June 22, 2020

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 **"Provisions Pertaining to Certain Investments in the United States by Foreign Persons," RIN 1505-AC68 (the "Proposed Mandatory Filing Changes")**

Dear Mr. Feddo:

The National Venture Capital Association ("NVCA") appreciates the efforts by the Committee on Foreign Investment in the United States ("CFIUS") to implement the Foreign Investment Risk Review Modernization Act ("FIRRMA"). Since the enactment of FIRRMA, CFIUS and its member agencies have engaged productively with NVCA, and NVCA is pleased that CFIUS has addressed some of NVCA's concerns regarding FIRRMA implementation, including with respect to the mandatory filing rules instituted by FIRRMA.

However, with respect to the Proposed Mandatory Filing Changes, NVCA urges:

(i) a further change, moving the 25% threshold proposed to delineate a "voting interest for purposes of critical technology mandatory declarations" to 50%;
(ii) the retention of the original (currently effective) language that, in the context of investment funds, helpfully focuses analytical efforts on a fund's general partner or equivalent; and
(iii) a clarification regarding the License Exception ENC carve-out for mandatory filings.

All three of these suggestions are made with the aim of maintaining a robust set of FIRRMA mandatory filing rules while ensuring innovative American companies are able to raise capital, including during the current challenging times.

Utilize a 50% stakeholder test for assessing whether a review of potential export control authorization requirements with respect to a given stakeholder is necessary.

The current rules have a two-prong test to determine whether a critical-technology-specific mandatory CFIUS filing is required with respect to an investment that grants a foreign investor certain triggering rights. First, the parties must assess whether a U.S. business works with critical technologies in certain ways, and second, the parties must assess whether the U.S. business uses that critical technology in its activities in, or designs that critical technology for use in, any of 27 specified industries. The Proposed Mandatory Filing Changes replace the '27 industry' prong of the test. The new prong instead would require assessing whether export of the U.S. business' critical technology to certain direct and indirect transaction parties would require authorization by the U.S. government (USG).

Among the indirect transaction parties that must be assessed are foreign persons who hold a 25% voting interest, direct or indirect, in an investor. As described in the Proposed Mandatory Filing Changes, "a voting interest for purposes of critical technology mandatory declarations" exists when a foreign person has a 25% or greater direct or indirect voting interest in a foreign investor. If an export of critical technology to such a person would trigger a requirement for USG authorization – e.g., an export license from the Department of Commerce's Bureau of Industry and Security – then the investment generally would satisfy this prong of the mandatory CFIUS filing test.

The burden entailed in this proposal becomes evident when considering a U.S. fund – based entirely in the U.S. and investing with U.S. limited partners' capital – that is managed by a general partner comprised of three individuals, two of whom are U.S. citizens and one of whom is a Brazilian citizen, each with a 33.3% stake in the general partner. If a U.S. company receiving an investment from this fund were required to obtain USG authorization to export the company's critical technology to Brazil, then the mandatory filing prerequisites that concern the U.S. company's characteristics would be fulfilled.[1]

The 25% threshold – which satisfies a key element of the mandatory CFIUS filing test in the example above because each individual has a 33.3% stake – is too low and therefore will sweep in far too many transactions. A more appropriate threshold is 50%. It is logical and intuitive that a 50% stakeholder of an investing entity would have to be analyzed for export purposes to the same extent as the investor itself, because a 50% stakeholder often can force specific actions by the investor. There is no similar logic or intuition for a 25% threshold.

[1] This hypothetical is intentionally unclear regarding whether there is a foreign person within the meaning of the CFIUS regulations, an investment by a foreign person being a necessary ingredient for a mandatory CFIUS filing. FIRRMA regulations have not squarely addressed the question of whether and under what circumstances a non-U.S. citizen with a stake in the general partner of a U.S. fund causes the fund itself to be a foreign person. This remains an open question and one with which many U.S. venture funds struggle. NVCA recognizes that this question will not be resolved in this rulemaking, but the ambiguity increases NVCA member sensitivity regarding modifications to other prongs of the mandatory filing test. It is critical that the proposed rule not add to the uncertainty and attendant burdens already in place.

Moreover, this revised prong appears to create a bias against smaller investment funds that is magnified by this lower threshold. Paradoxically, the same fund with six members of the general partner, two of whom are Brazilian citizens – i.e., with the same proportion of Brazilians to U.S. citizens – would not appear to be required to file under the same circumstances, as each of the stakeholders would individually own 16.6% (unless the two Brazilians were deemed to be acting in concert).

NVCA accordingly suggests that in the proposed 31 CFR 800.256, the number "25" should be replaced with the number "50."

Retain current bright-line rule for assessing interest in a fund – both under the test for "substantial interest" and the new definition of "voting interest for purposes of critical technology mandatory declarations."

For purposes of determining whether there is a government "substantial interest" in an investment fund, which may trigger a mandatory CFIUS filing, the current rule is clear: the question is whether a foreign government has a substantial interest in the "general partner, managing member, or equivalent."

The Proposed Mandatory Filing Changes, however, would muddy the waters by indicating that the analytical focus can be limited to the general partner or equivalent only if the fund is "primarily directed, controlled, or coordinated" by the general partner or equivalent.

The meaning of the phrase "primarily directed . . ." is unclear and creates substantial uncertainty. While both "control" and "parent" relationships are long-standing concepts used throughout the FIRRMA regulations, "primarily directed" is an undefined phrase previously used only in the context of the definition of "principal place of business." As one example, suppose a foreign government-owned investor is a limited partner in a fund and has a representative on the fund's limited partner advisory committee. Suppose further that the advisory committee can veto investment decisions of the general partner. In these circumstances, it is not clear whether the fund would be deemed to be "primarily directed" by the general partner, or whether CFIUS might find that the government-owned investor has a "substantial interest" in the fund by virtue of its participation in the veto-wielding limited partner advisory committee.

The Proposed Mandatory Filing Changes would compound this problem by repeating the muddying phrasing "primarily directed" in the context of assessing "a voting interest for purposes of critical technology mandatory declarations." As another example, suppose a fund is run entirely by U.S. general partners out of the United States, with sole authority to manage the fund and its portfolio, but a limited partner with a 51% economic interest in the fund is a Japanese corporation. There is long-standing ambiguity about whether such a limited partner would be considered to have "control" over the fund, and it is unclear whether the activities of such a fund would be considered to be "primarily directed" by the general partners or the Japanese corporation. Accordingly, it is unclear whether U.S. authorization for export of the technology to Japan would need to be considered for purposes of determining whether there is "a voting interest for purposes of critical technology mandatory declarations."

As discussed above, the Proposed Mandatory Filing Changes often would require export authorization assessment of any 25% stakeholder in an investor, which NVCA proposes should be changed to 50%. Regardless of the threshold, in the case of an investment fund, the proposed rule would permit an exclusive analytical focus on the stakeholders in the fund's general partner or equivalent only if the fund is "primarily directed, controlled, or coordinated" by a general partner or equivalent. Because the meaning of "primarily directed . . ." is unclear, it often will be difficult for investment funds to ascertain the universe of persons who must be assessed – in particular, whether that universe can be limited to general partner stakeholders – when determining whether there is a mandatory CFIUS filing obligation.

NVCA suggests that the language in the current CFIUS "substantial interest" test is appropriate: i.e., "In the case of an entity with a general partner, managing member, or equivalent" the question should be whether a foreign person crosses a threshold interest in the general partner or equivalent. That should be the case not only when assessing interest for purposes of a government "substantial interest" but also for the new "voting interest for purposes of critical technology mandatory declarations." Deviating from the bright line – the exclusive focus on the general partner or equivalent – will result in substantial uncertainty for investment funds and U.S. companies receiving investments from these funds.

When assessing mandatory filing obligations, clarity and certainty are crucial. The current language provides that clarity and certainty, but the proposed "primarily directed" language does not.

Clarifying what it means to be "eligible" for a license exception – in particular, License Exception ENC.

With respect to encryption technology that meets the definition of "critical technology," the Proposed Mandatory Filing Changes retain an important exception to mandatory filing obligations, but it is an exception that needs clarification.

Many companies use off-the-shelf encryption in a manner that, due to quirky export control rules, makes their own technology "critical technology." Fortunately, the currently applicable CFIUS rules provide an exception to mandatory filing obligations if the encryption is "eligible" for an exception to export control licensing requirements, more specifically if the critical technology is "eligible for export, reexport, or transfer (in country) pursuant to License Exception ENC of the EAR (15 CFR 740.17)." Under the Proposed Mandatory Filing Changes, this emphasis on "eligibility" is retained and expanded to address additional license exceptions. No mandatory filing is needed for a "covered transaction that requires one or more U.S. regulatory authorizations and *each of which is satisfied by the foreign person's eligibility* for [multiple specified license exceptions, including License Exception ENC]." (emphasis added)

In order to actually export a product or technology utilizing License Exception ENC, however, certain administrative requirements, such as submitting a classification request to the Department of Commerce or filing an annual self-classification report, may be required. A common view among CFIUS attorneys is that "eligibility" for License Exception ENC means that a company could take the administrative steps and then make the export, but not that the administrative steps

have already been undertaken. However, this view is not universal: some attorneys have taken the view that in order to be excepted from the CFIUS mandatory filing requirement, the target business must take all of the steps that would be necessary to make a product or technology exportable under License Exception ENC (e.g., a filing with the Department of Commerce).

Because many venture-backed companies use encryption, the uncertainty looms large regarding what it means for a foreign person to have "eligibility" to access a particular U.S. business's products pursuant to License Exception ENC. The distinction in the interpretation of the rules has practical implications because, when the transaction takes place, a company may not be exporting its software yet and thus may not have been required to submit the related export filings. If interpreted to mean that the exception from mandatory CFIUS filings is not available without actually undertaking the administrative steps at the Department of Commerce, such interpretation would result in either many more filings with the Department of Commerce or many more filings with CFIUS – either way, creating more legal overhead for the venture ecosystem. It is important to recall that startups generally are very resource constrained and that investment capital spent on regulatory filings is capital that is not spent on scientific and technological development.

Accordingly, it would be helpful to confirm that, indeed, the administrative steps are not required in order for License Exception ENC to remove a company's technology from the scope of "critical technology" for which there are mandatory CFIUS filing obligations. The following example would provide the necessary interpretive guidance:

31 CFR 800.401

. . .

(j) Examples:

. . .

(6) Example 6. Corporation A, a U.S business, develops technology that is subject to the Export Administration Regulations and is a critical technology as defined by 31 CFR 800.215(b)(1). Corporation B, a foreign company located in Country K, proposes to acquire Corporation A. The license exception at 15 CFR 740.17 authorizes Corporation A to export the critical technology to Country K without a license if Corporation A makes a commodity classification request to the Bureau of Industry and Security at the Department of Commerce, which has not to date been made. Assuming no other relevant facts, the acquisition is not subject to a mandatory declaration.

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NVCA again expresses its appreciation to CFIUS for its engagement with NVCA and its attention to these comments.