CFIUS Update: Final Regulations Implement FIRRMA

The US Department of the Treasury has issued two final regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"). The final regulations broadly expand the jurisdiction of the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee") to review foreign investment transactions that implicate US national security concerns and to mitigate such concerns.[1]

This alert provides an overview of the Committee and its authority, discusses key aspects of the final regulations and addresses questions that the business and investment communities will face as they consider whether future investments may be subject to CFIUS jurisdiction and the requirement to submit mandatory CFIUS filings in certain circumstances.

Key aspects of the final regulations

- **Greatly expanded jurisdiction to review noncontrolling investments:** Whereas in the past CFIUS jurisdiction was narrowly limited to transactions resulting in foreign control of a US business, FIRRMA and the final regulations give CFIUS broad new authority to review non-passive, noncontrolling investments in certain US businesses that deal in "critical technology," "critical infrastructure" or "sensitive personal data." US businesses that fall within the scope of this expanded jurisdiction are referred to in the final regulations as "TID US businesses" (*i.e.*, "T" for technology, "I" for infrastructure and "D" for data). This expansion of jurisdiction to cover certain noncontrolling investments in TID US businesses, coupled with the requirement to submit mandatory filings for certain investments, represents the most significant change to the CFIUS regime in a decade.
- **Mandatory filings:** Whereas CFIUS filings have historically been ostensibly voluntary, the final regulations compel mandatory filings for foreign investments in TID US businesses in two general situations – where a foreign government will acquire (directly or indirectly) a "substantial interest" in a TID US business or where a foreign investor will obtain access to certain information and/or governance rights in a TID US business that deals in one or more "critical technologies" and deploys a critical technology in certain industries of concern to the Committee.[2] Failure to make a mandatory filing when one is required can subject the parties to penalties in amounts up to the value of their transaction.
- **Excepted Investors:** The final regulations exempt from mandatory filing requirements certain investments made by nationals and entities from "Excepted Foreign States" (currently, Canada,

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[1] The final regulations are comprised of two distinct parts. Part 800 addresses foreign acquisitions of and investments in US businesses; Part 802 addresses transactions involving foreign persons and US real estate. *See* 31 C.F.R. Part 800; 31 C.F.R. Part 802.

[2] Note that the term "substantial interest" is defined in the final regulations with a two-prong test requiring a foreign government of a single foreign state (other than an Excepted Foreign State) to have a substantial interest – 49% or more – in the foreign person that is acquiring a substantial interest – 25% or more – in the TID US business.

the United Kingdom and Australia) that meet specific qualifying criteria. CFIUS will announce additional eligibility criteria in forthcoming regulations and, in the future, may add to or remove nations from the list of Excepted Foreign States.

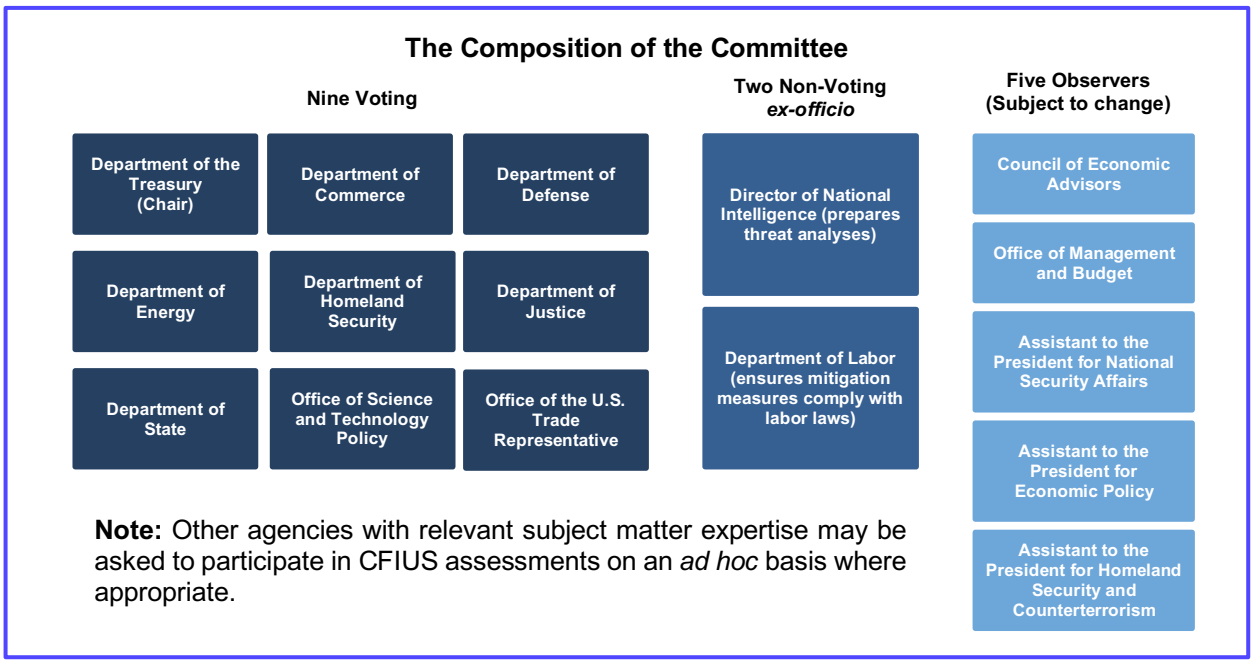
- **Investment funds:** The final regulations clarify that certain noncontrolling investments in TID US businesses by investment funds (*e.g.*, venture capital funds) may fall outside CFIUS jurisdiction notwithstanding that a fund has foreign limited partners, *provided* the fund is managed by US persons and meets certain other structuring requirements that are commonly addressed in limited partnership agreements and/or side letters. Furthermore, a new and more favorable definition of a fund's principal place of business focusing on a "nerve center" test may permit investments by some US-based funds to fall outside CFIUS jurisdiction, even if the funds are organized abroad (*e.g.*, in the Caymans). Finally, the application of the Excepted Investor rule may allow some fund investments in TID US businesses to fall outside a mandatory CFIUS filing requirement.
- **Expanded jurisdiction to review real estate transactions:** The final regulations provide CFIUS with new authority to review certain real estate transactions involving the **purchase** or **lease** by, or **concession** to, a foreign person of real estate in the United States in circumstances where there is no "US business" involved in the transaction (*e.g.*, the lease of unimproved land in proximity to a port or a sensitive government facility).

The Committee on Foreign Investment in the United States

CFIUS is an interagency committee comprised of US government agencies and departments tasked with reviewing foreign acquisitions of and investments in US businesses for potential national security risk. Federal statutes and regulations give CFIUS broad authority to review, suspend, modify or prohibit transactions within the Committee's jurisdiction ("covered transactions") in order to address perceived national security risks.

The Committee is chaired by the Department of the Treasury and comprised of nine voting members with deep expertise in matters of national security, including the Departments of Defense, State, Justice, Commerce, Energy and Homeland Security.

In addition to the voting members, various non-voting Committee members with national security responsibilities – including the Director of National Intelligence – support the Committee's mission and operations.



The final regulations codify the Committee's longstanding framework for evaluating the national security implications of a transaction by considering the following elements:

- The ***threat***, which is a function of the intent and capability of the foreign person (*i.e.*, the threat actor) to take action to impair the national security of the United States;
- The ***vulnerabilities***, which are the extent to which the nature of the US business presents susceptibility to impairment of national security; and
- The ***consequences*** to national security, which are the potential effects on national security that could reasonably result from the exploitation of the vulnerabilities by the threat actor.

CFIUS Has Broad Authority to Mitigate Security Risks

Where CFIUS identifies a national security risk with a foreign investment, the Committee has sweeping and virtually unchallengeable powers to mitigate that perceived risk. In 2019, for example, CFIUS compelled Shenzhen-based iCarbonX to divest its majority stake interest in PatientsLikeMe, an online community for patients seeking treatments for common health conditions. Shortly thereafter, facing CFIUS challenges in connection with a review, Beijing Kunlun Tech agreed to divest its ownership of Grindr, a popular dating app. The PatientsLikeMe and Grindr transactions highlight CFIUS concerns regarding foreign access to the sensitive personal information.

Preliminary questions from the business and investment communities

The final regulations' broad expansion of CFIUS jurisdiction and the Committee's sweeping authority to review foreign investment transactions and mitigate related national security risks have significant legal and practical implications for the US business and investment communities. The following discussion addresses frequently asked questions posed by US businesses and foreign investors.

1. What types of foreign investment transactions are covered by the final regulations and therefore subject to CFIUS jurisdiction and review?

Any transaction that is subject to CFIUS jurisdiction under Part 800 is termed a "covered transaction." The final regulations contemplate two broad categories of Covered Transactions involving US businesses: Covered Control Transactions and Covered Investments[3]. As people familiar with CFIUS know, the Committee always has had jurisdiction to review control transactions (*i.e.*, transactions that could result in a foreign person gaining control of a US business). Covered Investments, on the other hand, are a creation of FIRRMA and are intended to address longstanding government concerns that CFIUS did not have the necessary tools to review non-controlling investments that present national security risks.

National Security Concerns Regarding Minority Investment

"[T]he threat to critical technology industries is more significant than ever as some foreign parties seek, through various means, to acquire sensitive technologies with relevance for US national security. Foreign investment in US critical technologies has grown significantly in the past decade, and an enhanced framework is needed to address the potential impacts of this growth on US national security.

Prior to FIRRMA, CFIUS' authorities did not sufficiently address the new and emerging risks that foreign direct investment can pose to US technological superiority. For example, foreign investors do not need to acquire a controlling interest in order to affect certain decisions made by, or obtain certain information from, a US business with respect to the use, development, acquisition or release of critical technology."

– CFIUS Pilot Program Interim Rule, 83 Fed. Reg. 51322, 51324 (October 11, 2018).

- **Covered Control Transactions:** *CFIUS has long had jurisdiction to review transactions that could result in a foreign person gaining control over a US business*. Importantly, the term "control" is vaguely and broadly defined as the ability, direct or indirect, and whether exercised or not, to "determine, direct or decide important matters affecting" the US business in a transaction. CFIUS routinely finds that control exists with minority investments. While there is no specific minimum ownership threshold at which CFIUS will find control, the final regulations provide that the acquisition of 10% or less of a US business by a foreign person "solely for the purpose of a passive investment" does not implicate control.
- **Covered Investments:** C*FIUS has new jurisdiction to review direct or indirect foreign investments in TID US businesses where the foreign investor will obtain certain information and/or governance rights in the target company.* For an investment to be a Covered Investment, both jurisdictional prongs must be satisfied. The investment must involve a TID US business, and the foreign investor must obtain one or more specified information or governance rights. Further, no jurisdictional exceptions may apply.

[3] Real estate transactions that are subject to CFIUS jurisdiction under Part 802 but not Part 800, discussed below, are termed "Covered Real Estate Transactions."

If a foreign investment will involve a TID US business, the parties must determine whether the investment will afford the foreign party any Covered Investment rights. If the foreign investor will obtain Covered Investment rights in a TID US business, CFIUS will have jurisdiction to review the transaction, and a mandatory CFIUS filing may be required. Covered Investment rights include all of the following:

(1) Access to any material nonpublic technical information in the possession of the TID US business;

(2) Membership or observer rights on, or the right to nominate an individual to a position on, the board of directors or equivalent governing body of the TID US business; or

(3) Any involvement, other than through the voting of shares, in substantive decisionmaking of the TID US business regarding:

(a) The use, development, acquisition, safekeeping or release of sensitive personal data of US citizens maintained or collected by the TID US business;

(b) The use, development, acquisition or release of critical technologies; or

(c) The management, operation, manufacture or supply of Covered Investment critical infrastructure.

TID US Business

A TID US business is defined as an entity "engaged in interstate commerce" in the United States that:

1. Produces, designs, tests, manufactures, fabricates or develops one or more "**critical technologies**," as that term is defined in the final regulations (*e.g.*, companies dealing in certain types of controlled military and commercial technologies, including companies in the defense, semiconductor, advanced computing and software, aviation and aeronautics, biotechnology, high-performance batteries and fuel cells, and nuclear fields);
2. Performs certain functions or provides certain goods or services to specified "**critical infrastructure**" in the United States (*e.g.*, a company that manufactures or services industrial control systems for certain industries or that provides physical or cybersecurity to an oil refinery or public water system); or
3. Maintains or collects, directly or indirectly, "**sensitive personal data**" of US citizens (*e.g.*, companies that develop mobile applications that collect users' location data, that collect individuals' genetic data or that collect certain financial data).

Note that the final regulations provide two exceptions from Covered Investment jurisdiction:

- First, a Covered Investment (*i.e.*, a noncontrolling investment) by a foreign person who qualifies as an Excepted Investor is not subject to CFIUS jurisdiction. However, this Excepted Investor jurisdictional carve-out does not apply to Covered Control Transactions over which CFIUS retains its jurisdiction to review.

- Second, both Covered Investments and Covered Control Transactions involving certain air carriers – which are subject to a different national security review regime – are excluded from CFIUS jurisdiction.

In addition to the two broad categories of CFIUS jurisdiction discussed above (*i.e.*, Covered Control Transactions and Covered Investments), the final regulations create jurisdiction over two other types of transactions:

- **Change-in-rights transactions:** *Section 800.213 defines "covered transaction" to include a change in the rights that a foreign person has with respect to a US business in which the foreign person has an investment, if that change could result in a Covered Transaction.* For example, CFIUS would have jurisdiction over a transaction in which a foreign person makes a passive equity investment in a TID US business, and subsequently obtained the right to nominate a director to the company's board of directors, without making an additional equity investment. Similarly, CFIUS could assert jurisdiction where a foreign investor previously made a passive equity investment in a TID US business and months or years later entered into a commercial agreement with the TID US business pursuant to which the foreign investor is afforded access to the TID US business' material nonpublic technical information or access to the company's executive team. Jurisdiction based on a change in rights will present challenges for both businesses and investors as CFIUS jurisdiction may arise based on activities undertaken in the ordinary course of business and not temporally related to an equity investment, and therefore making it more difficult for parties to identify and account for jurisdiction triggering events.
- **Transactions to evade:** *CFIUS can also review any transaction, transfer, agreement or arrangement that is designed or intended to evade or circumvent CFIUS review.*

2. When are CFIUS filings mandatory, and what are the penalties for failing to file?

Part 800 of the final regulations requires parties to a Covered Transaction to submit a **mandatory** pre-closing filing with CFIUS in two circumstances – where a **foreign government** will acquire – directory or indirectly – a substantial interest in a TID US business or where a foreign investor will obtain certain information or governance rights in a TID US business that deals in a **critical technology** and operates in one or more of the industries identified in the final regulations by the corresponding North American Industry Classification System ("NAICS") codes.

Where a mandatory filing is required, parties have the option of submitting a short-form declaration involving an assessment period of 30 days or a more comprehensive notice involving a lengthier assessment period that can last up to several months. The decision regarding which form to use involves a number of factors, chief among them being the parties' determination of how likely CFIUS is to approve (or clear) their transaction during the abbreviated 30-day declaration assessment period. Generally speaking, if a transaction is relatively complex or implicates potentially meaningful national security issues, it may require more than 30 days for CFIUS to understand and resolve the issues, in which case beginning the assessment with a notice may ultimately save time and expense. On the other hand, a relatively simple transaction with a benign national security profile may stand a good chance of clearing CFIUS in 30 days and may be a good candidate for a declaration.

Regardless of the form of filing, when a mandatory filing is in play, the parties must submit it to CFIUS at least **30 days before closing** (or – more precisely – at least 30 days before the foreign investor is afforded control of the TID US business or any Covered Investment rights in the TID US business).

Notably, it is important for US companies and foreign investors to understand that getting a mandatory filing analysis right is critical; failure to make a mandatory filing where one is required can subject the parties to penalties in amounts up to the value of the transaction.

Submitting a CFIUS Declaration

The preparation by the parties and assessment by CFIUS of a declaration is significantly less complex and costly than the preparation and assessment of a notice. The declaration document itself can often be prepared in a matter of days, whereas it often requires several weeks to prepare a notice. Once a declaration is submitted to CFIUS, the Committee has 30 days to assess the underlying transaction and determine what action to take. (For notices, the assessment often takes several months to complete.)

Upon completing its assessment of a declaration, CFIUS can either clear the transaction (having concluded there are no unresolved national security concerns with it), request the parties submit a notice to give the Committee additional time and information to assess the transaction or inform the parties CFIUS is not able to complete action to determine that there are no unresolved national security concerns, and the Committee invites – but does not require – the parties to submit a notice. (This third result is often referred to by the CFIUS bar as a "shrug" or a "no action" letter.)

If CFIUS issues a no action letter and the parties elect **not** to submit a notice voluntarily, CFIUS can request that the parties submit a CFIUS notice in the future. As with the notice process, if CFIUS completes its review of a declaration and determines there are no unresolved national security concerns, the parties receive safe harbor protection from future review of the transaction.

Finally, note that where the parties' diligence confirms that a mandatory filing is not required, they should nonetheless consider whether the circumstances of the transaction (*i.e.*, the presence of potential national security issues) warrant the submission of a **voluntary** CFIUS filing.

3. What does a CFIUS filing look like?

As discussed above, CFIUS filings can take the form of an abbreviated declaration or a full notice. The declaration is an innovation of the CFIUS Pilot Program (*see* 31 C.F.R. Part 801), which first introduced the requirement of a mandatory CFIUS filing.

While some in the business and investment communities were disappointed to see the final regulations preserve the Pilot Program's mandatory filings, the option to submit declarations under Part 800 of the final regulations was a welcome development. Declarations are five-page form documents published and designed by CFIUS facilitate a high-level summary of a Covered Transaction and an accelerated assessment by the Committee.

In contrast, a CFIUS notice requires the submission of far more detailed information about the US business and the foreign investor or acquirer (including personal identification information for the officers and directors of the foreign investor or acquirer) and is significantly more costly and time consuming to prepare.

Submitting a CFIUS Notice

Unlike the more cursory information called for in a declaration, a notice calls for comprehensive information about the transaction at issue and both parties to it, including detailed personal information about the foreign investors' owners, directors and officers. Once a notice is submitted and formally accepted by CFIUS, the Committee has 45 days to conduct its preliminary review of the transaction. At the conclusion of the review period, CFIUS may clear the transaction or extend the process for another 45-day investigation period.

At the conclusion of the investigation, CFIUS will typically either clear (*i.e.*, approve) the transaction having determined there are no unresolved national security concerns, clear the transaction subject to certain mitigation measures designed to address any national security concerns or recommend to the president that the president block the transaction entirely. Transactions that receive CFIUS clearance – with or without mitigation – receive safe harbor protection from future review and potential unwinding by the Committee.

4. What is an Excepted Investor, and how does a foreign investor qualify for this partial jurisdictional carve-out?

The final regulations carve out investments by Excepted Investors from the mandatory filing requirements of Part 800, as well as from the scope of Covered Investments more broadly. Importantly however, Excepted Investor status does not affect the Committee's authority to review Covered Control Transactions. To qualify as an Excepted Investor, the foreign party to the transaction must meet one of the three Excepted Investor criteria.[4] Looking to the future, US companies and investors should be aware that a second set of Excepted Investor criteria will come into effect in February 2022, pursuant to which CFIUS will also need to determine whether the foreign state from which the investor hails has in place effective processes and a record of cooperation with the United States in addressing national security risks arising from foreign investment. Specifically, the final regulations require CFIUS to assess whether the foreign state "has established and is effectively utilizing a robust process to analyze foreign investments for national security risk and to facilitate coordination with the United States on matters relating to investment security."

While the club of Excepted Foreign States may expand its membership slightly, it is likely to remain small, thereby limiting the number of investors that will be eligible for Excepted Investor status.

5. How do the final regulations affect investment funds?

Part 800 of the final regulations affect investment funds by preserving the Pilot Program's clarification regarding indirect foreign investments (*e.g.*, by foreign limited partners) through funds, proposing a more favorable definition of a fund's principal place of business and introducing the concept of the Excepted Investor not subject to Covered Investment CFIUS jurisdiction.

- **Clarification concerning investment fund investments:** Section 800.307 of the final regulations clarifies that certain indirect investments in TID US businesses by foreign persons

[4] While the Excepted Foreign States list currently includes only Australia, Canada and the United Kingdom, CFIUS has authority under the final regulations to add and remove foreign states from the Excepted Foreign States list.

investing through an investment fund (*e.g.*, a venture capital fund) may fall outside the scope of a Covered Investment. Specifically, if a foreign limited partner of an investment fund has membership on the fund's advisory board or Committee, the foreign limited partner's indirect investment through the fund in a TID US business will not trigger CFIUS jurisdiction if all of the relevant criteria are met:

This clarification (often mischaracterized as an independent jurisdictional carve-out) for investment fund investments makes it clear that indirect, mostly passive investments in TID US businesses by foreign limited partners through funds that are structured to meet the criteria in 31 C.F.R. § 800.307 **may** fall outside CFIUS jurisdiction.

There is no guarantee, however, that a fund formally structured in accordance with 31 C.F.R. § 800.307 necessarily will – as a practical matter – fall outside CFIUS jurisdiction.

Notably, the investment fund clarification is drafted with a focus on the foreign investor's ability and access – as opposed to the investor's rights as reflected in a limited partnership agreement ("LPA") or side letter. Accordingly, it may not be enough to draft an LPA or side letter to conform with § 800.307. Rather, to limit the risk that CFIUS might find a foreign limited partner controls a fund or has the abilities contemplated in the investment fund clarification, parties should assess the practical realities of how an investment fund operates. For example, a fund with one or several significant foreign limited partners may not be able to satisfy the criteria in § 800.307, as CFIUS may infer that a dominant foreign limited partner controls the investment fund through informal means. In such circumstances, the foreign-controlled fund must carefully assess its investments to understand whether a prospective portfolio company is a TID US business.

- **Principal place of business:** The final regulations include an interim rule revising the definition of the term "principal place of business", which – if preserved as drafted – will reduce CFIUS exposure for certain foreign-domiciled funds with US-based operations and management (*e.g.*, Cayman funds with US citizen managers). Specifically, the interim definition in 31 C.F.R. § 800.239 provides that an investor's principal place of business is:

  > 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.**

  Note that principal place of business analyses must be done with care. Under the interim rule, if a fund is deemed to have a principal place of business in the United States pursuant to the test above, but **also** has represented to a government entity that its principal place of business is outside the United States, the representation to the government entity may be controlling for CFIUS purposes.

- **Excepted Investors as funds or limited partners:** The potential availability of Excepted Investor status (discussed above) for a limited partner or for a fund itself may prove valuable for funds investing in TID US businesses.

6. What types of real estate transactions are subject to CFIUS review?

Under Part 802 of the final regulations, CFIUS has new authority to review certain real estate transactions involving the **purchase** or **lease** by, or **concession** to, a foreign person of real estate in the United States. While the regulations cover a variety of types of real estate transactions, the focus is on transactions involving US maritime ports, airports and real estate in proximity to certain locations in the United States with national security implications (*e.g.*, military installations). In order to be subject to CFIUS jurisdiction under Part 802, purchase, lease or concession transactions must result in the foreign party obtaining at **least three** of the four specific Part 802 property rights or abilities.

Part 802 Property Rights

Part 802 of the final regulations defines the term "property right" to include the following rights or abilities, whether or not exercised, whether or not shared concurrently with any other person and whether or not the underlying real estate is subject to an easement or other encumbrance:

1. The right or ability to physically access the real estate;
2. The right or ability to exclude others from physically accessing the real estate;
3. The right or ability to improve or develop the real estate; or
4. The right or ability to attach fixed or immovable structures or objects to the real estate.

Notably, Part 800 and Part 802 are separate and mutually exclusive sources of CFIUS jurisdiction – an important rule to understand given that certain real estate transactions may appear to constitute a Covered Transaction under Part 800 and a Covered Real Estate Transaction under Part 802. For example, a controlling investment by a foreign person in a US business that includes real estate (*e.g.*, a hotel on a two-acre lot) would be subject to Part 800 rather than Part 802. In contrast, the acquisition of the same two-acre lot without a business on it likely would not be subject to jurisdiction under Part 800 but may be subject to jurisdiction under Part 802. Because Part 800 has certain mandatory filing requirements and both Part 800 and Part 802 authorize CFIUS to impose penalties, parties will need to carefully consider the applicable regulatory regime and filing requirements.

Like Part 800, Part 802 allows parties to file declarations and notices. However, unlike Part 800, there is no mandatory filing requirement in Part 802. While the lack of a mandatory filing requirement for Covered Real Estate Transactions may generally be a welcome development, it also adds a degree of uncertainty with respect to the CFIUS risks associated with real estate transactions. In the absence of the clarity associated with a mandatory filing regime, it will be up to the transacting parties to identify and assess potential national security issues with a given transaction. This may prove to be a difficult task given that by their very nature, the location of, and national security vulnerabilities associated with, sensitive government facilities in proximity to US real estate are not readily discernable to the public.

Another notable aspect of Part 802 is the fact that the revised definition of "principal place of business" has been incorporated as an interim rule open to public comment. Part 802 also carries over the Excepted Investor concept from Part 800: in the real estate context, an excepted foreign investor is termed an "excepted real estate investor." The jurisdictional carve-out applies the same

criteria as in Part 800. For now at least, the list of Excepted Real Estate Foreign States mirrors the list of Excepted Foreign States in Part 800 (*i.e.*, Australia, Canada and the United Kingdom).

Practitioner observations/key transactional implications

1. **Effective diligence: the complexity and breadth of the final regulations require a multidisciplinary approach to diligence.**

   Given the breadth and complexity of the final regulations, and correspondingly broad scope of CFIUS jurisdiction, a key challenge facing transacting parties and CFIUS practitioners will be to establish diligence practices that are sufficiently robust to reasonably assess CFIUS jurisdiction (*i.e.*, is a given transaction a Covered Transaction) and CFIUS risk (*i.e.*, must or should the parties notify CFIUS of the transaction), but not so overwrought as to add unnecessary expense and delay to transactions.

   While some of the concepts in the final regulations will be familiar to those who have experience with the traditional CFIUS regime or the CFIUS Pilot Program, other concepts are new. For example, an assessment of critical technology generally requires counsel with expertise in US export control regulations. Further, while many companies may confidently conclude that they do not have a nexus to any of the critical infrastructure identified in the final regulations, the issue of whether a company collects or maintains sensitive personal data is less easily susceptible to a clear answer. Because the term "sensitive personal data" is so broadly defined, we anticipate this concept will capture many businesses that do not think of themselves as implicating a national security issue. Parties and their legal counsel will need to adopt an integrated, multidisciplinary approach to CFIUS diligence.

2. **Completion date: with due caution, parties can continue the established practice of tranching (or bifurcating) transactions to delay the onset of CFIUS jurisdiction while providing immediate foreign capital to US businesses.**

   The CFIUS Pilot Program instituted mandatory filing requirements where foreign investors would be afforded certain rights in a US business dealing in critical technology. Due in part to this new filing requirement, it became more commonplace for foreign investments in such Pilot Program US businesses be structured in two tranches. Typically, in the initial closing, the foreign investor provides funding and acquires shares but does not obtain any of the information or governance rights that would trigger CFIUS jurisdiction. In the second closing, the foreign investor is afforded the information and governance rights for which it had negotiated but only if and after the parties received CFIUS clearance. This approach allows US business to obtain much needed capital from foreign investors permitting the US business to continue operations without running afoul of the mandatory pre-closing filing requirements.

   For purposes of determining when a transaction closes and a foreign investor obtains rights in a US business, the final regulations 31 C.F.R. § 800.206 define the term "completion date" as:

   > [T]he earliest date upon which any ownership interest, including a contingent equity interest, is conveyed, assigned, delivered, or otherwise transferred to a person, or a change in rights that could result in a Covered Control Transaction or Covered Investment occurs.

   On its face, this language arguably suggests that a transaction's completion date could be the date on which an equity interest is conveyed – even if that equity interest is devoid of information or governance rights. Under this interpretation, tranched or bifurcated transactions would no longer be a

viable tool. Thankfully, however, the preamble of the final regulations clarifies that a transaction's completion date is the earliest date on which "any transfer of interest or change in rights **that constitutes a covered transaction occurs**." This clarification indicates that tranched or bifurcated transactions are still an option.

Specifically, because the initial close in a two-tranche transaction is not a Covered Transaction, the practice of tranched closings can continue without running afoul of the Committee's filing requirements, though parties must be careful to ensure that a foreign person's rights or abilities that would trigger CFIUS jurisdiction are in fact not obtained until after the second tranche and CFIUS clearance is received.

3. **Foreign investor rights versus abilities: in defining the term "involvement" with respect to "substantive decisionmaking," the final regulations broaden the scope of conditions that can trigger a mandatory filing requirement.**

   The interim regulations that established the temporary Pilot Program created a mandatory filing requirement where an investment would afford a foreign person "[a]ny involvement…in substantive decisionmaking of the pilot program US business regarding the use, development, acquisition or release of critical technology." Though the interim regulations did not define the term "involvement," clarifying *Frequently Asked Questions* released by the Treasury Department explained that the term "any involvement" contemplated various investor *rights*, such as the right to consult with or provide advice to a decisionmaker and the right to have direct access to decisionmakers.

   Significantly, the final regulations provide a more expansive definition of "involvement" (*see* 31 C.F.R. § 800.229) that contemplates not only a foreign investor's rights with respect to the US business in which it is invested, but also the foreign investor's abilities concerning the business. This expanded definition of "involvement" likely will capture more transactions and – in the case of investments in critical technology companies – subject them to mandatory filing requirements.

Involvement in Substantive Decisionmaking

Under the final regulations, involvement includes the *right or ability* of a foreign investor with respect to the following as it concerns a TID US business:

- providing input into a final decision;
- consulting with or providing advice to a decisionmaker;
- exercising special approval or veto rights;
- participating on a Committee with decisionmaking authority; or
- advising on the appointment officers or selecting employees who are engaged in substantive decisionmaking.

In practice, this expanded definition of "involvement" will require parties to look beyond the four corners of their transaction agreements (*i.e.*, their LPAs and side letters) to determine whether an investment triggers a mandatory filing with CFIUS. For example, if an investor does not have the right to appoint a director to a company's board but is informally invited to attend board meetings, such arrangement would suggest the investor has the ability to attend board meetings.

Accordingly, in addition to carefully drafting transaction agreements, parties will need to understand all the facts and circumstances of an investor's relationship with a US business to determine whether a foreign person has the ability to participate in substantive decisionmaking, even if that ability is not memorialized in writing.

We anticipate that CFIUS will use this expanded authority to exercise jurisdiction over transactions it otherwise could not review, such as a nominally passive investment that, in reality, permits the investor to access company decisionmakers – for example through informal or personal relationships.

4. **CFIUS reps and warranties will evolve: foreign Investors and US businesses should anticipate being asked to make representations and warranties to address new issues arising from the final regulations.**

   The advent of the CFIUS Pilot Program in November 2018 spawned the evolution of standard or market reps and warranties addressing the particular issues and risks created by that new variant of CFIUS jurisdiction (*i.e.*, foreign investments in certain US businesses that deal in critical technologies).

   Foreign investors and US businesses should expect the same to happen in response to the final regulations. Specifically, we anticipate that new rep and warranty language will evolve in the near-term to address the following issues:

   - Whether a US business meets the definition of a "TID US business";
   - Whether a US business maintains or collects "sensitive personal data";
   - Whether real property subject to a real estate transaction is in proximity to any facility appearing on the *List of Military Installations and Other US Government Sites* in Appendix A to Part 802 of the final regulations;
   - Whether a foreign person's indirect investment in a TID US business is held solely and directly via a FOCI (foreign ownership, control or influence) mitigated entity operating under a valid facility security clearance;
   - Whether a foreign government has a substantial interest in a foreign investor; and
   - Whether a foreign investor meets the definition of an Excepted Investor.

Notable anticipated changes

While the final regulations resolve many of the questions of concern to the business and investment communities, several issues remain to be addressed. Key issues that remain open include the following:

1. **Enforcement shaping conduct: in an environment of mostly voluntary filings, CFIUS enforcement actions will shape conduct.**

   We anticipate that most transactions subject to the expanded scope of CFIUS jurisdiction will not trigger a mandatory filing requirement and that the very significant majority of Covered Investments will not be reported to CFIUS on a voluntary basis – just as the significant majority of control transactions historically have not resulted in voluntary filings.

   Notwithstanding our expectation, CFIUS is dedicating significant new resources to identifying transactions within its jurisdiction that were not the subject of a filing (*i.e.*, non-notified transactions) and determining whether such transactions warrant a national security review. CFIUS also has

dedicated new resources to pursue enforcement actions, including with respect to failures to submit mandatory filings and violations of mitigation agreements with CFIUS.

The nature and frequency of such enforcement actions will influence parties' risk calculus with respect to whether a voluntary filing is warranted in a given transaction.

2. **Filing fees: filing fees are authorized, but not yet imposed.**

   FIRRMA authorizes CFIUS to impose filing fees for notices in an amount of 1% of the value of the transaction, up to a maximum of $300,000. The final regulations do not impose the fees but do reference a pending rulemaking process that will address a filing fee regime.

3. **"Principal place of business" definition subject to change.**

   As noted above, the final regulations include a new definition of "principal place of business" as an interim rule subject to public comment. The Department of the Treasury is currently accepting comments on this term through February 18, 2020. Modifications to this term under both Part 800 and Part 802 would likely impact which investors are able to utilize the Excepted Investor and Excepted Real Estate Investor carve-outs and how funds structure their investments to address CFIUS jurisdictional concerns.

4. **Department of the Treasury proposes phasing out reliance on NAICS codes.**

   The Department of the Treasury plans to issue a notice of proposed rulemaking that would revise the criteria for the mandatory filing requirement concerning foreign investments in US businesses that deal in a critical technology. Under Part 800, the mandatory filing requirement applies where a TID US business produces, designs, tests, manufactures, fabricates or develops a critical technology that the US business either utilizes in connection with its business activities in or designs specifically for use in one or more specific industries identified by the corresponding NAICS codes.

   In issuing the final Part 800 rule, the department announced its intention to replace the NAICS code-based jurisdictional prong with a prong predicated on export control licensing requirements. The Treasury Department has not provided details regarding the new proposed analysis, nor has the department indicated when it plans to publish the proposed rule.

   Notwithstanding the lack of detail surrounding the government's approach, an export licensing analysis would likely represent a significant shift in the way CFIUS approaches mandatory filing for Covered Transactions involving critical technologies. Under the existing industry-based analysis, CFIUS focuses on the utilization of critical technologies in identified industries of concern. Notably, under the existing analysis, the specific nationality of the foreign investor or buyer is not as relevant to whether a transaction is subject to mandatory reporting. An analysis based on export licensing considerations, however, would presumably focus on the nationality of the foreign investor or acquirer and whether an export license would be required to release the US business' technology to that foreign person under applicable export control laws and regulations. Under such an approach, it is unclear how CFIUS would be able to fully reconcile narrow export control licensing requirements with the broader national security considerations confronting the Committee.

5. **Emerging and foundational technologies.**

   The definition of "critical technologies" includes technologies to be identified by the Department of Commerce as either "emerging" or "foundational" technologies. Under the Export Control Reform Act of 2018, passed contemporaneously with FIRRMA, the Department of Commerce is charged with

identifying those technologies that are “essential to the national security of the United States” and which are not significantly controlled under current export control regulations. In November 2018, the Department of Commerce published an advance notice of proposed rulemaking that identified the following 14 representative technology categories within which it is looking for potential emerging technologies:

1) Biotechnology
2) Artificial intelligence and machine learning technology
3) Position, navigation and timing technology
4) Microprocessor technology
5) Advanced computing technology
6) Data analytics technology
7) Quantum information and sensing technology
8) Logistics technology
9) Additive manufacturing
10) Robotics
11) Brain-computer interfaces
12) Hypersonics
13) Advanced materials
14) Advanced surveillance technologies

See 83 Fed. Reg. 58201 (November 19, 2018).

Based on public statements from senior Department of Commerce officials, we expect the Department of Commerce to introduce new categories of emerging technologies on a rolling basis. In addition, foundational technologies are likely to be those that were not previously tightly controlled but, due to new potential applications, could pose national security concerns. Once the Department of Commerce adds further export controls to identified emerging and foundational technologies, investments in companies that were previously not subject to mandatory CFIUS filings may be subject to the mandatory filing requirements. There is no timeline for when to expect an ANPRM for foundational technologies, or even the first emerging technologies.