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CFIUS's New Pilot Program Signals an Expansive Approach to Its Jurisdiction Under FIRRMA

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In August 2018, Congress passed and the President signed the highly-anticipated Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”), significantly amending the authority and process of the Committee on Foreign Investment in the United States (“CFIUS”) to review foreign direct investment that raises national security concerns.¹ Our initial client alert on this legislative development can be found [here](#). Congress left to CFIUS the important task of implementing this authority, and on October 10, the Committee took its first step toward doing so, in the form of a new “pilot program” addressed to transactions in 27 identified industries.

In launching the new “pilot program,” CFIUS has served notice that it intends to aggressively exercise its expanded authorities under FIRRMA. Notably, the program— aspects of which have immediate impact—mandates that parties to all foreign investments in the defined group of industry sectors must submit those transactions for review, when specific triggers are met. Failure to comply carries a civil penalty.

Equally notable is what CFIUS’s approach to the design of the pilot program augers for its full implementation of FIRRMA authorities in the future. CFIUS appears poised to assume all powers conferred by Congress to review foreign investment transactions, including possibly mandating filings in circumstances beyond just those involving foreign government actors.

CFIUS Signals a Broad Approach

Most commentators and practitioners had initially focused on FIRRMA’s authorization mandating so-called “declarations” (short-form filings) for certain transactions involving foreign government interests.² However, for its pilot program, CFIUS invoked a lesser-noticed provision giving it discretion to “require the submission of a declaration ... with respect to any covered transaction identified under regulations prescribed by the Committee for purposes of this item, at the discretion of the Committee, that involves a United States business” dealing in the production of so-called “critical technologies.”

In its document announcing the pilot program, CFIUS candidly explained that it sought to create a baleen-like “strainer” designed to capture the maximum volume of transactions falling within this scope “in order to understand and examine, in a comprehensive manner, the nature of foreign direct investment as it relates to critical technologies and pilot program industries.”³ Moreover, no country is exempted because “foreign investors that may present national security concerns are becoming increasingly sophisticated in structuring investments in a manner that may obfuscate those concerns,



including by utilizing entities in other jurisdictions.”⁴ The pilot program (which goes into effect on November 10 and ends no later than the date on which final FIRRMA regulations are implemented) is intended “to inform the full implementation of FIRRMA,” including whether the final regulations will apply to “certain categories of foreign persons.”⁵

The impact of the pilot program’s “go broad” approach is tempered by the fact that, as described more fully below, it is focused on industries and transactions that in most cases experienced CFIUS lawyers would have counseled the parties to bring to the attention of the Committee through a voluntary filing. Still, parties doing deals in the industries covered by the pilot program need to have a thorough understanding of its scope, as failure to make a mandatory filing for a “pilot program covered transaction” could result in a civil penalty of up to the full value of the transaction.

Key Program Takeaways

As noted, the pilot program begins on November 10, 2018, and it will apply to any transaction covered under the program that has not closed prior to that date, or for which the parties have not entered into a binding written agreement prior to October 11, 2018. Mandatory declarations must be submitted no later than 45 days before closing.

Among key points for those who might fall within the scope of the program:

- Only transactions in U.S. businesses operating within the 27 industries identified by CFIUS are covered, and then only if the U.S. business is involved in the design, development, testing or production of “critical technologies” designed for use in, or utilized in connection with the target’s activities in, one or more of the identified industries.
- The program extends beyond those transactions in which the foreign investor acquires “control,” and covers even non-controlling investments, including minority positions, in a U.S. business.
- Parties will need to assess whether their transactions fall within the scope of the new pilot program in the first instance. If so, they will face a choice whether to file a declaration or instead proceed through a full formal notice process before CFIUS. Either way, sufficient room will need to be built into the transaction timeline, and appropriate strategies for addressing CFIUS outcomes will need to be considered. For those covered pilot program transactions expected to close before the end of the year, parties have less than a month to prepare a declaration or submit a notice to the Committee.

Pilot Program Details

The pilot program (i) expands the scope of transactions reviewable by CFIUS to include investments, even non-controlling investments, by foreign persons in certain U.S. businesses that design, develop, test or produce “critical technologies” used in connection with the identified pilot program industries (so-called “pilot program covered transactions”) and (ii) requires that the parties to those transactions submit them for review, either through a “short-form” declaration procedure or a full notice.

Targeted Industries. The pilot program covers foreign investments in U.S. businesses that produce, design, test, manufacture, fabricate, or develop one or more “critical technologies” that are utilized in connection with the investment target’s activity in, or designed specifically for use in, one or more of the pilot program’s 27 identified industries. These industries⁶ include manufacturing and production related to aircraft and aircraft engines; aluminum and other metallurgy; ball and roller bearings;



computer storage devices; electronic computers; guided missile and space vehicles; propulsion units; military armored vehicles; nuclear electric power generation; optical instruments; chemical; petrochemical; batteries; radio, television broadcasting and wireless communications equipment; search, detection, navigation, and guidance instruments; semiconductors; turbines; and R&D in biotechnology and nanotechnology.

In its published notice, CFIUS asserts that the list of targeted industries “has been carefully developed by the U.S. government to narrowly scope the pilot program to include only those industries in which the threat of erosion of technological superiority from some foreign direct investment requires immediate action.”⁷ Importantly, the pilot program only applies where the U.S. business actually produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies in those industries, *not* simply if it operates in that industry; however, even if a transaction does not trigger the mandatory reporting requirement of the pilot program, it still might qualify as a covered transaction subject to CFIUS’s traditional jurisdiction (as modified by FIRRMA) and warrant a voluntarily filing in order to obtain a “safe harbor” from future CFIUS intervention.

Critical Technologies. The pilot program regulations implement FIRRMA’s definition of “critical technologies,” to cover (1) defense articles and services set forth in the International Traffic in Arms Regulations; (2) items controlled under the Commerce Control List for reasons related to national security, chemical and biological weapons proliferation, nuclear nonproliferation, missile technology, regional stability, or surreptitious listening; (3) specially designed and prepared nuclear equipment; (4) nuclear facilities, equipment, and material; (5) select agents and toxins; and (6) emerging and foundational technologies, as defined in the Export Control Reform Act of 2018 (“ECRA”).⁸ The ECRA, passed in conjunction with FIRRMA, sets forth an interagency process to identify technologies not currently subject to heightened controls but deemed critical to U.S. military and strategic competitiveness. The inclusion of “emerging and foundational technologies” in the pilot program regulations provides a placeholder for future application, which could be filled soon if the U.S. government, as rumored, comes forward with new controls in this area as well.

Pilot Program Covered Investment. An investment in a pilot program covered industry can trigger mandatory disclosure if the transaction affords the foreign investor person either (i) control (as traditionally defined by CFIUS) or (ii) access to material nonpublic technical information, membership or observer rights on the board or equivalent governing body, or participation in corporate decision-making in the pilot program target.

Exemption for Qualifying Limited Partners. Significantly, for private equity and other fund sponsors, the interim regulation does not sweep in deals solely on the basis of participation by foreign investors as passive limited partners in a qualifying fund structure. In particular, investments in most funds by a foreign person as a limited partner, even if the foreign limited partner participates in an advisory board or a committee, are excluded if: (1) the fund is managed exclusively by a general partner; (2) the foreign person is not the general partner; (3) the advisory board does not have the ability to approve, disapprove or otherwise control investment decisions of the fund or decisions made by the general partner; (4) the foreign person does not have the ability to control the investment fund; and (5) the foreign person does not have access to material nonpublic technical information as a result of its participation.



Strategic Considerations

Providing notice to CFIUS of a proposed transaction has, heretofore, been voluntary. Parties to a transaction could determine not to submit their transaction for review and assume the business risk that CFIUS may intervene at a later date and block or require divestiture of or other restrictions on the investment. Most transactions still fall into this category. For the first time, however, investments within the scope of the pilot program will now need to be submitted for review.

Under the pilot program, parties may choose either to submit a formal notice to CFIUS (with additional required information specific to pilot program covered transactions) or file a mandatory declaration.⁹ In either case, the submission must be made at least 45 days prior to completion, if the transaction is scheduled to be completed after December 25, 2018; however, if the transaction will be completed between November 10, 2018 and December 25, 2018, the notice or declaration must be submitted November 10, 2018 or promptly thereafter.

If a declaration (rather than a full notice) is submitted, the Committee will have 30 days after “acceptance” to provide its assessment, resulting in one of four outcomes: (1) CFIUS could request a full formal written notice be submitted on the transaction; (2) CFIUS could advise that it cannot complete its review on the basis of the declaration, and give the parties the option to submit the transaction for full review (if they want to obtain the “safe harbor” against future intervention); (3) CFIUS could initiate a unilateral review of the transaction; or (4) CFIUS could notify the parties that it has completed its action, thereby rendering the transaction eligible for the safe harbor.

Parties to a pilot program covered transaction thus face a strategic choice of whether to seek review by declaration or by full notice. The path taken will be driven by a number of factors, including anticipated timing and whether the parties believe that the transaction presents sufficiently complex issues, so that going through the 30-day declaration procedures will likely (or even inevitably) lead to a full filing in any event.

That CFIUS filing for certain deals is now mandatory represents a watershed, but for many the landscape will not change fundamentally. The 27 industries selected for the pilot program are all sensitive from a national security standpoint, and well-advised parties would likely have elected to present the transaction for CFIUS clearance, in the case of any foreign investment that involved control over or access to critical technologies. CFIUS’s treatment of these transactions likely will bear the hallmarks of the more aggressive reviews that were undertaken even before FIRRMA passed, as CFIUS’s scrutiny began to sharpen in the final months of the Obama administration and only grew thereafter.

How CFIUS manages the increased caseload that will result from the pilot program, and what its expanded scope portends for the future implementation of FIRRMA’s authorities, are issues that will continue to come into focus in the coming months. For now, it appears to be full speed ahead for CFIUS.

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- ¹ Foreign Investment Risk Review Modernization Act of 2018, Subtitle A of Title XVII of Pub. L. 115-232 (Aug. 13, 2018) (hereinafter “FIRRMA”).
 - ² FIRRMA § 1706 (to be codified as Section 721(b)(1)(C)(v)(IV)(bb) of the Defense Production Act of 1950 (50 U.S.C. § 4565(b)(1)(C)(v)(IV)(bb)).
 - ³ Determination and Temporary Provisions Pertaining to a Pilot Program To Review Certain Transactions Involving Foreign Persons and Critical Technologies, 83 Fed. Reg. 51322, 51324 (Oct. 11, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-10-11/pdf/2018-22182.pdf>.
 - ⁴ *Id.*
 - ⁵ *Q&A: Interim Regulations for FIRRMA Pilot Program*, U.S. Dept. of Treasury at Q. 19 (Oct. 10, 2018), <https://home.treasury.gov/system/files/206/OA-FIRRMA-Pilot-Program.pdf>.
 - ⁶ The complete list of the 27 industries, along with their identifying NAICS codes upon which CFIUS makes its industry determination, can be found in Annex A to Part 801 of the interim regulation, available at https://home.treasury.gov/system/files/206/FR-2018-22182_1786904.pdf at 51-52.
 - ⁷ *Id.* at 51333-51334.
 - ⁸ The complete definition of “critical technologies” can be found at FIRRMA 1703(a)(6)(A) (to be codified as Section 721(a)(6)(A)(i)-(vi)).
 - ⁹ CFIUS is developing an online template for declarations, which according to the Committee, will be available “in the coming days.”

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