

CFIUS BROADENS JURISDICTION AND INSTITUTES MANDATORY FILING UNDER INTERIM RULE

On October 10, 2018, the U.S. Department of the Treasury, as chair of the Committee on Foreign Investment in the United States ("**CFIUS**"), issued interim regulations establishing the Critical Technology Pilot Program, which implements parts of the Foreign Investment Risk Review Modernization Act ("**FIRRMA**") including expanding the scope of "Covered Transactions" and making transactions that involve sensitive technologies in certain industries subject to mandatory declarations. Failure to notify CFIUS when required could expose the parties to civil penalties equal to the value of the transaction as a whole. As a practical matter, these changes may push potential non-U.S. investors into detailed due diligence on the U.S. target's exposure to critical technologies and covered industries well in advance of signing the Share Purchase Agreement, as failure to identify and address the mandatory filing requirement when it applies could put the entire transaction at risk.

MANDATORY FILINGS FOR TRANSACTIONS SUBJECT TO THE PILOT PROGRAM

The CFIUS process has historically been voluntary, providing parties who notify CFIUS of their transaction with a "safe harbor" that would eliminate the risk that CFIUS could alter or unwind the transaction after the fact if it identified any national security concerns. The Critical Technology Pilot Program (the "**Pilot Program**") institutes mandatory notification requirements for parties to file with CFIUS if the proposed transaction falls within the scope of the Pilot Program. Parties who do not file when required can be assessed a civil monetary penalty up to the value of the transaction.

CERTAIN INDUSTRIES AND CRITICAL TECHNOLOGIES TARGETED FOR MANDATORY FILING

The Pilot Program applies to U.S. businesses that are either part of, or are involved with *critical technologies for*, 27 industries (the "**Pilot Program**

Key issues

- New CFIUS Critical Technology Pilot Program implements parts of FIRRMA
- Scope of CFIUS' jurisdiction now covers all but the most passive of foreign investments
- Starting November 11, CFIUS filings are now mandatory for all transactions involving sensitive technologies in the aerospace, defense, computer, telecom, chemicals and certain industrial manufacturing sectors
- Certain ongoing transactions may be affected by the new regulations
- Penalties for failure to file when required can be up to the value of the transaction *as a whole*

Industries") identified by their North American Industry Classification System ("NAICS") code. The Pilot Program Industries are:

- Aircraft Manufacturing (NAICS Code: 336411)
- Aircraft Engine and Engine Parts Manufacturing (NAICS Code: 336412)
- Alumina Refining and Primary Aluminum Production (NAICS Code: 331313)
- Ball and Roller Bearing Manufacturing (NAICS Code: 332991)
- Computer Storage Device Manufacturing (NAICS Code: 334112)
- Electronic Computer Manufacturing (NAICS Code: 334111)
- Guided Missile and Space Vehicle Manufacturing (NAICS Code: 336414)
- Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing (NAICS Code: 336415)
- Military Armored Vehicle, Tank, and Tank Component Manufacturing (NAICS Code: 336992)
- Nuclear Electric Power Generation (NAICS Code: 221113)
- Optical Instrument and Lens Manufacturing (NAICS Code: 333314)
- Other Basic Inorganic Chemical Manufacturing (NAICS Code: 325180)
- Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing (NAICS Code: 336419)
- Petrochemical Manufacturing (NAICS Code: 325110)
- Powder Metallurgy Part Manufacturing (NAICS Code: 332117)
- Power, Distribution, and Specialty Transformer Manufacturing (NAICS Code: 335311)
- Primary Battery Manufacturing (NAICS Code: 335912)
- Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing (NAICS Code: 334220)
- Research and Development in Nanotechnology (NAICS Code: 541713)
- Research and Development in Biotechnology (except Nanobiotechnology) (NAICS Code: 541714)
- Secondary Smelting and Alloying of Aluminum (NAICS Code: 331314)
- Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing (NAICS Code: 334511)
- Semiconductor and Related Device Manufacturing (NAICS Code: 334413)
- Semiconductor Machinery Manufacturing (NAICS Code: 333242)
- Storage Battery Manufacturing (NAICS Code: 335911)
- Telephone Apparatus Manufacturing (NAICS Code: 334210)

- Turbine and Turbine Generator Set Units Manufacturing (NAICS Code: 333611)

Within those industries, the Pilot Program covers any U.S. business that is involved in any way with "critical technologies." Critical technologies are defined under FIRRMA as:

- **Defense articles or defense services** included on the United States Munitions List set forth in the International Traffic in Arms Regulations (ITAR) (22 CFR parts 120-130);
- **Items included on the Commerce Control List** of the Export Administration Regulations (EAR) (15 CFR part 774) and controlled pursuant to multilateral regimes or for reasons relating to regional stability or surreptitious listening;
- Specially designed and prepared **nuclear equipment**, parts and components, materials, software, and technology covered by 10 CFR part 810 (relating to assistance to foreign atomic energy activities);
- **Nuclear facilities**, equipment, and material covered by 10 CFR part 110 (relating to export and import of nuclear equipment and material);
- **Select agents and toxins** covered by 7 CFR part 331, 9 CFR part 121, or 42 CFR part 73; and
- **Emerging and foundational technologies** controlled pursuant to section 1758 of the Export Control Reform Act of 2018. As of yet no emerging and foundational technologies have been identified by the U.S. Government.

MANDATORY FILING APPLIES TO TRANSACTIONS EVEN WHEN THE FOREIGN PARTY RECEIVES NO CONTROL

Previous to FIRRMA, CFIUS had jurisdiction over transactions that could result in "control" over a U.S. business.¹ The Pilot Program implements new authority from FIRRMA to cover transactions in the applicable industries even if the transaction does not provide a non-U.S. party with control of a U.S. business. Under the Pilot Program, CFIUS' jurisdiction now also applies to transactions within the identified industries that would give the foreign acquirer:

- Access to any "material nonpublic technical information" in the possession of the target U.S. business;
- Membership or observer rights on the board of directors or equivalent governing body of the U.S. business, 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
- Any involvement, other than through voting of shares, in substantive decision-making of the U.S. business regarding the use, development, acquisition, or release of critical technology.

¹ CFIUS defines control as " the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity." 31 C.F.R. §800.204

FIRRMA defines "material nonpublic technical information" as information that is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods.

THE REVIEW PROCESS MAY OR MAY NOT BE EXPEDITED

Parties may either file a traditional notice or a "Declaration" – a short-form notice (five pages or fewer), on which CFIUS will have approximately 30 days to act. Under FIRRMA, CFIUS can respond to a declaration by closing the case and taking no further action; by requesting the parties file a full notice, which will add at least four months to the review process; by rejecting the declaration and leaving the parties to file a full notice if they so choose; or by initiating a unilateral review. Of all these outcomes, only the first—closure of the case—will result in expedited CFIUS clearance as compared to filing a full notice under the standard processes.

Despite the current focus on Chinese investment within the CFIUS regime, the Pilot Program applies to all foreign acquirers and does not provide either a "white list" for expedited review or single out specific countries for additional scrutiny.

CURRENT TRANSACTIONS MAY BE AFFECTED

The Pilot Program regulations and an accompanying FAQ explain that the regulations will not apply to transactions consummated prior to November 11, 2018, or transactions where the following has occurred before October 11, 2018:

- i. The parties to the transaction have executed a binding written agreement or other document establishing the material terms of the transaction;
- ii. A party has made a public offer to shareholders to buy shares of a pilot program U.S. business; or
- iii. A shareholder has solicited proxies in connection with an election of the board of directors of a pilot program U.S. business or has requested the conversion of convertible voting securities.

CONCLUSIONS – EXTREME DILIGENCE REQUIRED

The Pilot Program raises urgent issues for both non-U.S. investors and U.S. companies considering investment from non-U.S. sources. Most importantly, it will create the need for effective early due diligence in most inbound investment transactions to determine whether the U.S. target contains any sensitive "critical technology" or exposure to any of the 27 identified industries. Specifically:

- Many inbound transactions will now need to be scrutinized for exposure by the U.S. target to the 27 industries;
- Every US target with exposure in those industries will need to be examined closely in advance of signing the SPA for critical technologies in their portfolios. Many U.S. companies do not fully understand themselves what their exposure to such technologies is, and transaction parties will need to plan for a potentially significant due diligence effort in this regard.

- CFIUS resources may be challenged by a significant increase in CFIUS filings as parties submit mandatory declarations either because they are required or out of an abundance of caution in the face of *potentially* significant fines.

PUBLIC COMMENT PERIOD

The Treasury Department had an official comment period on the interim rule until November 10, 2018. However, Treasury likely will continue to accept comments informally as parties gain experience with the Pilot Program. Comments may be submitted electronically through the Federal government eRulemaking Portal at <https://www.regulations.gov> or by mailing to U.S. Department of the Treasury, Attention: Thomas Feddo, Deputy Assistant Secretary for investment Security, 1500 Pennsylvania Avenue NW, Washington, DC 20220. Comments may be helpful in identifying issues for Treasury to address in its final regulations.

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