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Expansion of CFIUS Oversight of Certain Non-Controlling Foreign Investments

On October 10, 2018, the Department of the Treasury, which chairs the Committee on Foreign Investment in the United States (CFIUS), released an interim rule establishing a temporary pilot program under the Foreign Investment Risk Review Modernization Act (FIRRMA), which was enacted on August 13, 2018. The pilot program involves two primary changes to, and expansions of, existing CFIUS legislation, which focuses exclusively on the impact of foreign investments in U.S. businesses on U.S. national security: (1) expanding CFIUS’s jurisdiction to review certain foreign non-controlling, non-passive investments in companies that produce, design, test, manufacture, fabricate, or develop one or more “critical technologies” within a specific subset of industries, and (2) mandating that persons engaged in such transactions file a declaration (a short-form of the existing CFIUS notice) containing certain descriptions of the covered transaction. Until the passage of FIRRMA earlier this year and the enactment of the pilot program, CFIUS reviewed only investments that could result in foreign control of a U.S. business, and notice to CFIUS of such transactions was entirely voluntary. Failure to submit a mandatory declaration when required under the new pilot program can result in potentially significant civil penalties, up to the value of the transaction.

The pilot program will remain in effect until final FIRRMA regulations are implemented, which will be no later than February 2020.

Although FIRRMA will ultimately increase CFIUS’s jurisdiction beyond its traditional review of direct foreign investments to include reviews of several categories of transactions (including those involving critical infrastructure and/or an impact on sensitive personal data), this summary focuses on the critical technologies pilot program, which is the only formally structured piece of legislation to date.

PILOT PROGRAM COVERED TRANSACTIONS

Traditionally, CFIUS reviewed only “covered transactions” involving direct control of a U.S. business. As a first step in growing its jurisdiction pursuant to FIRRMA, CFIUS has implemented a temporary pilot program which regulates Pilot Program Covered Transactions, which are transactions that involve the following three criteria (each defined below):

- a Pilot Program Covered Investment;
- a Critical Technology; and
- a Pilot Program Industry.

A. Pilot Program Covered Investments

Pilot Program Covered Investments are all direct and indirect investments—defined as the acquisition of any equity interest, whether noncontingent or contingent—by a foreign person in a Pilot Program U.S. Business that would not result in control by a foreign person of a pilot program U.S. business but that affords the foreign person:

- access to material nonpublic technical information in the possession of the pilot program U.S. business;
- 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 definition of “control” under the pilot program is consistent with the long-standing definition of a “covered transaction” under the existing CFIUS regulations.

Although FIRRMA authorizes CFIUS to limit its regulation of non-controlling investments to certain categories of foreign persons (e.g., nationals of a specific country), CFIUS elected not to implement any such limitations for the pilot program. Rather, the pilot program applies globally, with no exemptions for any particular nation of origin or foreign individual.

B. Critical Technologies

The pilot program applies only to investments in U.S. businesses that produce, design, test, manufacture, fabricate, or develop one or more “Critical Technologies”, which the pilot program defines as:

- Defense articles or defense services included on the United States Munitions List set forth in the International Traffic in Arms Regulations;
- Items included on the Commerce Control List set forth in the Export Administration Regulations and controlled (1) pursuant to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology; or (2) for reasons relating to regional stability or surreptitious listening;
- Specifically designed and prepared nuclear equipment, parts and components, materials, software, and technology covered by 10 CFR Part 810 (relating to assistance to foreign atomic energy activities);

- (d) Certain nuclear facilities, equipment, and material (relating to export and import of nuclear equipment and material);
- (e) Certain chemical agents and toxins; or
- (f) Emerging and foundational technologies controlled pursuant to the Export Control Reform Act of 2018 (which was signed into law on the same day as FIRRMA).

The pilot program does not define “emerging and foundational technologies”, which is subject to forthcoming guidance, but such broad category has the potential to affect a wide range of businesses. To that end, on November 19, 2018, the Department of Commerce published an advanced notice of proposed rulemaking seeking stakeholder input regarding the review of controls for such emerging technologies.

C. Pilot Program Industries

In order for a U.S. business to be covered by the pilot program, that business must also be in one of the twenty-seven covered pilot program industries in which CFIUS believes there exists a risk that some foreign investment threatens to undermine the technological superiority that is critical to U.S. national security. A full list of the twenty-seven industries is attached hereto as Annex A, and includes industries ranging from aircraft manufacturing and nuclear electric power generation, to research and development in nanotechnology and biotechnology.

For the avoidance of doubt, a Pilot Program Covered Transaction must satisfy all three criteria to be subject to the declaration requirement (addressed in more detail below). For example, if a transaction would constitute a Pilot Program Covered Investment in a Pilot Program Industry, but does not involve the production, design, testing, manufacturing, fabrication, or development of a Critical Technology (and vice versa), the mandatory declaration would not be required.

TREATMENT OF CERTAIN INVESTMENT FUND INVESTMENTS

There exist two enumerated exceptions to FIRRMA regulation under the pilot program, one being transactions involving certain air carriers, and the other being certain investment fund investments. To expand on the latter, the regulations provide that indirect investments by a foreign person through an investment fund that affords the foreign person (or a designee) membership as a limited partner or equivalent on an advisory board or committee of the investment fund are exempt from pilot program regulation so long as such investments also meet all of the following conditions:

- (a) The fund is managed exclusively by a general partner, a managing member, or an equivalent;
- (b) The foreign person is not the general partner, managing member, or equivalent;
- (c) The advisory board or committee does not have the ability to approve, disapprove, or otherwise control (i) investment decisions of the investment fund, or (ii) decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested;

- (d) The foreign person does not otherwise have the ability to control the investment fund, including the authority to (i) approve, disapprove, or otherwise control investment decisions of the investment fund, (ii) approve, disapprove, or otherwise control decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested, or (iii) to unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing member, or equivalent;
- (e) The foreign person does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee; and
- (f) The investment otherwise meets the requirements of paragraph 4(D) of subsection (a) of section 721 of the Code.

TIMING AND CONTENTS OF MANDATORY DECLARATION

Under the pilot program, the mandatory declaration that must be filed with CFIUS by the parties in connection with a Pilot Program Covered Transaction (i.e., a non-controlling, non-passive foreign investment in a U.S. business that deals in some form with a Critical Technology in one of the Pilot Program Industries) must be filed with the Committee at least forty-five (45) days before the closing date of the transaction.

The mandatory declaration generally should not exceed five pages in length, and should include certain critical details about the transaction, including:

1. Subject of the transaction
2. Information on the parties to the transaction, including a detailed corporate ownership structure
3. Information about the business activities of the U.S. business and the foreign investor
4. A description of the nature of the transaction and its structure, to include the value of the transaction and details on the interests being acquired

In addition, CFIUS urges those filing a declaration to consider stipulating in the contents of the declaration that the transaction is a pilot program covered transaction, in order to streamline the CFIUS review process. The parties may also choose to file a formal written notice in lieu of an abbreviated declaration, which notice would contain more detail than is required by the mandatory declaration, in order to streamline CFIUS' review.

Once the Committee is in receipt of the declaration, the Staff Chairperson will inform the parties that the declaration has been accepted and is under review; this notice from the Staff Chairperson triggers a thirty-day time period in which CFIUS must review the transaction to determine whether such transaction poses a threat to U.S. national security. During this period, CFIUS may request certain follow-up information from the parties, request that the parties file a more formal written notice with more detail on the transaction, approve the transaction, or block the transaction. During the CFIUS review process, the parties have an ongoing obligation to inform the Committee of any material change in the information presented in the declaration/notice.

FUTURE IMPLICATIONS

The pilot program itself significantly expands the current practice of review of foreign investments in the United States, but FIRRMA will result in CFIUS expanding even further in the coming months and years. Under FIRRMA, CFIUS also has the jurisdiction to implement legislation in the future to regulate other forms of non-controlling investments, such as transactions involving critical infrastructure, sensitive personal data, and even certain types of real estate investments that are related to or located in proximity to a U.S. military installation or another sensitive government location.

Because the pilot program is not permanent and CFIUS has the jurisdiction to implement further rules that regulate other categories of foreign investment, it remains critical for investors and U.S. businesses alike to continuously monitor CFIUS legislation over the coming months and years.

The existing and long-standing CFIUS requirements remain in full effect as they pertain to any qualifying direct foreign investment, regardless of whether a transaction involves a Pilot Program Covered Investment, a Critical Technology, or a Pilot Program Industry.

ANNEX A - Pilot Program Covered Industries

1. Aircraft Manufacturing, NAICS Code: 336411
2. Aircraft Engine and Engine Parts Manufacturing, NAICS Code: 336412
3. Alumina Refining and Primary Aluminum Production, NAICS Code: 331313
4. Ball and Roller Bearing Manufacturing, NAICS Code: 332991
5. Computer Storage Device Manufacturing, NAICS Code: 334112
6. Electronic Computer Manufacturing, NAICS Code: 334111
7. Guided Missile and Space Vehicle Manufacturing, NAICS Code: 336414
8. Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing, NAICS Code: 336415
9. Military Armored Vehicle, Tank, and Tank Component Manufacturing, NAICS Code: 336992
10. Nuclear Electric Power Generation, NAICS Code: 221113
11. Optical Instrument and Lens Manufacturing, NAICS Code: 333314
12. Other Basic Inorganic Chemical Manufacturing, NAICS Code: 325180
13. Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing, NAICS Code: 336419
14. Petrochemical Manufacturing, NAICS Code: 325110
15. Powder Metallurgy Part Manufacturing, NAICS Code: 332117
16. Power, Distribution, and Specialty Transformer Manufacturing, NAICS Code: 335311
17. Primary Battery Manufacturing, NAICS Code: 335912
18. Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing, NAICS Code: 334220
19. Research and Development in Nanotechnology, NAICS Code: 541713
20. Research and Development in Biotechnology (except Nanobiotechnology), NAICS Code: 541714



21. Secondary Smelting and Alloying of Aluminum, NAICS Code: 331314
22. Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing, NAICS Code: 334511
23. Semiconductor and Related Device Manufacturing, NAICS Code: 334413
24. Semiconductor Machinery Manufacturing, NAICS Code: 333242
25. Storage Battery Manufacturing, NAICS Code: 335911
26. Telephone Apparatus Manufacturing, NAICS Code: 334210
27. Turbine and Turbine Generator Set Units Manufacturing, NAICS Code: 333611

Questions or Information:

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