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Insights

REFLECTIONS ON THE FINAL CFIUS REGULATIONS: EXPANSIONS, EXEMPTIONS, AND ISSUES TO BE RESOLVED

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On January 17, 2020, the United States Treasury Department published final regulations affecting the jurisdiction and practice of the Committee on Foreign Investment in the United States ("CFIUS") and implementing the provisions of the Foreign investment Risk Review Modernization Act ("FIRRMA") at 31 C.F.R. Part 800 and 31 C.F.R. Part 802 (the "Regulations"). These Regulations will take effect on February 13, 2020.

In the Regulations, the Treasury Department has (1) revised the circumstances under which a transaction is subject to CFIUS jurisdiction, voluntary or mandatory, and provided additional examples intended to clarify that jurisdiction; (2) created some limited exemptions and exclusions from CFIUS jurisdiction for certain transactions; and (3) put off until another day addressing certain issues raised by FIRRMA but not resolved in the Regulations. While these actions provide insights into CFIUS's thinking in finalizing the Regulations, navigating these rules will continue to require a careful analysis of the relevant facts in order to conclude whether CFIUS has jurisdiction over a particular transaction. To that end, below are responses to a few of the questions we have received regarding the Regulations.

1. How has CFIUS jurisdiction changed?

Prior to the passage of FIRRMA, CFIUS had authority under Section 721 of the Defense Production Act of 1950, as amended over time, to review whether a "foreign person" taking "control" of a U.S. business raised national security concerns. Pursuant to FIRRMA, CFIUS now has three distinct areas of jurisdiction: (1) transactions through which a foreign person obtains "control" over a U.S. business (a "covered control transaction"); (2) transactions through which a foreign person does not gain control but acquires certain trigger rights over particular types of businesses (a "covered investment"); and (3) transactions through which a foreign person acquires certain rights to particular pieces of real estate. In addition, FIRRMA explicitly extends CFIUS jurisdiction to cover changes in any existing rights held by a foreign person if the change would implicate any of the above as well as any transaction or agreement designed to evade or circumvent CFIUS review. Further, while participation in the CFIUS review process historically has been voluntary, pursuant to FIRRMA, certain transactions are subject to mandatory reporting requirements.

2. When is filing mandatory?

In response to the evolving national security threat landscape, FIRRMA identified three types of U.S. businesses for which foreign investment will be subject to heightened scrutiny, namely those that: (1) produce, design, test, manufacture, fabricate or develop one or more "Critical Technologies"; (2) perform designated functions with respect to certain "Critical Infrastructure"; or (3) maintain or collect "Sensitive Personal Data" of U.S. citizens. Collectively, such businesses with sufficient involvement in **t**echnology, **i**nfrastructure, or **d**ata are referred to in FIRRMA and the Regulations as "TID U.S. businesses".

Filing a notice with CFIUS remains voluntary, except in connection with two types of transactions involving TID U.S. businesses that are subject to mandatory reporting:

- Transactions, including non-controlling investments if they include triggering rights, in a TID U.S. business that produces, designs, tests, manufactures, fabricates or develops certain critical technologies; or
- Any transaction that results in a foreign government obtaining a substantial interest in a TID U.S. business, which is defined to capture transactions in which a foreign government owns at least 49% of the voting interest in an entity that, in turn, acquires at least 25% of the equity in a TID U.S. business.

The Regulations include limited exceptions for transactions that would otherwise be subject to mandatory reporting to CFIUS, including exceptions for qualified Excepted Investors (as defined in the Regulations), transactions that involve U.S. companies that require access to classified information and are operating under agreements to mitigate foreign ownership, control, or influence, and certain investments by investment funds that are exclusively managed by a U.S. general partner or managing member.

3. Should I opt for a short form declaration?

The Regulations permit short form declarations, as opposed to full notices, to be used for both mandatory and voluntary filings, but a declaration may not be the most efficient option for some transactions. While the idea of being able to satisfy CFIUS with a short form that must be reviewed quickly may seem very appealing, it is important to note the potential limitations of a declaration. Most importantly, CFIUS may review a declaration and determine that it cannot conclude its review without submission of a full notice. As parties are not permitted to file a notice and a declaration at the same time, parties that submit a notice in response to a request from CFIUS, after completing a declaration, will find themselves starting that review timeline several weeks later than if they had filed a notice initially. Even if CFIUS does not request the parties file a formal notice, parties may find themselves thirty (30) days after submitting a declaration without the benefit of the safe harbor that results from CFIUS concluding its review with no further action. Accordingly, before deciding to submit a declaration instead of a full notice, we recommend scrutinizing the likelihood that CFIUS

will be able to conclude its review based on the declaration alone. Should a transaction be likely to raise national security concerns (in the eyes of CFIUS's staff or member agencies) or should the safe harbor be of particular importance to any of the parties, then the parties may wish to skip the declaration and file a formal notice in the first instance.

4. What can I be doing now to better position myself or my entity for a CFIUS review?

Following the issuance of the Regulations, due diligence – both self diligence and diligence of all other transaction parties – is more important than ever. While CFIUS's jurisdiction is only implicated when there is a change in rights or control, there are issues that you may consider in advance of any particular transaction that can provide information to guide future investment decisions. As an entity that may be seeking investment, determine whether you or any of your affiliated entities are a U.S. business that may be subject to CFIUS review. This analysis can be particularly important for foreign businesses with U.S. operations that may not consider those operations to constitute U.S. businesses (given existing foreign ownership or control) but that may meet the definition for CFIUS purposes. Further, if you or any entity in your corporate chain is a U.S. business, consider conducting an analysis to determine whether you would qualify as a TID U.S. business, whichmay be subject to additional scrutiny or mandatory filing requirements. Conversely, if you are a foreign person seeking investment opportunities, consider your existing ownership and control to identify any potential areas of concern that could arise in a CFIUS review, particularly any foreign government ownership. While such analyses should be updated prior to and in the light of any particular transaction, having this baseline information available will allow parties to seek investments and/or investment opportunities with a better understanding of the potential implications of CFIUS review on such a transaction.

5. What further changes should I be looking for going forward?

Despite the extensive breadth of the Regulations, there are several issues raised by FIRRMA that CFIUS has left to further rulemaking.

- Fees: Most notably, FIRRMA authorized CFIUS to impose filing fees, up to the lesser of one percent (1%) of the transaction value or $300,000, but the Regulations do not implement any such fees. Nonetheless, the Treasury Department stated that it will publish a separate proposed rule regarding fees at some point in the future.

- Emerging and foundational technologies: The Regulations define "Critical Technologies" to include items controlled by the Department of Commerce as "emerging and foundational technologies" pursuant to the Export Control Reform Act of 2018. While the Commerce Department issued an advanced notice of proposed rulemaking on the review of controls for certain emerging technologies in November 2018, it has yet to issue proposed controls for such technologies or a similar notice for foundational technologies. Further, any such rules

are expected to be subject to regular revision as, by definition, emerging technologies will change over time.

- Industries of interest: The Regulations impose mandatory filing requirements on parties to certain transactions involving a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more Critical Technologies that is either utilized in connection with the TID U.S. business's activity in one or more identified industries or is designed by the TID U.S. business specifically for use in one or more identified industries. Currently, the Regulations utilize North American Industry Classification System ("NAICS") codes to identify relevant industries, but the Treasury Department has stated that it anticipates issuing a separate rule that would use export control licensing requirements in place of NAICS codes.

- Principal place of business: In an effort to narrow the definition of "foreign person," the Regulations propose, for the first time, a definition of "principal place of business" to include within U.S. businesses those entities for which the "nerve center" of the entity is in the United States. That is, the proposed definition of "principal place of business" includes "the primary location where an entity's management directs, controls, or coordinates the entity's activities..." In the case of an investment fund, the principal place of business is "where the fund's activities and investments are primarily directed, controlled, or coordinated by or on behalf of the general partner, managing member, or equivalent." The foregoing is true unless the entity or investment fund has most recently asserted to a government that its principal place of business and/or principal office, principal executive office, or headquarters is located outside the United States and not subsequently changed to the United States. Because this definition was not included in the original proposed regulations, this provision is subject to a 30-day comment period, but it will be enacted as part of the Regulations (subject to change) on February 13, 2020.

- Excepted States: While the Regulations introduce the concept of Excepted States, from which certain individuals or entities may qualify as Excepted Investors to the mandatory filing requirements, the list of Excepted States is currently limited to only the United Kingdom, Canada, and Australia. In explaining the choice of those states, CFIUS noted that it identified these countries due to aspects of their robust intelligence sharing and defense industrial base integration mechanisms with the United States. The Regulations make clear that the continued inclusion of the United Kingdom, Canada, and Australia among the list of Excepted States, and the potential inclusion of additional countries in that list, will depend upon an on-going evaluation of those countries' bilateral cooperation, continued intelligence sharing, and integrated defense base with the United States. Notably, the concept of Excepted States does not apply to covered control transactions, and the participation by an investor in the United Kingdom, Canada, or Australia may still be subject to CFIUS jurisdiction in such a transaction.

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