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CFIUS Issues Final Rules Implementing FIRRMA: Key Changes and Developments

Attorneys
Ama A. Adams
Brendan C. Hanifin
Emerson Siegle

On January 13, 2020, the U.S. Department of the Treasury released final regulations (the "Final Rules") to implement the Foreign Investment Risk Review Modernization Act ("FIRRMA"), signed into law by President Donald Trump on August 13, 2018. The Final Rules are scheduled for publication in the Federal Register on January 17, 2020, and will become effective on February 13, 2020.

The Final Rules modify certain aspects of the proposed regulations that the Department of the Treasury issued in September 2019 (the "Proposed Rules"). Please see the following prior alerts, available here and here, for a more detailed discussion of the Proposed Rules.

Among other changes, the Final Rules clarify and implement the excepted investor exemption, retain (in large part) the rules of the critical technology pilot program, narrow the definition of sensitive personal data of U.S. citizens, introduce a definition for "principal place of business," and make certain conforming and clarifying changes to the new rules governing real estate. Consistent with the Proposed Rules, the Final Rules mark a significant expansion of the Committee on Foreign Investment in the United States' ("CFIUS" or the "Committee") jurisdiction to review foreign investments in the United States.

Changes to the Primary CFIUS Regulations

A (Very Short) White List

CFIUS has been grappling with whether to issue a so-called "white list" of countries or actors that are exempt from CFIUS's jurisdiction in order 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, could present the greater national security risk). The Proposed Rules introduced the concept of an "excepted investor," defined as

1. a foreign national who was a national of one or more "excepted foreign states" and was not also a national of any foreign state that is not an "excepted foreign state";

2. a foreign government of an "excepted foreign state"; or

3. a foreign entity that met certain criteria, including

    a. being organized under the laws of either an "excepted foreign state" or the United States;

    b. having a principal place of business in an "excepted foreign state" or the United States;

    c. having **all** members of its board of directors (or comparable body) as citizens of either the United States or an "excepted foreign state"; and

    d. 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 (under dissolution) meeting the same tests set forth above.

The Proposed Rules exclude from the "excepted investor" definition otherwise eligible foreign investors that have been the subject of adverse action by CFIUS or violated various U.S. laws, including export control laws and economic sanctions. Notably, the Proposed Rules did not provide any guidance as to which countries the U.S. Government was considering as "excepted foreign states."

In the Final Rules, CFIUS has selected Australia, Canada, and the United Kingdom of Great Britain and Northern Ireland (the "UK") as the initial group of "excepted foreign states," a designation that will apply automatically between February 13, 2020 and February 13, 2022. 31 C.F.R. § 800.218. After February 13, 2022, each of these countries—as well as any future candidates—will qualify as excepted foreign states only upon a determination by CFIUS that the country has "established and is effectively utilizing a robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security." *Id.* §§ 800.218(a), 800.1001(a).

The Final Rules slightly modify the requirements to meet the definition of "excepted investor":

- The Final Rules provide that an entity may be deemed an "excepted investor" if—among other requirements—**75 percent or more of the members and 75 percent or more of the observers** of the board of directors (or comparable body)—as opposed to the **100 percent** requirement articulated in the Proposed Rules—are citizens of either the United States or an excepted foreign state; and
- The Final Rules provide that an entity may be deemed an "excepted investor" if—among other requirements—all investors that hold a **10 percent or greater** equity interest—as opposed to the **5 percent or greater** requirement set forth in the Proposed Rules—are citizens of either the United States or an excepted foreign state.

31 C.F.R. § 800.219(a)(3)(iii), (iv). According to explanatory guidance, CFIUS rejected several broader proposals—including the option of extending "excepted investor" status to trusted counterparties based in jurisdictions that are not identified as "excepted foreign states"—and emphasized that the exception remains fundamentally a narrow one.

Although these changes will relieve some investors from Australia, Canada, and the UK of the obligation to make CFIUS filings, at least over the next two years, the so-called white list is very narrow, and its application will require a close review of the technical requirements.

Substantial Interest – Fewer Mandatory Filings

The Proposed Rules introduced 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." The Proposed Rules defined "substantial interest" 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" and clarified that for funds and partnerships, a foreign government would be deemed to have a "substantial interest" if it held either a 49 percent interest in the general partner or held a 49 percent limited partner voting interest.

The Final Rules kept in place the general framework introduced by the Proposed Rules, but clarified that a foreign government will be deemed to have a substantial interest in a fund or partnership only where the foreign government holds "49 percent or more of the interest in the general partner, managing member, or equivalent[.]" 31 C.F.R. § 800.244(b). Accordingly, investments by funds, partnerships, and similar entities with a significant foreign government-affiliated limited partner will not automatically trigger a mandatory CFIUS filing, although the participation of such foreign investors still may present CFIUS risk under the Committee's voluntary jurisdiction.

Sensitive Personal Data – Culling Around the Edges

The Proposed Rules aimed to expand CFIUS's jurisdiction with respect to certain companies that collect "sensitive personal data" of U.S. citizens. The Proposed Rules defined "sensitive personal data" to include (1) "genetic information," as defined under HHS regulations; and (2) certain categories of "identifiable" data if the U.S. business either (i) tailors its products and services to U.S. agencies with intelligence, national security, or homeland security responsibilities or (ii) maintains or collects such data on greater than one million individuals.

The Final Rules narrow the scope of genetic information that qualifies as sensitive personal data by (1) re-focusing the definition on "genetic tests," as defined in the Genetic Information Non-Discrimination Act of 2008 (GINA), 42 U.S.C. 300gg-91(d)(17); and (2) limiting coverage to identifiable data (*i.e.*, "The results of an individual's genetic tests, including any related genetic sequencing data, whenever such results constitute identifiable data"). 31 C.F.R. § 800.241(a)(2). Importantly, the Final Rules specifically omit from coverage "data derived from databases maintained by the U.S. Government and routinely provided to private parties for purposes of research." *Id.*

With respect to "identifiable" data, the Final Rules do not make material changes to the categories articulated in the Proposed Rules, but do provide new examples intended to clarify the Rules' application. Specifically, the examples seek to clarify application of the one million individual threshold to companies whose access to identifiable data fluctuates over the time. The examples also clarify that the one million individual threshold is an aggregated threshold that applies across all categories of identifiable data set forth in the Proposed Rules (*i.e.*, for jurisdiction to exist, it is not required that the U.S. business collect a single category of identifiable data for more than one million individuals).

Critical Technology Pilot Program – Retained, with Changes

The Final Rules will permanently implement the rules set forth in the critical technology pilot program—including the mandatory filing obligation—subject to some key exceptions.[1] Notably, the Final Rules exempt certain transactions that otherwise would qualify as pilot program covered transactions, including:

- Transactions in which the foreign investor that would obtain "control" is an "excepted investor," as described above;
- Transactions in which a foreign person's indirect investment in the covered U.S. business is held solely and directly via an entity that is, as of the completion date, (1) subject to an agreement by a cognizant security agency to offset foreign ownership, control, or influence ("FOCI") pursuant to the National Industrial Security Program regulations, 32 C.F.R. Part 2004; and (2) operating under a valid facility security clearance pursuant to the same such regulations;
- Transactions by an investment fund that (1) is managed exclusively by a general partner, managing member or equivalent that is ultimately controlled exclusively by U.S. nationals *or* is not a foreign person; and (2) satisfies the requirements of the indirect fund exemption;
- Transactions that involve "excepted investors" who lose that status (*i.e.*, the mandatory filing obligation does not apply retroactively);

[1] The critical technology pilot program, issued in October 2018 (1) expanded CFIUS's jurisdiction to certain non-passive investments in critical technology companies; and (2) introduced a mandatory notification requirement. The critical technology pilot program applies if a U.S. business "produces, designs, tests, manufactures, fabricates, or develops a critical technology" that is utilized in connection with, or developed for use in, a "pilot program industry." 31 C.F.R. § 801.213. "Pilot program industry" is defined with reference to the North American Industry Classification System ("NAICS") code of the relevant U.S. business(es). *Id.* § 801.212.

- Transactions in which the foreign investor would obtain "control" and involving an air carrier, as defined in 49 U.S.C. § 40102(a)(2), that holds a certificate issued under 49 U.S.C. § 41102; and
- Transactions involving certain encryption-related items, where the only "critical technology" involved is eligible for export, reexport, or transfer (in country) pursuant to License Exception ENC of the Export Administration Regulations.

31 C.F.R. § 800.401(e). Collectively, the above exceptions will result in a modest reduction in the number of transactions subject to a mandatory filing requirement going forward.

Also of interest, the Final Rules state that the U.S. Government anticipates issuing a notice of proposed rulemaking that would revise the mandatory declaration requirement regarding critical technology "from one based upon North American Industry Classification System (NAICS) codes to one based upon export control licensing requirements." As the Rules do not provide further detail, the significance of this modification remains to be seen.

Modifications to CFIUS Declarations and Notices – More Information Must Be Provided

The Proposed Rules expanded the availability of the abbreviated declaration—introduced in connection with the critical technology pilot program—to all covered transactions, providing parties to covered transactions the option 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).

The Final Rules modify the information that must be provided in both abbreviated declarations and full-form notices. For abbreviated declarations, parties will be required to provide more information about, inter alia, data-gathering practices, dealings in critical technology, and government contracts. 31 C.F.R. § 800.404(c)(9), (22), (24). Similarly, for joint voluntary notices, parties will be required to provide more information about, inter alia, the scope of rights that foreign parties are receiving, dealings in critical technology (including how export classifications were determined), and data-gathering practices. 31 C.F.R. § 800.502(c)(1)(xi), (3)(x), (xi). These changes may make the preparation and submission of CFIUS filings more time-consuming, particularly for parties that have not performed internal assessments of their export control and data protection controls.

New, Interim Definition of "Principal Place of Business"

The existing CFIUS regulations define "foreign entity" as any entity "organized under the laws of a foreign state if either [1] its principal place of business is outside the United States; or [2] its equity securities are primarily traded on one or more foreign exchanges," unless the entity can demonstrate that a majority of its equity interests is ultimately owned by U.S. nationals. However, the regulations do not define "principal place of business." In practice, some parties have borrowed corporate law standards—such as the nerve center test—to assess CFIUS jurisdiction.[2] This approach is subject to practical limitations, including that the corporate test does not apply cleanly to investment funds. Further, in many cases, the consequences of reaching an inaccurate principal place of business determination are significant in the CFIUS context.

The Department of the Treasury has now issued an interim rule that defines "principal place of business." Subject to an estoppel exception (described below), "principal place of business" means "the primary location where an entity's management directs, controls, or coordinates the entity's activities, or, in the case of an investment fund, where the

[2] As referenced above, the definition of principal place of business will be relevant to excepted investor determinations.

fund's activities and investments are primarily directed, controlled, or coordinated by or on behalf of the general partner, managing member, or equivalent." 31 C.F.R. §§ 800.239(a), 802.232(a).

This definition will control principal place of business determinations, except where an entity previously has declared a non-U.S. principal place of business in a U.S. or other government filing or submission. *Id.* §§ 800.239(b), 802.232(b). In other words, an entity may not claim a U.S. principal place of business for CFIUS purposes, but a non-U.S. principal place of business for other (*e.g.*, tax) purposes. If an entity previously has declared a non-U.S. principal place of business in a government filing or submission, that entity would be required to show that its principal place of business "has changed to the United States since such submission or filing" if it wishes to be treated as a U.S. entity. *Id.*

The definition of "principal place of business" will become effective with the rest of the Final Rules, although the Department of the Treasury has solicited comments on the definition for a period of 30 days.

Changes to the New Real Estate Rules

Many of the key changes to the Proposed Rules extending CFIUS's jurisdiction to cover certain real estate transactions mirror those to the Part 800 regulations. For example, the Final Rules provide for the same "excepted real estate foreign states" (*i.e.*, Australia, Canada, and the UK) and reduce the burden to qualify as an "excepted real estate investor" in the same manner. 31 C.F.R. §§ 802.214, 802.215. However, the Final Rules with respect to real estate also include some specific, real estate-related changes, as discussed below.

Changes to Definitions

The Proposed Rules defined "covered real estate," potentially subject to CFIUS's jurisdiction, to include real estate that is (1) located within, or will function as part of, an "airport" or "maritime port"; or (2) located within (i) close proximity (*i.e.*, one mile from the outer boundary) of a designated military installation or another facility or property of the U.S. Government; (ii) extended range (*i.e.*, 100 miles outward from the outer boundary or, where applicable, 12 nautical miles off the U.S. coastline) of certain, specified military installations; (iii) any county or other geographic area identified in connection with certain, specified military installations; and (iv) any part of certain specified military installations located within 12 nautical miles of the coastline of the United States.

The Final Rules replace the definition of "airport" and "maritime port" with a single term, "covered port"—which largely tracks the prior definitions and is defined in reference to statistics and determinations made by the Department of Transportation. The Final Rules also replace references to "12 nautical miles" to "within the limits of the territorial sea of the United States." 31 C.F.R. §§ 802.210, 802.211. Helpfully, the Final Rules state that CFIUS intends to make a web-based tool available in the near term to assist the public with assessing what real estate transactions qualify as "covered real estate transactions," potentially subject to CFIUS review.

Excepted Real Estate Transactions – More and Clarified Exceptions

The Proposed Rules set forth several "excepted real estate transactions" over which CFIUS would not have jurisdiction, including:

- Most transactions involving covered real estate within an "urbanized area" or "urban cluster";
- Purchases, leases, or concessions of covered real estate that is a single housing unit;
- Leases by or concessions to foreign persons of covered real estate within an airport or maritime port that may only be used as retail trade, accommodation, or food service sector establishments;

- Purchases or leases by, or concessions to, foreign persons of commercial office space, if the foreign person does not (i) hold, lease, or have concession with respect to more than 10% of the building's total square footage; and (ii) represent more than 10% of the buildings tenants;
- Purchases, leases, or concessions of certain land held by native groups; and
- Certain lending transactions.

The Final Rules also added a new exception for real estate transactions where the foreign person is a "foreign air carrier," as defined at 49 U.S.C. § 40102(a)(21), for whom the Transportation Security Administration within the U.S. Department of Homeland Security has accepted a security program under 49 C.F.R. § 1546.105 (but only to the extent that the lease or concession is in furtherance of its activities as a "foreign air carrier"). 31 C.F.R. § 802.216(e)(1).

In addition, the Final Rules modified some of the exceptions articulated in the Proposed Rules, including by:

- Broadening the exception for transactions in covered ports for the purpose of retail trade, accommodation, or food service sector establishments by removing references to NAICS codes and expanding the exception to cover leases or concession "for the purpose of engaging in the retail sale of consumer goods or services to the public" (and, accordingly, capturing additional categories of businesses such as car rentals); and
- Clarifying that the exception for commercial office space applies where the foreign person does not, in addition other applicable requirements, represent more than 10% of the total number of tenants, "based on the number of ownership, lease and concession arrangements for commercial space in the building."

Id. §§ 800.216(e)(2), (f).

Procedural Changes – More Real Estate Information Must Be Provided

Consistent with the changes to the Part 800 regulations, the Final Rules for real estate transactions will require parties to provide more information to CFIUS in connection with both abbreviated declarations and joint voluntary notices. Real estate-specific information that must be provided includes information on (1) whether the foreign person is acquiring a collection of assets or interest in an entity, and whether it is part of a larger project undertaken by the foreign person; (2) the distance(s) to any covered property relevant to CFIUS jurisdiction; and (3) whether any of the leases, licenses, permits, easements, encumbrances, or other grants or approvals associated with the real estate involve the U.S. government. 31 C.F.R. §§ 802.402(c)(2)(i), (3)(ii), (3)(iv), (3)(v); *Id.* §§ 802.502(b)(1)(i), (b)(2)(iii), (b)(2)(iv).

Updates to the List of Military Installations and Other U.S. Government Sites

Finally, the Final Rules incorporate minor revisions to the list of military installations and other sensitive U.S. government sites included in Appendix A to Part 802. CFIUS will continue to revise this list from time to time on a going forward basis.

Effective Date – Certain Transactions Are Grandfathered

Although the Final Rules take effect on February 13, 2020, consistent with past practice, the Final Rules incorporate a grandfathering provision for certain, advanced stage transactions. In particular, the Rules will not apply to a transaction for which *any* of the following milestones has occurred prior to February 13, 2020:

- The completion date;
- The parties have executed a binding written agreement, or other binding document, establishing the material terms of the transaction;

- A party has made a public offer to shareholders to buy shares of a U.S. business; or
- A shareholder has solicited proxies in connection with an election of the board of directors of a U.S. business or an owner or holder of a contingent equity interest has requested the conversion of the contingent equity interest.

31 C.F.R. § 800.104(b).

Conclusion

Although modest in scope, the changes implemented by the Final Rules will have significant effect for certain, limited categories of investments (*e.g.*, investments in U.S. businesses that collect genetic information) and investors (*e.g.*, certain investors from Australia, Canada, and the UK). For the vast majority of the investors and investment targets, implementation of the Final Rules on February 13 will require a top-to-bottom reassessment of investment strategy and pre-investment due diligence requirements.