September 22, 2020

CFIUS Releases Final Regulations Changing 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.[1] On September 11, 2020, the Treasury Department released final versions of these regulatory changes, making only minor changes to the proposed regulations. These regulatory changes are effective on October 15, 2020. However, the current rules apply to any transaction where the parties have signed a binding agreement prior to October 15.

On February 13, 2020, a full set of regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA")[2] went into effect.[3] These regulations required a mandatory CFIUS filing (either a short-form declaration or a traditional notice) whenever a foreign person acquired control over, or made 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 FIRRMA implementing regulations also required transaction parties to make a mandatory CFIUS filing (either a short-form declaration or a traditional notice) whenever a covered control transaction or covered

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1 Our prior memorandum on these proposed regulations can be found here: https://www.paulweiss.com/practices/litigation/litigation/publications/cfius-proposes-changes-to-mandatory-filing-requirements?id=37218.

2 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.

3 Our prior memorandum on the FIRRMA implementing regulations 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.

investment resulted in the acquisition of a substantial interest in a TID U.S. business by a foreign person in which a foreign government had a substantial interest. These regulations defined "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 FIRRMA implementing regulations also provided 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.

Key takeaways from the recent regulatory changes are as follows:

1. As CFIUS predicted at the time the FIRRMA implementing regulations were issued in January, the focus under the recent regulatory changes is no longer on the industry sector that the TID U.S. business's critical technology is linked to, and all references to specific industries and NAICS codes have been removed from the critical technologies mandatory filing requirement. Instead, the focus is now 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 recently revised regulations provide that license exceptions set forth in the relevant U.S. export control regulations are to be ignored.

2. The result of this important change in the critical technologies mandatory filing requirement is to make an export control assessment critical in determining whether a mandatory CFIUS filing is triggered by a particular acquisition of control over, or a covered investment in, a TID U.S. business. Unless a transaction agreement will be signed prior to October 15, 2020, it will no longer be possible to avoid this assessment simply by confirming that the TID U.S. business is 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. However, in response to one comment received during the public comment period on the proposed

regulations, the Treasury Department made one helpful change to address the possibility that a U.S. business having no critical technologies at the time of deal signing could have critical technologies prior to closing due to a change in U.S. export control regulations. Under the final regulatory changes, such a revision to the export control regulations between deal signing and closing would not trigger a mandatory filing requirement, but it could still create CFIUS jurisdiction over the transaction.

3. Another important consequence of this recent change in the critical technologies mandatory filing requirement is 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 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 recent regulatory change with respect to the mandatory filing requirement for foreign government-linked acquisitions and covered investments is more minor in nature, and is unchanged from the proposed regulations. As noted above, the FIRRMA implementing regulations provided 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 recent regulatory changes, this provision was 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. In order to address concerns expressed during the public comment period on the proposed regulations regarding situations in which a general partner delegates certain functions to a third party (such as an investment manager), the Treasury Department included the following statement in its guidance accompanying the final regulatory changes: "In a situation where a third party coordinates the activities of an entity on behalf of the general partner, the general partner does not cease to primarily direct, control, or coordinate the activities of the entity simply by contracting a third party to perform such services."

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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