

CFIUS: Final Rule Weds Declaration Requirements for Critical Technology Transactions with Export Controls

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Law360 / Global Trade Alert

09.17.2020

The U.S. Department of the Treasury published a [Final Rule](#) (the Rule) on September 15, 2020, revising provisions in the regulations of the Committee on Foreign Investment in the United States (CFIUS) that implement section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA). The Rule becomes effective October 15, 2020, and once in place, will do away with the critical technology mandatory declaration based on North American Industry Classification System (NAICS) codes that were part of a [rule published January 17, 2020](#), and are applicable to U.S. businesses in one of 27 industries identified by a NAICS code. In that rule, the Treasury anticipated it would revise the mandatory declaration requirement regarding critical technology at 31 CFR § 800.401(c) from NAICS codes to one based on export control licensing requirements. The NAICS code protocol, nevertheless, will continue to apply to transactions for which specified actions occurred on or after February 13, 2020, but prior to October 15, 2020.

Mandatory Declarations Are Triggered by Export Controls

The Rule modifies the mandatory declaration provision for certain foreign investment transactions involving a U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies. Specifically, the Rule mandates declarations in connection with covered transactions where U.S. regulatory authorizations would be required to export, reexport, transfer (in country), or retransfer a U.S. business's critical technology to certain transaction parties or others in the ownership chain.

The term "U.S. regulatory authorization" is defined as licenses or authorizations required by the Department of State (pursuant to the International Traffic in Arms Regulations), the Department of Commerce (pursuant to the Export Administration Regulations as modified by the Export Control Reform Act), the Department of Energy (pursuant to regulations governing assistance to foreign atomic energy activities at 10 CFR § 810 other than the general authorization described in 10 CFR § 810.6(a)) as well as the Nuclear Regulatory Commission (pursuant to regulations governing the export or import of nuclear equipment and material at 10 CFR § 110). In sum and substance, if one of the

aforementioned export control regimes requires licensing or authorization prior to the export of said critical technology to the home country of the foreign investor(s), a mandatory declaration is required for that particular transaction.

Mandatory Assessment Timelines and Triggers

The parties are required to conduct a critical technology assessment upon the earliest of the execution of a binding agreement by the parties or any change to investors' rights that results in a covered transaction or covered investment. Both direct and indirect ownership interests must be evaluated to determine whether a U.S. regulatory authorization would be required for the hypothetical export activity of the U.S. business's critical technology to the direct acquirer, or to a person with 25 percent or more voting interest, direct or indirect, in such direct acquirer. In certain circumstances, this 25 percent threshold would apply up the ownership chain to the direct acquirer's general partner (or equivalent). The Rule clarifies that foreign persons who are related, have formal or informal arrangements to act in concert, or are agencies or instrumentalities of, or controlled by, the national or subnational governments of a single foreign state are considered part of a group of foreign persons, and their individual holdings are aggregated.

Critical Technology Early-Stage Companies Take Note

Export controls are a cornerstone of the national security reviews of foreign inward investment. Those involved in critical, foundational, and emerging technologies should understand that the importance of export controls will continue to grow due simply to the inseparability of strictly civil from potentially military and strategic technologies. Attracting foreign investment in U.S. early-stage companies that develop cutting-edge dual-use technologies may also assist the foreign investor's home country in augmenting that country's military and strategic capabilities. Some of those countries may be strategic competitors of the United States. FIRRMA was enacted to address "the nature of the investments that pose the greatest potential risk to national security, which warrants an appropriate modernization of the processes and authorities of [CFIUS] and of the United States export control system."

How to Prepare

- Seek out and engage export control and CFIUS counsel. This is not your current deal counsel. Profound and thorough export control due diligence is required, as is genuine experience with the CFIUS process.
- Buyers must be aware of any potential successor liability from the unmitigated export control violations of sellers.
- In addition to the standard CFIUS representations and warranties, buyers should also consider asking for export control representations and warranties.
- In addition to CFIUS requirements, buyers and sellers may be subject to mandatory notice requirements under the ITAR that will determine whether work may continue on existing licenses or agreements post-acquisition.
- Buyers will need to determine whether they conduct business in countries subject to U.S. or multilateral sanctions, or whether they conduct business with entities that are denied/debarred/listed by one of several U.S. government agencies.
- Sellers must be sure to conduct thorough export control classification of their products, technologies, or services prior to the CFIUS filing.
- Sellers must ensure that an export control compliance assessment has been performed and that no export control violations are identified. If violations are identified, sellers must determine whether a voluntary self-disclosure is appropriate.
- Sellers should be extraordinarily careful not to release export controlled technical data to foreign investors during due diligence, negotiations or any time until all appropriate authorizations are in place from the cognizant government agency.

Fines

Recently, CFIUS received over \$24 million in funding to hire an additional 39 full-time employees before the end of the next fiscal year. This signals that CFIUS anticipates growth in its caseload. Those transactions that are subject to mandatory declaration but are not declared are subject to monetary penalties of \$250,000 or the value of the transaction, whichever is greater. Not only does CFIUS have the authority to seek out undeclared transactions, but its increased budget and staffing signal that this may be a priority. It is crucial, therefore, that both the seller and the buyer receive proper guidance concerning the export control classification of the technology that is the subject of the transaction. Specifically, the parties must be able to accurately determine licensing requirements or exceptions thereto.

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