ALLEN & OVERY

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U.S. Treasury Implements Final FIRRMA Regulations

INTRODUCTION

This week, new regulations promulgated by the U.S. Department of the Treasury (the **Treasury**) went into effect to finalize and comprehensively implement the Foreign Investment Risk Review Modernization Act of 2018 (**FIRRMA**). These newly-amended regulations (the **Final FIRRMA Regulations**) both broaden the jurisdictional scope of the Committee on Foreign Investment in the United States (**CFIUS**), and institute key exceptions scaling CFIUS's authority over certain foreign investments. The new rules represent a marked expansion of CFIUS's ability to address national security concerns, as CFIUS's review authority is no longer limited to transactions resulting in foreign control of a U.S. business. As a result of the new rules, CFIUS's jurisdiction now extends to select non-controlling covered investments that afford a foreign person specified access, rights, or involvement in certain types of U.S. businesses (31 C.F.R. part 800), as well as select real estate transactions that previously generally fell outside CFIUS' jurisdiction (31 C.F.R. part 802).

While the CFIUS review process remains largely voluntary, the Final FIRRMA Regulations establish a mandatory filing requirement for covered investments involving critical technologies and covered transactions that result in the acquisition of a "substantial interest" in certain U.S. businesses by a foreign person that is directly or indirectly controlled by a foreign government. In a significant procedural change, the new rules allow a short-form declaration to act as an alternative to CFIUS's traditional voluntary notice for any covered transaction or covered real estate transaction. While CFIUS must take action on a declaration within 30 days of receipt, requesting parties will be required to file a full notice if CFIUS declines to grant a "safe harbor" to the transaction. Though the timeline for a declaration is shorter, CFIUS's already lengthy review process will be further protracted if a full notice is then requested, as such notice may not be filed during the review of a prior declaration concerning the transaction.

The Final FIRRMA Regulations establish a designated status for "excepted investors" from "excepted foreign states" – Australia, Canada, and the United Kingdom are the only "excepted foreign states" enumerated in the initial list – which exempts such investors from CFIUS's review of non-controlling covered investments. Another important jurisdictional exception limits CFIUS's jurisdictions by exempting transactions involving indirect investment in specified U.S. businesses by a foreign person through an investment fund where the foreign investor is a limited partner in the fund and does not hold management or investment rights, and where the fund's general manager is a U.S. person. Regardless of any excepted status, CFIUS retains the authority to review transactions where a foreign person acquires control over any U.S. business.

Though the Final FIRRMA Regulations largely follow the proposed rules released by the Treasury in September 2019, a number of revisions incorporate concerns raised during the public comment period. Such updates include the addition of an interim definition for "principal place of business," amendments to the criteria for "substantial interest" and "excepted investor," and clarifications related to covered real estate transactions and the "incremental acquisition" rule. An overview of such modifications, the key provisions of the final regulations, and expected future Treasury actions follows below.

JURISDICTIONAL EXPANSION TO COVER NON-CONTROLLING INVESTMENTS IN "TID" U.S. BUSINESSES

Under the Final FIRRMA Regulations, certain non-controlling investments in U.S. businesses dealing in certain critical **t**echnologies, critical **i**nfrastructure, or sensitive personal **d**ata (a **TID** – technology infrastructure, data – **U.S. business**) are now subject to CFIUS review if a non-controlling foreign investment affords a non-U.S. investor the following governance or access rights:

> (i) access to material non-public technical information in the possession of the TID U.S. business;
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> (ii) membership or observer rights on, or the right to nominate an individual to a position on, the board of directors of the TID U.S. business; or
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> (iii) any involvement, other than through voting shares, in substantive decision-making of the TID U.S. business.

While the Final FIRRMA Regulations retain the definitions and related functions of "critical technologies" and "critical infrastructure" from the proposed rules, they expand the definition of "sensitive personal data" with regard to the treatment of genetic information. Commentary on the specific types of TID U.S. businesses covered under the new regulations follows below.

Covered Investments Involving Critical Technologies

Under the Final FIRRMA Regulations, non-controlling foreign investments in U.S. businesses that design, test, manufacture, fabricate, or develop one or more critical technologies may be required to submit a mandatory declaration to CFIUS. While a mandatory declaration requirement was not addressed in the proposed regulations, it was included in the Critical Technologies Pilot Program (the **Pilot Program**), which tested CFIUS's new mandatory filing authority under FIRRMA.[1]

The definition of "critical technologies" under the Final FIRRMA Regulations includes certain items subject to export and other existing regulatory schemes, as well as emerging and foundational technologies controlled pursuant to the Export Control Reform Act of 2018. The identified critical technologies must be utilized in or designed by a TID U.S. business for use in one of 27 specified industries identified by North American Industry Classification System (NAICS) codes, including the manufacturing of aircrafts, electronic computers, semiconductor machinery, computer storage devices, petrochemicals, and guided missile and space vehicles, among others.

Covered Investments Involving Critical Infrastructure

FIRRMA broadens CFIUS's authority to review non-controlling investments by a foreign person in a U.S. business that owns, operates, manufactures, supplies, or services critical infrastructure. This jurisdictional expansion applies only to specific types of critical infrastructure across certain subsectors, including transportation, telecommunications, energy and utilities; a new appendix to the Final FIRRMA Regulations identifies the scope of this term in more detail. The new regulations do not require a mandatory declaration for non-controlling foreign investments in critical infrastructure.

Covered Investments Involving Sensitive Personal Data

CFIUS may now review non-controlling investments by a foreign person in a U.S. business that maintains or collects the sensitive personal data of U.S. citizens in a manner that threatens U.S. national security. Under the Final FIRRMA Regulations, "sensitive personal data" encompasses ten categories of data maintained or collected by U.S. businesses that engage in the following:

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[1] Though the Critical Technologies Pilot Program was withdrawn on February 13, 2020, many of its key aspects have been enacted through the Final FIRRMA Regulations.

(i) tailoring or targeting products or services to certain populations, including U.S. military members and employees of federal agencies with national security responsibilities;

(ii) collecting or maintaining data on at least one million individuals within a 12-month period; or

(iii) having a demonstrated business objective to maintain or collect such data on greater than one million individuals within a 12-month period where such data is an integrated part of the U.S. business's primary products or services.

Specific categories of data that constitute sensitive personal data are narrowly identified under the new regulations to generally exclude the data collected by U.S. businesses on employees as a consequence of employment. Personal employment data associated with U.S. government contractors who hold personnel security clearances, however, would be within scope if such data meets the other necessary qualifications. The Final FIRRMA Regulations cover U.S. citizens' genetic information, as well as financial, geolocation, health, and biometric data.

In response to public comments concerned with the broad scope of genetic information covered in the proposed rules, the Treasury has incorporated revisions in the final rules to adjust the treatment of genetic data. The Final FIRRMA Regulations clarify that sensitive personal data will include the results of an individual's genetic tests, including any related genetic sequencing data, where such results constitute identifiable data, while any genetic data derived from databases maintained by the U.S. government and routinely provided to third parties for the purposes of research is expressly excluded. Non-controlling investments in sensitive personal data will not be subject to a mandatory declaration.

JURISDICTIONAL EXCEPTIONS AND CLARIFICATIONS

Excepted Foreign Investors and Excepted Foreign States

The Final FIRRMA Regulations invoke for the first time the concept of "excepted investors" from Australia, Canada, and the United Kingdom, which have been designated as "excepted foreign states" due to their robust intelligence-sharing and defense industrial base integration mechanisms with the U.S. As any exemption can potentially raise significant implications for U.S. national security, CFIUS has limited the number of excepted foreign states initially identified and instituted safeguards to ensure such states meet U.S. standards on national security-based foreign investment review processes and bilateral cooperation on such reviews. In order to determine whether countries can retain their status as excepted foreign states, CFIUS will assess whether U.S. standards have been met at the end of the two-year delayed effectiveness period (February 13, 2022).

Only certain indirect or non-controlling foreign investments in TID U.S. businesses are exempt for excepted foreign states under the Final FIRRMA Regulations, as CFIUS retains its authority to review transactions involving all foreign persons if they result in foreign control of a U.S. business. In addition, the new rules clarify that not all foreign persons based in an excepted foreign state will qualify as excepted investors. Foreign persons must meet strict guidelines regarding principal place of business, place of incorporation, ownership, and compliance with the law. However, addressing concerns raised during the public comment period, the Treasury has relaxed the following standards in the Final FIRRMA Regulations:

(i) excepted investors may now have up to 25% membership by non-excepted foreign states on their board of directors; and

(ii) the minimum excepted ownership percentage—i.e., the percentage ownership that must be held by the U.S. or excepted foreign state persons in order to maintain their status as an excepted investor—has been lowered from 90% to 80%.

As a result of the limited number of countries currently designated as excepted foreign states, as well as the low probability that additional countries will be designated as excepted foreign states in the future, this exception is unlikely to have a significant impact on the way the vast majority of foreign investors approach CFIUS filings. In addition, we note that qualifying as an excepted investor may be of little practical benefit in many cases. In particular, while excepted investors are not strictly required to file a declaration or notice with CFIUS when contemplating non-controlling investments in TID businesses, such investors are advised to carefully consider whether a voluntary filing is nevertheless warranted.

Investment Funds Exception

Under the Final FIRRMA Regulations, certain transactions involving indirect or non-controlling investments in TID U.S. businesses by a foreign person through an investment fund are exempted from CFIUS's authority where the following requirements are met:

(i) the fund is managed by a U.S. general partner or equivalent;

(ii) the foreign investor does not have control over the U.S. fund's management or investment decisions through the fund board or committee on which they sit as limited partner; and

(iii) the foreign investor does not have access to material non-public technical information on the target company.

As such, investments in U.S. businesses by any fund where one or more non-U.S. limited partners have indirect or non-controlling interests will not be subject to CFIUS's jurisdiction solely as a consequence of their membership or observer rights on fund committees or advisory boards, provided the above criteria are met. This exception has been retained from criteria included in the proposed rules on exemptions for passive foreign investments in TID U.S. businesses through U.S.-managed investment funds.

Substantial Ownership Qualifications

The Final FIRRMA Regulations require the submission of a mandatory declaration for covered transactions where a national or subnational foreign government of a single foreign state (not including an excepted foreign state) acquires a "substantial interest" in a TID U.S. business. In a significant change from the proposed regulations, the Final FIRRMA Regulations refine CFIUS's threshold for mandatory declarations by amending the definition of "substantial interest" to include the following:

(i) the foreign person must acquire a direct or indirect voting interest of 25% or more in a TID U.S. business; and

(ii) the foreign state must have a direct or indirect voting interest of 49% or more in the foreign-person acquirer of the TID U.S. business.

The new rules provide a number of examples to demonstrate application of the substantial interest test in various contexts. For example, in the case of an investment fund, the foreign government will be considered to hold a substantial interest if it holds 49% or more of the interest in the general partner, managing member, or equivalent of the entity.

Interim Definition for Principal Place of Business

In an effort to reduce ambiguity, the Final FIRMMA Regulations include a proposed definition for "principal place of business" in response to concerns raised during the public comment process over how such a term, not previously defined by CFIUS, would be applied. The definition clarifies which entities are subject to CFIUS's jurisdiction by adopting the U.S. federal courts' "nerve center" test,

where "principal place of business" is defined as the "primary location where an entity's management directs, controls, or coordinates the entity's activities."

The proposed definition reduces uncertainty for U.S.-managed private equity funds and investors by guaranteeing U.S. investments will not be subject to CFIUS review due to the jurisdiction of the investment vehicle. If an entity has represented in an official filing that its principal place of business is outside of the U.S., however, CFIUS will consider the fund's principal place of business to be the non-U.S. location, unless the entity can prove the situation has changed. Though the definition has become effective with the rest of the rule, the Treasury will accept public comments for 30 days before the definition is made final.

Incremental Investments

The Final FIRRMA Regulations also clarify that "incremental acquisitions," or transactions involving foreign persons acquiring an additional interest in a U.S. business over which that foreign person already received direct control as a result of a previous CFIUS-approved covered control transaction, do not qualify as "covered transactions" subject to CFIUS's review. This clarification strengthens the safe harbor protection afforded to parties whose covered control transactions received CFIUS approval. Importantly, the "incremental acquisitions" rule does not apply to foreign persons who did not acquire control in the prior transaction but do acquire control in the subsequent one; in such cases the later transaction is a covered control transaction.

CFIUS' JURISDICTION EXPANDED FOR REAL ESTATE TRANSACTIONS

The Final FIRRMA Regulations expand CFIUS's ability to review certain transactions involving U.S. real estate, including the purchase or lease by, or concession to, a foreign person of private or public real estate that:

(i) is, is within, or will function as part of certain specified air or maritime ports;

(ii) is in "close proximity"— defined as one mile—of certain specified U.S. military installations;

(iii) is within the "extended range"—defined as between one mile and 100 miles—of certain specified military installations; and

(iv) is within certain geographic areas associated with missile fields and offshore ranges.

Such transactions in U.S. real estate will be covered if they afford the foreign person three or more of the following property rights: (i) to physically access; (ii) to exclude others from physically accessing; (iii) to improve or develop; or (iv) to affix structures or objects.

The Final FIRRMA Regulations will exempt covered real estate transactions which involve foreign persons defined as "excepted real estate investors" based on their connection to "excepted real estate foreign states" – Australia, Canada, and the United Kingdom are the first countries to be assigned this status – and their compliance with certain criteria established pursuant to CFIUS's extended authority under FIRRMA. The new regulations create exceptions for the following, among other specified types of transactions:

(i) real estate transactions in an "urbanized area" or "urban cluster," as defined by the U.S. Census Bureau, excluding relevant ports and those in "close proximity" to certain specified military installations;

(ii) the purchase, lease, or concession of a single "housing unit," as defined by the Census Bureau;

(iii) the lease or concession of real estate in airports and maritime ports only for the purpose of retail sales; and

(iv) the purchase, lease, or concession of certain commercial space in a multi-unit commercial building.

The military installations covered through CFIUS's new authority over certain real estate transactions are listed by name in an appendix to the Final FIRRMA Regulations. The relevant maritime ports and airports are included in lists published by the U.S. Department of Transportation and are also identified in the regulations.

Covered transactions involving U.S. real estate are not subject to mandatory filing requirements. For all transactions, a short-form declaration notifying CFIUS of the transaction can be filed in order to potentially qualify for a safe harbor letter, which would limit CFIUS's authority to subsequently initiate a review of the transaction, except under limited circumstances.

EXPECTED FUTURE ACTIONS

Though the new regulations implement the majority of FIRRMA's provisions and include in-depth guidance, the Treasury is expected to establish additional rules and clarifications on the following:

- **Removal of use of NAICS codes in critical technologies definition:** The Treasury has indicated its intention to issue a notice of proposed rulemaking revising the mandatory declaration requirement regarding critical technology to eliminate the use of NAICS industry classifications and instead base the determination on export control licensing requirements.

- **Clarification on criteria for excepted foreign states:** The Treasury has signaled it may expand the list of "excepted foreign states." The Treasury has stated it will explicate the factors CFIUS will consider when making such a status determination, specifically with regard to an eligible foreign state's national security-based foreign investment review process and bilateral cooperation with the U.S. on national security-based investment reviews.

- **Definition for principal place of business:** As CFIUS is now receiving public comments on a proposed definition of "principal place of business," the definition will likely be finalized in the coming months, pending revisions based on such comments

- **Web-based tool to clarify scope of real estate regulations:** The Treasury anticipates it will make available a Web-based tool to help the public understand and interpret the geographic coverage of the new regulations for transactions involving certain U.S. real estate.

- **Filing fees:** The Final FIRRMA Regulations do not include provisions imposing filing fees; the Treasury has indicated it will enact a separate proposed rule regarding fees at a later date.

FINAL COMMENTS

Though the Final FIRRMA Regulations provide substantial guidance on CFIUS's expanded authority over non-controlling foreign investments and certain real estate transactions under FIRRMA, they also add significant complexity to the review process. Relevant parties must now consider: whether transactions are covered by the numerous stipulations of the final regulations, including broader and more diverse sector- and country-specific provisions; whether transactions are subject to mandatory filing requirements; and whether a short-form declaration or a full notice should be filed.

U.S. businesses pursuing foreign investment should be aware of their status under the new regulations, and they should alert investors to attributes of their business that may impact an analysis around CFIUS requirements or practice. Prospective non-U.S. acquirors of U.S. assets must similarly ensure

that they fully understand the new rules and their potential to impact deal timing and certainty, transaction structure, and post-closing plans for the business or assets to be acquired. Finally, in spite of the robust expansion of CFIUS's authority under the new rules and in relation to non-controlling investments, key stakeholders should remain cognizant of CFIUS's traditional jurisdiction over any transaction resulting in foreign control of a U.S. business.