WINSTON & STRAWN LLP

BLOG

Congress Ramps Up Investigations of U.S. Venture Capital Firms Investing in Chinese Companies

JULY 28, 2023, 12:00 PM

Last week, a select committee of the U.S. House of Representatives sent letters to four venture capital (VC) firms requesting detailed information about their investments in Chinese companies developing technology involving artificial intelligence (AI), semiconductors, and quantum computing. The letters are a clear sign that Congress is ramping up its investigation of U.S. investments in Chinese high-tech firms. U.S.-based VC firms that regularly invest in Chinese companies should be aware that this is a growing area of concern for Congress, review the information requests carefully, and develop a plan for how to respond in the event they are targeted next.

Background

The Biden administration and lawmakers are growing increasingly concerned that U.S.-based VC firms are helping the Chinese government develop emerging and critical technologies that could be used to undermine U.S. national security by investing in Chinese companies that work in high-tech areas, such as AI, semiconductors, and quantum computing. Accordingly, the Biden administration is reportedly drafting an executive order that would create an outbound-investment screening regime. In addition, lawmakers have drafted bills that would create a similar regime by statute, but none of the bills have been passed into law.

In February 2023, Georgetown University's Center for Security and Emerging Technology (CSET) published a report analyzing outbound investments into Chinese AI companies using investment data pulled from Crunchbase. The report states that 167 U.S.-based investors participated in 401 investment transactions involving Chinese AI companies during the time period from 2015 to 2021. According to the report, the top-10 U.S. investors in Chinese AI companies during this time period were:

U.S. INVESTOR	NUMBER OF TRANSACTIONS IN CHINESE AI COMPANIES	NUMBER OF TRANSACTIONS IN ALL AI COMPANIES GLOBALLY	PERCENTAGE OF INVESTOR'S TOTAL AI INVESTMENT ACTIVITY IN CHINA (BY # OF TRANSACTIONS)
GGV Capital	43	112	38%
SOSV	38	284	13%
GSR Ventures	33	62	53%
BlueRun Ventures	20	24	83%
DCM Ventures	16	35	46%
Qualcomm Ventures	13	61	21%
Walden International	12	31	39%
Intel Capital	11	144	8%
HAX	11	84	13%
GL Ventures	11	12	92%

Source: CSET.

The data shows only that a certain VC firm participated in a particular funding round for a specific Chinese AI company, but the data does not show how much money the VC firm invested as part of the funding round. For example, although the report notes that GGV Capital participated in 43 funding rounds for Chinese AI companies, the report's authors could not determine how much money GGV Capital invested in each funding round.

Overall, the report noted that most investment in Chinese AI companies comes from Chinese investors, and that Chinese AI companies can also raise capital from other, non-U.S. sources. Based on its findings, the report expressed doubt as to whether an outbound-investment screening regime would have a "long-term crippling effect" on China's AI advancement. However, the report noted that the existing U.S. outbound investment into China, and the intangible benefits that flow from such investment, warrant further investigation.

The Letters

Last week, on July 18, 2023, the Select Committee on the Chinese Communist Party (China Select Committee or Committee) sent letters to four VC firms—GGV Capital, GSR Ventures, Qualcomm Ventures, and Walden International—requesting information relating to their investments in Chinese AI and semiconductor companies, as well as any investments they have made in China-based quantum-computing firms. It appears from the letters that the Committee pulled the names of these four VC firms directly from the CSET report published earlier this year. It is not clear why the Committee sent letters to only four of the VC firms included in CSET's top-10 list, and not the other six.

In the letters, the Committee asserts that all investments made in Chinese high-tech firms, particularly in the areas of AI, semiconductors, and quantum computing, help the Chinese government perpetrate human rights abuses and enhance China's military capabilities, regardless of whether the Chinese company that receives the investment has ever worked with the Chinese government or military. Because of China's civil-military fusion policy, the Committee takes the position that every Chinese company is the *de facto* equivalent of a Chinese state-owned entity, and that any dual-use technology developed by a Chinese company will automatically be made available to the Chinese government who will use the technology for nefarious purposes. As the Committee puts it, "China's policy of military-civil fusion . . . ensures that no technology company in China is truly a private company."

The Committee concludes each letter by demanding that each VC firm provide detailed information about its investments in China, including:

- a list of each Chinese AI, semiconductor, or quantum company in which it has made an investment;
- the dollar amount of those investments;
- all internal policies and procedures that relate to how the VC firm decides whether to invest in a company that is based in China;
- the risk factors that the VC firm considers during the due diligence process when considering whether to invest in a company that is based in China;
- the extent of Chinese state ownership in the VC firm's investments;
- whether the Chinese government or the Chinese Communist Party maintains a presence within the target company such as through a party committee; and
- how the VC firm would respond if the U.S. government placed one of its Chinese portfolio companies on a trade restriction list.

Takeaways

1. The China Select Committee is trying to fill in some of the gaps in the CSET report, including trying to determine how much U.S. capital is flowing into entities in China that are working on AI, semiconductors, and quantum computing. The requested information will likely be used to further refine plans for an outbound-investment screening mechanism for outbound investments in Chinese high-tech companies.
2. US.-based VC firms that choose to continue investing in China should be aware that the U.S. Government is increasingly taking the view that all U.S. investments in Chinese high-tech companies—particularly companies working in the areas of AI, semiconductors, and quantum computing—undermine U.S. national security.
3. U.S.-based VC firms are on notice that Congress is requesting detailed information about investments in Chinese AI, semiconductor, and quantum companies. VC firms should review the information requests carefully and develop a strategy for responding to similar requests if Congress targets their firms.

4. VC firms should not discount the possibility that the China Select Committee will transfer information it receives to the Office of Foreign Assets Control, the Bureau of Industry and Security (BIS) End-User Review Committee, or other U.S. government bodies involved in imposing trade sanctions. If your VC firm was named in the February CSET report, consider updating the risk assessment of your relevant investments. Voluntary self-disclosure programs are available to divulge issues to regulatory agencies under friendlier and more forgiving settings. Congressional investigations have occasionally led to later regulatory enforcement, including the largest standalone administrative penalty in BIS history against Seagate Technology LLC and its Singaporean affiliate this year following a 2021 Senate committee report.

5 Min Read

Authors

Tony Busch

David Houck

Tommy Leinenweber

Related Locations

Chicago | Washington, DC

Related Regions

North America

Related Professionals

Tony Busch

David Houck

Tommy Leinenweber

This entry has been created for information and planning purposes. It is not intended to be, nor should it be substituted for, legal advice, which turns on specific facts.