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CFIUS Update: Treasury Department Issues Interim Rules, Expands Jurisdiction to Certain Non-Controlling Investments, and Establishes Mandatory Filing Requirements

October 11, 2018

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Summary

On October 10, the U.S. Department of the Treasury, as chair of the Committee on Foreign Investment in the United States ("CFIUS"), issued interim rules (the "Interim Rules") that update the CFIUS regulations to address certain definitional and procedural aspects of the Foreign Investment Risk Review Modernization Act ("FIRRMA") and, for the first time, (i) expand the Committee's jurisdiction to cover certain non-controlling investments in U.S. businesses involved with critical technologies and (ii) mandate filings for such transactions. Our prior alerts on the passage of FIRRMA, which was enacted in August, are here and here.

The Interim Rules mark a fundamental transformation of the legal framework for national security regulation of foreign investment in the United States. Until today, the CFIUS process was predicated on a voluntary filing structure that incentivized transaction parties to file with CFIUS if there was reason to believe the transaction could convey control of the U.S. business to the foreign investor and could implicate U.S. national security considerations, while reserving authority for the government to initiate reviews on its own authority. This framework relied on transaction parties and their counsel to make judgments about whether a transaction merited a filing with CFIUS, and the relative costs and benefits of filing versus not filing. Through the Interim Rules, CFIUS has taken that decision away from the parties for certain categories of transactions involving critical technologies in certain industry sectors, instead mandating short-form filings for transactions covered by the new rules, and allowing CFIUS to determine whether the transaction merits a full notice and review by the Committee (although the parties can still voluntarily file a full notice with the Committee at the outset, if they so choose). According to the Interim Rules, CFIUS believes this change is necessary in order to "assess and address ongoing risks to the national security of the United States resulting from two urgent and compelling circumstances: (1) the ability and willingness of some foreign parties to obtain equity interests in U.S. businesses in order to affect certain decisions regarding, or to obtain information relating to, critical technologies; and (2) the rapid pace of technological change in certain U.S. industries."

Most significantly, the Interim Rules establish a "Pilot Program" — essentially a form of temporary regulations — that will:

> (1) expand the scope of CFIUS jurisdiction to review a broader range of foreign investments — including very small minority investments coupled with additional rights — in certain U.S. businesses that involve "critical technology"; and
>
> (2) require the submission of short-form filings (i.e., "declarations") or full CFIUS notices for those transactions.

Parties that fail to comply with the mandatory filing requirements may be liable for a civil penalty up to the value of the transaction. The Pilot Program will remain in effect until the promulgation of final regulations implementing FIRRMA, which will occur no later than March 5, 2020. The Interim Rules also make certain changes to the existing CFIUS regulations to conform to FIRRMA.

Importantly, the Pilot Program is limited to U.S. businesses involved in "critical technologies" related to certain enumerated industries. According to the Interim Rules, this list reportedly comprises industries for which "certain strategically motivated foreign investment could pose a threat to U.S. technological superiority and national security." The Pilot Program does not apply to certain other categories of U.S. businesses that FIRRMA also identified for heightened scrutiny: (1) businesses that own, operate, manufacture, supply or service critical infrastructure, and (2) businesses that maintain or collect sensitive personal data of United States citizens that may be exploited in a manner that threatens national security. Those categories of U.S. businesses may, however, be the subject of future Pilot Programs that CFIUS implements pursuant to its authority under FIRRMA.

The Treasury Department will be accepting public comments from interested parties on the Interim Rules; however, Treasury also states that it will consider and address any such comments in the process of promulgating any final rule, suggesting that they will not have any impact on the Interim Rules.

Questions and Answers Regarding the Interim Rules and Pilot Program

With the foregoing as background, we answer some of the key questions that transaction parties may have regarding the Interim Rules and the Pilot Program.

1. What foreign investors are implicated by the Pilot Program?

The Pilot Program covers investments by all foreign (i.e., non-U.S.) persons and entities, including from countries that are close allies of the United States. A "foreign person" is any "foreign national, foreign government, or foreign entity" and "any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity." "Control" for CFIUS purposes is broadly defined to include the ability of the investor to determine, direct or decide important matters. In practice, this is regularly applied to even small minority investments, and U.S. entities may be considered "foreign persons" if they have any foreign ownership from foreign parties sufficient to constitute "control" under CFIUS's definition.

2. What type of investment is necessary to trigger mandatory filing under the Pilot Program?

There is no minimum equity threshold. An acquisition of any equity interest or contingent equity interest — as little as a single share — in a U.S. business by a foreign person is sufficient to trigger mandatory filing requirements if, ***but only if***, the investment is accompanied by any of the following rights:

1. Access to any material nonpublic technical information in the possession of the U.S. business;

2. Membership or observer rights on the board of directors or equivalent governing body of the pilot program U.S. business or the right to nominate an individual to a position on; or

3. Any involvement, other than through voting of shares, in substantive decision-making of the Pilot Program U.S. business regarding the use, development, acquisition, or release of critical technology.

Material nonpublic technical information means "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" and specifically does not include financial information regarding business performance.

3. What categories of target businesses are implicated by the Pilot Program?

The Pilot Program will apply to any U.S. business that "produces, designs, tests, manufactures, fabricates, or develops a critical technology that is either utilized in connection with the U.S. business's activity in one or more pilot program industries, or designed by the U.S. business specifically for use in one or more pilot program industries." The "Pilot Program Industries" consist of an enumerated set of industries defined by reference to 27 North American Industry Classification System ("NAICS") codes, as follows:

1. Aircraft Manufacturing NAICS Code: 336411

2. Aircraft Engine and Engine Parts Manufacturing NAICS Code: 336412

3. Alumina Refining and Primary Aluminum Production NAICS Code: 331313

4. Ball and Roller Bearing Manufacturing NAICS Code: 332991

5. Computer Storage Device Manufacturing NAICS Code: 334112

6. Electronic Computer Manufacturing NAICS Code: 334111

7. Guided Missile and Space Vehicle Manufacturing NAICS Code: 336414

8. Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing NAICS Code: 336415

9. Military Armored Vehicle, Tank, and Tank Component Manufacturing NAICS Code: 336992

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

4. What is a "critical technology"?

"Critical technology" is defined by reference to technology lists maintained by other U.S. regulatory authorities — particularly export control authorities — and encompasses technologies that will be added to those lists in the future. Specifically, critical technologies include:

- Defense articles or defense services included on the United States Munitions List set forth in the International Traffic in Arms Regulations (ITAR) (22 CFR parts 120-130).
- Items included on the Commerce Control List set forth in Supplement No. 1 to part 774 of the Export Administration Regulations (EAR) (15 CFR parts 730-774) and controlled (1) pursuant

to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology; or (2) for reasons relating to regional stability or surreptitious listening.

- Specially designed and prepared nuclear equipment, parts and components, materials, software, and technology covered by 10 CFR part 810 (relating to assistance to foreign atomic energy activities).
- Nuclear facilities, equipment, and material covered by 10 CFR part 110 (relating to export and import of nuclear equipment and material).
- Select agents and toxins covered by 7 CFR part 331, 9 CFR part 121, or 42 CFR part 73.
- Emerging and foundational technologies controlled pursuant to section 1758 of the Export Control Reform Act of 2018.

This last category of "emerging and foundational technologies" is particularly important because there will be a separate rulemaking to define such technologies during the pendency of the Pilot Program. Thus, the Pilot Program could further expand through the additional identification of new technologies that are controlled under the Export Control Reform Act.

5. When does the Pilot Program go into effect?

The Pilot Program goes into effect on November 10, 2018. Specifically, the Pilot Program does not apply to transactions that are completed (i.e., closed) prior to November 10, 2018, or "transactions for which the parties have executed a binding written agreement or other document establishing the material terms of the transaction" prior to October 11, 2018. Thus, if parties entered into an agreement before October 11, 2018, they can close the transaction at any time and not be subject to the Pilot Program. However, transactions entered into on or after October 11, 2018, and that otherwise fit the criteria of the Pilot Program will be subject to it if they close after November 10, 2018. (Any transaction that nevertheless confers control over a U.S. business to a foreign person would still be subject to CFIUS jurisdiction.)

6. How do the Interim Rules apply to investment funds?

The Interim Rules provide a framework for how U.S. investment funds may avoid being considered "foreign persons" notwithstanding the fact that they have foreign limited partners ("LPs"). Specifically, to codify the special clarification for investment funds in FIRRMA, the Interim Rules provide that an indirect investment by a foreign person in an investment fund will not be covered by the Pilot Program if the foreign person is not the general partner, and the foreign limited partner has no ability to control the investment fund or general partner, including the authority to (i) approve, disapprove, or otherwise control investment decisions of the investment fund, (ii) approve, disapprove, or otherwise control decisions made by the general partner related to entities in which the investment fund is invested, or (iii) unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner. Foreign LPs may participate in an advisory board or committee, but only if such board or committee does not have the ability to approve, disapprove or otherwise control (i) investment decisions of the investment fund, or (ii) decisions made by the general partner related to entities in which the investment fund is invested. The foreign LP also cannot have access to material nonpublic technical information.

7. Does the Pilot Program apply to investments in affiliated businesses?

Generally no. If the foreign person already holds more than fifty percent of the outstanding voting interest or has the right to appoint more than half of the members of the board of directors or equivalent governing body, then an additional investment by the foreign person is not subject to the Pilot Program.

8. What will the mandatory filing or "declaration" encompass?

The filings mandated by the Pilot Program will not be the full CFIUS "notices" that parties submit to CFIUS today. Rather, they will be shorter filings, or "declarations" that — at least in theory — should be no more than five pages. That said, the Interim Rules set out a fairly extensive list of items that must be included in the declaration, including information on the foreign person(s), including ultimate ownership; a description of the transaction; a statement regarding whether the foreign party will have access to nonpublic technical information and a description of such access; a description of the U.S. business, including addresses or geocoordinates of all facilities of the U.S. business; a description of any critical technology that the U.S. business produces, designs, tests, manufactures, fabricates, or develops; a statement regarding whether the U.S. business has any U.S. government contracts, including classified contracts, or has received grants or funding from the Departments of Energy or Defense; and a complete organizational chart; among other items. It is not exactly clear at this stage how all of this information will fit with the five page limitation for the declarations.

9. Can a change in rights trigger a mandatory filing?

Yes. If a foreign person submits a declaration regarding an investment and CFIUS completes action, and the foreign person later acquires certain additional rights (such as access to nonpublic technical information or the right to appoint a member of the board), then a new mandatory filing is required.

10. What will be the process once mandatory filings are submitted to CFIUS?

Upon receiving a declaration submitted pursuant to the Pilot Program, CFIUS can: (1) request that the parties submit a full notice of the transaction, (2) inform the parties to the transaction that the Committee is not able to complete action with respect to the transaction on the basis of the declaration and that the parties may file a full notice to seek written notification from the Committee; (3) initiate a unilateral review of the transaction; or (4) notify the parties that CFIUS has completed action. CFIUS is required to take action within 30 days of accepting the declaration.

11. Will the legal "safe harbor" apply to declarations submitted under the Pilot Program?

Yes, to a degree. If CFIUS completes final action with regards to a declaration, the legal "safe harbor" that historically has attached to CFIUS approvals appears to apply with regards to the investment as described in the declaration. However, it would not apply for subsequent additional equity accruals in the same U.S. business that are coupled with additional rights or which may result in control. It appears that full safe harbor for all subsequent investments would apply if all Committee action is completed after submission of a full notice, though there is some ambiguity as to whether full safe harbor would apply if the full notice related just to a non-controlling investment and not one that could result in control.

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We hope that you find this report useful. Please do not hesitate to contact the following members of our CFIUS practice if you would like to discuss any aspect of the foregoing in further detail:

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