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CFIUS Proposes Changes to Mandatory Filing Requirements

On May 20, 2020, the Treasury Department issued proposed regulations to fundamentally change the mandatory filing requirement related to a foreign person acquiring control over, or making a covered investment in, a U.S. business involved with critical technologies in certain industry sectors. The proposed regulations also would modify slightly the separate mandatory filing requirement with respect to the acquisition of a substantial interest in a U.S. business that involves critical technology, critical infrastructure, or the maintenance or collection of sensitive personal data of U.S. citizens (a "TID U.S. business") by a foreign person in which a foreign government has a substantial interest. CFIUS is accepting public comments on the proposed regulations through June 22, 2020.

On February 13, 2020, final regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") [1] went into effect. [2] These regulations require a mandatory CFIUS filing (either a short-form declaration or a traditional notice) whenever a foreign person acquires control over, or makes a covered investment in, a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops critical technologies used in connection with the TID U.S. business's activity in, or designed by the TID U.S. business specifically for use in, one of 27 industries identified by their North American Industry Classification System ("NAICS") codes.

The final implementing regulations also require transaction parties to make a mandatory CFIUS filing (either a short-form declaration or a traditional notice) 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 (except for Canada, the United Kingdom, and Australia, which qualify as "excepted foreign states"). The final implementing regulations also 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

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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 Our prior memorandum on the final regulations implementing FIRRMA can be found here: https://www.paulweiss.com/practices/transactional/mergers-acquisitions/publications/final-cfius-regulations-implementing-the-foreign-investment-risk-review-modernization-act-of-2018-are-now-in-effect?id=30718.

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

Key takeaways from the proposed regulations are as follows:

1. As CFIUS predicted at the time the final implementing regulations were issued in January, the focus under the proposed regulations would no longer be on the industry sector the TID U.S. business's critical technology is linked to, and all reference to specific industries and NAICS codes would be removed. Instead, the focus would now be on whether the foreign person acquiring control over, or making the covered investment in, the TID U.S. business involved with critical technologies (i) has its principal place of business in a country to which a transfer of the U.S. business's critical technology would require a U.S. export control license or (ii) has 25% or more of its voting interest controlled by another foreign person or group of foreign persons whose principal place of business (in the case of entities) or nationality (in the case of individuals) is linked to a country to which a transfer of the U.S. business's critical technology would require a U.S. export control license. In both cases, and with a few exceptions, the proposed regulations provide that license exceptions set forth in the relevant U.S. export control regulations are to be ignored.

2. The result of this proposed change in the critical technologies mandatory filing requirement would be to make an export control assessment critical in determining whether a mandatory CFIUS filing would be triggered by a particular acquisition of control over, or a covered investment in, a TID U.S. business. It would no longer be possible to avoid this assessment simply by confirming that the TID U.S. business was not linked to one of the identified industry sectors. Having to base mandatory filing determinations on export license assessments, and requiring that those assessments extend up the ownership/control chain of the acquirer or investor, has the potential to increase significantly the challenges associated with making these filing determinations. This is particularly true since many U.S. companies (and especially start-ups and companies that are not exporters) do not have a good understanding of the export control classification of their equipment, materials, products, software, and technology.

3. Another important consequence of this proposed change in the critical technologies mandatory filing requirement would be to move away from a mandatory filing requirement that treated all countries the same (with the exception of more favorable treatment for Canada, the United Kingdom, and Australia) to one that will place a heavier filing burden on countries that are the target of more stringent U.S. export controls. In other words, investors from U.S. allies will be significantly less likely to trigger a mandatory filing requirement when making an acquisition of control over, or a covered investment in, a TID U.S. business involved with critical technologies than an investor from a country such as China or Russia.

4. The proposed change with respect to the mandatory filing requirement for foreign government-linked acquisitions and covered investments is a good bit more minor in nature, and is a bit puzzling. As noted above, the final implementing 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. In the proposed regulations, this provision would be changed so that it would only apply to partnerships and similar entities whose activities are directed, controlled, or coordinated by or on behalf of the general partner, managing member, or equivalent. It is not clear what problem CFIUS is trying to address with this change, at least in the context of investment funds, as it would seem to be a rather unusual limited partnership that failed to meet this test.

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:

H. Christopher Boehning
+1-212-373-3061
cboehning@paulweiss.com

Adam M. Givertz
+1-212-373-3224
agivertz@paulweiss.com

Roberto J. Gonzalez
+1-202-223-7316
rgonzalez@paulweiss.com

Tarun M. Stewart
+1-212-373-3567
tstewart@paulweiss.com

Betty Yap
+852-2846-0396
byap@paulweiss.com

Kaye N. Yoshino
+81-3-3597-8101
kyoshino@paulweiss.com

Richard S. Elliott
+1-202-223-7324
relliott@paulweiss.com

Associate Joshua R. Thompson contributed to this client memorandum.