Client Alert

January 2020

The US Department of Treasury Announces Final Rules Implementing FIRRMA and Expanding CFIUS Authority

What Happened: On January 13, 2020, the US Department of the Treasury (**Treasury**) announced final rules (**Final Rules**) implementing the Foreign Investment Risk Review Modernization Act (**FIRRMA**), which was signed into law in August 2018.[1] Subject to the adoption of implementing rules, FIRRMA was intended to broaden and change certain authorities of the Committee on Foreign Investment in the United States (**CFIUS**) under Section 721 of the Defense Production Act of 1950 (**DPA**) related to investments in US businesses and real estate assets by foreign persons. Treasury had announced proposed rules implementing FIRRMA in September 2019 (**Proposed Rules**). We discussed the Proposed Rules in detail in an earlier client alert.[2] The Final Rules make only minor adjustments to the implementation of FIRRMA's authorities set forth in the Proposed Rules and do not substantially change the scope of CFIUS's expanded jurisdiction contemplated by the Proposed Rules.

The Final Rules will become effective on February 13, 2020. However, Part 800 or Part 801 of the rules as in effect on February 12, 2020, will continue to govern for any covered transaction or pilot program covered transaction, respectively, for which any of the following is true prior to such effective 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.

Investors with interests in US businesses and real estate, US businesses and owners of US real estate should become familiar with the Final Rules and understand how the Final Rules may affect control, investment and real estate transactions completed on or after February 13, 2020. Market participants should also recognize that, on and after February 13, 2020, the analysis of whether a CFIUS submission must or should be made will become much more technical and complicated than under current regulations, and CFIUS expects that many more submissions will be made as a result of the Final Rules.

The Bottom Line: On and after February 13, 2020, the Final Rules will, consistent with the Proposed Rules, make a number of significant changes to CFIUS's review of foreign investments in the United States under Section 721 of the DPA. Among other things, CFIUS's jurisdiction will expand to include:

- reviewing certain noncontrolling investments in a broad range of US businesses that develop or manufacture critical technology, that involve certain specified critical infrastructure or that possess certain types (and quantities) of sensitive personal data;

[1] The Final Rules consist of two separate rule sets. 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 final Part 800 rules can be accessed here. The second set of final 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] Our memorandum to clients dated October 3, 2019 (**Prior Memo**) can be accessed here. Terms used in this memorandum but not defined herein have the meanings given them in the Prior Memo.

- reviewing a wider range of transactions that parties will be prohibited from consummating without a submission to CFIUS (beyond the narrow scope contemplated by the pilot program rules)[3]; and

- reviewing certain real estate transactions even if the assets are not part of the acquisition of a US business by a foreign person.

While the general scope of the Final Rules is quite similar to the Proposed Rules, we discuss further below certain salient changes made in the Final Rules relating to excepted investors, the pilot program/mandatory clearances, the definition of principal place of business, genetic information and the scope of real estate transactions covered by Part 802.

The Full Story:

Excepted Investors. As noted in the Prior Memo, the proposed Part 800 rules introduced the concept of an "excepted investor" to create a narrow category of foreign investors who would not be required to seek CFIUS approval for certain investments; this exception does not apply to covered control transactions involving US businesses. The final Part 800 rules made a number of changes to the definition and application of the excepted investor concept:

(1) First, for an entity to be considered an excepted investor, the Proposed Rules required that each and every director (or equivalent) and observer of the governing body of such entity had to be a US national or a national of certain excepted states to be identified by CFIUS (each, an **excepted foreign state**) who is not also a national of a state that is not an excepted foreign state. The Final Rules loosen these requirements somewhat and specify that at least 75 percent of the directors (or equivalents), and at least 75 percent of the observers, for such governing body must be US nationals or nationals of an excepted foreign state who are not also nationals of a state that is not an excepted foreign state.

(2) Second, for a foreign entity to be considered an excepted investor, the Proposed Rules also required that any foreign person who holds (and each foreign person who is part of a group of foreign persons who hold) 5 percent or more of the outstanding voting interests of such foreign entity, who has the right to 5 percent or more of the profits of that foreign entity or who has the right upon dissolution to 5 percent or more of the assets of that foreign entity must be (a) a national of an excepted foreign state who is not also a national of a state that is not an excepted foreign state, (b) a government of an excepted foreign state or (c) an entity that is formed under the laws of an excepted foreign state and has its principal place of business in an excepted foreign state or in the United States. The Final Rules increase each of these thresholds to 10 percent.

(3) Third, for a foreign entity to be considered an excepted investor, the Proposed Rules also required that at least 90 percent of the voting power, 90 percent of the share of profits and 90 percent of the share of liquidation amounts had to be held by one or more persons each of whom is (a) not a foreign person, (b) a foreign national who is a national of one or more excepted foreign states and is not also a national of any state that is not an excepted foreign state, (c) a government of an excepted foreign state or (d) a foreign entity that is organized under the laws of an excepted foreign state and has its principal place of business in an excepted foreign state or in the United States. The Final Rules loosened the foregoing threshold from 90 percent to 80 percent. Under the Final Rules (as under the Proposed Rules), the threshold drops to a majority if the entity in question is primarily traded on an exchange located in the United States or an excepted foreign state.

[3] Closing most covered transactions remains permitted both under the existing rules and the Final Rules without seeking CFIUS clearance. However, the US government possesses significant tools to remedy adverse national security effects, including ordering the buyer to divest its acquired interest, where a covered transaction is closed without seeking CFIUS clearance.

Treasury also made corresponding changes addressing the "excepted real estate investor" definition and related provisions in the final Part 802 rules.[4]

In connection with publishing the Final Rule, CFIUS identified the initial three excepted foreign states (and excepted real estate foreign states)—Australia, Canada and the United Kingdom of Great Britain and Northern Ireland—and may identify further initial exceptions in the future. These initial designations will automatically expire on February 13, 2022, and no new designations may be added after that date, unless CFIUS determines that each such foreign state has established a robust process to analyze foreign investments for national security risks and coordinates with the United States on matters relating to investment security.

Pilot Program/Mandatory Clearance. The Final Rules integrate the former pilot program rules into Part 800 for transactions entered into after February 13, 2020.[5] The Final Rules add a new Appendix B specifying a subset of industries that are relevant for purposes of certain mandatory filings; this list is identical to the "Pilot Program Industries" list attached as Annex A to the Part 801 pilot program rules. Section 800.401(c) of the Final Rules then makes any covered investment by a foreign person in, or that could result in control by a foreign person of, a TID US business in one or more such specified industries subject to mandatory clearance by CFIUS. In addition, the official commentary on the Final Rules notes that Treasury expects to issue a notice of proposed rulemaking that would change the mandatory declaration requirement from one based upon North American Industry Classification System codes to one based upon export control licensing requirements.

In response to various comments on the Proposed Rules, the Final Rules add a number of exceptions to the mandatory filing requirements of Section 800.401. For example, under Section 800.401(d), a mandatory filing in connection with a covered transaction involving a substantial interest by a foreign person in which foreign governments have a substantial interest will not be required if:

(1) the transaction is a covered transaction by an investment fund that is exclusively managed by a general partner or similar entity that is not a foreign person and the investment fund satisfies the criteria specified in Section 800.307 with respect to partner participation on an advisory board or committee of the fund, or

(2) the transaction involves an air carrier that holds certain certificates issued under transportation regulations.

Similarly, under Section 800.401(e), a mandatory filing will not be required if:

(1) the transaction is a covered control transaction by an excepted investor;

(2) the transaction is a covered transaction in which the foreign investor's interest is held solely and directly in an entity that is subject to (and meets) certain requirements under the National Industrial Security Program regulations;

(3) the transaction is a covered transaction by an investment fund that is exclusively managed by a general partner or similar entity that is not a foreign person (or is ultimately controlled by US persons) and the investment fund satisfies the criteria specified in Section 800.307 with respect to limited partner participation on an advisory board or committee of the fund;

(4) the transaction is an investment that is covered solely because of Section 800.215(d);

[4] Note that under the final Part 802 rules relating to real estate (and unlike the final Part 800 rules), the excepted real estate investor carve-out to CFIUS approval applies both to noncontrol investments and to control transactions involving real estate.

[5] The pilot program rules can be found at 30 C.F.R. Part 801. For any transaction to which the pilot program rules were applicable during the period from November 10, 2018, to February 12, 2020, these Part 801 rules remain applicable.

(5) the transaction involves an air carrier that holds certain certificates issued under transportation regulations; or

(6) the transaction is a covered investment in, or that could result in foreign control of, a US business that is a TID US business solely because such business produces or develops one or more critical technologies that are eligible for export, reexport or transfer (in country) pursuant to License Exception ENC of the Export Administration Regulations (15 C.F.R. § 740.17). License Exception ENC refers to software that is controlled based on encryption technology.

Principal Place of Business. Treasury has attempted to add greater clarity to the meaning of the term "principal place of business," which is used in a number of places in the Proposed Rules but was not defined.[6] Treasury proposes to define this term as "the primary location where an entity's management directs, controls, or coordinates the entity's activities, or, in the case of an investment fund, where the fund's activities and investments are primarily directed, controlled, or coordinated by or on behalf of the general partner, managing member, or equivalent." However, an entity may not claim that its primary place of business is in the United States for CFIUS purposes, if that entity has identified a foreign principal place of business, principal office and place of business, address of principal executive offices, address of headquarters or equivalent in its most recent submission to any US governmental or foreign governmental authority (unless the claiming entity can demonstrate a change of location since that submission). The purpose of this clarification is to make it easier for certain US-headquartered private equity funds and hedge funds to claim the benefit of a US primary place of business, which could have the effect of making an otherwise "foreign entity" into a nonforeign entity and/or into an "excepted investor."

Genetic Information. As noted in our Prior Memo, the Proposed Rules contemplated that any US business with any quantity of genetic information (as defined pursuant to 45 C.F.R. § 60.103) would be considered a US TID business and without regard to whether such data could be used to identify or distinguish any individuals. The result of this provision was that investments in any US business with genetic information would likely be subject to CFIUS jurisdiction, and control or noncontrolling transactions involving such business could be subject to mandatory clearance depending on certain other factors. The Final Rules, however, narrow this category of sensitive personal information. First, such information will be considered sensitive personal information only if the data could be used to identify or distinguish individuals. Among other things, encryption or anonymization may—depending on the particular facts – take genetic data outside the scope of sensitive personal information (and thus, potentially, take the business outside the scope of a US TID business). Second, the definition of genetic testing under the Final Rules appears to be considerably narrower than the definition of genetic information under the Proposed Rules. Third, the Final Rules specify that results derived from databases maintained by the US government and routinely provided to private parties for purposes of research will not be considered identifiable data.

Real Estate Transactions. Part 802 of the Final Rules narrow somewhat the scope of real estate transactions that are considered covered real estate transactions. The Final Rules modify certain of the exceptions for certain real estate transactions in airports and maritime ports and refine the geographic coverage relating to certain military installations on Appendix A to the final Part 802 rules. As noted above, the final Part 802 rules also incorporate certain conforming changes to the definition of excepted investors under the final Part 800 rules.

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[6] Because the term "principal place of business" was not defined in the Proposed Rules, this definition is (technically) an interim rule that is effective immediately but may be amended further depending on any comments that might be received within 30 days of publication.

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

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