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Client Alert

New Interim Rules and Pilot Program Expand CFIUS Coverage and Impact Cross-Border M&A into the United States

Foreign Investment Risk Review Modernization Act of 2018

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Seyfarth Synopsis: *On October 10, 2018, the U.S. Department of the Treasury, which acts as the chairperson of the Committee on Foreign Investment in the United States ("**CFIUS**"), issued interim rules ("**Interim Rules**") implementing the recently enacted Foreign Investment Risk Review Modernization Act of 2018 ("**Act**"). The Act (1) expands the scope of CFIUS' coverage to include certain non-controlling investments in U.S. businesses that implicate "critical technologies" and (2) sets forth the process for related mandatory filings.*

Pre-Act

Prior to the enactment of the Act, the U.S. Defense Production Act of 1950 empowered the President of the United States, acting through CFIUS, to retain the authority to review mergers, acquisitions and takeovers by or with any foreign person which could result in foreign control of any person engaged in matters relating to the national security or certain critical industries or infrastructure of the U.S.

The *status quo* prior to the Act was such that parties to an M&A deal with a relevant nexus to the U.S. could voluntarily file with CFIUS if there was a reason to believe that the transaction could convey control of the U.S. business to a foreign investor and could implicate U.S. national security concerns. This voluntary filing structure existed notwithstanding CFIUS' baseline right to initiate its own review, at any time, of transactions which it independently deemed to be questionable from a national security perspective.

Post-Act

In the post-Act world, the framework for CFIUS notification and review has fundamentally changed. The Interim Rules now require, at minimum, short-form filings[1] from parties to certain types of "covered" M&A transactions that fall within an enumerated set of industry sectors and which involve "critical technologies."[2] CFIUS retains the right to determine whether it will require a longer-form filing with respect to any matter. In addition, the initial CFIUS review period has been increased from 30 days to 45 days.

[1] These declarations should include, at the very least, information pertaining to ultimate beneficial ownership, a description of the transaction at hand, statements regarding access to nonpublic technical information, geo-coordinates of facilities of the U.S. business implicated, descriptions of U.S. government contracts implicated and a complete and thorough organizational chart. The Interim Rules set forth a more detailed list of what is to be included.
[2] Of course, parties are always still free to voluntarily file a regular, full, long-form notification for a covered transaction if they opt to do so.

The Interim Rules have effected these changes through the establishment of a "pilot program." The pilot program went into effect on November 10, 2018.

The Act broadens the authority of the President, acting through CFIUS, to scrutinize and possibly block U.S. inbound deals in which foreign persons acquire minority equity stakes in any U.S. business that "produces, designs, tests, manufactures, fabricates, or develops a critical technology that is either utilized in connection with the U.S. business's activity in one or more pilot program industries, or designed by the U.S. business specifically for use in one or more pilot program industries."

Pilot Program Industries

The pilot program industries stated above include a specific set of industries stated in the Interim Rules by reference to certain North American Classification System codes. These industries include, among others, aircraft manufacturing, computer storage device manufacturing, optical instrument and lens manufacturing, nanotechnology R&D, primary battery manufacturing and specialty transformer manufacturing.

"Critical Technology"

The Interim Rules define a "critical technology" to include:

- Defense articles or defense services included on the United States Munitions List set forth in the International Traffic in Arms Regulations (ITAR) (22 CFR parts 120-130);
- Items included on the Commerce Control List set forth in Supplement No. 1 to part 774 of the Export Administration Regulations (EAR) (15 CFR parts 730-774) and controlled (1) pursuant to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology; or (2) for reasons relating to regional stability or surreptitious listening;
- Specially designed and prepared nuclear equipment, parts and components, materials, software, and technology covered by 10 CFR part 810 (relating to assistance to foreign atomic energy activities);
- Nuclear facilities, equipment, and material covered by 10 CFR part 110 (relating to export and import of nuclear equipment and material);
- Select agents and toxins covered by 7 CFR part 331, 9 CFR part 121, or 42 CFR part 73; and
- Emerging and foundational technologies controlled pursuant to section 1758 of the Export Control Reform Act of 2018.3

The Investment Trigger

The Interim Rules do not explicitly stipulate any actual equity threshold amount which would trigger a filing. Instead, they suggest any acquisition of an equity interest or securities convertible into equity interests by a foreign person in a covered U.S. business is sufficient to trigger a mandatory short-form filing if the investment affords the foreign person:

- Access to any material nonpublic technical information[4] in the possession of the U.S. business;
- Membership or observer rights on the board of directors or equivalent governing body of the pilot program U.S. business or the right to nominate an individual to a position on the governing body; or
- Any involvement in substantive decision-making of the pilot program U.S. business regarding the use, development, acquisition, or release of critical technology -- including but not limited to the voting of shares which constitutes control or effectively constitutes control or otherwise circumvents the above stated governing body prohibition.

[3] "Emerging and foundational technologies" remains undefined and may be the subject of a future pilot program or an expansion of the existing pilot program.
[4] Material nonpublic technical information means "information that is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods" and specifically does not include financial information regarding business performance.

Investment Fund Refuge

In response to certain investors seeking to circumvent CFIUS scrutiny by shielding themselves behind an investment fund or other indirect ownership, the Interim Rules specifically address investment fund investments and have clarified when a U.S. investment fund may avoid being considered a foreign person even though it may have foreign limited partners.

To this end, the Interim Rules state that an indirect investment by a foreign person in an investment fund will not be covered by the pilot program as long as the foreign person is not the general partner or managing member (or their legal equivalents) of the fund. Further, the foreign person must have no ability to control the investment fund, including the authority to (i) approve, disapprove, or otherwise control investment decisions of the investment fund; (ii) approve, disapprove, or otherwise control decisions made by the general partner, managing member or equivalent related to entities in which the investment fund is invested; or (iii) unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing member or equivalent.

Penalties for Non-Compliance

For transactions that (i) are subject to the mandatory reporting requirement described above, and (ii) are slated to close prior to December 25, 2018, the parties to those transactions must make the CFIUS filing by November 10th or "promptly thereafter." In all other transactions subject to the requirement, the parties must file at least 45 days before the completion of the transaction.

Parties that fail to comply with the mandatory filing requirements can be assessed a civil monetary penalty up to the complete value of the transaction itself and can incur other harsher sanctions and penalties in the discretion of CFIUS.

Conclusion

In light of these recent changes to the CFIUS regulatory regime, it is imperative that legal counsel to parties involved in transactions where foreign persons may be acquiring equity interests in U.S. businesses pay careful attention to whether a CFIUS notification filing may be required.

This is important to (i) evaluate the need for a filing before significant resources are committed towards consummating a transaction, and (ii) if appropriate, include appropriate provisions addressing potential CFIUS review in the definitive deal documentation. The consequences of ignoring CFIUS, and in particular the Interim Rules described herein, could result in significant financial penalties and, in some cases, in an entire acquisition deal being unwound.

Seyfarth Shaw LLP is experienced in advising on CFIUS transactions. If you have any questions about this Client Alert, please contact Robert Bodansky at rbodansky@seyfarth.com, Joseph Dyer at jdyer@seyfarth.com or Sai Pidatala at spidatala@seyfarth.com.