

## Proposed Rule Signals CFIUS' Commitment to Jurisdictional Carve Out for Transactions Involving Trustworthy Investors

November 30, 2021

On behalf of the Committee on Foreign Investment in the United States (CFIUS), the US Department of the Treasury published a [proposed rule](#) on November 15, 2021, relating to excepted foreign state (EFS) and excepted real estate foreign state (EREFS) determinations under the regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA).

As [explained in our client alert on February 13, 2020](#), FIRRMA requires CFIUS to limit the application of its jurisdiction over certain nonpassive, noncontrolling investments in US businesses and real estate transactions to certain categories of foreign persons. Accordingly, certain transactions by or with trustworthy ("excepted") investors may be exempt from a mandatory filing or CFIUS jurisdiction if the foreign person is sufficiently linked to an EFS or EREFS.

The EFS and EREFS definitions are set forth in Parts 800 and 802 of the CFIUS regulations, respectively. Both definitions (which are similar but not identical) involve a two-part test. Part 800 implements CFIUS' authorities and the processes and procedures to review:

- Mergers, acquisitions or takeovers by or with a foreign person that could result in foreign control of a US business.
- Noncontrolling, nonpassive investments in a US business that afford a foreign person specified rights in the US business (a covered investment).
- Any change in a foreign person's rights if such change could result in foreign control of a US business or a covered investment.
- Any other transaction, transfer, agreement or arrangement whose structure is designed or intended to evade or circumvent the application of Section 721 of the Defense Production Act of 1950.

In turn, Part 802 implements CFIUS' authorities and the process and procedures to review transactions involving the purchase or lease by, or concession to, a foreign person of certain real estate in the United States.

The first prong of the EFS and EREFS definitions is the same: an "eligibility" designation based on national security considerations. CFIUS identified only three countries – Australia, Canada and the UK –as eligible foreign states under [Part 800](#) and [Part 802](#) effective February 2020. CFIUS explained that the countries were identified "due to aspects of their robust intelligence-sharing and defense industrial base integration mechanisms with the United States."

The second prong of the EFS and EREFS definitions are different:

- Under Part 800, the second prong is a determination that an eligible foreign state has "**established and is effectively utilizing** a robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security."
- Under Part 802, the second prong is a determination that a foreign state has "**made significant progress** toward establishing and effectively utilizing a robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security."

A foreign state naturally may be able to meet the second prong under Part 802 before it can meet the second prong of the EFS definition. Notably, therefore, EREFS status may be more quickly achieved than EFS status.

Importantly, the final rules effective February 13, 2020, provided that CFIUS need not issue a determination under the second criterion of the EFS and EREFS definitions until a delayed date of February 12, 2022. This allowed Australia, Canada and the UK to enjoy EFS and EREFS status for two years without a follow-on determination by CFIUS, seemingly to incentivize these countries to implement robust regimes and coordinate with the United States to re-secure their coveted status in early 2022.

Pursuant to the proposed rule, the timing of CFIUS' determination relevant for the second prong of the EFS and EREFS definitions is delayed for exactly one year. The effect of the proposed rule is small –Australia, Canada and the UK maintain their status for one more year. But CFIUS will have an additional year to make its determinations for the three eligible foreign states – as well as any other state that the Committee identifies as an eligible foreign state between now and February 12, 2023.

We do not believe that CFIUS really needs additional time to review the foreign direct investment (FDI) regimes and cooperation postures of Australia and Canada, which are two Five Eyes countries that have long-standing FDI regimes. The UK, on the other hand, recently established an investment screening regime that does not take effect until January 4, 2022. CFIUS may need additional time to adequately review the UK regime after its implementation. It is also possible that this one-year extension is needed so CFIUS can review the regimes of other states that have been lobbying for EFS and EREFS status in the previous two years and may be named as eligible foreign states in the coming months.

Either way, the rule signals a clear commitment by CFIUS to the mandate of FIRRMA that requires the Committee to carve out from its jurisdiction certain transactions involving trustworthy investors. We hope that by February 13, 2023, we may see a few more states identified as eligible foreign states and under consideration for EFS and EREFS status.

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## Key Contacts

Bridget R. Reineking Washington, DC	breineking@cooley.com +1 202 776 2220
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