

8 Takeaways From CFIUS' Proposed Risk Review Rules

By **Christian Davis and Thor Petersen** (September 20, 2019, 4:59 PM EDT)

On Sept. 17, the Committee on Foreign Investment in the United States released long-anticipated draft regulations to implement the Foreign Investment Risk Review Modernization Act of 2018.

Signed into law on Aug. 13, 2018, FIRRMA was billed as an effort to modernize the CFIUS review process to ensure that it was capturing a broad range of transactions viewed as potentially harmful to U.S. national security. CFIUS implemented a critical technology pilot program to test its expanded jurisdiction under FIRRMA in November 2018.

In drafting the proposed regulations, CFIUS appears to have focused on specific national security concerns, as opposed to taking a broader approach that some feared. As a result, however, the proposed regulations are significantly more complex than the pre-FIRRMA regime.

The draft regulations are open for comment until Oct. 17, and final regulations must be effective by February.

With that context, here are eight takeaways from the draft regulations:

1. A diverse (yet targeted) array of infrastructure investments will be subject to CFIUS review.

The draft regulations expand CFIUS jurisdiction to include certain covered investments in a new category of businesses, technology, infrastructure and data, or TID, U.S. businesses.

Covered investments are those that afford the foreign person access to material nonpublic technical information, membership or observer rights on the board of directors of the U.S. business or any involvement in substantive decision making of the U.S. business related to critical technologies, critical infrastructure or sensitive personal data.

TID U.S. businesses include those that perform specific functions — e.g., owning, operating, servicing, supplying — related to particular types of critical infrastructure, as identified in an appendix to the regulations. The types of infrastructure covered are diverse, spanning the energy, telecommunications,



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finance, utilities, manufacturing and transportation sectors.

At the same time, the set of businesses captured is targeted in terms of the specific infrastructure identified in these sectors — e.g., focusing on major assets or ties to military applications in many cases — and the specific functions that the business must perform related to the specific infrastructure to trigger jurisdiction.

2. New rules define sensitive personal data with more certainty and, as a result, capture investments involving a variety of companies.

TID U.S. businesses also include those that maintain or collect sensitive personal data of U.S. citizens. This includes genetic data, as well as certain "identifiable data" — i.e., data that can be used to distinguish/trace an individual's identity — that satisfies a two-tier test.

First, the identifiable data must be maintained or collected by a U.S. business that (1) targets or tailors products or services to sensitive U.S. government personnel or contractors, or (2) maintains or collects such data on greater than one million individuals (or has demonstrated a business objective to do so).

Second, the data must fall within one of the specifically enumerated categories in the draft regulations. These are wide-ranging, including certain financial data, health-related data, email communications, geolocation data, biometric data and data used for government ID cards or personnel security clearances.

This proposed approach establishes a much greater degree of certainty in terms of what constitutes sensitive personal data. Still, these rules will apply to a variety of companies, including those in the insurance, technology, healthcare, financial and government contracting sectors, among others.

3. Mandatory reporting will apply for certain foreign government investments in TID U.S. businesses.

The proposed regulations add a new category of mandatory filing requirements. Under these provisions, mandatory filings apply to transactions in which a foreign government holds a substantial interest (defined as a 49% or greater voting interest) in a foreign person who obtains a substantial interest (defined as a 25% or greater voting interest) in a TID U.S. business.

In the case of a limited partnership, a foreign government is considered to have a substantial interest in the partnership if it either (1) holds 49% or more of the voting interest in the general partner, or (2) is a limited partner and holds 49% or more of the voting interest of the limited partners.

The established thresholds are more permissive than what FIRRMA would have allowed, which set a floor at 10% for this threshold. As a result, the proposed expansion of mandatory reporting only applies to transactions involving TID U.S. businesses that were likely to constitute controlling investments (e.g., 25% voting interest or greater in the target) under the existing CFIUS regime.

Also, unlike the pilot program, which requires mandatory filings be submitted 45 days prior to completing the transaction, the draft regulations require mandatory filings be submitted 30 days prior to completing the transaction. Penalties for failing to file a mandatory transaction include a civil penalty of up to \$250,000 per violation or the value of the transaction, whichever is greater.

4. Covered real estate transactions are identified with specificity and capture many new transactions.

The draft regulations include a separate Part 802 to the CFIUS regulations to implement the real estate provisions of FIRRMA. These provisions expand CFIUS jurisdiction to capture the purchase, lease or concession of U.S. real estate to a foreign person that is located within, or will function as part of, an air or maritime port or is in close proximity to a U.S. military or other sensitive U.S. government location. The ports covered are generally major and those associated with a military or strategic use.

The proposed rules identify specific military installations in an appendix and expand CFIUS jurisdiction to certain covered real estate transactions that are within defined proximities of those installations, subject to certain exceptions.

Such transactions include any purchase, lease or concession of covered real estate that affords the foreign person at least three out of four enumerated property rights — the rights to physically access the real estate, exclude others from physical access to the real estate, improve or develop the real estate, or attach fixed or immovable structures or objects to the real estate.

As with the other expanded jurisdiction, CFIUS opted for specificity and transparency over generality and obscurity in establishing the scope of the real estate provisions. Nevertheless, these regulations have the potential to capture certain “greenfield” investments in the United States and other real estate transactions that previously were not subject to CFIUS review.

5. Certain investors can be excluded (but there is no blacklist).

The regulations provide a process through which CFIUS can designate countries as “excepted foreign states,” although no countries have yet to be designated. Certain investors associated with excepted foreign states would be exempt from the expanded jurisdiction over covered investments in TID U.S. businesses.

Specifically, “excepted foreign investors” would include foreign nationals of an excepted state, the government of an excepted state and foreign entities that meet a number of stringent requirements, including relating to board and investor nationality and ultimate beneficial ownership thresholds. Even if they would otherwise qualify, investors that have violated certain U.S. laws — e.g., export controls and sanctions — or are otherwise restricted will fall out of the exclusion.

It remains to be seen how broadly CFIUS extends the list of excepted countries. The regulations do not provide the full list of factors to be considered eligible, though one factor that will be considered is whether the country has a robust system to screen foreign investment for national security concerns and to cooperate with the U.S. government in this regard.

This whitelist approach is notable because many speculated as to whether CFIUS would adopt such an approach, opt for a blacklist targeting only specific countries or investors or continue its tradition of treating all investors equally from a regulatory perspective. Along those lines, the proposed regulations do not include specific provisions targeting China, which had been a subject of speculation given that Chinese investment was the major policy driver behind FIRRMA.

6. Declarations will be available for all transactions.

Consistent with FIRRMA, the proposed rules establish that short-form declarations will be available for

all transactions. The proposed rules provide details regarding the required content of declarations, which are intended to be no longer than five pages. CFIUS has 30 days to review and take action on a declaration, which could result in clearance, a request for a written notice, the initiation of a review or acknowledgment of receipt without clearance — i.e., if the parties wanted clearance, they would need to submit a full notice.

As it currently stands, declarations have only been available for pilot program transactions, which, by design, tend to be sensitive transactions. Consequently, CFIUS reportedly has cleared very few transactions through the declaration process in the pilot program, which has resulted in many parties bypassing the declaration and proceeding to a full written notice and review.

Given that many covered transactions outside of the pilot program present fewer national security concerns, the declaration process could become a more popular mechanism for notifying CFIUS of these transactions without subjecting the parties to a prolonged review. At the very least, it presents another option for parties to consider in determining how to address CFIUS risk in a transaction.

7. The existing CFIUS regime largely remains intact.

The regulations are also notable for what they don't change. First, CFIUS maintains jurisdiction over transactions that would result in foreign control of a U.S. business. The voluntary review regime is also largely intact with only a few adjustments to the timing and process.

Additionally, the CFIUS pilot program remains in effect, meaning mandatory filing requirements still apply under those rules. The proposed rulemaking explains that CFIUS is still considering whether to include in the final regulations mandatory filing requirements for investments in critical technology companies.

8. The public has until Oct. 17 to comment.

Comments on the proposed rules are due on Oct. 17. Given the complexity and breadth of the proposed rules, this is a very short time frame. U.S. and non-U.S. businesses should review these proposed rules carefully to determine how they may affect investment activities and act quickly to comment, as appropriate.

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