TREASURY PROPOSES REGULATIONS IMPLEMENTING NEARLY ALL OF FIRRMA'S PROVISIONS

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U.S. International Trade Alert

On September 24, 2019, the U.S. Department of the Treasury ("Treasury") published two proposed rules (found here and here) (together, the "Proposed Rules") to implement the remaining provisions of the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"), which updated and enhanced the authority of the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee"). CFIUS also issued FAQs and a Fact Sheet to accompany the Proposed Rules. Interested parties will have until October 17, 2019, to provide written comments to Treasury on the Proposed Rules. FIRRMA requires that the final implementing rules be put into effect no later than February 13, 2020. CFIUS is the inter-agency committee chaired by Treasury that has authority to review and, if necessary, modify or block, foreign acquisitions in the United States to safeguard against threats to U.S. national security. Among a number of changes to CFIUS's regulations, the Proposed Rules will specify CFIUS review jurisdiction over non-controlling investments by foreign persons in certain U.S. businesses as well as "covered real estate transactions." Highlights of the Proposed Rules are as follows:

- The Proposed Rules specifically extend CFIUS's review jurisdiction to "covered investments," which are non-controlling investments in "TID" (***t***echnology, ***i***nfrastructure, and ***d***ata) U.S. businesses that afford a foreign person access to material nonpublic technical information, board membership and/or observer rights, or substantive decisionmaking of the TID U.S. business regarding critical technologies, critical infrastructure, or sensitive personal data of U.S. citizens;
- The Proposed Rules exclude from CFIUS jurisdiction certain covered investments by (a) "excepted investors," defined, among other factors, by reference to a "white list" of closely allied countries to be determined in future rulemaking by CFIUS, and (b) foreign persons as limited partners in an investment fund that meets certain required parameters;
- Notifications to CFIUS of covered investments will not be mandatory; however, (a) certain investments directly or indirectly by foreign governmental entities will be mandatory, and (b) the Proposed Rules do not modify the mandatory declaration requirement of the CFIUS Critical Technology Pilot Program, which will continue to remain in effect for the time being;
- The Proposed Rules create a new category of mandatory notifications for covered transactions that result in the acquisition of a "substantial interest" in a TID U.S. business by a foreign person in which a foreign government has a "substantial interest";
- The Proposed Rules also implement a provision of FIRRMA specifically extending CFIUS jurisdiction to certain purchases or leases by, and concessions to, a foreign person of U.S. real estate located in, or that

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functions as part of an airport or maritime port, or proximate to identified sensitive military and intelligence assets;

- In an attempt to simplify the CFIUS notification process, parties will now have the option of notifying CFIUS of covered control transactions via the submission of a short-form declaration, rather than a lengthy Joint Voluntary Notification ("JVN"); and
- Treasury intends to issue regulations regarding CFIUS's authority to impose filing fees and to mandate the filing of declarations for certain types of transactions involving critical technologies (which are currently the subject of the Critical Technology Pilot Program).

A. MODERNIZATION OF CFIUS'S REGULATIONS AND IMPLEMENTATION OF FIRRMA PROVISIONS

The Proposed Rules revise CFIUS's main regulations, found at 31 C.F.R. Part 800, to incorporate most of the remainder of FIRRMA, as follows:

Non-Controlling "Covered Investments." Along with CFIUS's traditional jurisdiction over transactions that could result in control directly or indirectly of a U.S. business by a foreign person (called "covered control transactions" in the Proposed Rules), the Proposed Rules extend CFIUS's jurisdiction to certain non-controlling "covered investments" in a "TID [i.e., technology, infrastructure, and data] U.S. business," defined as a U.S. business that:

produces, designs, tests, manufactures, fabricates, or develops one or more "*critical technologies*," which generally include export controlled items, foreign atomic energy activities, the export/import of nuclear equipment and material, select agents and toxins, and "emerging" and "foundational" technologies that will be defined under future rulemaking with the Department of Commerce's Bureau of Industry and Security ("BIS");

performs certain defined functions with respect to "*covered investment critical infrastructure*," a defined subset of critical infrastructure set forth in an annex to the Proposed Rules that includes certain internet protocol networks and exchange points; certain telecommunications and fiber optic cable systems; submarine cable systems and supporting services and infrastructure; satellites and satellite systems servicing the Department of Defense; the manufacture of certain industrial resources and materials for defense-related purposes; certain electrical generating, transmission, distribution, and storage facilities; certain oil and gas product refineries, storage facilities, oil and gas pipelines and related control systems, and liquefied natural gas import and export terminals; certain financial market exchanges; certain rail lines and connectors; identified maritime ports and airports, and certain types of public water systems; or

maintains or collects, directly or indirectly, "*sensitive personal data*" of U.S. citizens, which is identifiable data that is incorporated into products or services within certain categories, including financial distress or hardship, health conditions, geolocations, biometric enrollment data, government ID cards, and genetic information, where the U.S. business targets or tailors products or services to agencies with intelligence, national security, or homeland security responsibilities or personnel and contractors thereof, has maintained or collected data on more than one million individuals over the past twelve months, or has a demonstrated business objective to maintain or collect such data on more than one million people and the data is integrated into the U.S. business's primary products or services.

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Covered investments are defined as non-controlling direct or indirect investments by a foreign person (other than an "excepted investor," as discussed below) in an unaffiliated TID U.S. business that affords the foreign person one of the following:

- Access to "material nonpublic technical information," which is defined as information that (a) "[p]rovides 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 (b) "[i]s not available in the public domain and is necessary to design, fabricate, develop, test, produce, or manufacture a critical technology, including without limitation processes, techniques, or methods";
- Board membership or observer status or nomination/appointment rights with respect to the TID U.S. business; or
- Any involvement other than through voting of shares in substantive decisionmaking of the TID U.S. business regarding the use, development, acquisition, safekeeping, or release of sensitive personal data of U.S. citizens; the use, development, acquisition, or release of critical technologies; or the management, operations, manufacture, or supply of covered critical infrastructure.

Excepted Investors. The Proposed Rules include a carve-out from the definition of "covered investments" for certain investments by an "excepted investor," defined by reference to an "excepted foreign state," which is a "white list" to be defined in future rulemaking by CFIUS that is expected to include close U.S. allies with a similar national security review process for foreign acquisitions and investments. The list of excepted foreign states will be subject to periodic review and modification by CFIUS. The definition of an "excepted investor" has certain exclusions that may have broad application, such as if the foreign person or any of its parents or subsidiaries has in the past five years received a written Finding of Violation or Penalty Notice from Treasury's Office of Foreign Assets Control ("OFAC"), received written notice of debarment from the Department of State's Directorate of Defense Trade Controls ("DDTC"), or been the subject of a final order issued under export control laws by BIS. Note that the excepted investors carve-out will not apply to "covered control transactions," i.e., if the investment in fact results in control of a U.S. business by the foreign investor

Most Covered Transactions Remain Voluntary. Under the Proposed Rules, the CFIUS notification process remains mostly voluntary, with parties having the option to notify CFIUS and obtain a safe harbor against subsequent review if CFIUS clears the transactions. There are two exceptions where notifying CFIUS is or will be mandatory. First, the Proposed Rules will implement a mandatory declaration requirement for certain direct and indirect foreign government acquisitions and investments involving TID U.S. businesses, as discussed in the next paragraph. Second, the Proposed Rules have not modified the Critical Technology Pilot Program, which must end by February 2020. As a result, for now the mandatory declaration requirement for critical technology transactions covered by the Critical Technology Pilot Program still applies.

New Mandatory Declaration Requirement. The Proposed Rules create a new requirement to submit a mandatory declaration of a covered transaction (including covered investments and covered control transactions) that result in the acquisition of a "substantial interest" in a TID U.S. business by a foreign person in which a foreign government has a "substantial interest." For purposes of this rule, "substantial interest" is defined as "a voting interest, direct or indirect, of 25 percent or more by a foreign person in a U.S. business and a voting

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interest, direct or indirect, of 49 percent or more by a foreign government in a foreign person." Parties may file a JVN instead of a required declaration.

Expansion of "Covered Transaction" Definition to Real Estate. As provided under FIRRMA, the Proposed Rules expand the definition of a "covered transaction" to include certain real estate transactions as described. These new requirements are discussed in Section B, below.

Other Types of Covered Control Transactions. As part of the definition of "covered transaction," the Proposed Rules also extend CFIUS jurisdiction to cover situations where a foreign person acquires additional rights in a U.S. business in which the foreign person is an investor, if a change in control could result in a covered control transaction or covered investment. Changes in control may come about not only through mergers and acquisitions but also through acquisition of voting proxies, long-term leases or concession arrangements, or the conversion of a contingent equity interest in a U.S. business. Covered transactions also include any other transaction, transfer, agreement, or arrangement structured to evade or circumvent CFIUS jurisdiction.

Declarations in Lieu of a JVN. The Proposed Rules will allow for a short-form declaration to be submitted for covered transactions in lieu of a lengthier JVN. Currently, a short-form declaration is only allowed for transactions covered by the Critical Technology Pilot Program. Such declarations, once accepted as complete by CFIUS, will be subject to a maximum 30-day review period. While CFIUS has had some difficulty completing its review of declarations under the Critical Technology Pilot Program, resulting in either a request to file a full JVN or a notice that the parties can proceed with a transaction but without benefit of the safe harbor of CFIUS clearance, some parties may find this new opportunity to submit a declaration preferable to filing a full JVN.

B. EXPANSION OF CFIUS'S JURISDICTION TO CERTAIN REAL ESTATE TRANSACTIONS

The Proposed Rules will complete implementation of FIRRMA by formally establishing CFIUS's expanded jurisdiction to certain real estate transactions, to be put into a new subset of the CFIUS regulations (31 C.F.R. Part 802).

Covered Real Estate Transactions. In particular, the Proposed Rules set forth three categories of "covered real estate transactions," as follows:

1. Any purchase, lease, or concession [1] to a "foreign person" of properties constituting "covered real estate" that afford the foreign person at least three "qualifying property rights." These rights include the right to: (i) physically access the real estate, (ii) exclude others from physical access to the real estate, (iii) improve or develop the real estate, or (iv) attach fixed or immovable structures or objects to the real estate. Regardless of whether these rights are exercised, purchases, leases, or concessions that afford three out of four of these rights (in any combination) to foreign persons over "covered real estate" (defined below) are reviewable by the Committee;
2. Any change in a foreign person's existing ownership, lease, or concession rights regarding "covered real estate" if the change results in the foreign person having at least three of the qualifying property rights; and
3. Any other transactions, transfers, agreements, or arrangements that evade or circumvent CFIUS real estate regulations.

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Covered Real Estate. There are four categories of properties that constitute "covered real estate" under the Proposed Rules:

4. Property located within, or that will function as part of, an "air or maritime port." The Proposed Rules define "maritime port" to cover the country's largest container, tonnage, and dry bulk ports and other strategic seaports.
5. Property located near a U.S. military installation or another facility or property of the U.S. government that is sensitive for reasons relating to national security. This includes property located within:

"Close proximity" of a designated military installation or another facility or property of the U.S. government. The Proposed Rules list almost 200 qualifying "military installations" along with their proximity restrictions in Appendix A of 31 C.F.R. § 802. "Close proximity" typically means one mile from the outer boundary of a designated military installation or government facility.

Extended range of certain, specified military installations. Extended range typically means 100 miles outward from the outer boundary or, where applicable, 12 nautical miles of the U.S. coastline.

Any county or other geographic area identified in connection with certain, specified military installations.

Any part of certain, specified military installations located within 12 nautical miles of the coastline of the United States.

Voluntary Notifications. Parties engaging in a covered real estate transaction do not have any mandatory filing requirements under the Proposed Rules. Rather, parties to a covered real estate transaction have the option to submit a short-form declaration or a full JVN to CFIUS. Both forms of notification would require the parties to provide details on the real estate, the parties, the transaction structure, and the qualifying property rights to be obtained by a foreign person. As with all voluntary notifications to CFIUS, the benefit of providing notice is that the parties may qualify for a "safe harbor" letter, which generally protects the parties from a subsequent CFIUS review.

"Excepted Real Estate Transactions." The Proposed Rules include several notable exceptions to the Committee's jurisdiction over covered real estate transactions. Under the Proposed Rules, an "excepted real estate transaction" includes real estate within an "urbanized area" or "urban cluster" (as defined by the Census Bureau). However, the property remains subject to the Committee's review authority if the property is in close proximity to a designated military installation or sensitive government property, or will function as part of, an airport or maritime port. Excepted real estate transactions include transactions for single housing units, including fixtures and adjacent land, provided the land is incidental to the use of the real estate as a single housing unit.

Additionally, excepted real estate transactions include transactions with (1) land owned by certain Alaska Native entities or held in trust by the United States for American Indians, Indian tribes, Alaska Natives, and Alaska Native entities, (2) land located within an airport or maritime port that is to be used only for retail, accommodation, or food service, and (3) office space within a multi-unit commercial office building, provided the foreign person will not (i) hold, lease, or have a concession with respect to more than 10% of the building's total square footage and (ii) represent more than 10% of the building's tenants.

"Excepted Real Estate Investors." The Proposed Rules also provide a carve-out for certain real estate transactions by an "excepted real estate investor." Similar to the definition of excepted investor discussed

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previously, excepted real estate investors will be defined by reference to a "white list" of foreign states expected to be defined and periodically updated by CFIUS, and will have a similarly scoped carve-out if the foreign investor or any of its parents or subsidiaries has in the past five years been subject to certain enforcement actions by OFAC, DDTC, and BIS.

Other Exceptions. The Proposed Rules make clear that CFIUS jurisdiction does not extend to mortgages, loans, or similar financing arrangements by foreign persons to other persons for the purpose of the purchase, lease, or concession of covered real estate. In addition, transactions that involve real estate that also constitute investments in "U.S. businesses" are not "covered real estate transactions" but rather should be treated as non-real estate transactions that may be subject to CFIUS jurisdiction under 31 C.F.R. Part 800. Such transactions could be subject to CFIUS jurisdiction, for example, if a foreign investor obtains certain control or qualifying non-control rights.

C. CONCLUSION

Continue to follow K&L Gates as we track CFIUS's regulatory implementation. Contact any of the authors for additional information on CFIUS, the implementing Proposed Rules, or any other related topic.

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[1] The Proposed Rules give the terms "purchase" and "lease" their ordinary meaning, but the term "concession" is defined specifically as "an arrangement whereby a U.S. public entity grants a right to use real estate for the purpose of developing or operating infrastructure for an airport or maritime port" (including the assignment of a concession by the party who is not the U.S. public entity).

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