

What's Changed And What's The Same In Final CFIUS Rules

By **Christian Davis, Thor Petersen, Michael Adame and Cameron Peek**

On Jan. 13 the U.S. Department of the Treasury released final rules implementing the Foreign Investment Risk Review Modernization Act, which reforms the Committee on Foreign Investment in the United States framework. These rules will take effect on Feb. 13.

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.

Background

CFIUS is an interagency committee that reviews foreign investments in the United States to assess national security concerns. In August 2018, President Donald Trump signed FIRRMA into law, which required CFIUS to issue implementing regulations no later than February 2020.

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 so-called critical technology and required mandatory declarations for investments in such businesses.

On Sept. 17, 2019, Treasury issued two proposed rules to implement most of the remaining provisions of FIRRMA and requested public comments on the proposed rules.[1] The final rules released on Jan. 13 amend and clarify the proposed rules in response to public comments, and will come into effect on Feb. 13.

Key Differences Between the Final Rules and Proposed Rules

While the final rules include a number of revisions 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



Christian Davis



Thor Petersen



Michael Adame



Cameron Peek

requirements related to excepted investors, entities subject to certain foreign ownership, control or influence mitigation, pursuant to the National Industrial Security Program regulations,[2] certain encryption technology and investment funds managed exclusively by, and ultimately controlled by, U.S. nationals.

In addition, CFIUS 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 Feb. 12, but beginning Feb. 13, 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 — so-called 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' 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 United Kingdom 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 Feb. 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% 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 a 5% interest in the excepted investor. This threshold was increased to 10% in the final rules.

Finally, the proposed rules and the final rules both require that, for an entity 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% 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%.

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 United States, 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 entities.

Substantial Interest Test

The proposed rules established 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% or more of the voting interest in the general partner or (2) if the government was the limited partner and held 49% 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% 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. The term sensitive personal data 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 satisfy 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 include 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 Feb. 13, 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 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 on specific airports and maritime ports denoted on lists published by the U.S. Department of Transportation, as well as military installations named in appendices 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 multi-unit 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% 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% 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 exempted 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 Prefiling 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 pre-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 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 involving certain companies associated with 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 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.

Christian C. Davis is a partner, and Thor Petersen, Michael James Adame and Cameron Peek are associates at Akin Gump Strauss Hauer & Feld LLP.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] See, 8 Takeaways From CFIUS' Proposed Risk Review Rules, Christian Davis and Thor Petersen, Law360 (Sept. 20, 2019).

[2] 32 CFR Part 2004.