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Treasury Issues Final CFIUS Rules to Fully Implement FIRRMA

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January 27, 2020 – On January 13, 2020, following the receipt of numerous comments on proposed rules issued last September, the U.S. Department of the Treasury issued two final rules to implement changes required by the Foreign Investment Risk Review and Modernization Act of 2018 (“FIRRMA”) to the foreign investment review process of the Committee on Foreign Investment in the United States (“CFIUS” or “Committee”). The first rule will wholly replace the existing regulations governing “traditional” CFIUS reviews, found at 31 C.F.R. Part 800, with updated rules to reflect numerous changes required by FIRRMA. The temporary regulations governing CFIUS mandatory Pilot Program notifications found at Part 801 will also be folded into new Subpart D of the revised Part 800. The second rule creates an entirely new set of regulations to govern the Committee’s review of certain investment transactions involving real estate in the United States. The new rules will become effective on February 13, 2020.

We previously reviewed the proposed rules that CFIUS issued in September 2019. Below we summarize the major differences between the September 2019 proposed rules and the January 2020 final rules.

Part 800 CFIUS Review

The final rule largely brings forward the substance of the proposed rule, with a few important changes, particularly regarding the definitions of “excepted foreign state” and “principal place of business,” as well as the operation of provisions governing mandatory declarations for certain non-controlling investments. We summarize below these and other important changes from the proposed rules that may have practical impacts on the decisions and strategies of potential foreign investors.

1. Modified Mandatory Declaration Requirement Maintained in the Final Rules

The final rule continues the requirement in the proposed rule for mandatory declarations involving two categories of foreign investments that do not result in control of a U.S. business. The first involves transactions that had been covered by the mandatory declaration provisions of the Part 801 Pilot Program – in the terminology used in the

revised Part 800, certain investments in a “TID U.S. business.” The second involves transactions that result in the acquisition of a “substantial interest” in a “TID U.S. business” by a foreign person in which a foreign government has a “substantial interest.” For both purposes, a “TID U.S. business” is a U.S. business that is engaged in specified activities involving “critical technologies” or “critical infrastructure,” or that maintains or collects “sensitive personal data” of U.S. citizens.

The Part 801 Pilot Program had created, for the first time, a mandatory declaration requirement for covered transactions involving non-controlling investments in certain categories of businesses involved with certain critical technologies. The final rule integrates into Part 800 the mandatory declaration requirement from the Pilot Program (and, accordingly, removes the separate Pilot Program regulations at Part 801). The requirement for mandatory declarations for the moment continues to be based on whether a transaction involves certain U.S. businesses with a nexus to specified industries identified by North American Industry Classification System (“NAICS”) codes. The Treasury Department stated, however, that it anticipates issuing a separate rule that would replace the reference to certain NAICS industries with a reference to specified categories of export control licensing requirements. The final rule also continues the proposed rule’s requirement for mandatory declarations for transactions that result in the acquisition of a “substantial interest” in a “TID U.S. business” by a foreign person in which a foreign government has a “substantial interest.”

The final rule broadens the proposed rule’s exemptions for certain transactions that would otherwise be subject to the two mandatory declaration requirements. These exemptions relate to excepted investors (discussed further below), entities with mitigation agreements already in place to address Foreign Ownership, Control, or Influence (“FOCI”) concerns, transactions involving certain encryption technology, and investment funds managed exclusively by, and ultimately controlled by, U.S. nationals.

It should be kept in mind that if a “covered transaction” is not subject to, or is otherwise exempted from, the mandatory declaration requirements, the parties to the transaction may still wish to evaluate whether to provide a voluntary notice of the transaction.

2. Excepted Foreign State: Australia, Canada, and the UK

The final rule identifies Australia, Canada, and the United Kingdom as initial “excepted foreign states.” The proposed rule defined “excepted foreign state” to refer to a group of eligible foreign countries for whom CFIUS would limit the application of FIRRMA’s expanded jurisdiction over covered investments by foreign entities with “substantial” foreign government ownership. (“We discuss “substantial interest” separately in in Section 6 below.)The Treasury Department selected these three countries because of “their robust intelligence sharing and defense industrial base integration mechanisms with the United States.” The Treasury Department explained in commentary to the final rule that this initial list is limited to these three countries because “the concept and definition of ‘excepted foreign states’ are new and an expansive application carries potentially significant implications for the national security of the United States.” However, the Treasury Department made it clear that it “may expand the list in the future.”

Furthermore, the final rule clarifies that these countries only temporarily have favored status as excepted foreign states. In order for each country to remain an excepted foreign state, after the end of a two-year period (i.e., February 13, 2022), the Treasury Department must make a determination that they should continue to qualify. The excepted foreign state rule may be one of the initial steps for the U.S. government to coordinate with other countries on the issue of “national security.” As the Treasury Department made clear in the final rule: “This two-year period is intended to provide these initial eligible foreign states time to ensure that their national security based foreign investment review processes and bilateral cooperation with the United States on national security-based investment reviews meet the requirement of the regulations.”

3. Excepted Investor

The final rule liberalizes the qualification of “excepted investor” compared with the proposed rule in three ways. First, the board member nationality criterion is revised to allow up to 25 percent representation by nationals of foreign states that are not excepted foreign states. Second, the percentage ownership limit is revised from five to ten percent for an individual investor in an excepted investor who is not affiliated in the any of the manners described with an excepted foreign state. Third, the definition of “minimum excepted ownership” is revised by reducing the minimum excepted ownership percentage from 90 to 80 percent.

The final rules also clarify two points related to the concept of minimum excepted ownership. First, to qualify for the lower minimum excepted ownership threshold in the final rule, the majority of an entity’s outstanding shares must be traded on one or more exchanges in the United States or in an excepted foreign state. Second, regarding the minimum excepted ownership criterion’s application up the ownership chain of the foreign person that is the actual direct investor, the final rule clarifies that all of the prerequisite conditions applicable to an “excepted investor,” including the minimum excepted ownership conditions, must apply to each “parent” of the foreign person.

4. “Principal Place of Business”

Several sections of the proposed rule included the concept of “principal place of business,” but without defining that term. (For example, the proposed rule included in the definition of “foreign entity” an entity whose “principal place of business” is outside the United States, but did not define “principal place of business”). The final rule now defines “principal place of business” as “the primary location where an entity’s management directs, controls, or coordinates the entity’s activities, or, in the case of an investment fund, where the fund’s activities and investments are primarily directed, controlled, or coordinated by or on behalf of the general partner, managing member, or equivalent.” Because of the interest in this issue expressed in the comments received on the proposed rule, Treasury is treating the new definition as an interim rule, and is affording parties a 30-day period in which to comment on the definition. Comments are due by February 17, 2020.

5. Sensitive Personal Data, and Material Nonpublic Technical Information

As described above, the new rules incorporate the concept of “TID U.S. business;” this includes U.S. businesses that maintain or collect “sensitive personal data” on U.S. citizens. The final rule recalibrates the proposed rule’s treatment of genetic testing “sensitive personal data” in two ways: first, by focusing the definition on “genetic tests” as that term is defined in the Genetic Information Non-Discrimination Act of 2008 (GINA); and second, by limiting the coverage of the rule to “identifiable data.” To account for datasets commonly used in research, the rule also carves out genetic testing data derived from databases maintained by the U.S. Government and routinely provided to private parties for purposes of research.

With regard to the “critical technologies” component of “TID,” the final rule makes no changes, but it does add an illustrative example regarding technical milestones. Specifically, what constitutes “material nonpublic technical information” will depend on particular facts and circumstances. “Material nonpublic technical information may include,” but is not limited to, information necessary to reverse engineer a component of a company’s product. Conversely, information that is readily accessible to people with no connections to the TID U.S. business is likely in the public domain and therefore not material nonpublic technical information. However, any such a determination requires a fact-specific evaluation.

Last, no changes were made to the rules covering the “critical infrastructure” component of a TID business.

6. “Substantial interest”

As described above, the final rule continues the proposed rule's mandatory declarations for transactions that result in the acquisition of a "substantial interest" in a "TID U.S. business" by a foreign person in which a foreign government has a "substantial interest." While the proposed rule established a voting interest threshold for the definition of "substantial interest," it did not address how, if at all, the rules apply to a government interest in limited partners of investment funds. Furthermore, the proposed rules did not sufficiently clarify how a government's voting interest in an entity would be counted in applying the "substantial interest" test.

The final rule revises the definition of "substantial interest" in situations where the foreign entity operates with a general partner or managing member, or similar structure. In such cases, only a foreign government's interests in the general partner (or equivalent) will be considered, and any interests in limited partners or non-managing members will be disregarded. This provides clarity to parties in the investment fund context, focusing the substantial interest analysis on the entity that typically is responsible for the day-to-day decision-making regarding the investment fund.

Additionally, the final rule clarifies that references to a substantial interest of a "foreign government" applies to both national and subnational governments of a particular foreign country, including their respective departments, agencies, and instrumentalities. The rule also excludes governments of excepted foreign states in order to better harmonize the application of the two mandatory filing requirements in Subpart D of Part 800.

Part 802 Review of Real Estate Transactions

The final rule codifies FIRRMA's expansion of CFIUS jurisdiction to cover certain real estate transactions. The real estate provisions, set forth in Part 802, are substantially similar to the provisions set forth in the proposed rule.

1. Covered Real Estate Transactions

The Part 802 real estate provisions are triggered for transactions that do not otherwise qualify as covered transactions under Part 800 because there is no transaction where a foreign person acquires control of, or makes an investment in, an ongoing U.S. business. Specifically, Part 802 permits CFIUS review if a transaction involves a purchase or lease by, or concession to, a foreign person of certain real estate, or gives a foreign person three or more of the following property rights: physical access; ability to exclude others from physically accessing; ability to improve or develop; or the ability to affix structures or objects.

The final rule does not change the definition of "covered real estate transaction" that was set forth in the interim rule. Part 802 authorizes CFIUS to review "the purchase or lease by, or a concession to, a foreign person of private or public real estate that:"

- Will function as part of certain air or maritime ports;
- Is in close proximity to a U.S. military installation or another facility that is sensitive for national security reasons;
- Could reasonably provide the foreign person the ability to collect intelligence on activities being conducted at a military installation or other sensitive property; or
- Could otherwise expose U.S. national security activities at a military installation or facility or other type of property.

A property is in "close proximity" to sensitive real estate if it is within a one-mile radius from the boundary of the relevant real estate, and is in "extended range" if it is within 99 miles (subject to certain exceptions for properties located in urban areas). To assist parties to transactions in determining whether a transaction involves "covered real estate," the Treasury Department has said that it would create an online tool to help the public determine the geographic coverage of the rule. The Treasury Department will also separately publish the relevant lists of airports and maritime ports referenced in the rule.

2. Exceptions

Part 802 excludes certain real estate transactions from CFIUS review, including those involving excepted real estate investors. Excepted real estate investors must be connected with excepted real estate foreign states, and the Part 802 definition mirrors the excepted foreign state requirements set forth in Part 800. As in Part 800, the Treasury Department initially determined that eligible foreign states will include Australia, Canada, and the United Kingdom.

The final rule also broadens the criteria for excepted real estate investors, which include foreign persons that are:

- A foreign national who is a national of one or more excepted real estate foreign states (as defined above);
- A foreign government of an excepted real estate foreign state; or
- A foreign entity that meets certain ownership criteria.

The final rule continues other exemptions that had been included in the proposed rule, such as many real estate transactions in urbanized areas, and the acquisition of a single housing unit.

3. Filing Requirements

Although the Committee's jurisdiction has been expanded to real estate, the final regulations do not establish mandatory filing requirements for covered real estate transactions. Instead, parties may file a notice or submit a short-form declaration notifying CFIUS of a real estate transaction or a full voluntary notice. As under Part 800, by doing so, and if CFIUS has no concerns with the transaction, the parties can receive a "safe-harbor" letter from CFIUS, which prevents CFIUS from subsequently blocking the transaction (except in limited circumstances).

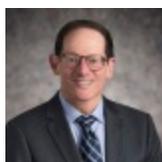
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