

CLIENT ALERT

CFIUS Pilot Program Initiates Mandatory Notice of Foreign Investment in Certain Sectors

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On October 11, 2018, the U.S. Department of the Treasury moved aggressively to begin implementation of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) with publication of two Interim Rules. FIRRMA is the most significant revision of the United States' foreign investment review process in the last decade and seeks to enhance review of investments in certain sectors and by investors from certain countries. The [first Interim Rule](#), effective immediately, largely provides technical revisions to implement FIRRMA's procedural changes (like lengthening the review period), but also establishes new definitions of "transaction," "covered transaction," and "critical technologies." The [second](#), effective November 10, 2018, initiates a "pilot program" that will implement an important expansion of the Committee on Foreign Investment in the United States's (CFIUS's) jurisdiction imposing mandatory notice of even modest-sized, non-controlling investments in certain sensitive areas.

The pilot program, to be found in 31 C.F.R. Part 801, initiates one of the major changes introduced by FIRRMA, the use of mandatory "declarations" to provide CFIUS with notice of an expanded universe of investments involving critical technologies created or utilized in certain specified industries. Specifically, the Interim Rule identifies 27 industries ("pilot program U.S. industries"), defined by North American Industry Classification System (NAICS) codes, where an investment, *regardless of size*, can trigger the mandatory declaration requirement where the U.S. business designs, develops, or produces "critical technology" that the U.S. business either uses itself in a pilot program industry or has specially designed for use in such industry. Any such business is considered a "pilot program U.S. business." The identified list of "pilot program U.S. industries" includes not only predictable ones – like semiconductors – where CFIUS has long been active, but also others reflecting broader concerns with the defense industrial base (as addressed in DoD's recent [assessment](#)). Indeed, Treasury emphasized an "unacceptable risk of erosion of technological superiority" as justification for implementing this mandatory declaration process on an interim rule basis.

Under both Interim Rules, "critical technology" includes a variety of technologies currently export controlled as well as any "emerging or foundational" technology to be identified through a process to be led by the U.S. Department of Commerce under Section 1758 of the Export Control Reform Act of 2018. On October 12, 2018, Secretary Ross issued a [statement](#) supporting the pilot program and announcing that Commerce would be pursuing "a parallel rulemaking effort to identify, review, and potentially control emerging and foundation technologies."

Any controlling investment in a "pilot program U.S. business" is a "pilot program covered transaction" and subject to the mandatory declarations (although, as a practical matter, parties may well simply proceed with a traditional Joint Voluntary Notice (JVN) to CFIUS instead). For non-controlling investments in "pilot program U.S. businesses," whether the investment will constitute a "pilot program covered transaction" requiring a mandatory declaration depends on whether the investor will obtain one or more of the following rights:

- Access to material nonpublic technical information related to design, fabrication, development, test, production, or manufacture of critical technologies, including processes, techniques, or methods.
- Membership (including observer or nomination rights) on the Board or other governing body of the “pilot program U.S. business.”
- Any involvement, other than through voting shares, in substantive decision making of the “pilot program U.S. business.”

Any subsequent investment that provides or enhances any of these rights or would establish the foreign person’s control over the “pilot program U.S. business” would be subject to a new mandatory declaration.

There is a limited exception to mandatory notice available to indirect foreign investment through an “investment fund.” A foreign person’s indirect investment through an “investment fund” in a “pilot program U.S. business” will not trigger the mandatory declaration process, even where the foreign person participates on an advisory board or committee of the fund, provided certain conditions are met, including that the advisory board or committee does not have authority to approve, disapprove, or control the fund’s investment decisions or decisions by the general partner related to entities in which the fund has invested.

Under the pilot program, mandatory declarations must be submitted to CFIUS no later than 45 days prior to completion date of any “pilot program covered transaction” (with a transition rule for transactions closing between November 10 and December 25, 2018). The content of the declaration is reduced from what is required for a traditional JVN – often substituting a statement of whether the U.S. business is involved in certain activities instead of the descriptions and detailed lists required for a traditional JVN. Nonetheless, the declaration will require significant effort to complete and, like a JVN, must be accompanied by a certification that the declaration is accurate and complete.

Once a mandatory declaration has been submitted, CFIUS has 30 days from the date of receipt to take one of the following four actions:

- Request the parties to the transaction file a complete JVN (with the additional information required by Subpart E of the pilot program).
- Inform the parties that CFIUS is unable to complete action under Section 721 of the Defense Production Act, leaving it to the parties to decide whether to submit a JVN.
- Initiate a unilateral review of the transaction.
- Notify the parties that CFIUS has concluded all action under Section 721.

The pilot program is temporary and will ultimately be superseded by the final regulations necessary to implement all of the FIRRMA revisions. Those regulations have not yet been proposed but are to be completed and final by March 5, 2020.

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