October 17, 2019

Via www.regulations.gov (Docket Nos. TREAS-DO-2019-0008-0001 and TREAS-DO-2019-0008-0002)

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

Re: American Investment Council Comments on Provisions Pertaining to Certain Investments in the United States by Foreign Persons

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 proposed rule (the "Regulations") that would replace the current regulations that implement section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") as they relate to the authorities and process of the Committee on Foreign Investment in the United States ("CFIUS" or "the Committee"). 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 2013-2018, private equity invested an estimated $3.4 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 35,000 American companies that are benefiting from private equity investment. There are also 8.8 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 10.2 percent surpassing public equity's 8.5 percent, fixed income's 4.8 percent, and real estate's 4.8 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 concerns.

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 legislative and regulatory 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.

We also note that one of the great advantages of the United States as a destination for investment is the clarity of its laws and regulatory framework, calibrated not to interject government review into investment deployment unless absolutely necessary to protect core national interests. Put simply, investors and transaction parties desire two things from a regulatory environment: certainty and clear, reasonable timelines. Laws and regulations that impede either of these may ultimately detract from the flow of important capital that enhances both economic interests and national security.

With this in mind, we appreciate that, in the Regulations, CFIUS has implicitly recognized that mandating certain filings, while necessary to protect national security, also may have a profound impact on the flow of investment into the United States as well as the CFIUS process. Thus, we were heartened to see that CFIUS defines "substantial interest" – a core trigger for mandatory declarations involving investment in infrastructure and personal data-related businesses – at reasonable thresholds, with a focus on "the ability of a person to influence the actions of another person in a manner that has the potential, directly or indirectly, to impair the national security." Limited partners are almost always passive in private equity funds; thus, this framework does not impede most private equity investments.

Nevertheless, AIC believes there are a handful of issues that require further clarification in the final rules.

As we understand the Committee to be seeking comments on both the Regulations and the CFIUS Critical Technologies Pilot Program implemented under rules promulgated in November 2018, this letter reiterates and updates some feedback we provided in a previous letter during the earlier rulemaking, as well as makes new points related to the recently released Regulations.

A. Mandatory Declarations and Investment Fund Scope — Foreign Entity and Principal Place of Business

Consistent with the statutory language in FIRRMA, the Pilot Program, in section 31 C.F.R. 801.304, affirms that an indirect investment by a foreign limited partner in a U.S. pilot program business through an investment fund managed exclusively by a general partner who is not a foreign person will not be considered 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, as we have previously stated, the mandatory declarations required of "pilot program covered transactions" and the breadth of the Pilot Program (since it applies to all foreign persons) introduced some uncertainty into transaction planning and execution, including for many private equity firms and their managed funds. This uncertainty potentially could be addressed if CFIUS narrowed the mandatory filing requirements for investments in critical technologies to a more precise group of foreign persons, *e.g.*, if the mandatory declaration requirements were triggered by investments that involved substantial interests from foreign persons in which a foreign government holds a substantial interest, like with the infrastructure and data components of "TID U.S. businesses." But if the scope of the mandatory declaration requirement for investments in critical technologies continues to apply to all "foreign persons," or to a broader scope than the substantial interest test for investments in data and infrastructure businesses, then we respectfully submit CFIUS should clarify and address certain arguable ambiguities in the term "foreign entity," which currently is defined in 31 C.F.R. § 800.212 and under the Regulations will be in 31 C.F.R. § 800.221, and "principal place of business" so that CFIUS's authorities applies to persons who actually are foreign persons or controlled by foreign persons, and not to funds that are controlled exclusively by U.S. persons.

1. Clarification of Foreign Entity Definition

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 have assumed greater importance given the mandatory nature of the Pilot Program and potential exposure of parties to significant fines, which the Committee may adopt on a permanent basis in the final regulations. In particular, it would be helpful for CFIUS to confirm 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.

In addition to confirming the foregoing point in the final regulations, we also would encourage Treasury to provide a clarifying illustrative example, such as:

> Individuals A, B, and C collectively 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 foreign person controls Business D, directly or indirectly. Business D acts as the general partner of, and controls, Fund Vehicle E, which is incorporated in an offshore jurisdiction. Fund Vehicle E includes a diverse set of passive limited partners, none of whom individually or collectively control the Fund and who are not acting in concert. 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.

The foregoing confirmation and example will be important, at a minimum, to ensure that the final rules related to mandatory filings for critical technology investments do not create confusion for fund investments and are 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 or participate as board directors or observers, access material nonpublic technical information, or be involved in substantive decision making in relation to critical technologies of a pilot program U.S. business.

Beyond such clarifications of new authorities and related examples, AIC also recommends that the definition of "foreign entity" as it pertains to investment funds 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" in the final regulations. We specifically suggest recognizing the unique nature of fund structures and relationships, consistent with the approach taken under both FIRRMA and the Pilot Program, by adding the following exception to the "foreign entity" definition:

> With respect to any investment fund, as defined by [31 CFR 800.229], the term "foreign entity" does not include any entity, even if it is organized under the laws of a foreign state, where:
>
> 1. No foreign person ultimately controls the general partner, managing member, or equivalent of the entity;
>
> 2. the aggregate equity of foreign limited partners' investments from the same country is less than 50%; and
>
> 3. 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.

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[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].

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.

2. *Principal Place of Business*

In addition to that change, we would recommend providing a clear, practical definition for "principal place of business." Many U.S. funds use offshore structures – for example, those incorporated in the Cayman Islands – while managing and controlling the funds from their principal places of business in the United States. Therefore, investments by such funds have historically not been subject to CFIUS jurisdiction, assuming no other foreign person controls the fund. The parameters of the term "principal place of business" have remained ambiguous, however, because of the lack of a statutory or regulatory definition. In an era of mandatory filings, this ambiguity takes on more significance and could lead to an uneven application of CFIUS's authorities.

The U.S. Supreme Court, in Hertz Corp v. Friend (559 U.S. 77, 130 S. Ct. 1181 (2010)) indicated that "principal place of business" for the purposes of diversity jurisdiction is best understood as the "place where the corporation's high level officers direct, control, and coordinate the corporation's activities. Lower federal courts have often metaphorically called that place the corporation's 'nerve center.'" In practice, it should normally be the place where the corporation maintains its headquarters -- provided that the headquarters is the actual center of direction and control, and not, for example, an office where the corporation only holds its board meetings.

As a practical matter, we note that there may be various factors, in turn, that help demonstrate that the headquarters in fact functions as a nerve center, including where important matters affecting an entity are primarily decided, and the place where, in the case of a fund, most principal managing directors or their equivalent have their principal offices.

We suggest that CFIUS take a similar approach to defining "principal place of business" in the final regulations. We offer the following definition and example for your consideration.

> **§ 800.2[XX] Principal Place of Business** – The term *principal place of business* means the primary location from where an entity's directors or officers direct and control the entity's activities, or, in the case of an investment fund, from where the activities and investments of the fund are primarily directed and controlled on behalf of the general partner, managing member, or equivalent.

> *Example 1.* Entity A is an investment fund company, controlled by U.S. persons. Entity A's managing directors and officers are primarily located in the United States. General Partner B is an entity incorporated in an offshore jurisdiction, but is under the control of Entity A. Fund Vehicle C, also incorporated in an offshore jurisdiction, is under the control of General Partner B. No foreign person ultimately controls Entity A, General Partner B, or Fund Vehicle C. Assuming no other relevant facts, the principal place of business of both General Partner B and Fund Vehicle C is the United States.

B. The U.S. Business Definition

Consistent with the objective of ensuring that CFIUS's authorities are clear, properly scoped, and can be effectively and efficiently applied, we encourage CFIUS to revert to the existing regulatory definition of "U.S. business," from 31 C.F.R. § 800.226 in the final regulations. We note that FIRRMA and the Regulations define "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 Committee's jurisdiction 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. We appreciate that CFIUS has attempted to address the breadth of this expansion by providing an example suggesting that a foreign corporation that exports goods to U.S. corporations is not a U.S. business if it has no U.S. assets, but this example is limited in scope, is itself ambiguous, and does not address the breadth of potential business structures implicated by the plain language of the definition.

It is not clear, for example, whether the following would be considered U.S. businesses under this definition: (i) a foreign company with no U.S. assets that provides services, such as engineering services, to U.S. customers; (ii) a company with no U.S. assets that sells bundled software products and related services to U.S. customers; or (iii) a company that does not have a branch office, subsidiary, or fixed place of business in the United States, but that directly employs sales personnel in the United States and sells products and services to U.S. customers. Because such businesses already involve such a substantial foreign nexus, the likelihood of a related acquisition posing national security concerns is small, but without further clarification, it will be unclear to parties whether

CFIUS has jurisdiction to review related transactions, and whether mandatory filing are required.

As our members also are among the world's leading global investors – including the most prominent U.S. investors in foreign assets, with the growth from such investments ultimately enhancing our members' ability to invest in the United States – we have several concrete concerns related to such a definition.

First, the United States generally, and CFIUS specifically, serves as a global exemplar for how to appropriately balance an open investment environment with an properly, narrowly scoped national security investment review regime. By adopting such a broad and ambiguous definition of U.S. business – particularly at a time when the United States, as clearly reflected in the Regulations, is leading an effort to educate and help other countries adopt responsible national security-based review mechanisms for foreign investment – CFIUS may unintentionally encourage a proliferation of similarly expansive and ambiguous terms in other countries' laws. It could also inadvertently lead to a backlash against perceived attempts by the United States to extend its jurisdiction extraterritorially. Either result would create broader uncertainty to the investment community.

Second, many of our members will, on occasion, sell assets to foreign persons or receive co-investment from foreign persons. Historically, the application of CFIUS jurisdiction to such transactions has been clear: if the transaction did not involve assets in the United States that comprise a U.S. business and potential control by a foreign person, then there would be no CFIUS jurisdiction. The revised definition, however, creates significant uncertainty in this fundamental aspect of transaction planning. Such uncertainty could be a significant hindrance to the normal functioning of a healthy M&A market.

Third, with this shift in the definition of U.S. business – on top of the FIRRMA-required expanded jurisdiction governing certain investments in TID U.S. businesses and real estate transactions – we have concerns that CFIUS will be flooded by even more filings, including ones where, in reality, there is no true U.S. business in scope, only sales or services to the United States. Reviewing such transactions could further drain Committee resources and, in turn, have an impact on the overall efficiency and effectiveness of the CFIUS process.

For these reasons, we strongly encourage the Committee to adopt the existing historical definition of "U.S. business," as currently reflected in 31 C.F.R. § 800.226, when it finalizes the Regulations.

C. The Country Specification Provision

We appreciate the Committee's efforts to judiciously exercise its new authorities under the "Country Specification" provision of FIRRMA. We have some concerns, however, that the pool of initial "excepted foreign states" and "excepted investors" will be too narrow, as those terms are currently defined in the Regulations. To avoid the risks

of the system being flooded with unnecessary filings, we would recommend a more inclusive approach that excepts investors who have a demonstrable record of meeting clear criteria that, taken together, fairly reflect that a non-controlling or greenfield investment by such investors would not reasonably raise national security concerns.

Specifically, in terms of the set of countries that CFIUS will designate as "excepted foreign states," we would suggest such states should include those countries with strong national security and economic ties to United States. Criteria for inclusion could include:

- countries that have mutual defense treaties or defense cooperation agreements with the United States, including member states of the North Atlantic Treaty Organization ("NATO");

- those countries that have been designated as a major non-NATO allies, pursuant to section 517 of the Foreign Assistance Act of 1961;

- those countries that have a bilateral treaty with the United States and are member of the European Union or the European Free Trade Association; or

- other such countries as CFIUS publicly designates.

We recognize and appreciate CFIUS's concerns that jurisdictional exceptions, if not carefully specified, could be subject to abuse by those who may want to circumvent the Committee's authorities. That said, we believe the Regulations are too limited in their criteria for potential "excepted investors" and are not adequately tailored to address only the circumstances that non-excepted foreign persons could exploit. To this end:

- We recommend that CFIUS remove the requirement that all board members must be from the United States or an excepted foreign state. Most major decisions of a board require a majority or a super-majority vote -- no one board member typically has the power, by themselves, to make or veto major decisions. Therefore, we would suggest that the requirement be amended to allow non-U.S./excepted state board members so long as the non-excepted state board members are not so numerous that they can make or veto major decisions of the board, consistent with the board voting requirements laid out in the entity's articles of incorporation or comparable document.

- Similarly, we recommend that threshold for ownership by non-excepted foreign state entities in excepted investors be raised to 20 percent (from the current 5 percent), unless the foreign entity in question has access to the equivalent of material nonpublic technical information, board member or observer status, or

involvement in substantive decision making of the excepted investor. This would bring the requirement in line with CFIUS's own assessment framework for control and influence and would prevent purely passive investors who may nonetheless have a greater than 5 percent equity stake from unnecessarily disqualifying a foreign investor that would otherwise qualify as an excepted investor.

- Consistent with our comments on the Pilot Program, we also would encourage the Committee to adopt specific clear criteria that objectively reflect a lower investor threat profile, such as:

    - The investor's prior record of approval by CFIUS, including acquisitions or investments having been approved within a recent period of time, such as 12 or 18 months, and that there have been no material changes to the ownership, places of operation, scope of business, material business relationships, or key management personnel of the acquirer since the CFIUS approval. This will reflect that CFIUS approval was based, at least in part, on an up-to-date national security threat assessment of the acquirer.

    - The investor's record of compliance with CFIUS mitigation agreements.

    - Whether the investor has been approved to own companies performing on classified contracts under Foreign Ownership, Control, or Influence ("FOCI") mitigation with the Defense Counterintelligence and Security Agency or under equivalent national industrial security requirements.

    - Whether the direct acquirer actually operates under a FOCI mitigation agreement (which, in turn, should automatically qualify for "excepted" status, since the entity's foreign ownership and control is already mitigated by an agreement with national security agencies).

We submit this approach, in combination with preserving the Regulations' exclusions for an excepted investor under paragraphs (c) and (d) of the "excepted investor" definition at 31 C.F.R. § 800.220, would provide for fairer and more equal treatment of more investors, and assist in ensuring that the expanded jurisdiction over TID U.S. businesses and real estate truly applies to those investments that could reasonably create a potential national security risk.

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AIC and its members understand the need to adjust the Committee's authorities to address evolving risks and sincerely appreciate the Committee's strong efforts to provide clear guidance and direction through the Regulations. We suggest, however, that U.S. national security, CFIUS, the private equity community, and the U.S. economy would be well served if the Committee provided some adjustments to its authorities, as described in detail throughout the preceding pages. We believe that implementation of our recommendations would help the Committee strike the proper balance between demonstrably 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 our perspective and recommendations.

Sincerely,

Jason Mulvihill
Chief Operating Officer & General Counsel