

CLIENT ALERT

## CFIUS Establishes Its First Pilot Program Under FIRRMA: Focus on Companies with Critical Technology

OCTOBER 17, 2018

On October 10, 2018, the Department of the Treasury used authority under the Foreign Investment Risk Review Modernization Act (“FIRRMA”) to release two interim rules affecting national security reviews by the Committee on Foreign Investment in the United States (“CFIUS” or “the Committee”).

The first rule updated existing CFIUS regulations to reflect provisions of FIRRMA that had been enacted, including an extension of the review period for CFIUS Notices. More notably, the second rule establishes a Pilot Program allowing CFIUS to review certain non-controlling investments by foreign persons in companies with certain involvement in critical technology (“Pilot Program U.S. Businesses”). This interim rule also requires mandatory pre-closing filings called “Declarations” for controlling and certain non-controlling investments in these Pilot Program U.S. Businesses. The Pilot Program will go into effect on November 10, 2018.

### BACKGROUND

On August 13, 2018, the President signed FIRRMA into law as part of the National Defense Authorization Act for Fiscal Year 2019. FIRRMA made many changes to CFIUS jurisdiction and the CFIUS review process as discussed in our previous briefing. A majority of FIRRMA’s provisions do not go into effect until 30 days after CFIUS publishes implementing regulations in the Federal Register or 18 months after enactment February 13, 2020, whichever is earlier. FIRRMA authorized CFIUS to institute pilot programs to implement those provisions until final regulations are in place.

This Pilot Program is the first issued by CFIUS under FIRRMA and focuses on U.S. businesses that produce, design, test, manufacture, fabricate, or develop critical technology used in certain industries (listed below).

The Pilot Program and its requirements go into effect November 10, 2018. The Pilot Program *will not* apply to the following transactions:

- Transactions with a completion date before November 10, 2018; or
- Transactions where, prior to October 11, 2018, one of the following occurred: (i) the parties to the transaction executed a binding written agreement or other document establishing the material terms of the transaction; (ii) a

party made a public offer to shareholders to buy shares of a Pilot Program U.S. Business; or (iii) a shareholder solicited proxies in connection with an election of the board of directors of a Pilot Program U.S. Business or requested the conversion of convertible voting securities.

## THE PILOT PROGRAM

The Pilot Program implements authorities provided in two sections of FIRRMA:

- The expansion of the scope of transactions subject to CFIUS review to include certain non-controlling investments made by foreign persons in U.S. businesses involved in critical technologies related to specific industries; and
- FIRRMA's mandatory-Declarations provision for transactions that fall within the scope of the Pilot Program.

Under the Pilot Program, CFIUS's jurisdiction is being expanded to give the Committee the authority to review not only controlling investments but also certain other non-controlling investments related to critical technology. To be subject to review, the non-controlling investment must meet certain requirements related, in essence, to access or influence in the target (as described below), and the target must be a Pilot Program U.S. Business.

### Pilot Program “Covered Investment” (Requirement of Access or Influence)

To be covered by the Pilot Program as a “covered investment,” a non-controlling investment by a foreign person in an unaffiliated<sup>1</sup> Pilot Program U.S. Business must grant the foreign investor one of the following:

- Access to any material nonpublic technical information in the possession of the Pilot Program U.S. Business;
- Membership or observer rights on the board of directors or equivalent governing body of the Pilot Program U.S. Business, or the right to nominate an individual to a position on the board of directors or equivalent governing body of the Pilot Program U.S. Business; or
- Any involvement, other than through voting or shares, in substantive decision making of the Pilot Program U.S. Business regarding the use, development, acquisition, or release of critical technology.

### What is a Pilot Program U.S. Business?

A Pilot Program U.S. Business is one that (i) produces, designs, tests, manufactures, fabricates, or develops a **critical technology**, and (ii) the critical technology is utilized in connection with the business's activity in, or designed specifically for use in, a **pilot program industry** (listed below).

**Critical Technology** is defined by reference to other regulatory regimes and includes the following:

- Defense articles or defense services included on the U.S. Munitions List set forth in the International Traffic in Arms Regulations (ITAR) (22 CFR Parts 120–130)
- Items included on the Commerce Control List set forth in Supplement No. 1 to part 74 of the Export Administration Regulations (EAR) (15 CFR parts 730–774) and controlled for reasons related to national security, chemical or biological weapons proliferation, nuclear nonproliferation, missile technology, regional stability, or surreptitious listening
- Specially designed and prepared nuclear equipment, parts and components, materials, software, and technology covered by 10 CFR part 810 (relating to assistance to foreign atomic energy activities)
- Nuclear facilities, equipment, and material covered by 10 CFR part 110 (relating to export and import of nuclear equipment and material)

- Select agents and toxins covered by 7 CFR part 331, 9 CFR part 121, or 42 CFR part 73
- Emerging and foundational technologies controlled pursuant to section 1758 of the Export Control Reform Act of 2018

The emerging and foundational technologies have not yet been identified by the export-control authorities, but it is anticipated that some will be identified soon.

A **Pilot Program Industry** is identified by reference to North American Industry Classification System (“NAICS”) codes:

- Aircraft Manufacturing; NAICS Code: 336411
- Aircraft Engine and Engine Part Manufacturing; NAICS Code: 336412
- Alumina Refining and Primary Aluminum Production; NAICS Code: 331313
- Ball and Roller Bearing Manufacturing; NAICS Code: 332991
- Computer Storage Device Manufacturing; NAICS Code: 334112
- Electronic Computer Manufacturing; NAICS Code: 334111
- Guided Missile and Space Vehicle Manufacturing; NAICS Code: 336414
- Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing; NAICS Code: 336415
- Military Armored Vehicle, Tank, and Tank Component Manufacturing; NAICS Code: 336992
- Nuclear Electric Power Generation; NAICS Code: 221113
- Optical Instrument and Lens Manufacturing; NAICS Code: 333314
- Other Basic Inorganic Chemical Manufacturing; NAICS Code: 325180
- Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing; NAICS Code: 336419
- Petrochemical Manufacturing; NAICS Code: 325110
- Powder Metallurgy Part Manufacturing; NAICS Code: 332117
- Power, Distribution, and Specialty Transformer Manufacturing; NAICS Code: 335311
- Primary Battery Manufacturing; NAICS Code: 335912
- Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing; NAICS Code: 334220
- Research and Development in Nanotechnology; NAICS Code: 541713
- Research and Development in Biotechnology (except Nanobiotechnology); NAICS Code: 541714
- Secondary Smelting and Alloying of Aluminum; NAICS Code: 331314
- Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing; NAICS Code: 334511
- Semiconductor and Related Device Manufacturing; NAICS Code: 334413
- Semiconductor Machinery Manufacturing; NAICS Code: 333242
- Storage Battery Manufacturing; NAICS Code: 335911
- Telephone Apparatus Manufacturing; NAICS Code: 334210
- Turbine and Turbine Generator Set Units Manufacturing; NAICS Code: 333611

# MANDATORY DECLARATIONS OF BOTH CONTROLLING INVESTMENTS AND (NON-CONTROLLING) “COVERED INVESTMENTS” IN PILOT PROGRAM U.S. BUSINESSES

Parties to Pilot Program Covered Transactions must file a “Declaration” with CFIUS 45 days in advance of closing the deal. Pilot Program Covered Transactions include both controlling investments and non-controlling, “covered investments” in Pilot Program U.S. Businesses as described in detail above.

The interim rule states that a Declaration should generally not exceed five pages in length but might, in practice, be longer. Despite the suggested page limit, Declarations must include a significant amount of information, including names of the relevant parties and contact information; a description of the transaction; a statement of the basis for the transaction falling under the scope of the Pilot Program; information about the U.S. business, including the industry in which it operates and the technology that it uses; and information about the foreign person, including its ownership structure and any foreign government connections.

CFIUS will have 30 days to review a Declaration *once the CFIUS Staff Chairperson has transmitted the Declaration to the Committee*, which cannot occur until CFIUS accepts the Declaration. The interim rule states that the Staff Chairperson “shall promptly inspect” and decide whether to accept the Declaration, but the rule does not further define “promptly.” It may take days or weeks.

By the conclusion of the 30-day review period, the Committee must take one of the following actions:

- Initiate a unilateral review;
- Request that a full Notice be filed;
- Notify the parties that the Committee has completed all action (i.e., cleared the transaction); or
- Inform the parties that the Committee cannot make a determination based on the Declaration and that the parties can file a full Notice to seek written notification from the Committee that it has concluded all action.

If CFIUS completes all action (option 2 above), then the parties have a safe harbor for that transaction. That safe harbor does not extend to any subsequent or incremental acquisitions, however. Any additional acquisition that constitutes a Pilot Program Covered Transaction thus requires a new Declaration.

Parties can elect to file a full written Notice under CFIUS’ standard procedures rather than file a Declaration. If Parties elect to file a full Notice as opposed to an abbreviated Declaration, however, and CFIUS clears the transaction, a safe harbor will extend to subsequent or incremental acquisitions.

Failure to file a Declaration or Notice 45 days in advance of closing the deal could result in civil monetary penalties up to the value of the transaction.

## Filing Timelines for Near-Term Transactions

According to the interim rule, parties to transactions that must submit a Declaration under the Pilot Program must submit the filing to CFIUS no later than:

- November 10, 2018, or promptly thereafter, if the completion date of the transaction is between November 10, 2018, and December 25, 2018; or
- For transactions completed after December 25, 2018, 45 days before the completion date.

## Key Considerations Going Forward

Companies considering making or receiving foreign investments should be acutely aware of key takeaways:

- Declaration filings for Pilot Program Covered Transactions will become mandatory on November 10, 2018.
- CFIUS is continuing its focus on critical technologies.
- The establishment of mandatory filings will increase the number of filings that CFIUS receives. Because CFIUS' 30-day window to review a Declaration does not begin until the CFIUS Staff Chairperson accepts the Declaration and submits it to the Committee, parties might face long wait times before they receive notice of CFIUS's decision.
- Because a Declaration-derived safe harbor does not extend to subsequent or incremental acquisitions, parties that anticipate that the foreign investor will gain additional investments or acquisitions should consider instead filing a full Notice, which does provide a safe harbor for those future acquisitions.

If you have questions as you address these complex matters, please contact us for assistance.

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<sup>1</sup> Note: the Pilot Program does not apply to additional investments by a foreign person in a U.S. business in which it already holds more than 50% of the voting shares or has the right to appoint more than half of the members of the governing body.

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