

CFIUS Reform Puts Spotlight on Tech Companies, Foreign Government-Controlled Investors

August 13, 2018

On August 13, 2018, President Trump signed the John S. McCain National Defense Authorization Act for fiscal year 2019. The NDAA includes the Foreign Investment Risk Review Modernization Act, which expands the power of the Committee on Foreign Investment in the United States to review certain investments in US businesses by non-US entities and persons.

Notably, unless otherwise indicated below, these changes will be implemented by new regulations and therefore may not become effective for up to 18 months. This delay will give companies some breathing room to consider how FIRRMA will impact their future investments and time to make necessary organizational and strategic decisions. Further, FIRRMA will not have a retroactive effect on transactions completed prior to its enactment or prior to the effective date of those FIRRMA provisions that do not take immediate effect.

Key changes

- **Expanded definition of "covered transaction:"** CFIUS has jurisdiction to review "covered transactions," a term presently defined as a transaction that could result in "control" of a US business by a foreign person (*i.e.*, a foreign national, foreign government, foreign entity or any entity controlled by a foreign person). FIRRMA revises the definition of "covered transaction" first by explicitly stating that "control" can manifest as the result of a "merger, acquisition or takeover carried out through a joint venture." More importantly, FIRRMA also expands the definition of a covered transaction to include other types of transactions, some of which may not result in foreign control of a US business. These new types of covered transactions include:
 - Acquisitions, including leases, by a foreign person of **US private or public real estate** that is either (1) associated with an airport or maritime port or (2) in close proximity to a military installation or otherwise sensitive US government facility.
 - "Other investments" by a foreign person in a US business that would provide a foreign person access to (1) **critical infrastructure**, (2) **critical technologies** or (3) **sensitive personal data of US citizens**, but only if such "other investments" also would provide a foreign person:
 - a. **access to "material nonpublic technical information"** (*i.e.*, information that provides key know-how not available in the public domain relating to critical infrastructure or critical technologies);
 - b. **membership or observer rights on the US business' board of directors** (or equivalent body); or
 - c. **any involvement in substantive decision-making** (other than through the voting of shares) of the US business regarding critical infrastructure, critical technologies or sensitive personal data.
 - **Forthcoming CFIUS regulations pertaining to covered transactions:** With respect to CFIUS' expanded jurisdiction to review "other investments," the terms "critical infrastructure" and "critical technologies" will be defined in forthcoming regulations prescribed by CFIUS. Significantly, the definition of "critical technologies" will include **"emerging and foundational technologies,"** a list of which will be determined pursuant to a new interagency process involving (at a minimum) the Secretaries of the Departments of Commerce, Defense, Energy and State. Such emerging and foundational technologies almost certainly will include artificial intelligence, quantum computing, encryption technologies and nanoscale technologies, all of which have been the focus of recent attention by CFIUS. FIRRMA also permits CFIUS to focus the scope of its review of the real estate transactions and "other investments" described above on certain categories of foreign persons, including investors from **certain countries of concern or foreign government-backed investors**. If CFIUS decides to exercise this authority, investors from China and Russia will undoubtedly receive heightened scrutiny.
- **Carve-out for private equity and other investment funds:** FIRRMA creates a limited jurisdictional carve-out for foreign

persons who participate in an investment in a US business as limited partner (or the equivalent) in an investment fund. Specifically, the participation of a foreign limited partner in a transaction will not constitute an "other investment" as described above where all of the following conditions are met:

- a. the fund is managed exclusively by a general partner (or equivalent entity) that is *not* a foreign person;
- b. the advisory board (or equivalent committee) on which the limited partner sits does not have the power to control investment decisions of the fund or decisions made by the general partner;
- c. the foreign person is not able to control the fund; *and*
- d. the foreign person does not have access to "material nonpublic technical information."

Because of the narrow scope of this carve-out, investment funds – and particularly those that anticipate making investments in US businesses involving critical infrastructure, critical technologies or sensitive personal data – must consider how CFIUS will regard the presence of non-US limited partners in a fund.

- **Mandatory declaration requirements:** In contrast with the current voluntary CFIUS regime under which parties have no affirmative obligation to notify CFIUS of a covered transaction, FIRRMA contemplates mandatory filings in certain circumstances. FIRRMA also establishes a new process (also to be defined in the forthcoming CFIUS regulations) by which parties to a covered transaction may submit an **abbreviated "declaration"** to CFIUS, generally not exceeding five pages in length. Upon receiving a declaration, CFIUS will have the option to:
 - a. notify the parties that CFIUS has completed all action with respect to the transaction (*i.e.*, "cleared" the transaction);
 - b. request that the parties submit a full notice of the transaction;
 - c. inform the parties that CFIUS is not able to "clear" the transaction based on the declaration alone, in which case the parties can elect to submit a full CFIUS notice, or
 - d. initiate a unilateral review of the transaction.

While the specific circumstances that will trigger a mandatory declaration will be determined in regulations, FIRRMA provides that declarations will be required for transactions resulting in the acquisition of a "substantial interest" in a US business by a foreign person in which a foreign government has a "substantial interest" where such acquisition would provide the foreign person access to critical infrastructure, critical technologies and/or sensitive personal data of US citizens. The definition of a "substantial interest" will be determined in the forthcoming CFIUS regulations. CFIUS also will have authority to require declarations for any "other investments" described above in US businesses involving critical technologies.

- **Extension of the CFIUS review and investigation timelines:** Effective immediately, the timeframe for the initial review of a transaction by CFIUS will extend from 30 days to 45 days. If CFIUS decides thereafter to initiate an investigation of a transaction, such investigation will run for 45 days, unless the CFIUS Chairperson elects to extend the investigation period for an additional 15 days due to "extraordinary circumstances."
- **Filing fees:** Also effective immediately, CFIUS may require a filing fee for each full notice submitted in connection with a covered transaction. The process for determining the amount of the fee will be further defined in the CFIUS regulations, but it **will not exceed the lesser of one percent of the value of the transaction or \$300,000**. In prescribing further regulations, FIRRMA instructs CFIUS to consider the effect of the filing fee on small business concerns and foreign investment more broadly. Notably, the filing fee will apply only to notices voluntarily submitted to CFIUS and not to reviews initiated by CFIUS or in connection with the new abbreviated declaration process established by FIRRMA.

The full impact of FIRRMA will be determined in the coming months, particularly with the promulgation of the new CFIUS regulations referenced throughout FIRRMA. However, it is clear that there will be significant implications for foreign investment in US technology companies, depending on how the term "critical technologies" is defined in CFIUS regulations and in the parallel process described in the Export Control Reform Act also included in the NDAA. Additionally, investors with ties to foreign governments will need to consider whether their investments will implicate the mandatory declaration requirement established in FIRRMA. Private equity and other investment funds also must consider how the jurisdictional carve-out provided in FIRRMA will impact the participation of foreign limited partners in funds and investments going forward.

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