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Client Alert Commentary

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US Treasury Department Publishes Proposed Regulations to Implement FIRRMA: 10 Key Questions Answered

CFIUS has offered a one-month comment period for proposed rulemaking to implement provisions of CFIUS legislation passed in August 2018.

More than a year ago, in August 2018, US President Donald Trump signed the Foreign Investment Risk Review Modernization Act (FIRRMA) into law. FIRRMA addresses perceived gaps in the scope and process of foreign investment review by the Committee on Foreign Investment in the United States (CFIUS) (see previous *Client Alert* for further detail on FIRRMA). FIRRMA was not self-executing, however, as most of its provisions require implementing regulations.

Almost a year ago, on October 10, 2018, the US Treasury Department issued regulations on behalf of CFIUS as the first part of a phased implementation of FIRRMA. Those regulations launched a so-called "Pilot Program" that, pursuant to FIRRMA, extended CFIUS' jurisdiction to certain small, but not passive, investments ("non-controlling, non-passive investments") in US "critical technology" companies. The Pilot Program also required mandatory declarations for investments in such businesses (see previous *Client Alert* for further detail on the Pilot Program).

On September 17, 2019, the Treasury Department released a second set of regulations to implement additional provisions of FIRRMA. The proposed regulations include Provisions Pertaining to Certain Investments in the United States by Foreign Persons and Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate in the United States (together, the Proposed Regulations).

These important Proposed Regulations truly bring FIRRMA to life, articulating the expansion of CFIUS' jurisdiction to review:

- Certain non-controlling, non-passive investments in **T**echnology, **I**nfrastructure, and **D**ata businesses in the United States (so-called TID US businesses)
- Certain real estate investments

As the Treasury Department explains in short FAQs released with the proposed rulemaking, the Proposed Regulations "comprehensively implement FIRRMA." And while the Proposed Regulations are complex in many respects, and represent a notable departure from current practice, the new rules were, of course, anticipated in FIRRMA.

The Treasury Department issued the proposed regulations as the first step in a notice-and-comment rulemaking process. CFIUS has thus invited public comments on the Proposed Regulations by October 17, 2019. Comments will be publicly available at https://www.regulations.gov. CFIUS will review the comments before publishing the final regulations, which likely will occur on or before February 13, 2020.

This *Client Alert* addresses 10 key questions regarding the new Proposed Regulations.

1. Will the Proposed Regulations immediately change the Pilot Program regarding critical technology?

No. The Proposed Regulations do not modify the Pilot Program relating to critical technology investments, by which CFIUS mandates filings for certain investments in US businesses that produce, design, test, manufacture, fabricate, or develop critical technology in connection with 27 specified industries. In fact, the Proposed Regulations explain that "CFIUS continues to evaluate the Pilot Program Interim Rule, and the Department of the Treasury welcomes comments on the retention of the mandatory declaration aspect of the Pilot Program Interim Rule for certain transactions involving critical technologies."

The Proposed Regulations do, however, expand CFIUS' jurisdiction to review covered investments involving critical technology companies (the "T" in TID US businesses) — without limiting the review to companies that operate in connection with specified sensitive industries, as the Pilot Program does. The definition of critical technology in the Proposed Regulations is the same as that set out in FIRRMA and the Pilot Program, and includes most items that are controlled under US export control laws. Separately, the US Commerce Department and other agencies continue to work on developing lists of "emerging" and "foundational" technologies, as required by the Export Control Reform Act of 2018. Once implemented, these lists will supplement the definition of critical technologies. To date, the Commerce Department has published an Advanced Notice of Proposed Rulemaking, identifying broad categories of emerging technologies the agencies are considering. The Commerce Department has not yet released final regulations setting out foundational and emerging technologies.

2. Under which circumstances can CFIUS review investments in TID US businesses?

CFIUS already has the authority to review any transaction that could result in "control" of a US business by a foreign person if that transaction could have an impact on US national security. By virtue of the current Pilot Program, CFIUS also mandates review of certain non-controlling, non-passive investments relating to critical technology businesses.

Consistent with FIRRMA, under the Proposed Regulations, CFIUS would also have the authority to review a non-controlling investment by a foreign person in a TID US business that affords the foreign person one or more of the following:

- Access to material, nonpublic technical information in the possession of the TID business
- Membership or observer rights on the board of directors or equivalent governing body of the TID business, or the right to nominate an individual to a position on the board of directors or equivalent governing body
- Any involvement, other than through voting of shares, in substantive decision-making of the TID business regarding any of the following:

- Use, development, acquisition, safekeeping, or release of sensitive personal data of US citizens maintained or collected by the TID US business
- Use, development, acquisition, or release of critical technologies
- Management, operation, manufacture, or supply of critical infrastructure

Investments meeting these criteria are defined as covered investments. The Proposed Regulations limit covered investments to those made in "unaffiliated" TID US businesses, which is to say excluding investments in entities in which a foreign person already holds a majority of the voting interest or the right to appoint the majority of the entity's board or equivalent governing body.

The Pilot Program for critical technologies implemented the ability under FIRRMA to submit a shorter form "declaration," rather than a full CFIUS notice. Parties to covered investments in TID US businesses will have the choice to submit a declaration or a full notice. If the submission of a declaration is mandatory (*see* question 6), parties must submit their transactions to CFIUS for review 30 days prior to the completion of the transaction — as compared to the current 45 days under the existing Pilot Program for critical technologies. The differences between a short-form declaration and a full CFIUS notice are reviewed in this *Client Alert* relating to the Pilot Program.

3. Under which circumstances can CFIUS review investments in TID US businesses made through investment funds?

Under FIRRMA, indirect investment in an unaffiliated TID US business that gives a foreign limited partner membership on a fund advisory board or committee does not in itself mean the investment is subject to CFIUS jurisdiction. The Proposed Regulations include "specific clarifications" for investment funds. According to the Proposed Regulations, such an investment is not a covered investment if the following factors are present:

- The fund is managed exclusively by a general partner, a managing member, or the equivalent, and that general partner, manager, or equivalent is not the foreign investor

- If any foreign person is on an advisory board or committee of the fund, that board or committee does not have the ability to approve, disapprove, or otherwise control investment decisions of the fund, including decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested

- The foreign limited partner does not otherwise have the ability to control the investment fund (including by having the authority to (i) approve, disapprove, or otherwise control investment decisions of the investment fund; (ii) approve, disapprove, or otherwise control decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested; or (iii) unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing member, or equivalent)

- The foreign limited partner does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee

- The foreign limited partner is not afforded the access, rights, or involvement described in the definition of a "covered investment"

These criteria largely apply today with respect to the Pilot Program.

4. Which types of infrastructure companies qualify as TID US businesses?

The proposed critical infrastructure rules apply to 28 enumerated categories of "covered investment critical infrastructure," which includes certain "soft" infrastructure companies, such as telecom services and internet exchange points. To be a TID US business, a company must perform one or more corresponding functions in connection with covered investment critical infrastructure.

Accordingly, an "infrastructure" TID US business is defined according to a two-step assessment set out in the Proposed Regulations. To simplify the evaluation, the Proposed Regulations provide two lists. The first is a list of "types" of critical infrastructure, including, for example, certain air and maritime ports and terminals, energy infrastructure (such as pipelines and refineries), significant financial market utilities and securities exchanges, internet and telecom technologies, public water systems, and specialty manufacturing. The list is subject to future revisions.

The second is a list of "functions": own, operate, manufacture, supply, or service. A US business that performs one of the specified functions with respect to a correlating covered infrastructure qualifies as a TID US business.

The examples in the table below illustrate the interplay between these lists, which are found in Appendix A of the Provisions Pertaining to Certain Investments in the United States by Foreign Persons.

Column 1 (Covered investment critical infrastructure)	Column 2 (Functions related to covered investment critical infrastructure)
(xvi) Any crude oil storage facility with the capacity to hold 30 million barrels or more of crude oil	(xvi) Own or operate any crude oil storage facility with the capacity to hold 30 million barrels or more of crude oil
(xxiii) Any interstate natural gas pipeline with an outside diameter of 20 or more inches	(xxiii) Own or operate any interstate natural gas pipeline with an outside diameter of 20 or more inches
(xx) Any technology service provider in the Significant Service Provider Program of the Federal Financial Institutions Examination Council that provides core processing services	(xx) Own or operate any technology service provider in the Significant Service Provider Program of the Federal Financial Institutions Examination Council that provides core processing services

5. Which companies with sensitive data qualify as TID US businesses?

The Proposed Regulations would allow CFIUS to review investments in an unaffiliated TID US business that maintains or collects sensitive personal data of US citizens that may be exploited in a manner that threatens to harm national security. Sensitive personal data include specific categories of "identifiable" data that can be used to determine an individual's identity, and must satisfy a two-part test. First, the data must fall into one of the following categories:

- Data that could be used to analyze or determine an individual's financial distress or hardship
- The set of data in a consumer report, subject to certain limitations
- Data in an application for health insurance, long-term care insurance, professional liability insurance, mortgage insurance, or life insurance
- Data relating to an individual's physical, mental, or psychological health condition

- Non-public electronic communications between or among users of a US business' products or services, if a primary purpose of such product or service is to facilitate third-party user communications
- Geolocation data collected using positioning systems, cell phone towers, or WiFi access points such as via a mobile application, vehicle GPS, other onboard mapping tool, or wearable electronic device
- Biometric data, including facial, voice, retina/iris, and palm/fingerprint templates
- Data for generating a state or federal government identification card
- Data concerning US government personnel security clearance status
- Data in an application for a US government personnel security clearance or an application for employment in a position of public trust

Second, the data must be maintained or collected by a US business that:

- Targets or tailors its products or services to sensitive US government personnel or contractors
- Maintains or collects such data on greater than 1 million individuals
- Demonstrates a business objective to maintain or collect such data on more than 1 million individuals, and such data is an integrated part of the US business' primary products or services

Sensitive personal data also includes all genetic information (identifiable or not). For US businesses with genetic information relating to US citizens, the thresholds identified above (*e.g.*, businesses that maintain or collect data on greater than 1 million individuals) do not apply.

The term "sensitive personal" data excludes (1) data maintained or collected by a US business concerning its own employees (unless the data pertains to employees of US government contractors who hold US government personnel security clearances) and (2) data that is a matter of public record, such as court records or other government records that are generally available to the public.

6. Do the Proposed Regulations introduce new requirements for investments involving foreign government-owned investors?

Yes. FIRRMA provides that CFIUS filings will become mandatory for certain investments by foreign government-owned investors in TID US businesses, and the Proposed Regulations will implement those provisions. This filing requirement will apply if:

- A foreign government holds a voting interest of 49% or more in a foreign investor
- The foreign investor is acquiring a voting interest of 25% or more in a TID US business
- The transaction would give the foreign investor control over the US business or is the type of non-controlling, non-passive investment described in the answer to question 2 in this *Client Alert*

In determining whether the 49% and 25% thresholds are satisfied, foreign investors must consider both direct and indirect interests, and should treat any voting interest that a parent company holds in a subsidiary as a 100% voting interest. For instance, if a foreign government owns 100% of the voting interest in a foreign investor, that foreign investor owns 60% of the voting interest in another company, and that company is acquiring 25% of the voting interest in a TID US business through the type of non-controlling, non-passive investment described above, a filing will be required because the regulations will treat the foreign investor as indirectly acquiring 25% of the US business.

When a filing requirement applies, parties to a transaction will have to submit a full notice or a short-form declaration at least 30 days before closing (as opposed to the current 45-day period under the existing Pilot Program).

Notably, although FIRRMA authorizes CFIUS to waive this requirement for particular foreign investors, the Proposed Regulations do not provide for waivers at this time. However, this requirement relating to foreign investors with significant government ownership does not apply to qualifying investments through US-managed investment funds — an exception discussed in greater detail in the answer to question 3.

7. Do the Proposed Regulations impose a "white" list and a "black" list of foreign investors?

Not exactly. The Proposed Regulations provide for a limited exemption from CFIUS' expanded jurisdiction under FIRRMA for certain foreign investors with close connections to "excepted foreign states." To qualify, an investor must satisfy two requirements:

- The investor must be the government of an excepted foreign state, an individual who is a national of one or more excepted foreign states but not also a national of a non-excepted foreign state, or an entity with very substantial ties to one or more excepted foreign states.
  - In the case of an individual, a dual national of an excepted foreign state and a non-excepted foreign state will not qualify for an exemption.
  - In the case of an entity: (1) the entity must be organized under the laws of and have its principal place of business in an excepted foreign state or the US; (2) all of the entity's directors must be nationals of excepted foreign states or the US; (3) each of the entity's owners holding certain interests of 5% or more must themselves be from excepted foreign states or the US; and (4) either a majority (in the case of an entity whose shares are primarily traded on an exchange in an excepted foreign state or the US) or 90% (in the case of any other entity) of certain interests in the investor must be held by parties from excepted foreign states or the US. Each of the entity's parent companies must also satisfy those criteria.
- The investor and its subsidiaries must not have recently made misstatements in a CFIUS filing, violated a mitigation agreement with CFIUS, had a transaction blocked through the CFIUS process, been subjected to a penalty by CFIUS or the government agencies responsible for sanctions and export controls, or been convicted of a felony.

CFIUS has not yet published the list of excepted foreign states, but the Proposed Regulations indicate that the Committee "initially intends to designate a limited number of eligible foreign states" and may expand the list in the future.

If an investor satisfies the criteria for exemption, CFIUS will not have jurisdiction over its non-controlling investments in TID US businesses or its real estate investments that would otherwise have been subject to CFIUS' expanded jurisdiction under FIRRMA. Significantly, CFIUS will retain jurisdiction over transactions that could result in "control" of a US business by an excepted investor. Because CFIUS interprets "control" broadly, many investments by excepted investors will remain subject to the Committee's jurisdiction.

The Proposed Regulations do not create a so-called "black list." They do not prohibit investments from any country or subject investors from particular countries to additional requirements, although in practice CFIUS will continue to apply more scrutiny to investors from countries that are perceived as high risk from a CFIUS perspective (*e.g.*, China and Russia).

8. Under which circumstances will CFIUS have jurisdiction to review real estate transactions?

FIRRMA expands CFIUS' jurisdiction to authorize the Committee to review the national security impact of foreign investments involving "the purchase or lease by, or a concession to, a foreign person of private or public real estate" in the US located within (or functioning as a part of) an airport or maritime port or in "close proximity to" a US military installation or other facility "sensitive for reasons relating to national security." The Proposed Regulations implement FIRRMA's provisions regarding real estate investments by providing greater specificity regarding the geographic location of covered real estate. The types of real estate investments — purchases but also leases — that would be subject to CFIUS review, if the proposed rule is finalized as currently drafted, would include:

- Real estate located within or functioning as part of certain airports (*e.g.*, major US passenger and cargo airports based on volume) and maritime ports, as well as "joint use airports" where both military and civilian aircraft share use of a military airfield.

- Real estate located within one of the following areas:

  - One mile (close proximity) of certain military installations identified in Appendix A to the Proposed Regulations such as Adelphi Laboratory Center in Adelphi, Maryland, Fort Belvoir in Fairfax, Virginia, and MacDill Air Force Base in Tampa, Florida

  - Certain counties identified in connection with military installations identified in Appendix A, such as Chase, Dundy, and Goshen counties in Nebraska identified in Part 3 of Appendix A in connection with the 90th Missile Wing Francis E. Warren Air Force Base Missile Field

  - One to 100 miles (the extended range) of certain military installations such as real estate located within 40 miles of Fort Benning in Columbus, Georgia

  - 12 nautical miles seaward of the US coastline (for offshore ranges (identified in Part 4 of Appendix A) and if any portion of the extended range of a military installation identified in Appendix A falls offshore)

A purchase, lease, or concession of covered real estate falls within CFIUS jurisdiction when the foreign investor is afforded three out of four of the following property rights:

- To physically access the real estate
- To exclude others from physical access to the real estate
- To improve or develop the real estate
- To attach fixed or immovable structures or objects to the real estate

The Proposed Regulations also identify excepted real estate transactions not considered to be covered under FIRRMA. The Proposed Regulations carve out the following real estate transactions:

- Transactions in which a foreign investor is a national of certain countries that CFIUS will identify at a later time as "excepted real estate foreign states" (an excepted real estate investor)

- The purchase/lease/concession of:

- Real estate located within an "urbanized area" (an area with a minimum population of at least 50,000 individuals according to the most recent US Census) or an "urban cluster" (an area containing at least 2,500 and less than 50,000 people) — except if the real estate is located within or functioning as part of an air or maritime port, or within close proximity to a military installation:
    - A single housing unit, including fixtures and adjacent land — as long as the land is incidental to the use of the real estate
    - In the context of airport and maritime port leases and concessions, real estate for which the terms of the lease or concession restrict use to retail trade, accommodation, or food service
    - Commercial office space within a multi-unit commercial office building so long as, at the completion of the transaction: (1) the amount of space occupied by a foreign person is equal to 10% or less of the total square footage; and (2) the ratio of a foreign person and its affiliates to the total number of tenants in the building amounts to less than 10% of the total number of tenants
    - Land owned by or held in trust for Alaskan Natives and Native Americans

FIRRMA does not institute mandatory filings for real estate transactions. Parties to a covered real estate transaction can decide whether to file a full notice with CFIUS or submit a short-form declaration.

9. Have the new CFIUS filing fees been announced?

No. While FIRRMA authorizes CFIUS to assess a fee with respect to covered transactions for which the parties elect to file a full notice (as opposed to a declaration), the Proposed Regulations do not address FIRRMA's provisions regarding filing fees. The Treasury Department explained that it will eventually publish a separate proposed rule regarding filing fees. FIRRMA authorizes CFIUS to assess and collect filing fees that are no greater than 1% of the value of the transaction or US$300,000, whichever is less.

10. How can interested parties comment on the Proposed Regulations?

Parties interested in submitting comments may do so electronically through the Federal Government's eRulemaking Portal or by mailing comments to: US Department of the Treasury, Attention: Thomas Feddo, Assistant Secretary for Investment Security, 1500 Pennsylvania Avenue, NW, Washington, D.C. 20220. Comments are due by October 17, 2019, and will be available for public review. Please contact any of the authors listed below for assistance with preparing and submitting comments.

There may be additional opportunities to learn more information about the rulemaking. The Treasury Department announced that it will hold one or more teleconferences on the Proposed Regulations; the first will occur on September 27, 2019.

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