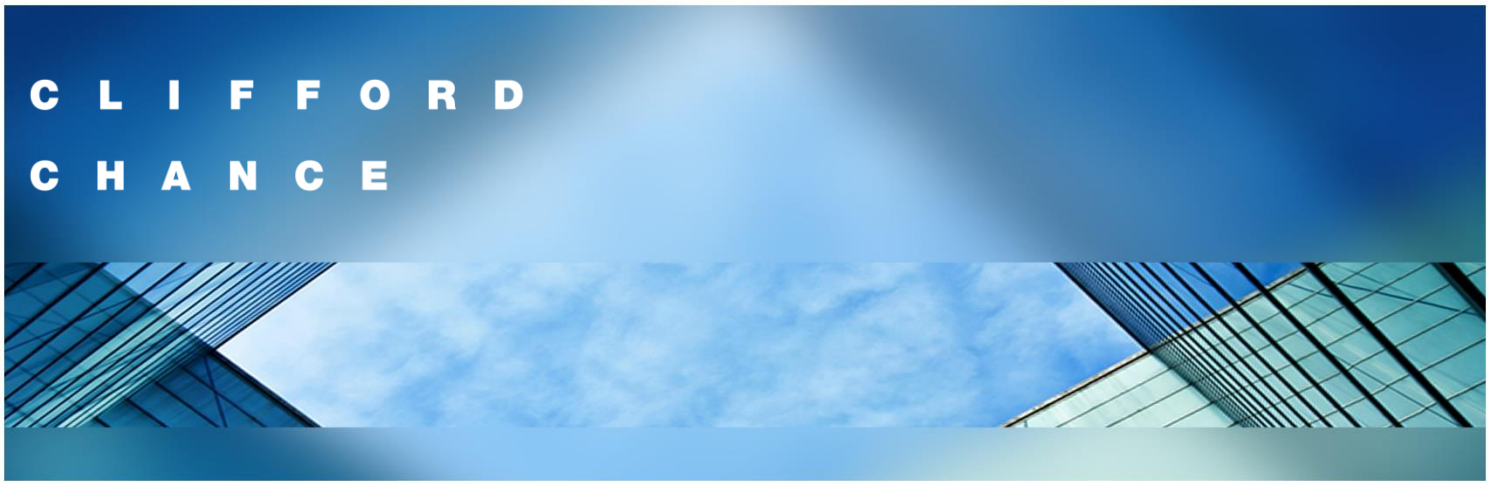

U.S. TREASURY DEPARTMENT ISSUES PROPOSED RULES IMPLEMENTING NEW CFIUS REGULATIONS UNDER FIRRMA

Pursuant to the Foreign Investment Risk Review Modernization Act of 2018 ("**FIRRMA**"), the United States Treasury Department's Office of Investment Security has issued Proposed Rules implementing the changes FIRRMA brought to the Committee on Foreign Investment in the United States ("**CFIUS**"). Among the changes, the Proposed Rules extend CFIUS' jurisdiction to "covered investments" that do not provide foreign investors with control, provides for a "white list" process for favoring investors from certain countries in the CFIUS review process, and sets out rules for real estate transactions. Comments on the Proposed Rules are due by October 17, 2019.

Key issues

- U.S. Treasury Department issues Proposed Rules to implement FIRRMA changes to CFIUS
- CFIUS jurisdiction extended to "covered investments" which do not require the non-U.S. buyer to gain "control", if they obtain access to material non-public information
- Sensitive personal data as a component of national security codified
- Critical Infrastructure defined with respect to covered investments
- Greenfield real estate transactions covered and proximity distances defined
- 'White List' provided for – if those countries have also established robust foreign investment review processes
- Declaration process opened to all transactions
- Pilot Program remains in place
- Rule regarding filing fees to follow at a later date

EXECUTIVE ANALYSIS

The Proposed Rules offer both risks and rewards for international investors. The new rules significantly expand the scope of CFIUS jurisdiction over non-controlling transactions and acquisition of greenfield sites. They also increase the stakes for non-U.S. buyers by continuing mandatory filing for FIRRMA Pilot Program covered investments, expanding mandatory filing to certain investments where a non-U.S. government has a stake in the transaction, and imposing penalties up to the total value of the transaction for failure to file when required. Combined with CFIUS's new powers to identify non-notified transactions and its increasingly aggressive enforcement, these provisions make the decision whether to seek CFIUS review even more strategically critical in deal planning and execution.

The Proposed Rules also offer key advantages for certain investors, however. They define for the first time important CFIUS concepts, such as:

- What qualifies as sensitive personal data, and when does access to such data create concerns for CFIUS review;
- What proximity thresholds between an acquired site and a "sensitive" U.S. installation trigger CFIUS concerns; and

- What qualifies as "critical infrastructure" where increased CFIUS scrutiny is merited.

The specificity afforded by these definitions should help clarify when CFIUS filing is appropriate, potentially saving significant deal time and avoiding the need for CFIUS review in many cases.

Equally important, the Proposed Rules create an entirely new opportunity for non-U.S. investors to avoid CFIUS jurisdiction in certain cases. If an investor qualifies as an "excepted investor" at the time of the transaction and for 3 years afterwards, its non-controlling investments are not subject to CFIUS review. This could provide a potentially critical advantage for favored investors when competing for deals, because their competitors might be subject to a CFIUS review requirement when they would not, providing both a cost and time savings in relation to their competition. The criteria for identifying "excepted investors" are complex, but largely involve their exclusive affiliation with close U.S. allies who have adopted CFIUS-like investment controls, and their being on the right side of U.S. export control, national security and criminal law. However, the rules for determining "excepted investor" status are not binary, and the Proposed Rules do not define a process to determine "excepted investor" status. It remains unclear how investors will know whether they qualify in advance, and therefore whether they can avoid CFIUS filing for non-controlling investments. We would encourage parties interested in this mechanism to file comments with CFIUS by the October deadline, perhaps to suggest creation of a participatory process for determining in advance of deal structuring whether the non-U.S. investor(s) qualify as "excepted investors."

JURISDICTION OVER "COVERED INVESTMENTS"

Before FIRRMA, CFIUS' jurisdiction only extended to transactions that could result in "control" over a U.S. business. However, the Proposed Rules continue the expansion of CFIUS' jurisdiction seen with October 2018's Critical Technology Pilot Program. (See our previous alerter here). Under the Proposed Rules, CFIUS will have jurisdiction over non-controlling "Covered Investments," in addition to controlling investments and greenfield investments. These "Covered Investments" are transactions by non-U.S. investors in Technology, Infrastructure, and Data ("**TID**") businesses that are involved in critical technologies, critical infrastructure, and sensitive personal data. These foreign investments do not grant control as traditionally defined by CFIUS, but provide:

- Access to any "material nonpublic technical information";
- Membership or observer rights on the board of directors or equivalent governing body; or
- Any involvement in substantive decision making of the U.S. business regarding certain actions related to critical technologies, critical infrastructure, or sensitive personal data.

The Proposed Rules largely adopt the language of the Critical Technology Pilot Program in terms of "material nonpublic technical information" and critical technologies. The former is defined as: (1) knowledge, know-how, or understanding not available in the public domain, of the design, location, or

operation of critical infrastructure, including without limitation, vulnerability information such as that related to physical security or cybersecurity; or (2) not available in the public domain and necessary to design, fabricate, develop, test, produce, or manufacture a critical technology, including without limitation processes, techniques, or methods.

The "critical technologies" over which the Proposed Rules expand CFIUS jurisdiction for non-controlling investments are defined to include:

- Defense articles or defense services included on the United States Munitions List (USML) set forth in the International Traffic in Arms Regulations (ITAR) (22 CFR parts 120- 130);
- Items included on the Commerce Control List set forth in Supplement No. 1 to part 774 of the Export Administration Regulations (EAR) (15 CFR parts 730-774), and controlled;
- 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 (50 U.S.C. 4817).

FOCUS ON DATA

The Proposed Rules also formalize CFIUS' elevated interest in transactions that involve sensitive personal data. Over the past few years, CFIUS has intervened in several transactions implicating the data U.S. companies hold on U.S. citizens, including Ant-Financial/MoneyGram, Fosun International/Wright & Co, Grindr/Kunlun, and PatientsLikeMe/iCarbonX. (See previous alerters here and here). In summary, the Proposed Rules define sensitive personal data as either genetic information, or data maintained or collected by a U.S. business that fulfills certain parameters.

First, other than genetic information, which is subject to expanded CFIUS jurisdiction for sensitive personal data in all cases, the U.S. business must either: (1) target or tailor products or services to national security-oriented U.S. government agencies or contractors; (2) maintain or collect such data on greater than one million individuals at any point over the preceding twelve (12) months; or (3) have a demonstrated business objective to maintain or collect such data on greater than one million individuals and such data is an integrated part of the U.S. business's primary products or services.

Second, if the U.S. business fulfils one or more of those conditions, then the actual data must fall within one or more of the following categories:

- Data regarding an individual's financial distress or hardship;
- Data in a consumer report;

- Insurance data of multiple types;
- Data relating to the physical, mental, or psychological health condition of an individual;
- Non-public electronic communications;
- Geolocation data;
- Biometric enrollment data;
- State or federal government identification card data;
- Data concerning U.S. Government personnel security clearance status; or
- Data in an application for a U.S. Government personnel security clearance or an application for employment in a position of public trust.

However, the Proposed Rules require that, for CFIUS jurisdiction to apply to a non-controlling investment based on the U.S. business's access to sensitive personal data, that data must be *identifiable* to the U.S. business. If the U.S. business cannot access identifiable data about individuals because it is encrypted, it would not be subject to the expanded CFIUS jurisdiction.

CRITICAL INFRASTRUCTURE SPECIFIED

Prior to the recent focus on critical technologies, CFIUS appeared to be expanding the definition of critical infrastructure in terms of what would be considered relevant from a national security perspective. Investors and U.S. businesses have been asking CFIUS to provide clarity on what constitutes critical infrastructure for over a decade. The Proposed Rules provide some answers on this front, but continue to leave some questions open. FIRRMA required these implementing regulations to limit the newly expanded jurisdiction over Covered Investments to a subset of critical infrastructure to be specified in the regulations. The Proposed Rules define this subset as a list of 28 areas of infrastructure summarized as follows:

- IP networks and Internet exchanges that support public peering;
- Telecommunications services;
- Submarine cable systems, associated facilities, and data centers co-located at a submarine cable landing point, landing station, or termination station;
- Satellite or satellite system providing services directly to the DOD;
- Defense equipment and related resources manufactured or operated for a Major Defense Acquisition Program or DPAS order, or funded under several DoD programs;
- Manufacturing facilities for specialty metal, covered materials, chemical weapons antidotes, or armor plate;
- Electricity generation and related infrastructure;
- Oil and gas refineries, pipelines, and related infrastructure;
- LNG import or export terminals;

- Financial market utilities and securities exchanges;
- Railway lines, airports, maritime ports, and port terminals; and
- Public water systems, industrial control systems, and treatment works.

Only U.S. businesses that perform specified functions with respect to these elements of infrastructure are subject to the expanded jurisdiction for non-controlling investments. It should be noted, however, that this list only applies to CFIUS's covered investment jurisdiction – it does not limit CFIUS's definition of critical infrastructure for transactions within its traditional "control" jurisdiction. Moreover, it does not necessarily define what falls into each of these categories, thus leaving some areas open for further analysis.

REAL ESTATE TRANSACTIONS COVERED

Geographic proximity issues have long been an aspect of CFIUS risk. The Ralls Corp/Sany Group divestment order over a deal regarding wind farms in Oregon sparked increased interest in CFIUS back in 2012. Over the past decade, geographic considerations and CFIUS risks have often created transactional concerns. Indeed, until now CFIUS has not provided formal guidance to investors on what should be considered sensitive sites or what distance would constitute a proximity issue.

The Proposed Rules provide some welcome clarity in this area. The rules define "close proximity" as one mile for certain U.S. military facilities, while defining "extended range" as between one mile and 100 miles for other facilities. Moreover, the new rules provide a list of military installations divided into four parts – each subject to different proximity definitions. The Proposed Rules also apply to the top 25 tonnage, container, and dry bulk ports in the United States as well as strategic seaports, based on Department of Transportation information.

The Proposed Rules also establish CFIUS's jurisdiction as covering the purchase or lease by, or a concession to, a foreign person of certain real estate in the United States that affords the foreign person three or more of the following property rights: to physically access; to exclude; to improve or develop; or, to affix structures or objects. Critically, the Proposed Rules excludes from its new real estate jurisdiction transactions for the purchase of real estate in an “urbanized area” or “urban cluster,” as defined by the Census Bureau, except those relating to relevant ports and those in “close proximity” to certain military installations. The Proposed Rules also set forth limited exceptions for transactions involving a single housing unit, and for commercial office space in multi-unit buildings.

'WHITE LIST' RESURRECTED

In a move that could provide critical advantages for certain non-U.S. investors, the Proposed Rules waive CFIUS review requirements for "excepted investors" in non-controlling investments. "Excepted investors" can include foreign persons who are (and continue to be for three years after closing) of the transaction):

- Nationals exclusively of one or more Excepted Foreign States;
- A foreign government of an Excepted Foreign State; or

- A foreign entity organized under the laws of an Excepted Foreign State or in the United States, with its principal place of business in an Excepted Foreign State or the United States, subject to additional conditions.

Under this system, CFIUS could designate certain countries as an Excepted Foreign State based on the alignment of their foreign investment rules with U.S. interests. Once that happens over the next two years, investors from those countries could be identified as "excepted investors" and excluded from CFIUS's expanded jurisdiction over non-controlling investments. In other words, they would be exempted from both voluntary and mandatory CFIUS filing requirements when making non-controlling investments in U.S. businesses with exposure to critical technology, critical infrastructure or sensitive personal data. The Proposed Rules provide no indication as to whether "excepted investor" status is automatic or must be sought, how CFIUS will determine who qualifies as an "excepted investor" in unclear cases, or how parties can petition to receive that status if required.

Of all the changes reflected in the Proposed Rules, this "white list" process may be of greatest interest to investors from countries closely aligned with the United States – and perhaps, for opposite reasons, to investors from countries that are not treated as Excepted Foreign States. If a non-U.S. buyer qualifies as an "excepted investor," they could avoid the uncertainty, expense and delay inherent in CFIUS reviews in many cases, even as competing bidders may not. While benefiting those investors' bottom line, it would also improve their prospects for deal success, because sellers would likely show preference for the certainty of an excepted investment over one that would require CFIUS review.

To work as a practical matter, however, the process for identifying "excepted investors" must be elaborated and investors identified in advance. Buyers must know in advance of bidding whether they qualify as "excepted investors" and therefore whether they can avoid potentially mandatory CFIUS filing requirements. Because there is currently no process for this defined in the Proposed Rules, investors from both sides of the issue – those who may seek "excepted investor" status and those who want to restrict the ability of potential competing bidders to do so – may wish to provide comments in advance of the October 17th deadline on how they would like to see this issue resolved.

THE DECLARATIONS OPEN TO ALL

As under the Critical Technology Pilot Program, parties may either file a traditional notice or a "Declaration" – a short-form notice (five pages or fewer), on which CFIUS will have 30 days to act. CFIUS has provided a fillable online form for declarations. In responding to a declaration, CFIUS can: 1) close the case and take no further action; 2) request the parties file a full notice, which will add at least four months to the review process; 3) reject the declaration and leave the parties to file a full notice if they so choose; or 4) initiate a unilateral review. Only the first of these outcomes would result in an expedited process compared to filing a full notice under the standard process. Statistics from the Critical Technology Pilot Program are not publicly available to analyze whether declarations have been worthwhile for parties, but anecdotal evidence suggests that most CFIUS filers have not benefited from the Declaration process.

OTHER AMBIGUITIES CLARIFIED

Finally, the Proposed Rules provide clarity on some other aspects of the CFIUS process. "Passive investment" is defined as where the investor does not plan or intend to exercise control and: (1) Is not afforded any rights that if exercised would constitute control; (2) Does not acquire any access, rights, or involvement in issues specified in the regulations; (3) Does not possess or develop any purpose other than passive investment; and (4) Does not take any action inconsistent with holding or acquiring such interests solely for the purpose of passive investment.

Furthermore, the Proposed Rules modify the definition of "business day" to exclude days where the U.S. Office of Personnel Management has announced the closure of Federal offices in the Washington, DC Area – which has occurred during recent government shutdowns.

UNFINISHED BUSINESS

Investors should note that there are two areas left unaddressed in the Proposed Rules: 1) CFIUS's authority to impose filing fees, and 2) CFIUS's authority to implement mandatory declarations for critical technologies. Both of these areas will be the subject of future rulemaking. In the meantime, the FIRRMA Pilot Program is slated to remain in place, and – in a development likely welcome to all potential filers – CFIUS filings will continue to have no filing fee until further notice.

CONCLUSIONS

While they have been anticipated since enactment of FIRRMA in August 2018, the Proposed Rules nonetheless reflect the most sweeping and important revision to CFIUS requirements in at least two decades. A number of elements of CFIUS lore – such as proximity issues, critical infrastructure and sensitive personal data controls, and similar – are now being codified, to the benefit of everyone who needs clarity both before and after closing of a transaction. At the same time, CFIUS now presents greater risk, as jurisdiction over real estate transactions and non-controlling investments is being expanded and mandatory filing requirements have been confirmed for certain transactions. Finally, the "white list" process promises to reshape the competitive dynamic between bidders, favoring those able to benefit from the "excepted investor" process to the detriment of those who are not. How the "white list" process will work in practice remains to be seen.

The Treasury Department is accepting comments on the interim rule until October 17, 2019. We would encourage both non-U.S. investors and U.S. companies seeking foreign investment to provide comments on the rules. A number of key issues remain unresolved, including how the "excepted investors" process will work, the process for determining filing fees (which by statute can be up to $300,000 per transaction), and how transactions will be subject to mandatory filing requirements. The opportunity to help influence the shaping of these issues and CFIUS practice generally for the foreseeable future will not come again.

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