# Client Alert

**October 2019**

## Proposed Rules Would Substantially Expand CFIUS Authority

**What Happened**: On September 17, 2019, the US Department of Treasury released for public comment two sets of proposed rules implementing many of the provisions of the Foreign Investment Risk Review Modernization Act of 2018 (**FIRRMA**) which are not yet in effect. These proposed rules, once effective, will significantly alter the regulatory landscape overseen by the Committee on Foreign Investments in the United States (**CFIUS**) pursuant to the Section 721 of the Defense Production Act of 1950 (**DPA**).[1] These new rules are also expected to expand significantly the number of submissions made to CFIUS each year. Interested parties have until October 17, 2019, to provide comments on the proposed rules. In accordance with FIRRMA, these rules (as they may be amended) will take effect no later than February 13, 2020.

**The Bottom Line**: As drafted, the proposed rules would make a number of significant changes to CFIUS's review of foreign investment in the United States under Section 721 of the DPA:

- The Pilot Program interim rules[2] granted CFIUS, for the first time, authority to review certain noncontrolling investments in US businesses (i.e., those that develop or manufacture critical technology in a narrow set of industrial sectors). The new Part 800 rules would expand CFIUS reviews to certain noncontrolling investments in a much broader range of US businesses that develop or manufacture such critical technology. These new rules would also provide CFIUS with the authority to review noncontrolling investments in US businesses that involve certain critical infrastructure or that possess certain types (and quantities) of sensitive personal data.

- Prior to FIRRMA, all submissions to CFIUS were voluntary in the sense that it was not against the law to complete a transaction without CFIUS clearance.[3] The Pilot Program interim rules established a requirement that certain transactions involving a narrow set of industrial sectors be submitted to CFIUS for review prior to closing. The new Part 800 rules would expand the scope of transactions subject to the mandatory submission requirement.

- Prior to FIRRMA, CFIUS did not have authority to review real estate transactions if they were not part of the acquisition of a US business by a foreign person. The new Part 802 rules would expand CFIUS jurisdiction by including certain real estate transactions proximate to sensitive government installations.

[1] The first set of proposed rules is a complete amendment and restatement of the existing main body of CFIUS rules, which are and will be codified at 31 CFR Part 800. The full text of the proposed Part 800 rules can be accessed here. With certain limited exceptions discussed below relating to mandatory filings, the investment fund safe harbor and the abbreviated declaration process, this amendment generally does not affect the processes for clearance of transactions involving the acquisition by a foreign person of control over a US business. The second set of proposed rules is specifically for certain US real estate transactions not involving a US business and will be codified at 31 CFR Part 802. The full text of the proposed Part 802 rules can be accessed here.

[2] CFIUS had previously issued interim regulations to implement a pilot program under FIRRMA (**Pilot Program**) that granted CFIUS authority to review certain noncontrol transactions and created a category of transactions (control and noncontrol) which the parties are obligated to submit for CFIUS clearance prior to closing. An explanation of the Pilot Program, which has been in effect since November 10, 2018, can be accessed here.

[3] While ostensibly voluntary, closing a covered transaction without seeking CFIUS clearance—both under the existing rules and the proposed rules—leaves the US government with significant tools to remedy adverse national security effects, including ordering the buyer to divest its acquired interest.

- Prior to FIRRMA, CFIUS was not authorized to exempt foreign buyers or investors based in certain friendly states from CFIUS review. The new proposed rules would provide a narrow exception from CFIUS review for certain foreign investors from certain friendly states involved in making investments in US businesses or US real estate or acquiring control over US real estate.

If CFIUS's estimates are correct, its workload—and the workload of the companies involved in international acquisition and investment activity and such companies' advisors—will increase dramatically when the foregoing changes are implemented. CFIUS estimates that under the new rules there will be 200 notices and 550 declarations filed under Part 800 per year and 150 notices and 200 declarations under Part 802 per year. The total number of notices and declarations (1,100) is more than ***four times*** the number of notices filed with CFIUS in 2017, the most recent year for which data is available.

**The Full Story:**

1. Noncontrolling Investments

One of the most significant changes introduced by the proposed rules is the expansion of CFIUS's authority to include reviewing any "**covered investment**" (but not all investments) in any "**TID US business**" (but not all US businesses). A covered investment is a noncontrol investment in a TID US business that gives the foreign person (1) access to material "**non-public technical information**"[4] in the possession of the US business, (2) membership or observer rights on the board of directors (or equivalent body) of the US business or (3) any involvement in "**substantive decision-making**"[5] of the US business regarding certain actions related to TID US business.[6] A TID US business is a US business that produces, designs, tests, manufacturers, fabricates or develops critical ***T***echnologies; or owns, operates or manufactures (or, in some cases, supplies or services) certain critical ***I***nfrastructure; or maintains or collects sensitive personal ***D***ata on US citizens. Each of these key concepts is discussed further in the succeeding paragraphs.

Critical Technologies. Under the proposed rules, the definition of "**critical technologies**" mirrors how the term was previously defined under the Pilot Program. Both definitions include emerging and foundational technologies controlled under the Export Control Reform Act of 2018 (**ECRA**). The US Department of Commerce, pursuant to its rulemaking authority under the ECRA, is expected to issue proposed rules soon expanding the definition of technologies that qualify as "emerging or foundational technologies" thereby expanding the types of critical technologies that will be subject to CFIUS's review.

Critical Infrastructure. The proposed rules introduce the new term "**covered investment critical infrastructure**" to identify the specific subset of critical infrastructure[7] that is subject to potential CFIUS review of noncontrolling investments. Generally, a US business will qualify as covered investment critical infrastructure if it owns, operates or manufacturers one or more of the types of infrastructure meeting the specific descriptions or thresholds listed in Column 1 of Appendix A to the proposed Part 800 rules.[8] In certain limited circumstances, however, merely supplying or servicing a US business that owns or operates

[4] Material nonpublic technical information means information that: "(1) provides knowledge, know-how, or understanding not available in the public domain, of the design, location, or operation of critical infrastructure, …; or (2) is not available in the public domain and is necessary to design, fabricate, develop, test, produce, or manufacture a critical technology…." Material nonpublic technical information does not include financial performance related to an entity's performance.

[5] Substantive decision-making means the process through which decisions regarding significant matters affecting an entity are undertaken, including without limitation: (1) pricing, sales and specific contracts; (2) supply arrangements; (3) corporate strategy and business development; (4) research and development; (5) manufacturing locations; (6) access to critical technologies, covered investment critical infrastructure, material nonpublic technical information or sensitive personal data; (7) physical and cyber security protocols; (8) practices, policies and procedures governing the collection, use or storage of sensitive personal data; or (9) strategic partnerships.

[6] If the foreign person holds, directly or indirectly, a 50 percent or greater interest in the target TID US business (or has the right to appoint more than half of its board members) prior to making a further investment in such business, such further investment transaction will not constitute a covered investment.

[7] The proposed new rules did not make any material changes to the definition of "**critical infrastructure**." It is defined as "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security."

[8] See note 1 above for a link to the Part 800 rules and Appendix A relating to covered investment critical infrastructure.

a listed critical infrastructure can qualify a US business as a TID US business as described in Column 2 of Appendix A. Examples of covered investment critical infrastructure include, but are not limited to, oil refineries over a certain size, gas pipelines over a certain diameter, interstate oil pipelines meeting certain size or other criteria and certain ports and airports that are described in the proposed Part 802 rules.

Although the rules differentiate between covered investment critical infrastructure (which in theory only applies to noncontrol investments) and critical infrastructure (which only applies to control transactions), the commentary accompanying the proposed rules clearly describes the former as a subset of the latter. Thus, a US business that fits within the description of covered investment critical infrastructure in Column 1 of Appendix A should be presumed to be critical infrastructure in a control transaction as well. The converse is not necessarily true—a business that is not covered investment critical infrastructure may still be critical infrastructure in the context of a control transaction. However, the size or other requirements associated with covered investment critical infrastructure may become useful data points in assessing the question of whether a US business constitutes critical infrastructure.

Sensitive Personal Data. A US business will also qualify as a TID US business if it maintains or collects data that constitutes "sensitive personal data." Sensitive personal data is present if three conditions are met:

- first, the US business either (a) targets or tailors its products or services to any US executive branch agency or military department with national security responsibilities, or such organizations personnel or contractors, or (b) maintained or collected, or plans to maintain or collect, data on more than one million individuals;

- second, that data is "**identifiable data**," which means the data can be used to distinguish or trace a person's identity; and

- third, the data collected or maintained falls into one of ten types including, but not limited to, financial information, credit report and similar information, insurance information and health condition information.[9] A US business that collects and maintains genetic data qualifies as a TID US business irrespective of whether the quantitative thresholds described in the first bullet are satisfied.

To the extent that a foreign person proposes to make a covered investment in a TID US business, CFIUS will have the authority to review such transaction applying procedures and analyses similar to those that would apply for covered control transactions.[10]

2. Additional Mandatory Filings

The proposed rules introduce an additional mandatory filing requirement for any covered transaction (e.g., acquisition or investment) involving a TID US business that results in an acquisition of a substantial interest by a foreign person in which a foreign government has a substantial interest. "**Substantial interest**" is defined as a "voting interest, direct or indirect, of 25 percent or more by a foreign person in a US business and a voting interest, direct or indirect, of 49 percent or more by a foreign government in a foreign person." Any voting interest of a parent entity in a subsidiary entity will be deemed to be a 100 percent voting interest.[11] Under the proposed rules, mandatory declarations, or notices in lieu of a declaration, must be

[9] Other sensitive personal data includes nonpublic electronic communications, including messaging and chat services, between and among users of a US business that facilitates third-party user communications, geological data, biometric enrollment data, data used for state or federal government identification cards and data used for US government personnel security clearance status or any application for employment in a position of public trust.

[10] A "**covered control transaction**" is a transaction that results in control of a US business by a foreign person. This was also the definition of "covered transaction" under the Part 800 rules that predated FIRRMA.

[11] In other words, if Foreign Government A owns 50 percent of the voting stock of Foreign Company B which owns 50 percent of the voting stock of Foreign Company C which proposes to acquire 25 percent of US Company D, Foreign Government A

submitted to CFIUS at least 30 days before the completion date. Parties may choose to file a notice or declaration to satisfy the mandatory filing requirement.

3. New Voluntary Filings for Real Estate Transactions

The second set of proposed rules—Part 802—creates new rules for US real estate transactions involving foreign buyers where the transaction does not also involve a US business.[12] As noted above, such real estate only transactions were not formerly subject to CFIUS's jurisdiction.

Scope. The proposed rules introduce the new term "**covered real estate**" to define the scope of real property that is potentially subject to review by CFIUS. Covered real estate encompasses (1) real estate that is located within or will function as part of an airport or maritime port; and (2) real estate proximate to military installations, within four specific categories:

- First, real estate within ***one mile*** of certain Air Force command, research and testing sites, Army combat training centers and radar sites in certain states, Naval and Marine Corps bases, military ranges and training sites in certain states;

- Second, real estate within an ***expanded area of 99 miles*** (but no more than 12 nautical miles seaward of the US coastline) of certain Army combat training centers, major range and test facilities, other military ranges or joint forces training centers located in certain states;

- Third, real estate anywhere within ***specified counties or other geographic areas*** related to certain Air Force missile wings and ballistic missile fields; and

- Fourth, any ***part of a US Navy offshore range complex or operating area*** extending 12 nautical miles seaward from the coastline of the United States.

The foregoing categories are described in detail in the proposed rules and the Department of Treasury has appended a list of military installations in four parts to assist persons in identifying covered areas.[13]

CFIUS has authority to review a transaction involving covered real estate if such transaction constitutes a "**covered real estate transaction**." Specifically, a covered real estate transaction is the purchase or lease by, or concession (for the purposes of developing or operating infrastructure for a port) to, a foreign person of covered real estate that affords the foreign person at least three of four key property rights: (1) the right to physical access; (2) the right to exclude; (3) the right to improve or develop; and (4) the right to attach fixed or immovable structures or objects.[14] This means that a transaction that results in a foreign person owning only a minority interest in "covered real estate" would fall under CFIUS review if the transaction affords the foreign person at least three of the four property rights.

Exceptions. The proposed rules for covered real estate transactions would not apply if the purchase, lease or concession of covered real estate is for certain purposes or in certain areas. The broadest exception would exclude the purchase or lease of a single housing unit (regardless of the location of such real estate). There are also other exceptions that apply to transactions as they relate to certain types of covered real estate. For example, there is an exception for the lease or concession of retail trade, accommodation or food service establishments connected to or operating as part of airports or maritime ports (but not—at

would be deemed have a substantial interest in both foreign companies, and both foreign companies would be deemed to have a substantial interest in US Company D.

[12] If a transaction involves real estate and a US business, that transaction is evaluated under the general Part 800 rules, not the Part 802 rules.

[13] See note 1 above for a link to the Part 802 rules and Appendix A relating to military installations.

[14] Transactions that would have the effect of changing the rights that a foreign person with a leasehold or concession interest in covered real estate would likewise be covered real estate transactions if it results in the foreign person having at least three of the four property rights.

least as currently drafted—for covered real estate in close proximity to a military installation).[15] There is also an exception for real estate transactions within certain urbanized areas (but not as it relates to ports, airports or military installations in the "one mile" category of covered real estate described above). Finally, there is a narrow exception for the lease or concession of commercial office space within a multi-unit office building. This exception applies only if the foreign person (and its affiliates) is not the primary tenant/concessionaire of the building and meets certain other requirements.

The proposed Part 802 rules also create exceptions for transactions involving two classes of persons. First, the purchase, lease or concession of land owned by Alaska Natives and certain affiliated groups or corporations, or held in trust by the United States for American Indians, Indian tribes, Alaska Natives and certain affiliated groups or corporations, is excepted from the definition of covered real estate transactions. Second, as described more fully in the next section, there is an exception for the sale, lease or concession to certain foreign persons.

Process. The process for seeking clearance of covered real estate transactions largely tracks the process under Part 800 for covered control transactions.

4. Excepted Investors and Excepted Real Estate Investors

In addition to expanding CFIUS's authority to review foreign investments, the proposed rules in Part 800, in accordance with FIRRMA, establish a narrow class of investors—"**excepted investors**"—whose noncontrol investments in a US business do not constitute covered investments (i.e., who can engage in covered investments without CFIUS clearance and without fear of subsequent adverse action by CFIUS). The proposed Part 802 rules include a similar exception—for "**excepted real estate investors**"—for real estate. However, as proposed, these exceptions have no application to the acquisition of control over a US business.

To qualify as an excepted investor (or excepted real estate investor), the foreign person must be: (1) a foreign national who is a national of one or more excepted foreign states[16] and is not a national of any nonexcepted foreign state; (2) a foreign government of an excepted foreign state; or (3) a foreign entity (a) that is organized under the laws of an excepted foreign state or the United States; (b) that has a principal place of business in an excepted foreign state or the United States; (c) that has a board of directors (or comparable body) all of whose members are citizens of either an excepted foreign state or the United States; (d) that, to the extent it has any persons holding, directly or indirectly, legal or beneficial ownership of 5 percent or more voting power, profits interest or liquidation share, all such persons are citizens of either an excepted foreign state or the United States; and (e) that the "***minimum excepted ownership***" of such entity is held, individually or in the aggregate, directly or indirectly, by nationals of the United States or an excepted foreign state, a foreign government of an excepted foreign state or a foreign entity organized under the laws of excepted foreign state that has its principal place of business in the United States or an excepted foreign state. The proposed rules set different minimum ownership thresholds depending on whether a foreign investor is public or private. For foreign investors whose securities trade on an exchange in the United States or an excepted foreign state, minimum excepted ownership is "a majority of its voting interest, the right to a majority of its profits, and the right in the event of dissolution to a majority of its assets." For foreign investors whose securities do not trade on any such exchange in the US or in an excepted foreign state, the minimum excepted ownership that must be held is 90 percent or more of the company's voting interest, the right to 90 percent or more of its profits and the right, in the event of dissolution, to 90 percent or more of its assets.

A foreign person that might otherwise qualify as an excepted investor will be disqualified if, for example, that person or an affiliate has been subject to adverse action by CFIUS or another federal US agency

[15] CFIUS has specifically invited comment on how to structure this exception to avoid over-inclusive impacts on foreign investment.

[16] The proposed rules do not indicate which countries will ultimately qualify as excepted foreign states, except to note that CFIUS initially intends to designate a limited number of eligible foreign states.

responsible for administering sanctions and export controls. Additionally, the criteria that qualifies a foreign person as an excepted investor must remain effective for three years following the completion date. If the investor ceases to be an excepted person for any reason during that period, each covered investment in which they are a party will fall under CFIUS's authority.

5. Other Matters

Effective Time. Each of the Part 800 and Part 802 rules will become effective upon publication of the final rules. However, as to Part 800, the rules in effect immediately prior to such publication will continue to govern for any transaction for which any of the following is true prior to such publication date: (1) the transaction is completed; (2) the parties to the transaction have executed a binding written agreement establishing the material terms of the transaction; or (3) certain public offers or proxy solicitations have been made with respect to a US business. As to Part 802, the rules will not apply if the conditions in clause (1) or clause (2) of the prior sentence are met.

Investment Fund Safe Harbor. The proposed Part 800 rules implement FIRRMA's safe harbor provisions for investment funds in substantially the same way as the Pilot Program. Under the proposed Part 800 rules, an indirect investment in a TID US business through an investment fund that affords a foreign person membership as a limited partner or the equivalent on an advisory board or committee may be excluded from a covered investment if certain criteria are met. Such a transaction will be excluded under the safe harbor if: (1) the fund is managed exclusively by a general partner, managing member or equivalent that is not a foreign person; (2) the advisory board or committee of which the foreign person serves does not have the ability to approve, disapprove or otherwise control investment decisions by the fund or by the general partner, managing member or equivalent; (3) the foreign person does not otherwise have the ability to control the fund, including by dismissing or determining compensation of the general partner, managing member or equivalent; and (4) the foreign person does not have access to material nonpublic technical information of the US TID business.

Pilot Program Interim Rules. The proposed rules leave in place the Pilot Program and the provision under the Pilot Program interim rules that acquisitions of, and investments in, certain US businesses with critical technologies involving one or more of the 27 specified industries are required to submit a declaration or notice prior to completing the transaction. We expect that the Department of Treasury will make the Pilot Program permanent and will issue final Pilot Program rules prior to February 13, 2020.

Declaration Process. The proposed rules expand the short-form voluntary declaration process previously established under the Pilot Program to all covered transactions.[17] The contents for submitting mandatory declarations (under the Pilot Program) and voluntary declarations (under proposed Part 800) are identical. The proposed rule requires that CFIUS take action on any declaration within 30 days.

* * * * *

Foreign investors and US businesses that are potential investment targets for foreign persons should review this alert and CFIUS's proposed rules. Persons interested in commenting on the proposed rules must submit those comments to the Department of Treasury no later than October 17, 2019.

The mergers and acquisitions, competition and international and cross-border transactions practices at Hunton Andrews Kurth LLP will continue to monitor the development of this rule-making and other CFIUS and cross-border investment matters. Please contact us if you have any questions, would like further information regarding the proposed rules or CFIUS, or require our assistance in submitting written comments on the proposed rules.

[17] The abbreviated declaration process is described in the explanation of the Pilot Program linked in note 1 above.

**Contacts**

**Eric R. Markus**
ericmarkus@HuntonAK.com

**Leslie W. Kostyshak**
lkostyshak@HuntonAK.com

**Sevren R. Gourley**
sgourley@HuntonAK.com