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U.S. Treasury Department Issues Final Regulations to Implement CFIUS Reform

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On January 13, 2020, the U.S. Department of the Treasury ("Treasury") issued final regulations (the "Final Regulations") implementing certain provisions of the *Foreign Investment Risk Review Modernization Act* ("FIRRMA"). The Final Regulations supersede the proposed regulations implementing certain provisions of FIRRMA that Treasury issued on September 17, 2019 (the "Proposed Regulations"). While the Final Regulations generally hew closely to the Proposed Regulations, there are critical differences that may affect deal timing, certainty, feasibility and cost. Because the Final Regulations will take effect in just a few weeks — on February 13, 2020 — investors and companies must assess with urgency whether their near-term transactions may have potential new or different CFIUS considerations.

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The View from Washington

Passed in 2018 with broad bipartisan support, FIRRMA is the most significant reform of the Committee on Foreign Investment in the United States ("CFIUS") in its history. Except for a mechanism to adopt a filing fee, the Final Regulations fully implement all of the provisions of FIRRMA. The Final Regulations expand CFIUS' jurisdiction to cover two specific types of transactions that U.S. national security stakeholders had identified as posing potential national security risks: (i) non-controlling, non-passive

investments in U.S. businesses involved in specified ways with critical technologies, critical infrastructure or sensitive personal data ("TID U.S. Businesses"); and (ii) certain transactions involving real estate located in proximity to certain identified sensitive U.S. government locations.

Here are eight key things to know about the Final Regulations.

1. A new definition of "principal place of business" may provide some clarity to U.S. private equity sponsors that CFIUS will not have jurisdiction to review their investments solely based on the jurisdiction in which their investment vehicles are organized.

Under an interim rule that accompanied the Final Regulations, which also becomes effective on February 13, 2020, an investment fund's "principal place of business" is defined as the primary location 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. The interim rule helps to clarify that U.S. private equity sponsors will not be considered "foreign persons" whose investments are subject to CFIUS' jurisdiction simply because they invest through non-U.S. entities (e.g., Cayman limited partnerships), so long as investment decisions are primarily made in the U.S. and there are no foreign co-investors or other indicia of foreign "control."

2. Non-controlling foreign investments in certain U.S. businesses and transactions involving undeveloped real estate will be subject to CFIUS' expanded legal authority.

CFIUS will now have jurisdiction to review two additional types of transactions:

> i. "Covered investments," which the Final Regulations define as non-controlling, non-passive investments in a TID U.S. Business that afford a foreign investor any of the following rights:
>
> - Access to the TID U.S. Business' "material nonpublic technical information";
> - Membership or observer rights on, or the right to nominate a member to the board of directors of, the TID U.S. Business; or
> - Involvement in substantive decision-making related to sensitive personal data, critical technologies or critical infrastructure (e.g., the right to advise a decision-maker at a target company about business strategy).

ii. "Covered real estate transactions," which the Final Regulations define as the purchase or lease of undeveloped real estate located within close proximity (1 mile) or extended range (99 miles) of sensitive U.S. government installations identified in the Final Regulations.

3. The Final Regulations specifically exclude qualifying investors from Australia, Canada and the U.K. ("Excepted Foreign States") from CFIUS' newly expanded jurisdiction over covered investments and covered real estate transactions.

This is the first time that CFIUS has specifically exempted certain types of investors ("Excepted Investors") from its jurisdiction. CFIUS highlighted these countries' intelligence sharing and defense industrial base integration with the U.S. in support of their designation. The three countries will remain Excepted Foreign States until February 13, 2022, at which time CFIUS will evaluate whether each country has established, and is effectively utilizing, its own robust process to analyze foreign investments for national security risks, and whether each is facilitating coordination with the U.S. on investment security matters. With that said, CFIUS will continue to have jurisdiction over these investors' "control" transactions. Notably, New Zealand is the only member of the Five Eyes intelligence alliance not included in this initial list of Excepted Foreign States.

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4. While CFIUS relaxed the qualifications for Excepted Investors, determining individual investors' eligibility for exemption from CFIUS' newly expanded jurisdiction requires a highly technical assessment.

CFIUS' new jurisdiction to review covered investments and covered real estate transactions does not apply to Excepted Investors if, among other things:

- 75 percent (instead of 100 percent in the Proposed Regulations) of the foreign person's board members are nationals of the U.S. or Excepted Foreign States;

- Any foreign investor that holds 10 percent or more (instead of 5 percent or more in the Proposed Regulations) of the voting or economic interests in the foreign person is a national of an Excepted Foreign State; and
- At least 80 percent (instead of 90 percent in the Proposed Regulations) of the voting and economic interests in the foreign person are held by nationals of the U.S. or Excepted Foreign States.

5. The Final Regulations require certain transactions to be notified to CFIUS prior to closing, while providing important exemptions.

The Final Regulations require that two types of transactions must be notified to CFIUS prior to closing. These are:

i. Certain foreign investments in companies that fabricate, produce, manufacture, develop, test or design "critical technologies" with a nexus to one or more industries as identified by North American Industry Classification System ("NAICS") codes; and

ii. Certain foreign government investments in TID U.S. Businesses.

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Notably, the Final Regulations also provide exemptions from the mandatory declaration requirement for:

- Qualifying Excepted Investors;
- Investments in entities subject to Foreign Ownership, Control, or Influence ("FOCI") mitigation administered by the Department of Defense, Defense Counterintelligence and Security Agency ("DCSA");
- Investments in companies that qualify as TID U.S. Businesses only because they produce software that is controlled based on its encryption functionality.

Treasury left open the possibility of implementing a "waiver mechanism" that would exempt previously cleared investors in certain cases.

Moreover, Treasury anticipates issuing a new rule to identify investments in companies dealing in "critical technologies" by reference to export control licensing requirements, as opposed to NAICS codes, although it did not provide a timeline for this new rule.

6. The Final Regulations narrow the mandatory filing requirement for foreign government investments in TID U.S. Businesses that was set forth in the Proposed Regulations.

Investments involving a "substantial interest" by a non-excepted foreign government investor in a TID U.S. Business require submission to CFIUS of, at a minimum, a mandatory short-form "declaration." The Final Regulations define a "substantial interest" to mean the foreign person with the closest relationship to the U.S. business holds a 25 percent or greater direct or indirect voting interest in such business, and the foreign government holds a 49 percent or greater direct or indirect voting interest in the foreign person.

The Final Regulations clarify that a "substantial interest" in the private equity context requires the foreign government investor to have a 49 percent or greater interest in the general partner, as opposed to holding a limited partnership interest. Moreover, a single foreign government must hold such interest.

7. A voluntary 30-day short-form "declaration" process will be available for all transactions subject to CFIUS' jurisdiction, which may shorten the time required for the CFIUS review process.

The Final Regulations permit all transactions subject to CFIUS' jurisdiction to be notified to CFIUS through a short-form "declaration" in lieu of a traditional long-form "notice." The short-form declaration requires significantly less disclosure than a full notice, and the review period for a declaration is only 30 days. At the end of the 30-day review period, however, CFIUS can request that the parties file a full notice, which could extend the overall CFIUS process by several months. Transaction parties should carefully consider whether a voluntary declaration would shorten the overall CFIUS timeline for a particular deal, based on factors including CFIUS' familiarity with the parties, the size and complexity of the transaction, the sensitivity of the target U.S. business, and CFIUS' administrative backlog.

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8. Filing fees are still pending.

The Final Regulations do not require that transaction parties pay filing fees for CFIUS reviews. Instead, Treasury indicated that it will publish a separate proposed rule implementing CFIUS' fee authority at a later date.

Key Takeaways

- **U.S. private equity sponsors that utilize non-U.S. investment vehicles may now have more clarity on how CFIUS may impact their transactions.** If adopted in its proposed form, the proposed definition of "principal place of business" would give many U.S. private equity sponsors greater comfort that their buy-side transactions utilizing non-U.S. investment vehicles will not be subject to CFIUS review, absent participation by foreign co-investors or other indicia that the U.S. sponsor is "controlled" for CFIUS purposes by a foreign person.
- **Qualifying investors from Australia, Canada and the U.K. will be exempt from CFIUS' newly-expanded jurisdiction over covered investments and covered real estate transactions.** Notably, the qualifying investors from these countries will remain subject to CFIUS' historic jurisdiction over control transactions.
- **New types of transactions will be subject to mandatory CFIUS filing requirements.** In particular, parties to transactions involving foreign government investors (e.g., as co-investors) should assess whether such transactions may now require a CFIUS filing.
- **More changes are coming.** Treasury anticipates issuing two additional proposed rules on (i) CFIUS filing fees that may be imposed; and (ii) revisions to the current mandatory filing requirement for certain investments in U.S. "critical technology" companies.

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Faith Dibble was also a contributing author to this publication (*Not admitted to practice law, practice is supervised by principals of the rm).*

Authors

Mario Mancuso, P.C.

Partner / Washington, D.C. / New York

Shawn B. Cooley

Partner / Washington, D.C.

Lucille Hague

Associate / Washington, D.C.

J. Matthew O'Hare

Associate / Washington, D.C.

William G. Phalen

Associate / Boston

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