International Trade Alert

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Treasury Proposes CFIUS Mandatory Filing Based on Export Licensing

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Key Points

- On May 21, 2020, Treasury published a Proposed Rule to align the CFIUS mandatory filing framework for transactions involving critical technologies with existing export-licensing requirements.
- Under the Proposed Rule, rather than being pegged to targeted industries associated with the U.S. business, mandatory filings will be triggered by export control requirements specific to the critical technologies and foreign persons involved in the transactions. The Proposed Rule does not change the underlying definition of critical technology.
- The Proposed Rule also makes clarifying revisions to the definition of "substantial interest" as used in the provisions requiring filings for certain transactions involving a foreign government. The Proposed Rule does not change the percentage thresholds for foreign government interest in the foreign investor and the investor's interest in the U.S. business needed to trigger mandatory filing.
- Treasury is seeking comments on the Proposed Rule. Comments are due by June 22, 2020.

Background

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. The Proposed Rule is the latest update to the U.S. Department of the Treasury's implementation of the Foreign Investment Risk Review Modernization Act (FIRRMA) enacted in August 2018 (see our previous alert). CFIUS implemented most of its expanded FIRRMA authority in February 2020 (see our previous alert).

One of FIRRMA's key changes to the CFIUS review process was to make certain covered transactions subject to mandatory filing requirements. The Proposed Rule makes an anticipated modification to the framework used for determining which transactions involving critical technology are subject to the mandatory filing requirement.

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Under the current rules, this mandatory filing requirement generally applies to covered transactions if two primary criteria are met. First, the transaction must involve a U.S. business that produces, designs, tests, manufactures, fabricates or develops one or more “critical technologies.” Pursuant to FIRRMA, critical technologies are items that are:

- Included on the United States Munitions List (USML) set forth in the International Traffic in Arms Regulations (ITAR);
- Identified on the Commerce Control List (CCL) set forth in the Export Administration Regulations (EAR) and controlled pursuant to multilateral regimes or for reasons relating to regional stability or surreptitious listening;
- Subject to certain nuclear controls set forth in 10 C.F.R. Part 110 and 10 C.F.R. Part 810;
- Select agents and toxins covered by 7 C.F.R. Part 331, 9 C.F.R. Part 121 and 42 C.F.R. Part 73; and
- Emerging and foundational technologies identified pursuant to Section 1758 of the Export Control Reform Act of 2018 (to date, no such technologies have been identified).

Second, under the current rules, the U.S. business must either (i) utilize such technology in connection with its activities in a targeted industry or (ii) specifically designs such technology for use in a targeted industry. The targeted industries are currently identified in Appendix B to 31 C.F.R. Part 800 and are categorized using North American Industry Classification System (NAICS) codes. The specific industries targeted are understood to be focused on those identified in China’s Made in 2025 Plan.

Change to Mandatory Filing Critical Technology Framework

The Proposed Rule removes the mandatory filing criteria based on the targeted industries and NAICS codes and replaces it with a trigger based on export-licensing requirements. Under the Proposed Rule, mandatory filing would apply when the critical technologies that the U.S. business produces, designs, tests, manufactures, fabricates or develops would require a U.S. regulatory authorization to export, re-export, transfer (in-country) or retransfer to the foreign persons involved in the transaction. A foreign person would trigger this licensing analysis in a transaction if it:

- Could directly control the U.S. business as a result of the transaction;
- Is directly acquiring (a) access to material nonpublic technical information of the U.S. business; (b) membership or observer rights on, or the right to nominate an individual to a position on, the board of directors of the U.S. business; or (c) any 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;
- Has a direct investment in the U.S. business, the rights of such foreign person with respect to the U.S. business are changing and such change in rights could result in a covered transaction;
- Is a party to any transaction, transfer, agreement or arrangement designed to evade CFIUS jurisdiction with regard to the U.S. business; or

- Individually holds, or is part of a group of foreign persons that, in the aggregate, holds, a “voting interest for purposes of critical technology mandatory declarations” in a foreign person described in the preceding bullets.1

For purposes of identifying the foreign persons covered by the final category, the Proposed Rule defines “voting interest for purposes of critical technology mandatory declarations” to mean a direct or indirect voting interest of 25 percent or more in the foreign person described in one of the preceding categories. The Proposed Rule specifies that in the case of transactions involving investment funds, i.e., “entities whose activities are primarily directed, controlled, or coordinated by or on behalf of a general partner, managing member, or equivalent,” this term refers to 25 percent or more of the interest in the entity’s general partner, managing member or equivalent. Additionally, for purposes of determining the percentage of voting interest held indirectly by one person in another, the Proposed Rule specifies that any interest of a parent will be deemed to be a 100 percent interest in any entity of which it is a parent.

As a general rule, applicable license exemptions or exceptions would not extinguish the mandatory reporting requirement. However, the Proposed Rule states that a mandatory filing **would not** be required for covered transactions where the following license exceptions under the EAR apply:

- **Technology and Software—Unrestricted (TSU)**, which authorizes certain exports and reexports of operation technology and software; sales technology and software; software updates (bug fixes); and “mass market” software. 15 C.F.R. 740.13.
- **Subsection (b) of License Exception Encryption Commodities, Software and Technology (ENC)**, which authorizes certain exports, reexports and transfers of certain encryption commodities, software and components. 15 C.F.R. 740.17(b).
- **Subsection (c)(1) of License Exception Strategic Trade Authorization (STA)**, which authorizes certain exports, reexports and transfers of items controlled for national security (NS), chemical or biological weapons (CB), nuclear nonproliferation (NP), regional stability (RS), crime control (CC) and/or significant items (SI) to certain countries. 15 C.F.R. 740.20(c)(1).

In addition, under the nuclear export controls, certain general licenses (i.e., 10 CFR 810.6(a) general authorization and any general license under 10 C.F.R. Part 110) would not trigger mandatory filing under the Proposed Rule.

Other Changes

The Proposed Rule does not change the structure of the mandatory filing requirement for covered transactions where a foreign government has at least a 49 percent interest (i.e., a “substantial interest”) in the foreign person that is acquiring at least a 25 percent interest (i.e., a “substantial interest”) in a TID U.S. business.2 However, it does make two clarifying changes to the definition of “substantial interest.” First, in Section 800.244(b), the Proposed Rule replaces “an entity with a general partner, managing member, or equivalent” with “an entity whose activities are primarily directed, controlled, or coordinated by or on behalf of a general partner, managing member, or equivalent” presumably to better reflect the structure of investment funds. Second, the Proposed Rule removes the word “voting” before “interest” wherever it appears in Section 800.244(c) to clarify that the calculation rule of paragraph (c) applies to both the calculation of “voting interests” as described in paragraph (a) and “interests” as described in paragraph (b). This change is to make it clear that for the purposes of

determining the percentage interest held indirectly by one entity in another under either paragraph, any interest of a parent will be deemed to be a 100 percent interest in any entity of which it is a parent.

Conclusion

By removing the industry criteria and replacing it with an export licensing analysis, the Proposed Rule both narrows and expands the scope of transactions subject to mandatory filing requirements. Under the current framework, certain transactions involving critical technology and countries of concerns previously did not trigger mandatory reporting when the industry nexus was lacking. On the other hand, other transactions involving investors from closely allied countries triggered a mandatory filing even though such technology transfers may not raise significant national security concerns. By leveraging the foundations of the existing export licensing regimes, CFIUS appears to be aiming to be better focus on transactions that present technology transfer concerns.

With that in mind, we recommend that stakeholders closely review the Proposed Rule and consider whether it could be better refined. One area of focus for comments is likely to be the rules regarding which foreign persons in a transaction would trigger the reporting requirement that are identified in Section 800.401(c)(1)(i-v). The deadline for submitting comments is June 22.

1 We note that, as drafted, § 800.401(c)(1)(v) does not clearly apply to foreign persons within the ownership chain of the foreign investor who are not also parties to the transaction. Section 800.401(c)(1)(v) refers to "a foreign person **that is a party to** the covered transaction **and such foreign person** . . . .[i]ndividually holds, or is part of a group of foreign persons that, in the aggregate, holds, a voting interest for purposes of critical technology mandatory declarations in a foreign person described in [the preceding subsections]." Treasury's explanation of how Section 800.401(c)(1)(v) is intended to apply makes it likely that Treasury intended to capture foreign persons within the foreign investor's ownership chain who are **not** party to the transaction.

2 "TID" stands for "technology, infrastructure, and data." Under the CFIUS regulations, "TID U.S. Business" is defined as "any U.S. business that: (a) Produces, designs, tests, manufactures, fabricates, or develops one or more critical **technologies**; (b) Performs the functions as set forth in column 2 of appendix A to this part with respect to covered investment critical **infrastructure**; or (c) Maintains or collects, directly or indirectly, sensitive personal **data** of U.S. citizens."

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