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CFIUS Publishes Proposed FIRRMA Regulations, Part 1: A Sea Change for Foreign Investments in U.S. Businesses

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On September 17, 2019, the U.S. Department of the Treasury published proposed regulations to implement provisions of the Foreign Investment Risk Review Modernization Act ("FIRRMA"), signed into law by President Donald Trump on August 13, 2018, that were not addressed by the critical technology pilot program announced by the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee") in October 2018.[1]

The draft regulations set forth in the Proposed Rules, if implemented in their current form, would mark a significant expansion of CFIUS's jurisdiction to review foreign investments in the United States. Among other changes, the Proposed Rules would provide the Committee with the ability to review non-controlling investments by foreign persons in certain categories of U.S. businesses, including those dealing in critical infrastructure and sensitive data, and make certain filings by foreign government-affiliated investors mandatory for the first time. The Proposed Rules also would alleviate existing CFIUS-related considerations for certain foreign investors, including by codifying exceptions to CFIUS's jurisdiction, adjusting the procedures used to notify CFIUS of covered transactions, and potentially creating exclusions from the Committee's jurisdiction for investors associated with certain countries.

I. How We Got Here

CFIUS is an interagency committee with authority to review certain foreign investments in the United States. The Committee received authority to review foreign transactions following passage of the Exon-Florio Amendment, which amended Section 721 of the Defense Production Act of 1950 and granted the President authority to block foreign investments in the United States when "the transaction threatens to impair the national security of the United States."[2]

CFIUS has authority to review any "covered transaction," which historically has meant "any transaction . . . by or with any foreign person[] which could result in control of a U.S. business by a foreign person."[3] FIRRMA—which was motivated by the perception that the existing CFIUS regime was ill-equipped to handle new threats to U.S. national security posed by foreign investment—introduced key reforms to the Committee's review authority and process, including provisions expanding CFIUS's jurisdiction to cover non-passive, non-controlling foreign investments in certain categories of U.S. businesses, making certain filings mandatory, and introducing an abbreviated declaration process.

In October 2018, CFIUS implemented a "pilot program" that (1) expanded CFIUS's jurisdiction to certain non-passive investments in critical technology companies; and (2) introduced a mandatory notification requirement for transactions involving critical technology companies. The pilot program applies to investments in U.S. businesses that produce, design, test, manufacture, fabricate, or develop "critical technology" and that afford the foreign investor:

- Control rights over the pilot program U.S. business;
- Access to any material nonpublic technical information in the possession of the pilot program U.S. business;

[1] Provisions Pertaining to Certain Investments in the United States by Foreign Persons (to be codified at 31 C.F.R. § 800), https://home.treasury.gov/system/files/206/Proposed-FIRRMA-Regulations-Part-800.pdf [hereinafter the "Proposed Rules"].
[2] 50 U.S.C. § 2170.
[3] 31 C.F.R. § 800.207.

- Membership or observer rights on the board of directors or equivalent governing body of the pilot program U.S. business or the right to nominate an individual to a position on the board of directors or equivalent governing body of the pilot program U.S. business; or
- Any involvement, other than through voting of shares, in substantive decision-making of the pilot program U.S. business regarding the use, development, acquisition, or release of critical technology.

The remainder of FIRRMA was scheduled to be implemented by February 2020. The Proposed Rules represent the U.S. Government's effort to meet this deadline.

II. Expansion of Jurisdiction

Building off of the critical technology pilot program, the Proposed Rules would expand CFIUS's jurisdiction to "covered investments," defined to include an investment by a foreign person in an unaffiliated "TID U.S. Business" that affords the foreign investor:

- Access to any material nonpublic technical information[4] in the possession of the TID U.S. Business;
- Membership or observer rights on the board of directors or equivalent governing body of the TID U.S. Business or the right to nominate an individual to a position on the board of directors or equivalent governing body of the TID U.S. Business; or
- Any involvement, other than through voting of shares, in substantive decision-making[5] of the TID U.S. Business regarding either (1) the use, development, acquisition, safekeeping, or release of sensitive personal data of U.S. citizens maintained or collected by the TID U.S. Business; (2) the use, development, acquisition, or release of critical technologies; or (3) the management, operation, manufacture, or supply of covered investment critical infrastructure.

31 C.F.R. § 800.211(b)(1)-(3). In short, if a foreign investor were to make a non-controlling investment a "TID U.S. Business," pursuant to which the investor acquires one of the above rights, the investment would be a "covered investment" within the scope of CFIUS's jurisdiction.

The term "TID U.S. Business"—short for Technology, Infrastructure, and Data U.S. Business—covers the three categories of U.S. businesses that were the central focus of FIRRMA; namely, U.S. businesses that:

- Produce, design, test, manufacture, fabricate, or develop one or more critical technologies;
- Perform the functions as set forth in the appendix of the Proposed Rules with respect to covered investment critical infrastructure; or
- Maintain or collect, directly or indirectly, sensitive data of U.S. citizens.

[4] The definition of "material nonpublic technical information" would be expanded to include not only information that "is not available in the public domain and is necessary to design, fabricate, develop, test, produce, or manufacture a critical technology, including without limitation processes, techniques, or methods" but also information that "provides knowledge, know-how, or understanding not available in the public domain, of the design, location, or operation of critical infrastructure, including without limitation vulnerability information such as that related to physical security or cybersecurity." 31 C.F.R. § 800.233(a)(1), (2).

[5] The definition of "substantive decisionmaking" would be expanded to include "the process through which decisions regarding significant matters affecting an entity are undertaken," including (1) pricing, sales, and specific contracts; (2) supply arrangements; (3) corporate strategy and business development; (4) research and development; (5) manufacturing locations; (6) access to critical technologies, covered investment critical infrastructure, material nonpublic technical information, or sensitive personal data; (7) physical and cyber security protocols; (8) practices, policies, and procedures governing the collection, use, or storage of sensitive personal data; and (9) strategic partnerships. 31 C.F.R. § 800.254(a)(1)-(9).

31 C.F.R. § 800.248(a)-(c).

Critical Technology

The Proposed Rules specify that they do "not modify the regulations currently at 31 CFR Part 801, which sets forth the Pilot Program Interim Rule" and that "CFIUS continues to evaluate the Pilot Program Interim Rule, and the Department of the Treasury welcomes comments on the retention of the mandatory declaration aspect of the Pilot Program Interim Rule for certain transactions involving critical technologies."[6]

Importantly, the definition of "critical technology" set forth in the Proposed Rules mirrors the definition in effect under the pilot program, and applies to (1) items controlled under the International Traffic in Arms Regulations and included on the United States Munitions List; (2) certain items controlled under the Export Administration Regulations and included on the Commerce Control List; (3) certain nuclear-related materials; (4) select agents and toxins regulated under the Select Agents and Toxins Regulations; and (5) emerging and foundational technologies controlled pursuant to the Export Control Reform Act ("ECRA"). 31 C.F.R. § 800.215(a)-(f). The Proposed Rules clarify that "[a]s technologies become controlled pursuant to rulemaking under ECRA, they will automatically be covered under the definition of 'critical technologies' under part 800."[7] However, to date, the U.S. Department of Commerce has not issued proposed rules under ECRA, and the categories of technology that will become subject to export controls on a going-forward basis have not yet been announced.

In brief, the status quo would remain largely in effect for evaluating what U.S. businesses qualify as U.S. critical technology companies (and, accordingly, TID U.S. Businesses), though this definition will expand as ECRA is implemented (and could be subject to further change as CFIUS continues to assess the contours of the critical technology pilot program).

Critical Infrastructure

Critical infrastructure is defined in the Proposed Rules, at a high level, as "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." 31 C.F.R. § 800.214. However, only a subset of critical infrastructure is relevant to the new jurisdictional standards set forth in the Proposed Rules. This subset of critical infrastructure is defined as "covered investment critical infrastructure," and includes "the systems and assets, whether physical or virtual, set forth in" the appendix to the Proposed Rules. 31 C.F.R. § 800.212.

Appendix A to the Proposed Rules sets forth guidance regarding (1) the categories of infrastructure that qualify as "covered investment critical infrastructure" and; (2) the functions a U.S. business must perform with respect to covered investment critical infrastructure to qualify as a "TID U.S. Business." A simplified version of that guidance is set forth below.

[6] Proposed Rules at 10.
[7] *Id.* at 15.

Covered Critical Infrastructure	Covered Functions[8]
Internet protocol networks with access to other internet protocol networks via settlement free-peering Telecommunication or information services, as defined under the Communications Act, or fiber optic cable that directly serves military installations	Owns or operates
Internet exchange points that support public peering	Owns or operates
Submarine cable systems requiring licenses pursuant to the Cable Landing Licensing Act of 1921 (*e.g.*, associated submarine cable, submarine cable landing facilities, and facilities performing support functions for such systems)	Owns or operates
Submarine cable, landing facility, or facility that performs network management, maintenance, or other operational functions for submarine cable systems (described above)	Supplies or services
Data centers collocated at submarine cable landing points, landing stations, or termination stations	Owns or operates
Satellite or satellite systems providing services directly to the Department of Defense, or components thereof	Owns or operates
Industrial resources other than commercially available off-the-shelf items (as defined in the National Defense Authorization Act for Fiscal Year 1996, as amended) that are manufactured or operated for a Major Defense Acquisition Program or Major System (as defined the Defense Technical Corrections Act of 1987), **if** either (1) the U.S. business is a single source, sole source, or strategic multisource; **or** (2) the industrial resource requires 12 months or more to manufacture or is a "long lead" item	Manufactures
Industrial resources other than commercially available off-the-shelf items (as defined in the National Defense Authorization Act for Fiscal Year 1996, as amended) that have been manufactured pursuant to a "DX" priority rated contract or under the Defense Priorities and Allocations System regulation in the preceding 24 months	Manufactures
Facilities in the United States that manufacture either (1) specialty metal, covered metal, or chemical weapons antidotes contained in automatic injectors (all as defined in 10 U.S.C. §§ 2533b, 2534); or (2) carbon, alloy, and armor steel plate that is in Federal Supply Class 9515 or described by specifications of the American Society for Testing Materials or the American Iron and Steel Institute	Manufactures (any of the foregoing materials)
Industrial resources other than commercially available off-the-shelf items (as defined in the National Defense Authorization Act for Fiscal Year 1996, as amended) that have been funded, in whole or in part, during the past 60 months, by certain defense programs, including the Defense Production Act of 1950 Title III program, the Industrial Base Fund, the Rapid Innovation Fund, the Manufacturing Technology Program, the Defense Logistics Agency Warstopper Program, or the Defense Logistics Agency Surge and Sustainment contract	Manufactures (any of the foregoing materials)

[8] The Proposed Rules set forth many key definitions. "Manufactures" means "to produce or reproduce, whether physically or virtually." 31 C.F.R. § 800.232. "Owns" means "to directly possess the applicable covered investment critical infrastructure." *Id.* § 800.235. "Services" means "to repair, maintain, refurbish, replace, overhaul, or update." *Id.* § 800.242. "Supplies" means "to provide third-party physical or cyber security." *Id.* § 800.246. The Proposed Rules do not define the term "Operates," which is to be accorded the "commonly understood meaning of the term." Proposed Rules at 18.

Systems, including facilities, for the generation, transmission, distribution, or storage of electric energy comprising the bulk-power system (as defined in the Federal Power Act)	Owns or operates
Electrical storage resource (as defined by regulation) physically connected to that bulk-power system	Owns or operates
Facilities that provide electric power generation, transmission, distribution, or storage directly to or located on any military installation	Owns or operates
Industrial control systems utilized by systems comprising the bulk-power system or military installations, as described above	Manufactures or services
Individual refineries with the capacity to produce 300,000 or more barrels per day (or equivalent) of refined oil or gas products, or collections of one or more refineries owned or operated by a single U.S. business with the aggregate capacity to produce 500,000 or more barrels per day (or equivalent of refined oil or gas products)	Owns or operates
Crude oil storage facilities with the capacity to hold 30 million barrels or more of crude oil	Owns or operates
Liquefied natural gas (LNG) import or export terminals requiring approval under the Natural Gas Act or a license pursuant to the Deepwater Port Act, or natural gas underground storage facilities or LNG peak-shaving facilities requiring a certificate of public convenience and necessity under the Natural Gas Act	Owns or operates
Financial market utilities that the Financial Stability Oversight Council has designated as systematically important pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act	Owns or operates
Exchanges registered under section 6 of the Securities Exchange Act of 1934 that facilitates trading in any "national market system security" (as defined by regulation), and which exchange during at least four of the prior six months has either (1) ten percent or more of the average daily dollar volume reported by applicable transaction reporting plans (for most national market system securities); or (2) fifteen percent or more of the same (for listed options)	Owns or operates
Technology service providers in the Significant Service Provider Program of the Federal Financial Institutions Examination Council that provide core processing services	Owns or operates
Rail lines and associated connector lines designated as part of the Department of Defense's Strategic Rail Corridor Network	Owns or operates
Interstate oil pipelines that (1) have the capacity to transport either 500,000 barrels per day or more of crude oil or 90 million gallons per day or more of refined petroleum product; or (2) directly serve the strategic petroleum reserve, as defined in the Energy Policy and Conservation Act	Owns or operates
Interstate natural gas pipelines with an outside diameter of 20 or more inches	Owns or operates
Industrial control systems utilized by the interstate oil or natural gas pipelines described above	Owns or operates
Specified airports	Owns or operates
Specified maritime ports, as well as individual terminals at such ports	Owns or operates

Public water systems, as defined in the Safe Drinking Water Act, or treatment works, as defined in the Clean Water Act, which either regularly serve 10,000 individuals or more or directly serve military installations	Owns or operates
Industrial control systems utilized by public water systems or treatment works, as described above	Manufactures or services

In short, if a U.S. business performs the specified service (*i.e.*, owns, operates, manufactures, services, supplies) with respect to one of the identified categories of "covered investment critical infrastructure," the U.S. business qualifies as a "TID U.S. Business," and the expanded jurisdictional rules would apply.

Sensitive Data

The Proposed Rules define "sensitive data" to include certain categories of "identifiable data," as defined under the Proposed Rules, and "genetic information," as defined in U.S. Department of Health and Human Services ("HHS") regulations:

- "Identifiable data" is defined as "data that can be used to distinguish or trace an individual's identity, including without limitation through the use of any personal identifier," and generally does not include "aggregated data or anonymized data" (unless a party has "the ability to disaggregate or de-anonymize the data, or if the data is otherwise capable of being used to distinguish or trace an individual's identity") or "encrypted data" (unless the U.S. business "has the means to de-encrypt the data so as to distinguish or trace an individual's identity"). 31 C.F.R. § 800.227.
- "Genetic information" is defined under HHS regulations to include genetic tests, manifestations of diseases or disorders, and requests for, or receipt of, genetic services (or participation in clinical research relating to genetic services), and excludes information about sex or age. 45 C.F.R. § 160.103.

For identifiable data to be deemed sensitive data, it must (1) be maintained or collected by a qualifying U.S. business; **and** (2) fall within a designated category of information. A simplified version of the requirements is set forth below (with one of the points in each column necessary for the "sensitive data" definition to apply).

Category of U.S. Business	**Category of Data**
Targets or tailors[9] products or services to any U.S. executive branch agency or military department with intelligence, national security, or homeland security responsibilities (or personnel and contractors thereof)	Data that could be used to analyze or determine an individual's financial distress
Has maintained or collected covered data on greater than one million individuals at any point over the preceding twelve (12) months	A set of data in a consumer report, as defined pursuant to 15 U.S.C. § 1681a, subject to exceptions
Has demonstrated a business objective to maintain or collect such data on greater than one million individuals and such data is an integrated part of the U.S. business's primary products or services	A set of data in an application for health insurance, long-term care insurance, professional liability insurance, mortgage insurance, or life insurance

[9] "Targets or tailors" is defined in the Proposed Rules as "customizing products or services for use by a person or group of persons or actively marketing to or soliciting a person or group of persons." 31 C.F.R. § 800.247(a).

	Data relating to the physical, mental, or psychological health condition of an individual
	Non-public electronic communications (*e.g.*, email, messaging, chat communications) between or among users of a U.S. business's products or services
	Geolocation data collection by positioning systems, cell phone towers, or WiFi access points (including mobile applications, vehicle GPS, other onboard mapping tools, or wearable electronic devices)
	Biometric enrollment data, including without limitation facial, voice, retina/iris, and palm/fingerprint templates
	Data stored and processed for generating a state or federal government identification card
	Data concerning U.S. Government personnel security clearance status
	Set of data in an application for a U.S. Government personnel security clearance or an application for employment in a position of public trust

31 C.F.R. § 800.241(a)(1). Accordingly, if a U.S. business (1) qualifies as one of the above categories of U.S. business **and** deals in one of the above categories of identifiable data; or (2) deals in genetic data, it deals in "sensitive personal data." The Proposed Rules also clarify that identifiable data is not "sensitive personal data" if it relates exclusively to data maintained or collected by a U.S. business concerning employees (unless the employees work for a U.S. Government contractor and hold personnel security clearances) or is a matter of public record. *Id.* § 800.241(b)(1)-(2).

In sum, if a U.S. business maintains or collects, directly or indirectly, any "sensitive personal data," the U.S. business qualifies as a "TID U.S. Business," and the expanded jurisdictional rules would apply.

III. Mandatory Filing Requirements

The Proposed Rules would maintain—at least for the time being—the mandatory notification requirement for investments in TID U.S. Businesses dealing in critical technology. Importantly, subject to the exception described below, the Proposed Rules would not extend the mandatory notification requirement to TID U.S. Businesses that deal in critical infrastructure or sensitive personal data. Accordingly, while both control transactions and "covered investments" in such businesses would be within CFIUS's jurisdiction, there would not be a mandatory notification requirement (or potential failure-to-file penalty) in place for either of these two categories of transactions.

Of note, the Proposed Rules **would** introduce a new, mandatory filing requirement for transactions that "result[] in the acquisition of a substantial interest in a TID U.S. Business by a foreign person in which a foreign government has a substantial interest." 31 C.F.R. § 800.401. "Substantial interest" is defined as a "voting interest, direct or indirect, of 25 percent or more by a foreign person in a U.S. business and a voting interest, direct or indirect, of 49 percent or more by a foreign government in a foreign person." 31 C.F.R. § 800.244(a). (For funds and partnerships, a foreign government is deemed to have a "substantial interest" if it holds either 49% of the interest in the general partner or has 49% of the

limited partner voting interest.) *Id.* § 800.244(b). Accordingly, if a foreign entity in which a foreign government holds a 49 percent or greater interest acquires 25 percent or greater interest in a TID U.S. Business, a filing would be mandatory.

As under the critical technology pilot program, parties that fail to submit a mandatory filing may face penalties. The failure-to-file penalties can be up to $250,000 or the value of the transaction at issue (whichever is greater). 31 C.F.R. § 800.901(b).

IV. Exceptions

While the net effect of the Proposed Rules is to significantly expand CFIUS's jurisdiction, the Proposed Rules also incorporate noteworthy carve outs to the Committee's jurisdiction, including:

- Incremental Acquisitions: Any transaction in which a foreign person acquires an additional interest in a U.S. business, over which the same foreign person previously acquired control, would not be subject to CFIUS's jurisdiction, provided that the initial investment was noticed to (and approved by) the Committee. 31 C.F.R. § 800.305.
- Lending Transactions: Any transaction that involves only "[t]he extension of a loan or a similar financing arrangement by a foreign person" would not, "by itself, constitute a covered transaction," though certain exceptions apply. 31 C.F.R. § 800.306(a). For example, a loan that provides "financial or governance rights characteristic of an equity investment but not of a typical loan may constitute a covered transaction." *Id.* § 800.306(b).
- Indirect Investments through Investment Funds: As under the critical technology pilot program, indirect investments by foreign persons in TID U.S. Businesses through investment funds that afford the foreign person membership as a limited partner or equivalent on an advisory board or a committee of the fund are not subject to CFIUS's jurisdiction, **provided** certain conditions are met. 31 C.F.R. § 800.307. As a general matter, for the exception to apply, the limited partner may not obtain control rights or any of the rights that trigger a "covered investment."

While none of these exceptions is new conceptually, several have not been codified. CFIUS's decision to carry over the investment fund exception from the critical technology pilot program will likely be of particular consequence to funds, though the availability—and limitations of—this exception have not yet been significantly tested.

V. White List?

One of the questions that the U.S. Government has grappled with in implementing FIRRMA is whether to issue a so-called "white list" of countries or actors that are exempt from CFIUS's jurisdiction, to reduce the burden on the Committee of reviewing notices and declarations (and to focus CFIUS's energy on the actors that, in the U.S. Government's estimation, present the greatest national security risk). The Proposed Rules suggest that the Committee is looking seriously at implementing a version of a "white list," though the exceptions appear narrow and key details are not yet available.

The Proposed Rules introduce the concept of an "excepted foreign state." 31 C.F.R § 800.219. However, the Proposed Rules do not define which countries will be considered "excepted foreign states." Instead, this list will be "separately published on the Department of the Treasury website" and, "[a]s this is a new concept with potentially significant implications for the national security of the United States, CFIUS initially intends to designate a limited number of eligible foreign states."[10] CFIUS has not yet provided any guidance as to which countries it is considering as excepted foreign states.

[10] Proposed Rules at 24.

Of note, not all parties located in or organized under the laws of an "excepted foreign state" would be exempt from CFIUS's jurisdiction. Instead, an "excepted investor" would be defined as:

- A foreign national who is a national of one or more excepted foreign states and is not also a national of any foreign state that is not an excepted foreign state;
- A foreign government of an excepted foreign state; or
- A foreign entity that meets certain criteria, including: (1) being organized under the laws of either an excepted foreign state or the United States; (2) having a principal place of business in an excepted foreign state or the United States; (3) having **all** members of its board of directors (or comparable body) as citizens of either the United States or an excepted foreign state; and (4) having **all** investors with either an equity interest of five percent or more, a right to five percent of the profits, or a right to five percent or more of the assets of the entity (upon dissolution) meeting the same tests set forth in (1) through (3), above.

31 C.F.R. § 800.220(a). In addition, even if all of the above criteria are met, a foreign person would not qualify as an "excepted investor" if, in the past five years, that person has been subject to any adverse action by CFIUS **or** a range of other agencies of the U.S. government, including the agencies responsible for administering U.S. economic sanctions and export control laws. *Id.* § 800.220(c). Furthermore, if the above criteria are met as of the date of the transaction but cease to become effective during the three-year period following the completion date, the designation of "excepted investor" no longer applies (and CFIUS could, in theory, retroactively review the formerly exempt transaction). *Id.* § 800.220(d).

VI. Procedural Changes

Finally, the Proposed Rules would introduce a number of procedural changes, including expanded the availability of the abbreviated declaration—introduced in connection with the critical technology pilot program—to all covered transactions. 31 C.F.R. § 800.403(a); 31 C.F.R. § 800.501(a). Accordingly, for every transaction within CFIUS's jurisdiction, if the parties opt to file, they will face the strategic choice of submitting either an abbreviated declaration (less preparation time and potential for faster resolution, but no guarantee of final action by the Committee) or full-form notice (more preparation and review time, but guarantee of final action by the Committee). CFIUS will introduce standardized forms for both types of submissions that parties may use.

In addition to the penalties for failing to file mandatory declarations discussed above, the Proposed Rules would clarify that parties who submit "a material misstatement or omission in a declaration or notice, or make[] a false certification" may face a civil penalty of up to $250,000 per violation. 31 C.F.R. § 800.901(a). Finally, the Proposed Rules do not yet introduce a filing fee, instead suggesting that the Department of Treasury will address filing fees at a later date.[11]

VII. Next Steps

CFIUS has provided interested parties one month, or until October 17, 2019, to provide comments that the Committee may consider in finalizing the Proposed Rules. After comments are received, CFIUS has until February 13, 2020 to issue final, binding rules. (Providing interested parties such a brief window to provide comments suggests that the Committee may, consistent with anecdotal reports, be pushing to issue the final rules sooner than technically required under FIRRMA.)

Once final rules are issued, they will become effective immediately, including for pending transactions. The Proposed Rules implementing FIRRMA would significantly expand CFIUS's jurisdiction, and may—if implemented in their current form—fundamentally alter how foreign parties seeking to invest in the United States assess potential opportunities.

[11] Proposed Rules at 10.

Part 2 of this alert will cover the new proposed regulations CFIUS issued simultaneously to address its expanded jurisdiction under FIRRMA to review certain real estate transactions.