

## CFIUS – FIRRMA PROPOSED REGULATIONS EXPAND U.S. SCRUTINY OF CROSS-BORDER DEALS

October 1, 2019

### I. Executive Summary

On September 17, 2019, the U.S. Department of the Treasury published proposed final regulations to implement the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”), a major effort to modernize and expand the jurisdiction of the Committee on Foreign Investment in the United States (“CFIUS”) for current national security concerns, particularly in sensitive technologies, infrastructure and data. In particular, CFIUS jurisdiction will in some circumstances include *minority*, as opposed to control, foreign investments in U.S. businesses with involvement in those critical sectors, whether those sectors are the target U.S. business’s core business or not. Also, certain real estate transactions with potential national security implications will be subject to CFIUS review. Final versions will take effect by February 13, 2020, as required by FIRRMA.

### II. Background

#### a. CFIUS

The principal law regulating foreign investment in the United States is the Exon-Florio amendment to the 1988 Omnibus Trade Bill (“Exon-Florio”). Exon-Florio authorizes, and in some cases mandates, the President of the United States to review, on national security grounds, mergers, acquisitions and takeovers of U.S. businesses by non-U.S. (“foreign”) persons or entities. The investigation is mandatory when the acquirer is “an entity controlled by or acting on behalf of a foreign government” and when the acquisition could “affect” U.S. national security. The definition does not require majority control by the foreign acquirer, whether a state or private party; Exon-Florio implicates even minority investments when effective control of the U.S. target is obtained by the foreign party in the transaction. Furthermore, a foreign entity need not be majority owned by foreign state or private parties to implicate mandatory or discretionary Exon-Florio review if a foreign minority owner has effective control equivalent to majority or veto rights through “golden shares,” classes of shareholder rights, or other minority control devices.

Exon-Florio review in practice has been conducted under delegated authority to CFIUS, which is an inter-agency panel chaired by the Secretary of the Treasury and including the Secretaries of

State, Defense, Homeland Security, Energy, and Commerce; the Attorney-General, the U.S. Trade Representative, and the Chair of the Council of Economic Advisors.

Notification to CFIUS of a potentially implicated, but not mandatory, transaction prior to closing is voluntary but encouraged. CFIUS may also initiate review of a transaction on its own motion either prior to or post-closing. Upon receipt of a notice, CFIUS has 30 days to decide whether to conduct an Exon-Florio review. If CFIUS decides to review the transaction, it has 45 days to review and render a decision. The President then has 15 days to review and approve the CFIUS decision. Information submitted during the review process is confidential. Executive authority under Exon-Florio may be exercised only if the President finds that (i) there is credible evidence that the foreign entity “might take action that threatens to impair the national security;” and (ii) other statutory authorities, including the International Emergency Economic Powers Act, do not provide adequate protection for national security. Upon such findings, the President may prohibit or suspend a proposed transaction, or order divestiture of a completed one. No judicial review is permitted. Because transactions *not* reported to CFIUS may be subsequently reviewed at any time and the divestiture sanction imposed without the possibility of judicial review, voluntary Exon-Florio reporting in the early stages of a transaction that would grant effective control to a foreign person and which may implicate security concerns is sound practice.

b. FIRRMA

FIRRMA was enacted in August 2018 to expand and reinforce CFIUS’s jurisdiction and modernize its application in the post 9/11, cybercrime age. FIRRMA expanded CFIUS jurisdiction to include certain non-control transactions – that is, transactions in which the foreign investor did not gain legal control of the U.S. target. FIRRMA added to the types of CFIUS covered transactions real estate transactions for properties located proximity to sensitive U.S. government facilities; other investments in certain U.S. businesses that give a foreign person or entity access to material nonpublic technical information in possession of the U.S. business, membership on the U.S. target’s board of directors, or other decision-making rights; any change in a foreign investor’s rights resulting in foreign control of a U.S. business or “other investment” in certain U.S. businesses; and any other transaction or agreement designed to circumvent CFIUS jurisdiction. FIRRMA also expanded the CFIUS review period from 30 to 45 days, subject to extension for another 15 in case of extraordinary circumstances, allowed a streamlined filing process, and allowed for CFIUS pilot programs, which the Treasury Department initiated in October 2018, and which will continue going forward.

### III. The Proposed Regulations and Discussion

The proposed final regulations were published on September 17, 2019, are out for public comment until October 17, 2019 and must, pursuant to FIRRMA, take effect by February 13, 2020. The proposed regulations were issued in two parts: those pertaining to certain investments in the U.S. by foreign persons; and those pertaining to certain transactions by foreign persons involving real estate in the U.S.

The most significant feature of the proposed regulations is to expand CFIUS jurisdiction beyond transactions that would result in foreign control of U.S. business to include *non-controlling investments*, direct or indirect, by a foreign person, that give the foreign person:

- Access to material nonpublic technical information in possession of the U.S. business;
- Board of Directors (or equivalent governance body) membership or observer status, or the right to nominate others to those governance bodies;
- Any involvement, other than by voting of shares, in substantive decision making by the U.S. business regarding
  - use, development, acquisition or release of “Critical Technologies;”
  - management, operation or supply of “Critical Infrastructure;” and
  - use, development, acquisition, safekeeping or release of “Sensitive Personal Data” of U.S. citizens collected or maintained by the U.S. business.

The relevant sectors are called in the proposed regulations “TID” businesses, for Technologies, Infrastructure, and Data. Non-control investments implicating the TID sectors are called “Covered Investments.”

The proposed regulations define Critical Technologies generally as those subject to technology export regulations such as the International Traffic in Arms (“ITAR”) regulations of the U.S. State Department (which notably includes most satellite and space technology, and is more expansive than the “arms” part of the title would imply) and the Export Administration Regulations (“EAR”) of the U.S. Department of Commerce, as well as the Export Control Reform Act of 2018.

Critical Infrastructure includes U.S. businesses owning, operating, manufacturing, supplying, or servicing telecommunications, utilities, energy, and transportation.

Sensitive Personal Data is defined to include ten categories of personal data collected or maintained by U.S. businesses including military personnel, federal employees in national security agencies, and populations of over one million individuals. The categories affected include financial, biometric, geolocation, and health data.

In other words, under CFIUS up until now, only majority investments – acquisitions of one kind or another – by a foreign investor of a U.S. target business were subject to CFIUS review, with minority investments only subject to review if the foreign investor gained “effective control” of the target in the transaction. Now, under the proposed regulations, even *minority investments* by a foreign party in a U.S. target business that do not give the foreign party effective control are subject to CFIUS review as Covered Investments if the TID sectors are involved and the other above-stated criteria (access, Board membership, etc.) are met. ***In other words, a whole range of strategic and financial minority investments, even those not granting effective control over the target U.S. business, by foreign investors, including private equity and venture capital firms, hedge funds, family offices, trusts, and others, may now be subject to CFIUS review, and subject to sanctions up to post-closing divestiture if voluntary CFIUS review is not sought by the parties to the transaction and approval obtained.***

The CFIUS notification process remains largely voluntary, but erring on the side of caution is more advisable than ever. However, FIRRMA mandates CFIUS notification for covered transactions where a foreign government has a “substantial interest,” a looser and more subjective standard than the existing CFIUS standard for mandatory review in the case of foreign government involvement (see s. II (a), *above*). FIRRMA also authorizes CFIUS to mandate notification when covered transactions involve certain U.S. businesses that produce, design, test, manufacture, fabricate, or develop one or more Critical Technologies. Again, the proposed regulations only cover U.S. businesses with TID sectors involvement, *but it is important to realize that the TID sector involvement need not be the target U.S. business’s core business*. For example, a consumer goods enterprise selling non-TID products like clothing online might well be a Covered Investment by reason of its collection and maintaining its customers’ Sensitive Personal Data.

The proposed regulations create an exception from “Covered Investments” for certain defined “Excepted Investors” with ties to certain countries identified as “Excepted Foreign States” and their compliance with specified laws and regulations. Importantly, those Excepted Investors are still subject to pre-FIRRMA CFIUS regulation, however; foreign investments that would result in foreign control of a U.S. business remain subject to CFIUS jurisdiction if they were subject to it before, notwithstanding being excepted from CFIUS jurisdiction for *non-control* Covered Investments.

As stated, the second of the two proposed regulations also authorizes CFIUS to review the purchase or lease by a foreign person or entity of private or public real estate when the real estate in question is:

- within or part of a maritime port or airport;
- in proximity to a U.S. military installation or other sensitive (for national security purposes) U.S. Government facility or property;
- situated in a way that might provide the foreign person with the means to collect intelligence on the activities at the neighboring military or government property or facility; and
- situated in a way that could otherwise expose national security activities at such a facility or property to foreign surveillance.

The property rights covered include physical access, right to exclude, right to improve or develop, or to build structures or objects. The proposed regulations do not provide for mandatory notifications or declarations for real estate; the process is voluntary. There is provision for an “Excepted Real Estate Investor” similar to the Excepted Investor status. Other CFIUS jurisdiction exceptions are provided for certain urban and multi-unit office space transactions.

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