New Rules Governing Review of Foreign Investment in the United States

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As mandated by the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”), the Committee on Foreign Investment in the United States (“CFIUS”) has issued new regulations (the “Regulations”) that expand CFIUS jurisdiction to include “covered investments” in U.S. businesses dealing in critical technology, critical infrastructure, or sensitive personal data (the subject of 31 C.F.R. Part 800) and “covered real estate transactions” (the subject of 31 C.F.R. Part 802). The Regulations, which became effective on February 13 (the “Effective Date”), apply to all transactions that closed on or after that date, unless certain key transaction milestones occurred prior to the Effective Date. Under the Regulations, CFIUS maintains its original authority to review “covered control transactions,” which are transactions “by or with any foreign person that could result in foreign control of any U.S. business.” The term “control” remains broadly defined.

The Regulations also introduce mandatory filing requirements for certain transactions and certain process changes, including the ability to file a declaration in lieu of the traditional joint voluntary notice.

“Covered Investments”

A “covered investment” is a direct or indirect investment by a foreign person (other than an excepted investor) that affords the foreign person the following rights with respect to a “TID U.S. business” (as defined below):

(1) access to any material nonpublic technical information in the possession of the TID U.S. business;

(2) membership or observer rights on, or the right to nominate an individual to a position on, the board of directors or equivalent governing body of the TID U.S. business; or

(3) any involvement, other than through voting of shares, in substantive decisionmaking of the TID U.S. business regarding certain matters related to critical technologies, critical infrastructure, or sensitive personal data of U.S. citizens.

TID U.S. Businesses Subject to “Covered Investment” Jurisdiction

As noted above, CFIUS authority to review non-control transactions applies only to U.S. businesses engaged in certain activities involving critical technologies, critical infrastructure, or sensitive personal data of U.S. citizens, i.e., TID U.S. businesses. Specifically, TID U.S. businesses are those that:

(1) produce, design, test, manufacture, fabricate, or develop one or more “critical technologies;”

(2) perform certain functions specified in the Regulations with respect to covered investment “critical infrastructure;” or

(3) maintain or collect, directly or indirectly, “sensitive personal data” of U.S. citizens.

The Regulations define “critical technologies” to include (i) defense articles, technical data, or defense services on the U.S. Munitions List; (ii) most commodities, technology, and software on the Commerce Control List; (iii) certain controlled nuclear facilities, equipment, parts and components, materials, software, and technology; (iv) certain agents and toxins; and (v) once identified by the Department of Commerce, emerging and foundational technologies controlled for export pursuant to the Export Control Reform Act of 2018 (“ECRA”).

“Critical infrastructure” is defined broadly to mean “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.” These systems and assets include, but are not limited to, certain telecommunications and internet services, natural gas and oil pipelines, financial market utilities, rail lines, maritime ports, and electric energy and public water systems. The functions performed with respect to the “covered investment critical infrastructure” listed in the Regulations that will trigger review of a “covered investment” vary according to the critical infrastructure in question. For example, a U.S. business that owns or operates any crude oil storage facility with the capacity to hold 30 million barrels or more of crude oil is a TID U.S. business subject to review of covered investments, as is any business that owns or operates certain interstate oil or gas pipelines or certain maritime ports or any satellite or satellite system providing services to the Department of Defense.

As defined by the Regulations, “sensitive personal data” is comprised of identifiable data maintained or collected by a
U.S. business that (i) targets or tailors products or services to certain agencies of the U.S. government; (ii) has maintained or collected such data, generally, on more than one million individuals; or (iii) has a demonstrated business objective to do so and such data is an integrated part of the U.S. business’s primary products or services. Furthermore, sensitive data must be (i) financial data that could be used to determine an individual’s financial distress or hardship; (ii) nonpublic electronic communications; or (iii) certain consumer report, insurance, health, geolocation, biometric, genetic, federal government identification, or security clearance data. Sensitive personal data does not include data that is a matter of public record, such as certain court data or government records, or certain data concerning the employees of a target U.S. business who do not hold security clearances.

**Mandatory Review Requirements for Certain Transactions**

While still a largely voluntary process, under the new Regulations, CFIUS requires mandatory declarations for certain transactions, subject to limited exceptions as discussed below.

Any “covered transaction” (i.e., “covered control transaction” or “covered investment”) that results in acquisition of a “substantial interest” in a TID U.S. business by a foreign person in which a foreign government holds a “substantial interest” is subject to the mandatory filing requirements. In general, “substantial interest” in this context means a direct or indirect voting interest of 25% or more on the part of the foreign person and a direct or indirect voting interest of 49% or more on the part of the foreign government.

Also subject to mandatory filing requirements are covered transactions related to TID U.S. businesses that (i) produce, design, test, manufacture, fabricate, or develop one or more “critical technologies” for their own use in certain North American Industry Classification System (“NAICS”) codes or (ii) design such items for customers operating in such NAICS codes. The industries covered by the specified NAICS codes include, among others, the aircraft, computer, nuclear power, and guided missile and space vehicle manufacturing industries. These mandatory requirements replace the requirements of the “Critical Technology Pilot Program” that was implemented in 2018.

However, mandatory filing requirements do not apply if the acquisition:

1. is conducted by a U.S.-controlled investment fund that meets the requirements specified by the Regulations; or
2. involves acquisition of a regulated aircraft.

In addition, the “critical technologies” mandatory filing requirements do not apply to transactions involving excepted investors or TID U.S. businesses:

1. that have a security clearance and already operate under a mitigation agreement pursuant to the National Industrial Security Program; or
2. whose only involvement with critical technologies is limited to involvement with encryption items eligible for License Exception ENC.

**“Covered Real Estate Transactions”**

Part 802 of the Regulations extends CFIUS jurisdiction to all purchases, leases (including subleases), or concessions involving “covered real estate” in which a foreign person (other than an excepted investor) acquires three of the following four property rights (even if “shared concurrently” with another party):

1. the right to physical access;
2. the right to exclude others from physical access;
3. the right to improve or develop the property; and
4. the right to attach structures or objects to the property.

Although the definition of “covered real estate transaction” does not automatically include mortgages or other lending transactions, such transactions could be covered if there is “a significant possibility,” because of “imminent or actual default or other condition,” that the lending transaction could result in a foreign person gaining three of the four property rights described above.

“Covered real estate” is comprised of two broad categories of real estate:

1. real estate that is within or that “will function as part of” an airport or maritime port; and
2. real estate that is within specified distances of certain U.S. military installations that are identified in the Appendix to the Regulations. This second category of covered real estate includes real estate (including subsurface and submerged land) that is:

   - within “close proximity” (i.e., one mile) of an installation listed in Part 1 of the Appendix;
   - within an “extended range” (i.e., 100 miles) of an installation listed in Part 2 of the Appendix;
   - within specified counties or other geographic areas near missile ranges listed in Part 3 of the Appendix; or
• within 12 nautical miles of the U.S. coastline near off-shore range complexes and operating areas listed in Part 4 of the Appendix.

There are, however, carveouts for (i) certain real estate transactions involving real estate that is within an “urbanized area” or “urban cluster” as defined by the Regulations; (ii) leases that are restricted to certain purposes; and, in certain circumstances, (iii) commercial office spaces in multiunit buildings. Importantly, however, if a potentially “covered real estate transaction” is subject to CFIUS review as part of a “covered investment” or “covered control transaction,” the Regulations make clear that the transaction would be subject to Part 800 rather than Part 802.

Excepted Foreign Investors

CFIUS jurisdiction over covered real estate transactions and certain of the mandatory filing requirements of Part 800 do not apply to investors from “excepted foreign states” (currently only Australia, Canada, and the United Kingdom under both Part 800 and Part 802, although the lists could diverge in the future), including

(1) the governments thereof;
(2) nationals thereof who are not also nationals of any other state; and
(3) entities organized in any such country or the United States whose principal place of business is in any such country or the United States,

provided that certain requirements are met. These requirements include limitations on the level of participation of investors, board members, and observers from non-excepted foreign states, in addition to certain disqualifying factors, e.g., if the foreign investor or any of its parents or subsidiaries is on the Bureau of Industry and Security’s Unverified List or the Entity List, or, within the five years preceding completion of the transaction, has

(1) been involved in enforcement proceedings before the Office of Foreign Assets Control, the Departments of State, Commerce, or Energy, or CFIUS; or
(2) been subject to a divestiture order in previous proceedings before CFIUS.

Process Changes

As under the Critical Technology Pilot Program, mandatory filings generally are to take the form of short form declarations. In addition, for the first time, any party to a proposed or completed transaction may submit a declaration to CFIUS regarding the transaction. In assessing cases filed pursuant to the declaration process, CFIUS has the option of advising the parties that it cannot conclude action under Section 721 of the Defense Production Act, as amended by FIRRMA, on the basis of the declaration, in which case the parties would not obtain the “safe harbor” from an order suspending or prohibiting the transaction or requiring unwinding or divestment unless the traditional notice procedure is undertaken. On the other hand, traditional notices may be filed in any case, including in lieu of declarations in cases subject to mandatory filing requirements, so that the parties to a transaction may decide to forgo the somewhat faster mandatory notice process in favor of the additional certainty that may be offered by the traditional notice process.

Transitional Matters – And More Changes to Come

The Regulations took effect February 13, 2020, but do not apply to certain transactions. The regulations found in 31 C.F.R. Part 800 in effect on February 12 continue to apply to any transaction for which any of the following occurred prior to February 13:

(1) the completion date;
(2) the execution of a binding written agreement establishing the material terms of the transaction;
(3) a party has made a public offer to shareholders to buy shares of a U.S. business; or
(4) a shareholder has solicited proxies in connection with an election of the board of directors of a U.S. business or an owner or holder of a contingent equity interest has requested the conversion of such interest.

The Regulations pertaining to “covered real estate transactions” found in 31 C.F.R. Part 802 took effect February 13, 2020, but do not apply to transactions with respect to which completion or execution of a binding written agreement occurred prior to February 13.

Finally, the regulations found in 31 C.F.R. Part 801, which govern the Critical Technology Pilot Program (as amended by the Regulations only as to applicability) continue to apply to any transaction subject to the pilot program for which any of the above-listed aspects of the transaction occurred on or after November 10, 2018 and before February 13, 2020.

In addition to ensuring that they evaluate their transactions under the applicable set of Regulations, parties to transactions that may involve foreign investors should note the potential for new rules regarding matters such as CFIUS filing fees and changes to the definition of “principal place of business.” CFIUS also intends to issue a proposed rule that would revise the mandatory declaration requirements for transactions involving “critical technology” from one based on NAICS codes to one based on export control licensing requirements.
With respect to the definition of “covered real estate,” the Department of Defense will continue to develop the list of military installations and applicable distances set forth in the Appendix to Part 802. There is also a potential for the Appendix to include “other facilities or properties of the U.S. Government” that, while not military installations, may be deemed sensitive for national security reasons such that real estate within close proximity would become covered real estate.

As noted above, although the initial list of excepted foreign states includes Australia, Canada, and the United Kingdom, CFIUS has signaled that it may expand the list in the future to include other countries with “robust intelligence-sharing and defense industrial base integration mechanisms with the United States.” However, even the currently excepted countries will not enjoy this status beyond February 13, 2022 if they do not demonstrate (i) that their national security-based foreign investment review processes and bilateral cooperation with the United States on such reviews meet the requirements of Part 800 or (ii) in the context of Part 802 applicable to real estate transactions, significant progress toward establishing a robust process to analyze foreign investments for national security risks and to facilitate coordination with the United States on matters related to investment security. In this regard, CFIUS has announced its intention to publish a list of factors that CFIUS will consider when making a determination regarding an eligible foreign state’s national security-based foreign investment review program.

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