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Proposed CFIUS Regulations Draw Questions on Foreign Investment Definitions, Enforcement

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On October 17, 2019, the public comment period closed on the proposed regulations implementing certain provisions of the Foreign Investment Risk Review Modernization Act ("FIRRMA") aimed at evaluating foreign investments in U.S. businesses and issued by the Department of the Treasury as chair of the Committee on Foreign Investment in the United States ("CFIUS"). The comments demonstrate significant interest from private equity investors and companies, as well as industry trade groups, foreign government agencies, and law firms about the scope and potential impacts of the proposed regulations. CFIUS will consider the comments when drafting the final implementing regulations, which must become effective no later than February 13, 2020.

Many comments focused on the potential breadth and perceived ambiguities and gaps of the provisions, requesting clarification and further guidance from CFIUS on implementation and enforcement. We summarize below the most pressing open questions that CFIUS will need to consider when drafting its final rules.

Do the proposed regulations materially expand the definition of a "U.S. Business"?

While the proposed regulations delete the limiting language of the existing definition of a U.S. Business (i.e., any entity "engaged in interstate commerce in the United States, but only to the extent of its activities in interstate commerce"), Treasury explained that this change was merely intended to conform with the statutory definition in FIRRMA.

In its public comments, the House Committee on Financial Services (the "Financial Services Committee") specifically noted that Congress intended to keep CFIUS' jurisdiction limited to the portion of a transaction with a clear nexus to interstate commerce. To date, neither CFIUS nor Congress has expressed a clear intention to expand CFIUS' jurisdiction to include any portion of cross-border transactions that does not otherwise involve interstate commerce in the U.S.

As a result, it would be surprising if the final regulations included any material change to this definition.

What countries will be "excepted" from CFIUS' expanded jurisdiction?

Commenters expressed significant interest in CFIUS' forthcoming list of "excepted states," which Treasury confirmed would not be a "null set." A common suggestion was to exempt all military allies (e.g., NATO members, states involved with the Foreign Assistance Act) and traditional economic allies (e.g., non-NATO European Union members and European Free Trade Association states).

As an alternative, some commenters recommended incorporating by reference an existing U.S. government list based on specific criteria for inclusion. The Financial Services Committee echoed these recommendations in its comments. Unsurprisingly, many interested countries (including Sweden, Japan, Singapore, Canada and the U.K.) advocated for their inclusion on the excepted states list. China, for its part, requested that all foreign states be treated equally by CFIUS.

Given CFIUS' historic emphasis on analyzing transactions on a case-by-case basis, we anticipate that the initial list of excepted states is likely to be short.

Can CFIUS expand the current definition of "Excepted Investor"?

Commenters explained the difficulty of ensuring that every board member was either a U.S. person or a national from an excepted state. Alternative proposals included setting a lower threshold of board members that must meet this criteria, deeming that board members from allied countries that are not on the excepted states list meet the

requirement, and not considering a board member with dual nationality from a non-excepted state to have caused the board to violate the requirement.

Many commenters also suggested that CFIUS lower the ownership threshold of companies not traded on a U.S. stock exchange that must be owned by U.S. persons or persons from an excepted state. The Financial Services Committee emphasized that "hurdles to qualify as an excepted foreign investor are inconsistent with Congressional intent."

When can U.S.-controlled investment funds be deemed "foreign" for CFIUS purposes?

The proposed regulations do not provide conclusive guidance regarding how CFIUS will treat U.S. investment funds with foreign limited partners. FIRRMA clarifies that an otherwise U.S.-controlled investment fund will not be deemed "foreign" for the purpose of CFIUS' jurisdiction simply because its advisory committee has foreign members, and the proposed regulations leave in place CFIUS' current treatment of standard minority shareholder protections (i.e., CFIUS will continue to evaluate whether such protections confer control on a limited partner on a case-by-case basis).

Commenters requested guidance on how a fund may ensure that foreign limited partners do not obtain control such that the U.S. investment fund would fall under CFIUS' jurisdiction. It appears that no bright-line tests are forthcoming, but CFIUS could issue additional examples to provide more guidance for U.S.-controlled funds.

Will CFIUS maintain or limit its current pilot program for critical technologies?

Commenters noted the apparent ambiguities in CFIUS' current pilot program and requested that CFIUS terminate the program, or, in the alternative, reduce its impact by creating a more specific list of technologies of interest. In particular, some commenters recommended exempting technology that relates to encryption items eligible for export under the Commerce Department's "License Exception ENC" (which broadly authorizes exports of certain encryption items).

Even if CFIUS terminates the pilot program, the committee would retain its expanded jurisdiction to review minority non-passive investments in companies involved with

critical technologies, but the decision to seek CFIUS review and approval would be voluntary.

What could be "material nonpublic technical information" that subjects an investment to CFIUS' jurisdiction?

Commenters expressed concern that the proposed regulations could deter foreign investment if investors are not able to receive adequate information to monitor the economic performance of their investments. Accordingly, some requested that this term be limited to information needed to reverse-engineer a product.

Will CFIUS narrow the definition of "sensitive personal data"?

Commenters recommended that CFIUS exclude de-identified data and anonymized genetic information. In a similar vein, the Financial Services Committee encouraged Treasury to tailor this definition to "real-world circumstances" and narrow it to focus on "credible national security threats."

Finally, commenters requested that CFIUS increase the threshold number of individuals on whom data is collected from one million to five million, and that CFIUS provide guidance on how to determine if data is "integrated" into a "primary" product or service. Any changes will be of particular importance to companies operating in the pharmaceutical and healthcare sectors.

Will CFIUS provide interactive maps or other online tools to clarify what property will be subject to the expanded real estate jurisdiction?

Several commenters requested clarity on what properties will be subject to CFIUS' expanded real estate jurisdiction and made requests for a list of criteria, maps or other interactive tools. Treasury is considering making a mechanism available to provide clarity on the geographic coverage of the proposed regulations. Such mechanisms would likely help provide investors and companies with more clarity.

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