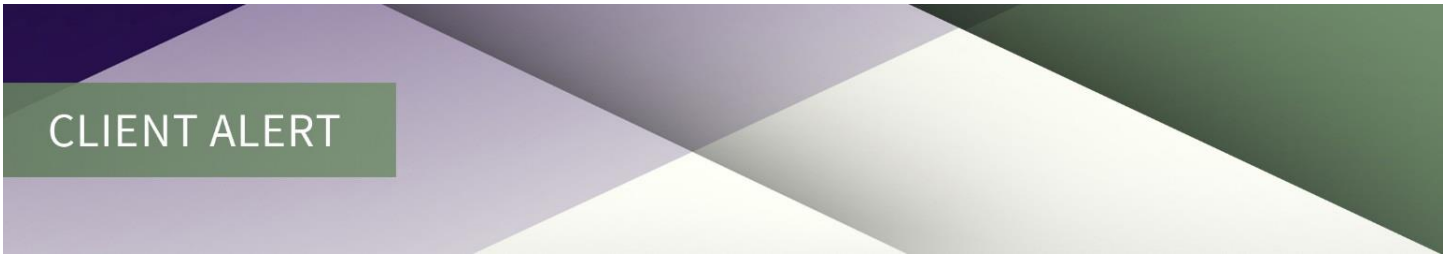

CFIUS Ties Mandatory Filing Requirement to Critical Technologies Requiring Export Licenses

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On September 15, 2020, the Committee on Foreign Investment in the United States ("CFIUS") published a final rule changing its mandatory filing requirement for covered investments involving certain critical technology U.S. businesses. The mandatory filing requirements were originally introduced in CFIUS' Pilot Program under the Foreign Investment Risk Review Modernization Act ("FIRRMA") and were maintained in the final FIRRMA regulations published on February 13, 2020, and applied only to U.S. businesses operating in, or developing technology specifically for, a covered industry. The filing requirement now hinges on whether the foreign investor makes a covered investment in a U.S. business that designs, produces, tests, manufactures, fabricates, or develops technology that would require a license for export to certain persons in the new ownership chain. The new requirement will apply to all transactions completed after October 15, 2020.

Original Mandatory Filing Requirements

Previously, CFIUS' regulations required a filing ahead of closing for investments by foreign parties (subject to certain exemptions) in a U.S. business that designs, produces, tests, manufactures, fabricates, or develops critical technologies in connection with the U.S. business's activity in one or more of 27 industries identified by their North American Industry Classification System ("NAICS") Code in an appendix to the regulations, if the investor also was provided:

- Access to any material non-public technical information;
- Membership or observer rights on the business' board of directors; or

- Involvement in substantive decision-making of the U.S. business regarding critical technologies, critical infrastructure, or sensitive personal data of U.S. citizens.

New Mandatory Filing Requirement for Transactions Involving Critical Technologies

The new rule does away with the focus on a U.S. business's NAICS code. Instead, mandatory filings will be required for foreign investments in a U.S. business, involving the investor rights described above, where any critical technology or technologies designed, produced, tested, manufactured, fabricated, or developed by the U.S. business would require one or more U.S. regulatory authorization[1] in order to be exported, re-exported, transferred, or retransferred to a person that:

- Could directly control such U.S. business as a result of the covered transaction;
- Is directly acquiring an interest that is a covered investment in such U.S. business;
- Has a direct investment in such U.S. business, the rights of such person with respect to such U.S. business are changing, and such change in rights could result in a covered control transaction or a covered investment;
- Is a party to any covered transaction; or
- Individually holds, or is part of a group of foreign persons that, in the aggregate, holds, a voting interest of 25% or more in a person that meets one of the criteria listed above.[2]

Mandatory declarations will generally be required even if a license exception under the EAR or a license exemption under the ITAR would be available for the export of the product to the foreign person in question. However, the rule provides for three narrow exceptions stating that a mandatory declaration would not be required if the export would be eligible for

1 U.S. regulatory authorization is defined as a license or other approval issued by the Department of State under the International Traffic in Arms Regulations; a license from the Department of Commerce under the Export Administration Regulations; a specific or general authorization from the Department of Energy; or a specific license from the Nuclear Regulatory Commission. 31 CFR § 800.254.

2 Note that in a traditional fund structure, a person holds a voting interest for purposes of critical technology mandatory filings in such entity only if it holds 25% or more of the interest in the general partner, managing member, or equivalent. 31 CFR § 800.256(b). Additionally, for the purposes of calculating a foreign person's ownership, foreign persons who are related, have formal or informal arrangements to act in concert, or are agencies or instrumentalities of, or controlled by, the national or subnational governments of a single foreign state are considered part of a group of foreign persons and their individual holdings are aggregated. 31 CFR § 800.256(d). Lastly, a parent who directly or indirectly holds 50% or more of the outstanding interest in ,or the profits of, an entity is deemed to own 100% of the interest held by that entity. 31 CFR § 800.235(a)(1), 256(c). A general partner, managing member, or equivalent of an entity will also be considered a parent of a relevant entity. 31 CFR § 800.235(a)(2).

license exceptions under the EAR because the item is considered unrestricted technology or software,[3] is a specified type of encryption technology,[4] or is authorized for export without a license for strategic reasons.[5]

Effective Date

The new rule will generally apply to all transactions signed after October 15, 2020. The previous NAICS-based requirement will apply to any transactions for which the following has occurred between February 13, 2020 and October 15, 2020:

- The completion date;
- The parties to the transaction 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.[6]

Potential Implications

Basing the mandatory filing requirement on any authorizations that would be required to export a product technologies designed, produced, tested, manufactured, fabricated, or developed by the U.S. business to the foreign investor will likely lead to more mandatory filings after the final rule goes into effect on October 15. Investors from countries that are subject to significant export controls will be more likely to be required to file a declaration prior to closing than they would have been previously. Moreover, some U.S. businesses that have never exported from the United States may find their sale to a foreign buyer subject to a mandatory filing nonetheless, if their products would in theory require an export license.

Note that CFIUS also requires pre-closing filings for covered transactions by foreign parties with substantial foreign government ownership that would result in the foreign government acquiring a 25% or greater stake in the U.S. business. A mandatory pre-closing declaration would also be required when a national or subnational government of a foreign country holds a 49% or greater interest in the foreign investor that invests at least 25% in a covered U.S. technology,

3 License Exception TSU at 15 CFR § 740.13.

4 License Exception ENC at 15 CFR § 740.17(b).

5 License Exception STA at 15 CFR § 740.20(c)(1).

6 31 CFR § 800.104(d).

infrastructure, or data ("TID") business.[7] The final rule clarified that in the case of entities whose activities are primarily directed, controlled, or coordinated by or on behalf of a general partner, managing member, or equivalent, a national or subnational government will only be considered to have a substantial interest in that entity if they hold a 49% or greater interest in the general partner, managing member, or equivalent of the entity.[8]

Failure to comply with CFIUS' mandatory filing requirements for covered transactions involving critical technologies or a substantial foreign government interest can result in civil penalties capped at the greater of $250,000 or the value of the transaction.[9] Pre-closing filings must be submitted at least thirty days before the completion date of the transaction,[10] making it essential that companies accurately identify as early as possible whether a proposed transaction is subject to these mandatory declaration requirements.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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7 31 CFR § 800.401(b), 244.

8 31 CFR § 800.244(b).

9 31 CFR § 800.901(b).

10 31 CFR § 800.401(g)(2).