

## CFIUS Pilot Program Makes Notifications Mandatory for Specific Areas of Critical Technology

***Program requires parties to submit to CFIUS notice of certain foreign investments in US businesses involved in specified critical technologies at least 45 days prior to closing.***

### Key Points:

- The US Treasury Department announced a FIRRMA-authorized pilot program implementing the expanded jurisdiction of CFIUS over non-controlling foreign investments in critical technology companies, and requiring the filing with CFIUS of mandatory declarations for such investments.
- The pilot program interim rule takes effect on November 10, 2018.

### Background

On October 10, 2018, the US Treasury Department issued two sets of interim regulations, as part of a phased implementation of the Foreign Investment Risk Review Modernization Act of 2018 ([FIRRMA](#)) signed into law in mid-August 2018.

The interim rule on the "[Provisions Pertaining to Certain Investments in the United States by Foreign Persons](#)" implements a handful of FIRRMA provisions that became effective immediately when President Trump signed FIRRMA into law, such as a 45-day Review Period (replacing the earlier 30-day Review Period). This interim rule became effective on October 11, 2018. The Treasury Department also released [Frequently Asked Questions](#) in connection with this interim rule.

Of greater significance, the Treasury Department also announced an interim rule on the "[Determination and Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies](#)." This interim rule establishes a temporary pilot program requiring parties to notify the Committee on Foreign Investment in the United States (CFIUS), prior to closing, of certain transactions involving US critical technology companies. The Treasury Department issued this pilot program sooner than many expected, and it marks a significant milestone in the history of CFIUS, in that certain transactions must now be submitted to the Committee for national security review. Investors must quickly assess whether the new regulations apply to their transactions, a determination that will depend on the nature of the US business and the rights that the foreign investor will receive with respect to the US business. This interim rule is effective November 10, 2018, but it can impact transactions prior to that date. With this interim rule, the Treasury Department simultaneously released a [Fact Sheet](#) about this new pilot program.

## US Businesses Within the Pilot Program

The CFIUS pilot program applies to investments in US businesses that produce, design, test, manufacture, fabricate, or develop one or more “critical technologies” either used in connection with, or designed specifically for, one or more of 27 pilot program industries. Such businesses are termed “pilot program U.S. businesses.”

The term “critical technologies” is defined by FIRRMA according to US-export-controlled technologies, and includes:

- Defense articles and defense services subject to the International Traffic in Arms Regulations
- Civilian/military dual-use technologies subject to Export Administration Regulations that are either:
  - Under multilateral regimes relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology (*i.e.*, excluding, for instance, “EAR99” items, as well items controlled only for anti-terrorism reasons)
  - Included for reasons relating to regional stability or surreptitious listening
- Nuclear technologies covered by rules relating to foreign atomic energy activities and export and import of nuclear equipment and materials
- Select agents and toxins
- Emerging and foundational technologies controlled pursuant the Export Control Reform Act of 2018 (which have yet to be defined, but should be forthcoming from the US Commerce Department)

The 27 identified industries subject to the pilot program — based on their five-digit North American Industry Classification System (NAICS) code — are those in which “certain strategically motivated foreign investment” could pose a threat to US technological superiority and national security. According to the interim rule, the list of pilot program industries was “carefully developed by the U.S. government” to scope the pilot program to target industries facing imminent threats of erosion of technological superiority from foreign direct investment. Notwithstanding this characterization, the list of pilot program industries is expansive, and the 27 affected industries are listed at the end of this *Client Alert*.

The pilot program applies to transactions that could result in “control” of a pilot program US business by a foreign investment, as well as non-controlling and non-passive investments by foreign investors. Non-controlling investments in pilot program US businesses must be submitted to CFIUS for review if the foreign investor has any of the following:

- Access to any “material nonpublic technical information” in the possession of the target US business, which is defined to include “information that is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods”
- Membership or observer rights on the board of directors or equivalent governing body of the US business, or the right to nominate an individual to a position on the board of directors or equivalent governing body of the US business
- Any involvement, other than through voting of shares, in substantive decision-making of the US business regarding the use, development, acquisition, or release of critical technology

## Mandatory Declarations for Pilot Program Transactions

CFIUS must now review foreign investment in pilot program US businesses — either through a short-form “declaration” process (intended to be approximately five pages) or the traditional joint voluntary notice. Parties must file the more streamlined declaration with CFIUS at least 45 days prior to completing the

transaction. For transactions that will be completed between the interim regulations' effective date of November 10, 2018, and December 25, 2018, parties must file the declaration on or soon after November 10, 2018. CFIUS will have 30 days to respond to a declaration by either:

- Requesting that the parties file a full joint notice
- Informing the parties that CFIUS cannot reach a decision on the basis of the declaration and that the parties may file a notice regarding the transaction
- Initiating a unilateral review of the transaction through an agency notice
- Notifying the parties that CFIUS has completed all action and “clearing” the transaction pursuant to the pilot program rules

The declaration is intended to be an abbreviated version of the joint voluntary CFIUS notice. The interim rule lists the information that must be submitted by the US business and the foreign investor in the declaration. Unlike a joint voluntary notice, the foreign investor does not have to provide personal identifier information or *curricula vitae* of its officers and directors and those of its immediate parent, ultimate parent, and each intermediate parent. Notably, a transaction cleared by CFIUS through the declaration process does not entitle the parties to the “safe harbor” from subsequent CFIUS review for incremental investments after a full joint voluntary notice has been submitted and cleared. That is, only a full joint notice will continue to entitle the parties to the CFIUS safe harbor; the apparent purpose of a mandatory declaration is to apprise CFIUS of the investment.

Parties who fail to file their transaction with CFIUS in instances mandated by the pilot program are exposed to civil penalties up to the value of the transaction.

## Exemption From Pilot Program Review for Certain Indirect and Passive Investments

The interim regulations seek to exempt from mandatory review indirect investment by a foreign person in a pilot program US business through US-managed investment funds, as FIRRMA itself does. This apparent carve out for indirect investments via an investment fund applies if the foreign investor participates as a limited partner (or equivalent) on an advisory board or a committee of the fund and the following criteria are met:

- The fund is managed exclusively by a US general partner (or the equivalent of a general partner).
- An advisory board/committee lacks the ability to approve/disapprove/control investment decisions of the fund or decisions by the general partner with respect to the fund's portfolio assets.
- The foreign limited partner cannot otherwise control the fund.
- The foreign limited partner lacks access to material nonpublic technical information as a result of its participation on the advisory board or committee.
- The investment otherwise meets the requirements of “other investments” (*i.e.*, non-passive, non-controlling transactions) set forth in FIRRMA.

## Applicability to Completed and Pending Transactions

The interim rule relating to the pilot program takes effect on November 10, 2018. The interim rule invites comments for 30 days from October 10. The pilot program is temporary in that it will be replaced by FIRRMA's full implementation, which is expected to take place no later than March 2020.

The pilot program regulations do not apply to transactions completed before the pilot program effective date (November 10, 2018). The pilot program also does not apply to transactions for which, prior to October 11, 2018, any of the following have occurred:

- The parties executed a binding written agreement or other document establishing the material terms of the transaction.
- A party made a public offer to shareholders to buy shares of a US business.
- A shareholder solicited proxies in connection with the election of the board of directors or requested the conversion of convertible voting securities.

## Conclusion

In light of the significant changes introduced by the new pilot program and its near-immediate effectiveness, investors are advised to review their transactions in US businesses against the new rules.

## List of Pilot Program Industries

1. Aircraft Manufacturing (NAICS Code: 336411)
2. Aircraft Engine and Engine Parts Manufacturing (NAICS Code: 336412)
3. Alumina Refining and Primary Aluminum Production (NAICS Code: 331313)
4. Ball and Roller Bearing Manufacturing (NAICS Code: 332991)
5. Computer Storage Device Manufacturing (NAICS Code: 334112)
6. Electronic Computer Manufacturing (NAICS Code: 334111)
7. Guided Missile and Space Vehicle Manufacturing (NAICS Code: 336414)
8. Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing (NAICS Code: 336415)
9. Military Armored Vehicle, Tank, and Tank Component Manufacturing (NAICS Code: 336992)
10. Nuclear Electric Power Generation (NAICS Code: 221113)
11. Optical Instrument and Lens Manufacturing (NAICS Code: 333314)
12. Other Basic Inorganic Chemical Manufacturing (NAICS Code: 325180)
13. Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing (NAICS Code: 336419)
14. Petrochemical Manufacturing (NAICS Code: 325110)
15. Powder Metallurgy Part Manufacturing (NAICS Code: 332117)
16. Power, Distribution, and Specialty Transformer Manufacturing (NAICS Code: 335311)
17. Primary Battery Manufacturing (NAICS Code: 335912)
18. Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing (NAICS Code: 334220)
19. Research and Development in Nanotechnology (NAICS Code: 541713)
20. Research and Development in Biotechnology (except Nanobiotechnology) (NAICS Code: 541714)
21. Secondary Smelting and Alloying of Aluminum (NAICS Code: 331314)
22. Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing (NAICS Code: 334511)
23. Semiconductor and Related Device Manufacturing (NAICS Code: 334413)
24. Semiconductor Machinery Manufacturing (NAICS Code: 333242)
25. Storage Battery Manufacturing (NAICS Code: 335911)
26. Telephone Apparatus Manufacturing (NAICS Code: 334210)
27. Turbine and Turbine Generator Set Units Manufacturing (NAICS Code: 333611)

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If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

**[Les P. Carnegie](#)**

les.carnegie@lw.com  
+1.202.637.1096  
Washington, D.C.

**[Steven P. Croley](#)**

steven.croley@lw.com  
+1.202.637.3328  
Washington, D.C.

**[Edward J. Shapiro](#)**

edward.shapiro@lw.com  
+1.202.637.2273  
Washington, D.C.

**[Zachary N. Eddington](#)**

zachary.eddington@lw.com  
+1.202.637.2105  
Washington, D.C.

**[Bridget R. Reineking](#)**

bridget.reineking@lw.com  
+1.202.637.1015  
Washington, D.C.

**[Cooper M. Rekrut](#)**

cooper.rekrut@lw.com  
+1.202.637.2246  
Washington, D.C.

**[Lauren Talerma](#)**

lauren.talerman@lw.com  
+1.202.637.2200  
Washington, D.C.

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