

CFIUS Pilot Program Expands Jurisdiction and Imposes Mandatory Reporting on Certain Industries

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Key Points

- On October 10, 2018, CFIUS announced a pilot program that implements significant provisions of FIRRMA. The program becomes effective November 10, 2018.
- Under the program, CFIUS jurisdiction will be expanded to cover certain noncontrolling investments in U.S. businesses that produce, design, test, manufacture, fabricate or develop a “critical technology” (i.e., most export-controlled technology) associated with any of 27 industry sectors (Pilot Program U.S. Businesses).
- Parties must make a CFIUS filing, either in short or long form, when a controlling or noncontrolling investment in a Pilot Program U.S. Business is subject to CFIUS jurisdiction. CFIUS may impose substantial civil penalties, up to the value of the transaction, for failing to make such a filing in advance of closing (45 days prior, in most cases).
- This program imposes significant new compliance requirements on non-U.S. investors and U.S. companies. Consequently, we recommend that investors and U.S. companies take action to assess the implication of this program on their business, including conducting an export control and jurisdictional analysis, and to implement appropriate measures to address these requirements.

Background

The Committee on Foreign Investment in the United States (CFIUS) is an interagency committee that conducts national security reviews of investments that could result in a foreign person’s gaining the ability to control a U.S. business—a “covered transaction.” CFIUS has the authority to initiate reviews of transactions, impose mitigation measures to address national security concerns, suspend transactions, and recommend that the President block pending transactions or order divestitures of completed transactions. To mitigate against such risks, parties may file a voluntary notice with CFIUS seeking clearance (“safe harbor”) with respect to a notified transaction.

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On August 13, 2018, President Trump signed the Foreign Investment Risk Review Modernization Act (FIRRMA), a bipartisan bill that reforms the CFIUS process to address perceived gaps in the existing CFIUS review process. While the bill sponsors were primarily concerned about issues surrounding technology transfers to China, the new law has broader implications for foreign investment, as we discussed in our [previous alert](#) in August 2018, and for the energy sector, as we discussed in our [previous alert](#) in September 2018.

Under FIRRMA, CFIUS is authorized to conduct pilot programs to implement FIRRMA provisions that did not become effective immediately upon enactment. On October 10, CFIUS issued temporary regulations that expand the scope of CFIUS review to include certain noncontrolling investments relating to critical technology and that requires mandatory declarations for such investments. This alert gives an overview of this program.

Overview of the Pilot Program

1. Expanded Scope to Cover Certain Noncontrolling Investments in U.S. Businesses Involved in Critical Technology and Associated with Certain Sectors

The pilot program implements FIRRMA provisions that expand the scope of CFIUS review to cover certain noncontrolling investments by any foreign person in certain U.S. businesses involved with critical technologies (i.e., export-controlled technology).

The pilot program specifically focuses on any U.S. business that produces, designs, tests, manufactures, fabricates or develops a critical technology that is: (i) utilized in connection with the U.S. business's activity in one or more of the following specified industries, or (ii) designed by the U.S. business specifically for use in one or more of the following specified industries (collectively, "Pilot Program U.S. Business"):

- Aircraft Manufacturing
NAICS Code: 336411
- Aircraft Engine and Engine Parts Manufacturing
NAICS Code: 336412
- Alumina Refining and Primary Aluminum Production
NAICS Code: 331313
- Ball and Roller Bearing Manufacturing
NAICS Code: 332991
- Computer Storage Device Manufacturing
NAICS Code: 334112
- Electronic Computer Manufacturing
NAICS Code: 334111
- Guided Missile and Space Vehicle Manufacturing
NAICS Code: 336414
- Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing
NAICS Code: 336415
- Military Armored Vehicle, Tank, and Tank Component Manufacturing
NAICS Code: 336992

- Nuclear Electric Power Generation
NAICS Code: 221113
- Optical Instrument and Lens Manufacturing
NAICS Code: 333314
- Other Basic Inorganic Chemical Manufacturing
NAICS Code: 325180
- Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing
NAICS Code: 336419
- Petrochemical Manufacturing
NAICS Code: 325110
- Powder Metallurgy Part Manufacturing
NAICS Code: 332117
- Power, Distribution, and Specialty Transformer Manufacturing
NAICS Code: 335311
- Primary Battery Manufacturing
NAICS Code: 335912
- Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing
NAICS Code: 334220
- Research and Development in Nanotechnology
NAICS Code: 541713
- Research and Development in Biotechnology (except Nanobiotechnology)
NAICS Code: 541714
- Secondary Smelting and Alloying of Aluminum
NAICS Code: 331314
- Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing
NAICS Code: 334511
- Semiconductor and Related Device Manufacturing
NAICS Code: 334413
- Semiconductor Machinery Manufacturing
NAICS Code: 333242
- Storage Battery Manufacturing
NAICS Code: 335911
- Telephone Apparatus Manufacturing
NAICS Code: 334210
- Turbine and Turbine Generator Set Units Manufacturing
NAICS Code: 333611

The pilot program applies to noncontrolling investments (known as “other investments”) in a Pilot Program U.S. Business that afford a foreign person:

- access to any “material nonpublic technical information” in the possession of the target U.S. business;
- membership or observer rights on the board of directors or equivalent governing body of the U.S. business, or the right to nominate an individual to a position on the board of directors or equivalent governing body of the U.S. business; or
- any involvement, other than through voting of shares, in substantive decision-making of the U.S. business regarding the use, development, acquisition or release of critical technology.

The interim rule governing the pilot program defines “material nonpublic technical information” as “information that is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods.” Material nonpublic technical information does not include financial information related to the performance of an entity.

Notably, the pilot program applies to **all foreign persons** and is not country-specific. CFIUS explains in the interim rule that the pilot program did not exempt any countries from this requirement because the pilot program is intended to be a comprehensive examination of the nature of foreign direct investment as it relates to critical technologies and the aforementioned pilot program industries. Furthermore, CFIUS noted that foreign investors are “becoming increasingly sophisticated in structuring investments in a manner that may obfuscate those concerns, including by utilizing entities in other jurisdictions.”

2. Mandatory Disclosures under the Pilot Program

The pilot program establishes a **mandatory declarations requirement** for transactions that (i) could result in control of a Pilot Program U.S. Business by a foreign person or (ii) involve a noncontrolling investment in a Pilot Program U.S. Business. The parties to such transactions may either submit a written notice that triggers a full CFIUS review or a “declaration” (i.e., abbreviated notices that generally should not exceed five pages in length). If parties file a declaration, CFIUS will have 30 days to either clear the transaction, request a written notice, initiate a CFIUS review or inform the parties that CFIUS did not have enough time to complete its review and that the parties may submit a written notice.

3. Timing and Penalties

The pilot program is effective November 10, 2018 and is set to end no later than the implementation of the FIRRMA regulations, which must occur by February 2020. If a transaction is completed prior to the effective date, the mandatory reporting requirement does not apply. In addition, the requirement does not apply to transactions in which, prior to October 11, 2018: (i) parties have executed a binding written agreement or other document establishing material terms of the transaction, (ii) a party has made a public offer to shareholders to buy shares or (iii) a shareholder has solicited proxies in connection with a board election or has requested the conversion of convertible voting securities.

For transactions that are subject to the reporting requirement, and that are set to close prior to December 25, 2018, the parties must file by November 10 or “promptly thereafter.” In all other transactions subject to the requirement, the parties must file 45 days before the completion of the transaction.

Parties can be assessed a civil monetary penalty up to the value of the transaction for failing to meet this filing requirement.

Conclusion

The pilot program will impose mandatory CFIUS reporting requirements on parties to a transaction for the first time. These requirements will apply to a broad array of investments that previously had either not been subject to CFIUS review because they were noncontrolling investments or were controlling investments in which the parties apparently had decided that national security concerns did not warrant a filing.

Consequently, this program will likely result in a significant increase in CFIUS filings, which, at the very least, will have an impact on deal timelines.

In addition, parties now will have compliance risk associated with failing to meet the mandatory reporting requirement. To address this risk, parties will need to take action to identify whether the pilot program applies to the relevant U.S. business, which likely will require a detailed export control and jurisdictional analysis. Along those lines, the threshold term “critical technology” will cover a broad range of items and consequently capture many U.S. companies, particularly due to the breadth of industries identified in the pilot program. Assuming that a U.S. company is or could be captured, parties will then need to determine how to address the requirement in the context of a specific transaction and also consider what steps will be effective in identifying this risk on an ongoing basis.