November 6, 2018

Via www.regulations.gov (Docket Nos. TREAS-DO-2018-0021 and -0022)

Mr. Thomas Feddo
Deputy Assistant Secretary for Investment Security
U.S. Department of the Treasury
1500 Pennsylvania Avenue
Washington, DC 20220

Re: American Investment Council Comments on the Interim Rule Regarding Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies

Dear Mr. Feddo:

The American Investment Council ("AIC"), on behalf of its members in the U.S. private equity community, appreciates your time and consideration of these comments regarding the interim rule that sets forth the scope of and procedures for a Committee on Foreign Investment in the United States ("CFIUS" or "the Committee") pilot program ("Pilot Program") relating to critical technologies pursuant to certain provisions of the Foreign Investment Risk Review Modernization Act ("FIRRMA"). AIC is an advocacy and resource organization established to develop and provide information about the private investment industry and its contributions to the long-term growth of the U.S. economy and retirement security of American workers. Member firms of the AIC consist of the country's leading private equity and growth capital firms united by their successful partnerships with limited partners and American businesses.

Overall, between 2012-2017, private equity invested an estimated $3 trillion to grow American businesses. These U.S. companies span from coast to coast and every state in between. In fact, today there are currently about 32,000 American companies that are benefiting from private equity investment. There are also 4.9 million Americans who are employed by both small and large companies backed by private equity. Private equity also continues to lead all asset classes in long-term investment performance, with private equity's median 10-year annualized return of 8.6 percent surpassing public equity's 6.1 percent, fixed income's 5.3 percent, and real estate's 4.7 percent. The financial benefits of these returns directly impact millions of dedicated American public servants like teachers, firefighters, and police officers who rely on pension income in retirement.

Preserving a regulatory environment that enables AIC members to continue to attract and manage capital from all over the world and deploy it in the United States to realize these economic benefits is critical. At the same time, AIC recognizes and values the important role that CFIUS plays in protecting the national security of the United States. To that end, we welcomed the enhancements to CFIUS, including additional

resources, provided in FIRRMA and Congress's concurrent affirmation in FIRRMA that the United States remains open to foreign investment. To ensure that CFIUS can carry out its essential functions without inadvertently impairing beneficial passive foreign investment, we support a CFIUS process that provides transaction parties with regulatory certainty, operates according to predictable timelines, and is readily administrable to permit CFIUS to focus on the transactions that implicate U.S. national security.

We sincerely appreciate Treasury's and the Committee's efforts to take into consideration the unique characteristics of the private equity investment model during both the FIRRMA and Pilot Program drafting processes. We recognize and are grateful that Treasury and CFIUS understand that the typical U.S. private equity structure — with a general partner and investment committee controlled by U.S. persons whose principal place of business is in the United States and a diverse pool of passive U.S. and foreign limited partners — does not present any concerns for U.S. national security and, in fact, is a critical source of capital needed for the development of U.S. business. This letter identifies a handful of important outstanding issues to the private equity community with regards to the Pilot Program and proposes clarifications to help enable effective, efficient administration of the process.

We believe that our comments can be primarily addressed through surgical clarifications in the Pilot Program, including by adding to the examples in the interim rules and further FAQs published by Treasury. At the same time, we also wish to take this opportunity to highlight important definitional and scoping points that we believe should be addressed in the final rulemaking under FIRRMA, if not directly in the Pilot Program.

A. Investment Fund Scope — Foreign Entity Definition Confirmations

Consistent with the statutory language in FIRRMA, the Pilot Program, in section 31 C.F.R. 801.304, affirms that a foreign limited partner who participates on an advisory body or committee of an investment fund will not be a pilot program covered investment under traditional fund structures in which the foreign limited partner does not control the fund or otherwise receive rights or information that would trigger the Pilot Program. This is a helpful confirmation that the Pilot Program is not intended to pick up standard passive limited partner investments in funds that are themselves not otherwise foreign persons.

Nevertheless, many private equity firms and their managed funds respectfully submit that it would be very helpful to confirm the scope of the "foreign person" and "foreign entity" definitions, in sections 31 C.F.R. 800.216 and 800.212, respectively, given the mandatory nature of the Pilot Program. In particular, 31 C.F.R. 800.212 defines "foreign entity" as follows:

> (a) The term foreign entity means any branch, partnership, group or sub-group, association, estate, trust, corporation or division of a corporation, or organization organized under the laws of a foreign state if either its principal place of business

> is outside the United States or its equity securities are primarily traded on one or more foreign exchanges.
>
> (b) Notwithstanding paragraph (a) of this section, any branch, partnership, group or sub-group, association, estate, trust, corporation or division of a corporation, or organization that demonstrates that a majority of the equity interest in such entity is ultimately owned by U.S. nationals is not a foreign entity.

Under this definition, a private equity-formed general partner or fund organized under the laws of a foreign state is not a foreign entity if, among other things, its principal place of business is within the United States ***or*** if a majority of the equity interest in such entity is ultimately owned by U.S. nationals. Any doubt about this interpretation was less acute historically when filings were voluntary and focused on controlling investments, but they assume greater importance given the mandatory nature of the pilot program. Confirmation of the following points with respect to the "foreign entity" definition is therefore appropriate and necessary:

1. Confirmation that a fund that is organized offshore but as to which (a) no single foreign person, or group of foreign persons acting in concert, controls the fund; and (b) the decisions of the fund are ultimately controlled by U.S. persons whose principal place of business is the United States, is not a "foreign entity" and therefore not a foreign person.
2. Confirmation that regardless of the principal place of business, if a fund does not have a majority of the limited partners that are foreign persons and no other foreign person controls the fund, then the fund also would not be a "foreign entity" under 31 C.F.R. 800.212(b) and therefore also not a foreign person. To this end, it also is important to clarify that while 31 C.F.R. 800.212(b) refers to "a majority of equity interest … is ultimately owned by U.S. nationals," equity interests that are owned by other persons who are not-foreign persons (i.e., institutional U.S. investors that are not controlled by a foreign person) would be treated the same way as any investment owned by a U.S. national.

In addition to confirming the foregoing points through the Pilot Program Q&As, we also would encourage Treasury to provide a clarifying illustrative example in the Pilot Program rules, such as:

> Individuals A, B, and C collectively own and control, directly or indirectly, Business D, which has a principal place of business in the United States and is incorporated in an offshore jurisdiction. Individuals A, B, and C are U.S. citizens, not foreign persons, and no other foreign person controls Business D, directly or indirectly. Business D acts as the general partner of, and fully controls, Fund Vehicle E. Fund Vehicle E includes a diverse set of limited partners, none of whom individually or collectively control the Fund, with the majority of equity coming from diverse foreign limited partners, and no other foreign person controls Fund

> Vehicle E. Fund Vehicle E is also incorporated in an offshore jurisdiction. U.S. citizens A, B, and C control and manage the administration of Business D and Fund Vehicle E from the United States. Therefore, the principal place of business for Business D and Fund Vehicle E is the United States. Assuming no other relevant facts, neither Business D nor Fund Vehicle E are foreign entities or foreign persons.

For purposes of the Pilot Program, the foregoing confirmations and example will be important to ensure that the Pilot Program does not create confusion in the private equity market and is appropriately circumscribed to transactions that truly involve investments where foreign persons, acting individually or in concert, have the ability through an investment to exercise control over a fund, participate as board directors or observers, access material nonpublic technical information, or exercise decisionmaking authority in relation to critical technologies of a Pilot Program U.S. Business.

Beyond such clarifications and examples, however, AIC also wants to highlight the critical importance of the further rulemaking that CFIUS will undertake to implement FIRRMA — and, in particular, properly clarifying the scope of the "foreign entity" definition. Ultimately, we believe that the definition of "foreign entity" should be updated in the FIRRMA regulations to focus more on "control" than "equity," to reflect the realities of modern funds, where fund equity owned by limited partners typically entails no relevant governance or material nonpublic technical information rights with respect to underlying portfolio investments that should trigger national security concerns.

We note that the current regulatory definition of "foreign entity," at 31 C.F.R. 800.212, provides an exception to the general definition, indicating that entities that can demonstrate that a majority of their equity interests are owned by U.S. nationals will not be regarded as "foreign entities." This approach makes sense for standard direct investments, where equity percentage may be a reasonable proxy for degree of control. That heuristic breaks down, however, for typical investment funds, where the control is usually held by a general partner and the overwhelming majority of equity is held by passive limited partners. This is consistent with the current CFIUS regulations, which recognize in Example 8 to 31 C.F.R. 800.204, that fund equity ownership by limited partners in a limited partnership does not equate to control.[1]

Given this background, we encourage CFIUS to update its definition of "foreign entity," if not in the Pilot Program then certainly in the final rules implementing FIRRMA. We specifically suggest recognizing the unique nature of fund structures and

[1] "Example 8. Limited Partnership A comprises two limited partners, each of which holds 49 percent of the interest in the partnership, and a general partner, which holds two percent of the interest. The general partner has sole authority to determine, direct, and decide important matters affecting the partnership and a fund operated by the partnership. *The general partner alone controls Limited Partnership A and the fund.*" [emphasis added].

relationships, consistent with the approach taken under both FIRRMA and the Pilot Program, by adding the following exception to the "foreign entity" definition:

> With regard to investment funds, the term 'foreign entity' does not include an investment fund or fund vehicle where --
>
> a. the general partner, managing member, or equivalent is not a foreign person or foreign entity;
>
> b. the aggregate equity of foreign limited partners' investments from the same country is less than 50%; and
>
> c. No foreign limited partners in the fund, whether individually or through an advisory board or committee, otherwise have the ability to control the fund, including authority to approve, disapprove, or otherwise control investment decisions of the fund or decisions made by the general partner, managing member or equivalent, or unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the general partner, managing member, or equivalent.

This additional exception should achieve the same goal for investment funds as the existing, majority U.S. ownership exception provides for standard investments, *i.e.*, not treating funds that are truly controlled by U.S. persons as foreign entities, even if they have majority foreign equity ownership held by passive limited partners. Investments from such entities will not create a risk that a foreign person, by exercising control over a U.S. business, could threaten to impair the U.S. national security, and therefore should be specifically excluded from CFIUS's jurisdiction.

B. Clarification of the U.S. Business Definition

We encourage CFIUS to confirm that the existing regulatory definition of "U.S. business," from 31 C.F.R. 800.226, is still in force. We note that FIRRMA defines "U.S. business" as "a person engaged in interstate commerce in the United States,'' while the existing regulatory definition embodies the same essential definition, but further qualifies it:

> The term U.S. business means any entity, irrespective of the nationality of the persons that control it, engaged in interstate commerce in the United States, *but only to the extent of its activities in interstate commerce*. [Emphasis added.]

We believe this is a critical qualification to avoid sweeping into the mandatory filing requirements of the Pilot Program transactions where the target of the acquisition is a foreign entity with no physical presence in the United States, but some limited sales of goods or services into U.S. interstate commerce.

Explicit confirmation would also be consistent with the representations captured in the September 12, 2018 letter to Secretary Mnuchin from the leadership of the House

Financial Services Committee which indicated that, "during conference discussions, Treasury staff confirmed that CFIUS has no intention of altering [the U.S. business definition]."

C. Foreign Person Definition for Pilot Program

The Pilot Program interim rule indicates that:

> The purpose of the pilot program is to assess and address ongoing risks to the national security of the United States resulting from two urgent and compelling circumstances: (1) The ability and willingness of some foreign parties to obtain equity interests in U.S. businesses in order to affect certain decisions regarding, or to obtain certain information relating to, critical technologies; and (2) the rapid pace of technological change in certain U.S. industries.[2]

The interim rule goes on to state that:

> The Committee has developed this pilot program without exempting any country from the mandatory declaration requirement in order to understand and examine, in a comprehensive manner, the nature of foreign direct investment as it relates to critical technologies and the pilot program industries.

While we agree that is a laudable goal in the abstract, we believe that the decision not to tailor the Pilot Program to those countries that have a demonstrated history of exploiting equity interests for technology transfer purposes comes at a significant cost, one not justified by the limited potential benefit. As further noted below, we believe there is a real danger that the Committee will be overwhelmed, as a procedural matter, reviewing declarations for transactions that have little-to-no chance of posing a national security issue, adding costly delays and uncertainty to a wide range of transactions under review by the Committee, both declarations and notices.

Therefore, we ask that the Committee reconsider its comprehensive approach to the Pilot Program and suggest that it avail itself of its authority under Section 721(a)(4)(E) of the Defense Production Act, as amended by FIRRMA, to "prescribe regulations that further define the term 'foreign person' for purposes of clauses (ii) and (iii) of subparagraph (B) [*which define "covered transaction" to include certain real estate transactions and other investments involving critical infrastructure, critical technologies, and sensitive personal data*]." That provision goes on to state, "[i]n prescribing such regulations, the Committee shall specify criteria to limit the application of such clauses to the investments of certain categories of foreign persons. Such criteria

[2] Determination and Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies, 83 Fed. Reg. 51,324 (Oct. 11, 2018).

shall take into consideration how a foreign person is connected to a foreign country or foreign government, and whether the connection may affect the national security of the United States."[3]

In order to tailor the "foreign person" definition for purposes of the Pilot Program to those countries whose companies have a history of exploiting equity interests for technology transfer purposes, and assuming that CFIUS is not prepared to list such countries directly, we suggest the following criteria, for your consideration:

1. Whether the investor is organized, headquartered, and managed from a member country of the North Atlantic Treaty Organization (NATO) or one designated as a major non-NATO ally pursuant to section 517 of the Foreign Assistance Act of 1961;
2. Whether the investor is organized, headquartered, and managed from a country that has another mutual defense treaty or a defense cooperation or enhanced security cooperation agreement with the United States;
3. The extent to which the investor's country of origin has a history of compliance with other significant U.S. policy objectives, including laws relating to counter-terrorism and non-proliferation;
4. Whether the process of the country for reviewing the national security effects of foreign investment and associated international cooperation effectively safeguards national security interests the country shares with the United States;
5. Whether the investor has had an investment approved by CFIUS within the last 18 months;
6. The investor's record of compliance with CFIUS mitigation agreements;
7. Whether the investor has been approved to own companies performing on classified contracts under Foreign Ownership, Control, or Influence ("FOCI") mitigation with the Defense Security Service or under equivalent national industrial security requirements; and
8. The investor's record of compliance with U.S. laws relating to export control and trade sanctions.

D. Guidance on Penalties

Under the interim rule, Section 801.409 indicates any person who fails to comply with the requirements of Section 801.401, *i.e.*, to provide a declaration or notice for a "pilot program covered transaction," may be liable for a civil penalty up to the value of the transaction. While we understand the need for penalties as an incentivizing force, the

[3] Defense Production Act § 721(a)(4)(E) (as amended by FIRRMA).

provision as written leaves tremendous ambiguity regarding when the Committee might seek a penalty and how it would determine the amount.

We strongly encourage CFIUS to provide guidance regarding the specific circumstances under which it would seek a penalty, as well as how it would calculate the specific penalty for any given violation. This is especially the case in the early stages of implementation of the Pilot Program, when potential definitional ambiguities are likely to still be discovered, and there is not a body of cases that demonstrate the nuances of the Committee's definitional interpretations on which parties can rely in making their own assessments regarding the necessity to file. That is, there are likely to be parties who will have a made a good faith effort to assess whether their transaction meets the requirements of Section 801.401 and concluded it did not, while CFIUS may yet reach a different conclusion. Imposition of a significant — much less the maximum — penalty would be very disproportionate in such circumstances.

To address such circumstances, we encourage the Committee to provide guidelines on when it will assess penalties and, in particular, to indicate that parties who can demonstrate that they have made such a good faith effort and not filed will not be subject to the same civil penalty as parties who have not made a demonstrably good faith effort, especially if the former immediately file upon request from the Committee. Evidence of a good faith effort could include, for example, whether the U.S. business has conducted a reasonable examination of the various critical aspects of the Pilot Program, including (a) examining the ownership chain of the investor to determine whether the investor is clearly controlled by a foreign person; (b) evaluating the target U.S. business to assess whether it is producing, designing, testing, manufacturing, fabricating, or developing critical technologies, which also would include an examination of the applicable export controls; and (c) evaluating the relevant industry of the target U.S. business to determine whether it is reasonably encompassed by any of the 27 NAICS codes identified in the Pilot Program.

E. Committee Commitment to Timeliness and Efficiency

While AIC and its members recognize that it is in the Committee's best interests to be timely and efficient in conducting its transactional reviews, we are concerned that the Pilot Program will deluge the Committee with declarations and notices, resulting in significant delays in case processing, given the limits of available staff. As we are sure you appreciate, the predictability of the CFIUS process is of paramount concern to the investment community. Delays in processing of transactions under the Committee's existing "control" jurisdiction, both in terms of the timing of acceptance of the notices and rate of completing action within the review period, can frustrate the planning and execution of transactions, delay the flow of critical capital into the United States, and distort a competitive open investment regime that is crucial to the United States' economic and national security.

Thus, it is of paramount importance for the orderly functioning of the U.S. economy that, in addition to addressing the points above, the Committee adhere to the 30-day timeline contemplated by FIRRMA for processing declarations. To this end, we encourage the Committee specifically to clarify provisions of the 30-day pilot program assessment period to ensure that the Committee's actions during the pilot program stay as close as possible to that 30-day benchmark. As drafted, section 801.404(a)(1) of the interim rule gives the CFIUS Staff Chairperson discretion to determine when "day one" of the 30-day period begins. That discretion is bounded only by the undefined requirement that the Staff Chairperson "promptly" notify the parties of that date. We understand the time pressures and resource constraints that the Committee is facing, but we recommend clarifying that "promptly," in this context, means no more than two business days from the date the parties submit the declaration. We submit that this clarification will meaningfully balance the government's workload concerns with providing a clear regulatory framework and timeline for parties, which is crucial to continuing to foster an active investment and transactional environment.

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AIC and its members understand the need to adjust the Committee's authorities to address evolving risks related to the potential transfer of critical technologies to those countries who might leverage them to compromise U.S. national security. We suggest, however, that U.S. national security, CFIUS, and the private equity community would be well served if the Committee provided some clarifications regard its authorities and intentions under the Pilot Program, as well as considered tailoring application of its expanded authorities to investments only from countries that are likely to pose an elevated technology transfer threat. We believe that implementation of our recommendations would help the Committee strike the right balance between supporting U.S. open investment policy and thoroughly protecting U.S. national security. We hope you find our comments helpful and constructive and appreciate your time and consideration of them.

Sincerely,

Jason Mulvihill
Chief Operating Officer & General Counsel