International Trade Update

October 2020

New CFIUS Critical Technology Mandatory Filing Requirements Take Effect October 15

Key Notes:

- On September 15, 2020, the Department of the Treasury published in the *Federal Register* a final rule amending the disclosure regulations of the Committee on Foreign Investment in the United States (CFIUS) pursuant to the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA).
- The final rule significantly alters the *mandatory* CFIUS filing requirements relating to foreign persons' investments in or acquisitions of U.S. businesses involving critical technologies, critical infrastructure or sensitive personal data.
- The final rule comes into effect on October 15, 2020.

Effective October 15, 2020, the Department of the Treasury's September 15 final rule ("Rule") will modify certain regulations of the Committee on Foreign Investment in the United States (CFIUS) pursuant to the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). In a previous blog post, we noted that the Rule would change the requirements for making *mandatory* disclosures to the U.S. government prior to completing certain types of foreign investments in, or acquisitions of, certain types of U.S. businesses. These changes are comprehensive and will require parties entering into these types of transactions to undertake new due diligence efforts to ensure they are in compliance with CFIUS's strict liability requirements and avoid penalties for noncompliance. This update describes the underlying legislation as well as the legal and practical implications of the Rule.

FIRRMA's Expansion of CFIUS Jurisdiction and Mandatory Filings

In 2018, Congress enacted FIRRMA to expand the government's ability to monitor and mitigate national security risks arising from non-controlling, non-passive foreign investments in and acquisitions of U.S. businesses. Notably, FIRRMA introduced mandatory filing requirements to the CFIUS review process. The first mandatory filings implemented were for foreign investments in "critical technologies" resulting in the transfer of certain rights to the investor under the pilot program in November 2018 ("Pilot Program"). Under the Pilot Program, the "critical technologies" mandatory CFIUS filing was determined through a combination of identifying the covered technology and confirming whether it was designed for use in specific industries. The filings were mandatory regardless of the nationality of the foreign investor. Subsequently, broader regulations implementing FIRRMA became effective in February 2020. These included additional mandatory filing requirements for certain transactions in which a foreign government-owned investor would obtain a "substantial interest" in a U.S. company involved with (i) **critical technologies**, (ii) **critical infrastructure**, or (iii) **sensitive personal data**. The CFIUS regulations call such companies "TID U.S. businesses" ("***T***" for technology, "***I***" for infrastructure and "***D***" for data).

Mandatory CFIUS Filings as of October 15, 2020

Critical Technology Mandatory Filings

As of October 15, 2020, the new Rule significantly updates the critical technology mandatory filing requirement. The

Rule removes and replaces the industry component of the analysis and instead requires the parties to determine whether the foreign investor and other foreign entities in the investor's ownership chain would require certain U.S. export authorizations to receive or access the U.S. business's critical technologies. Specifically, Section 800.401(c)(1) of the Rule provides that a mandatory CFIUS filing is required with respect to any covered transaction involving:

1. A TID U.S. business that "produces, designs, tests, manufactures, fabricates or develops" one or more "critical technologies";
2. "Critical technologies" that would require a "U.S. regulatory authorization" for export, reexport, transfer (in-country) or retransfer of such critical technology to a foreign person who is a party to the transaction; and
3. A foreign person who is an "investor" within the five categories of investors identified in Section 800.401(c)(1).

"U.S. regulatory authorization" includes any license or other approval issued by the Department of State under the International Traffic in Arms Regulations (ITAR), the Department of Commerce's Bureau of Industry and Security (BIS) under the Export Administration Regulations (EAR), any specific or general authorization from the Department of Energy under foreign atomic energy regulations, or any specific license from the Nuclear Regulatory Commission. Except for some limited EAR license exceptions, a U.S. regulatory authorization is considered to be required even though a license exception or exemption may be available under the EAR or ITAR, respectively.

A foreign person is an "investor" in a TID U.S. business for purposes of Section 800.401(c)(1) if it:

1. May directly control the TID U.S. business as a result of the covered transaction;
2. Is directly acquiring an interest that is a covered investment in such TID U.S. business, such as (i) access to any "material nonpublic technical information" in the possession of the US business; (ii) membership or observer rights on, or the right to nominate an individual to a position on, the board of directors or equivalent governing body of the U.S. business; or (iii) any "involvement," other than through voting of shares, in "substantive decision-making" of the U.S. business regarding U.S. sensitive personal data, critical technologies or covered investment critical infrastructure;
3. Has a direct investment in such TID U.S. business, the rights of such person in the TID U.S. business are changing and its rights could result in a covered control transaction or a covered investment;
4. Is a party to any transaction, transfer, agreement, or arrangement designed to circumvent CFIUS jurisdiction; and
5. Holds, or is part of a group of foreign persons that in the aggregate holds, a voting interest (direct or indirect) of 25% or more in a foreign investor of the type described in categories 1-4 above.

Foreign Government "Substantial Interest" Mandatory Filings

This "substantial interest" requirement remains unchanged except that, as explained in our previous blog post, what constitutes a "substantial interest" by a foreign government in a foreign person was defined in the Rule. Under the Rule, a foreign government is considered to have a substantial interest in an entity whose activities are primarily directed, controlled, or coordinated by or on behalf of a general partner, managing member, or equivalent, only if they hold 49% or more of the interest in that general partner, managing member, or equivalent.

Summary of Mandatory Filings

A mandatory filing is required when there exists a covered transaction:

- That results in the acquisition of a substantial interest in a TID U.S. business by a foreign person in which the government of a non-excepted foreign state has a substantial interest; and
- Involving a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies for which a U.S. export authorization would be required for the export, reexport, transfer (in-country), or retransfer of such critical technology to a foreign "investor" as defined by Section 800.401(c)(1).

Key Legal and Practical Implications of the Rule for U.S. Businesses

Knowledge of U.S. Export Control Laws and Regulations

On its face, changing the CFIUS rules to more closely align with U.S. export controls and regulations makes sense as both regimes are concerned with national security issues and limiting the influence of U.S. adversaries. However, legally and practically, CFIUS rules and U.S. export controls were developed to target different types of transactions, companies and aims.

For example, ITAR and the EAR were designed to address national security concerns with real exports of U.S. products and technology in the context of a specific transaction. Determining whether an export authorization is required for actual export involves a complex analysis of various factors specific to each transaction including: export control classification numbers (ECCN) on the Commerce Control List (CCL); types of products, software, technology or services being exported; country destinations of those exports; intended or potential end-uses of those products; and a determination of the actual end-users of the product. Companies that are not exporters or trained in export controls may be at a disadvantage and could easily expose themselves and their potential partners to risk of noncompliance.

Enhanced Due Diligence on Foreign Partners

In addition to analyzing the regulatory designations of the U.S. business's products, the new assessment requires diligence on investors. It is often not obvious whether a foreign person is involved in a transaction indirectly. In addition, U.S. companies must ascertain not only whether a foreign investor is involved, but also the identities and nationalities of all foreign persons involved, including parent entities and ownership chains of control, to determine whether mandatory filing requirements apply relative to each specific foreign person.

FOR MORE INFORMATION

Thompson Hine LLP's International Trade practice group has extensive experience in CFIUS filings. For more information, please contact:

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