October 17, 2019

Via www.regulations.gov

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

Re: National Venture Capital Association Comments on Proposed Rule RIN 1505-AC64, Provisions Pertaining to Certain Investments in the United States by Foreign Persons (84 FR 50174) ("Part 800 Rules") and Proposed Rule RIN 1505-AC63, Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate in the United States (84 FR 50214) ("Part 802 Rules")

Dear Mr. Feddo:

The National Venture Capital Association ("NVCA") appreciates the opportunity to submit comments on the Part 800 Rules and the Part 802 Rules (collectively, the "Proposed Rules"). The Proposed Rules, published on September 17, 2019 on the website of the Department of the Treasury, include a wide range of proposed revisions to the operating guidelines for the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee"). These changes will undoubtedly have wide-ranging impacts on the U.S. innovation ecosystem in general, and NVCA and its members in particular. Accordingly, NVCA submits these comments (the "Comments") to provide feedback to CFIUS on how best to ensure that the final implementation of the proposed rules addresses the national security concerns that led to the passage of the Foreign Investment Risk Review Modernization Act ("FIRRMA") while minimizing disruption to America's vibrant and vital venture capital community.

NVCA and the Role of Venture Capital

NVCA has a diverse membership base of venture capital firms and corporate venture capital groups spread across the country, investing in sectors as varied as medical devices, information technology, biotechnology, and cybersecurity. Venture capitalists invest and partner with high-growth startups with transformative ideas that power innovation and our economy. As the voice of the U.S. venture capital community, NVCA empowers its members by advocating for policies that encourage innovation and reward long-term investment. NVCA also serves as the definitive resource for venture capital data and unites its member firms through a full range of professional services.

The model of venture firms is to raise capital from investors (limited partners, or LPs) to invest in early-stage companies. Some of these limited partners are from abroad, as foreign investors seek returns in the same manner as U.S. investors. Corporate venture groups also invest significantly in early-stage companies and some of these are headquartered overseas. In addition, some U.S. venture firms have one or more foreign general partners. Investments from all of these funds fuel U.S. entrepreneurship, jobs, technological leadership, and ultimately national security.

Introduction to NVCA Comments on the Proposed Rule and Reiteration of November Comments

The Proposed Rules expand CFIUS's jurisdiction, add a new mandatory filing requirement, re-solicit comments on previously implemented mandatory filing requirements, and create or reiterate complex tests for determining foreign person status or being exempted from such status. NVCA believes that the mission set forth in FIRRMA – i.e., permitting CFIUS to review potentially sensitive investment to protect national security and prevent the illicit transfer of technology to other countries – is sound. However, the Proposed Rules in their current form do not provide the requisite clarity to enable investors to understand which investments should – or must – be filed. Accordingly, these rules may serve as a significant deterrent to investment in many sectors of the U.S. economy, including investment in the companies that need it most – new businesses working with novel technologies that need venture capital support in order to thrive. NVCA submits these Comments in part to address that concern.

As a threshold matter, NVCA should note that it has previously commented in detail on one subpart – i.e., the pilot program implementing "critical technology" mandatory filings, which has been incorporated by reference into the Part 800 Rules. The text surrounding the new rules has not addressed the concerns that NVCA emphasized in its comments of November 7, 2018 (the "November Comments")[1] regarding the lack of clarity inherent in that pilot program. Instead, the Proposed Rules promise to address all comments on the pilot program received last November when the final rules are issued next year. NVCA reiterates its November Comments with respect to the pilot program and still hopes that the CFIUS agencies will take those comments into consideration in advance of the publication of the final rules. The November Comments are attached as Exhibit A to these Comments.

NVCA also wants to emphasize a key point made in the November Comments: a lack of clarity on the scope of the rules may be as detrimental as overbroad rules. The absence of clear answers to many of the questions raised in the November Comments has negatively impacted foreign investment over the past year. Without CFIUS guidance on these issues and the others raised below, the continued confusion in the marketplace will harm U.S. interests. This manifests not only in the stifling of foreign investment, but also, paradoxically, in CFIUS seeing fewer filings on technologies regarding which the Committee might have serious national security concerns. That is because gray areas in the regulations have made filing obligations extremely unclear to foreign investors and U.S. businesses alike. Furthermore, this lack of clarity has caused some investors to step back from the U.S. market until the fog has lifted and instead direct their investments to other countries, including economic rivals of the United States.

In addition, NVCA should note that these Comments exclusively reference the Part 800 Rules. However, to the extent that applicable regulatory language is reiterated in the Part 802 Rules – e.g., with respect to the excepted investor process – NVCA would favor parallel application of the same revisions to those rules as well.

[1] *See National Venture Capital Association Comments on the Interim Rule Regarding Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies*, submitted Nov. 7, 2018 in docket TREAS-DO-2018-0022 pertaining to Proposed Rule RIN 1505-AC61, Interim Rule Regarding Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies

Finally, before providing a list of areas where it believes the Proposed Rules should be improved, NVCA wants to commend CFIUS for its careful consideration of the equities of the venture community to date. In particular, the reduction of the Committee's review time for mandatory declarations from 45 to 30 days in the Part 800 Rules, and the permission to submit a voluntary declaration with a 30-day review period, will significantly lessen the negative impact of the pilot program on the startup ecosystem. As NVCA has discussed with the Committee in the past, venture fundraising happens on a very abbreviated timeline. Commitments by CFIUS to expedite its review process will help ensure that U.S. companies are better-placed to obtain venture funding. NVCA is highly appreciative of the Committee's consideration of its input and of the changes it has made in the Proposed Rules as a result of that input.

Ultimately, NVCA hopes to work with CFIUS both to clarify ambiguities and points of confusion in the regulations and to rebalance selected aspects of the Proposed Rules to ensure that national security is protected and adverse economic and national security consequences are avoided. Small changes can help ensure the U.S. remains the leading destination for venture investment, and thus that the U.S. has the first look at the next-generation of emerging technologies. At the same time, those small changes will have only a limited impact on the Committee's ability to review transactions, and in many cases will help avoid filings with respect to those transactions that the Committee is less interested in reviewing (which NVCA will call "nuisance cases"). To that end, NVCA in these Comments addresses eleven selected areas where changes or clarifications to the Proposed Rules would, in its view, enhance national security.

Issue 1: CFIUS Should Clarify the "Principal Place of Business" Test for Funds to Exclude Nuisance Cases

CFIUS's rules have historically considered an entity a "foreign entity" if it either has a "principal place of business" outside the United States or it has equity securities traded on a foreign exchange (with certain caveats). Thus, if the entity in question can demonstrate that its principal place of business is in the United States, it will not be a "foreign entity" within the meaning of the CFIUS regulations. This traditional approach is reiterated at § 800.221(a) of the Proposed Rules, and NVCA finds no fault with this foreign entity definition. However, CFIUS's traditional approach to this issue assumes that a "principal place of business" is easily determined – something that may be true in the traditional corporate context in which CFIUS historically has operated but which is less true of investment funds, including venture funds, that are increasingly impacted by CFIUS due to the expansion of its jurisdiction via FIRRMA.

Unlike many publicly traded corporations, a fund is not established as a hierarchy of legal entities leading up to a single legal entity with a publicly reported headquarters. Funds, instead, are generally organized with multiple separate fund entities – usually with no employees or physical locations – managed by a team of investors and/or managers. For example, a U.S.-based group of investors that starts a venture capital firm known as Great Venture Investors may invest through Great Venture Investors Fund I (which may be a U.S. entity), Great Venture Investors Fund II (which may be a Caymans entity) and Great Venture Investors Fund III (which may be a Jersey entity). In each of those cases (i.e. Fund I-Fund III) that fund will have its investment decisions made by – and management duties performed by – the Great Venture Investors team in the U.S. However, it is not clear under the current rules whether Fund II's principal place of business is in the Caymans and Fund III's principal place of business is in Jersey simply because those locations are the only places where those legal entities exist.

NVCA understands CFIUS to be interested in determining whether foreign parties are responsible for the day to day decision-making at an investment fund, rather than in the legal formalities of its creation. Accordingly, NVCA proposes that CFIUS provide a definition for the heretofore undefined term "principal place of business" to avoid dragging in cases that CFIUS does not need or want to review.

NVCA proposes that the principal place of business be defined as "*the primary location from where an entity's directors and 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*." If a fund is then managed by individuals, the majority of whom are U.S. residents, then the fund's "principal place of business" would be considered to be the United States and, thus, the fund would not be a foreign entity.

The issuance of an example related to that definition would further help drive home the appropriate treatment of investment funds under the new rules. Revisions to this definition would save CFIUS from seeing nuisance cases – e.g., investments run by U.S. persons that happen to be made out of a fund incorporated in the Cayman Islands – that distract it from its core mission of reviewing foreign investments that give foreign investors substantive control.

<u>Issue 2: CFIUS Should Provide Additional Examples for the Definition of "Foreign Person" to Exclude Nuisance Cases</u>

While clarifying the definition of "foreign entity" will help eliminate a number of nuisance cases, an adjustment to the definition of "foreign person" would address an even larger subset of such cases. The current version of that latter definition in the Proposed Rules largely replicates the definition in the pre-existing CFIUS rules. However, as is the case with the "foreign entity" definition, that old definition makes less sense in the context of the investment fund cases that are becoming increasingly common at CFIUS.

Under the Proposed Rules, CFIUS has jurisdiction over any covered transaction involving a "foreign person," and the definition of a "foreign person" includes not only "[a]ny foreign national, foreign government, or foreign entity" (Proposed Rules § 800.225(a)(1)) but also "[a]ny entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity" (Proposed Rules § 800.225(a)(2)). "Control" in turn, means "the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity." (Proposed Rules § 800.208(a)). In the context of the day-to-day operation of an investment fund, little information on the scope of "control" is provided. The only two examples on point, at Proposed Rules § 800.208(e)(7)-(8), say that whether or not a limited partner is deemed to have control is determined by whether or not that investor has important veto rights.

More important than the limited partner control question, however, is what rights the general partner will have. In most contexts, it is the general partner that will exercise "control," as CFIUS defines it, on a day to day basis. For funds with a subset of foreign general partners, the question is whether those partners' minority share of the vote in fund operations constitutes "control" over their funds, making those funds "foreign persons." This is not an uncommon problem – many diversified investment funds have general partners who are foreign citizens. This may include a longstanding U.S. resident on a green card or an individual resident in a foreign country who may be charged with identifying new investment for the fund and possibly bring the founders of a company to the U.S to start a new American company. Including such investors on their teams allows venture firms to benefit from access to the world's best investors to help launch new U.S. enterprises. This practice also provides the fund with global insights on what customers and patients need, which is critical as companies grow into international markets. All these benefits also accrue to the U.S. government as it helps ensure the United States remains the global technology leader and that those companies are subject to U.S. law.

Why is NVCA concerned that a minority of foreign GPs would constitute foreign control? Under traditional CFIUS interpretations of control, one or two members of a board of directors appointed by an investor from a foreign country can, at CFIUS's discretion, put a corporation under foreign "control." This is true even if those directors represent a distinct minority of that board. If that same logic were to hold true in the fund context, many funds with a U.S. place of business and a majority of U.S. based investment partners, but a few foreign general partners, would be considered "foreign persons" subject to CFIUS review. However, such an interpretation of "foreign person" would result in CFIUS seeing many nuisance cases – e.g., investments that in practice are made by a majority of U.S.-based personnel from a U.S. business, despite the presence of a foreign general partner somewhere in the general partnership – that do not present national security concerns. This result would also ignore an important distinction: venture capital funds are partnerships, which by their nature means the partners collectively make investment decisions. Thus, the ultimate decision to invest capital into a company typically would not be made by the minority of a general partnership that is composed of foreign general partners.

CFIUS should clarify, ideally through the inclusion of additional examples on point under the definition of either "foreign person" or "control," that there are exceptions to the scope of "foreign person" status such that these cases are not covered. In particular, CFIUS should provide an example in the final regulations that states that foreign citizens may serve as general partners or the equivalent in an investment fund as long as they represent a minority of the overall decision-making group for that fund (such as the general partnership).

Issue 3: CFIUS Should Improve the Exceptions Process for Covered Investments

Section 1703 of FIRRMA states that, with respect to the revised definition of "covered transactions" added by FIRRMA, CFIUS regulations "shall specify criteria to limit the application of [the term foreign person] to the investments of certain categories of foreign persons" and that such criteria must take into account how the foreign person is connected to a foreign country (see the revised definition codified at 50 U.S.C. § 4565(a)(4)(E)). The Congressional intent behind this provision is clear: to ensure that investments from investors in countries presenting demonstrated national security concerns are not left on the same footing as investments from investors in countries allied with the United States. Outreach to the Treasury Department from members of Congress most intimately familiar with FIRRMA demonstrates this intent. For example:

- Senator Cornyn, the author and chief advocate of FIRRMA, wrote to Secretary Mnuchin that Congress hoped CFIUS would "both focus its efforts on investments emanating from countries or governments that pose the greatest national security risk and also avoid needlessly putting up barriers to friendly investment from our key allies and other friends around the world."[2]

- Senator Warner, the Vice Chairman of the Senate Select Committee on Intelligence and a member of the Senate Banking Committee, wrote to the Secretary to emphasize the inclusion of the exception authority in FIRRMA and to encourage Treasury to "fully use that authority to exempt investments made by investors from friendly countries."[3]

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[2] *See* Letter from Senator John Cornyn to Secretary Mnuchin re FIRRMA on January 11, 2019.

[3] *See* Letter from Senator Mark Warner to Secretary Mnuchin re FIRRMA on November 14, 2019.

- Senators Perdue, Cotton, and Tillis, all members of the Senate Banking Committee, similarly encouraged Secretary Mnuchin to "utilize the discretion Congress provided in FIRRMA to create a process where foreign entities can qualify for an expedited or lighter scrutiny process."[4]

- Representatives Hensarling and Waters, who were Chairman and Ranking Member of the House Committee on Financial Services during consideration of FIRRMA, were joined in a letter by Representatives Barr and Moore in stating that "Our NATO allies and other friends from around the world – including countries such as Japan, South Korea, Singapore, Australia, New Zealand, and Israel – should not be the target of CFIUS's limited resources given the ongoing risks posed by Beijing and Moscow."[5]

CFIUS has implemented the exception requirement primarily through the definition of "excepted investor" in § 800.220 of the Proposed Rules and related definitions. NVCA appreciates the effort and thoughtfulness involved in the crafting of those definitions. However, as implemented, the test for serving as an "excepted investor" is extremely difficult to satisfy even for well-respected investors from U.S. allied countries. As a result, the exception itself has limited utility and would benefit from improvements in the final rules.

A brief high-level summary of the test demonstrates how difficult it is to satisfy. Under the current rules, individual foreign states must be selected by CFIUS, must be specifically determined by the Committee to have a robust foreign direct investment review process, and must cooperate with the U.S. before they are eligible for excepted status (though CFIUS has deferred the latter parts of this requirement for two years). Once a foreign state qualifies, an individual investor from that state must satisfy several specific tests – including having all of its directors, observers, and 5% or greater owners be from an excepted foreign state – before it can qualify for excepted status. In addition, it must ensure that the "minimum excepted ownership" – at least 50% of a publicly traded company or at least 90% of a privately held fund or entity – is held by U.S. persons or citizens of an excepted foreign state. And finally, any failure to adhere to various U.S. laws can cause an otherwise excepted foreign investor to lose its status.

While NVCA understands that CFIUS hopes to set a high bar for removal from its extended jurisdiction, the bar described in the Proposed Rules is so high as to render the exception of limited utility. Key changes and clarifications are needed for the congressional intent behind the provision to be realized:

First, in order for an excepted investor not to be treated as a "foreign person" for certain CFIUS purposes, the investor must be closely connected to an excepted foreign state. Treasury officials have stated that a list will be issued along with the final rules implementing FIRRMA and that an excepted investor associated with an excepted foreign state will benefit immediately from that excepted investor status.[6] NVCA encourages Treasury not to deviate from that intention.

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[4] *See* Letter from Senators Perdue, Tillis, and Cotton to Secretary Mnuchin re FIRRMA on August 13, 2019.

[5] *See* Letter from Representatives Hensarling, Waters, Barr, and Moore to Secretary Mnuchin re FIRRMA on September 12, 2018.

[6] *See* pp. 3-4 of *Summary of Public Stakeholder Briefings on Proposed Regulations Implementing FIRRMA by Senior Treasury Officials*, available at https://home.treasury.gov/system/files/206/Proposed-FIRRMA-Regulations-Summary-of-Public-Stakeholder-Briefings.pdf.

Second, NVCA joined with a diverse set of other industry associations in submitting a proposal to Treasury regarding the implementation of this provision.[7] As stated therein, NVCA believes the appropriate initial group of eligible states is the member states of the North Atlantic Treaty Organization ("NATO");[8] countries that are major non-NATO ally pursuant to 517 of the Foreign Assistance Act of 1961;[9] and any country that has a bilateral treaty with the United States and is a member of the European Union or the European Free Trade Association.[10] Decades of security and intelligence cooperation agreements demonstrate that these countries should rightfully be regarded as strong U.S. allies, but absent inclusion on the list, they will be treated as equivalent to strategic competitors, leading to unnecessary friction in the startup ecosystem.

Third, the Proposed Rules indicate that in determining which countries will be excepted foreign states, CFIUS will evaluate whether a country "has established and is effectively utilizing a robust process to assess foreign investments for national security risks and to facilitate coordination with the United States on matters relating to investment security" (Proposed Rules § 800.1001(a)). In making this determination, NVCA encourages CFIUS to acknowledge that the features of foreign investment screening regimes will vary among countries and often differ from CFIUS's own. CFIUS should not insist upon identical procedures to its own, which may not have the same benefits in other countries and contexts. In addition, such processes may disadvantage U.S. investors, to the ultimate detriment of the United States.

Fourth, CFIUS should clarify the operation of the excepted investor provision as applied to corporate venture capital (CVC) groups with parent companies that are headquartered in U.S. allied countries – a key segment of the venture capital community. Specifically, the "minimum excepted ownership" qualification – part of the test for "excepted investor" status, as indicated above – states that an investor can qualify if it is a "foreign entity that is organized under the laws of an excepted foreign state and has its principal place of business in an excepted foreign state or in the United States" (Proposed Rules § 800.220(a)(3)(v)(D)). For CVCs with foreign-headquartered parents, the foreign entity that holds the minimum excepted ownership will in the vast majority of cases be the parent company of the CVC.

NVCA currently understands that a CVC parent company will qualify under this test if it is a company organized under the laws of an excepted foreign state and has its headquarters in that state, and that there is no additional requirement to show that the owners of the parent company are themselves affiliated with the excepted foreign state. This makes policy sense: a look-through requirement that would require the parent company of a CVC to determine the nationality of all its shareholders (which could number in the tens of thousands) would render the excepted investor provision useless for many CVCs. However, because some CFIUS rules require looking through a corporation to its shareholders, and because the definition of "hold" raises some ambiguity about whether the "minimum excepted ownership" may be considered to be held "directly or indirectly" (Proposed Rules § 800.226), NVCA seeks explicit

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[7] *See Implementation of the "Country Specification" provision and the Scope of Mandatory Filings Under the Final Foreign Investment Risk Review Modernization Act (FIRRMA) Regulations* from the National Venture Capital Association, U.S. Chamber of Commerce, American Investment Council, Biotechnology Innovation Organization, Organization for International Investment, Medical Device Manufacturers Association, and Advanced Medical Technology Association, *available at* https://nvca.org/wp-content/uploads/2019/09/Coalition-proposal-re-country-specification-section-and-mandatory-filings.pdf.

[8] *See* North Atlantic Treaty Organization Member Countries, *available at* https://www.nato.int/cps/en/natohq/topics_52044.htm.

[9] *See Major non-NATO ally,* 22 CFR § 120.32, *available at* https://www.law.cornell.edu/cfr/text/22/120.32.

[10] *See* The European Free Trade Association States, *available at* https://www.efta.int/about-efta/the-efta-states. An example of a country that would meet this conjunctive test is Switzerland.

clarification on this point. More specifically, NVCA seeks an additional example stating that a foreign CVC's parent is not subject to this look-through requirement.

Fifth, and finally, under the Proposed Rules, an excepted investor must show that "[e]ach member or observer of the board of directors or similar body of such entity is a U.S. national or, if a foreign national, is a national of one or more excepted foreign states and is not also a national of any foreign state that is not an excepted foreign state" (Proposed Rules § 800.220(a)(3)(iii)). NVCA understands that CFIUS may have concerns about parties who may be in a position to obtain information from a U.S. company but believes CFIUS can meet its security objective through less stringent terms. Permitting board members and observers from a broad group of allied countries – one that may exceed the set of excepted foreign states – will help more investors qualify as excepted. As discussed above, NVCA favors a broad initial listing of excepted foreign states. Those who serve as board members or board observers of an excepted investor should be even less constrained – i.e., permitted to be drawn from a set of nations that includes all allies of the U.S. A requirement that all board members and observers be only from countries with a demonstrated effective foreign investment screening mechanism appears to have no security advantage over a rule that allows board members and observers to be from any allied country. By broadening the group of potential board directors and/or observers CFIUS can facilitate broad usage of the excepted investor and thus congressional intent.

Issue 4: CFIUS Should Implement the Waiver Provision for Mandatory Filings for Investors from Selected Foreign Countries

Section 1706 of FIRRMA permits CFIUS to waive the mandatory filing requirement for entities that "demonstrate[] that [their] investments are not directed by a foreign government and [that have] a history of co-operation with the Committee" (see the revised definition to be codified at 50 U.S.C. § 4565(b)(1)(C)(IV)(bb)(CC)). However, the proposed regulations do not address this optional waiver, focusing instead on the exemption from extended jurisdiction in Section 1703 (see Issue 3, above). CFIUS should choose to implement a waiver process to further eliminate the filing of nuisance cases as mandatory filings.

Currently, the Proposed Rules include two forms of mandatory filings - the "substantial interest" mandatory filing requirement set forth at Proposed Rules § 800.401(b) and the "critical technologies" mandatory filing requirement set forth in the pilot program. CFIUS is explicitly permitted to create a waiver program for the former and implicitly for the latter (since the scope of that latter requirement is left entirely to the Committee's discretion). The implementation of such a waiver would benefit CFIUS by removing nuisance cases from its docket and freeing it to focus on cases of more significant interest.

As noted in the introduction, the current implementation of the pilot program is rife with uncertainties that grant investors and companies limited guidance on whether the rules truly apply to their individual situations. The result of that uncertainty is unsurprising – conservative, compliance-oriented investors have submitted filings, while companies that need immediate financial support and investors willing to bear the risk inherent in extrapolating from CFIUS's limited guidance have not filed. Ironically, this means that many of the filings that CFIUS has seen during the pilot program period are those it is least interested in seeing – those involving conservative foreign investors who present little national security risk. CFIUS can expect a similar result if the final rules largely reflect the Proposed Rules and the pilot program as they currently stand.

A waiver program could help reduce the number of conservative investor filings that CFIUS sees, freeing up the Committee to pursue additional cases. Through targeted enforcement actions against investors who are not filing, CFIUS could then begin to clarify what it believes to be the scope of the regulations as they currently stand. Moreover, such a waiver program could be implemented in a manner that would require (a) very limited effort for the Committee and (b) no additional record-keeping within CFIUS. NVCA would propose that such a program be implemented in the following manner:

- First, CFIUS would add an additional yes or no question to the set of standard questions in the long-form CFIUS notice as follows: "If this transaction is found to present no unresolved risks to national security, would the foreign investor wish to be considered for a waiver from future mandatory filings?"
- Second, if the question is answered in the affirmative, CFIUS would, as part of its review and investigation, consider whether the investor in question is one that is likely to present national security risk in the future, based on the ownership, director, and officer information presented to CFIUS in that review. This decision would only be made during a review and investigation process, during which CFIUS would have sufficient time to consider the issue.
- Third, if the investor is deemed to qualify for the waiver, CFIUS would add a sentence to the final clearance letter indicating that such a waiver had been granted. Maintaining a copy of that letter and presenting it to CFIUS would be the foreign investor's responsibility – no list of "waived" investors would need to be kept by the Committee itself.

This waiver process could include limitations to ensure that the waiver does not result in the Committee missing key investments, but instead is used to eliminate uninteresting nuisance cases. The regulations on point would make clear that such waivers would only last a specified time – perhaps five or ten years – from the date of the clearance and would then require resubmission. This would help ensure that CFIUS was not losing track of investors' transactions over the long term. Moreover, the regulations would make clear that any material changes to the information submitted to CFIUS – e.g., changes in foreign ownership or the addition of new foreign directors or officers – would void the waiver.

Finally, the waiver regulations would clarify that the waiver would apply only to mandatory filings. Accordingly, granting a waiver would not stop CFIUS from requesting or compelling a voluntary notice with respect to any future investment by that investor, and so would not give any foreign investor carte blanche to, e.g., acquire a U.S. defense contractor.

By implementing this waiver process adjunct to the existing review and investigation process, CFIUS could help shape the set of cases that it sees without adding a separate "TSA Pre-check" review process. CFIUS could thereby avoid additional nuisance cases and focus its resources on those cases that matter most.

Issue 5: CFIUS Should Reconsider the Pilot Program "Critical Technology" Filing Requirement, and, at a Minimum, Rescope that Requirement

As noted in the discussion of Issue 4, above, it is NVCA's understanding that the pilot program in its current form has not resulted in CFIUS seeing the foreign investments of greatest concern. In significant part, as discussed both immediately above and in the Introduction, this can be attributed to the vagueness of the pilot program regulations, which themselves can be interpreted to require or not to require a filing in various contexts. Thus, as previously noted, NVCA reiterates its requests for clarification set forth in its November Comments. However, the Part 800 Rules also state that commenters concerned about the scope of the pilot program should use the opportunity provided by this commenting period to provide input to CFIUS about their concerns. Accordingly, NVCA in this subsection will further extend its comments on the pilot program in light of its members' experiences with that program to date, and suggests that CFIUS reconsider or, at a minimum, rescope that program.

Venture investors continue to pay a U.S. investment 'penalty' as a result of the critical technologies mandatory filing requirement. The mandatory filing requirement makes the evaluation of potential

CFIUS risk a gating item for a large percentage of venture investments, slowing down U.S. companies' access to venture capital. While from CFIUS's perspective, the limited number of filings received by the Committee may appear to indicate that the burden has been light, the number of filings does not accurately reflect the transaction costs imposed on investors. Many investors are spending time and capital determining their filing obligations, which is time and capital that could instead be invested directly into their portfolio companies. Both because of the limited scope and because of the lack of clarity in the pilot program rules, most foreign investors ultimately determine that a CFIUS filing is probably not required, but the cost is still incurred. Moreover, the transactions that do file are not necessarily those that the Committee is most interested in reviewing. Furthermore, NVCA is aware of many foreign investors that have decided to *not* invest in the U.S. because the cost, time, and uncertainty of a CFIUS filing is too burdensome. This may not have been a viable option for foreign investors in the not-too-distant-past, but today startup ecosystems are spread across the globe and therefore venture investors have many more opportunities outside the U.S. than ever before.[11] Ultimately, this suggests that the imposition of the critical technology filing requirement has to date not proven to be worth the drag on U.S. investment. NVCA would support the outright removal of the critical technology filing requirement on that basis.

However, if CFIUS nevertheless intends to retain the critical technology filing requirement, NVCA would suggest that it rescope the pilot program in a manner that both provides more clarity as to its applicability and focuses on real technologies of interest. More specifically, there is no obligation under FIRRMA for CFIUS to implement a critical technology filing requirement that applies equally to all statutorily defined "critical technologies." CFIUS should consider focusing its attention on a subset of critical technologies that it deems to be of interest and removing the mandatory filing requirement for technologies of lesser concern. The Export Administration Regulations (EAR), which define the largest subset of such technologies, describe a number of items that, by current lights, are of limited national security interest. For example, many software products, including many SaaS products, are properly categorized as 5D002 under the EAR, a national security classification that makes them critical technologies for CFIUS purposes. Such classification is partly a function of policy battles that occurred more than 20 years ago regarding export controls for encryption. However, only a few of those software products – e.g., those directly related to information security – have traditionally been of interest to CFIUS. If CFIUS does retain the critical technologies filing requirement, it should consider narrowing the set of technologies to which it applies.

Given that the full scope of critical technologies remains undefined, this approach would require CFIUS to participate more actively in the definition process for "emerging and foundational" technologies. NVCA understands that the lead role in that process belongs to the Department of Commerce. However, given its importance to the CFIUS process, NVCA would strongly encourage close coordination between Treasury and Commerce in that definition process (and has advocated and will continue to advocate for Commerce to take the same approach in that parallel proceeding).

[11] Consider that the share of global venture capital invested in the U.S. has fallen from 90 percent to 51 percent in the last 20 years. *See* NVCA 2019 Yearbook, Data provided by PitchBook, *available at* https://nvca.org/wp-content/uploads/2019/08/NVCA-2019-Yearbook.pdf.

Issue 6: CFIUS Should Clarify that Foreign Limited Partner Direct Investments do not Result in CFIUS Jurisdiction over Investments by Funds in Which Those Limited Partners Passively Participate

As noted in the November Comments, an issue that FIRRMA does not speak to directly but that is raised by its new emphasis on fund investments is that of direct investments by limited partners in funds. Specifically, if a foreign limited partner in a fund makes a direct investment in one of the fund's portfolio companies, without coordination with the fund, the rules do not clarify that that direct investment will be treated separately from the fund's investment. This uncertainty means that funds may have to consider the CFIUS risk associated with their limited partners' investments in their portfolio companies – an issue over which the funds have no control. A fund might ensure that no foreign limiter partner has access to material non-public technical information through the fund but then discover the limited partner has such access because of its direct investment into a portfolio company.

The Proposed Rules do not directly address this concern, but the CFIUS FAQs released by CFIUS to address questions related to the pilot program state that "[e]ven if an indirect investment through an investment fund, standing alone, does not constitute a pilot program covered investment, the direct investment by the foreign person may nevertheless be covered."[12] CFIUS says it will "consider the totality of the particular facts and circumstances of the transaction" in such cases. Accordingly, it remains unclear whether CFIUS, in some circumstances, would be willing to aggregate that limited partner's direct investment and its indirect investment via the fund, and if so, would be prepared to require the fund to participate in the CFIUS process because of the limited partner's investment.

CFIUS should include an example in the regulations directly stating that an investment fund will not be subject to a CFIUS filing on the basis of a limited partner's direct participation in that fund's portfolio company if the limited partner has not obtained "control" or the extended set of triggering rights through that fund. Failing that, the Committee's FAQs for the final rules should clarify that while a limited partner's direct investment may result in a covered transaction, that will not implicate the funds in which it participates. This clarification would not stop CFIUS from considering a fund's investment to be part of the limited partner's investment, or from bringing the limited partner's investment in for review – it would merely confirm that the fund would not be expected to participate in that review process. Such an FAQ would provide much-needed comfort to funds by assuring them that as long as they properly insulate their own investments, they will not be held responsible for the direct investments of their limited partners, which they cannot control.

Issue 7: CFIUS Should Expand Upon the Definition of "Material Nonpublic Technical Information"

In the November Comments, NVCA laid out a number of concerns related to the use of unclear definitions in the context of the pilot program (e.g., what it means to be "utilized" in activities in a pilot program industry). In these Comments, NVCA wants to expand upon its stated concerns with respect to one such definition – that of "material nonpublic technical information." The Proposed Rules and the pilot program use near-identical language to define that term as it is applied to critical technology companies: i.e., information "not available in the public domain [that] is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including without limitation processes,

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[12] *See* FAQ 22 of *FAQs on FIRRMA Critical Technology Pilot Program*, updated July 2019, *available at* https://home.treasury.gov/system/files/291/-Pilot-Program-FAQs.pdf

techniques, or methods" (31 C.F.R. § 801.208(a) & Proposed Rules § 800.233(a)(2)).[13] In the absence of a clearer understanding of what CFIUS considers "necessary to" design a critical technology, this definition makes both the Committee's jurisdiction and the obligation it may trigger to make a mandatory filing unacceptably vague.

As noted in the November Comments, the statutory language appears to NVCA to capture the concept of reverse engineering – i.e., to cover the types of information that would enable duplication of technology. Even more specifically, it calls out the information "necessary to design a critical technology" – i.e., information without which that technology cannot be built. The intent appears to be to cover design specifications, source code, or other similar technological knowledge that a party must have to replicate a technology and not cover mere discussion of technology of a company that would not enable reverse engineering.

Many venture investors have become concerned that information such as nonpublic technical milestones – i.e., information that explains the capabilities of a technology but says nothing about how to replicate those capabilities – is also covered. Access to such information helps investors monitor the progress of their investments; without being able to monitor their investments, those investors are less likely to invest into innovative technologies in the United States. Accordingly, a broad or unclear definition deters foreign investors while doing little to defend the specific kinds of information that FIRRMA appears to be interested in protecting.

To avoid this outcome, NVCA would appreciate the Committee including an example in the final rules that clarifies that information that is not specifically necessary to engineer or reverse engineer a technology is not covered by "material nonpublic technical information." For example, CFIUS could clarify that information contained in layperson investment or sales presentations, which often describe the technology or note technical milestone achievements – but which would not facilitate reverse engineering – would not be covered by the definition.

Issue 8: CFIUS Should Clarify What Types of Changes in Control Trigger its Jurisdiction Over a New Covered Investment (and Therefore, in Some Cases, a Mandatory Filing)

The Proposed Rules indicate that a covered transaction occurs any time there is a "change in the rights that a foreign person has with respect to a U.S. business in which the foreign person has an investment, if that change could result in a covered control transaction or a covered investment" (Proposed Rules § 800.213(c)). As NVCA noted in the November Comments with respect to the very similar verbiage found in the amendments to the rules that accompanied the pilot program, this is a particularly problematic definition for venture investors, who regularly make small investments into growing businesses. In particular, it is unclear what type of "change in the rights" would satisfy this test.

To paraphrase the November Comments: Take the case where a foreign entity already has rights that may under a traditional CFIUS view constitute control of a U.S. business – e.g., 20% of the equity in that U.S. business and a seat on the board. Do any of the following cases constitute a change in rights that would result in foreign control? If so, would the foreign entity be subject to the mandatory declaration requirements if the U.S. business is a pilot program U.S. business?

[13] The only difference is the use of the two words "without limitation," which are found only in the Proposed Rules.

1. In a subsequent round of investment, the foreign entity invests pro rata with other investors and maintains its existing 20% share of the U.S. business and single board seat.
2. In a subsequent round of investment, additional U.S. investors dilute the foreign entity's share of the U.S. business down to a level that may still result in control – e.g., 17% of the U.S. business and a single board seat.
3. In a subsequent round of investment, the foreign entity increases its share of the equity in the U.S. business, but all other rights remain the same – e.g., it now holds 25% of the U.S. business and a single board seat.
4. In a subsequent round of investment, the foreign entity gains new rights with respect to the U.S. business – e.g., it now holds 25% and two board seats – but already held control before that subsequent round.

The Part 800 Rules do not speak directly to any of these examples. NVCA would encourage CFIUS to include additional examples within the definition of covered transaction that more directly address these situations, and, in particular, would suggest that Cases 1 through 3 as set forth above – and, assuming CFIUS agrees, Case 4 – should be clarified not to give rise to CFIUS jurisdiction.[14]

Issue 9: CFIUS Should Consider a Broader Definition of Passivity to Provide Investors with Certainty

Section 1703 of FIRRMA permits a foreign limited partner to be part of a limited partner advisory committee without giving rise to CFIUS's extended jurisdiction as long as certain criteria are met. These criteria include:

(i) the fund must be managed by a general partner that is not a foreign person;
(ii) the foreign limited partner must not be able to control the fund or decisions of the fund; and
(iii) the foreign limited partner must not have access to material nonpublic technical information.

However, this exception does not extend to "control" exercised by limited partners. CFIUS acknowledges that limited partners may exercise "control" through the examples at Proposed Rules § 800.208(e)(7)-(8) but does not fully explain the situations in which such control may arise. CFIUS should articulate more clearly how a fund can ensure its investors do not obtain control. Doing so would enable venture funds to take advantage of more foreign capital and thus expand the pool of capital available to U.S. businesses. The benefit of this is that the risk is spread globally (via foreign capital in a U.S. fund) but the benefit is concentrated in the U.S. (via new business formation and innovation).

Historically, CFIUS has expressed concerns that some funds with foreign limited partners may be under foreign control by virtue of those investors' legal rights to control fund decision-making. In some cases, CFIUS has indicated that funds may be under foreign control by virtue of their investors' de facto economic power over the funds – e.g., by providing a dominant economic stake in the fund. If CFIUS hopes to maximize the amount of foreign capital available to U.S. innovators while avoiding foreign control over novel technological areas, providing clear rules of the road in this area would be immensely helpful.

In particular, the Committee can help ameliorate this issue by providing clear guidance as to what funds can and cannot permit their investors to do. In their organizational documents, funds could then go further than simply not providing limited partners with certain rights – they could expressly bar them

[14] Except, of course, to the extent that CFIUS already held jurisdiction over the foreign investor's previous investment, in which the original 20% interest and board seat was acquired, and that original investment was not filed with the Committee.

from influencing the fund's operations in specified manners, as described by CFIUS. With well-understood rules of the road, CFIUS would permit the flow of valuable foreign capital back into the U.S. marketplace while ensuring that U.S. investment personnel remain in the driver's seat with respect to those investments.

To provide such guidance, CFIUS could look to established guidelines for insulating funds from foreign influence, such as NVCA's own Model Legal Documents,[15] which provide a standard limited partnership agreement insert for U.S. funds.[16] CFIUS could specify that funds following such a model can benefit from a 'safe harbor' against CFIUS finding foreign control. Alternatively, the Committee could draft its own clear rules of the road. Either way, if the Committee were to take that additional step in the final regulations, it would help many U.S. venture funds continue to attract foreign capital to support their domestic venture activities.

Issue 10: CFIUS Should Consider Narrowing the Scope of "Sensitive Personal Data"

The Proposed Rules introduce the concept of "sensitive personal data" as a trigger for CFIUS's new, extended jurisdiction over covered investments. However, in at least two ways this definition is overbroad.

First, § 800.241(a)(2) of the Proposed Rules indicates that any company with data that is "[g]enetic information, as defined pursuant to 45 CFR 160.103," is subject to that extended jurisdiction. However, many biotechnology companies may have access to genetic information under that broad definition. Some may have information about a patient paired with information about their genetic susceptibility to an illness, while others may have completely de-identified genetic information developed in a clinical testing context or even downloaded from a public database. Without a rescoping of this definition, a significant portion – perhaps the majority – of all investments into the biotechnology sector may fall into CFIUS's extended jurisdiction.

If CFIUS intends to review only businesses that present national security sensitivities, the Committee should clarify that genetic information for these purposes means, e.g., information about an individual's entire genome, and not, for example, information about an individual genetic test (*cf.* 45 C.F.R. § 160.103, definition of "genetic information" at (1)(i)). Furthermore, the Committee should narrow the definition of "sensitive personal data" to include those categories of genetic information which could actually present a national security threat. For example, the Committee should recognize that genetic information that has been "de-identified" does not present the same concerns as that which can identify an individual. Simply put, aggregated or anonymized genetic information that cannot be traced back to an individual should not be treated as "sensitive personal data."

Second, another trigger for qualifying as a data-driven TID business is having "a demonstrated business objective to maintain or collect [many different kinds of data] on greater than one million individuals and such data is an integrated part of the U.S. business's primary products or services" (Proposed Rules § 800.241(a)(1)(i)(C)). This prong is vague and will confuse many investors given its potential sweeping

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[15] The NVCA Model Legal Documents represent the industry standard for deal documents and are widely embraced in the venture and startup ecosystem. Since January 2019, the documents have included an "LPA Insert Language on CFIUS" to provide model language for funds with foreign LPs.

[16] *See LPA Insert Language on CFIUS* at NVCA Model Legal Documents, *available at* https://nvca.org/model-legal-documents/. NVCA anticipates revisiting changes made to the Model Legal Documents due to the Pilot Program once the final regulations are published.

applicability. The mere "demonstrated business objective to maintain or collect [data]" encompasses vast numbers of startups with business plans that are very likely never to come to fruition. Startups routinely present "pitch decks" to venture capitalists that boast of market penetration and business plan goals that never materialize. When one considers the incredibly high failure rate among startups,[17] pinning the applicability of the TID business qualification to a startup "objective" that may never be realized makes no sense.

In this same definition, CFIUS introduces an ambiguous test that asks whether "such data is an integrated part of the U.S. business's primary products or services." This language leaves businesses to determine what "integrated" means and what is a "primary" product or service. These undefined terms will lead to varying interpretations of when a startup may be under CFIUS jurisdiction, thus opening CFIUS up further to seeing more nuisance cases. For these reasons, NVCA requests that CFIUS remove the trigger in § 800.241(a)(1)(i)(A) of the Proposed Rules entirely. Doing so would allow CFIUS to exercise jurisdiction over investments under § 800.241(a)(1)(i)(A) and (B) of the Proposed Rules, which suffice to scrutinize investments into companies that truly may hold sensitive personal data of U.S. citizens.

Issue 11: CFIUS Should Maintain its Traditional Jurisdiction with Respect to U.S. Businesses

Historically, the CFIUS regulations have defined "U.S. business" – i.e., the business over which CFIUS has jurisdiction – as "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" (31 C.F.R. § 800.226). The Proposed Rules redefine "U.S. business" to remove that latter clause, potentially granting CFIUS jurisdiction over the foreign and domestic operations of any business engaged in interstate commerce, whether or not those operations relate to that commerce (Proposed Rules § 800.252(a)). CFIUS should reconsider this revision and, in the final rules, limit its reach to U.S. businesses engaged in commerce in the United States.

NVCA understands that CFIUS may view this expanded reach as a valuable tool, permitting the Committee to more directly reach investments into large, strategically interesting foreign companies with U.S. subsidiaries. However, NVCA submits that CFIUS already has within its jurisdiction many potentially sensitive transactions that it has not found the opportunity to review, and this further expansion will spread an already stretched agency even thinner.

Moreover, the change introduces significant uncertainties when coupled with the mandatory filing regimes that the Committee has put in place through FIRRMA. Would the corporate venture capital arm of a German business that invests in a German company that has a small U.S. division and works with critical technologies potentially be forced to make a mandatory filing if the target company? Would the European arm of a U.S. venture capital fund, managed by European partners and focused on European investment, run afoul of CFIUS by investing into a French TID business that happens to have a U.S. sales arm? These questions, already unclear on the face of the existing CFIUS regulations, will become even less clear if CFIUS expands the definition of "U.S. business." And, as a policy matter, leaving these questions unclear will encourage fast-growing European start-ups not to open U.S. offices or spread into

[17] *See* "Why Companies Fail—and How Their Founders Can Bounce Back, *Harvard Business School*, March 11, 2011, *available at* https://hbswk.hbs.edu/item/why-companies-failand-how-their-founders-can-bounce-back. ("If failure means liquidating all assets, with investors losing most or all the money they put into the company, then the failure rate for start-ups is 30 to 40 percent, according to Shikhar Ghosh, a senior lecturer at Harvard Business School who has held top executive positions at some eight technology-based start-ups. If failure refers to failing to see the projected return on investment, then the failure rate is 70 to 80 percent. And if failure is defined as declaring a projection and then falling short of meeting it, then the failure rate is a whopping 90 to 95 percent.")

the United States more generally, for fear of hamstringing their ability to raise capital. Ultimately, an expansive application of CFIUS to investments involving primarily non-U.S. businesses will cost the U.S. jobs and make it less competitive in the world market.

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NVCA appreciates this opportunity to provide comments on the Proposed Rules and reiterate its comments from the November Comments. In addition, NVCA wants to restate its appreciation for the Committee's hard work to date and for those modifications to the Proposed Rules that appear to be intended to lessen their impact on the venture capital and startup ecosystem. Establishing clear rules of the road, removing points of confusion, and creating a more focused version of the Proposed Rules is in all parties' interest. If too many nuisance cases are filed, CFIUS stands less chance of seeing those that are of the most importance. By contrast, focusing on the areas of greatest interest – on more specific lists of technologies, of purchasers, of nations of interest – will allow CFIUS to better protect national security. At the same time, cleaner, clearer, narrower final rules will reduce the economic headwinds that over-regulation can create. NVCA looks forward to continuing to engage with CFIUS in order to explain potential impacts on American innovation and mitigate any adverse economic and national security effects that may arise as a result of the final rules.

EXHIBIT A

November 7, 2018

Via www.regulations.gov

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

Re: National Venture Capital Association 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 National Venture Capital Association (NVCA) appreciates this opportunity to submit comments – here generally in the form of questions and requests for clarifications – regarding the interim rule (Interim Rule) published on October 10, 2018, implementing aspects of the Foreign Investment Risk Review Modernization Act (FIRRMA).

NVCA has a diverse membership base of venture capital firms and corporate venture capital groups spread across the country, investing in sectors as varied as medical devices, information technology, and cybersecurity. Venture capitalists invest in and partner with high-growth startups with transformative ideas that power innovation and our economy. As the voice of the U.S. venture capital community, NVCA empowers its members by advocating for policies that encourage innovation and reward long-term investment. NVCA also serves as the definitive resource for venture capital data and unites its member firms through a full range of professional services.

The model of venture firms is to raise capital from investors (limited partners) to invest in early-stage companies. Some of these limited partners are from abroad, as foreign investors seek returns in the same manner as U.S. investors. Corporate venture groups also invest significantly in early-stage companies and some of these are headquartered overseas. These investments fuel U.S. entrepreneurship, jobs, technological leadership, and ultimately national security.

The Interim Rule focuses significantly on foreign investors, including limited partners, altering the Committee on Foreign Investment in the United States (CFIUS) and the attractiveness of the United States as a recipient of foreign investment. While NVCA shares with CFIUS the goal of protecting national security and preventing illicit transfer of technology to other countries, NVCA is concerned that the Interim Rule could significantly harm not only the U.S. economy, but also U.S. national security. That is so because the Interim Rule will deter investment in U.S. companies and technologies that are critical for U.S. technological leadership and national security – indeed it already has deterred investment from allied countries in Europe and elsewhere.

According to the Interim Rule itself, comments on the Interim Rule will be considered and addressed in the course of promulgating final rules to implement FIRRMA, rather than in the course of administering the Interim Rule. NVCA therefore will reserve suggested changes for when the proposed final rules are under consideration, aiming here to clarify some of the ambiguities of the Interim Rule and its relationship to longstanding CFIUS rules. NVCA hopes to work with CFIUS to clarify these points and then, when final rules are proposed, to provide comments aimed at protecting national security without the adverse economic and national security consequences that are likely to flow from the Interim Rule.

1. <u>Limited partner direct investments.</u> If a foreign limited partner in a fund makes a direct investment in one of the fund's portfolio companies, without coordination with the fund, will that direct investment be treated in isolation from the fund's investment? Suppose, for example, that Foreign Company A is an investor in Fund X, which itself invests in U.S. Business B. With regard to Foreign Company A's investment in Fund X, Foreign Company A does not receive any rights with respect to U.S. Business B that would trigger a mandatory filing. Suppose further that Foreign Company A invests directly in U.S. Business B. NVCA seeks confirmation that Fund X's investment in U.S. Business B would not trigger a mandatory filing under the Interim Rule because of Foreign Company A's direct investment in U.S. Business B.

2. <u>Scope of "Material nonpublic technical information."</u> The Interim Rule defines "Material nonpublic technical information" as information "not available in the public domain [that] is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods." 31 C.F.R. § 801.208(a). This definition appears to capture the concept of reverse engineering, i.e., information that would enable duplication of technology. NVCA would appreciate confirmation that information contained in layperson investment or sales presentations, which often describe the technology or note technical milestone achievements – but which would not facilitate reverse engineering – would not be covered by the definition.

3. <u>Offshore fund incorporation.</u> Current CFIUS regulations exclude from the definition of "foreign entity" an entity that is organized under foreign law if it neither has a principal place of business outside the United States nor is traded on a foreign exchange. 31 C.F.R. § 800.212(a). Many private investment funds (which do not trade on any exchanges) are incorporated offshore for tax reasons but are managed by entities and individuals in the United States. NVCA seeks confirmation that, consistent with current rules, such a fund would not constitute a "foreign entity."

4. General partner “control.” When a U.S. fund is managed by a general partner entity that is incorporated in the United States but owned by a foreign person, NVCA understands that the U.S. fund might be deemed to be under the control of a foreign person. If a majority of the general partnership equity is owned by U.S. nationals, however, can the fund safely disregard the mandatory disclosure rules established by the Interim Rule? NVCA understands that, to the extent a foreign limited partner obtains certain rights in a portfolio company, that limited partner might trigger mandatory filing obligations. That is a distinct issue from the status of the fund itself. NVCA seeks clarification that a general partnership that is majority owned by U.S. nationals will not, by virtue of a minority foreign stake in the general partnership, yield a determination that the fund itself is under foreign control.

5. “Utilized” in connection with a pilot program industry. The Interim Rule states that a pilot program U.S. business is, in part, “any U.S. business that produces, designs, tests, manufactures, fabricates, or develops a critical technology that is ... [u]tilized in connection with the U.S. business’s activity in one or more pilot program industries.” 31 C.F.R. §§ 801.213 & 801.213(a). If the U.S. business does not itself operate in a pilot program industry, but it has customers or clients that are in a pilot program industry, does its business with those customers or clients constitute “activity” in a pilot program industry?

6. Scope of the term “transaction” that can trigger mandatory filing. The recent amendments to Part 800 of the regulations alter the definition of “transaction” to include “[a]ny change in rights that a person has with respect to an entity in which that person has an investment.” 31 C.F.R. § 800.224(b). In addition, they clarify that covered transactions include those where “[a] change in the rights that a foreign person has with respect to a U.S. business in which the foreign person has an investment ... could result in foreign control of the U.S. business,” but not a change that “could not result in foreign control of a U.S. business.” 31 C.F.R. §§ 800.301(e), 800.302(f). Take the case where a foreign entity already has rights that may constitute “control” of a U.S. business – e.g., 20% of the equity in that U.S. business and a seat on the board. Do any of the following cases constitute a “change in rights” that would “result in foreign control”? If so, would the foreign entity be subject to the mandatory declaration requirements if the U.S. business is a pilot program U.S. business?

    a. Case 1: In a subsequent round of investment, the foreign entity invests pro rata with other investors and maintains its existing 20% share of the U.S. business and single board seat.

    b. Case 2: In a subsequent round of investment, additional U.S. investors dilute the foreign entity’s share of the U.S. business down to a level that may still result in control – e.g., 17% of the U.S. business and a single board seat.

    c. Case 3: In a subsequent round of investment, the foreign entity increases its share of the equity in the U.S. business but all other rights remain the same – e.g., it now holds 25% of the U.S. business and a single board seat.

d. Case 4: In a subsequent round of investment, the foreign entity gains new rights with respect to the U.S. business – e.g., it now holds 25% and two board seats – but already held control before that subsequent round.

7. Penalties when non-filing decisions are made in good faith. If a U.S. business or foreign investor engages in a good faith review of its obligations and determines that it is not subject to a mandatory filing, but CFIUS concludes otherwise, will both parties still be subject to penalties under the Interim Rule? Suppose, for example, that a foreign investor receives a representation from a U.S. business to the effect that it does not work with critical technologies, or that a U.S. business receives a representation from an investor to the effect that it is not a foreign person. Will a contrary conclusion by CFIUS give rise to penalties, notwithstanding diligence and good faith reliance on such representations?

8. Determining when an investment occurs and when rights attach. The Interim Rule states that for pilot program purposes, the term "investment" means "the acquisition of equity interest, including contingent equity interest." 31 C.F.R. § 801.206. NVCA understands that, with respect to a limited partner in a fund (and any associated indirect stake in a portfolio company), an investment occurs when the investor receives rights with respect to the fund – typically when a capital commitment is made – rather than occurring only when capital is called. NVCA would appreciate confirmation of this understanding. However, NVCA also understands that, consistent with 31 C.F.R. § 801.304, rights associated with contingent equity interests generally do not attach until that contingency has occurred for purposes of assessing mandatory filing obligations under the Interim Rule. Take the case in which a foreign investor acquires a contingent equity interest in a pilot program U.S. business:

   a. If there are no equity-like rights and no rights of access to U.S. business critical technologies associated with the contingent equity interest until a future point of conversion, would it be correct to state that while there has been an "investment" by the foreign investor, no pilot program covered investment has occurred until conversion?

   b. Conversely, if the acquisition of the contingent equity interest is accompanied by a license granting access to material non-public technical information about U.S. business technologies, would it be correct to state that a pilot program covered investment has occurred immediately, even if the foreign investor acquires no other equity-like rights until conversion?

9. Mandatory filing obligations when a U.S. business is not involved with "critical technologies" until after closing. Suppose a U.S. business is not involved in any "critical technology," and a foreign person makes an investment in that U.S. business but does not make a filing with CFIUS, because filing is not mandatory. Then suppose the U.S. government subsequently designates the technology of the U.S. business as a critical technology. NVCA interprets 31 C.F.R. § 801.302(c) to mean that a filing would be mandatory if, after such designation, there were a subsequent pilot program covered transaction, but that a filing would not become mandatory at the moment the U.S.

government designates the technology of the U.S. business as a critical technology. NVCA would appreciate confirmation of this understanding.

10. <u>Mandatory filing premised on limited partner access to material non-public technical information</u>. Under FIRRMA, the submission of a mandatory declaration "shall not be required" for an investment by an investment fund when the investment fund meets certain criteria. Those criteria are: (i) management exclusively by a general partner or equivalent, (ii) that general partner or equivalent is not a foreign person, and (iii) neither a foreign limited partner nor any advisory board or committee on which that foreign limited partner participates has certain prohibited control rights. 50 U.S.C. § 4565(b)(1)(C)(v)(IV)(dd). Access to material nonpublic technical information is not mentioned among those prohibited control rights and, accordingly, it does not appear that such information access, by itself, should trigger a mandatory filing when a fund with a foreign limited partner invests in a pilot program U.S. business. The Interim Rule, however, states that an investment into a pilot program U.S. business by a fund with a foreign limited partner will trigger a mandatory filing unless the foreign limited partner "does not have access to material non-public technical information as a result of its participation on the advisory board or committee." NVCA requests an explanation of this apparent discrepancy between the statute and the Interim Rule.

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NVCA appreciates this opportunity to obtain clarifications regarding the Interim Rule and looks forward to seeing proposed final rules to implement FIRRMA, and to providing assistance with respect to the final rules that might mitigate the adverse economic and national security effects of the Interim Rule.