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CFIUS Launches Pilot Program for Critical Technology Investment

By Ted Posner

On October 10, 2018, the Department of the Treasury, which heads the inter-agency Committee on Foreign Investment in the United States (“CFIUS”), issued two sets of regulations to begin implementing the Foreign Investment Risk Review Modernization Act (“FIRRMA”), enacted on August 13. (See our International Trade Current on FIRRMA [here](#).) The first, available [here](#), is an interim rule that amends CFIUS’s existing regulations to accord with FIRRMA provisions that took effect immediately upon enactment. The amended regulations take effect immediately and deal with largely technical issues including, for example, the time allotted for CFIUS reviews, definitions of key terms, and procedures for submitting notices to CFIUS.

The second set of regulations, also promulgated as an interim rule and available [here](#) (the “Pilot Program Regulations”), rolls out a pilot program for CFIUS’s newly expanded authority to review certain investments involving “critical technologies” in 27 different industrial sectors listed in an annex to the regulations. Importantly, in a departure from CFIUS’s status since its inception 30 years ago as a voluntary regime, the Pilot Program Regulations *require* the submission of a short-form notice, referred to as a “declaration,” for “pilot program covered transactions.” In this International Trade Current, we discuss the declaration requirement and the kinds of investment covered by the Pilot Program Regulations.

The mandate to establish a pilot program is set forth in section 1727(c) of FIRRMA, which authorizes CFIUS to “conduct one or more pilot programs to implement any authority provided pursuant to any provision of or amendment made by [FIRRMA] not specified in subsection (a)” (*i.e.*, the subsection specifying provisions that took effect immediately upon enactment). The authority implemented by the Pilot Program Regulations includes the expanded definition of a “covered transaction” eligible for review by CFIUS,¹ as well as the authority to require the submission of a declaration for certain covered transactions.²

The Pilot Program Regulations are set forth in a new Part 801 to Title 31 of the Code of Federal Regulations (the existing CFIUS regulations being set forth in Part 800, which continues to apply to proceedings under the Pilot Program Regulations). They will take effect on November 10, 2018 and terminate no later than March 5, 2020 (although their substance may be incorporated into the final FIRRMA implementing regulations that CFIUS will promulgate).

The Requirement to Submit a Declaration

At the heart of the Pilot Program Regulations is the requirement that parties to a pilot program covered transaction submit a declaration to CFIUS at least 45 days prior to closing.³ If parties wish, they may submit a full notice in lieu of the abbreviated declaration.⁴ If parties fail to timely submit a declaration or notice in lieu of declaration, they may be held liable for a civil penalty up to the value of the transaction.⁵

In accordance with FIRRMA, a declaration should be a relatively brief summary of the required information (ordinarily not exceeding five pages). Section 801.403 of the Pilot Program Regulations sets forth the information to be included in a declaration, which is largely identical to the information required to be included in a notice (though with some notable exceptions, such as the absence of a requirement to submit personal identifier information for directors and officers of the acquiring foreign person and its parents).⁶ It remains to be seen how parties will provide all of the information required by section 801.403 while keeping declarations relatively brief as compared to notices. One feature that may help to reduce the information that must be included in a declaration is the option to make a stipulation on certain points, including whether a transaction is a pilot program covered transaction, whether it could result in control of a U.S. business by a foreign person, and whether it is a foreign government-controlled transaction.⁷

Upon receiving a declaration, the CFIUS Staff Chairperson (an official at the Treasury Department) will determine whether it is complete. If it is complete, the Chairperson will accept it and circulate it to the other CFIUS members, which will start a 30-day clock for consideration of the declaration. If it is incomplete, the Chairperson will so notify the parties.⁸

At the end of the 30-day review period, CFIUS will be required to make one of four decisions: (1) request a full notice, (2) inform the parties that CFIUS is not able to complete action on the basis of the declaration and that they may submit a full notice if they wish, (3) initiate a unilateral review of the transaction on the basis of a so-called “agency notice” as it could do if

no declaration or notice had been submitted, or (4) notify the parties that CFIUS has concluded action with respect to the transaction.⁹

Of course, the ideal outcome for parties will be conclusion of action by CFIUS. However, parties should be aware that conclusion of action under the Pilot Program Regulations will not insulate them from review of the foreign party’s future acquisition of an additional interest in the U.S. business. This is in contrast to the existing rule under section 800.204(e) of the CFIUS regulations. That rule pertains to a transaction meeting the pre-FIRRMA definition of “covered transaction” – *i.e.*, a transaction that could result in control of a U.S. business by a foreign person. Section 800.204(e) establishes the proposition that “control” is a binary concept; it either exists or it does not exist, and the definition of “covered transaction” is indifferent to the existence of greater or lesser degrees of control. Thus, under section 800.204(e), if CFIUS has reviewed a transaction, found it to be a covered transaction, and concluded action, a later transaction in which the same foreign person increases its ownership interest in the relevant U.S. business will not be treated as a covered transaction. A transaction declared to CFIUS under the Pilot Program Regulations, however, will not benefit from this rule.¹⁰ Accordingly, a subsequent acquisition of an additional interest in the U.S. business by the foreign person could still qualify as a new covered transaction.

The Definition of “Pilot Program Covered Transaction”

In view of the new mandate to submit a declaration for a pilot program covered transaction, it is critical to understand what a pilot program covered transaction is. That concept as defined in the Pilot Program Regulations has three components: [1] the rights acquired by the foreign person, [2] whether the U.S. business produces, designs, tests, manufactures, fabricates, or develops a “critical technology,” and [3] the identity of the industrial sector in which such critical technology is used by the U.S. business or for which the critical technology is designed.

1. Rights Acquired by Foreign Person

With respect to rights acquired by the foreign person, unlike the pre-FIRRMA definition of “covered transaction,” it is not necessary that the foreign person acquire control of the U.S. business for the transaction to qualify as a pilot program covered transaction. Rights short of actual control could cause a transaction to meet the definition, if those rights include: access to material non-public information; membership or observer rights on the board of the U.S. business or the right to nominate a person to the board; or any involvement in substantive decision-making regarding the use, development, acquisition or release of critical technology.¹¹

In setting forth this prong of the definition of “pilot program covered transaction,” the Pilot Program Regulations take account of FIRRMA’s exception for certain investments that a foreign person may make through an investment fund that is managed by a party that is not a foreign person. FIRRMA lays out several criteria that must be met to come within this exception, and the Pilot Program Regulations repeat those criteria.¹² They include, in addition to the foreign person not being the fund manager, a requirement that any fund advisory board or committee on which the foreign person sits not have the ability to approve, disapprove, or otherwise control investment decisions or decisions by the general partner related to portfolio companies, and a requirement that the foreign person not otherwise have the ability to control the investment fund.

2. Critical Technologies

With respect to the question whether the U.S. business produces, designs, tests, manufactures, fabricates, or develops a “critical technology,” the key issue is the definition of critical technology. That term is defined by reference to inclusion on key lists of controlled technologies, including, for example, the United States Munitions List and certain items on the Commerce Control List. A FIRRMA-related addition to the definition of critical technology is “[e]merging and foundational technologies controlled pursuant to section 1758 of the Export Control Reform Act of 2018.” This is a reference to a separate subtitle in the same omnibus legislation that included FIRRMA. The

referenced provision contemplates adding to the list of technologies that may be considered critical technologies.¹³

3. Pilot Program Industries

Finally, in addition to a foreign person’s having the above-summarized investment-related rights and the U.S. business being one that produces, designs, tests, manufactures, fabricates, or develops a critical technology, in order for a transaction to be a pilot program covered transaction subject to mandatory declaration, there must be some nexus between the critical technology and one of the 27 industrial sectors specified in the Pilot Program Regulations. In particular, the critical technology must be “utilized in connection with a U.S. business’s activity in one or more pilot program industries,” or “designed by the U.S. business specifically for use in or more pilot program industries.”¹⁴

If a transaction meets all three prongs of the definition of “pilot program covered transaction” then a declaration of that transaction must be submitted to CFIUS at least 45 days prior to closing. If any one of the prongs is not met then no declaration is required.

Undoubtedly, much will be clarified in the course of implementing the Pilot Program Regulations in the context of individual transactions. Companies should consult with CFIUS counsel to determine whether proposed transactions might be subject to the declaration requirement.

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Questions regarding the Pilot Program Regulations may be addressed to Ted Posner, a partner in Weil’s International Arbitration and Trade Regulatory group at ted.posner@weil.com or 202-682-7064.

¹ 50 U.S.C. § 4565(a)(4)(B)(iii), as amended by FIRRMA § 1703.

² 50 U.S.C. § 4565(b)(1)(C)(v)(IV)(aa), as added by FIRRMA § 1706.

³ 31 C.F.R. § 801.401. For deals due to close between November 10 and December 25, 2018, the deadline is November 10.

⁴ 31 C.F.R. §§ 800.401(b) & 800.501.

⁵ 31 C.F.R. § 801.409. The Pilot Program Regulations do not specify a method for transaction valuation, nor do they state whether a penalty based on transaction value would take into account the global value of a transaction or only that part that involves a U.S. business.

⁶ See 31 C.F.R. § 800.402.

⁷ 31 C.F.R. § 801.403(c)(3).

⁸ 31 C.F.R. § 801.404.

⁹ 31 C.F.R. § 801.407(a).

¹⁰ 31 C.F.R. § 801.401(d).

¹¹ 31 C.F.R. § 801.209.

¹² 31 C.F.R. § 801.304.

¹³ 31 C.F.R. § 801.204.

¹⁴ 31 C.F.R. § 801.213.

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