Congress Criticizes VC Investments in China, Suggesting Broader Investment Restrictions into China

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The House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party (Select Committee) issued a bipartisan report criticizing investments made by U.S. venture capital firms (VC), as well as U.S. institutional investors as limited partners (LP), into companies in the People's Republic of China (PRC) in artificial intelligence (AI) and semiconductor sectors (Report). In line with the Select Committee's previously released report strategizing how to reset the United States' economic and technological competition with China, the Report signals Congress' intensified interest in curtailing the unintentional flow of US investments into China's military industrial complex.

The Report examined that five US-based VCs collectively invested $3 billion into PRC companies and provided intangible supports including management expertise and credibility to engage with co-investors and industry partners, which, the Report notes, supported PRC military and semiconductor supply chains and facilitated human rights abuses.

The Reports recommends codification of two types of investment restrictions:

- Company specific investment prohibition on companies identified on U.S. sanctions and red flag lists as supporting the PRC military or engaging in forced labor; and
- Sector specific restriction on PRC companies in specific sectors that support military or human rights abuses.

In congruence with Congress, in August 2023, President Biden issued an executive order (EO) on restrictions on outbound investments followed by the US Treasury Department's advance notice of proposed rulemaking which indicated adoption of an exception for certain LP investments. However, the proposed LP exception was narrowly scoped to only cover a relatively small LP investment below a *de minimis* threshold to be determined. Treasury Department has not adopted a final implementation regulation of the EO, and, meanwhile, the Report may fuel Congress's on-going efforts to codify outbound investments restrictions, which could limit global investment opportunities and require more robust risk mitigation and compliance strategies.

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