

Committee on Foreign Investment in the U.S. Issues Final Regulations Implementing 2018 Statutory Overhaul

On January 13, 2020, the Treasury Department-chaired inter-agency Committee on Foreign Investment in the United States (“**CFIUS**”) issued final regulations to implement the amendments to its governing statute (section 721 of the Defense Production Act of 1950, codified at 50 U.S.C. § 4565) made by the Foreign Investment Risk Review Modernization Act (“**FIRRMA**”) enacted in August 2018.¹ The final regulations will take effect on February 13, 2020. At that point CFIUS will have almost completed the overhaul of the system for national security reviews of foreign investment in the United States that began with FIRRMA’s enactment. (One notable piece that has not yet been put into place is a set of rules establishing filing fees for CFIUS notices, as authorized by FIRRMA.)²

The final regulations address comments on the notices of proposed rulemaking (“**NPRMs**”) that CFIUS issued on September 17, 2019,³ which we discussed in our International Trade Current available [here](#). Like the NPRMs, the final regulations are set forth in two separate documents, one pertaining to foreign investment in U.S. businesses (31 C.F.R. part 800), and one pertaining to foreign investment in U.S. real estate (31 C.F.R. part 802).⁴ The document containing the part 800 regulations also includes a provision preserving for limited purposes 31 C.F.R. part 801, which contained an interim rule making mandatory (on a “pilot program” basis) the pre-closing notification to CFIUS of certain investments in U.S. businesses involved with “critical technology.” Although the pilot program will expire on February 13, the interim rule will remain applicable to transactions that would have been covered by the pilot program for which specified events (e.g., execution of a binding written agreement) occurred between November 10, 2018 and February 12, 2020. Meanwhile, the requirement that certain investments in critical technology businesses be notified to CFIUS going forward is preserved in the new 31 C.F.R. § 800.401(c).

Not surprisingly, the final regulations closely resemble the September 2019 proposed regulations. However, in response to public comments, CFIUS made a number of noteworthy amendments and clarifications. Most of these relate to CFIUS’s jurisdiction. Highlights include the following.

Voluntary Filings: For most covered transactions, the decision whether to notify CFIUS and, if so, when, will continue to be a voluntary decision for the transaction parties. Moreover, the parties will have the option of submitting a full notice or, alternatively, an abbreviated form of notice known as a “declaration.” Until now, the declaration option had been available only for transactions covered by the pilot program that was established in October 2018. Under the final regulations, it will be available for all transactions.⁵

A declaration may be advantageous to some transaction parties, inasmuch as CFIUS must complete its assessment based on a declaration relatively quickly (within 30 days of acceptance).⁶ The drawback, however, is that CFIUS’s

¹ FIRRMA was enacted as Title XVII of the John S. McCain National Defense Authorization Act for Fiscal Year 2019, Pub. L. No. 115-232, 132 Stat. 1636, 2174 (Aug. 13, 2018).

² 50 U.S.C. § 4565(p)(3).

³ The NPRMs were published in the Federal Register on September 24, 2019. See Provisions Pertaining to Certain Investments in the United States by Foreign Persons, 84 Fed. Reg. 50174 (Sep. 24, 2019) and Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate in the United States, 84 Fed. Reg. 50214 (Sep. 24, 2019).

⁴ The final regulations were published in the Federal Register on January 17, 2020 and can be found at 85 Fed. Reg. 3112 (part 800 regulations) and 85 Fed. Reg. 3158 (part 802 regulations).

⁵ 31 C.F.R. § 800.402. Unless otherwise indicated, all references to sections of the CFIUS regulations are to the sections as set forth in the final regulations.

⁶ 31 C.F.R. § 800.405(b).

determination based on a declaration may be inconclusive. That is, CFIUS may be unable to conclude definitively that there are no national security concerns,⁷ which would deprive the parties of the CFIUS “safe harbor” absent re-starting the process with a full-blown notice.

Mandatory Filings: In two cases, it will be mandatory for parties to submit a declaration (or, at their option, a notice) at least 30 days before closing. Both categories of mandatory filings are defined by reference to FIRRMA’s expansion of CFIUS’s jurisdiction. Historically, a transaction was considered to be “covered” (and therefore eligible for CFIUS review) only if it could result in foreign control of a U.S. business (referred to in the final regulations a “**covered control transaction**”). FIRRMA expanded the definition of covered transaction to include: (1) certain non-controlling foreign investment in a U.S. business involved with “critical technology,” “critical infrastructure,” or “sensitive personal data” of U.S. citizens (known as a “**TID U.S. business**” (the acronym standing for Technology, Infrastructure, Data)) (such investment referred to as a “**covered investment**”),⁸ and (2) certain foreign investment in real estate at or near air and sea ports or in close geographical proximity to military bases or other national security sensitive sites (“**covered real estate investment**”).⁹

Subject to exceptions, two categories of covered investment must be declared (or, at the parties’ option, notified) to CFIUS. These are (a) “acquisition of a substantial interest in a TID U.S. business by a foreign person in which the national or subnational governments of a single foreign state (other than an excepted foreign state [discussed below]) have a substantial interest;”¹⁰ and (b) covered investment or covered control transaction in a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more “critical technologies” that is utilized in or designed by the business specifically for use in one of 27 industries identified by reference to their North American Industry Classification System (NAICS) codes.¹¹

The first of these categories was required by provisions of FIRRMA itself.¹² In the NPRM, CFIUS defined “substantial interest” such that for the requirement to be triggered, the foreign person must hold a 25% or greater (direct or indirect) voting interest in the U.S. business, and the foreign government must hold a 49% or greater (direct or indirect) voting interest in the foreign person. CFIUS maintained that definition in the final regulations, but clarified that the test applies with respect to the interest held by governments of a single foreign state rather than multiple foreign states.¹³

The second category corresponds to the pilot program that will expire on February 13, 2020. As anticipated, CFIUS essentially made the substance of the pilot program part of the final rule. However, while the industrial activities that define this category currently are identified by reference to NAICS codes, CFIUS has stated its intention to move away from NAICS codes and have export control licensing requirements be the basis for identifying relevant activities at some point in the future.¹⁴

Exceptions to Mandatory Filings: Moreover, the final regulations set forth exceptions to the mandatory filing requirement. Certain of those exceptions are based on the investor’s status as an “excepted investor” (see below) or an investment fund that meets the criteria of the investment fund exception.¹⁵ Exceptions newly introduced in the final regulations include one for an investment made through an entity that is subject to foreign ownership, control or influence (“**FOCI**”) mitigation under the National Industrial Security Program (“**NISP**”) regulations,¹⁶ and one for a transaction in

⁷ 31 C.F.R. § 800.407(a).

⁸ 50 U.S.C. § 4565(a)(4)(B)(iii).

⁹ 50 U.S.C. § 4565(a)(4)(B)(ii).

¹⁰ 31 C.F.R. § 800.401(b).

¹¹ 31 C.F.R. § 800.401(c).

¹² 50 U.S.C. § 4565(b)(1)(C)(v)(IV)(bb).

¹³ 31 C.F.R. § 800.244.

¹⁴ See 85 Fed. Reg. at 3113.

¹⁵ For discussion of the investment fund exception, see our September 2019 International Trade Current at page 6 (available [here](#)).

¹⁶ 31 C.F.R. § 800.401(e)(2).

which the only critical technology that causes a business to be a TID U.S. business is encryption technology subject to license exception ENC under the Export Administration Regulations.¹⁷

FOCI mitigation under the NISP is a regime similar to CFIUS, but focused on foreign investment in U.S. entities that possess “facility clearances” usually issued by the Department of Defense that enable them to handle classified information. Recognizing the particular risk associated with foreign investment in such entities, the Department of Defense requires such entities to undertake certain commitments to mitigate that risk. Under the final CFIUS regulations, an investment by a FOCI mitigated entity in a TID U.S. business is excepted from the mandatory declaration requirement.

The exception for transactions involving a business whose only critical technology is encryption technology subject to license exception ENC appears to address the situation in which a company meets the definition of a TID U.S. business, but its critical technology raises low if any national security concern. Thus, encryption technology is generally subject to export controls and qualifies as “critical technology” for CFIUS purposes. But certain encryption technology raises minimal concerns and can be exported to most destinations without obtaining a specific license from the Department of Commerce, instead relying on a provision in the Export Administration Regulations known as license exception ENC. Under the final CFIUS regulations, if such technology is the only thing that causes a business to be a TID U.S. business, then an investment in that business that ordinarily would be mandatorily notifiable is excepted.

“Excepted Investor”: In addition to expanding CFIUS’s jurisdiction in the ways just described, FIRRMA directed CFIUS to prescribe regulations to limit the application of the expanded jurisdiction “to the investments of certain categories of foreign persons.”¹⁸ CFIUS did this in the NPRMs by defining the concept of an “excepted investor.” Broadly speaking, an excepted investor is an investor that is a national of an “excepted foreign state.” A transaction that ordinarily would be covered by one of the new jurisdictional categories generally will not be covered if the foreign investor in question is an excepted investor. Likewise, a foreign investor’s status as “excepted” ordinarily will excuse it from mandatory notification in cases where that requirement otherwise would apply.

In short, a lot hinges on the definitional question whether a given investor is an “excepted” investor. A key aspect of the definition, of course, is whether the investor is a national of an excepted foreign state. In the final regulations, CFIUS prescribed a two-part test for designating countries as excepted foreign states: first, a state must be designated by CFIUS as eligible; and, second, CFIUS must determine that the state “has established and is effectively utilizing a robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security.”¹⁹

In its final regulations, CFIUS designated Australia, Canada, and the United Kingdom as eligible, and it waived application of the second part of the test until February 13, 2022.²⁰ In other words, for the next two years (subject to any change CFIUS may make in the designation of eligible states, and subject to other exceptions generally related to bad conduct, such as providing false or incomplete information to CFIUS or breaching an agreement with CFIUS), if an investor is a national of Australia, Canada, or the United Kingdom, then it is an “excepted investor,” and a non-controlling investment by that investor will be outside CFIUS’s jurisdiction. (An investment that could result in the investor’s control of a U.S. business, however, will still be in CFIUS’s jurisdiction regardless of whether the investor is an excepted investor.)

The next question, then, is how to determine whether an investor is a national of an excepted foreign state. If the investor is an individual or a government, this usually will be a straightforward analysis.²¹ (In the case of an individual, however, if the person is a national of multiple states and one of those is not an excepted foreign state, then the individual is not an

¹⁷ 31 C.F.R. § 800.401(e)(6).

¹⁸ 50 U.S.C. § 4565(a)(4)(E).

¹⁹ 31 C.F.R. § 800.218 & § 800.1001(a).

²⁰ 31 C.F.R. § 800.218.

²¹ 31 C.F.R. § 800.219(a)(1) & (2).

excepted investor.) If the investor is a fund or other entity, the analysis gets more complicated. There are several criteria that must be met by the entity and each of its direct and indirect parents, including:²²

- Each such entity must be organized under the laws of the United States or an excepted foreign state;
- Each such entity must have its principal place of business in the United States or an excepted foreign state;
- At least 75 percent of the board members and 75 percent of any board observers of each entity must be nationals of the United States or an excepted foreign state (down from 100 percent in the proposed regulations);
- Any foreign person that individually or as part of a group holds 10 percent or more of the entity must meet the excepted investor nationality criteria (up from 5 percent in the proposed regulations); and
- The “minimum excepted ownership” in the entity must be held by persons who are nationals of the United States or an excepted foreign state. The minimum excepted ownership is a majority interest for entities whose equity securities are primarily traded on an exchange in an excepted foreign state or the United States. For all other entities, the threshold is 80 percent (down from 90 percent in the proposed regulations).

If the entity making the investment and each of its parents meets each of the foregoing criteria, then the entity is an “excepted investor” and an investment by it in a TID U.S. business will not constitute a “covered investment.” (But, again, it remains possible that the transaction will constitute a “covered transaction” if a foreign person could acquire control of the U.S. business, even if that foreign person is an excepted investor.)

Principal Place of Business: An essential concept in the definition of “excepted investor” as well as in the definition of “foreign entity”²³ is an entity’s principal place of business. Indeed, that concept was essential to the definition of “foreign entity” even before enactment of FIRRMA. But until now, CFIUS regulations had not defined “principal place of business.” In promulgating the final regulations, CFIUS provided a definition, but it did so via an interim rule attached to the final rule, thereby giving stakeholders the opportunity to comment on the definition.

The definition in the interim rule is “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.”²⁴

This definition should help clarify circumstances in which, for example, an investment fund qualifies as a U.S. entity (by virtue of its general partner making decisions from the United States) even though the limited partnerships making up the fund are established outside the United States.

Genetic Information: As noted above, CFIUS’s expanded jurisdiction under FIRRMA relates primarily to foreign investments in TID U.S. businesses as well as foreign investments in certain real estate. One kind of TID U.S. business is a business that handles “sensitive personal data,” defined in the regulations to include several different categories of information, one of which is genetic information. In the final regulations, CFIUS elaborated on the concept of genetic information to clarify what is and what is not included in the definition. In particular, sensitive personal data includes “[t]he results of an individual’s genetic tests, including any related genetic sequencing data, whenever such results constitute identifiable data.” But there is a carve-out for “data derived from databases maintained by the U.S. Government and routinely provided to private parties for purposes of research.”²⁵

Real Estate: A number of the amendments and clarifications in the part 800 final regulations have counterparts in the part 802 real estate regulations. For example, the “excepted investor” concept is similar in both sets of regulations, and the

²² 31 C.F.R. § 800.219(a)(3).

²³ 31 C.F.R. § 800.220.

²⁴ 31 C.F.R. § 800.239.

²⁵ 31 C.F.R. § 800.241(a)(2).

initial group of excepted foreign states (Australia, Canada, and the United Kingdom) is the same for both.²⁶ Likewise, the real estate regulations include the newly proposed definition of “principal place of business.”²⁷

Key to the real estate provisions is the concept of proximity of real estate to a port or military base or other national security sensitive site. In promulgating the final real estate regulations, CFIUS addressed some commenters’ request that CFIUS make available an online tool to aid in the analysis of proximity. CFIUS anticipates making such a tool available in the future.²⁸

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²⁶ See 31 C.F.R. §§ 802.214 & 802.215.

²⁷ See 31 C.F.R. § 802.232.

²⁸ See 85 Fed. Reg. at 3160.