Hughes Hubbard & Reed

CFIUS Proposes Changes to Mandatory Declaration Requirements

Client Advisories

Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

May 27, 2020 — On May 21, 2020, the U.S. Department of the Treasury published a proposed rule that would amend the scope of mandatory filings before the Committee on Foreign Investment in the United States ("CFIUS"), an interagency body that reviews foreign investments into the United States to assess national security risks. The proposed rule follows the Treasury Department's publication of the regulations implementing the Foreign Investment Review Modernization Act, a statute passed in 2018, which aimed to streamline and modernize the CFIUS review process. We previously summarized the CFIUS regulations here and here. The proposed rule amends the scope of the mandatory declaration requirement for transactions involving U.S. businesses involved in critical technologies, and makes clarifying revisions to the definition of "substantial interest" in the context of acquisitions involving foreign governmental involvement.

Modification of Critical Technology Rules for Triggering Mandatory Declarations

Most notably, the proposed rule would make three key changes to criteria triggering a mandatory declaration requirement in transactions involving a "TID U.S. business" involved in "critical technologies." (For an analysis of what constitutes a TID U.S. business, please see our earlier alert here.) The current rule requires a mandatory declaration to be filed, among other circumstances, in a covered investment or covered control transaction of a U.S. business involved in critical technologies that are used or designed for one or more industries identified by NAICS codes in Appendix B to 31 C.F.R. Part 800. The proposed rule would, first, refine the scope of the critical technologies triggering the mandatory declaration by covering only those technologies that would require "U.S. regulatory authorization" for the export, re-export, transfer (in-country), or retransfer to the foreign acquirer involved in the transaction. Second, as described further below, while focused in the first instance on the nationality of the foreign acquirer, if the foreign acquirer is itself subject to an ownership interest of 25% or more from a person in a third country, the export licensing requirements applicable to that third country person will also be relevant. Third, the amendments would eliminate the current requirement that the TID U.S. business be listed as one of the industries identified in Appendix B.

Regarding the first element, the proposed rule would define the term "U.S. regulatory authorization" to include authorization required by the Department of State under the International Traffic in Arms Regulations ("ITAR"); the Department of Commerce under the Export Administration Regulations ("EAR"); the Department of Energy relating to assistance to foreign atomic energy activities; or the Nuclear Regulatory Commission related to the export or import of nuclear equipment and material. In most cases, the availability of a license exception under the applicable export control regime would not be given effect; that is, if the export requires a license to the applicable parties under the relevant export control regime, the availability of a license exception for export would not similarly provide an exception to the mandatory declaration rule. There are, however, four carve outs—the first concerns the general authorization under Department of Energy export controls, and the other three concern three license exceptions under Part 740 of the EAR (specifically, the Strategic Trade Authorization (STA); Technology and Software – Unrestricted (TSU); and paragraph (b) of the Encryption (ENC) license exceptions). Thus, for example, transactions with foreign acquirers from countries with favorable treatment under the EAR's Strategic Trade Authorization (STA) license exception at 15 C.F.R. § 740.20(c)(1) may be exempt from mandatory declaration requirement under the proposed rule.

Second, the proposed rule could potentially expand the scope of transactions that trigger a mandatory declaration based on the export license requirements applicable to owners of the acquiring foreign entity. In this regard, the proposed rule would also make the mandatory declaration requirement applicable to transactions where there is a foreign person who holds, or is part of a group of foreign persons that together hold, a "voting interest for purposes of critical technology mandatory declarations" in a foreign acquirer. The proposed rule defines the term "voting interest for purposes of critical technology mandatory declarations" as a 25% voting interest or, in the case of entities organized as partnerships, a 25% interest in the general partner, managing member, or equivalent of the entity. Thus for, example, if foreign acquirer X of a TID U.S. business is from country to which a critical technology can be exported without a license, but X is 25% or more owned by Y in a third country to which an export license would be required, the mandatory declaration regulation would be triggered.

Finally, although not necessarily its intent, the proposed rule may actually broaden the application of the mandatory declaration requirement by removing the current Appendix B, such that the declaration requirement would no longer be limited to only those 27 industries listed in Appendix B. As a result, any acquisition of a U.S. TID business with the requisite involvement with a critical technology may trigger the mandatory declaration requirement, without regard to the industry in which the TID business operates.

Modification of Definition of "Substantial Interest"

The proposed rule would also amend the definition of "substantial interest" for purposes of transactions involving foreign governments. The current regulations require a mandatory declaration to be filed in transactions where a foreign person obtains a "substantial interest" in a TID U.S. business, and a foreign government (other than excepted foreign governments, currently only the U.K., Australia, and Canada) has a "substantial interest" in the foreign acquirer. The current definition of "substantial interest" applies, with respect to a foreign government's interest in a foreign acquirer organized as a partnership or similar entity, when the foreign government holds at least 49% of the general partner, managing member, or equivalent of the entity. The proposed rule would narrow that provision by applying it only when the general partner or equivalent entity primarily directs, controls, or coordinates the activities of the foreign acquirer. The current rule also contains a provision that any "voting interest" held by a parent entity in a subsidiary entity will be deemed to be 100%. Because there was some confusion as to whether this provision applied to non-voting partnership interests, the proposed rule would remove the term "voting" to clarify that this provision applies to such entities organized as both corporations (and equivalent entities) and partnerships (and equivalent entities).

Comments Due by June 22, 2020

Comments on the proposed rule may be submitted through June 22, 2020. Parties with interests which may be impacted by the rule should strongly consider submitting comments prior to this deadline to ensure that all relevant industry insight is considered by CFIUS prior to the final rule becoming effective.

Related People

Ryan Fayhee

Roy (Ruoweng) Liu

Alan G. Kashdan

Tyler Grove

Sydney Stringer

Related Areas of Focus

Sanctions, Export Controls & Anti-Money Laundering