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Penalties for Failing to Make Mandatory CFIUS Declaration Filings Become a Reality in Just Days: Is Your Transaction Impacted?

A few months ago, we informed you about the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") and its changes to the Committee on Foreign Investment in the United States ("CFIUS") process. [Government Contracts ConneKTion Blog/August 2018] One of FIRRMA's biggest changes to the CFIUS process was making CFIUS declarations mandatory in certain instances. Until FIRRMA, CFIUS had been—at least in theory—a voluntary process. FIRRMA changes that and in October, the Departmen of Treasury published interim regulations implementing a pilot program that now requires declarations for transactions subject to the pilot program. Failing to comply can result in civil monetary penalties equaling the amount of the transaction. The pilot program commences on November 10, 2018, so if you have a transaction in progress or contemplated, the time to evaluate these changes is now.

What Transactions Are Subject to the Pilot Program?

There are two types of transactions the pilot program applies to: (1) Any transaction resulting in "control" by a foreign person of a pilot program U.S. business; and (2) Any "pilot program covered transactions." While these terms seem simple enough, there's much more beneath the surface.

What is a Pilot Program U.S. Business?

A "pilot program U.S. business" is defined in the regulations as "any business that produces, tests, manufactures, fabricates, or develops a critical technology that is: (a) utilized in connection with the U.S. business's activity in one or more pilot program industries; or (b) designed by the U.S. business specifically for use in one or more pilot program industries."

A "critical technology" is defined as any of the following:

- Defense articles or defense services included on the U.S. Munitions List as set forth in the International Traffic in Arms Regulations;
- Items included on the Commerce Control List set forth in Supplement No. 1 to part 774 of the Export Administration Regulations and controlled: (i) pursuant to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology; or (ii) reasons relating to regional stability or surreptitious listening;
- Nuclear facilities, equipment, and material covered by 10 C.F.R. part 110 (relating to exporting and importing nuclear equipment and material);
- Select agents and toxins covered by specific parts of the C.F.R.; and

- Emerging and foundational technology controlled pursuant to the Export Control Reform Act of 2018. The technology covered here will be defined in the near future by the Department of Commerce.

A "pilot program industry" is either one or a combination of 27 industries identified by their specific North American Industry Classification System ("NAICS") codes. The full list of industries identified by their description and associated NAICS code is included below.

What About Non-Controlling Investments by Foreign Investors?

Whereas CFIUS has traditionally been concerned with transactions where a foreign party controls—or has the ability to control—a U.S. business, FIRRMA expands CFIUS's jurisdiction to cover non-controlling investments by foreign investors in certain instances. The pilot program covers this expansion and non-controlling investments are covered if it gives the foreign investor:

- Access to any "material nonpublic technical information" in the possession of the target U.S. business. "Material nonpublic technical information" is 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." The definition excludes financial information regarding the performance of an entity;
- 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; or
- Any involvement (besides voting of shares) in substantive decision making of the U.S. business regarding the use, development, acquisition, or release of critical technology.

The interim regulations also have a significant carve out for "certain investment fund investments." Specifically, indirect investment by a foreign investor in a pilot program U.S. business "through an investment fund that affords the foreign person…membership as a limited partner or equivalent on an advisory board or a committee of the fund shall not be considered a pilot program covered transaction" if the following conditions are satisfied:

1. The investment fund is "managed exclusively by a general partner, a managing member, or an equivalent;"
2. The investment fund's general partner, managing member, or equivalent is not the foreign person;
3. The advisory board or committee does not have the ability to approve, disapprove, or otherwise control the investment fund's investment decisions or decisions by the general partner (or equivalent) regarding portfolio assets;
4. The foreign person does not otherwise have an ability to control the fund;
5. The foreign person does not have access to "material nonpublic technical information" as a result

of its participation.

6. The investment otherwise satisfies the requirements of "other investments" set forth in FIRRMA (meaning the investment is non-passive, non-controlling).

This carve out is far from clear and given the stiff potential penalties for failing to make a required declaration, investment funds should carefully evaluate whether they truly satisfy the requirements.

My Transaction is Covered Under the Pilot Program, What Do I Need to File with CFIUS?

Companies that find their transaction is subject to the pilot program must file either a joint voluntary notice or a "declaration." The "declaration" process is new and intended to be the "CliffsNotes" of information that would be in a typical voluntary notice.

When Do I Need to File My Declaration?

When declarations need to be filed depends on when closing is anticipated:

- For transactions that are expected to close between November 10, 2018, and December 25, 2018, declarations should be filed "on November 10, 2018 or promptly thereafter."
- For transactions that are expected to close after December 25, 2018, the declarations should be filed at least 45-days before closing.

What Do I Put in My Declaration?

The interim regulations provided detailed information about what has to be disclosed in a declaration including:

- Identifying the parties;
- A brief description of the transaction including percentages of voting and economic interest acquired, total transaction value, and sources of financing;
- Description of the rights the foreign person will have in the business;
- Information on the U.S. business's government contracts and grants; and
- Whether the parties, including parents and subsidiaries, have been convicted of a crime within the past 10 years in any jurisdiction.

I Filed a Declaration, Now What?

After a declaration is filed, CFIUS is required to "promptly" review it and either accept it or return it and advise of what additional information is necessary for the declaration to be accepted. "Promptly" is not defined in days in the regulations and it is likely that there will be some lag between when declarations are submitted and accepted.

Once the declaration is accepted and reviewed, CFIUS within 30 days can take any of the following actions:

1. Request the parties submit a complete joint voluntary notice;

2. Inform the parties that CFIUS cannot reach a decision based on the declaration and that the parties *may* submit a complete joint voluntary notice;
3. Unilaterally review the transaction; or
4. "Clear" the transaction.

CFIUS is not required to take the full 30 days to complete its review and reach its decision. As these regulations come into practice, there is optimism that CFIUS will "clear" transactions that are of lesser concern quicker than 30 days. If however CFIUS requests or the parties decide to submit a complete joint voluntary notice, the timelines associated with such a review will apply.

What Happens if I Don't File a Declaration and it Was Required?

The interim regulations provide for potentially stiff penalties for failing to file a required declaration. CFIUS can issue a civil monetary penalty in an amount up to the value of the transaction. All of this is uncharted territory so whether CFIUS will come out swinging remains to be seen. The magnitude of penalties authorized though serves as a warning that CFIUS can and will pursue those that fail to make required declarations.

Pilot Program Industries (Description – Associated NAICS Code)

Aircraft Manufacturing – 336411
Aircraft Engine & Engine Parts Manufacturing – 336412
Alumina Refining & Primary Aluminum Production – 331313
Ball & Roller Bearing Manufacturing – 332991
Computer Storage Device Manufacturing – 334112
Electronic Computer Manufacturing – 334111
Guided Missile & Space Vehicle Manufacturing – 336414
Guided Missile & Space Vehicle Propulsion Unit & Propulsion Unit Parts Manufacturing – 336415
Military Armored Vehicle, Tank, and Tank Component Manufacturing – 336992
Nuclear Electric Power Generation – 221113
Optical Instrument & Lens Manufacturing – 333314
Other Basic Inorganic Chemical Manufacturing – 325180
Other Guided Missile & Space Vehicle Parts & Auxiliary Equipment Manufacturing – 336419
Petrochemical Manufacturing – 325110
Powder Metallurgy Part Manufacturing – 332117
Power, Distribution, and Specialty Transformer Manufacturing – 335311
Primary Battery Manufacturing – 335912
Radio & Television Broadcasting & Wireless Communications Equipment Manufacturing – 334220
Research & Development in Nanotechnology – 541713
Research & Development in Biotechnology (except Nanobiotechnology) – 541714
Secondary Smelting & Alloying of Aluminum – 331314

Search, Detection, Navigation, Guidance, Aeronautical, & Nautical System & Instrument Manufacturing – 334511
Semiconductor & Related Device Manufacturing – 334413
Semiconductor Machinery Manufacturing – 333242
Storage Battery Manufacturing – 335911
Telephone Apparatus Manufacturing – 334210
Turbine & Turbine Generator Set Units Manufacturing – 333611