February 27, 2020

Final CFIUS Regulations Implementing the Foreign Investment Risk Review Modernization Act of 2018 Are Now in Effect

On February 13, 2020, final regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") (which became law on August 13, 2018) [1] went into effect. On January 13, 2020, the Treasury Department released both sets of final regulations, along with a press release, a fact sheet, and a set of frequently asked questions ("FAQs").[2] These final regulations (collectively, the "new regulations") follow proposed regulations to implement FIRRMA, which were released by the Treasury Department on September 17, 2019, with a public comment period that closed on October 17, 2019.[3]

Key takeaways from the new regulations are as follows:

1. Although the interagency Committee on Foreign Investment in the United States ("CFIUS") made some technical changes to the proposed regulations in response to public comments, the new regulations are in most respects quite similar to the proposed regulations.

2. At the time the proposed regulations were issued, CFIUS deferred a decision concerning what to do with the CFIUS pilot program regulations, which went into effect on November 10, 2018 (and can be found at 31 CFR part 801). Specifically, CFIUS at the time deferred a decision whether to maintain the pilot program's mandatory filing requirement with respect to foreign acquisitions of control over, as well as certain non-controlling, non-passive foreign investments in, U.S. businesses that involve critical technology in certain industry sectors, regardless of what country the foreign investor is based or

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1 Our prior memorandum on the adoption of FIRRMA can be found here: https://www.paulweiss.com/practices/transactional/mergers-acquisitions/publications/president-trump-signs-cfius-reform-legislation?id=26899.

2 These Treasury Department materials can be found here: https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius.

3 Our prior memorandum on the release of the proposed regulations can be found here: https://www.paulweiss.com/practices/transactional/mergers-acquisitions/publications/cfius-issues-proposed-regulations-for-implementation-of-the-foreign-investment-risk-review-modernization-act-of-2018?id=29888.

organized in.[4] With minor technical changes, CFIUS decided in the new regulations to maintain this mandatory filing requirement (which is not required by FIRRMA).

3. At the time the proposed regulations were issued, CFIUS also deferred a decision concerning how to use its new authority under FIRRMA to impose fees for filing notices with CFIUS, with the Treasury Department indicating that it would publish separate proposed regulations regarding fees at a later date. With the release of the new regulations, the Treasury Department has re-published essentially the same statement, with no guidance concerning timing or expected content.

4. In the new regulations, CFIUS made one change that was substantive enough for CFIUS to issue it in the form of an interim rule rather than a final regulation – namely, the inclusion for the first time of a definition for "principal place of business." While the Treasury Department described the rationale for this new definition in business friendly terms, this definition is likely to make it harder for some U.S.-based private equity firms to take the position that their offshore funds are not foreign persons for CFIUS purposes. Although this new definition went into effect along with the new regulations on February 13, 2020, the Treasury Department accepted public comments on this definition through February 18, 2020.

I. Background

Prior to the enactment of FIRRMA, the jurisdiction of CFIUS – and the related ability of the President to block or unwind a transaction – was limited to acquisitions, investments, and joint ventures that could result in foreign control over any U.S. business, direct or indirect (referred to as "covered control transactions" in the new regulations). Subject to implementing regulations, FIRRMA expanded the range of transactions subject to CFIUS jurisdiction to include certain non-controlling, non-passive investments by foreign persons in U.S. businesses that involve critical technology, critical infrastructure, or the maintenance or collection of sensitive personal data of U.S. citizens (referred to as "TID U.S. businesses" in the new regulations). As was true of the proposed regulations, the new regulations implement this new authority under FIRRMA by expanding existing Treasury Department regulations found at 31 CFR part 800 – which previously covered just acquisitions, investments, and joint ventures that could result in foreign control over any U.S. business – so that these regulations ("the new investment regulations") also cover certain non-controlling, non-passive investments in TID U.S. businesses (referred to as "covered investments" in the new regulations). As was also true of the proposed regulations, the new investment regulations implement the requirement in FIRRMA that a mandatory filing requirement be imposed for

[4] Our prior memorandum on the adoption of the CFIUS pilot program regulations can be found here: https://www.paulweiss.com/practices/transactional/mergers-acquisitions/publications/cfius-adopts-pilot-program-that-imposes-mandatory-filing-requirement?id=27722.

covered control transactions and covered investments that result in the acquisition of a substantial interest in a TID U.S. business by a foreign person in which a foreign government has a substantial interest.

Again subject to implementing regulations, FIRRMA also expanded CFIUS jurisdiction to cover the purchase or lease by a foreign person of real estate located either (i) at an airport or maritime port or (ii) in close proximity to a U.S. military base or other U.S. government facility that is sensitive from a national security perspective. Prior to the adoption of FIRRMA, CFIUS could only review an acquisition of real estate if it was part of a transaction that could result in control by a foreign person of a U.S. business. As was true in the proposed regulations, rather than add this new authority to the existing CFIUS regulations, the Treasury Department has added a new part 802 to title 31 of the CFR (the "new real estate regulations"). In doing so, the Department said it had "determined that the technical and procedural aspects of CFIUS's review of transactions involving real estate are sufficiently distinct from those related to control transactions and [covered] investments to warrant separate rulemaking."

II. Expansion of CFIUS Jurisdiction to Cover Certain Non-Passive, Non-Controlling Investments by Foreign Persons in TID Businesses

Under the new investment regulations, CFIUS jurisdiction is extended to any "covered investment," which is defined as a non-controlling investment by a foreign person, direct or indirect, in an unaffiliated TID U.S. business that (i) is proposed or pending on or after February 13, 2020 and (ii) affords the foreign person one of the following:

1. access to any material nonpublic information[5] in the possession of the TID U.S. business;

2. membership or observer rights on the board of directors or equivalent governing body of the TID U.S. business or the right to nominate an individual to such a position; or

3. any involvement,[6] other than through voting of shares, in substantive decision-making of the TID U.S. business regarding (a) the use, development, acquisition, safekeeping, or release of sensitive personal data of U.S. citizens maintained or collected by the TID U.S. business, (b) the use, development,

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5 The new investment regulations define "material nonpublic information" as information that is not available in the public domain and that (i) provides knowledge, know-how, or understanding of the design, location, or operation of covered investment critical infrastructure, including vulnerability information such as that related to physical security or cybersecurity; or (ii) is necessary to design, fabricate, develop, test, produce, or manufacture a critical technology, including processes, techniques, or methods.

6 "Involvement" is broadly defined in the new investment regulations. It means the right or ability to participate, whether or not exercised, including the right or ability to (i) provide input into a final decision, (ii) consult with or provide advice to a decision-maker, (iii) exercise special approval or veto rights, (iv) participate on a committee with decision-making authority, or (v) advise on the appointment of officers or the selection of employees who are engaged in substantive decision-making.

acquisition, or release of critical technologies, or (c) the management, operation, manufacture, or supply of covered investment critical infrastructure.

Despite meeting these qualifications, the following two transactions are not covered investments, and therefore are not subject to CFIUS jurisdiction: (i) a non-controlling investment in an air carrier; and (ii) a non-controlling investment by an "excepted investor" (discussed below).

Based on the guidance provided in FIRRMA, the new investment regulations identify three types of TID U.S. businesses:

1. Critical Technology Businesses

The first type of business that constitutes a TID U.S. business under the new investment regulations is a U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies. Critical technologies are defined in a manner similar to the pilot program regulations – namely, (i) items that fall on the U.S. Munitions List, (ii) items that are controlled under the Export Administration Regulations pursuant to multilateral export control regimes or for reasons related to regional stability or surreptitious listening, (iii) nuclear-related items controlled by the Department of Energy or the Nuclear Regulatory Commission, (iv) select agents and toxins regulated under 7 CFR part 331, 9 CFR part 121, or 42 CFR part 73, or (v) emerging or foundational technologies controlled under the Export Administration Regulations.

An interagency group led by the Commerce Department is currently working to identify and control emerging and foundational technologies, pursuant to the Export Control Reform Act of 2018. A proposed set of regulations identifying and controlling emerging technologies was expected to be released by the end of 2019, but it has still not emerged. This regulatory process, together with the subsequent regulatory process to identify and control foundational technologies, has the potential to substantially expand the range of businesses that will constitute TID businesses under the new investment regulations.

It should also be noted that the range of critical technology businesses that will trigger CFIUS jurisdiction under the new investment regulations is broader than the range of critical technology businesses that will trigger a mandatory filing under these regulations. As was true under the pilot program regulations, and as suggested above, only U.S. businesses that are using critical technologies in connection with certain identified U.S. industries will trigger a mandatory CFIUS filing in the event that a foreign person engages in a covered control transaction or a covered investment with respect to such a business. Moreover, the new investment regulations introduce certain exceptions to this mandatory filing requirement that did not appear in the pilot program regulations. Specifically, the following transactions do not trigger this mandatory filing requirement:

(i) a covered control transaction by an "excepted investor" (discussed below);

(ii) a covered transaction in which the foreign person's indirect investment in a TID U.S. business is held solely and directly via an entity that (i) is operating under a valid U.S. government security clearance and (ii) is subject to a foreign ownership, control, or influence ("FOCI") mitigation agreement approved under the National Industrial Security Program regulations;

(iii) a covered control transaction involving an air carrier that holds a certificate issued under 49 USC 41102;

(iv) a covered transaction involving a TID U.S. business that qualifies as a TID U.S. business solely because it produces, designs, tests, manufactures, fabricates, or develops critical technologies eligible for export under License Exception ENC (related to certain encryption products, software, and technology); and

(v) a covered transaction by an investment fund if

- the fund is managed exclusively by a general partner, managing member, or equivalent;
- the general partner, managing partner, or equivalent is either (a) not a foreign person or (b) ultimately controlled exclusively by U.S. nationals;
- no foreign person has the ability to (a) approve, disapprove, or otherwise control investment decisions of the investment fund, (b) approve, disapprove, or otherwise control decisions by the general partner, managing member, or equivalent related to entities in which the investment fund is invested, or (c) unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing partner, or equivalent; and
- where any foreign person serves as a limited partner on an advisory board or committee of the investment fund, the advisory board or committee does not have the ability to approve, disapprove, or otherwise control (a) investment decisions of the investment fund or (b) decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested.

2. *Critical Infrastructure Businesses*

The new investment regulations effectively adopt two definitions of a critical infrastructure business, one to be used in connection with covered control transactions and one to be used in connection with covered investments. For the former purpose, the new investment regulations set forth a definition that is nearly identical to the prior CFIUS definition of "critical infrastructure" –

namely, "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security." The approach to critical infrastructure for purposes of a covered investment under the new regulations is much narrower and more specific. The re-write of 31 CFR Part 800 contains an appendix listing 28 industry sectors that are identified as "covered investment critical infrastructure" in such areas as telecommunications, utilities, energy, transportation, and financial services, and then specifies one or more functional relationships that a U.S. business must have to such critical infrastructure (commonly involving owning or operating, but in some cases involving manufacturing or servicing) in order to qualify as a TID U.S. business. For example, any internet exchange point that supports public peering is considered to be covered investment critical infrastructure, but a U.S. business must own or operate such an internet exchange point in order to qualify as a TID U.S. business.

3. Sensitive Personal Data Businesses

Under the new investment regulations, a U.S. business that maintains or collects, directly or indirectly, personal data of U.S. citizens would qualify as a TID U.S. business if (i) the data consists of the results of genetic tests on individuals, or (ii) if all of the following apply:

(i) the data collected or maintained by the U.S. business is identifiable data – i.e., data that can be used to distinguish or trace an individual's identity;[7]

(ii) the U.S. business (a) targets or tailors products or services to any U.S. executive branch agency or military department with intelligence, national security, or homeland security responsibilities, or to personnel or contractors thereof, (b) has maintained or collected identifiable data on greater than one million individuals at any point over the 12 months preceding the earlier of the transaction agreement execution date, the date on which a notice or declaration is filed with CFIUS, or the date on which another specified event occurs, or (c) has a demonstrated business objective to maintain or collect identifiable data on greater than one million individuals and such data is an integrated part of the U.S. business's primary products or services; and

(iii) the data falls into one of a number of categories specified in the new investment regulations, which include (a) data that can be used to analyze or determine an individual's financial distress or hardship, (b) data relating to the physical, mental, or psychological health condition of an

[7] This would include aggregated or anonymized data if any party to the transaction has, or will have as a result of the transaction, the ability to disaggregate or de-anonymize the data.

individual, (c) geolocation data, (d) biometric enrollment data, and (e) data concerning U.S. government personnel security clearances.

However, the following types of data will not qualify as sensitive personal data for these purposes: (i) data collected or maintained by a U.S. business concerning its own employees unless the data relates to employees of U.S. government contractors who hold U.S. government personnel security clearances; or (ii) data that is a matter of public record, such as court records or other government records that are generally available to the public.

III. New Mandatory Filing Requirement for Certain Foreign Government-Linked Acquisitions and Investments

Subject to implementing regulations, FIRRMA imposed a mandatory filing requirement with respect to any investment that results in the acquisition, directly or indirectly, of a substantial interest in what CFIUS now calls a TID U.S. Business by a foreign person in which a foreign government has, directly or indirectly, a substantial interest. The new investment regulations implement these FIRRMA provisions by requiring transaction parties to make a mandatory CFIUS filing – either a short-form declaration or a traditional notice, at the discretion of the parties – whenever a covered control transaction or covered investment results in the acquisition of a substantial interest in a TID U.S. business by a foreign person in which a foreign government has a substantial interest. These regulations define "substantial interest" to mean (i) a voting interest, direct or indirect, of 25 percent or more in a U.S. business by a foreign person and (ii) a voting interest, direct or indirect, of 49 percent or more in a foreign person by the national or subnational governments of a single foreign state. As is true for the mandatory filing requirement related to critical technologies, failure to comply with this new foreign government-linked mandatory filing requirement could lead to a civil penalty against both the buyer and the seller up to $250,000 or the value of the transaction, whichever is greater. However, the new investment regulations (unlike the proposed regulations) provide an exception to this new mandatory filing requirement where the relevant foreign state is an "excepted foreign state" (discussed below) – which currently includes only Canada, the United Kingdom, and Australia.

Where the foreign person making the investment in the U.S. business is a limited partnership, the proposed regulations set forth a puzzling description of what constituted a substantial interest on the part of a foreign government. Specifically, the proposed regulations provided that a foreign government would be considered to have a substantial interest in such a limited partnership if the foreign government (i) held 49 percent or more of the voting interest in the general partner or (ii) was a limited partner that held 49 percent or more of the voting interest of the limited partners. The new investment regulations eliminate this odd approach and focus solely on the general partner or the equivalent. Specifically, these regulations provide that, in the case of a foreign person that has a general partner, managing member, or the equivalent, the national or subnational governments of a single foreign state will be considered to have a substantial

interest in that foreign person only where those governments hold 49 percent or more of the interest in the general partner, managing member, or the equivalent.

As with the proposed regulations, and as driven by the language of FIRRMA itself, the new investment regulations also provide an exception to the mandatory filing requirement for investments by investment funds where the 25 percent and 49 percent thresholds are exceeded. Specifically, the new regulations provide that the mandatory filing requirement will not apply to an investment fund that is a foreign person where the investment fund meets each of the following criteria:

1. fund is managed exclusively by a general partner, managing member, or equivalent;

2. the general partner, managing member, or equivalent is not a foreign person;

3. no foreign person has the ability to (a) approve, disapprove, or otherwise control investment decisions of the investment fund, (b) approve, disapprove, or otherwise control decisions by the general partner, managing member, or equivalent related to entities in which the investment fund is invested, or (c) unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing partner, or equivalent; and

4. where any foreign person serves as a limited partner on an advisory board or committee of the investment fund, the advisory board or committee does not have the ability to approve, disapprove, or otherwise control (a) investment decisions of the investment fund or (b) decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested.

IV. Expansion of CFIUS Jurisdiction to Cover Certain Real Estate Transactions

FIRRMA extended CFIUS jurisdiction to cover the purchase or lease by, or a concession to, a foreign person of private or public real estate that is located in the United States and (i) is, is located within, or will function as a part of, an airport or maritime port or (ii) is in close proximity to a U.S. military installation or another facility or property of the U.S. government that is sensitive for national security reasons (referred to as "covered real estate" in the new real estate regulations). FIRRMA also provided CFIUS with broad discretion in determining how best to implement this expansion of its jurisdiction. CFIUS has exercised this discretion by expanding its jurisdiction in different ways depending on the location of the real estate in question, but with no mandatory filing requirement.

The new real estate regulations cover only "pure" real estate transactions. In other words, if a real estate interest is conveyed as part of an acquisition of control over, or a non-passive, non-controlling investment in, a U.S. business by a foreign person, the new investment regulations apply to the transaction. It should be noted, however, that transactions covered by the new real estate regulations can occur by means of certain M&A activity; in particular, if one non-U.S. company proposes to acquire another non-U.S. company

and the target company has no U.S. business but does have covered real estate in the United States, this acquisition will fall under the new real estate regulations.

With certain exceptions (described below), the new real estate regulations extend CFIUS jurisdiction to any purchase or lease by, or concession to, a foreign person of covered real estate that affords a foreign person at least three of the following property rights: (i) to physically access the real estate; (ii) to exclude others from physically accessing the real estate; (iii) to improve or develop the real estate; or (iv) to attach fixed or immovable structures or objects to the real estate (referred to as a "covered real estate transaction" under the new real estate regulations).

The new real estate regulations define "covered real estate" to mean real estate that meets any of the following criteria:

1. is, is located within, or will function as part of a "covered port"[8];

2. is located within one mile of approximately 130 military installations or other U.S. government properties identified in Part 1 of Appendix A to the new real estate regulations (such as the Biometric Technology Center in Clarksburg, West Virginia, the Defense Advanced Research Projects Agency in Arlington, Virginia, or the Cheyenne Mountain Air Force Station in Colorado Springs, Colorado);

3. is located within 100 miles of approximately 30 military installations identified in Part 2 of Appendix A to the new real estate regulations (such as the Aberdeen Proving Ground in Aberdeen, Maryland, Vandenberg Air Force Base in Lompoc, California, or the Yuma Proving Ground in Yuma, Arizona), but not exceeding the outer limit of the territorial sea of the United States;

4. is located within one of the approximately 50 counties or other geographic areas associated with U.S. Air Force ballistic missile fields and identified in Part 3 of Appendix A to the new real estate regulations (such as Cheyenne County, Nebraska or Cascade County, Montana); or

5. is part of approximately 25 U.S. Navy offshore ranges and operating areas identified in Part 4 of Annex A to the new real estate regulations (such as the Gulf of Mexico Range Complex located offshore of

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[8] This term covers any airport that is (i) a "large hub airport" (i.e., a commercial service airport that accounts for at least one percent of annual passenger boardings by revenue in the United States) or an airport with annual aggregate all-cargo landed weight greater than 1.24 billion pounds, in each case based on the most recent data reported by the Federal Aviation Administration; or (ii) any "joint use airport" (i.e., an airport owned by the Department of Defense where military and civilian aircraft both make use of the airfield). This term also covers any maritime port that is (i) a strategic seaport within the National Port Readiness Network, as identified by the Department of Transportation's Maritime Administration; or (ii) a top 25 tonnage, container, or dry bulk port, as identified by the Department of Transportation's Bureau of Transportation Statistics.

Mississippi, Alabama, and Florida or the Southern California Range Complex located offshore of California), but only to the extent located within the limits of the territorial sea of the United States.

However, the new real estate regulations also exclude certain types of real estate transactions from CFIUS jurisdiction. These exceptions are as follows:

1. a purchase or lease by, or concession to, an "excepted real estate investor" of covered real estate (discussed below);

2. a purchase, lease, or concession of covered real estate that is within an urbanized area or urban cluster,[9] except where the real estate (i) is, is located in, or will function as part of a covered port or (ii) is located within one mile of military installations or other U.S. government properties set forth in Part 1 or Part 2 of Appendix A to the new real estate regulations;

3. a purchase, lease, or concession of covered real estate that is a single housing unit, including fixtures and adjacent land as long as the fixtures and land are incidental to the use of the real estate as a single housing unit;

4. the lease by or concession to a foreign person of covered real estate that is located within a covered port and that, according to the terms of the lease or concession, may be used only for the purpose of engaging in the retail sale of consumer goods or services to the public;

5. the lease by or concession to a foreign air carrier of covered real estate that is located within a covered port where the Transportation Security Administration has accepted the air carrier's security program, but only to the extent the lease or concession is in furtherance of its activities as an air carrier;

6. the purchase or lease by, or concession to, a foreign person of commercial office space within a multi-unit commercial office building if, upon completion of the transaction, (a) the foreign person and its affiliates do not, in the aggregate, hold, lease, or have a concession with respect to commercial space in the building that exceeds 10 percent of the total square footage of the commercial space of the building, and (b) the foreign person and its affiliates (counted separately) do not represent more than 10 percent of the total number of tenants in the building; and

7. the purchase, lease, or concession of land either (a) owned by an Alaska Native village, Native group, or Native Corporation (as those terms are defined in the Alaska Native Claims Settlement Act), or (b) held

[9] A statistical geographic area identified in the most recent U.S. Census as consisting of a densely settled core created from census tracts or blocks and contiguous qualifying territory will qualify as either an "urban cluster" or an "urbanized area" if it has a minimum population of 2,500 individuals.

in trust by the United States for American Indians, Indian tribes, Alaska Natives, or any of the entities listed in clause (a).

Since all filings with respect to covered real estate transactions are voluntary, it remains to be seen how many filings CFIUS will receive in this area. In the supplementary information related to the proposed real estate regulations (which are substantially similar to the final regulations), the Treasury Department estimated that it would receive on an annual basis 350 filings related to covered real estate transactions (consisting of 150 traditional notices and 200 short-form declarations). Regardless of how many filings the new real estate regulations generate in practice, these regulations are likely to have value in assessing covered control transactions that raise proximity issues, as CFIUS has for the first time provided a list of military and other U.S. government facilities where it views proximity as raising potential national security concerns, and has even provided a sense as to how it ranks those facilities from a national security perspective.

V. The Exception for Excepted Investors

FIRRMA provides that, for what CFIUS now calls covered investments and covered real estate transactions, CFIUS "shall specify criteria to limit [its expansion of jurisdiction] to certain categories of foreign persons, . . . [taking] into consideration how a foreign person is connected to a foreign country or foreign government, and whether the connection may affect the national security of the United States." As the Treasury Department acknowledged in its supplementary information related to the proposed regulations, the "proposed rule sets forth a narrow definition of [excepted investor] [excepted real estate investor] in the interest of protecting national security, in light of increasingly complex ownership structures, and to prevent foreign persons from circumventing CFIUS's jurisdiction." Although the new regulations make it slightly easier to qualify as an "excepted investor" or an "excepted real estate investor" – and thereby to fall outside CFIUS jurisdiction for covered investments and covered real estate transactions, respectively (but not for covered control transactions) – the requirements for qualifying remain challenging, and it is hard to envision many foreign persons being able to take advantage of these provisions. Moreover, if a foreign person qualifies as an excepted investor or excepted real estate investor at the time a transaction takes place but within three years after the transaction closes ceases to meet certain requirements for being an excepted investor, then CFIUS can retroactively assert jurisdiction over a covered investment or a covered real estate transaction by the formerly excepted investor.

In order to qualify as an excepted investor or excepted real estate investor, a foreign person must, among other things, be able to meet a number of criteria demonstrating substantial connections to a country that CFIUS has identified as an "excepted foreign state" (for covered investments) or an "excepted real estate foreign state" (for covered real estate transactions). As noted above, CFIUS has decided to identify only Canada, the United Kingdom, and Australia as excepted foreign states at this time. Moreover, under the new investment regulations, a country's status as an excepted foreign state will cease if CFIUS has not issued a determination by February 13, 2022 that the "foreign state has established and is effectively utilizing a

robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters related to investment security." The new real estate regulations contain similar language, except that the foreign state need only have made "significant progress toward establishing and effectively utilizing" such a robust process.

Given the challenges for foreign persons to qualify as excepted investors and excepted real estate investors, there is some room for skepticism concerning the degree to which these provisions will motivate other countries as intended. That said, qualifying as an excepted foreign state will clearly be helpful for covered investments and covered real estate transactions by foreign governmental entities (including sovereign wealth funds and similar government-linked investment entities). It may also be the case that some countries see a political benefit in being named to, and remaining part of, these two "white lists."

VI. Declarations Versus Notices

Prior to the new regulations going into effect, short-form declarations could be filed only for transactions that fell under the pilot program regulations. The new regulations will implement the provision in FIRRMA that transaction parties be able to choose between short-form declarations and traditional notices for any transaction subject to CFIUS jurisdiction. The advantages of filing a declaration are that (i) declarations are shorter and less labor-intensive filings than the traditional notices, (ii) once the declaration has been accepted as complete by the Treasury Department, CFIUS has only 30 days in which to respond, and (iii) the filing fees that are expected to be imposed by CFIUS will not apply to declarations.

Unfortunately, the potential advantages of filing a declaration are undercut by the broad discretion that CFIUS has in determining how it responds to the filing. At the end of the 30 days, while CFIUS is empowered under FIRRMA and the new regulations to clear the transaction, it is also empowered to (i) ask the parties to file a traditional notice (at which point significant time has been lost that could have been committed up front to drafting and submitting a notice); or (ii) not make a decision with respect to the transaction (at which point the parties have to decide for themselves whether to file a notice in order to obtain a decision and thereby obtain protection against potential future action by CFIUS). Under the CFIUS pilot program, only around a third of declarations have reportedly been resulting in clearances by CFIUS. Based on the broad discretion that CFIUS has and the manner in which CFIUS has been exercising its discretion to date, it seems likely that most transaction parties will choose to file declarations only where they are confident that a transaction will be easy to clear, and they are filing only because (i) a filing is mandatory for the transaction or (ii) the buyer is quite conservative and wants the protection of a decision by CFIUS.

VII. Other Issues for U.S.-Based Private Equity Firms

Leaving aside the introduction of a mandatory filing requirement for covered control transactions where there is the acquisition of a substantial interest in a TID U.S. business by a foreign person in which a foreign

government has a substantial interest, the new investment regulations generally left intact CFIUS's existing approach to covered control transactions. However, as in the proposed regulations, the new investment regulations include a change in the existing definition of "control" that, depending on how it is interpreted by CFIUS, could have an impact on when investment funds are considered to be under foreign control – and consequently could expand the scope of CFIUS jurisdiction over acquisitions of U.S. businesses by investment funds (or their portfolio companies). Both the old definition of "control" and the definition in the new investment regulations refers to the ability "to determine, direct, or decide important matters affecting an entity," and then provides examples of such matters. However, an example in the old definition that referred to "the appointment or dismissal of officers or senior managers" has been changed to refer to "the appointment or dismissal of officers or senior managers or, in the case of a partnership, the general partner." CFIUS considers the power "to determine, direct, or decide important matters" to include the ability to block such action. Consequently, where a foreign limited partner has sufficient voting power to block the removal of a general partner for cause, it is possible that the partnership – whether formed inside or outside the United States – might be considered, under the new investment regulations, to be under the control of this limited partner (despite the limited partner being passive in all other respects).

Another change that could present issues for U.S.-based private equity firms, as noted in the introductory section above, is the introduction of a definition for "principal place of business." Principal place of business is an important concept for CFIUS purposes because, under both the old regulations and the new investment regulations, if an offshore fund or its non-U.S. general partner has its principal place of business outside the United States, the fund or the general partner is considered a foreign person for CFIUS purposes, even if ultimate control is exercised by U.S. citizens based in New York City or elsewhere in the United States. In response to requests from some parties that commented on the proposed regulations, CFIUS added a definition for "principal place of business" that is similar to the nerve center test commonly used by U.S. courts (and also similar to the manner in which most CFIUS practitioners had interpreted this term in the absence of any CFIUS regulatory definition); but CFIUS then added a proviso that could present problems for some U.S.-based private equity firms.

Specifically, the new investment regulations define "principal place of business" as "the primary location where an entity's management directs, controls, or coordinates its activities, or, in the case of an investment fund, where the funds activities and investments are primarily directed, controlled, or coordinated by or on behalf of the general partner, managing member, or equivalent." However, these regulations also provide that, if the entity has represented in its most recent filing with any government (U.S. or non-U.S.) that "its principal place of business, principal office and place of business, address of principal executive offices, address of headquarters, or equivalent" is outside the United States, such representation will be controlling in determining that entity's principal place of business for CFIUS purposes "unless the entity can demonstrate that such location has changed to the United States since such submission or filing." Consequently, it has now become important for U.S.-based private equity firms that use offshore funds for U.S. investments to ensure that their filings with governmental entities (whether for tax or other reasons)

avoid identifying the principal place of business, principal office, or headquarters of the fund or any non-U.S. general partner as outside the United States.

VIII. Conclusions

In our client memorandum on the proposed regulations, we noted that the new regulations represented a substantial undertaking on the part of the Treasury Department and other CFIUS agencies, and that, given the limited period of time between the end of the public comment period and the FIRRMA deadline for having final implementing regulations in effect, it was likely that the final regulations would look quite similar to the proposed regulations. This has in fact turned out to be the case. CFIUS has made some technical changes to the regulations, some of which are helpful from a business perspective, others of which – such as the definition of "principal place of business" – could prove to be more troublesome.

Probably the disappointing element of the new regulations is CFIUS's decision to retain the mandatory filing requirement with respect to foreign acquisitions of control over, as well as certain non-controlling, non-passive foreign investments in, U.S. businesses that involve critical technology in certain industry sectors, regardless of what country the foreign investor is based or organized in. Whether CFIUS's announced intention to shift away from a mandatory filing requirement based on a nexus between critical technology U.S. businesses and specified industries identified by NAICS code, to a mandatory filing requirement "based upon export licensing requirements," will prove to be helpful remains to be seen. If CFIUS decides simply to eliminate the linkage to those specified industries, the range of transactions captured by this mandatory filing requirement will expand significantly.

In our client memorandum on the proposed regulations, we also noted that the Treasury Department had at the time estimated a substantial increase in filings with CFIUS when the new regulations went into effect, even without taking account of the mandatory filing requirement under the pilot program regulations – specifically, over four times the number of annual filings that CFIUS was receiving prior to the adoption of FIRRMA. Now that we know that the mandatory filing requirement introduced under the pilot program is being retained in the new regulations, the strain on CFIUS resources is likely to be significant, even with the increases in funding and personnel under FIRRMA. As we noted back in October 2019, it remains to be seen to what extent the significant new demands on resources will constrain CFIUS's recently enhanced ability to monitor and, as necessary, take action in response to transactions that are not notified to CFIUS (whether by short-form declaration or traditional notice).

We will continue to monitor developments related to implementation of FIRRMA, and we will provide further updates as appropriate.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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