



## ONPOINT / A legal update from Dechert's International Trade Group

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### Treasury Department Releases Interim Rules and a Pilot Program Implementing Aspects of New Foreign Investment Reviews by CFIUS

The U.S. Department of the Treasury (“Treasury”) published two sets of interim rules on October 10, 2018, implementing certain provisions of the Foreign Investment Risk Review Modernization Act (“FIRRMA”). In addition to implementing certain provisions of the law that took effect immediately upon passage, the new rules create a Pilot Program concerning reviews of investments in U.S. businesses involved in so-called “critical technologies” related to specific industries.

FIRRMA, which became law on August 13, 2018, significantly reforms the Committee on Foreign Investment in the United States (“CFIUS” or “the Committee”) and creates new requirements for review of acquisitions of, and investments in, U.S. businesses by non-U.S. entities. For a detailed explanation of FIRRMA’s key provisions, please see our [August 2018 OnPoint](#). While the new rules implement certain provisions of FIRRMA, many changes to the CFIUS process required under FIRRMA will not occur until Treasury issues additional regulations over the coming months.

#### **Immediate Creation of a Pilot Program to Avoid “Erosion of U.S. Technological Superiority”**

FIRRMA was passed as part of the U.S. government’s emphasis on a [policy](#) of promoting and protecting the country’s national security innovation base and to address what policymakers view as key shortfalls in regulators’ ability to secure the predominance of U.S. innovation and the industries and businesses that support it. FIRRMA expanded CFIUS’ jurisdiction to include non-controlling investments in companies involved in critical technologies, critical infrastructure or sensitive personal data, investments in real estate located near sensitive U.S. government facilities, and other transactions that foreign entities may use to evade U.S. national security reviews. FIRRMA also includes key changes to how parties interact with CFIUS, including the content, timing and costs of filings.

Because FIRRMA provided regulators with many months to develop the resources and regulations to fully administer FIRRMA’s provisions (many significant provisions will not take full effect until February 13, 2020 or 30 days after the U.S. government publishes its determination that the entire regulatory framework is in place), the law provides for the establishment of pilot programs to more quickly implement the provisions considered most urgently needed. The new Pilot Program (perhaps the first of many):

- Authorizes CFIUS to review certain non-controlling investments in U.S. businesses involved in critical technologies and specific industries; and
- Requires new, short-form mandatory declarations by parties to transactions involving critical technologies and specific industries.

At least for now, the Pilot Program does not apply to investments in U.S. companies associated with “critical infrastructure” unless “critical technologies” also are involved. Failure to submit a timely mandatory

declaration could result in civil monetary penalties up to the value of the transaction.

## **27 Industries Impacted**

While FIRRMA does not restrict CFIUS' ability to review non-controlling investments in critical technologies by industry or sector, the Pilot Program applies only to a list of 27 industries, designated by their NAICS codes and listed at the end of the [interim rules](#). Treasury limited the Pilot Program's scope to those industries in which foreign direct investment may pose a threat to U.S. technological superiority sufficient to require immediate action.

Industries affected include those closely associated with national security (including manufacture of missiles, tanks and space vehicles) as well as industries whose products and technologies might have broader application, such as semiconductors, batteries, aviation and petrochemicals.

The new rules describe which businesses within these industries are covered under the Pilot Program ("Pilot Program U.S. Businesses"). Specifically, the Pilot Program allows CFIUS to review transactions involving U.S. businesses that produce, design, test, manufacture, fabricate, or develop a critical technology that is: (1) used in connection with the company's activity in a covered industry; or (2) designed by the company specifically for use in a covered industry.

## **FIRRMA's Limits Still Apply**

It is important to note that the Pilot Program applies only to transactions considered to be "Pilot Program Covered Transactions," which includes transactions in which a non-U.S. investor makes an investment that:

- Results in the non-U.S. person acquiring control over any Pilot Program U.S. Business; or
- Even without an acquisition of control, allows the non-U.S. person to:
  - Gain access to material nonpublic technical information in possession of a Pilot Program U.S. Business;
  - Acquire membership, observer or nomination rights for the board of directors (or equivalent governing body) of a Pilot Program U.S. Business; or
  - Have any involvement (other than voting rights) in substantive decision-making regarding critical technology.

The expansion of CFIUS review under the Pilot Program to include certain non-controlling investments made by U.S. businesses involved in "critical technologies" is significant; previously, CFIUS' jurisdiction extended only to transactions in which non-U.S. persons acquired control over a U.S. business (although historically "control" could be found for purposes of CFIUS jurisdiction at levels well below 50%).

In addition, because the Pilot Program focuses on critical technology, parties to potentially covered transactions should remember that the definition of "critical technologies" is limited to the definition enumerated in FIRRMA. Among other things, this definition includes items and technology subject to control under U.S. export control laws (such as the Export Administration Regulations, International Traffic in Arms Regulations, and nuclear-related controls maintained by the Department of Energy or Nuclear Regulatory Commission) as well as "emerging and foundational technologies" which will be regulated through an interagency process contemplated by the Export Control Reform Act of 2018 (companion legislation to FIRRMA). The Commerce Department, Bureau of Industry and Security ("BIS") is tasked with developing the controls on "emerging and foundational technologies." At the September public session of the BIS Regulations and Policies Technical Advisory Committee ("RAPTAC"), BIS officials stated that a preliminary request for comments is forthcoming in the next several weeks to solicit industry input on what types of technologies should be included. It is expected that the process of defining what to include and determining controls on "emerging and foundational technologies" could extend well into 2019.

The Pilot Program also implements FIRRMA's exemption for certain non-U.S. investments through U.S.-managed investment funds. An indirect investment through an investment fund that affords a non-U.S. investor membership as a limited partner is not covered by the Pilot Program as long as certain requirements are met, including that: (i) the fund is managed by a U.S. general partner (or equivalent), (ii) the fund board or committee on which the non-U.S. limited partner sits does not have control over the U.S. fund's management or investment decisions, and (iii) the non-U.S. limited partner does not have access to material non-public technical information of the target company, and other potential requirements. Therefore, even if a non-U.S. person is investing in a Pilot Program U.S. Business through a fund, the requirements of the Pilot Program may not be triggered if the requirements set forth above are met.

CFIUS is providing an opportunity for public comments on the Pilot Program between October 11, 2018 and November 10, 2018.

### **Mandatory Declarations**

The Pilot Program also implements FIRRMA's mandatory declaration process for transactions that fall within the scope of the Pilot Program, as described above. Again, regulators remain focused on foreign investments in critical technologies as an immediate threat to U.S. national security. While all CFIUS filings were technically voluntary in the pre-FIRRMA regime, the Committee will now require abbreviated filings for Pilot Program transactions. Specifically, the Pilot Program will enforce these requirements for investments by non-U.S. persons involving "Pilot Program U.S. Businesses" (i.e., U.S. businesses that produce, design, test, manufacture, fabricate or develop a critical technology in connection with one of the specified industries) – referred to as "Pilot Program Covered Transactions".

Parties to transactions covered by the Pilot Program must file mandatory declarations, which must be no longer than five pages, at least 45 days prior to the expected completion date of the transaction. Declarations must contain the information described in detail in the interim rules. Required information includes, but is not limited to, the size, timing, and governance rights implicated by the transaction, statements about the non-U.S. acquirer and the U.S. target, and information related to the critical technologies involved.

Following the filing, CFIUS may request that parties file a formal notice, inform the parties that it cannot complete its action and invite them to file a notice seeking written notification of the completion of the process, initiate a unilateral review of the transaction, or notify parties that it completed its review of the transaction.

Parties may elect to file a formal notice in lieu of a declaration.

### **Clarifying Interim Rules**

In addition to launching the Pilot Program, Treasury published [interim rules amending its CFIUS regulations](#) with immediate effect. These rule changes are largely technical and serve to update regulations to implement the provisions of CFIUS that took immediate effect upon passage of FIRRMA. For example, the rules now reflect the reality that CFIUS has already implemented FIRRMA's extension of its initial review time period from 30 to 45 days. In addition, the definition of a "covered transaction" subject to CFIUS review has been amended to include transactions and other arrangements designed or intended to evade or circumvent CFIUS jurisdiction and certain changes in rights held by non-U.S. persons with respect to a U.S. business in which the non-U.S. person already has an investment.

### **How Dechert Can Help**

FIRRMA represents a significant change in the U.S. government's policy toward national security reviews of cross-border transactions. In the short term, parties to transactions involving critical technologies will have to comply with the new interim rules. Dechert's experience with CFIUS review processes may help as parties complete transactions in this new regulatory environment. Dechert's experience includes advising parties considering engagement with the U.S. government during applicable public comment periods.

A proactive CFIUS strategy is essential for a broader universe of foreign investments in the United States. Parties to transactions involving foreign investments in U.S. businesses involved in critical technology, critical infrastructure, or the maintenance of sensitive personal information or the acquisition of certain U.S. real estate are impacted most significantly by CFIUS reform. Dechert has represented many clients through CFIUS reviews, including major players in the energy, telecommunications, high technology, defense and infrastructure industries. Dechert regularly advises U.S. and non-U.S. entities ("buyers" and "sellers," as well as other interested third parties) through the CFIUS review process, helping them to: determine whether or not to bring a transaction before the Committee, assemble the required information and materials for a voluntary filing and then (as necessary) negotiate national security agreements with CFIUS in a manner that minimizes both delay and the imposition of conditions that might threaten the transaction. The firm also gives counsel on strategies for identifying and addressing political and policy considerations that may arise.

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