



Morgan Lewis

CFIUS REFORM: FOREIGN INVESTMENT RISK REVIEW MODERNIZATION ACT OF 2018 (FIRREA)

E. John Park and Stephen Paul Mahinka
Venture Capital Taskforce, California Venture Capital Forum
January 16, 2019

© 2019 Morgan, Lewis & Bockius LLP

CFIUS and FIRRMA Background

- CFIUS, the Committee on Foreign Investment in the United States, is the US national security review system under which the US government can review any foreign acquisition of a US business based on its potential impact on national security.
- Historically, CFIUS has focused on transactions that could result in control of a U.S. business by a foreign person, in order to identify and address any national security concerns as a result of the transaction.
- On August 13, 2018, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) was passed. FIRRMA expands the jurisdiction and powers of CFIUS and authorizes CFIUS to conduct pilot programs to implement provisions of the legislation that did not become effective immediately upon enactment.

FIRRMA Pilot Program

- On October 10, 2018, the Department of the Treasury issued interim regulations for the FIRRMA pilot program to address specific risks to U.S. “critical technologies.”
- The FIRRMA pilot program expands the scope of transactions subject to review by CFIUS to include ***certain noncontrolling investments made by foreign persons in U.S. businesses that produce, design, test, manufacture, fabricate or develop a critical technology that is (1) used 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.***
- The pilot program will be temporary and only be in effect for no more than 570 days following the date of FIRRMA’s enactment. During this time, the Treasury Department will evaluate the pilot program as it drafts the new final rules that will be released for public comment in coming months, incorporating aspects of the pilot program in the final rules.
- In the meantime, the pilot program will be in effect and require compliance by the transactions that fall under its jurisdiction.

Pilot Program Covered Transactions

- Prior to FIRRMA, CFIUS's authority did not cover foreign direct investments in US businesses unless the foreign investor acquired a controlling interest.
- FIRRMA expands the jurisdiction of CFIUS by broadening the definition of "covered transaction" to include certain foreign direct investments in US business even in cases where the investment does not result in a controlling interest.
- However, the pilot program also does not cover every foreign investment. It covers only those investments in a pilot program U.S. business where a foreign party obtains control or, in the absence of control obtains:
 - access to any material nonpublic technical information in the possession of the target U.S. business;
 - 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 the board of directors or equivalent governing body of the U.S. business; or
 - any involvement, other than through voting of shares, in substantive decision-making of the U.S. business regarding the use, development, acquisition or release of critical technology.

Pilot Program US Businesses/Industries

- The pilot program applies to any US business that produces, designs, tests, manufactures, fabricates, or develops a *critical technology* that is either (1) utilized in connection with the US business's activity in one or more pilot program industries, or (2) designed by the US business specifically for use in one or more pilot program industries.
- In particular, the pilot program imposes new obligations on foreign parties making investments, even non-controlling investments, in U.S. businesses involved in 27 explicitly designated industries identified by their respective North American Industry Classification System (NAICS) code. (see Appendix A for list of industries and NAICS codes).
- The Committee can reconsider the industries identified and revise the list in future regulations or in final regulations for the pilot program (if CFIUS decides to issue final regulations).

Critical Technologies

- **Critical Technologies** - Under FIRRMA, “critical technologies” are defined as
 - defense articles or defense services included on the United States Munitions List;
 - items included on the Commerce Control List set forth in the Export Administration regulations and controlled (1) pursuant to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation or missile technology; or (2) for reasons relating to regional stability or surreptitious listening;
 - specially designed and prepared nuclear equipment, parts and components, materials, software and technology relating to assistance to foreign atomic energy activities;
 - nuclear facilities, equipment and material relating to export and import of nuclear equipment and material;
 - select agents and toxins covered by 7 Code of Federal Regulations (CFR) part 331, 9 CFR part 121, or 42 CFR part 73; or
 - **emerging and foundational technologies controlled pursuant to section 1758 of the Export Control Reform Act of 2018.**
- The types of emerging and foundational technologies to be identified are not yet publicly known. However, this could have broad coverage.

“Emerging and Foundational Technologies”

- During the discussions about CFIUS and export control reform bills, and related public discussions about CFIUS cases and China’s plans to acquire technologies pursuant to its “Made in China 2025” plan, the following emerging and foundational technologies were informally cited as warranting consideration for possible new controls:
 - advanced computing
 - artificial intelligence and machine learning
 - augmented reality
 - automated machine tools
 - additive manufacturing
 - autonomous vehicles
 - advanced battery technology
 - “big data”
 - biotechnology
 - driverless vehicle technology
 - gene editing
 - high-temperature superconducting technology
 - hydrogen and fuel cells
 - integrated circuits, semiconductors and microelectronics
 - intelligent mobile terminals
 - microelectronics
 - nanotechnology
 - robotics

Foreign Party/Investment Fund Exception

- While FIRRMA was enacted with a view to concerns particularly about Chinese access to US critical technologies, the statute does not expressly call out China. Rather, the pilot program applies to all non-US persons, no matter the country, and there are no exemptions, including for investors from countries considered to be close US allies.
- Despite the provision regarding board rights, limited partner participation on an advisory board or committee for an investment fund would not subject the investment to CFIUS jurisdiction, so long as:
 - the fund is exclusively managed by a U.S. general partner (or equivalent);
 - the general partner (or equivalent) is not a foreign person;
 - neither the advisory board nor the foreign person can approve, disapprove or otherwise control investment decisions or decisions of the general partner related to entities in which the fund is invested;
 - the foreign person cannot unilaterally remove the general partner (or equivalent); and
 - the foreign person does not have access to material nonpublic technical information.

Mandatory Declarations or Joint Voluntary Notice

- The program makes mandatory the filing of a “declaration” (an abbreviated CFIUS notice) for all transactions that fall within its specific scope. The pilot program will affect all transactions with a completion date after November 10, 2018.
- Parties to a pilot program covered transaction *must* submit to CFIUS either a “declaration” (new under FIRRMA) or a full joint voluntary notice (as under current CFIUS rules and procedures) no later than 45 days prior to the expected completion date of the transaction.
- An exception applies for any transaction that is completed by November 10, 2018. For any transaction to be completed between November 10 and December 25, 2018, parties must file such declaration or joint voluntary notice by November 10 “or promptly thereafter” (31 C.F.R. §§ 801.401, 402).
- Declarations are abbreviated notices intended to be no more than five pages in length, and must include a description of the transaction, including the basis on which it is deemed to fall under the purview of the pilot program, along with information about the US business and the foreign investor (31 C.F.R. § 801.403).
- In the event parties choose to file a declaration instead of a full notice, within 30 days after the filing, CFIUS will take one of the following four actions: (1) request that the parties file a full joint voluntary notice; (2) invite further communication between the parties and CFIUS; (3) initiate a review of the transaction; or (4) notify the parties that CFIUS has completed all action (31 C.F.R. § 801.407).

Filing Fees/Timing

- Under prior CFIUS regime, there was no CFIUS filing fee. FIRRMA will provide for a filing fee, up to the lesser of 1 percent of the value of the transaction or \$300,000 (adjusted annually).
- The prior CFIUS review process consisted of a 30-day initial review period, potentially followed by a 45-day investigation period.
- FIRRMA will extend the initial CFIUS review period from 30 days to 45 days, with an additional 15-day period extension for “extraordinary circumstances.”
 - As a practical matter, CFIUS reviews have been extended beyond the 30-day period already, with CFIUS moving many reviews into the 45-day investigation stage to allow more time. In addition, in several cases, CFIUS has asked parties to withdraw their filings and refile multiple times with the same intent of extending the Committee's time to review a deal.

Penalties for Noncompliance

- The new rules authorize CFIUS to impose penalties up to the value of a transaction for any person who fails to comply with the requirements of the new rules.
- Any transaction designed or intended to evade or circumvent CFIUS jurisdiction is also considered a covered transaction.
 - This provision is meant to address foreign investors deliberately structuring investments to fall outside of CFIUS's jurisdiction.
 - However, other than to address this general policy concern, there was little discussion about how CFIUS intends to interpret this authority and when, for example, structuring a transaction to merely avoid CFIUS review might be considered a violation.

Remedies Available to CFIUS

- FIRRMA explicitly gives CFIUS the authority to:
 - suspend a proposed or pending transaction that poses a risk to national security while it is under review by the committee;
 - refer transactions to the President for action at any time during the review or investigation;
 - use mitigation agreements, including, when needed, to address situations where the parties have voluntarily abandoned a transaction before CFIUS completes its review;
 - impose interim mitigation agreements;
 - require plans for monitoring compliance with mitigation agreements;
 - review older agreements and conditions to determine whether they are no longer warranted;
 - unilaterally initiate a review of a previously reviewed transaction if the parties, intentionally or unintentionally, materially breach terms and conditions of CFIUS clearance; and
 - allow for the use of independent parties to monitor agreements.

Key Takeaways

- Do not fail to notify CFIUS. Until now, CFIUS filings have been voluntary. It appears likely that certain transactions would trigger a mandatory filing. CFIUS is likely to ramp up the monitoring of announced deals and issue inquiries about transactions of which CFIUS is not notified. CFIUS retains the power to require that a transaction be submitted for review even after the deal has closed (assuming no notice was submitted beforehand).
- Allow for more time possibly more money (aside from the legal fees) for CFIUS due diligence, filing, and review. Anticipate possible CFIUS review if you are involved in outbound technology transfers, as they soon may be subject to new export controls.
- Anticipate that CFIUS will request information regarding limited partners and their control rights, especially when they are foreign government-controlled entities (regardless of the size of their investment). Much like critical technologies, CFIUS is interested in all government contracts (yes, purchase orders are contracts). Any meaningful assessment requires the U.S. entity or its counsel to understand whether they have contracts with the U.S. government and be able to identify them.

Key Takeaways (cont.)

- Transactions may also be structured to permit a foreign investor to close with passive rights, with additional rights upon CFIUS clearance.
- Parties may also want to revisit customary information rights, board memberships, and board observer rights to preempt national security concerns and expedite CFIUS clearance.
- Transactions with a mix of U.S. and foreign investors, for example, may be structured with multiple closings to allow investors not subject to CFIUS reporting requirements to close before those that are, with appropriate contingency plans in case a foreign investor is not able to complete a transaction.

Appendix A

PILOT PROGRAM INDUSTRIES
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

Appendix A (cont.)

Petrochemical Manufacturing NAICS Code: 325110
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

Speaker Biographies

Biography



E. John Park
Silicon Valley

T +1.650.843.7595
john.park@morganlewis.com

E. John Park focuses his practice on debt and equity offerings, public securities offerings, recapitalizations, and mergers and acquisitions (M&A). He assists clients at every stage of the business cycle, from initial company formation, venture capital financings, and M&A, to initial public offerings (IPOs), public company reporting, and general corporate counseling. In addition, John represents acquirers and targets in public-private and private-private business combination transactions.

Speaker Biographies

Biography



Stephen Paul Mahinka
Washington, DC

T +1.202.739.5205
smahinka@morganlewis.com

Stephen Paul Mahinka is a partner in the Washington, D.C. office of Morgan, Lewis & Bockius LLP, and a member of the firm's CFIUS Working Group. He is responsible for many of the firm's filings before the Committee on Foreign Investment in the United States (CFIUS), and has represented both foreign buyers/investors and domestic sellers of U.S. businesses in reviews, obtaining clearances for over 50 transactions in recent years, and has analyzed hundreds of proposed transactions. These CFIUS clearances obtained include transactions in the life sciences, energy (both conventional and renewable), technology, defense, and transportation industries. He has substantial experience in negotiating Foreign Ownership, Control, and Influence (FOCI) and other mitigation agreements that may be presented as conditions for clearance of a proposed transaction. Mr. Mahinka has published over 90 articles on CFIUS, FDA, and antitrust issues, and is a co-author of several books, including the ABA Antitrust Section's *Pharmaceutical Industry Antitrust Handbook* (2nd ed. 2018), *Food and Drug Law and Regulation* (3rd ed. 2015), and *Life Sciences Mergers and Acquisitions* (2008). Mr. Mahinka is a former leader of the firm's Antitrust Practice, founder of its FDA Practice, and co-founder and former chair of its Life Sciences Industry group. He is a graduate of Johns Hopkins University, *Phi Beta Kappa*, and of the Harvard Law School, where he was Executive Editor of the *Harvard International Law Journal*.

Morgan Lewis

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Almaty	Chicago	Houston	Orange County	Shanghai*
Astana	Dallas	London	Paris	Silicon Valley
Beijing*	Dubai	Los Angeles	Philadelphia	Singapore
Boston	Frankfurt	Miami	Pittsburgh	Tokyo
Brussels	Hartford	Moscow	Princeton	Washington, DC
Century City	Hong Kong*	New York	San Francisco	Wilmington



Morgan Lewis

*Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners.

THANK YOU

© 2019 Morgan, Lewis & Bockius LLP
© 2019 Morgan Lewis Stamford LLC
© 2019 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.

Morgan Lewis