

INTERNATIONAL BUSINESS ALERT

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Treasury proposes to amend rules on CFIUS mandatory filing requirement

On May 21, 2020, the U.S. Department of Treasury issued the [Provisions Pertaining to Certain Investments in the United States by Foreign Persons](#), modifying certain provisions in the regulations of the Committee on Foreign Investment in the United States (CFIUS) that implement section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). Specifically, this proposed rule would modify the mandatory declaration provision for certain foreign investment transactions involving a U.S. business that produces, designs, tests, manufactures, fabricates or develops one or more “critical technologies.” It also makes clarifying amendments to the definition of “substantial interest.” Written comments for this proposed rule must be received by June 22, 2020.

Background

CFIUS is an interagency body that assists the president in reviewing the national security aspects of foreign direct investments in the U.S. economy. The agency’s role is to evaluate whether, and to what extent, such transactions could impact U.S. national security. The CFIUS process is governed by a set of statutes and regulations, with the most recent and significant changes set forth in the FIRRMA issued on Aug. 13, 2018, and the FIRRMA implementing regulations issued on Jan. 13, 2020.

Prior to FIRRMA, CFIUS was a wholly voluntary process. One of FIRRMA’s most significant changes is that the Act makes CFIUS filings mandatory in certain situations, and imposes monetary penalties (up to the value of the investment) for the failure to file, in addition to the risk of having a transaction investigated or unwound post-closing.

After FIRRMA, CFIUS issued an interim rule titled “[Determination and](#)

Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies," (FIRRMA Program Implementing Regulation) codified at 31 C.F.R. part 801, which governs the continued application of the CFIUS Pilot Program between Nov. 10, 2018, and Feb. 12, 2020. The Pilot Program was a temporary program in response to FIRRMA and, by its terms, is set to expire this year. Much of the current Pilot Program has been published as part of the FIRRMA Implementing Regulations, and the Pilot Program expired on Feb. 12, 2020.

Under the rule, CFIUS required the filing of a declaration for both controlling and non-controlling investments in pilot program U.S. businesses (i.e., U.S. businesses with a nexus to specified industries identified by a North American Industry Classification System (NAICS) code that produce, design, test, manufacture, fabricate, or develop critical technologies) taking place between Nov. 12, 2018 through Feb. 12, 2020, to submit a mandatory filing with the CFIUS.

While the pilot program and the FIRRMA Pilot Program Implementing Regulation will no longer apply to transactions initiated on or after Feb. 13, 2020, the FIRRMA Implementing Regulations nevertheless maintain a mandatory filing regime for covered investments and covered controlled transactions in critical technology U.S. businesses. [31 C.F.R. § 800.401](#). Specifically, parties must file a declaration for investments – controlling and noncontrolling – involving a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies: (1) *utilized in connection with* 27 specifically enumerated industries (as identified by NAICS Code), or (2) designed by the TID Business specifically for use in one or more industries (as identified by NAICS Code). [31 C.F.R. § 800.401\(c\)](#). Specifically, such noncontrolling investments are covered, or subject to a review, if they would grant the foreign investor access to "material nonpublic technical information" in possession of the U.S. business; membership or observer rights on the board of directors; or any involvement in substantive decision making regarding critical technology.

For now, the NAICS Code that would trigger the mandatory declarations for critical technologies largely mirror CFIUS's existing Critical Technologies Pilot Program, including:

- Aircraft Manufacturing (NAICS Code: 336411)
- Aircraft Engine and Engine Parts Manufacturing (NAICS Code: 336412)
- Alumina Refining and Primary Aluminum Production (NAICS Code: 331313)
- Ball and Roller Bearing Manufacturing (NAICS Code: 332991)
- Computer Storage Device Manufacturing (NAICS Code: 334112)
- Electronic Computer Manufacturing (NAICS Code: 334111)
- Guided Missile and Space Vehicle Manufacturing (NAICS Code: 336414)

- Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing (NAICS Code: 336415)
- Military Armored Vehicle, Tank, and Tank Component Manufacturing (NAICS Code: 336992)
- Nuclear Electric Power Generation (NAICS Code: 221113)
- Optical Instrument and Lens Manufacturing (NAICS Code: 333314)
- Other Basic Inorganic Chemical Manufacturing (NAICS Code: 325180)
- Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing (NAICS Code: 336419)
- Petrochemical Manufacturing (NAICS Code: 325110)
- Petrochemical Manufacturing Powder Metallurgy Part Manufacturing (NAICS Code: 332117)
- Power, Distribution, and Specialty Transformer Manufacturing (NAICS Code: 335311)
- Primary Battery Manufacturing (NAICS Code: 335912)
- Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing (NAICS Code: 334220)
- Research and Development in Nanotechnology (NAICS Code: 541713)
- Research and Development in Biotechnology (except Nanobiotechnology) (NAICS Code: 541714)
- Secondary Smelting and Alloying of Aluminum (NAICS Code: 331314)
- Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing (NAICS Code: 334511)
- Semiconductor and Related Device Manufacturing (NAICS Code: 334413)
- Semiconductor Machinery Manufacturing (NAICS Code: 333242)
- Storage Battery Manufacturing (NAICS Code: 335911)
- Telephone Apparatus Manufacturing (NAICS Code: 334210)
- Turbine and Turbine Generator Set Units Manufacturing (NAICS Code: 333611)

Proposed amendments on mandatory filing requirement

On May 21, 2020, the treasury issued a notice of proposed rulemaking that would effectively eliminate the association between “critical technologies” and the 27 industries currently identified as sensitive. Under the proposed rule, the mandatory filing requirement would be triggered if the U.S. business produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies that is subject to the “U.S. regulatory authorization.” In other words, whether a mandatory filing would be required depends on whether the critical technologies are subject to any export licensing requirements. Specifically, a mandatory filing is required if the export of the critical technology requires:

1. A license or other approval issued by the Department of State under the International Traffic in Arms Regulation;
2. A license from the Department of Commerce under the Export Administration Regulations;
3. A specific or general authorization from the Department of Energy under the regulations governing assistance to foreign atomic energy activities at 10 CFR Part 810 other than the general authorization described in 10 CFR 810.6(a); or
4. A specific license from the Nuclear Regulatory Commission under the regulations governing the export or import of nuclear equipment and material at 10 CFR part 110.

A U.S. regulatory authorization is considered to be required even though a license exception or exemption may be available under the Export Administration Regulations (EAR) or International Traffic in Arms Regulations (ITAR), respectively. Comments for the proposed rule must be submitted by June 22, 2020, but it is unclear when the final rule will be issued. Before the proposed rule becomes the final rule, parties should continue to review NAICS codes as part of their mandatory filing analysis.

The shift away from the NAICS codes presumably reflects the treasury's concerns with the inherent ambiguities in basing the jurisdictional scope of a mandatory filing requirement on self-designated industry classifications. Although the 27 industries identified in the pilot program represent a wide swath of those that would likely raise national security concerns, the justification for treating two companies making the same critical technology differently based on self-assigned NAICS code differences was always suspect. However, how replacing NAICS codes with an export licensing prong will impact the scope of transactions for which mandatory filings would be required remains to be seen. For example, if the issue becomes whether an export license is required for a certain technology to be exported to the home country of the investor, for certain technologies certain countries may be favored over others. On the other hand, because many critical technologies would require licenses for export to most countries, opening the program to all industries could materially expand the scope of mandatory filing.

Additional changes

The proposed rule also makes clarifying amendments to paragraphs (b) and (c) of the definition of substantial interest at § 800.244 of the Part 800 Rule, which establishes how to determine the percentage of interest held indirectly by one entity in another for purposes of that term. Currently, 31 C.F.R. § 800.244 (b) provides that "[i]n the case of entity with a general partner, managing member, or equivalent, the national or subnational governments of a single foreign state will be considered to have a substantial interest in such entity only if they hold 49 percent or more of the interest in the general partner, managing member, or equivalent of the entity." 31 C.F.R. § 800.244 (c) further provides that "[f]or purposes of

determining the percentage of voting interest held indirectly by one entity in another entity, any voting interest of a parent will be deemed to be a 100 percent voting interest in any entity of which it is a parent.” (emphasis added). The proposed rule clarifies that paragraph (b) applies only where a general partner, managing member, or equivalent primarily directs, controls, or coordinates the activities of the entity. It also removes the word “voting” before “interest” wherever it appears in paragraph (c) so that the calculation rule clearly applies to the calculation of “voting interests” as described in paragraph (a) and “interests” as described in paragraph (b) of that section.

Take away

The new program under the proposed rule will require U.S. businesses considering foreign investment to have a clear understanding of the export control regimes applicable to their products and services. Companies that will likely be impacted by the proposed rule are encouraged to submit comments prior to June 22, 2020, to get their voice heard. It is unclear when the final rule will be issued or the impact of such final rule, but even if after the final rule, it is possible that Treasury will continue to scrutinize and prioritize transactions involving businesses that operate in sensitive sectors despite possible changes to the mandatory filing criteria. For most foreign investors considering transactions in these covered 27 industries under the Pilot Program, a voluntary filing will likely remain the norm.

For more information please contact [Yuanyou Yang](#) or any member of Porter Wright’s [International Business & Trade Practice Group](#).