

Impacts of New CFIUS Pilot Program on Investment Funds

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On October 10, 2018, the Department of the Treasury, which oversees the Committee on Foreign Investment in the United States (“CFIUS”), released interim regulations to implement portions of the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”), which was enacted in August.

The interim rules defined a new pilot program that will 1) significantly expand CFIUS’s mandate (previously limited to the review of “controlling” foreign investments in U.S. businesses for national security implications) to now include certain non-controlling, non-passive investments by foreign persons, *including investment made indirectly through U.S. entities such as investment funds*. The newly covered transactions involve foreign investment of **any magnitude** in companies involved with “critical technologies” within 27 specified industries; and 2) impose a mandatory filing requirement for all non-passive investments by foreign entities in covered U.S. businesses, at the threat of potentially significant penalties. There is no minimum amount or equity percentage threshold for qualifying investments. The pilot program will take effect on November 10, 2018.

This Alert provides an overview of the pilot program and its coverage with respect to investment funds.

Mandatory Declarations for Pilot Program Covered Transactions

The interim regulations under FIRRMA require CFIUS review of certain foreign investments in a U.S. business covered by the pilot program – either in the form of a “declaration” filing or the traditional, joint voluntary notice. The short-form declaration is a notice, approximately five pages in length, requiring details concerning the transaction, the investor and its owners, the pilot program U.S. business, all sources of financing and an explanation of the rights the foreign person will acquire, among other things.

The pilot program does **not** apply to transactions that close **prior to** November 10, 2018 or to transactions where prior to October 11, 2018, (i) the parties executed a binding written agreement or other document establishing the terms of the transaction, (ii) a party made a public offer to shareholders to buy shares of a pilot program U.S. business, or (iii) a shareholder solicited proxies in connection with the election of the board of directors of a pilot program U.S. business or requested the conversion of convertible voting securities.

Timing is critical to consider for investments taking place during or after this implementation period:

- For covered transactions that are scheduled to close from November 10, 2018 to December 25, 2018, parties must file a declaration on or promptly after November 10, 2018. CFIUS will have 30 days to review and act on such declarations, according to the regulations, although it is possible they will prioritize review of earlier filings, or for earlier targeted closing dates.
- For covered transactions that will close after December 25, 2018, parties must file a declaration with CFIUS at least 45 days prior to completing the transaction

Pilot Program Covered Businesses

Applicability of the new pilot program to an investment will depend on both the nature of the U.S. businesses involved in the transaction, as well as the rights granted to foreign investors with respect to their investment in those businesses.

The interim regulations will make CFIUS review a mandatory component of many foreign investments or transactions. Nearly all such investments pertaining to “pilot program U.S. businesses,” will be covered. A covered U.S. business is one that produces, designs, tests,

manufactures, fabricates, or develops one or more “critical technologies”¹ that are used and designed for one or more of 27 specified industries.

Pilot Program Covered Transactions

The pilot program applies to any direct or indirect investment in a pilot program U.S. business by a foreign person or entity, which includes non-controlling, non-passive investments by foreign investors. Mandated filings must be submitted to CFIUS for review if any foreign investor:

- receives access to any material, nonpublic technical information in the possession of the target U.S. business;
- obtains membership or observer rights on the board of directors or equivalent governing body, or the right to nominate an individual to a position on the board or its equivalent, of a pilot program U.S. business; or
- has any involvement other than through voting of shares, in substantive decision-making of the pilot program U.S. business regarding the use, development, acquisition, or release of critical technology.

Limited Exemption for Investment Funds

The pilot program provides an exemption for an indirect investment by a foreign person through an investment fund in a pilot program U.S. business that gives the foreign person membership as a limited partner or equivalent (including where the foreign person may have the right to serve on an advisory board or a committee of the fund) so long as:

- The fund is managed exclusively by a general partner, managing member or equivalent that is not the foreign person (effectively this requires the fund be managed by U.S. persons);
- The advisory board or committee does not have the ability to approve, disapprove or control investment decisions of the fund or decisions by the general partner, managing member or equivalent with respect to the fund’s investments;
- The foreign person does not have the ability to otherwise control the fund; and
- The foreign person does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee.

Certain advisory board rights, such as waiver of potential conflicts of interest, allocation limitations and similar activities are not considered to constitute control of the investment decisions of the fund except in extraordinary circumstances. While the carve out described above may take some investments outside the scope of the pilot program and mandatory reporting, examples of scenarios that may still trigger a review include:

- A foreign investor serves on the advisory board of a fund with access to information that may be considered material nonpublic technical information. This may be more common, for example, in funds focused on investing in technology with significant advisory board engagement in review of the fund’s portfolio;
- A foreign limited partner with the authority to unilaterally dismiss the general partner; and
- Certain investment structures, such as “funds-of-one”, separately managed accounts and co-investment vehicles, where a foreign investor (or a small group of foreign investors) may have more control than a passive limited partner typically would.

Conclusion

Any fund managers with foreign investors should review their relevant fund documents (including side letter arrangements with any foreign persons) and any applicable side letter agreements as soon as possible to determine whether the rights granted to such investors may trigger mandatory CFIUS filings, which go into effect November 10, 2018. Additionally, if the fund will not qualify for the investment fund exemption described above, any pending investments must be analyzed to determine whether the transaction will require a declaration filing. This analysis is highly fact-specific and each investment should be carefully reviewed to determine whether a filing will be required. If a declaration is in fact required, expectations of parties need to be reset regarding timing in order to build in the ability to prepare, present and complete the required waiting periods for the filing. Please contact your Foley Hoag lawyer with any questions.

1. “Critical technologies” is defined in accordance with U.S. export-controlled technologies, and captures many items and technologies

controlled under Export Administration Regulations, as well as other items and technologies including defense articles subject to the International Traffic in Arms Regulations, nuclear and chemical/biochemical controls, and “emerging and foundational technologies” (these last are still to be defined by the U.S. Department of Commerce).

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