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Client Alert

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CFIUS Proposes to Amend Scope of Certain Mandatory Filing Requirements

What Happened: On May 21, 2020, the US Department of Treasury (**Treasury**) announced a proposed rule (**Proposed Rule**) to amend certain rules currently governing the authority of the Committee on Foreign Investments in the United States (**CFIUS**) over foreign investments in US businesses. Specifically, the Proposed Rule would alter the scope of the mandatory filing requirement for control acquisitions and certain non-controlling investments by a foreign person in a US business with critical technologies. Comments for the Proposed Rule are due by June 22, 2020.[1]

The Bottom Line: The Proposed Rule would eliminate the current industry-focused test for certain mandatory CFIUS submissions and instead require that parties to covered transactions analyze the export control status of the relevant technology of the target US business, along with the principal place of business or nationality of the foreign investor and certain foreign persons with voting interests in that investor. If adopted, the Proposed Rule will thus heighten the importance of export classifications in the CFIUS process.

The Full Story:

As noted in a prior client alert,[2] Treasury published two sets of final rules (**Final Rules**) in January 2020 to implement provisions of the Foreign Investment Risk Review Modernization Act of 2018 (**FIRRMA**). The Final Rules, codified at 31 CFR Part 800 and 31 CFR Part 802, took effect on February 13, 2020. Insofar as mandatory submissions to CFIUS relating to critical technologies are concerned, Part 800 of the Final Rules largely adopted the substance of the interim "pilot program" rules (31 CFR Part 801 (**Pilot Program Rules**)) that were in effect for transactions entered into from November 10, 2018, through February 12, 2020.[3] Thus, under the Final Rules currently in effect, a mandatory submission to CFIUS is required for any transaction that involves foreign control over, or certain foreign investments in, a "TID US business" that produces, designs, tests, manufactures, fabricates or develops critical technologies in one or more of 27 industries designated by the North American Industry Classification System (**NAICS**) codes specifically identified in those rules.[4]

In practice, the use of NAICS codes as an element of the mandatory declaration requirement has been problematic for a number of reasons. The NAICS codes were developed for economic and statistical reporting purposes, and not necessarily with national security issues in mind. Thus, the use of these codes for purposes of identifying the businesses with critical technology that warranted mandatory CFIUS submissions has likely been under-inclusive from a national security perspective, as this requirement was limited to certain sectors of the US economy. The NAICS code-based criteria for defining the mandatory

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[1] The full text of the Proposed Rule and a link to submit formal comments can be accessed here.
[2] For further details, see Client Alert, The US Department of Treasury Announces Final Rules Implementing FIRRMA and Expanding CFIUS Authority (January 2020), available here.
[3] For further details, see Client Alert, US Government Expands the Scope of CFIUS Review (August 2018), available here.
[4] For an explanation of the meaning of the term "TID US business," see Client Alert, Proposed Rules Would Substantially Expand CFIUS Authority (October 2019), available here. In the interest of brevity, we use the term "produces" below to encompass the act of producing, designing, testing, manufacturing, fabricating or developing.

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filing requirement was also likely over-inclusive in that an investment by certain foreign persons could trigger mandatory CFIUS filings on the basis of the US business' production of a critical technology that could be freely exported to those persons. The NAICS codes were also problematic because of a lack of certainty as to what code or codes apply to a particular business; this sometimes led to uncertainty as to whether a transaction was subject to a mandatory filing or not.

Under the Proposed Rule, the NAICS code criteria would be eliminated completely from Part 800 of the Final Rules. Instead, the Proposed Rule would implement criteria that focus on export license and authorization requirements for the critical technologies produced by the US business, as well as the principal place of business (for entities) or nationality (for individuals) of certain foreign persons involved in the transaction. Assuming the Proposed Rule takes effect, transaction parties would need to consider carefully whether a US license or authorization would be required in order to be able to export, re-export, transfer (in country) or retransfer the critical technologies produced by the US business to certain foreign persons involved in the transaction, as if such persons were end users, under the four main US export control regimes. The applicable license and authorization regimes under the Proposed Rule include:

- a license or other approval from the International Traffic in Arms Regulations (**ITAR**) administered by the US Department of State, including licenses or authorizations required by the Directorate of Defense Trade Controls for defense articles or defense services on the United States Munitions List;
- a license required under the Export Administration Regulations (**EAR**) by the US Department of Commerce;
- a specific or general authorization required by the US Department of Energy under the provisions governing assistant to foreign atomic energy activities under 18 CFR Part 810 other than the general authorization described in 10 CFR 810.6(a); and
- a specific license required under the regulations administered by the Nuclear Regulatory Commissions at 10 CFR Part 110.

To determine whether an export control license or authorization requirement triggers a mandatory declaration filing, the Proposed Rule would require parties to look at the principal place of business or nationality not only for the foreign person directly acquiring an interest in a US business, but also for certain foreign persons in the ownership chain. For indirect owners, the Proposed Rule establishes a 25% ownership threshold of voting interests, direct or indirect, for purpose of determining what other persons must be considered for export license and authorization requirements. Under the Proposed Rule, the mandatory submission requirement will be triggered if a foreign person anywhere in the ownership chain: (1) meets the 25% interest threshold; and (2) would be subject to a mandatory export license or authorization if a critical technology of the US business were exported, re-exported, transferred (in country) or retransferred to such person as the end user.

In terms of assessing whether a submission to CFIUS is mandatory under the Proposed Rule, parties would generally disregard applicable exemptions under ITAR and exceptions under EAR that would otherwise be available when considering whether a license or similar application is required to authorize export of the technology to a foreign person. However, the Proposed Rule does permit parties to utilize three EAR license exceptions for purposes of excluding a transaction from the mandatory submission category: (1) section (b) of the License Exception ENC (Encryption Commodities, Software and Technology); (2) License Exception TSU (Technology and Software Unrestricted); and (3) section (c)(1) of the License Exception STA (Strategic Trade Authorization).

The use of export licenses and the foreign country involved is important because it will, among other things, "calibrate" the mandatory filing requirement based on what the technology is and the nationality of the foreign persons involved in the transaction. For example, if the transaction in question involved a German company buying a US business that manufactured a critical technology subject to the EAR, and if the sole 25% owner of the German company was a national of Pakistan, the parties would have to

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consider whether an export license would be required for the export of the business' critical technology to Germany and Pakistan. If the particular critical technology produced by the US business was subject to export restrictions to end users in Pakistan but not to any countries in the European Union, the transaction would be subject to the mandatory submission requirement because the presence of a national of Pakistan in the transaction. If, on the other hand, the sole 25% interest owner was a national of France, then there would be no mandatory CFIUS submission. Of course, even when a filing with CFIUS is not mandatory, the parties might still find it in their interest to make a voluntary CFIUS submission.

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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 Proposed Rule and other CFIUS and cross-border investment matters. Please contact us if you have any questions or would like further information regarding the Proposed Rule or CFIUS, or require our assistance in submitting written comments on the Proposed Rule.

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