

Final Regulations Expanding CFIUS Jurisdiction Over Investments by Foreign Persons

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On January 13, 2020, the U.S. Treasury Department issued final regulations (the Regulations) expanding the scope of foreign investments subject to review by the Committee on Foreign Investment in the United States (CFIUS) under the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). The Regulations are already in effect and are consistent with the proposed regulations issued in September 2019. Key takeaways from the Regulations include:

1. **Non-Controlling Investments.** The Regulations expand CFIUS's jurisdiction to include the review of some transactions involving a "non-controlling" investment by foreign persons in certain U.S. businesses that: (a) produce, design, test, manufacture, fabricate or develop critical technologies utilized in connection with one or more select industries; (b) own, operate, manufacture, supply or service critical infrastructure; or (c) maintain or collect sensitive personal data of U.S. citizens that could be exploited to threaten national security. Businesses that fall into one of these three categories are defined as "Technology, Infrastructure and Data (TID) U.S. businesses" (TID) in the Regulations. Historically, CFIUS had only reviewed transactions giving a foreign investor control of the target U.S. business.
2. **Covered Non-Controlling Investments.** Non-controlling investments by foreign persons in TID's are covered investments, subject to CFIUS review, to the extent that the investment transaction gives a foreign person: (a) access to material, nonpublic technical information in possession of the U.S. business; (b) membership, observer rights 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 (c) any involvement, other than through voting of shares, in substantive decision-making of the U.S. business regarding (i) the use, development, acquisition, safekeeping or release of sensitive personal data of U.S. citizens maintained or collected by the U.S. business, (ii) the use, development, acquisition or release of critical technologies, or (iii) the management, operation, manufacture or supply of critical infrastructure.
3. **Definition of Critical Technologies.** "Critical technologies," a term important in determining whether a non-controlling investment is subject to CFIUS review, is defined to include products that fall into several categories, including "emerging and foundational technologies controlled pursuant to section 1758 of the Export Control Act of 2018." However, the U.S. Department of Commerce has yet to define "emerging and foundational technologies." Not every U.S. businesses involved with critical technology is a TID. For example, a U.S. business would not be considered a TID if its involvement with a critical technology were limited to the use in its own product of a component considered critical technology and designed by a third party where the U.S. business is only verifying the fit and form of the component. Additionally, U.S. businesses previously subject to CFIUS review under the proposed regulations because of their involvement with products subject to certain encryption controls under the Export Administration Regulations, would not be considered TID's if they are eligible for the License Exception ENC.
4. **Industries Covered.** The Regulations indicate that the Treasury Department will issue a separate rule in the near future to change the method used to determine which select industries are covered by CFIUS review. The included industries will generally be based on export control licensing requirements, but will be further fleshed out in the forthcoming rule.
5. **Excepted Foreign States.** The Regulations designate Australia, Canada and the United Kingdom as "excepted foreign states." Transactions involving nationals, entities and governments of these three countries will not need to file declarations with CFIUS for non-controlling investments. These three states will retain their excepted status for two years, at the conclusion of which the Treasury Department will review their status. Other states may be added to the list of "excepted foreign investors" in the future and

these determinations will be made based on criteria listed on the Treasury Department website.

6. **Excepted Investors.** Transactions involving "excepted investors" do not require CFIUS filings for non-controlling investments if:

- at least 75% of the excepted investor's board observers or board members are from an excepted foreign state or the U.S.
- no more than 10% of the ownership interests in the U.S. business are held by a foreign person; or
- at least 80% of the ownership interests in the U.S. business are held by a U.S. person or person from an excepted foreign state.

The Regulations also identify criteria that would preclude a foreign person from qualifying as an excepted investor, such as non-compliance with the law.

7. **Exempted Investment Funds.** The Regulations exclude from CFIUS's jurisdiction certain non-controlling indirect investments in TID's through investment funds where: (1) the fund is managed exclusively by a general partner or equivalent that is not a foreign person; (2) if there is an advisory board or committee, the foreign person does not have the ability to control investment decisions of the fund through the advisory board or committee; (3) the foreign person does not otherwise have the ability to control the investment fund; and (4) the foreign person does not have any of the triggering rights discussed in Item 2 above (e.g., board or observer rights).
8. **FOCI.** The Regulations exempt from the CFIUS notification certain investments through an entity that is already subject to a security control agreement, special security agreement, voting trust agreement or proxy agreement to offset foreign ownership, control or influence pursuant to the National Industrial Security Program. Entities that already have such security controls in place are called FOCI. However, CFIUS review may still be required for FOCI where a foreign government has a substantial interest in the FOCI following investment.
9. **"Principal Place of Business" Defined.** The Regulations define "principal place of business" generally to mean "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, the regulations note, in determining the "principal place of business," that if a business had previously represented that it had a foreign address in its most recent filing or submission to the U.S. government, a U.S. subnational government, or a foreign government (outside filings to CFIUS), then CFIUS will apply the location given in such filing or submission. Accordingly, companies that principally work in the U.S., but have filed documents with a government entity noting a foreign business address fall into the foreign entity category.
10. **"Substantial Interest" Defined.** With certain exceptions, a CFIUS filing will be required for transactions where a foreign person, in which a foreign government has a "substantial interest," will itself acquire a "substantial interest" in a TID. A foreign government has a substantial interest in the foreign investor if the foreign government has a 49% or greater direct or indirect voting interest in the foreign investor. A foreign investor has a substantial interest in a TID if the investment gives the foreign investor a 25% or greater direct or indirect voting interest in the TID. The Regulations make clear that limited partnership interests held by a foreign government generally do not count toward the substantial interest test.
11. **Contingent Equity Interest and Timing.** The Treasury Department clarified that the acquisition of a contingent equity interest, without the acquisition of control or the access, rights, or involvement described in the Regulations is not a covered transaction. CFIUS review is not triggered until a foreign investor converts a contingent equity interest into actual control or the access, rights, or involvement described in the Regulations.

Additional Notes

A few additional items to note concerning the CFIUS regulations that are now in effect:

- Parties that fail to make a mandatory CFIUS filing are at risk of owing civil monetary penalties in an amount up to \$250,000 or the value of the transaction, whichever is greater.
- No filing fees have yet been put in place for CFIUS filings, but the Treasury Department is expected to issue a new rule in the near future listing filing fees.
- CFIUS also issued separate regulations for its authority to review real estate transactions. These comprehensive regulations concerning real estate transactions are not discussed in this client alert.

The White and Williams International Group advises U.S. companies in structuring transactions with foreign investors, counsels U.S. and foreign-based clients in filing declarations with CFIUS and assists them through the process. For further information please contact David Creagan (creagand@whiteandwilliams.com; 215.864.7032), Gwenn Barney (barneyg@whiteandwilliams.com; 215.864.7063), Jamie Wang (wangyi@whiteandwilliams.com; 646.766.1350) or Gary Biehn, Chair of the International Practice Group (biehng@whiteandwilliams.com; 215.864.7007).

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