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ALERT ▪ Committee on Foreign Investment in the United States

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Proposed Rule Could Affect Scope of Mandatory CFIUS Filings

Attorneys
Ama A. Adams
Brendan C. Hanifin
Emerson Siegle

On May 21, the U.S. Department of the Treasury published a Proposed Rule that would modify filing requirements for certain transactions subject to review by the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee").[1] Most significantly, the Proposed Rule would eliminate the industry nexus for mandatory filings related to non-passive investments in critical technology companies. As a result, depending on the identity of the foreign investor, investments in a broader range of critical technology companies may be subject to a mandatory CFIUS filing requirement.

The Treasury Department has solicited comments on the Proposed Rule from the public through June 22, 2020.

Background

In August 2018, President Donald Trump signed into law the Foreign Investment Risk Review Modernization Act ("FIRRMA"), which significantly expanded CFIUS's authority to review foreign investments in U.S. businesses. Two months later, CFIUS took the first step to implement FIRRMA, announcing a "pilot program" that introduced a mandatory filing requirement for non-passive investments in certain critical technology companies. In January 2020, the Treasury Department published final regulations to implement most aspects of FIRRMA (the "FIRRMA Regulations"), which took effect on February 13.

Among other changes, the FIRRMA Regulations made permanent the pilot program's mandatory filing requirement for non-passive, non-controlling investments in certain U.S. businesses that produce, design, test, manufacture, fabricate, or develop one or more "critical technologies."[2] Currently, to trigger the mandatory filing requirement, the U.S. business must either:

- **Use critical technology in connection with its activity in a designated sensitive industry** (as identified in appendix B to 31 C.F.R. part 800 by reference to the North American Industry Classification System; "NAICS"); *or*
- **Design critical technology specifically for use in a designated sensitive industry** identified in appendix B.[3]

In connection with publication of the FIRRMA Regulations, the Treasury Department announced that it intended to revise the mandatory declaration requirement for critical technology "from one based upon North American Industry Classification System (NAICS) codes to one based upon export control licensing requirements."[4] The Proposed Rule represents the fulfillment of that commitment.

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[1] Provisions Pertaining to Certain Investments in the United States by Foreign Persons, 85 Fed. Reg. 30,893 (May 21, 2020) [hereinafter "Proposed Rule"].

[2] "Critical technology" is defined to include defense articles and defense services listed on the U.S. Munitions List, many dual-use items on the Commerce Control List, specified nuclear-related equipment, select agents and toxins, and "emerging and foundational technology." 31 C.F.R. § 800.215.

[3] 31 C.F.R. § 800.401(c)(1), (2). A "TID U.S. business" is any U.S. business that (1) produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies; (2) performs the functions as set forth in column 2 of appendix A to this part with respect to covered investment critical infrastructure; or (3) maintains or collects, directly or indirectly, sensitive personal data of U.S. citizens." 31 C.F.R. § 800.248.

[4] Provisions Pertaining to Certain Investments in the United States by Foreign Persons, 85 Fed. Reg. 3,112, 3,113 (Jan. 17, 2020).

The Proposed Rule

The Proposed Rule would amend the FIRRMA Regulations' mandatory filing criteria for critical technology investments by eliminating the requirement that the target U.S. business operate within, or develop technology for use in, a designated sensitive industry. Under the Proposed Rule, a mandatory filing would be triggered for any non-passive investment in a U.S. business that deals in critical technology, *if* "**U.S. regulatory authorization**" would be required to export or transfer the critical technology to:

1. The foreign party to the transaction; *or*
2. Any foreign party that, individually or collectively with a group of foreign persons, holds a qualifying "**voting interest**" in the foreign party to the transaction.[5]

In this context:

- "**U.S. regulatory authorization**" means authorization from (1) the Directorate of Defense Trade Controls ("DDTC") within the U.S. Department of State, responsible for administering the International Traffic in Arms Regulations ("ITAR"); (2) the Bureau of Industry and Security ("BIS") within the U.S. Department of Commerce, responsible for administering the Export Administration Regulations ("EAR"); (3) the Department of Energy; or (4) the Nuclear Regulatory Commission.[6] Note, with limited exceptions under the EAR, a U.S. regulatory authorization is considered to be required *even if* a license exception or exemption is available under the EAR or ITAR.
- A qualifying "**voting interest**" means a 25% or greater voting interest (direct or indirect) in the foreign party to the transaction.[7] For entities whose activities are primarily directed, controlled, or coordinated by or on behalf of a general partner, managing member, or equivalent (such as investment funds), the relevant threshold is a 25% interest in the entity's general partner, managing member, or equivalent.

Takeaways

The Proposed Rule would expand the mandatory filing requirement for certain investors—*i.e.*, investors who are nationals of, or maintain their principal place of business within, countries subject to a broad range of export control restrictions. Because the mandatory filing requirement would no longer be limited to companies with a nexus to a designated sensitive industry, this subset of investors would need to consider the filing requirement in connection with a broader array of U.S. investments.

Equally important, the Proposed Rule would narrow the scope of the mandatory filing requirement for other investors—*i.e.*, investors who are nationals of, or maintain their principal place of business within, countries that are subject to more limited export control restrictions. For this subset of investors, even if the target U.S. business operates in a sensitive industry, a mandatory filing would not be triggered unless the target's critical technology required a license for export or transfer to the foreign investor (*provided* that no foreign party from a jurisdiction subject to more extensive export controls holds a qualifying "voting interest" in the foreign investor).

Across all parties, the Proposed Rule would simplify the mandatory filing analysis, by eliminating the inherent ambiguity in analyzing NAICS code descriptions—developed for an unrelated purpose—to assess whether a U.S. business has a nexus to a designated sensitive industry. One potential drawback, however, is that the Proposed Rule would place even greater emphasis on ensuring that the U.S. business has properly classified its products and technology. In particular,

[5] Proposed Rule at 30,898.
[6] *Id.*
[7] *Id.*

U.S. businesses could no longer assume they are exempt from a mandatory filing requirement due to lack of an industry nexus (*i.e.*, as substitute for a reliable classification analysis). While foreign investors and U.S. businesses have a shared interest in ensuring compliance with mandatory filing requirements, in assessing their filing obligations, foreign investors typically must rely upon the export classification assessment performed by the U.S. business. Another consequence is that foreign investors would need to assess the level of export restrictions that apply to them (taking into account their jurisdiction *and* the identities of their major shareholders).

In addition, the Proposed Rule underscores that, "consistent with FIRRMA and the Export Control Reform Act of 2018 (ECRA), CFIUS will continue its role in the process to identify emerging and foundational technologies as set forth in section 1758(a) of ECRA." In its current form, the Proposed Rule would raise the stakes for this ongoing interagency process to identify and impose new export controls on technologies that are "essential to the national security of the United States." Because controlled products and technology are not subject to identical licensing requirements, the scope of the new export controls promulgated under ECRA will affect the scope of CFIUS's mandatory filing jurisdiction on a prospective basis.

Conclusion

The Proposed Rule signals subtle but important shifts that will affect how parties consider whether a transaction triggers a mandatory CFIUS filing requirement. As discussed above, the Proposed Rule would create additional burdens for certain investors, while alleviating the current requirements for other investors. Foreign investors and U.S. businesses alike should consider the effect of the Proposed Rule, which is likely to take effect later this year, and ensure that they adjust their CFIUS diligence processes accordingly.