

CFIUS Announces Pilot Program: Mandatory Declaration Filings in Connection with Certain Transactions

by Lawrence Ward and T. Augustine Lo

A little more than two months after the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”) was signed into law, the United States Department of the Treasury (has invoked its new authority under the FIRRMA to implement a pilot program to review certain transactions involving foreign investment in U.S. companies. The new pilot program, which will be run by the Committee on Foreign Investment in the United States (“CFIUS”), an interagency committee chaired by the Treasury Department, marks a profound change in CFIUS’s regulatory authority. (For an overview of FIRRMA generally, please see our summary of this new law posted in August (available [here](#)).)

Before the pilot program, there was not a specific requirement to make a filing with CFIUS. The notice filing process was largely voluntary and largely based on whether a foreign person acquired “control” of a U.S. business. (Instead, there was a strong incentive to take advantage of that process, if the parties believed that their transaction was within the jurisdiction of Section 721 of the Defense Production Act of 1950, as amended (“Section 721”), as a “covered transaction,” in order to mitigate the risk that the President would seek to unwind the transaction after the fact.)

Now, under FIRRMA, parties to a transactions must analyze not only their transaction but also the nature of the underlying U.S. business to determine if it is subject to a requirement to file a declaration before completing the transaction, under threat of significant penalties for failing to do so. Under the pilot program, the mandatory declaration requirement extends to investments by foreign persons that do not constitute an acquisition of “control” of a U.S. business but which merely permit the foreign investor to receive one of the following:

- Access to any material, non-public technical information in the U.S. business’s possession;
- Membership or observer rights on the board of directors or equivalent governing body of the U.S. business, or the right to nominate an individual to a position on such body; or
- Any involvement, other than through voting of shares, in substantive decision-making

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of the U.S. business regarding the use, development, acquisition, or release of “critical technology.”

The pilot program covers any U.S. business that produces, designs, tests, manufactures, fabricates, or develops a “critical technology” that is: (1) utilized in connection with the U.S. business’s activity in one or more “Pilot Program Industries;” or (2) designed by the U.S. business specifically for use in one or more Pilot Program Industries. (“A list of the Pilot Program Industries is at the end of this eUpdate.”)

FIRRMA amended the definition of “critical technologies” to include items that are subject to export controls (e.g., the U.S. Munitions List under the International Traffic in Arms Regulations; the Commerce Control List under the Export Administration Regulations (the “EAR”); nuclear materials regulated by the Department of Energy or the Nuclear Regulatory Commission, etc.). In addition, FIRRMA identifies “[e]merging foundational technologies” as a new and separate category of “critical technology” that could trigger a CFIUS review. (This provision is a cross-reference to the new export control provisions that appear alongside FIRRMA in Title XVII of the National Defense Authorization Act for Fiscal Year 2019. Those new provisions will cause new legal changes to the EAR administered by the Bureau of Industry and Security (“BIS”) in the U.S. Department of Commerce.)

A “declaration” in this new process is essentially a short-form notice to CFIUS of the basic details of the proposed transaction and will not be as detailed as a standard CFIUS voluntary notice. By design, such a declaration is simply to give the U.S. Government “early warning” of a transaction that might otherwise go unnoticed and to allow CFIUS to tell the parties, in select cases, they should proceed to prepare and file a full joint voluntary notice before closing. Under FIRRMA, the CFIUS notice process itself has been lengthened from 90 days to 105 days (and potentially as long as 120 days if CFIUS finds “extraordinary circumstances.” So, if the parties go through a 45-day “declaration” under the pilot program and CFIUS then asks the parties to submit a full notice, the entire process could stretch 165 days before closing.

Effect on Current Transactions

The mandatory CFIUS declaration filing requirement applies to any transaction that is completed after November 10, 2018, or any transaction for which the material terms are established after October 11, 2018. Declarations must be filed at least 45 days before a transaction’s expected completion date. The pilot program will run until the final regulations implementing FIRRMA are promulgated or until March 5, 2020, whichever is first. Thus, parties to a covered transaction must carefully monitor regulatory developments under FIRRMA to determine what impact, if any, changes to the pilot program will have on the transaction.

In the initial implementation phase, for transactions closing between November 10, 2018 and December 25, 2018, the declaration must be filed by November 10, 2018 or “promptly thereafter.” Importantly, failure to file such a mandatory declaration will expose the transaction parties to a potential monetary penalty up to the value of the entire

underlying transaction. Furthermore, for deals for which such a declaration is not filed and the parties proceed to close without such a declaration, CFIUS will have the authority to recommend to the President that he order certain deals be legally unwound.

Key Takeaways

- *Seek Advice Early in the Deal Process.* As noted above, determining whether or not a declaration is mandated in any given transaction will take a careful factual analysis. Try to seek out advice as early as possible in the deal process so that clearing the CFIUS hurdle does not become a problematic condition to closing or an impediment to shareholder meetings or other such events.
- *Filing with CFIUS Still may be Advisable for Control Transactions.* The new pilot program is intended to pick up minority or non-controlling investments by foreign persons in U.S. businesses. It is still important to remember that, for control transactions that are not covered by the pilot program, a formal notice filing with CFIUS may still be advisable and analysis should be completed on a transaction-by-transaction basis.
- *Filing a Formal Notice with CFIUS an Alternative to Declaration Filing.* Instead of filing a “declaration” with CFIUS under the pilot program, parties may still opt to file a formal joint voluntary notice with CFIUS instead, which involves significantly more information. In most cases, there would not be much advantage to doing so but, in certain transactions (especially when the foreign person is intent from the outset on increasing its initial investment in the U.S. business in the future), filing a joint voluntary notice with CFIUS may be more practical, less expensive, and less time-consuming than facing a declaration plus a notice filing.
- *Emerging Technology Sector.* U.S. businesses developing emerging technologies are ripe for continued foreign investment. U.S. businesses contemplating such transactions in this space must be prepared to discuss the new pilot program and its impact on the transaction with potential foreign investors or business partners.
- *Critical Technologies.* A fair number of the industries listed below are thought of as “traditional” national security, military, or aerospace sectors. However, several of them are not and may well be surprising to some entrepreneurs and investors. In recent years, CFIUS has been particularly focused on deals in the semiconductor, biotechnology, nanotechnology, and telecommunications/wireless industry sectors.

Pilot Program Industries

The Treasury Department has listed the industries below as the 27 Pilot Program Industries. The formal list defines industries by specific classification codes in the North American Industry Classification System (“NAICS”). (For an explanation of NAICS and applicable codes, please see this U.S. Census Bureau website: [https://www.census.gov/eos/www/naics/.](https://www.census.gov/eos/www/naics/))

1. Aircraft Manufacturing
2. Aircraft Engine and Engine Parts Manufacturing
3. Alumina Refining and Primary Aluminum Production
4. Ball and Roller Bearing Manufacturing
5. Computer Storage Device Manufacturing
6. Electronic Computer Manufacturing
7. Guided Missile and Space Vehicle Manufacturing
8. Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts

Manufacturing

9. Military Armored Vehicle, Tank, and Tank Component Manufacturing
10. Nuclear Electric Power Generation
11. Optical Instrument and Lens Manufacturing
12. Other Basic Inorganic Chemical Manufacturing
13. Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing
14. Petrochemical Manufacturing
15. Powder Metallurgy Part Manufacturing
16. Power, Distribution, and Specialty Transformer Manufacturing
17. Primary Battery Manufacturing
18. Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing
19. Research and Development in Nanotechnology
20. Research and Development in Biotechnology (except Nanobiotechnology)
21. Secondary Smelting and Alloying of Aluminum
22. Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing
23. Semiconductor and Related Device Manufacturing
24. Semiconductor Machinery Manufacturing
25. Storage Battery Manufacturing
26. Telephone Apparatus Manufacturing
27. Turbine and Turbine Generator Set Units Manufacturing