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CHIPS Act Proposed Rule Would Impose Significant China-Related Restrictions on Fund Recipients

On March 23, 2023, the U.S. Department of Commerce’s National Institute of Standards and Technology (“NIST”) published a proposed rule (the “Proposed Rule”¹ defining two “clawback” mechanisms under the CHIPS Act of 2022 (the “Act”). The Proposed Rule defines the clawback mechanisms expansively and, as observers anticipated, signals that parties considering seeking funding under the Act will need to weigh the benefits of funding against the China-related restrictions imposed on fund recipients. While the Proposed Rule would not impose affirmative compliance obligations writ large on funding recipients, the clawback restrictions are another sign that U.S. policymakers continue to use all available tools to address concerns about the transfer of sensitive technology to China.

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Background

Signed into law in August 2022, the Act established a semiconductor incentives program that provides funding to support investments in the construction, expansion, and modernization of semiconductor facilities in the United States (the “CHIPS Incentives Program”). In total, the Act allocated \$52.7 billion for American semiconductor research, development, manufacturing, and workforce development, including \$39 billion for the CHIPS Incentives Program.²

Under the Act, Congress created two clawback mechanisms to prevent recipients of funds under the CHIPS Incentives Program from engaging in certain transactions with “foreign countries of concern,” namely, China, North Korea, Russia, Iran, and other countries determined to engage in activities detrimental to U.S. foreign policy goals.³

- First, pursuant to the “Expansion Clawback,” the Act requires that any recipient of funds under the CHIPS Incentives Program “enter into an agreement with the Secretary [of Commerce] specifying that, during the 10-year period beginning on the date of the award, . . . the covered entity may not engage in any significant transaction, as defined in the agreement, involving the material expansion of semiconductor manufacturing capacity in the People’s Republic of China or any other foreign country of concern.”⁴ If this agreement is violated, the Expansion Clawback provides for the full recovery of the funds provided under the CHIPS Incentives Program.⁵
- Second, pursuant to the “Technology Clawback,” the Act provides the U.S. government full recovery of funds if a covered entity knowingly engages in any joint research or technology licensing effort with a “foreign entity of concern” (as defined below) that relates to a technology or product that raises national security concerns.

It was widely understood that the Act’s clawback mechanisms were intended to prevent recipients of funding pursuant to the CHIPS Incentives Program from engaging in expanded semiconductor manufacturing or other technological collaborations involving China, as part of a broader effort to bolster the U.S. defense–industrial base. However, prior to the Proposed Rule, there was a significant question as to how the clawback mechanisms would be implemented (and, in turn, how extensive the restrictions relating to China would be for funding recipients).

The Proposed Rule

Expansion Clawback

The Proposed Rule would impose a clawback upon any recipient of funds under the CHIPS Incentives Program that “engage[s] in any significant transaction involving the material expansion of semiconductor manufacturing capacity in a foreign country of concern.” The Proposed Rule would define a “significant transaction” as one that is valued at \$100,000 or greater, or a series of transactions that, in the aggregate, is valued at \$100,000 or greater, and defines

“material expansion” as steps that would increase a semiconductor facility’s manufacturing capacity by “more than five percent.” In an accompanying press release, the U.S. Department of Commerce observed that “[t]hese thresholds are intended to capture even modest transactions attempting to expand manufacturing capacity” in foreign countries of concern.⁶ Violations of this restriction, subject to two exceptions, would be subject to the clawback of all funds provided under the CHIPS Incentives Program.

The first exception provides that the Expansion Clawback does not apply to a “funding recipient’s existing facilities or equipment for manufacturing legacy semiconductors that exist on the date of the award,” which would need to be disclosed in the application for funding. Notably, however, an “existing facility” does not include one that undergoes “significant renovations,” meaning that renovations that increase manufacturing capacity by adding an additional line or otherwise increasing semiconductor manufacturing capacity by 10 percent or more could be captured under the rule.

The second exception provides that the Expansion Clawback does not apply to “[s]ignificant transactions involving material expansion of semiconductor manufacturing capacity that” both (1) produce “legacy semiconductors”; and (2) “predominantly” serve the market of a foreign country of concern, meaning that at least 85 percent of the output by value must be incorporated into the final products used or consumed in the country of manufacture.

“Legacy semiconductors” are defined under the Proposed Rule as certain older semiconductor technologies, including (1) digital or analog logic semiconductors that are of the 28-nanometer generation or older; (2) memory semiconductors with a half-pitch greater than 18 nanometers for Dynamic Random Access Memory (DRAM) or less than 128 layers for Not AND (NAND) flash that does not utilize emerging memory technologies (such as transition metal oxides, phase-change memory, perovskites, or ferromagnetics relevant to advanced memory fabrication); or (3) other categories of semiconductors publicly identified by the Commerce Department. However, “legacy” semiconductors do not include the following:

- Semiconductors deemed “critical to national security,” which is defined to include (1) compound semiconductors; (2) semiconductors utilizing nanomaterials, including 1D and 2D carbon allotropes such as graphene and carbon nanotubes; (3) wide-bandgap/ultra-wide bandgap semiconductors; (4) radiation-hardened by process (RHBP) semiconductors; (5) fully depleted silicon on insulator (FD-SOI) semiconductors; (6) silicon photonic semiconductors; (7) semiconductors designed for quantum information systems; and (8) semiconductors designed for operation in cryogenic environments (at or below 77 Kelvin);
- Semiconductors with a post-planar transistor architecture (such as a fin-shaped field-effect transistor (FinFET), or gate all around field-effect transistor); or
- Semiconductors packaged utilizing 3D integration.

In sum, to avoid application of the Expansion Clawback, a recipient of funds under the CHIPS Incentives Program could (1) engage in only a minor expansion of activity at semiconductor facilities in China (or other countries of concern) for a period of 10 years after funding; or (2) utilize narrow exceptions that require any post-funding activity to relate to older—and, from the U.S. government’s perspective, less cutting-edge—semiconductors.

In addition, if a funding recipient seeks to rely on one of the foregoing exceptions, notice must be provided to the U.S. government, which will review and assess whether the proposed expansion plans comply with U.S. government expectations. As such, recipients of funds under the CHIPS Incentives Program may find that, as a practical matter, acceptance of funding constitutes a *de facto* commitment not to expand or otherwise continue semiconductor activities in China (or other countries of concern).

Technology Clawback

The Proposed Rule also would provide that, during the applicable term of any award granted under the CHIPS Incentives Program, “neither a funding recipient nor its affiliates may knowingly engage in any joint research or technology licensing with a foreign entity of concern that relates to a technology or product that raises national security concerns.”

As defined in the Proposed Rule:

- An “affiliate” includes any subsidiary of the funding recipient, any parent entity of the funding recipient, or any entity that a parent entity also owns. In each case, the standard for ownership—whether direct or indirect—is at least 50 percent ownership of the outstanding voting interests.
- “Knowledge” can be inferred from the conscious disregard or willful avoidance of facts, meaning that a party can act “knowingly” if they have reason to know, even if they lack actual knowledge.
- “Joint research” is defined as any research and development activity, as defined at 15 U.S.C. § 638(e)(5), that is jointly undertaken by two or more persons, including in connection with a joint venture (as defined at 15 U.S.C. § 4301(a)(6)).
- “Technology licensing” is defined as a contractual agreement in which one party’s patents, trade secrets, or know-how are sold or made available to another party.
- A “[t]echnology or product that raises national security concerns” includes any semiconductor critical to national security (as described above), or any item controlled under the Export Administration Regulations (“EAR”) for national security or regional stability reasons, if listed in Category 3 of the Commerce Control List.
- A “foreign entity of concern” is any foreign entity that is:
 - Designated as a foreign terrorist organization by the U.S. Secretary of State;
 - Included on the Specially Designated Nationals And Blocked Persons List (“SDN”) or the Non-SDN Chinese Military-Industrial Complex Companies List administered by the Office of Foreign Assets Control (“OFAC”), or that is subject to OFAC’s 50 Percent Rule by virtue of the entity being 50 percent or more owned by one or more SDNs;
 - Owned by, controlled by, or subject to the jurisdiction of the government of China, Iran, North Korea, or Russia (including any entity organized under the laws of one of these jurisdictions);
 - Alleged by the U.S. Attorney General to have been involved in activities for which a conviction was obtained under a range of laws relating to foreign policy considerations (including, without limitation, laws relating to economic espionage, export controls, and national security concerns);
 - Included on the Entity List administered by the U.S. Department of Commerce’s Bureau of Industry and Security;
 - Identified in the Federal Communication Commission’s list of Equipment and Services Covered by section 2(a) of the Secure and Trusted Communications Networks Act of 2019 as providing covered equipment or services; or
 - Otherwise identified as being engaged in “unauthorized conduct that is detrimental to the national security or foreign policy of the United States[.]”

In sum, a recipient of funds under the CHIPS Incentives Program is bound to ensure that neither it nor its affiliates engage in any joint research or technology licensing with a broad host of parties—including any Chinese firm—if the agreement would involve high-tech semiconductors or certain other items controlled under the EAR.

Timing

NIST has requested comments to the Proposed Rule by May 22, 2023. In parallel, the U.S. Department of the Treasury issued a notice of proposed rulemaking relating to the Advanced Manufacturing Investment Credit administered by the Internal Revenue Service as part of the Act, on which Treasury is seeking comments by May 22. Foreseeably, the U.S. government will work to address comments and issue final rules implementing the Act as soon as possible thereafter, in accordance with the Biden administration’s desire to disburse funds under the Act (with the attendant restrictions) as soon as feasible.

Conclusion

While the Act represents a significant effort by the U.S. government to bolster domestic semiconductor production, the Expansion Clawback and Technology Clawback (as defined in the Proposed Rule) are plainly intended to disincentivize U.S. companies from engaging in a broad range of semiconductor-related activities with countries of concern, including China, with an inevitable effect on the global semiconductor market. The Proposed Rule demonstrates the U.S. government's efforts to find sweeping and multifaceted approaches to addressing national security concerns, and the clawbacks described in the Proposed Rule foreseeably could serve as a template for future initiatives.

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1. Preventing the Improper Use of CHIPS Act Funding, 88 Fed. Reg. 17,439 (March 23, 2023).
 2. Press Release, White House, [FACT SHEET: CHIPS and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China](#) (Aug. 9, 2022).
 3. 10 U.S.C. § 4872(d)(2).
 4. 15 U.S.C. § 4652(a)(6)(C)(i).
 5. *Id.* § 4652(a)(6)(E)(iii).
 6. Press Release, [U.S. Department of Commerce, Commerce Department Outlines Proposed National Security Guardrails for CHIPS for America Incentives Program](#), (March 21, 2023).