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PROPOSED CFIUS REGULATIONS: THE U.S. REMAINS OPEN FOR BUSINESS … BUT READ THE FINE PRINT

To Our Clients and Friends:

On September 17, 2019, the U.S. Department of the Treasury issued over 300 pages of proposed regulations to implement the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"), legislation that expanded the scope of inbound foreign investment subject to review by the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee"). FIRRMA expanded—subject to the promulgation of these implementing regulations—the Committee's jurisdiction beyond transactions that could result in foreign control of a U.S. business. The Committee's jurisdiction will now include non-passive but non-controlling investments, direct or indirect, in U.S. businesses involved in specified ways with critical technologies, critical infrastructure, or sensitive personal data (referred to as "TID U.S. businesses" for technology, infrastructure, and data) and certain real estate transactions. The comment period will conclude on October 17, 2019, and as required by FIRRMA, the final regulations will become effective no later than February 13, 2020.

To date, only certain provisions of FIRRMA have been fully implemented. In late 2018, CFIUS launched a pilot program to require mandatory filings in higher risk "critical technology" investments. For the past year, the pilot program has served as a regulatory laboratory for the Committee—allowing it to experiment with the use of a short-form "declaration" and better assess the issues that arise in non-controlling but non-passive investments. Notably, the pilot program will remain in place for the foreseeable future, and the new proposed regulations will implement the remainder of the Committee's expanded authority under FIRRMA. Other developments are still to come—including the publication of a list of excepted foreign countries from which certain investors will receive less scrutiny.

Key developments are described below.

Covered Investments

1. **No Changes to the Critical Technologies Pilot Program**. The proposed regulations leave the existing pilot program for critical technologies untouched. Notably, "critical technologies" is defined to include certain items subject to export controls and other existing regulatory schemes, as well as emerging and foundational technologies controlled pursuant to the Export Control Reform Act of 2018 ("ECRA"). Throughout the summer, several political and non-political leads at the Department of Commerce reported that we can expect new emerging technologies to be identified under specific Export Administration Regulations export control classification numbers ("ECCNs") within weeks. However, no new emerging technologies ECCNs have been identified since Commerce issued its advanced notice of proposed rule-making ("ANPRM") on

the subject last fall. Commerce has also noted that it plans to release an additional ANPRM focused on foundational technologies in the coming weeks.

2. **Identification of Critical Infrastructure Sectors**. CFIUS may review transactions related to U.S. businesses that perform specified functions—owning, operating, manufacturing, supplying, or servicing—with respect to critical infrastructure across subsectors such as telecommunications, utilities, energy, and transportation. Relying in part on the definition provided in the USA Patriot Act of 2001, the new regulations define "critical infrastructure" to include physical or virtual systems or assets the destruction or incapacitation of which would have a debilitating impact on U.S. national security. Previously, President Obama used this definition to identify 16 critical infrastructure sectors meriting special protection and assistance. CFIUS is more specific in its new regulations, listing 28 particular types of "covered investment critical infrastructure" that require additional investment protection. This list, provided in an Appendix to the new regulations, includes a range of technology and assets—from producers of certain steel alloys to industrial control systems used by interstate oil pipelines with specified diameters. However, only U.S. businesses that perform the specific functions matched to each particular type of infrastructure are TID U.S. businesses. For example, companies providing physical or cyber security to a crude oil storage facility would be TID U.S. businesses, but those that provide fencing around the facility or commercially available off-the-shelf cyber security software to the facility are not. The new proposed regulations also provide specific definitions for the listed "covered investment critical infrastructure" functions.

3. **Definition of "Sensitive Personal Data."** CFIUS may review transactions related to U.S. businesses that maintain or collect sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security. "Sensitive personal data" is defined to include ten categories of data maintained or collected by U.S. businesses that (i) target or tailor products or services to sensitive populations, including U.S. military members and employees of federal agencies involved in national security, (ii) collect or maintain such data on at least one million individuals, or (iii) have a demonstrated business objective to maintain or collect such data on greater than one million individuals and such data is an integrated part of the U.S. business's primary products or services. The categories of data include types of financial, geolocation, and health data, among others. Genetic information is also included in the definition regardless of whether it meets (i), (ii), or (iii).

4. **Excepted Investors from Excepted Foreign States.** Under the new regulations, certain foreign investors with ties to "excepted foreign states" will receive preferential treatment with respect to the review of covered investments. The proposed regulations create an exception from covered investments (but not transactions that could result in control) for investors based on their ties to certain countries identified as "excepted foreign states," and their compliance with certain laws, orders, and regulations (including U.S. sanctions and export controls). An investor's nationality is not dispositive—the proposed regulations identify criteria that a foreign person must meet in order to qualify for excepted investor status. Among these, investors cannot qualify for and may lose their excepted status if they are parties to settlement agreements with OFAC or BIS, or are debarred by the Department of State, for sanctions or export control violations. This will have a

significant impact on foreign companies who run afoul of U.S. sanctions and export control regulations—the potential loss of this status for respondents might have the unintended effect of deterring disclosures to OFAC and BIS by those concerned about the loss of excepted investor status.

A list of factors will be posted on the Department of the Treasury's website outlining what the Committee will consider when making a determination on whether certain investors from a foreign state will be excepted from CFIUS scrutiny. Such factors will include whether the state has established and is effectively utilizing a robust process to assess foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security. The proposed regulations indicate that excepted states will be identified by the CFIUS Chairperson with the agreement of two-thirds of the voting members of the Committee, beginning two years after the effective date of the final rule (most likely February 2022). At the outset, the foreign state exception will likely apply to allies with whom the United States shares intelligence data under the multilateral UKUSA Agreement—Australia, Canada, New Zealand and the United Kingdom.

5. **Mandatory Filing Requirement**. The proposed regulations implement FIRRMA's requirement for mandatory declarations for certain transactions where a foreign government has a substantial interest, in addition to the mandatory filing requirement for certain investments in U.S. critical technology companies under the pilot program. The submission of a declaration is not required with respect to investments by qualified investment funds.

   Notably, a majority of the declarations filed under the pilot program have been pushed into the standard review process, meaning that the streamlined "light" filing actually resulted in a longer review process for the parties involved. Anecdotal evidence suggests that fewer than 10 percent of cases filed under the pilot program have been decided on the basis of the short-form declaration alone, despite a relatively low volume of filings. Numerous transactions have required the submission of the full notice, and it has been difficult for the intelligence community to complete their full assessment within the allocated 30 days.

Real Estate Transactions

FIRRMA expanded the scope of transactions subject to CFIUS review to include the purchase or lease by a foreign person of real estate that "is, located within, or will function as part of, an air or maritime port…"; "is in close proximity to a United States military installation or another facility or property of the United States Government that is sensitive for reasons relating to national security;" "could reasonably provide the foreign person the ability to collect intelligence on activities being conducted at such an installation, facility, or property; or;" "could otherwise expose national security activities at such an installation, facility, or property to the risk of foreign surveillance." Although FIRRMA sought to codify the Committee's standard practice of examining such risks, it punted on the task of defining such terms. As a result, the proposed regulations resolve a number of uncertainties in FIRRMA with respect to how national security risks associated with real estate transactions will be ascertained.

1. **Property Rights that Trigger CFIUS Review**. The proposed regulations clarify that—subject to certain exceptions for single housing units and real estate in urbanized areas—real estate transactions subject to the Committee's review include the purchase or lease by, or a concession to, a foreign person of certain real estate in the United States that affords the foreign person three or more of the following property rights: to physically access; to exclude; to improve or develop; or to affix structures or objects.

2. **Covered Real Estate**. Coverage is focused on transactions in and/or around specific airports, maritime ports, and military installations. The relevant military installations are listed by name and location in an appendix to the proposed regulations. The relevant airports and maritime ports are on lists published by the Department of Transportation. Notably, such real estate will include properties located within "close proximity" of any military installation identified in Appendix A, parts 1 and 2, "extended range" of any military installation identified in part 2, and any county or geographic area identified in connection with a military installation set forth in part 3 of Appendix A.

3. **Definition of "Close Proximity" and "Extended Range."** The proposed rule defines close proximity as "the area measured outward from the boundary of the relevant installation or other facility or property." The close proximity definition applies with respect to most of the military installations described in the proposed rule and in particular, those identified in the list in parts 1 and 2 of Appendix A. "Extended range" is defined as "the area that extends 99 miles outward from the outer boundary of close proximity" but, where applicable, "no more than 12 nautical miles seaward from the coastline of the United States." The extended range definition applies with respect to military installations described in part 2 of Appendix A.

4. **Exceptions for Certain Investors and Foreign States.** The proposed rule sets forth a narrow definition of excepted real estate investor in the interest of protecting national security, in light of increasingly complex ownership structures, and to prevent foreign persons from circumventing CFIUS's jurisdiction. Thus, the criteria specified in § 802.216 require that a foreign person have a substantial connection (e.g., nationality of ultimate beneficial owners and place of incorporation) to one or more particular foreign states in order to be deemed an excepted real estate investor. Note that foreign persons who have violated, or whose parents or subsidiaries have violated, certain U.S. laws will lose their excepted investor status under these provisions.

5. **Urban Cluster Exception**. FIRRMA requires that real estate in "urbanized areas," as defined by the Census Bureau in the most recent U.S. census, be excluded from CFIUS's real estate jurisdiction except as otherwise prescribed by the Committee in regulations in consultation with the Secretary of Defense. The urbanized area exclusion applies to covered real estate everywhere except where it is in "close proximity" to a military installation or another sensitive facility or property of the U.S. Government as listed in appendix A, or is, is within, or will function as part of, an airport or maritime port.

6. **Intersection of Real Estate and Other Covered Transactions or Investments**. The proposed regulations clarify that real estate transactions that are also subject to CFIUS's existing and

proposed regulations regarding control transactions and non-controlling investments involving U.S. businesses should be analyzed under those regulations.

7. **No Mandatory Filing Requirement.** The transactions described in the proposed rule on real estate are not subject to a mandatory declaration requirement. As a general matter, parties to a covered real estate transaction will decide whether to file a notice voluntarily or submit a declaration to CFIUS.

CFIUS Filings

1. **Voluntary Short Form Declarations as Alternative to Notice**. The proposed regulations provide a short-form declaration as an alternative to the Committee's traditional voluntary notice. To date, declarations have only been available under the pilot program. Declarations will allow parties to submit basic information regarding a transaction that should generally not exceed five pages in length. The Department of the Treasury will accept declarations submitted by parties using a standard template form which will be available on the Department of the Treasury's website by the time the final regulations become effective. The Committee will have 30 days to assess a covered transaction that is the subject of a declaration (as opposed to the 45-day initial review period available for notices).

2. **No Fees to Date**. The Department of the Treasury will publish separate proposed regulations regarding fees at a later date.

3. **5 p.m. Eastern Deadline.** The new regulations impose a 5 p.m. EST filing deadline—a seemingly small point that could have a substantial impact in a cross-border deal involving players in multiple time zones.

Regulatory Framework

The proposed regulations would replace the current regulations found at part 800 of title 31 of the Code of Federal Regulations (31 C.F.R. part 800) and implement the changes that FIRRMA made to CFIUS's jurisdiction and process with respect to transactions that could result in foreign control of any U.S. business, as well as certain non-controlling "other investments" that afford a foreign person certain access, rights, or involvement in certain types of U.S. businesses. These proposed regulations would establish a new part 802 of title 31 of the C.F.R. and implement the authority FIRRMA provided to CFIUS to review the purchase or lease by, or concession to, a foreign person of certain real estate in the United States. The proposed regulations do not at this time modify the regulations currently at 31 C.F.R. part 801, which set forth the scope of, and procedures for, a pilot program to review certain transactions involving foreign persons and critical technologies. CFIUS continues to evaluate the pilot program.

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