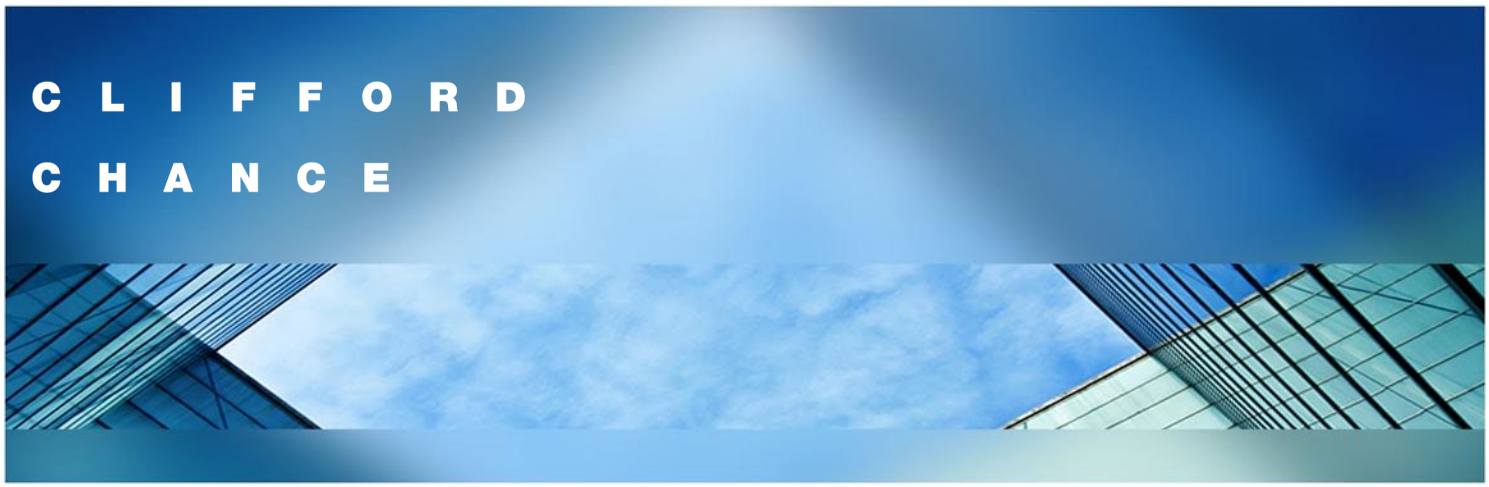


# CFIUS RULE CHANGES FOR MANDATORY FILINGS FOR CERTAIN TRANSACTIONS INVOLVING US BUSINESSES WITH CRITICAL TECHNOLOGIES AND INVOLVING FOREIGN GOVERNMENTS

The US Department of the Treasury has issued a Proposed Rule that modifies the mandatory filing provisions regarding investments in US businesses that produce, design, test, manufacture, fabricate, or develop critical technologies and for transactions involving foreign governments. These mandatory filing requirements were previously part of the "Critical Technology Pilot Program" until incorporated into CFIUS' regulations in February 2020. The Final Rule announcement for the current CFIUS regulations previewed this switch to export control licensing requirements that highlights the major change for mandatory filings under the Proposed Rule. Given the likelihood that the Proposed Rule ultimately becomes final, it is essential that US businesses that may seek non-US investors confront the export control compliance challenges that will come with the changes to the mandatory filing framework. As such, it is important to begin planning now for this development.

Under current regulatory requirements, CFIUS requires that parties to a transaction submit a mandatory filing to CFIUS if a non-US entity invests in a US business that produces, designs, tests, manufactures, fabricates, or develops a "critical technology" utilized in connection with one or more of 27 industries identified by their North American Industry Classification System ("**NAICS**") code, among other factors.

The Proposed Rule revises the mandatory filing requirement for critical technology transactions to no longer be based on NAICS codes. Instead, the Proposed Rule focuses on whether certain "US Regulatory Authorizations", such as licenses under the ITAR or EAR, would be required to export, re-export, transfer (in country), or retransfer the critical technology or technologies that the US business

produces, designs, tests, manufactures, fabricates, or develops to certain non-US entities involved in the transaction or in the ownership chain. ITAR Exemptions and EAR License Exceptions are considered regulatory authorizations for the purposes of this analysis, with only limited allowances for EAR exceptions STA, ENC, and TSU.

Under 31 CFR § 800.401(c), a non-US entity would trigger this US regulatory authorization's analysis in a transaction involving a critical technology US business if the non-US entity:

1. Could directly control the US business as a result of the transaction;
2. Is conducting a "covered investment" where the non-US entity is directly acquiring any of the following interests in the US business:
    a. Access to material nonpublic technical information of the US business;
    b. Membership or observer rights on, or the right to nominate an individual to a position on, the board of directors of the US business; or
    c. Any involvement, other than through voting of shares, in substantive decision-making of the US business regarding critical technology, critical infrastructure or sensitive personal information;
3. Is a party to any transaction, transfer, agreement or arrangement designed to evade CFIUS jurisdiction regarding the US business;
4. Individually holds, or is part of a group of non-US entities that, in the aggregate, holds, a direct or indirect voting interest of 25% or more in a non-US entity described in items 1,2,3, or 5 of this section; or
5. Already has a direct investment in the US business, but the rights of such non-US entity with respect to the US business are changing and such change in rights could result in a transaction described in the previous four items.

The Proposed Rule will effectively increase the export control compliance challenges for transaction parties – particularly in instances where multiple foreign states may be at issue and therefore increase the complexity of the end use and end user analysis.

Additionally, the Proposed Rule amends the definition of "substantial interest" for purposes of mandatory filings regarding transactions involving foreign governments. Under current regulatory requirements, CFIUS requires a mandatory filing for transactions where a non-US entity obtains a "substantial interest" in a TID US business, and a foreign government (other than excepted foreign governments, currently the UK, Australia, and Canada) has a "substantial interest" in that non-US entity. The definition of "substantial interest" applies, with respect to a foreign government's interest in an acquiring non-US entity organized as a partnership or similar entity, when the foreign government holds at least 49% of the general partner, managing member, or equivalent of that non-US entity. The new rule would narrow the definition by applying it only when the general partner

or equivalent entity primarily directs, controls, or coordinates the activities of the acquiring non-US entity.

In addition, for purposes of transactions involving foreign governments, the current rule states that any "voting interest" held by a parent entity in a subsidiary entity will be deemed to be 100%. The Proposed Rule would remove the term "voting" to clarify that this stipulation applies to entities organized as both corporations (and equivalent entities) and partnerships (and equivalent entities).

Consistent with the current regulatory framework, qualifying investors from Australia, Canada and the UK can still avoid CFIUS mandatory filing and standard jurisdiction requirements entirely for non-controlling transactions and real estate investments.

The Proposed Rule marks another important step in the US government's effort to tighten the regulatory framework governing certain types of foreign investments. As mentioned previously, the Critical Technology Pilot Program of October 2018 was the first step by the Treasury Department in implementing parts of the Foreign Investment Risk Review Modernization Act ("**FIRRMA**") and expanding CFIUS' jurisdiction. (See our previous alerter on this topic here). This was followed by the Proposed Rules in September 2019 (see previous alerter here) and the Final Rules in January 2020 (see previous alerter here) that further implemented FIRRMA's CFIUS expansion, going into effect in February 2020. Once again, Treasury and its partner agencies have placed non-US investors, and those involved in such transactions, on notice that such investments will get heightened scrutiny, again putting a premium on pre-transaction due diligence as it relates to CFIUS and other export control regulations.

Comments on the Proposed Rule close on June 22, 2020. The current rules for mandatory filings will remain in effect until Treasury publishes a final rule. The Proposed Rule can be accessed here.

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