

Treasury Releases Final Regulations Implementing CFIUS Reform

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Key Points

- On January 13, 2020, the U.S. Department of Treasury released final rules implementing FIRRMA, which reforms the CFIUS framework. These rules will take effect on February 13, 2020.
- The final rules expand the jurisdiction of CFIUS, implement mandatory reporting requirements for certain foreign government-affiliated transactions, maintain a modified version of the pilot program requiring mandatory filing requirements for certain investments involving critical technologies and revise and clarify a number of provisions included in the proposed rules from September 2019.
- In addition, Australia, Canada and the United Kingdom have been identified as “eligible foreign states,” and, barring removal from the list, will be treated as excepted foreign states until at least February 13, 2020. Still, investors from these states must meet certain criteria to qualify for an exclusion under the new rules. The list of eligible foreign states is not closed and may be expanded going forward.
- The Treasury also incorporated revisions to clarify the applicability of these rules to investments funds. One such change was to remove a mandatory reporting requirement that could have applied based on a foreign government holding limited partnership interests in a fund. In addition, the Treasury published an interim rule defining “principal place of business,” which is intended to clarify which entities qualify as foreign, particularly in the context of investment funds. While this interim rule will become effective on February 13, 2020, the Treasury is seeking public comment on the definition and may amend it based on the comments received.
- These final rules are the culmination of a multiyear effort to revamp the CFIUS regime to account for evolving national security risks that arise in the context of foreign investments. Investors and companies are now faced with a more complicated CFIUS framework and an interagency committee that is better resourced to administer and enforce these rules. As a result, CFIUS is on course to continue to be a key issue in variety of transactions going forward.

Background

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The Committee on Foreign Investment in the United States (CFIUS or the “Committee”) is an interagency committee that reviews foreign investments in the United States to assess national security concerns. In August 2018, President Trump signed into law CFIUS reform legislation known as the Foreign Investment Risk Review Modernization Act (FIRRMA), which required CFIUS to issue implementing regulations no later than February 2020 (see our previous [alert](#)). Shortly thereafter, in November 2018, CFIUS launched a pilot program to implement certain provisions under FIRRMA. This new pilot program expanded the scope of CFIUS reviews to certain noncontrolling investments in companies involved in “critical technology” and required mandatory declarations for investments in such businesses (see our previous [alert](#)).

On September 17, 2019, the U.S. Department of the Treasury (“Treasury”) issued two proposed rules to implement most of the remaining provisions of FIRRMA and requested public comments on the proposed rules (see our previous [alert](#)). The final rules released on January 13, 2020, amend and clarify the proposed rules in response to public comments, and will come into effect on February 13, 2020.

This alert outlines how the final rules differ from the proposed rules and highlights the key changes to the CFIUS process that will take effect on February 13, 2020, and what will remain the same.

Key Differences between the Final Rules and Proposed Rules

While the final rules included a number of changes to the proposed rules and additional clarifying examples, the following are key changes between the proposed and final rules:

- **Mandatory Reporting for Critical Technology Investments Maintained in Final Rules.** The final rules incorporate a modified version of the critical technology pilot program into the CFIUS regulations. Most importantly, a mandatory filing requirement will continue to apply to “covered investments” (i.e., noncontrolling investments affording certain rights to foreign persons) in U.S. businesses that produce, design, test, manufacture, fabricate or develop one or more critical technologies associated with certain targeted industries. The final rules, however, establish significant exemptions from mandatory filing requirements related to excepted investors, entities subject to certain foreign ownership, control or influence (FOCI) mitigation pursuant to the National Industrial Security Program regulations (32 CFR Part 2004), certain encryption technology and investment funds managed exclusively by, and ultimately controlled by, U.S. nationals. In addition, the Committee stated that it anticipates issuing a separate proposed rule that would replace the reliance on connections to targeted industries with a system based on export control licensing requirements.

The pilot program regulations (Part 801) will continue to be effective through February 12, 2020, but beginning February 13, 2020, the Part 800 regulations will govern transactions involving U.S. businesses associated with critical technologies.

- **Australia, Canada and the U.K. Exempted from Expanded Jurisdiction.** The proposed rules create exceptions to CFIUS jurisdiction for certain states (i.e., “excepted foreign states”). Where an investor meets certain criteria in relation to an excepted foreign state (discussed further below), the investor would not be subject to CFIUS’s expanded jurisdiction under FIRRMA. The proposed rules did not

identify specific countries that would qualify for such an exemption, but rather provided criteria for CFIUS to consider in making such a determination.

In the final rules, CFIUS has initially identified Australia, Canada and the U.K. as “eligible foreign states” which will be treated as excepted foreign states. The Committee noted that the list of eligible foreign states is not closed, and may be expanded in the future. Beginning February 13, 2022, foreign states will not only need to be identified as eligible to qualify under the exception, but also must be deemed to have a “robust process” for analyzing foreign investments for national security risks and to be coordinating with the United States on these issues.

- **Criteria for Entities to be Excepted Investors Loosened.** As indicated above, if an investor meets certain criteria in relation to an excepted foreign state, the investor may qualify as an “excepted investor.” Excepted investors will not be subject to the expanded jurisdiction for transactions involving U.S. businesses involved in critical technology, critical infrastructure, and sensitive personal data (“TID U.S. businesses”) and associated mandatory reporting requirements.

The final rules generally lower the threshold for investors to qualify as excepted investors as compared to the proposed rules. First, under the proposed rules, all members or observers of the entity’s board of directors were required to be either U.S. nationals or nationals of one or more excepted foreign states; the final rules only require 75 percent of both board members and observers, respectively, to satisfy this requirement. Second, the proposed rule created certain nationality requirements for foreign persons holding at least five percent interest in the excepted investor; this threshold was increased to 10 percent in the final rules. Finally, the proposed rules and the final rules both require that, for entities to be considered an excepted investor, the ownership of the entity must surpass a minimum threshold (the “minimum excepted ownership”) in regards to certain nationality criteria, such as being a U.S. person or national/entity of an excepted foreign state. In defining “minimum excepted ownership,” the proposed rules set a threshold of 90 percent of voting shares and other rights for entities whose equities are not traded in the United States or in an excepted foreign state. The final rules lower this threshold to 80 percent.

- **Definition for Principal Place of Business.** The proposed rules used, but did not define, the term “principal place of business,” which is relevant for the definition of the term “foreign entity” and the rules for excepted investors. The interim rule published along with the final rule for Section 800 defines “principal place of business” as: “the primary location where an entity’s management directs, controls, or coordinates the entity’s activities, or, in the case of an investment fund, 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.” However, if in its most recent filing to the U.S. government (or a state government or any foreign government) the entity represented that its principal place of business was outside the U.S., then this location will be deemed to be the entity’s principal place of business (unless the entity can demonstrate that its principal place of business has changed since the time of the submission or filing). This revision clarifies that, in many cases, offshore investment funds managed by U.S. persons in the United States would not qualify as foreign persons.
- **Substantial Interest Test.** The proposed rules introduced the term “substantial interest” as part of the test for mandatory filing requirements where an investor is

owned in part by a foreign government. Under the proposed rules, as applied to limited partnerships, a foreign government was considered to have a substantial interest if (1) it held 49 percent or more of the voting interest in the general partner or (2) if the government was the limited partner and held 49 percent or more of the voting interest of limited partners.

The final rules eliminate the second part of this definition. With regards to limited partnerships, the substantial interest test will only apply where a foreign government holds a 49 percent or greater interest in the general partner. Consequently, this change removes a mandatory reporting requirement that could have applied based on a foreign government holding limited partnership interests in a fund.

- **Clarifications to Sensitive Personal Data.** The proposed rules expand jurisdiction when an investment involves a U.S. business that collects or maintains “sensitive personal data.” This term was defined as either (1) “identifiable data” (i.e., traceable to specific individuals) falling under a number of defined categories and which is maintained by U.S. businesses that specific criteria and (2) genetic information as defined under Title 45 of the Code of Federal Regulations. The final rules do not significantly alter the first category, but clarify that covered genetic information is limited to the results of an individual’s genetic tests when these results are identifiable data and specifically exclude data derived from U.S. government databases routinely provided to private parties for research. The final rules also provide a number of examples to clarify what types of data would meet the criteria described in the definition for sensitive personal data.

How the CFIUS Process will Change

The following summarizes key changes to the CFIUS process that will take effect on February 13, 2020, including those that were not changed between the proposed and final rules:

- **Expanded Jurisdiction over Noncontrolling Investments in Technology, Infrastructure and Data Companies.** Prior to FIRRMA, CFIUS jurisdiction only extended to transactions where foreign persons gained control of a U.S. business. Under the new rules, CFIUS will have jurisdiction over covered investments in U.S. businesses involved in TID U.S. businesses. Covered investments include those that afford a foreign person (1) access to material nonpublic technical information; (2) membership or observer rights on, or the right to nominate an individual to a position on, the board of directors; or (3) involvement, other than through voting of shares, in substantive decision-making of the U.S. business regarding critical technology, critical infrastructure or sensitive personal information.
- **Expansion of CFIUS Jurisdiction over Real Estate Investments.** Under Part 802, the purchase, lease by or concession to a foreign person of certain U.S. real estate will become covered under CFIUS jurisdiction even when no U.S. business is involved in the transaction. These rules apply when the real estate is within certain proximity of a covered site and the transaction affords the foreign person three or more of the following property rights: physical access; exclusion of others; improvement or development; and the right to affix structures or objects. Importantly, the real estate regulations in Part 802 only apply to a transaction if the Part 800 rules governing investments in U.S. businesses are not triggered. Real estate transactions will not be subject to a mandatory filing requirement.

Covered sites are focused in and/or around specific airports and maritime ports denoted on lists published by the Department of Transportation, as well as military installations named in appendixes to the regulations. With respect to the identified military installations, CFIUS identifies specific geographic proximities covered with respect to these locations (e.g., “close proximity” within one mile of the installation and “extended range” within 100 miles of the installation).

Notably, the regulations allow for a number of exceptions to remove real estate from Part 802 jurisdiction, including exceptions to real estate in “urbanized areas” and “urban clusters,” transactions involving residential housing, lease and concession in airports and maritime ports for the purpose of retail sales, and certain transactions involving commercial space in multiunit commercial buildings.

- **Mandatory Filing Requirements.** Parties to certain transactions will be required to submit a declaration or full notice to CFIUS. Specifically, mandatory filing requirements will apply to covered transactions that result in the acquisition of a substantial interest (defined as 25 percent or more voting interest) in a TID U.S. business by a foreign person in which a foreign state (other than an excepted foreign state) has a substantial interest (defined as a 49 percent or more voting interest).

As noted above, mandatory filing will also apply to covered transactions that are a covered investment in, or that could result in foreign control of, a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies related to targeted industries.

- **Excepted Foreign States and Excepted Investors will be Recognized.** As described above, Australia, Canada and the U.K. will be considered excepted foreign states. Investors that satisfy certain nationality requirements related to Australia, Canada or the U.K. (or any future country designated as and excepted foreign states) will be recognized as excepted investors and excepted from expanded jurisdiction and associated mandatory reporting under FIRRMA.
- **Changes in Rights.** The definition of “covered transaction” will include a change in rights of a foreign person with respect to a U.S. business in which that foreign person has an investment, if such change could result in a covered control transaction or a covered investment. This change makes clear that CFIUS can have jurisdiction over business relations (e.g., joint ventures) even after the initial investment occurs if rights change.
- **Declaration Available for all Covered Transactions.** Once the final rules go into effect, parties to a transaction will have the option to submit either a declaration or full notice for all covered transactions, including both covered transactions based on control and covered investments. CFIUS must respond to a declaration within 30 days after acknowledgement of its acceptance. This option will allow parties to obtain an expedited review of a transaction, which will be particularly helpful in less complex cases.
- **Limits on Pre-Filing Timeline.** Under the final regulations, parties to a transaction may stipulate that CFIUS has jurisdiction in a pre-filing (i.e., a draft filing before initiation of a formal notice). If a party makes such a stipulation, CFIUS will be required to provide comments on, or accept the notice, no later than 10 business days after the date of the filing. This new timeline puts a limit on lengthy pre-filing phases, which have been known to extend for indefinite periods in certain cases.

What Will Not Change about CFIUS

- **CFIUS Maintains Control Jurisdiction.** The new regulations maintain the same test for control jurisdiction that existed in pre-FIRRMA regulations. Most traditional mergers and acquisitions (M&A) activity will be captured under these existing rules.
- **Most Filings Will Still be Subject to Voluntary Reporting.** Mandatory filing requirements only apply to covered transactions in certain companies involved in critical technologies and transactions where a foreign government obtains a substantial interest in a TID U.S. business. All other transactions that are subject to CFIUS jurisdiction will be subject to voluntary reporting.
- **Focus on Non-Notified Transaction.** While most reporting is voluntary, CFIUS has historically monitored non-notified transactions to determine whether they present national security concerns and should be reviewed by CFIUS. Under FIRRMA, this function has been mandated and provided with additional resources. In our experience, CFIUS has been more aggressively monitoring and inquiring into non-notified transactions after the passage of FIRRMA. This same focus will continue under the new rules.
- **No Filing Fees.** CFIUS has not implemented its FIRRMA authority to require filing fees in connection with filing a notice. However, the Committee noted its intention to publish separate proposed regulation regarding filing fees at a later date.

Conclusion

These final rules are the culmination of a multiyear effort to revamp the CFIUS regime to account for evolving national security risks that arise in the context of foreign investments. Investors and companies are now faced with a more complicated CFIUS framework and an interagency committee that is better funded to administer and enforce these rules. As a result, CFIUS is on course to continue to be a key issue in variety of transactions going forward.

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