

## TREASURY DEPARTMENT ISSUES FINAL RULES IMPLEMENTING CFIUS REGULATIONS UNDER FIRRMA

On January 13, 2020 the United States Treasury Department's Office of Investment Security issued two Final Rules implementing the Foreign Investment Risk Review Modernization Act of 2018 ("**FIRRMA**"). The Final Rules are broadly similar to the Proposed Rules issued in September 2019, but make some important modifications including defining "principal place of business", adopting some provisions of the Critical Technology Pilot Program, and adjusting the qualifications for Excepted Investors. The Final Rules also designate Australia, Canada, and the United Kingdom as the first Excepted Foreign States. The Final Rules are slated to enter into force on February 13, 2020.

### NEW POWERS AND JURISDICTION CONFIRMED

As described in our previous briefing analyzing the Proposed Rules, the Final Rules maintain the significant expansion of CFIUS jurisdiction over non-controlling transactions and acquisition of greenfield sites. For example:

- 1) CFIUS jurisdiction is extended to "covered investments" which do not require the non-U.S. buyer to gain "control," if they obtain access to material non-public information.
- 2) Sensitive personal data is codified as a component of national security with some additional context on genetic data and examples of businesses covered.
- 3) Critical infrastructure defined for covered control transactions and covered investments in a "TID U.S. business".
- 4) Greenfield real estate transactions are now explicitly covered with proximity thresholds defined and a listing of sensitive US government installations.

While these core aspects of the post-FIRRMA CFIUS landscape carry over from the Proposed Rules to the Final Rules, there are some new additions:

#### Key issues

- U.S. Treasury Department issues Final Rules to implement FIRRMA changes to CFIUS
- Expanded CFIUS jurisdiction from Proposed Rules remain in Place
- CFIUS adopts "Nerve Center" test for transactions by investment funds.
- Australia, Canada, and the UK become the first Excepted Foreign States.
- Final Rule relaxes requirements for Excepted Foreign Investors.
- Critical Technology Pilot Program transitions into mainline CFIUS regulations.

## **CLARITY FOR PRIVATE EQUITY AND VENTURE CAPITAL**

One of the pressing topics for commenters on the Proposed Rules was the need for clarification regarding CFIUS' jurisdiction over transactions by investment funds, with some commenters recommending redefining "foreign entity" to focus on control by foreign persons, rather than the amount of equity held by foreign persons.

In addressing these comments, the Treasury Department took a different approach, adding to the rules a definition for "principal place of business," which was present in the previous versions of the CFIUS regulations but left undefined. The Final Rules adopt the "nerve center" test used in federal courts, defining 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."*

Under this approach, the management of a private equity or venture capital fund will determine whether a transaction is within CFIUS' jurisdiction – with U.S.-managed funds being excluded regardless of whether the fund's equity is held by non-U.S. persons. In addition, the definition of "substantial interest" as it relates to a foreign government's interest in an investment fund is limited only to the general partner – not any of the limited partners.

However, investors should note that there are circumstances in which a limited partner may have a filing obligation – for example if it receives access to material non-public technical information.

## **THREE OF THE FIVE EYES ARE EXCEPTED FOREIGN STATES**

The Proposed Rules provided for a system of "Excepted Investors" from "Excepted Foreign States" that could be exempt from CFIUS' expanded jurisdiction over investments in TID U.S. businesses. The Final Rules have identified Australia, Canada, and the United Kingdom as the first Excepted Foreign States, citing their *"robust intelligence sharing and defense industrial base integration mechanisms"* with the United States. While the Final Rules state that CFIUS has not made a determination on whether these countries have a *"robust process to analyse foreign investments for national security risks"* as required under §801.1001, these countries have existing mechanisms for reviewing foreign direct investment. Notably, these countries are three of the "Five Eyes" – the intelligence sharing alliance with the United States that also includes New Zealand. Pre-FIRREA hopes of a broad "white list" for countries with which the U.S. has a mutual defense treaty are likely extinguished. CFIUS has indicated that the list may be expanded in the future but that the number of eligible foreign states will be limited because of the "significant implications" of the list for national security review.

## "RELAXED" CRITERIA FOR EXCEPTED INVESTORS

In addition to the designation of Excepted Foreign States, CFIUS also loosened the criteria for entities to become Excepted Investors. Several commenters had noted that the Proposed Rules' requirements were too stringent – requiring 100% of an investor's board to be U.S. or Excepted Foreign State nationals, among other requirements. The Final Rules provide that for Excepted Investors:

- Up to 25% of an investor's board can be made up of nationals of neither the U.S. or an Excepted Foreign State.
- Any investor that holds 10% or more of the voting or economic interests in the entity must be a national of either the U.S. or an Excepted Foreign State.
- The Minimum Excepted Ownership of the entity is at least 80%.

## PILOT PROGRAM INCORPORATED

The final major change in the Final Rules is that the inclusion of Critical Technology Pilot Program's mandatory filing rule for transactions involving critical technology. In addition, the Pilot Program will now only apply to transactions for which specified actions were taken between November 18, 2019 and February 13, 2020. Critically, the Final Rule indicates that CFIUS will be shifting away from using North American Industry Classification System ("**NAICS**") codes to identify TID industries, but will instead be using export control licensing requirements. That change will be addressed in a separate notice of proposed rulemaking.

## OTHER ADJUSTMENTS AND LINGERING ISSUES

- The Final Rule expands the "incremental acquisition rule" to apply to transactions made subsequent to a covered control transaction submitted to CFIUS via declaration and where CFIUS has concluded action based on that declaration.
- The abbreviated declaration process will now be available for all transactions.
- Filing of a declaration or notice will be mandatory for covered transactions where a foreign government is acquiring a "substantial interest" in certain U.S. businesses, as well as covered transactions involving a TID U.S. business.
- For its Real Estate jurisdiction, CFIUS has stated that the public should rely on existing tools and that additional tools will be made available to resolve existing ambiguity.
- CFIUS has provided a broader exception for retail services which now apply to "leases and concessions of real estate that may be used only for the purposes of engaging in the retail sale of consumer goods or services to the public".
- Filing fees will be dealt with in a subsequent rulemaking process.

## **CONCLUSIONS**

As with the Proposed Rules, the Final Rules reflect a new era for companies and investors in how they navigate CFIUS risk. While open questions still remain, the Final Rules provide significant guidance as companies decide whether and when to file with CFIUS. Furthermore, the Final Rule's introduction of the first Excepted Foreign States could accelerate growing global trends towards national security-based controls on foreign direct investment. Finally, CFIUS' indication it will be basing technology assessments on export control regulations rather than NAICS codes shows that the linkages between CFIUS and export control reform will only become stronger. The upcoming Commerce Department controls on Emerging and Foundational technologies could be the next focal point in this area.

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