

CLIENT ALERT

CFIUS Expands Jurisdiction and Introduces Mandatory Filings for Foreign Investments in Critical Technology Businesses

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On October 10, 2018, the U.S. Department of the Treasury released interim regulations pursuant to the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”) that implement a pilot program relating to foreign investment reviews in certain U.S. businesses by the Committee on Foreign Investment in the United States (“CFIUS”).¹ The pilot program expands CFIUS’s jurisdiction and, for the first time, introduces mandatory CFIUS filings for certain non-controlling investments involving critical technologies. The pilot program could cover, and require filings ahead of closing, minority direct investments by foreign entities, minority limited partners in U.S. funds, and foreign co-investors with a non-controlling stake in a U.S. business.

While some provisions of FIRRMA became effective immediately after passage of the statute, others would only become effective when new regulations were passed by Treasury or through pilot programs to test the effectiveness of certain provisions. Pursuant to the pilot program authority, CFIUS announced the immediate implementation of two parts of the authority granted by FIRRMA.

¹ For a more extensive background on CFIUS reform under FIRRMA, please see our prior Client Alerts, “Significant Changes to CFIUS Review Process and Export Controls Finalized in 2019 Defense Spending Legislation,” (available [here](#)) and “CFIUS Reform to Create Unique Issues for Private Equity” (available [here](#)).

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- The first element of the pilot program expands CFIUS’s jurisdiction to allow review of non-controlling investments into U.S. businesses in possession of “critical technologies.” The pilot program covers any U.S. business that produces, designs, tests, manufactures, fabricates or develops a critical technology that is: (1) utilized in connection with the U.S. business’s activity in a listed “Pilot Program Industry”; or (2) designed by the U.S. business specifically for use in one or more Pilot Program Industries (“Pilot Program U.S. Businesses”).
- The second element of the pilot program establishes mandatory declarations for foreign transactions involving Pilot Program U.S. Businesses. These mandatory declarations are abbreviated notices that generally should not exceed five pages in length.

The pilot program becomes effective on November 10, 2018, and will end no later than March 5, 2020, though likely sooner if the full regulations are issued before then.

I. Elements of Expanded CFIUS Jurisdiction under the Pilot Program

a. Non-Controlling Investment

Prior to FIRRMA, a “covered transaction” within CFIUS’s jurisdiction resulted in the “control” of a U.S. business by a foreign person. “Control” is defined broadly as the “power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity.”² Such transactions remain covered and subject to CFIUS’s jurisdiction post-FIRRMA.

With the advent of the pilot program, a non-controlling investment (referred to in FIRRMA as “other investments”) in a U.S. business involving critical technologies in a listed industry will now be considered a covered transaction if it provides a foreign investor:

- access to any material nonpublic technical information in the possession of the target U.S. business;
- membership or observer rights on the board of directors or equivalent governing body of the U.S. business, or the right to nominate an individual to a position on the board of directors or equivalent governing body of the U.S. business, or the right to nominate an individual to a position on the board of directors or equivalent governing body of the U.S. business; or

² 31 C.F.R. § 800.204

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- any involvement, other than through voting of shares, in substantive decision-making of the U.S. business regarding the use, development, acquisition, or release of critical technology.

Note that investments involving air carriers are specifically excluded as pilot program covered transactions.

b. Carve-Out for Investment Funds Remains

The regulations exclude certain investment fund transactions involving U.S. companies from the new category of covered non-controlling investments. Specifically, a foreign limited partner's investment in a U.S. fund will not render an investment by the fund a covered transaction on the basis of the foreign investor's membership on an advisory board or a committee of the fund if the fund meets certain criteria:

- The fund is managed exclusively by a general partner, a managing member, or an equivalent who is not a foreign person;
- The fund's advisory board or committee does not have the ability to control investment decisions of the fund, or decisions made by the general partner, managing member, or equivalent related entities in which the fund is invested;
- The foreign investor does not otherwise have the ability to control the fund, including authority to control investment decisions of the fund; control decisions made by the general partner, managing member, or equivalent related entities in which the fund is invested; or make compensation decisions for the general partner, managing member, or equivalent; and
- The foreign investor does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee.

c. Critical Technology

FIRRMA enumerates a number of types of "critical technologies," including certain items included on the Commerce Control List set forth as part of the Export Administration Regulations, and articles or services on the U.S. Munitions List set forth in the International Traffic in Arms Regulations. The scope of "critical technologies" is subject to change with potential additions.

d. Pilot Program Industries

To qualify as a pilot program investment subject to the declaration requirement, a non-controlling investment involving a critical technology in a U.S. business by a foreign investor must also occur within a particular Pilot Program Industry.

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These industries are identified using their respective North American Industry Classification System (“NAICS”) code. These 27 industries were specifically identified by Treasury to “narrowly scope the pilot program to include only those industries in which the threat of erosion of technological superiority from some foreign direct investment requires immediate action.”³

Aircraft Manufacturing <i>NAICS Code: 336411</i>	Nuclear Electric Power Generation <i>NAICS Code: 221113</i>	Research and Development in Nanotechnology <i>NAICS Code: 541713</i>
Aircraft Engine and Engine Parts Manufacturing <i>NAICS Code: 336412</i>	Optical Instrument and Lens Manufacturing <i>NAICS Code: 333314</i>	Research and Development in Biotechnology (except Nanobiotechnology) <i>NAICS Code: 541714</i>
Alumina Refining and Primary Aluminum Production <i>NAICS Code: 331313</i>	Other Basic Inorganic Chemical Manufacturing <i>NAICS Code: 325180</i>	Secondary Smelting and Alloying of Aluminum <i>NAICS code: 331314</i>
Ball and Roller Bearing Manufacturing <i>NAICS Code: 332991</i>	Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing <i>NAICS Code: 336419</i>	Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing <i>NAICS Code: 334511</i>
Computer Storage Device Manufacturing <i>NAICS Code: 334112</i>	Petrochemical Manufacturing <i>NAICS Code: 325110</i>	Semiconductor and Related Device Manufacturing <i>NAICS Code: 334413</i>
Electronic Computer Manufacturing <i>NAICS Code: 334111</i>	Powder Metallurgy Part Manufacturing <i>NAICS Code: 332117</i>	Semiconductor Machinery Manufacturing <i>NAICS Code: 333242</i>
Guided Missile and Space Vehicles Manufacturing <i>NAICS Code: 336414</i>	Power, Distribution, and Specialty Transformer Manufacturing <i>NAICS Code: 335311</i>	Storage Battery Manufacturing <i>NAICS Code: 335911</i>
Guided Missile and Space Vehicle Propulsion Unit Parts and Manufacturing <i>NAICS Code: 336415</i>	Primary Battery Manufacturing <i>NAICS Code: 335912</i>	Telephone Apparatus Manufacturing <i>NAICS Code: 334210</i>
Military Armored Vehicle, Tank, and Tank Component Manufacturing <i>NAICS Code: 336992</i>	Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing <i>NAICS Code: 334220</i>	Turbine and Turbine Generator Set Units Manufacturing <i>NAICS Code: 333611</i>

³ Interim Rule, “Determination and Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies,” Department of the Treasury Office of Investment Security, available at: https://home.treasury.gov/system/files/206/FR-2018-22182_1786904.pdf.

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II. Mandatory Declarations

The second element of the pilot program allows parties to a pilot program covered transaction to submit a declaration to CFIUS in lieu of a full CFIUS notice. The interim rule states that the declaration must be filed at least 45 days prior to a transaction's expected completion date, and requires that CFIUS take action on the declaration within 30 days. There is no obligation to file a declaration if parties choose to file a full CFIUS notice under CFIUS's standard procedures. Civil monetary penalties may also be assessed up to the value of the transaction if a declaration is not filed.

The requirement to file the declaration at least 45 days prior to transaction closing raises a question of whether the transaction parties are comfortable enough in their analysis of the transaction that CFIUS will not respond to the declaration with a request to file a full notification. This would then require composition of a full notice and the associated six-to-fourteen-week formal review timeline. The information requested by the mandatory declaration includes many of the same requests required by a full notification, including a brief description of the transaction and its structure, percentages of voting and economic interests acquired, governance rights, government contracts, and full ownership information of the foreign investor.

III. Next Steps for Investment Funds

In addition to foreign parties considering whether their U.S. investments may be covered by the pilot program, U.S. funds should examine how the expansion of CFIUS's jurisdiction and the new filing requirement could impact existing relationships with potential co-investor limited partners. Investment funds should consider the following steps:

- Determine whether co-investment side letter rights should be modified so that a general partner may limit the ability of a limited partner to participate as a co-investor if that would cause a mandatory filing with CFIUS;
- Clarify with limited partner co-investors whether, for a covered pilot project investment, the limited partner's co-investment rights would be limited to restrict access to material nonpublic technical information or other rights that would rise to the level of a non-controlling investment subject to a mandatory CFIUS declaration.

The pilot program represents the first major regulatory expansion following the passage of FIRRMA. It is unclear whether CFIUS will continue to implement reform through additional pilot programs, or whether it will wait to propose fulsome draft regulations under the typical administrative process. Comments on the interim regulations may be submitted until November 10, 2018. CFIUS will notify interested parties of opportunities to comment on future draft regulations in the Federal Register when proposed. We will continue to monitor developments and provide analysis of their effects.

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