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NEWS

Impact of CFIUS Reform On Private Equity Transactions

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On August 13, the President signed into law the National Defense Authorization Act for Fiscal Year 2019 ("NDAA"), which included the bipartisan Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"). FIRRMA expands the scope of covered transactions subject to review by The Committee on Foreign Investment in the United States ("CFIUS" or "the Committee"), which reviews transactions to ensure that they do not implicate any national security concerns. Our prior briefing presents an overview of the changes FIRRMA brings.

This briefing provides further insights into the changes that have already taken effect, as well as those to monitor for possible future developments, and also offers key takeaways from CFIUS reform for private equity transactions.

Changes Effective Immediately

Very few CFIUS reforms became effective upon signing of the law. Most require regulatory clarification and implementation over the next 18 months. The most critical changes that are already effective involve review timelines:

- The total formal review period for a CFIUS filing is extended from 75 days to 105 days. Parties to a transaction and deal teams must plan for this extended review timeline.
  - The initial review period is lengthened from 30 days to 45 days.
  - The additional investigation period is allowed to be extended from 45 days to 60 days.
- If parties stipulate that a transaction is a "covered transaction," then CFIUS is obligated to accept a submitted notice within 10 days. This addresses the concern parties have had regarding prolonged waiting periods *before* the start of the formal review period.

Key Changes to Monitor for Development and Implementation

Most of the CFIUS reforms require regulatory action by CFIUS, although CFIUS does have some authority to initiate pilot programs in the interim. Key changes of interest to private equity investors include:

- **FIRRMA expands CFIUS coverage to include certain "other investments" by foreign persons in U.S. businesses that are not necessarily controlling.**
  - Specifically, investment in a business that:[1]
    - owns, operates, manufactures, supplies, or services critical infrastructure;
    - produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies; or
    - maintains or collects sensitive personal data of U.S. citizens that may be used in a way that threatens national security;

      AND where that investment affords the foreign person:

    - access to any material non-public technical information;
    - membership or observer rights on the board of directors or an equivalent governing body of the business or the right to nominate an individual to a position on that body; or
    - any involvement, other than through voting of shares, in substantive decision making regarding sensitive personal data of U.S. citizens, critical technologies, or critical infrastructure.
  - Notably, an investment fund that meets certain requirements regarding control issues will be excluded from this expanded definition of covered transactions.

This carve-out for investments by certain investment funds with limited rights is of particular importance for private equity funds with foreign persons as limited partners and for "club deals" where different investor groups are brought together by a private equity sponsor to make an investment where any of the investors are foreign persons. Although this exception will be further clarified through regulations, FIRRMA states that investment through a fund that affords the foreign person membership as a limited partner or equivalent on an advisory board of the fund shall not be considered an "other investment" (and thus, not covered by the expanded CFIUS review jurisdiction) if certain requirements are met. Specifically:

- The fund is managed exclusively by a general partner, managing member, or equivalent that is not a foreign person
- Neither the advisory board nor the foreign person has the ability to control investment decisions or other decisions related to entities in which the fund is invested (including veto rights)
- The foreign person cannot unilaterally control the hiring, dismissal, or compensation of the general partner
- The foreign person does not have access to material nonpublic technical information as a result of its participation in the advisory board

- **FIRRMA expands CFIUS coverage to include certain real estate purchases, leases, or concessions that:**
  - Are located within or will function as part of an air or maritime port; or
  - Are near military facilities or other sensitive government locations.
- **FIRRMA expands CFIUS coverage to include when there is a change in the rights that a foreign person has with respect to an investment in a U.S. business if that change could result in "control."** "Control" means the "power, direct or indirect, whether exercised or not exercised, to determine, direct, or decide important matters affecting an entity, subject to regulations prescribed by the Committee."
- **FIRRMA also creates a new CFIUS "Declaration" process, which consists of an abbreviated filing containing only basic information about the transaction,** as opposed to the more comprehensive information required for a full Notice.
  - Declarations will be **mandatory** where a **foreign government** would acquire a substantial interest, direct or indirect, in a U.S. business involved in critical infrastructure or critical technologies, or that maintains or collects

sensitive personal data of U.S. citizens.

- **CFIUS is authorized to impose filing fees on a Notice (not a Declaration) up to 1% of the value of the transaction, capped at $300,000.**

[1] Critical infrastructure and critical technologies are defined in FIRRMA, but we are watching to see whether more regulatory clarification will be provided, as the statutory definitions are relatively vague.

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