

Report from Washington

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Notably, investments falling within the scope of the Pilot Program will be subject to a mandatory declaration requirement, regardless of whether the foreign investor is owned or controlled by a foreign government.

U.S. Treasury Department Issues Interim FIRRMA Pilot Program Regulations

October 12, 2018

Introduction

On October 10, 2018, the U.S. Treasury Department, as Chair of the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”), issued interim regulations to conduct a Pilot Program in accordance with the Foreign Investment Risk Review Modernization Act (“FIRRMA”), which President Trump signed into law on August 13, 2018. The Pilot Program is designed to address specific risks to U.S. “critical technologies” and also will inform the Committee’s work in drafting final regulations that will fully implement FIRRMA. The Pilot Program goes into effect on November 10, 2018. Notably, investments falling within the scope of the Pilot Program will be subject to a mandatory declaration requirement, regardless of whether the foreign investor is owned or controlled by a foreign government.

The Pilot Program

Under the legislation and current regulations governing CFIUS, a proposed investment or acquisition is “covered” if it involves the acquisition by a foreign person of potential control over a U.S. business. Filings under the existing jurisdiction of the Committee are generally voluntary.

The Pilot Program implements the new authorities granted by FIRRMA by (i) expanding the Committee’s jurisdiction to include certain **non-controlling** investments made by foreign persons in U.S. businesses involved in critical technologies related to specific industries; and (ii) implementing FIRRMA’s **mandatory declaration** authority for transactions that fall within the scope of the Pilot Program.

Covered Investments. The Pilot Program expands the Committee’s jurisdiction by granting it the authority to review “other investments” made by any foreign persons that do

not constitute an acquisition of control of a U.S. business. Investments covered by the Pilot Program include those that would give the foreign investor:

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

Exception for Certain Investment Funds. Consistent with FIRREA, the Pilot Program interim regulations include an exception for investment funds where a foreign limited partner sits on an advisory board or a committee, so long as the investment fund is:

- Managed exclusively by a general partner or equivalent;
- The foreign person is not the general partner or equivalent;
- The advisory board or committee does not have the ability to approve, disapprove, or other control (i) the investment decisions of the investment fund; or (ii) decisions made by the general partner;
- The foreign person does not otherwise have the ability to control the investment fund; and
- The foreign person does not have access to material non-public technical information as a result of its participation on the advisory board or committee.

Foreign Persons. The Pilot Program applies to all foreign persons and is not country-specific.

U.S. Businesses. The Pilot Program covers any U.S. business that produces, designs, tests, manufactures, fabricates, or develops a critical technology that is (i) utilized in connection with the U.S. business's activity in one or more Pilot Program Industries (as defined below); or (ii) designed by the U.S. business specifically for use in one or more Pilot Program Industries ("Pilot Program U.S. Businesses").

Critical Technologies. The Pilot Program covers all critical technologies, as defined by FIRREA, including (i) defense articles or defense services included on the United States

Munitions List set forth in the International Traffic in Arms Regulations (“ITAR”), (ii) items specified on the Commerce Control List set forth in Supplement No. 1 to part 774 of the Export Administration Regulations (“EAR”) and controlled pursuant to multilateral regimes or for reasons related to regional stability or surreptitious listening, (iii) specially designed and prepared nuclear equipment, parts and components, materials, software and technologies covered by the Assistance to Foreign Atomic Energy Activities regulations, (iv) select agents and toxins specified in the Select Agents and Toxins regulations and (v) specified emerging and foundational technologies controlled pursuant to the Export Control Reform Act of 2018.

The Pilot Program is a significant first step in implementing the substantive reforms set out by FIRRMA. While the scope of the Pilot Program is limited to companies in the 27 specified industries and which also use or possess “critical technologies,” the expansion of jurisdiction beyond “control” transactions is unprecedented.

Industries. The U.S. Treasury Department determined that certain strategically motivated foreign investment in 27 industries could pose a particularly grave threat to U.S. technological superiority and national security. These industries, (the “Pilot Program Industries”), include the semiconductor, aircraft manufacturing, aluminum production, computer storage device manufacturing, electronic computer manufacturing, petrochemical manufacturing, certain defense-related industries and wireless communications equipment industries, among others. The Pilot Program Industries are identified by their North American Industry Classification System (“NAICS”) codes. See Appendix A for a full list of the Pilot Program Industries.

Mandatory Declarations. Transactions subject to the Pilot Program based on “other investment” jurisdiction, as well as transactions that could result in control of a Pilot Program U.S. Business, are subject to mandatory declaration requirements. A mandatory declaration is an abbreviated notice that generally should not exceed five pages in length.

- Declarations are due at least 45 days prior to a transaction’s expected completion date. The Committee then has 30 days to take action.
- Parties may file a notice under CFIUS’s standard procedures instead of a declaration.
- Civil monetary penalties up to the value of the transaction may be assessed against parties who fail to make a mandatory filing.

Effective Date. The Pilot Program will begin on November 10, 2018 and is applicable to transactions which have not yet closed on November 10, 2018, unless the parties have executed a binding written agreement or other document establishing the material terms of the transaction prior to October 11, 2018.

While we still expect the full implementation of FIRRMA's implementing regulations to occur over the next 6 to 9 months, or longer, this week's interim regulations make clear that CFIUS is willing to enact substantive regulations as soon as can be implemented.

Implications

The Pilot Program is a significant first step in implementing the substantive reforms set out by FIRRMA. While the scope of the Pilot Program is limited to companies in the 27 specified industries and which also use or possess “critical technologies,” the expansion of jurisdiction beyond “control” transactions is unprecedented. Equally significant is the application of the mandatory declaration procedures to Pilot Program transactions. The combination of expanded jurisdiction and mandatory declarations in the Pilot Program is likely to dramatically increase the number of transactions that are subject to CFIUS review. Transaction parties subject to the Pilot Program will be the among the first to proceed under the mandatory declaration procedures, and CFIUS's ability to cope with increased volume and new procedures will represent a critical stress test for FIRRMA.

While the Pilot Program is significant, there are many other aspects of FIRRMA that remain subject to regulatory rulemaking, including whether there will be changes to the definition of “foreign person” or “foreign entity,” the eventual development of the list of countries (if any) that will be placed on a “white list” exempting certain transactions by buyers from those countries from CFIUS review, and the application of filing fees.

Finally, while we still expect the full implementation of FIRRMA's implementing regulations to occur over the next 6 to 9 months, or longer, this week's interim regulations make clear that CFIUS is willing to enact substantive regulations as soon as can be implemented, including possibly through other “pilot programs” targeting transactions involving critical infrastructure, personal identifier information, foreign government investors, or real estate transactions. Further, CFIUS is acting under its authority to enact regulations without the ordinary notice and comment process, pursuant to exemptions under the Defense Production Act.

Any foreign person contemplating an acquisition or investment in the U.S. and the U.S. targets of those transactions should consult early on with CFIUS counsel in order to develop an optimal strategy for navigating the CFIUS process in the evolving post-FIRMMA environment.

To learn more about our National Security Regulatory Practice and how to navigate key processes, including matters before CFIUS, the Defense Department’s Defense Security Service, the State Department’s Directorate of Defense Trade Controls, and the Treasury Department’s Office of Foreign Assets Control (“OFAC”), please contact the following:

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ANNEX A – PILOT PROGRAM INDUSTRIES

Aircraft Manufacturing

NAICS Code: 336411

Aircraft Engine and Engine Parts 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



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