GIBSON DUNN

Judith Alison Lee is a partner at Gibson, Dunn & Crutcher LLP. She can be contacted on +1 (202) 887 3591 or by email: jalee@gibsondunn.com.

SPOTLIGHT ARTICLE April 2020

Final CFIUS regulations come into effect: mandatory filing requirements

BY JUDITH ALISON LEE

On 13 February 2020, final regulations came into effect to expand the scope of inbound foreign investment subject to review by the Committee on Foreign Investment in the United States (CFIUS).

CFIUS is an inter-agency federal government group authorised to review the national security implications associated with foreign acquisitions of, or investments in, US businesses and to block transactions or impose measures to mitigate any threats to US national security. Until last year, CFIUS's jurisdiction was limited to transactions that could result in the control of a US business by a foreign person. The 2018 Foreign Investment Risk Review and Modernization Act (FIRRMA) expanded the scope of transactions subject to CFIUS's review to include certain non-controlling but non-passive foreign investments in US businesses involved in critical technologies, critical infrastructure or sensitive personal data of US citizens. These businesses are known as businesses for technology, investment and data (TID). FIRRMA also reviews real estate transactions, including leases, sales and concessions, involving air or maritime ports or real estate in close proximity to sensitive US government facilities. Many of the critical issues set forth in FIRRMA were clarified by proposed regulations published by the US Department of the Treasury on 17 September 2019, and further refined in the final regulations published on 13 January 2020.

Given that Washington is rarely praised for its efficiency or collaboration, the deliberative process that shaped these new rules merits some discussion. At the earliest stages of the legislative process, proposed CFIUS reform bills would have required scrutiny of innumerable transactions with no ostensible national security risk, including passive foreign investments through investment funds in ostensibly low-risk industries and joint ventures with a foreign company partner. After months of negotiations, the House and Senate agreed upon legislation that expanded the scope of transactions subject to CFIUS's review, but punted key details to subsequent implementing regulations. Since proposing such regulations last year, CFIUS sought and reviewed numerous written comments and requests for clarifications regarding the regulations in a transparent and public

process. The final regulations reflect several changes made in response to such feedback, as well as lessons learned during the pilot programme for mandatory filings involving certain types of critical technologies. The result is a smarter set of regulations designed to target real risks, as well as commentary that reflects the effort being made by the intelligence community to assess and adapt to increasingly complex investment structures.

There have been several significant changes to the existing CFIUS process as a result of these final regulations. This article focuses on one aspect – new mandatory filing requirements.

Mandatory filings for critical technology US business transactions

The final regulations retain, with relatively minor changes, the pilot programme's mandatory filing requirements for certain transactions involving investments by foreign persons in US businesses that deal in one or more 'critical technologies'. Over the last year, the pilot programme has served as a laboratory for CFIUS to test out certain aspects of its newly expanded authority, including mandatory pre-transaction filings for transactions involving critical technology US businesses. These high-risk technologies include items subject to existing US export controls, as well as emerging and foundational technologies to be identified, pursuant to the Export Control Reform Act of 2018 (ECRA).

Under the new rules, transactions triggering mandatory CFIUS review will continue to include any investment by which a foreign person acquires material nonpublic technical information about the target critical technology US business, membership or observer rights on the target's board, or the right to participate in substantive decision making, as well as transactions in which foreign persons acquire control of a critical technology US business. Such businesses include those companies that produce, design, test, manufacture, fabricate or develop certain items subject to the Export Administration Regulations (EAR), articles or services subject to the International Traffic in Arms Regulations (ITAR), items included in the yet-to-be-defined category of 'emerging and foundational technologies', as well as items subject to several other US export control regimes.

To trigger the mandatory filing requirement under current regulations, the critical technology US business in which the foreign person plans to invest must also operate in one of 27 high-risk industries identified by their five-digit North American NAICS codes in Appendix B to Part 800. However, the pilot programme illustrated that there is no definitive means for establishing the NAICS code applicable to a particular US business. Furthermore, a company's 'primary' NAICS code, which CFIUS often requests, may not capture the full scope of its business operations, and companies also often have limited experience with evaluating the applicable NAICS codes or the process for doing so. Rather than depend on this uncertain, unfamiliar metric for determining its jurisdiction, CFIUS has indicated that it will eventually propose a new rule to replace the NAICS code requirement with a requirement based on export control licensing requirements. This change will likely make jurisdictional determinations more efficient and certain. The jurisdictional assessment for critical technology transactions already requires an evaluation of the target's exposure to US export controls. Additionally, determining export controls classifications and applicable licence requirements are a common component of compliance for many companies dealing in critical technologies.

Forthcoming Commerce Department rules governing the export of 'emerging and foundational technologies' will further clarify the full scope of CFIUS's jurisdiction over transactions involving critical technology businesses. Under the pilot programme and continuing under the new CFIUS regulations, 'critical technologies' include items to be controlled as 'emerging and foundational technologies' under new regulations the Department of Commerce is required to promulgate. Observers have been expecting these new regulations, which will purportedly include new controls on technologies such as artificial intelligence (AI) and quantum computing, to be published for months. Department of Commerce officials have long promised that publication of the new rules is imminent, but deliberations within the Trump administration may be delaying their publication. Depending on the schedule for publishing these rules, and how the Department of Commerce intends to seek international support for the new controls, it could be years before the definition of 'critical technologies' is settled.

For transactions subject to the CFIUS mandatory filing requirement, the parties will continue to have the option of either filing a short-form declaration, which is available on CFIUS's website, or filing a full-length notice. In many cases, given the scrutiny to which transactions involving critical technologies have recently been subject, a full-length notice may be advisable as it will reduce the total amount of time required for CFIUS to complete its review.

Mandatory filings for substantial foreign government investments

In addition to the mandatory filing requirement for non-passive, non-controlling investments in a US business dealing in critical technologies in connection with

certain high-risk industries, filings are now also required for all transactions by which a foreign government obtains a 'substantial interest' in a US TID business. Specifically, a filing is required when a foreign government holds a 49 percent or greater voting interest in a foreign person that would obtain a 25 percent or greater voting interest in the target US business. In the case of an entity with a general partner, managing member or equivalent, CFIUS will consider a foreign government to have a 'substantial interest' if the foreign government holds 49 percent or more of the interest in the general partner, managing member or equivalent. The new regulations further clarify that a 'substantial interest' applies to a single foreign government, including both national and subnational governments, and their respective departments, agencies and instrumentalities. In this regard, the Committee does not aggregate foreign governments' interests when determining whether they are 'substantial'. ■