

Legal Guidance for 2020 CFIUS Regulations

Overview

Masuda, Funai, Eifert & Mitchell, Ltd. recently filed a voluntary declaration under the new regulatory framework with CFIUS for one of our clients.

On January 13, 2020, the Office of Investment Security, Department of Treasury published its final regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"), which defines the jurisdiction and authorities of the Committee of Foreign Investment in the United States ("CFIUS") and modernizes CFIUS's review process of certain transactions that fall under its jurisdiction. The final regulations became effective on February 13, 2020. CFIUS issued its regulations in two parts: (1) Provisions Pertaining to Certain Investments in the United States by Foreign Persons; and (2) Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate.

Part 1, Provisions Pertaining to Certain Investments in the United States by Foreign Persons (31 C.F.R. part 800), replaces the current regulations in the Code of Federal Regulations ("C.F.R.") and applies changes FIRRMA made to CFIUS's expanded scope of authority with respect to foreign investments, as well as the establishment of a mandatory review process for transactions that afford a foreign person certain access in businesses involved with critical technology, critical infrastructure, or certain sensitive data.

Part 2, Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate (31 C.F.R. part 801), creates a new part in the C.F.R. and produces new regulations that implement CFIUS's new authority under FIRRMA to review the concession to, or purchase or lease by a foreign person of certain real estate in the United States.

This article will (1) address and summarize the main changes of CFIUS regulations in Part 1; (2) explain a sample analysis on whether a mandatory declaration or voluntary notice should be filed under Part 1; and (3) provide a flowchart illustrating a decision tree on whether a transaction is a covered transaction and whether a mandatory declaration is required, or if a mandatory declaration is not required, whether a voluntary notice may be recommended under Part 1.

1. Main Changes

The Defense Production Act of 1950 ("DPA") charges CFIUS to "review any covered transaction to mitigate any risk to the national security of the United States that arises as a result of such transaction." FIRRMA significantly expanded the definition of "covered transaction" and with its expanded definition broadened CFIUS jurisdiction to review other transactions, previously not included to address national security concerns arising from certain non-controlling investments and real estate transactions. Specifically, under the new definition covered transactions include:

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(i) "covered control transactions;" (ii) "covered investments;" (iii) any change in a foreign person's rights regarding an existing investment in a U.S. business that could result in a "covered control transaction" or a "covered investment;" (iv) or any other transaction, transfer, agreement, or arrangements designed or intended to evade or circumvent CFIUS review. Lastly, FIRRMA established a new class of transactions for which filing with CFIUS is mandatory, as opposed to voluntary, and made changes to the timeline of the CFIUS review process.

a) Covered Control Transaction

Prior to FIRRMA, DPA charged CFIUS solely with the review of transactions which could result in foreign control of a U.S. business. The new regulations did not change CFIUS existing jurisdiction over transactions that could result in foreign control and did not significantly modify the existing definition of "control." Section 800.210 defines a covered control transaction as "any transaction that is proposed or pending... by or with any foreign person that could result in foreign control of any U.S. business, including transactions carried out through joint ventures." A U.S. business with respect to CFIUS's regulations is "any entity engaged in interstate commerce in the United States." This includes branch offices or subsidiaries of foreign corporations. Importantly, a foreign corporation without a branch office, subsidiary, or fixed place of business in the United States that provides remote services or the exports of goods but does not have any assets or personnel located in the United States is not a U.S. business under CFIUS's jurisdiction.

CFIUS's regulations define "control" as "the power... to determine, direct, take, reach, or cause decisions regarding" important matters affecting an entity, including sales of principal assets, organizational changes of the entity and its facilities, major financial actions and commitments, pursuit of new business lines and ventures, significant contracts, policies and procedures with respect to certain non-public information, appointment and dismissal of officers, senior managers, or general partners, amendments to organizational or formation documents, and the appointment and dismissal of employees with access to critical technology, such as defense articles or products relating to nuclear equipment, and other sensitive or classified U.S. government information.

Notably, with respect to CFIUS's authority to review certain transactions, it does not matter whether the foreign person's power to influence these matters is direct or indirect, formal or informal, or whether the foreign person chooses to exercise this power. If the transaction *could* result in the control by a foreign person of a U.S. business, CFIUS has jurisdiction to review the transaction.

b) Covered Investment

CFIUS's expanded jurisdiction to include non-controlling investments and to require mandatory declaration filings are the most significant changes under FIRRMA. Specifically, this new authority applies to controlling and non-controlling investments in U.S. businesses that fall under the definition of "TID U.S. businesses." A TID U.S. business is a business that:

- Produces, designs, tests, manufactures, fabricates, or develops one or more "critical technologies," which definition includes specific items that are subject to export controls and other regulatory frameworks, such as defense articles or defense services, as well as emerging and foundational technologies regulated according to the Export Control Reform Act of 2018; or

- Owns, operates, manufactures, supplies, or services certain “covered investment critical infrastructure,” which includes specified and enumerated functions covering multiple areas, such as telecommunications, utilities, energy, and transportation; or
- Maintains or collects “sensitive personal data” of U.S. citizens, which “sensitive personal data” includes ten specific categories of identifiable data kept by the U.S. business to either (i) target or tailor products or services to U.S. military members or employees of federal agencies with national security responsibilities; (ii) collect or maintain data within one or more of ten specific categories on at least one million individuals; or (iii) demonstrate a business objective to collect or maintain data within one or more of ten specific categories on at least one million individuals. The ten categories of data include certain types of financial, health, biometric, and communications, as well as federal and state government personnel information.

Furthermore, a non-controlling investment in a TID U.S. business is a “covered investment” under the new regulations if it affords the foreign person:

- Access to any material nonpublic technical information in the possession of the U.S. TID business; or
- Membership of observer rights on, or the right to nominate an individual to a board position or equivalent governing body of the TID U.S. business; or
- Any involvement, other than voting of shares, in substantive decision making of the TID U.S. business regarding: (i) the use, development, acquisition, safekeeping, or release of sensitive personal data of U.S. citizens that is collected and maintained by the TID U.S. business; (ii) the use, development, acquisition, or release of critical technologies; or (iii) the management, operation, manufacture, or supply of covered investment critical infrastructure.

CFIUS defines “material nonpublic technical information” as information that provides knowledge, an understanding, or a know-how that is not available to the public and relates to the design, location, or operation of covered investment critical infrastructure.

Once a transaction meets the above outlined requirements, the transaction is a “covered investment” and subject to CFIUS’s expanded jurisdiction, irrespective of the percentage of voting interest acquired or previously concluded actions by CFIUS. However, there are certain exceptions. For example, the new regulations carve out from the definition of covered investments an exception for investments by foreign investors based on their ties with certain countries defined as “excepted foreign states.” “Excepted foreign states” are select countries that have robust intelligence-sharing and defense industrial base integration mechanisms with the United States. Currently, excepted foreign states are Australia, Canada, and the U.K. CFIUS identified these specific countries as excepted foreign states based on their “their robust intelligence-sharing and defense industrial base integration mechanism with the United States.” CFIUS reserves the right to update the list of excepted foreign states.

In order to fall under the “excepted foreign states” exception the foreign investor must be (i) a national of one or more excepted foreign states and not also a national of any other foreign state that is not an excepted foreign state; (ii) a foreign government of an excepted foreign state; or (iii) a foreign entity that meets specific conditions, such as being organized under the laws of an excepted foreign state or the U.S., having its principal place of business in an excepted foreign state or the U.S., and 75% or more of its members or observers of the board of directors are either U.S. nationals or nationals of an excepted foreign state. However,

investments of *all* foreign persons, including excepted foreign states, that could result in foreign control of a U.S. business remain subject to CFIUS's general jurisdiction.

In its new CFIUS regulations, the Department of the Treasury has proposed an interim rule for a new definition of "principal place of business" in response to comments it received. The proposed rule defines "principal place of business" as "the primary location where an entity's management directs, controls, or coordinates the entity's activities, or in 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."

Lastly, indirect investments in TID U.S. businesses through investment funds may also be exempt from covered investments if the investment: (i) affords the foreign person membership as a limited partner or equivalent on an advisory board or a committee of the fund, and (ii) that fund is managed exclusively by a general partner or equivalent who is not a foreign national, and (iii) the foreign person's position on the advisory board does not afford the foreign person to influence or control important decision or matters.

c) Mandatory Declarations

Under the new regulations some transactions require a mandatory filing:

- Covered transactions that result in the acquisition of a substantial interest in a TID U.S. business by a foreign person in which the national or subnational government of a single foreign state, other than Australia, Canada, and the U.K., have a substantial interest; and
- Covered investments in a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops on or more critical technologies that are either (i) utilized or (ii) designed specifically for use in certain industries that CFIUS has identified in Appendix B to 31 C.F.R. part 800, such as aircraft manufacturing and primary battery manufacturing industries.

"Substantial interest" in the context of the acquisition of interest by a foreign person means 25 % or more of indirect or direct voting interest. In the context of a foreign person in which the national or subnational government of a single foreign state have an interest, "substantial interest" means 49 % or more of direct or indirect voting interest.

Importantly, section 800.215 of 31 C.F.R. part 800 defines "critical technologies" to mean the following:

- Defense articles or defense services included on the United States Munitions List (USML) set forth in the International Traffic in Arm Regulations (ITAR) (22 C.F.R. parts 129-130), which includes 21 categories of articles, such as firearms, ammunition, and launch vehicles, etc.;
- Items included on the Commerce Control List (CCL) set forth in Supplement No. 1 to part 774 of the Export Administration Regulations (EAR) (15 C.F.R. parts 730-774), which includes 10 categories, spanning from nuclear materials to electronics and computers, and controlled (1) pursuant to unilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology; or (2) for reasons relating to regional stability or surreptitious listening;

- Specifically, designed and prepared nuclear equipment, parts and components, materials, software, and technology covered by 10 C.F.R. part 810 (relating to assistance to foreign atomic energy activities);
- Nuclear facilities, equipment, and material covered by 10 C.F.R. part 110 (relating to export and import of nuclear equipment material);
- Select agents and toxins covered by 7 C.F.R. part 331, 9 C.F.R. part 121, or 42 C.F.R. part 73; and
- Emerging and foundational technologies controlled under section 1758 of the Export Control Reform Act of 2018 (50 U.S.C. 4817).

The mandatory declaration must be prepared using a 5-page form (total of 8 pages, including the annexes) available on the Department of Treasury website. Once the mandatory declaration is accepted by the staff chairperson and then received by CFIUS the new 30-day assessment period begins.

In addition, parties may, for cautionary purposes, voluntarily file a declaration with CFIUS using the same form, even if it is not mandatory.

Parties remain free to file a voluntary notice, which is the traditional and substantially more extensive filing, with CFIUS. Once a voluntary notice has been accepted and received by the Committee, a 45-day review period starts.

2. Sample Analysis

Foreign Corporation A is a Japanese company with its principle place of business in Tokyo, Japan. No foreign government has a substantial interest of 49 % or more in Foreign Corporation A. Corporation A proposes to acquire a 4%, non-controlling equity interest in Corporation B. Corporation B, located in Schaumburg, Illinois, is engaged in interstate commerce in the U.S. and manufactures critical technology. Corporation B manufactures its products for commercial off-the-shelf use by businesses in various industries, including some that are identified in CFIUS's Appendix B. Under the terms of the investment, a designee of Foreign Corporation A will have the right to observe the meetings of the board of directors of Corporation B.

Question 1: Is Foreign Corporation A investing in a TID U.S. business?

Answer: Yes. Corporation B is a TID U.S. business. It manufactures critical technology.

Question 2: Is this a covered investment?

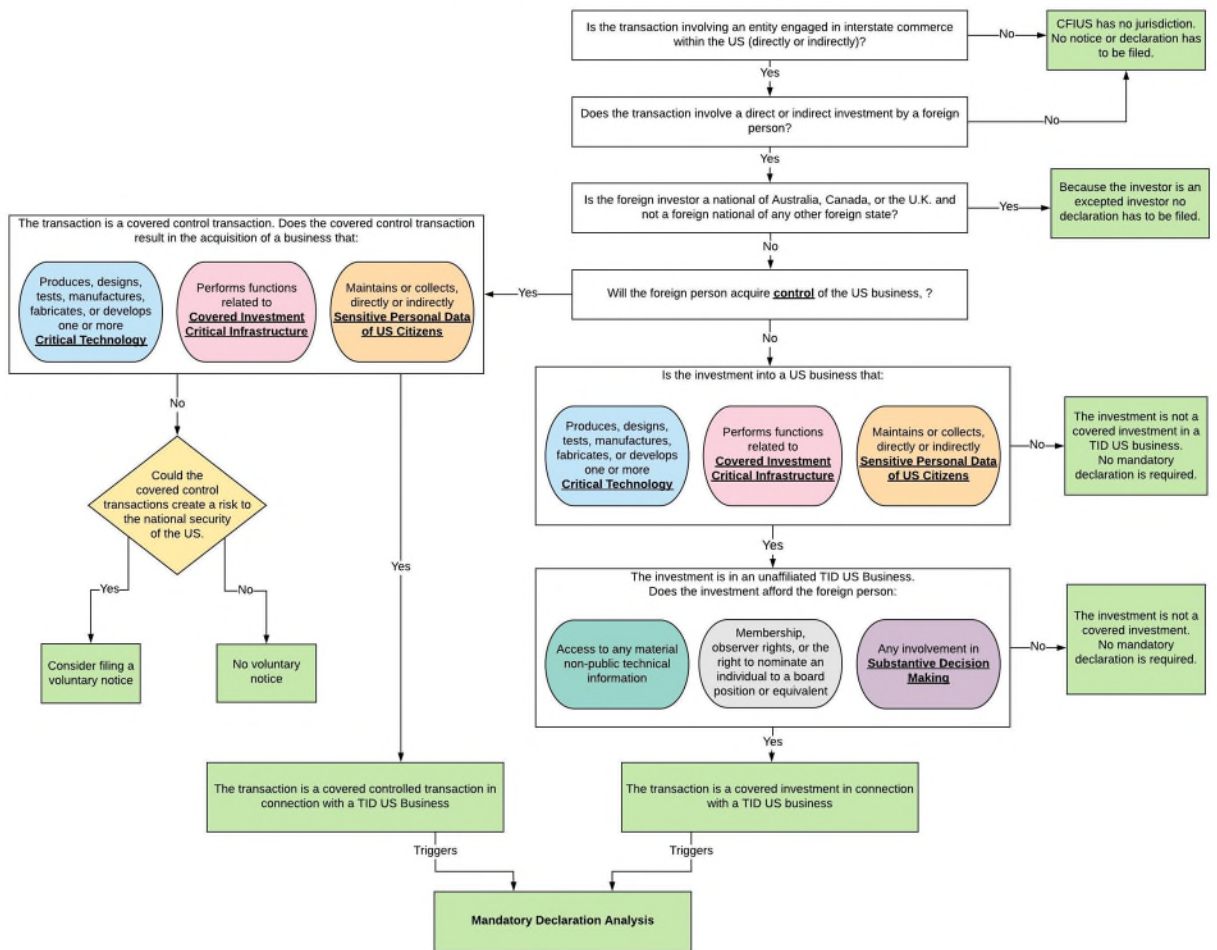
Answer: Yes. Foreign Corporation A will have access to material non-public technical information of Corporation B. Foreign Corporation A is Japanese and not a national of Australia, Canada, or the U.K. Thus, Foreign Corporation A is not an excepted investor.

Question 3: Is a mandatory declaration filing required?

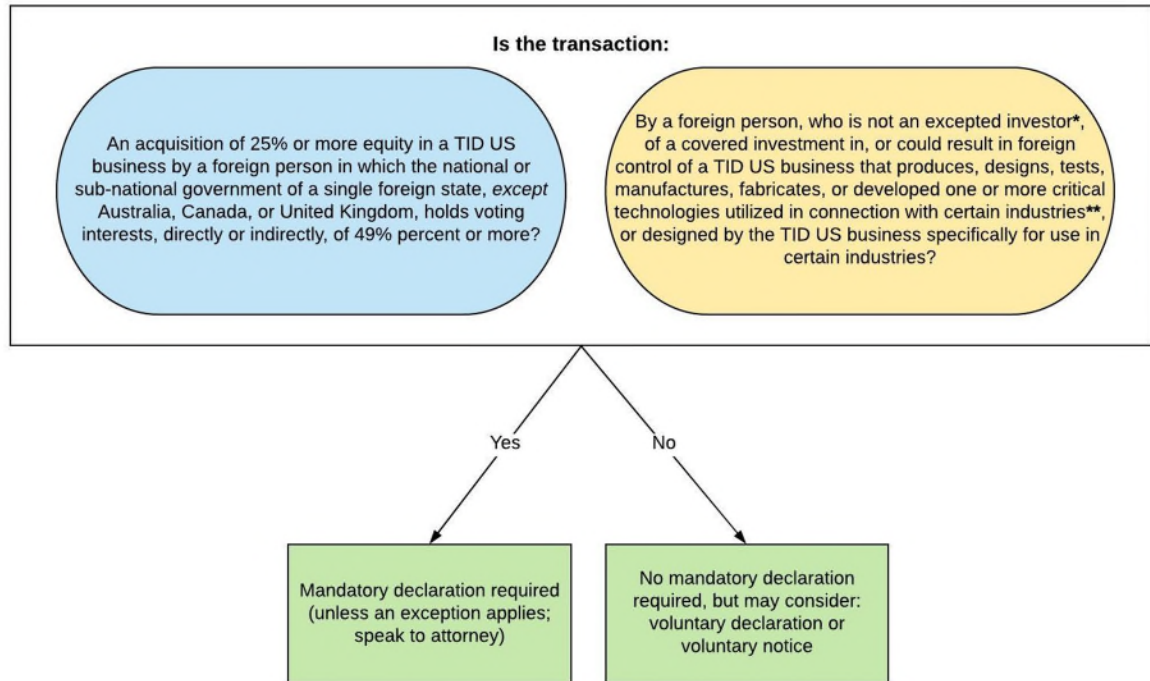
Answer: No. Even though the transaction is a covered investment in an unaffiliated TID U.S. business, Corporation B does not produce, design, test, manufacture, fabricate, or develop critical technology specifically for the use in one or more industries identified by CFIUS. Instead, it manufactures its products for commercial off-the-shelf use in various industries. Thus, the proposed transaction is not subject to a mandatory declaration, but a declaration or voluntary notice may be filed.

3. Decision Trees for Covered Transactions and Mandatory Declaration Analyses

Covered Transaction Analysis



Mandatory Declaration Analysis



*An **excepted investor** is a foreign national, who is a national of Australia, Canada, or the U.K. and not a foreign national of any other foreign state.

** These certain industries are the following, as listed in Appendix B of 31 C.F.R.

Part 800:

Aircraft Manufacturing;
 Aircraft Engine and Engine Parts Manufacturing;
 Alumina Refining and Primary Aluminum Production;
 Ball and Roller Bearing Manufacturing;
 Computer Storage Device Manufacturing;
 Electronic Computer Manufacturing;
 Guided Missile and Space Vehicle Manufacturing;
 Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing;
 Military Armored Vehicle, Tank, and Tank Component Manufacturing;
 Nuclear Electric Power Generation;
 Optical Instrument and Lens Manufacturing;
 Other Basic Inorganic Chemical Manufacturing;;
 Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing;
 Petrochemical Manufacturing;
 Powder Metallurgy Part Manufacturing;
 Power, Distributions, and Specialty Transformer Manufacturing;
 Primary Battery Manufacturing;
 Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing;
 Research and Development in Nanotechnology;
 Research and Technology in Biotechnology (except Nanobiotechnology);
 Secondary Smelting and Alloying of Aluminum;
 Search, Detection, Navigation, Guidance, Aeronautical, and Nautical Systems and Instrument Manufacturing;
 Semiconductor and Related Device Manufacturing;
 Semiconductor Machinery Manufacturing;
 Storage Battery Manufacturing;
 Telephone Apparatus Manufacturing;
 Turbine and Turbine Generator Set Units Manufacturing.