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Report from Washington

CFIUS Reform Update: Industry Groups and Investors Comment on Proposed FIRRMA Regulations

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To read the proposed regulations, please click here (Part 800) and here (Part 802).

Introduction

On September 17, 2019, the Office of Investment Security of the U.S. Department of the Treasury issued two proposed regulations intended to fully implement the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"). FIRRMA was enacted to expand the jurisdiction of the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee") and modernize its procedures. The period for public comment on the proposed regulations was open only until October 17. Under the statutory deadline in FIRRMA, CFIUS has until February 13, 2020, to consider the comments and issue a final set of regulations.

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Background

Signed into law in August 2018, FIRRMA expanded the definition of "covered transaction" to include non-controlling investments in U.S. businesses that are involved in critical technologies, critical infrastructure, or sensitive personal data on U.S. citizens, referred to in the proposed regulations as "TID U.S. businesses." Additionally, FIRRMA expanded CFIUS's jurisdiction to reach acquisitions and leaseholds by foreign persons of real estate in the U.S.

if located in a port, or in "close proximity" to a U.S. military installation or other sensitive U.S. government facility, even if no U.S. business is conducted on the property in question. Prior to proposing FIRRMA rules, CFIUS had implemented, as of November 2018, a Pilot Program requiring mandatory declarations by foreign investors in certain critical technology businesses.

Many of the substantive comments sought clarification on, or proposed edits to, the newly proposed regulations, ranging from suggestions for how to define key terms in FIRRMA to critiques of the existing Pilot Program. A handful of comments also requested an extension of the public comment period; in most cases the comment period lasts for 60 days, but Treasury only allotted 30 days for public comment on the proposed FIRRMA regulations. Commenters included a variety of interested persons, including trade associations, law firms, and companies that could be impacted by the new regulations. Under the formal rulemaking process, Treasury must address all substantive comments received during the public comment period, though it may reject any and all comments so long as it provides a reasonable justification for doing so when issuing the final regulations.

Commenters urged that [the] limitation [on the 'U.S. business' definition in the existing regulations] be retained, as removing this phrase could greatly expand CFIUS's jurisdiction, thereby reaching foreign companies without a physical presence in the U.S., for example, foreign companies engaging purely in import businesses.

Public Comments

DEFINITION OF "U.S. BUSINESS"

Several comments touched on the revised definition of "U.S. business," which is "any entity, irrespective of the nationality of the persons that control it, engaged in interstate commerce in the United States." This removes the limiting phrase "*but only to the extent of its activities in interstate commerce*" from CFIUS's existing regulations defining a "U.S. business." Commenters urged that this limitation be retained, as removing this phrase could greatly expand CFIUS's jurisdiction, thereby reaching foreign companies without a physical presence in the U.S., for example, foreign companies engaging purely in import businesses. If the original definition is not retained, other commenters suggested clarifying that businesses with no assets in the U.S. would not be considered "U.S. businesses." For example, one comment points out that it is unclear whether a foreign company with no U.S. assets that provides services to U.S. customers, or a company that "does not have a branch office, subsidiary, or fixed place of business in the United States, but that directly employs sales personnel in the United States and sells products and services to U.S. customers," would be considered a U.S. business. This point has been discussed widely among CFIUS practitioners and media reporting on the regulations. It remains a key open point that the investment community will look to in the final regulations. If the Committee does not adopt

its traditional limitation on the definition of a U.S. business, foreign investors will need to tread carefully in assessing the necessity of voluntary and mandatory CFIUS filings going forward.

INVESTMENT FUNDS' "PRINCIPAL PLACE OF BUSINESS"

A few comments, particularly from the private equity and venture capital spheres, requested clarification of the definition of "principal place of business." As drafted, the mandatory declaration requirement for investments in certain critical technology businesses applies to all foreign entities, including private foreign investors. Commenters expressed concern that without a clear definition of "principal place of business," investment firms and funds controlled by U.S. nationals that use offshore transaction structures may be inadvertently treated as foreign entities and thus trigger the mandatory declaration requirement; historically, investments by such firms and funds have not fallen under CFIUS's jurisdiction. Commenters sought to maintain the status quo by proposing the following as a definition for "principal place of business": "The term principal place of business means the primary location from where an entity's directors or officers direct and control the entity's activities, or, in the case of an investment fund, from where the activities and investments of the fund are primarily directed and controlled on behalf of the general partner, managing member, or equivalent."

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SCOPE OF EXCEPTION TO MANDATORY DECLARATIONS

Excepted Foreign Investor

Under the proposed regulations, an "excepted investor" will be exempted from CFIUS's mandatory filing requirement for foreign investments in TID U.S. businesses. However, under the proposed rules, a foreign investor must meet several requirements to qualify for such exceptions, including (i) being organized in and maintaining a principal place of business in an "excepted foreign state" or the U.S.; (ii) nationality requirements for board members and observers; and (iii) certain ownership requirements.

Many commenters noted that the proposed definition is too narrow, making it difficult in practice to qualify as an excepted investor. Some, in particular, focused on the fact that under the proposed definition, an entity would *not* qualify if 5 percent or more of its equity is owned by a foreign national, government, or entity that is not itself an excepted investor. These comments stated that the 5 percent threshold is too low and suggested raising the bar to 15 percent, or even 20 percent.

Other comments focused on the "excepted investor" requirement that all board members be nationals of the U.S. or an excepted foreign state in order to be exempted from certain mandatory filings. They requested that this requirement be removed, or at least amended to allow a certain threshold of board members from non-excepted states, reasoning that no individual board member typically has the power to make or veto major decisions.

Excepted Foreign State

The proposed regulations also contain a "country specification" provision to identify "excepted foreign states," but do not provide guidance on which countries will become excepted. A number of commenters nominated key U.S. allies, such as Australia, Japan, Singapore, Sweden, and the NATO member states, as potential "excepted foreign states." Some commenters took a different approach and identified criteria the Committee should use when determining "excepted foreign states," such as those that have been designated a major non-NATO ally, pursuant to section 517 of the Foreign Assistance Act of 1961, or those that have a bilateral treaty with the U.S. and are a member of the European Union or the European Free Trade Association. It is important to note that Treasury may not designate "excepted foreign states" for two years after the effective date to allow time for non-U.S. regimes to institute more robust investment control regimes. CFIUS also explained in the proposed regulations that, given this is a new concept with significant national security ramifications, the Committee will initially designate only a small number of eligible foreign states.

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Minimum Excepted Ownership

The proposed regulations also introduce the concept of "minimum excepted ownership," stating that to qualify as an "excepted investor," a minimum excepted ownership of the investor must be held by U.S. nationals or persons, governments, or entities of excepted foreign states. Minimum excepted ownership is defined such that either U.S. nationals or persons, governments, or entities of excepted foreign states must own a majority of any public company listed on an exchange in an excepted foreign state or the U.S., or 90 percent of the voting or equity interests for any entity not so listed on such an exchange. Some comments sought clarification for this requirement, such as how the term applies when an entity does not have a voting interest. Others felt the threshold for privately-held entities was too high, and suggested that it be lowered.

PILOT PROGRAM

Many comments expressed concern over the existing Pilot Program, effective last November, that requires mandatory filings for acquisitions of and investments in U.S. businesses in certain critical technology sectors. Given the wide jurisdiction this affords the Committee, several comments suggested that the Pilot Program be narrowed, either by refocusing from industries to the underlying technologies themselves, or explicitly exempting U.S. businesses that merely employ encryption software but that do not design or manufacture such software. This latter clarification would be especially welcome to avoid unnecessary filings. Another comment suggested narrowing the Pilot Program to a more limited group of investors, such as only investments in critical technology businesses by foreign government owned or controlled investors.

WAIVERS FOR MANDATORY DECLARATIONS

Many comments requested that the final regulations provide waivers for mandatory "substantial interest" declarations. As drafted, the proposed regulations require mandatory declarations, not only under the Pilot Program, but also for transactions in which foreign government owned or controlled investors acquire a "substantial interest" (defined as 25% or more) in a TID U.S. business. Such comments noted that FIRRMA permits the Committee to waive the mandatory filing requirement for entities that demonstrate that their investments are not directed by a foreign government and that have a history of cooperation with the Committee. Other comments proposed the establishment of a waiver process for certain acquirers, through the identification and exemption of low-risk transactions, or by granting waivers for excepted investors in controlling transactions.

PERSONAL DATA

Several commenters sought clarification on the scope of the definition of "sensitive personal data," currently defined to include "genetic information" and "identifiable data." Some commenters expressed concern that the term "genetic information" is too broad and could cover data used for scientific research that is otherwise de-identified from an individual. Such a broad definition could have a chilling effect on investment in the life sciences industry. Other commenters suggested limiting the definition of "identifiable data" to exclude data that can meet objective anonymization standards, such as those established by the Health Insurance Portability and Accountability Act of 1996.

REAL ESTATE

Finally, a number of comments were submitted regarding the proposed regulations for covered real estate transactions. Many commenters were concerned that the bright-line rules proposed by the regulations would be difficult to apply, as the "boundaries" of such sensitive facilities and installations are not necessarily clearly defined. Some suggested that Treasury provide a map, an interactive tool, or a monitored list of sensitive facilities, in order to better determine whether specific properties would be considered covered real estate for CFIUS purposes.

Key Takeaways

While the proposed regulations offer a great deal of color on the means by which CFIUS expects to implement its new jurisdictional authorities, many questions remain as to the extent by which FIRRMA has expanded the Committee's jurisdictional reach, the qualification process for excepted foreign states and excepted investors, and the scope of the mandatory declaration requirements. The comments submitted through this process will hopefully assist Treasury in refining and clarifying the regulations prior to implementation. As noted above, Treasury has until February 13, 2020, to promulgate the final regulations.

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