasury "no later than 30 days after the US person's acquisition of such knowledge." Notification of transactions would be required to include information about the US person and covered foreign person involved in the transaction and the status, transaction value, and commercial rationale for the transaction, among other information.

Definition of AI

Adopting the definition of AI systems set forth in the **Biden administration's October 2023 Executive Order on AI**, the proposed rule would define AI systems broadly to include "a machine based system that can, for a given set of human-defined objectives, make predictions, recommendations, or decisions influencing real or virtual environments," as well as "any data system, software, hardware, application, tool, or utility that operates in whole or in part" using such a system. Treasury specifically solicits additional comments on the definition of AI systems.

Conclusion

Treasury's proposed rule on outbound investments involving AI is part of recent executive actions **that we've covered** that aim to protect US national security and ensure that the US has a competitive edge against foreign adversaries in the domain of AI. Treasury has invited comments regarding the proposed requirements relating to AI systems, and interested stakeholders may submit comments by August 4, 2024, at **https://www.regulations.gov**. **Early reports** suggest that Treasury expects to finalize the rule by the end of the year, and interested stakeholders should take initial steps to prepare for compliance with the final rule.

While the rule, if finalized, could be modified or repealed by any future administration, Congress is also considering several bills that aim to regulate and restrict US outbound investments involving AI. Although the proposed **Outbound Investment Transparency Act of 2023** and **Preventing Adversaries from Developing Critical Capabilities Act** both include provisions relating to outbound investments in AI, both bills have stalled in Congress — but they lay the groundwork for potential future legislative activity around outbound investments in 2025.

We will continue to monitor, analyze, and issue reports on the proposed rule, as well as other Washington AI developments.

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