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The CFIUS Reform Bill

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On August 1, 2018, the Senate passed the Foreign Investment Risk Review Modernization Act (FIRRMA) as part of the 2019 defense authorization bill. FIRRMA represents the most sweeping changes to the law governing the Committee on Foreign Investment in the United States (CFIUS) since the passage of the Foreign Investment and National Security Act of 2007 (FINSA). While some provisions will take effect immediately upon enactment, many important details will be finalized only through the CFIUS rule making process or will be developed over time pursuant to CFIUS practice. The bill had already been passed by the House of Representatives and now awaits President Trump's signature; he is expected to sign the bill into law by mid-August.

FIRRMA contains several changes that will affect how parties approach foreign investment transactions and navigate the CFIUS process. Namely, FIRRMA makes the following alterations to the CFIUS landscape, which we discuss in more detail below:

- Expansion of CFIUS jurisdiction, including non-controlling investments and real estate;
- Specific carve-out for private equity funds with foreign investors;
- Introduction of declarations—abbreviated, 5-page filings;
- Mandatory declarations for certain foreign government-controlled transactions;
- Extension of the CFIUS timeline;
- Imposition of a filing fee;
- Grant of authority for CFIUS to suspend transactions; and
- Implementation of a new export control regime to address emerging technology.

Scope of CFIUS Jurisdiction Extended

FIRRMA revises the definition of a "covered transaction" to expand the scope of CFIUS's jurisdiction in several areas:

Certain Non-Controlling Investments

CFIUS jurisdiction is currently based on the transfer of control over a U.S. business to a foreign person. Under FIRRMA, CFIUS will be able to review non-controlling "other investments" by a foreign person in an unaffiliated U.S. business in certain circumstances. These circumstances focus on the sensitivity of the U.S. business—namely, where the U.S. business (1) owns,

operates, manufactures, supplies, or services critical infrastructure; (2) produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies; or (3) maintains or collects sensitive personal data of U.S. citizens that may be exploited in a way that threatens U.S. national security.

"Other investments" for purposes of this section is defined broadly. It includes any direct or indirect investment that would not otherwise qualify as a covered transaction, but allows the foreign investor (1) access to any material nonpublic technical information in possession of the U.S. business; (2) membership or observer rights on the board of directors (or equivalent) or the right to nominate a director (or equivalent); or (3) any substantive decision-making rights regarding sensitive personal data of U.S. citizens, critical infrastructure, or critical technology. Therefore, non-controlling transactions involving U.S. critical infrastructure, critical technology, or personal data will only become covered transactions if they also possess at least one of these factors.

FIRRMA defines critical infrastructure broadly to include "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security." This wording mirrors the language used in FINSA and by the Department of Homeland Security to describe the sixteen critical infrastructure sectors of the U.S. economy. It is likely that CFIUS regulations will provide further guidance on which critical infrastructure sections may lead to a transaction becoming a covered "other investment."

The definition of "critical technologies" includes the following:

- Defense articles or defense services included on the U.S. Munitions List of the International Traffic in Arms Regulations (ITAR);
- Items included on the Commerce Control List of the Export Administration Regulations (EAR) that are controlled by multilateral regimes (for reasons such as national security, chemical or biological weapons proliferation, nuclear nonproliferation, or missile technology) or for reasons relating to regional stability or surreptitious listening;
- Nuclear equipment, facilities, materials, software, and technology subject to export regulations by the Department of Energy or Nuclear Regulatory Commission;
- Select agents and toxins; and
- Emerging and foundational technologies (which will be discussed later in this alert).

With the exception of emerging and foundational technologies, this list largely consists of export-controlled items that are already part of the CFIUS notice as defined by CFIUS regulations. The list is potentially quite broad, and even includes certain items controlled only for encryption reasons. However, this definition does tie the concept of emerging and foundational technologies closer to the CFIUS review process. The exact details of how these technologies will affect a CFIUS filing may be determined in the CFIUS rulemaking process.

However, FIRRMA provides a specific carve-out to avoid capturing nearly all private equity investments where foreign limited partners have contributed to the fund. If a portfolio investment by a private fund meets all of the below criteria, it will not be considered an "other investment" and accordingly will not trigger a CFIUS filing:

- The fund must be managed exclusively by a general partner, managing member, or equivalent;
- The general partner, managing member, or equivalent must be a U.S. person;
- Any advisory board or committee containing the foreign person does not have approval rights or control over investment decisions of the fund or decisions made by the general partner, managing member, or equivalent related to entities in which the fund is invested;
- The foreign limited partners do not otherwise have the ability to control the fund, including approval rights or control over investment decisions of the fund, approval rights or control over the decisions made by the general partner, managing member, or equivalent, or the power to dismiss or select the compensation of the general partner, managing member, or equivalent; and
- The foreign limited partners do not have access to material nonpublic technical information as a result of their participation on the advisory board or committee.

Any private equity firm that raises money from foreign investors should review these requirements carefully and ensure that its funds and acquisitions are structured in such a way to take advantage of this safe harbor from CFIUS jurisdiction established by FIRRMA.

Real Estate Transactions

While CFIUS has always had the ability to review certain real estate transactions involving an existing U.S. business, FIRRMA codifies this existing ability and expands it beyond the current jurisdiction. CFIUS will now have the ability to review the purchase or lease by (or concession to) a foreign person of private or public real estate in the United States that (1) is located within or will function as part of an airport or port; or (2) is in close proximity to a U.S. military installation or otherwise sensitive U.S. governmental facility or property. This includes “greenfield” purchases of empty land, which were formerly excluded from CFIUS jurisdiction since empty land is not considered a U.S. business.

Given the breadth of the grant of jurisdiction relating to real estate, more specific regulations or guidance from CFIUS will be needed to determine the extent of FIRRMA’s impact on the real estate industry. In particular, CFIUS will have to define “close proximity” and provide some guidance on which government facilities are considered sensitive. However, in recognition of the potential regulatory burden on real estate transactions, FIRRMA does not include transactions related to single family housing units or real estate in “urbanized areas.”

Changes in Rights

Though likely already covered by existing CFIUS regulations, FIRRMA clarifies that changes in the rights of a foreign person could result in a “covered transaction” that will trigger CFIUS review. Under FIRRMA, any change in the rights that a foreign person has with respect to a U.S. business becomes a covered transaction if it results in foreign control of the U.S. business or if it fulfills the criteria of an “other transaction” (as described above).

Evasion and Circumvention

CFIUS now explicitly has the power to review a transaction, transfer, agreement, or arrangement where the structure is designed or intended to evade or circumvent CFIUS jurisdiction.

Declarations: Short/Expedited Filings for Certain Transactions; Mandatory Filings for Others

FIRRMA introduces a new, abbreviated type of CFIUS filing for the first time: the declaration. The declaration may be submitted instead of the complete joint voluntary notice. It is an "abbreviated notification" that will be limited to five pages in length. The exact contents of a declaration are not specified by FIRRMA and will be set out by CFIUS in the regulatory rulemaking process. Upon receipt of a declaration, CFIUS will have 30 days to review and may conclude by: (1) requesting the parties file a joint voluntary notice; (2) initiating a unilateral review of the transaction; (3) informing the parties that it is unable to take action based on the declaration alone; or (4) informing the parties that there are no unresolved national security concerns and CFIUS has completed its review of the transaction.

The declaration process may be an attractive middle ground in foreign buy-side transactions that the parties view as presenting a lower CFIUS risk and are inclined not to go through the uncertainty, delay, and expense of a full CFIUS filing. Though the final bill eliminated a "whitelist" of friendly and allied countries for which CFIUS filings would not be required, it seems likely that this voluntary declaration process will be used by foreign acquirers located in such countries to mitigate their CFIUS risk while avoiding formal filings.

Additionally, the declaration process introduces the first mandatory CFIUS filings in the history of the Committee. Parties must file a declaration for any transaction where the U.S. business (1) is being acquired by a foreign person in which a foreign government has, directly or indirectly, a substantial interest and (2) is involved in critical infrastructure, critical technology, or sensitive personal data of U.S. citizens. Congress did not define "substantial interest," instead leaving this definition to CFIUS's rulemaking power. However, they did provide limits and contours—if an interest is less than a 10% voting interest and does not otherwise meet the criteria for "other investment," it will not be considered a substantial interest. Similarly, if a transaction would fit the safe harbor exception for passive investments described above, it will also be given safe harbor from the mandatory declaration process. FIRRMA allows for civil penalties for not filing mandatory declarations.

The declaration process (including the requirement for mandatory filings) will not take effect immediately upon FIRRMA being signed into law. It will become effective on the earlier of (1) 18 months after the date of FIRRMA's enactment or (2) 30 days after publication in the Federal Register of a determination by the CFIUS chairperson that the required regulations, structure, personnel, and resources necessary to administer the new provisions are in place.

Because this represents the first truly mandatory filing in the history of CFIUS, companies involved in mergers and acquisitions should familiarize themselves with the triggers for mandatory declarations. Such companies should ensure that their diligence processes are updated to reflect these changes and to confirm the level of foreign government ownership or control in any potential acquirer. It remains to be seen how CFIUS will interpret FIRRMA's declaration provisions during the rulemaking process. As written, whether a foreign government has a "substantial interest" in a foreign person could be ambiguous in certain scenarios, which could lead to disagreements over whether a mandatory declaration is required. Accordingly, this is an area where we expect CFIUS rule making to play a significant role.

Timing Changes and Filing Fees

As predicted, FIRRMA will extend the potential timeline for CFIUS reviews. The current 30-day period will be extended to 45 days. The investigation period will remain a 45-day period, but CFIUS will be able to extend that period by 15 days in "extraordinary circumstances." These changes extend the official "on the clock" CFIUS time from a potential 75 days to a potential 105 days. Additionally, these changes become effective for any review or investigation initiated on or after the date of FIRRMA's enactment into law. If a CFIUS review concludes after FIRRMA becomes law and CFIUS chooses to refer it to investigation, that case will be subject to the new potential 60-day investigation period.

However, FIRRMA also now requires CFIUS to provide comments on a draft or formal filing and accept a formal filing within ten business days of the submission of such filing. In the past, when CFIUS was particularly overburdened, parties to a transaction could see wait times for draft comments stretch into multiple weeks, and even incur delays in the acceptance of a formal written filing, neither of which were circumscribed by law or regulation. Unlike the extended review timeline, this change is not immediate. It, like the declaration process, will become effective on the earlier of (1) 18 months after the date of FIRRMA's enactment or (2) 30 days after publication in the Federal Register of a determination by the CFIUS chairperson that the required regulations, structure, personnel, and resources necessary to administer the new provisions are in place.

These changes, once implemented, may help increase certainty with respect to the timing of the CFIUS process. The true impact of these changes will only be ascertained once they have been effective for some time. It is possible that with the longer timeline, fewer cases may be subject to requests to withdraw and refile in order to give CFIUS additional time. For a case that was destined to be withdrawn and refiled, the potential 105-day timeline still represents a time savings over two 75-day timelines after withdrawal and refiling. It remains to be seen precisely what will constitute "exceptional circumstances," and if they line up with the circumstances that currently trigger a withdraw and refile request. Additionally, it is possible that the extended first-stage review period may reverse the trend of a large majority of cases proceeding to investigation. Historically, around half of CFIUS transactions had been cleared in the 30-day review period; recently, however, this figure had increased significantly in part due to CFIUS's increased workload.

CFIUS will also begin charging filing fees for joint voluntary notices (but not the new declarations). Beginning as of the date of FIRRMA's enactment into law, FIRRMA permits CFIUS to charge fees of no more than 1% of the total value of the transaction or $300,000, whichever is less.

Authority to Suspend Transactions

Currently, the only person with the authority to suspend or block transactions is the President. Parties to a transaction being reviewed by CFIUS are currently technically permitted to close the transaction during the pendency of CFIUS review. FIRRMA grants CFIUS itself the authority to suspend a proposed or pending covered transaction that potentially poses a national security risk to the United States for as long as the covered transaction is under review. Additionally, CFIUS will have the ability to refer a transaction to the President for formal action (i.e. blocking) at any time during the review, rather than just at the end of the 45-day investigation period.

Export Control Modifications

In early drafts, FIRRMA vested CFIUS with increased jurisdiction where a U.S. business being acquired by a foreign person dealt in certain emerging technologies—including various restrictions on the flow of intellectual property from the U.S. business to foreign persons. Congress ultimately decided to address the issue of emerging technologies that may not be covered under existing export control authorities such as the Export Administration Regulations (EAR) or International Traffic in Arms Regulations (ITAR) by establishing additional export controls under the jurisdiction of the Department of Commerce rather than CFIUS. This was split from FIRRMA and is now titled the Export Controls Act of 2018 (ECA), which is also part of the passed 2019 defense authorization bill.

The ECA focuses on the control of "emerging and foundational technologies" that are not covered under the restrictions of the EAR and ITAR. Emerging and foundational technologies are defined as technologies that are essential to U.S. national security, but are not considered "critical technology" under FIRRMA. Under the ECA, an interagency process will identify emerging and foundational technologies through several avenues, including CFIUS reviews and classified intelligence information. This process will include the Departments of the Treasury, Defense, Energy, and State, as well as any other relevant agencies.

Emerging and foundational technologies will be subject to export licensing requirements as developed in regulations to come. However, the ECA provides that at a minimum, any export, reexport, or in-country transfer of such technology to a country subject to an embargo, including an arms embargo, by the United States, will require an export license. In addition to the comprehensively sanctioned countries, this language would also cover exports to China. A key component of the debates surrounding FIRRMA centered around Chinese appropriation and acquisition of U.S. emerging technologies, and many recent controversial CFIUS cases have involved Chinese acquisition of cutting-edge technologies, such as semiconductors.

Conclusion

FIRRMA greatly alters the landscape for inbound foreign investment transactions. Any company involved in international mergers and acquisitions, private equity, fund formation, or U.S. real estate transactions should become familiar with FIRRMA and the new procedures surrounding CFIUS it creates.