

October 18, 2018

# Mandatory CFIUS Filings for Foreign Investment in Specified Critical Technologies Companies

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## **New Pilot Program Pursuant to Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) Will Require Filings With CFIUS for Controlling or Non-controlling Investments in Specified Critical Technologies Companies**

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### **SUMMARY**

The Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”), discussed in our memorandum to clients dated August 7, 2018,<sup>1</sup> amended the statute governing the authority of and process for national security reviews of foreign investment conducted by the Committee on Foreign Investment in the United States (“CFIUS”). A number of FIRRMA’s provisions were not immediately effective, but required implementation through regulations. FIRRMA also provided CFIUS with authority to issue interim regulations and to conduct “pilot programs” to help inform the permanent rulemaking process.

In an exercise of its pilot program authority, the Department of the Treasury has proposed implementing certain FIRRMA provisions through new interim regulations<sup>2</sup> that will become effective on November 10, 2018 without notice and comment.<sup>3</sup> The interim regulations require that any transaction by or with any foreign person that could result in foreign control of a specified U.S. critical technologies business, or any covered non-control investment by a foreign person in such a U.S. business, is subject to mandatory notification to CFIUS. Failure to comply with this requirement may result in a civil penalty in an amount up to the value of the transaction in question.

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The phased-in timing of the mandatory declaration requirements may create complications for parties seeking to close covered transactions by December 31, 2018.

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### SUMMARY OF KEY COMPONENTS OF PILOT PROGRAM

#### Characteristics of Covered Investments

Any transaction by or with any foreign person that could result in foreign control of a U.S. business participating in any one of a large number of identified industries involving critical technologies (as described in further detail below under “Critical Technology Businesses”), including such a transaction carried out through a joint venture, is a covered transaction under the pilot program.

The pilot program also expands CFIUS’s jurisdiction, consistent with FIRRMA, to allow review of certain investments by foreign persons that do not constitute an acquisition of control of such a U.S. business (referred to in FIRRMA as “other investments”). For an “other investment” in such a U.S. business to be covered under the pilot program, it would have to give the foreign investor:<sup>4</sup>

- 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 target 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 the voting of shares, in substantive decision-making of the U.S. business regarding the use, development, acquisition, or release of critical technology.

“Investment” for purposes of the pilot program means the acquisition of an equity interest, including a contingent equity interest.

The interim regulations include a number of examples of non-control transactions that would be covered on the basis of these foreign investor rights. These examples make it clear that, if approval, control, or informational rights given to a foreign person meet the requirements described above, the interim regulations can require a filing even in cases where a very small portion of the outstanding equity is acquired by the foreign person or where a prior investment by a foreign person in the same entity had already been approved by CFIUS.

#### Critical Technology Businesses

The pilot program focuses on the potential of foreign investment to undermine technological superiority that underpins the United States’ military strategy and national security innovation base. Thus, covered under the pilot program are investments in any U.S. business that produces, designs, tests, manufactures, fabricates, or develops a critical technology utilized in or designed for one or more of 27 “pilot program industries.”<sup>5</sup> These 27 industries, identified by North American Industry Classification System (NAICS) code, are listed below:

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- 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)

In materials accompanying the release of the pilot program, the Treasury Department stated that the “U.S. Government carefully developed the list of pilot program industries for which certain strategically motivated foreign investment could pose a threat to U.S. technological superiority and national security.”

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### Definition of Critical Technologies

The term “critical technologies” is defined for purposes of the pilot program by reference to the FIRRMA definition, which in turn references other statutory and regulatory provisions, including emerging and foundational technologies that will be identified under the Export Control Reform Act of 2018, civilian-military dual use technologies subject to export control under the Export Administration Regulations, and defense articles and defense services as set forth in the International Traffic in Arms Regulations.<sup>6</sup>

### Examples of Transactions that are Not Covered Pilot Program Transactions

The interim regulations include a number of examples of transactions that are not covered pilot program transactions (which transactions may still require a filing with CFIUS pursuant to other statutory or regulatory requirements), including the following:

- **Non-critical technology manufacturing exception.** Investment by a foreign person in a U.S. business that manufactures technology used in a pilot program industry, but that does not produce, design, test, manufacture, fabricate, or develop one or more critical technologies.
- **Air carrier exception.** Consistent with FIRRMA, investments involving certain air carriers.
- **Investment fund exception.** Investments that are compliant with FIRRMA’s clarification for investments by funds are not covered under the pilot program. Thus, a foreign person may invest in a covered critical technologies company indirectly through an investment fund as a limited partner and may participate as a member of the fund’s advisory board, as long as:
  - the fund is managed exclusively by a general partner (or equivalent) who is a U.S. person;
  - the advisory board does not have the ability to approve, and the foreign person does not have the ability to approve, disapprove, or otherwise control, investment decisions of the fund or decisions made by the general partner related to entities in which the fund is invested;
  - the foreign person does not otherwise have the ability to control the investment fund, including the authority (i) to approve, disapprove, or otherwise control investment decisions of the investment fund; (ii) to approve, disapprove, or otherwise control decisions made by the general partner related to entities in which the investment fund is invested; or (iii) to unilaterally dismiss, prevent the dismissal of, select or determine the compensation of the general partner; and
  - the foreign person does not have access to material nonpublic technical information as a result of its participation on the advisory board.<sup>7</sup>

The interim regulations include two examples to illustrate application of the limited partner exception for investment funds:

- **Example 1.** A foreign person makes an investment in an investment fund as a limited partner. The investment confers membership on an advisory board of the investment fund. The investment fund holds 100 percent of the ownership interests in a pilot program U.S. business. The foreign person will have the right to approve decisions made by the general partner with respect to the use and development of the critical technologies produced by the pilot program U.S. business. This transaction is a pilot program covered transaction.
- **Example 2.** A foreign person makes an investment in an investment fund as a limited partner. The investment confers membership on an advisory board of the investment fund. The investment fund holds 100 percent of the ownership interests in a pilot program U.S.

business. The foreign person is not the general partner that wholly manages the investment fund. The foreign person lacks any ability to control the investment fund or its decisions. As a member of the advisory board, the foreign person has the right to vote on the compensation of the general partner and the right to vote on the dismissal of the general partner for cause, but does not have the power to determine either of these matters unilaterally. Assuming no other relevant facts, this transaction is not a pilot program covered transaction with respect to the foreign person.

### Mandatory Notifications to CFIUS

The pilot program requires the submission of a mandatory declaration for both control investments and other investments that meet the conditions outlined above. The requirement to file a mandatory declaration can also be satisfied by filing a standard CFIUS notice of transaction.

The regulations provide a lengthy and detailed list of what information must be included in any declaration filed with CFIUS, but the expectation nevertheless is that the declaration should not exceed five pages. For covered transactions with an expected closing date falling from (and including) November 10, 2018 through (and including) December 25, 2018, the parties must make the declaration on November 10, 2018, or promptly thereafter. For transactions expected to close after December 25, 2018, the mandatory submission must be made 45 days before the closing date. After submission of the mandatory declaration, CFIUS will have 30 days to act on the declaration, and CFIUS may require the parties to file a complete CFIUS notification in response. In that event, the complete CFIUS notification would start a separate CFIUS review process subject to the standard timing for review of notices.

Any person who fails to comply with the filing requirements included in the interim regulations can be liable for civil penalties in an amount up to the value of the transaction.<sup>8</sup>

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## IMPLICATIONS

As forecast by FIRRMA, these interim regulations change the landscape of foreign investment filings in the United States by broadening the scope of possibly reportable transactions beyond control investments. Although the pilot program adopted by the interim regulations is intended to carefully target industries for which certain strategically motivated foreign investments could pose a threat to U.S. technological superiority and national security, the list of covered industry sectors is long and diverse and extends far beyond purely defense-oriented sectors. The mandatory submissions required under the interim regulations will make it especially important for all foreign investors considering any kind of equity investment in the United States to consult with counsel early on in a proposed transaction process to identify potential filing obligations under these interim regulations, with an early focus on whether any of the target businesses fit within any of the 27 covered industries set forth above.

It should be noted that any acquiror, whether foreign or U.S. based, of a stake in a U.S. business operating in one of the enumerated critical technology sectors may find that these interim regulations make the transfer, sale, or other disposition of such investment more difficult in the future by limiting the

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range of potential foreign buyers of such investment. All parties will need to consider the potential for extended review of investments that are required to be submitted to CFIUS for review, and will need to consider carefully whether to submit a short form declaration, with the risk that CFIUS may call for a regular filing after 30 days of review of the short form declaration, or to proceed directly with a standard CFIUS notification.

Finally, the timing of the phased-in mandatory submission requirements means that the parties involved in any year-end covered transaction expected to close after December 25, 2018 will now have to build in at least a 45-day waiting period after the mandatory declaration submission before a scheduled closing, since closings of covered transactions after that day require submission of a mandatory declaration at least 45 days before closing. Accordingly, in light of this requirement, any parties signing an agreement to enter into such a covered transaction after November 15, 2018 will not have time to close their transaction before year-end.

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ENDNOTES

- <sup>1</sup> <https://www.sullcrom.com/files/upload/SC-Publication-CFIUS-Reform-The-Foreign-Investment-Risk-Review-Modernization-Act-of-20181.pdf>.
- <sup>2</sup> [https://home.treasury.gov/system/files/206/FR-2018-22182\\_1786904.pdf](https://home.treasury.gov/system/files/206/FR-2018-22182_1786904.pdf).
- <sup>3</sup> Treasury also published on October 10, 2018 new interim rules, effective October 11, 2018, that updated existing CFIUS regulations to reflect certain FIRRMA-based reforms. The interim rules can be reviewed [here](#). Comments are due by November 10, 2018. The interim rules will be superseded by final rules implementing FIRRMA in the future.
- <sup>4</sup> All foreign persons are covered; the pilot program is not country-specific.
- <sup>5</sup> [https://home.treasury.gov/system/files/206/FR-2018-22182\\_1786904.pdf](https://home.treasury.gov/system/files/206/FR-2018-22182_1786904.pdf).
- <sup>6</sup> The complete definition of “critical technologies” under the interim regulations, which is consistent with the corresponding definition in FIRRMA, reads as follows:
- (a) 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).
  - (b) 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:
    - (1) Pursuant to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology; or
    - (2) For reasons relating to regional stability or surreptitious listening.
  - (c) 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).
  - (d) Nuclear facilities, equipment, and material covered by 10 CFR part 110 (relating to export and import of nuclear equipment and material).
  - (e) Select agents and toxins covered by 7 CFR part 331, 9 CFR part 121, or 42 CFR part 73.
  - (f) Emerging and foundational technologies controlled pursuant to section 1758 of the Export Control Reform Act of 2018.
- <sup>7</sup> [https://home.treasury.gov/system/files/206/FR-2018-22182\\_1786904.pdf](https://home.treasury.gov/system/files/206/FR-2018-22182_1786904.pdf).
- <sup>8</sup> Transactions that are completed prior to November 10, 2018 are not covered, nor are transactions for which the parties have executed a binding written agreement establishing the material terms of the transaction before October 11, 2018, where a party has made a public offer to shareholders to purchase shares of the U.S. business before October 11, 2018, where a shareholder has solicited proxies in connection with an election of the board of directors of a U.S. business before October 11, 2018 or where a shareholder has requested the conversion of convertible voting securities before October 11, 2018.

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