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Final CFIUS Rules Issued: What It Means for Real Estate Transactions and Investors

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On January 13, 2020, the U.S. Department of Treasury issued final regulations (the "Final Rules") that implement most of the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"). These rules were issued in two parts, Part 802, addressing Real Estate, and Part 800, primarily addressing business acquisitions implicating potential national security concerns. In this Client Alert, we discuss the Part 802 Final Rules for real estate transactions along with the Committee on Foreign Investment in the United States' ("CFIUS") new authority under FIRRMA to review certain non-controlling investments addressed by Part 800. The Final Rules go into effect on February 13, 2020.

Background

Prior to the enactment of FIRRMA, CFIUS had authority to conduct national security reviews of foreign investment in the U.S. that resulted in "control" (broadly defined as the power generally to direct "important matters" of the business) of a U.S. business.[1] This authority included business acquisitions and investment that potentially implicated what it deemed sensitive real estate. FIRRMA now expands CFIUS' jurisdiction to include review of certain non-controlling investments in "TID U.S. businesses" (whether they include real estate or not), and jurisdiction to review certain "covered real estate" transactions.[2] The Final Rules clarify CFIUS' expanded jurisdiction and specify the rules and coverage for real estate transactions.

The Final Rules **do not** create a mandatory filing requirement for real estate transactions, and are centered on specific sites, certain airports, maritime ports, and military installations. Notably, the Treasury Department anticipates creating a Web-based tool to illustrate the geographic scope of the Final Rules. Until then, Treasury points investors to the Department of Commerce's TIGERweb system and the Bureau of Ocean Energy's web-based resources for guidance.

As described below, real estate investors should pay attention to both parts of the Final Rules, 800 and 802, as provisions in both parts will have impacts for real estate. Indeed, certain non-controlling investments by a foreign person in an entity engaged in interstate commerce in the United States and that owns, leases or manages real estate could be governed by Part 800 rather than Part 802.

Covered Real Estate Transactions

The Final Rules clarify CFIUS' jurisdiction over "covered real estate transactions." A "covered real estate transaction" means any purchase or lease by, or concession to, a foreign person of "covered real estate" if the foreign person obtains three or more of the following property rights:

(i) the right to physically access the real estate,

(ii) the right to exclude others from physically accessing the real estate,

(iii) the right to improve or develop the real estate, or

(iv) the right to attach fixed or immovable objects to the real estate.

"Covered real estate transactions" also include any change in rights that gives or could result in a foreign person gaining any three of the four listed property rights.

The Final Rules define "covered real estate" based on its proximity to specific locations. "Covered real estate" includes real estate within: i) a "covered port"[3]; ii) "close proximity" (*i.e.* one mile from the outer boundary) of over 100 listed locations; iii) "extended range" (*i.e.* 100 miles from the outer boundary, or up to the limit of territorial waters of the United States) of 32 military installations; iv) specific counties and geographic areas connected to listed Air Force bases in Colorado, Montana, Nebraska, North Dakota, and Wyoming; or v) any part of 23 military installations in the territorial waters of the United States. Appendix A lists covered locations, and the Final Rules point to separate lists kept by the Department of Treasury for "covered ports." Any additions to the Department of Transportation's lists after February 13, 2020 do not become "covered ports" until 30 days after their inclusion. By contrast, removal of a "covered port" becomes effective immediately upon the publication of its removal.

Practice Tip: When structuring joint ventures involving real estate, special attention must be paid by foreign investors to approval rights and general partners' or managing members' removal provisions in order to avoid conferring "control" rights.

"Excepted Real Estate Transactions"

In addition to covered real estate, the Final Rules outline categories of "excepted real estate transactions." CFIUS' new real estate jurisdiction excludes the following:

- **Transactions involving an excepted real estate investor** – The Final Rules define a category of "excepted real estate investors" connected to "excepted real estate foreign states." The Part 802 rules mirror those in Part 800 and include a "white list." Investors with a substantial connection to excepted foreign states *(i.e.,* Australia, Canada, and the United Kingdom, including Northern Ireland) will be outside the scope of CFIUS review. As discussed further below, funds in particular should be aware of the rules setting forth who can be an "excepted real estate investor."
- **Underwriting or Insurance** – An acquisition of securities by a person acting as a securities underwriter in the ordinary course of business, or an acquisition pursuant to a condition in an insurance contract relating to fidelity, surety, or casualty, if the insurance contract was made in the ordinary court of business.
- **Transactions without three or more property rights** – Real estate transactions that do not ultimately confer three or more of the property rights listed above are defined as "transactions that are not covered real estate transactions."
- **Transactions in urban areas** – The Final Rules exclude transactions in "urbanized areas" or "urban clusters" as defined by the Census Bureau. But this exception does not apply to "covered ports" and those in "close proximity" to certain military installations.
- **Single housing units** – The Final Rules exclude the purchase, lease, or concession of a single "housing unit" as a single family house, townhome, mobile home, trailer, apartment, group of rooms or single room occupied as separate living quarters, or a vacant home intended for occupancy as separate living quarters.
- **Commercial leases in a multi-unit commercial building** – The Final Rules exclude the purchase, lease, or concession of certain commercial space in a multi-

tenant commercial building. However, this exception applies only if the foreign person and its affiliates do not hold more than 10% of the total commercial square footage in the building and do not represent more than 10% of the total number of tenants in the building.

- **Certain leases in airports and maritime ports** – The Final Rules exclude the lease or concession of real estate in a "covered port" for the purpose of retail sales and the lease or concession of real estate in airports and maritime ports involving a foreign air carrier with a security program accepted by the Transportation Security Administration.
- **Tribal Land** – The Final Rules also exempt transactions involving real estate owned by Alaska Natives or held in trust by the United States for certain native populations.

Excepted Real Estate transactions include transactions, covered by Part 800 which include foreign person acquisitions of a controlling[4] interest in a U.S. business, or a *foreign person's non-control investment in certain businesses implicating critical technology, critical infrastructure or sensitive personal data of U.S. citizens that would afford the investor (i) access to "material non-public technical information"; (ii) membership or observer rights or the right to nominate an individual to the board; or (iii) rights to involvement, other than through voting of shares, in the "substantive decision-making"**[5]** with respect to critical technology, critical infrastructure or sensitive personal data — even where the control threshold of having the ability to direct and decide important matters affecting an entity is not met.*

Section 802.303 also exempts certain loans or mortgages from CFIUS jurisdiction. The extension of a mortgage, loan, or similar financing arrangement by a foreign person to another person for the purpose of the purchase, lease, or concession of covered real estate is not itself a covered real estate transaction. However, a loan or mortgage may be covered by Part 802.303(a)(1) if: "because of imminent or actual default or other condition, there is a significant possibility that a purchase or lease by, concession to, or a change in rights involving a foreign person may result from the default of other condition and that would constitute a covered real estate transactions." Similarly, loans that afford a foreign person control rights set forth in Part 800 may constitute covered transactions under that part. As a result, lenders should be careful to consider the rights afforded them under financing terms.

Practice Tip: If the jurisdiction is of CFIUS concern, restructuring the foreign investment, as a true loan should be explored. Parties should remember, however, that transactions structured to evade CFIUS review can be covered real estate transactions under 802.301(g).

Investors Acquiring Real Estate

The Final Rules do not include a mandatory filing requirement for real estate investors and transactions. However, CFIUS can review transactions within its jurisdiction without receiving a filing. Therefore, real estate investors should be aware of two threshold rules that frame CFIUS' jurisdiction.

1. Who Is a Foreign Person?

This is a threshold question in any CFIUS analysis because CFIUS covers only investments by foreign persons. A "foreign person" is generally defined as any foreign national, foreign government or foreign entity (whereby an entity controlled by a foreign national, foreign government or foreign entity is also a foreign person). A foreign entity is defined as:

> (*a) 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[6] 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.*

Where a division of a U.S. entity for instance is mainly located, operated and managed abroad, the relevant entity potentially may be considered a foreign entity under the principal place of business rule. The Final Rules, newly propose the following interim *nerve center* type definition for "principal place of business:" Comments are being accepted until February 15, 2020.

"*the primary location where an entity's management directs, controls, or coordinates the entity's activities, or, in the case of an investment fund, where the fund's activities and investments are primarily directed, controlled, or coordinated by or on behalf of the general partner, managing member or equivalent*."

Therefore, a U.S. managed fund will not necessarily be treated as a foreign person as a result of a foreign person's investment in the fund – even where the limited partner holds a significant interest in the fund. But, a fund that in substance represents a managed account of a foreign person may be at risk of being a deemed a foreign person given the breadth of the definition of "control" and concern the foreign person has *defacto* power over the fund or managed account. The fund structure needs to be examined to confirm that it would not be deemed a foreign person. CFIUS looks at substance over form, so it is the substance of the foreign investor's control rights and not the type of investment that will ultimately be dispositive. Under the examples provided to the Final Rules, veto rights for instance could potentially constitute control where they relate to any of the control rights (see, footnote 1) related to "important matters affecting an entity", but the following minority shareholder protections do not, standing alone, confer control:

(i) The power to prevent the sale or pledge of all or substantially all of the assets of an entity or a voluntary filing for bankruptcy or liquidation;

(ii) The power to prevent an entity from entering into contracts with majority investors or their affiliates;

(iii) The power to prevent an entity from guaranteeing the obligations of majority investors or their affiliates;

(iv) The power to purchase an additional interest in an entity to prevent the dilution of an investor's pro rata interest in that entity in the event that the entity issues additional instruments conveying interests in the entity;

(v) The power to prevent the change of existing legal rights or preferences of the particular class of stock held by minority investors, as provided in the relevant corporate documents governing such shares; and

(vi) The power to prevent the amendment of the Articles of Incorporation, constituent agreement, or other organizational documents of an entity with respect to the matters described in (i) through (v).

Practice Tip: Customary veto or approval rights granted in a typical joint venture agreement would not, standing alone, confer control to a foreign investor.

However, the interim definition also provides that if an entity's most recent filing with or submission to a U.S. government or a non-U.S. government it has identified its principal place of business, principal office and business, address of executive offices, address of headquarters or equivalent of any of the foregoing as being outside the U.S., such location is deemed to be the entity's principal place of business unless the entity can demonstrate that such location has changed to the U.S. since such filing or submission. Thus, careful consideration should be made when making any such filing or submission to ensure the entity is not jeopardizing (without good reason) its non-foreign person status under CFIUS.

As a general matter, this clarification should provide some certainty to U.S. based fund managers that form offshore funds and other vehicles to accommodate tax, legal, regulatory or other reasons (but still direct and control activities from within the U.S.) that the jurisdiction alone of such vehicle is not determinative of its foreign person status. Non-U.S. investment fund managers, on the other hand, are likely to continue find it challenging for the investment funds they manage to avoid being deemed a foreign person under this test.

Investment vehicles formed in any jurisdiction (including the U.S.) may be deemed foreign persons under FIRRMA to the extent they are ultimately controlled by foreign nationals. This is a fact-specific analysis.

2. Who is an "excepted real estate investor"?

As in Part 800, the Final Rules create a category of "excepted real estate investors" who are not subject to the Part 802 rules. The standard in Part 802, follows that of Part 800, and covers investors from an "excepted real estate foreign state." Foreign nationals from an "excepted real estate foreign state" (that are not also foreign nationals of another state) and the foreign governments of "excepted real estate foreign states" are covered. The test is more complex for funds.

> To be an excepted real estate investor, the following criteria must be met:
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> (i) the foreign entity is organized in an excepted real estate foreign state or the U.S.;
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> (ii) the foreign entity must have a principal place of business in an excepted real estate foreign state or the U.S.;
>
> (iii) 75% of the members (and observers) of the foreign entity's board of directors (or similar body) must be U.S. nationals or nationals from an excepted real estate foreign state;
>
> (iv) all foreign person investors with an equity interest of 10% or more of the outstanding voting interests of such entity (or that hold the right to 10% or more of the profits of such entity or that otherwise could exercise control over such entity) must be (a) a foreign government from an excepted real estate foreign state, (b) a national from an excepted real estate foreign state or (c) a foreign entity organized in an excepted real estate foreign state that has a principal place of business in the U.S. or an excepted real estate foreign state; and
>
> (v) the "minimum excepted ownership" of such entity must be held by (a) non-foreign persons, (b) foreign nationals from an excepted real estate foreign state, (c) a foreign government from an excepted real estate foreign state and/or (d) foreign entities organized in an "excepted real estate foreign state" with a principal place of business in an excepted foreign state or the U.S.

"Minimum excepted ownership" generally means: 80% of the voting interests and a right to 80% of the profits of the entity (or, in each case, a majority with respect to a publicly traded company).

The Final Rules also identify certain disqualifying events for "excepted real estate investors" including violations of CFIUS requirements, OFAC and other anti-money laundering laws and other U.S. laws and regulations. There is no process for CFIUS to provide an *ex ante* determination of whether a particular investor is an excepted real estate investor. Therefore, parties have to rely on self-assessments of whether they meet the criteria.

Investors Acquiring Interests in Entities Invested in Real Estate and Other Businesses

Even if the acquired real estate is not considered "covered real estate", the acquisition or investment can be reviewed by CFIUS under Part 800. The CFIUS review process is meant to identify national security risk, and CFIUS has gone to great lengths to list the real property that might raise concerns in Part 802. Therefore, there is reason to believe that real estate not covered by Part 802 may raise less significant national security concerns. However, investors should still be aware of the rules under Part 800, because any foreign investment in the United States can be reviewed by CFIUS to the extent it triggers the standards in Part 800, and can potentially trigger a filing requirement, for instance, depending on the nature of the business acquired and the identity of the investor.

Under Part 800, CFIUS has authority to review transactions that result in "control" of a U.S. business and non-controlling investments in "TID U.S. Businesses." Control is defined broadly and generally includes the power to determine, direct or decide important matters of the business. As noted above, TID U.S. Businesses are those that produce, design, test, manufacture, fabricate or develop one or more critical technologies; perform any of the functions set out in Appendix A to Part 800 with respect to specific critical infrastructure; and companies that maintain or collect, directly or indirectly, sensitive personal data of U.S. citizens. Non-controlling investments outside of these categories (that aren't otherwise covered by Part 802), would be outside the scope of CFIUS review. The rules also capture, for instance, changes in rights that could result in a covered control transaction or a covered investment, and changes in rights that could result in the foreign person having at least three of the four identified property rights. Moreover, acquisitions of secondary interests also potentially may result in jurisdiction or reporting requirements where the business is a TID U.S. Business or the triggering rights discussed above relating to control attach to the new holder.

Real Estate & Sensitive Data

The Part 800 Final Rules include a mandatory filing for foreign investments in U.S. Businesses that collect "sensitive personal data" of U.S. Citizens. A "sensitive personal data" investment is generally an investment in a U.S. business that maintains, collects, or has a demonstrated business objective to collect "identifiable data" (generally, data that can be used to identify a person of a type falling within one of the enumerated categories) of more than one million people, or tailors its product to U.S. executive branch or military personnel. There are ten categories of identifiable data identified in the final rule.

(i) data that could be used to determine a person's financial distress,

(ii) data contained in a consumer report (unless limited data is obtained from a consumer reporting agency for purposes described in the Fair Credit Reporting Act),

(iii) data contained in insurance applications,

(iv) data that relates to a person's physical, mental or psychological well-being (*i.e.*, health information),

(v) non-public electronic communications, including, email messaging, or chat communications between or among users of a U.S business' products or services (if the U.S. business is providing communications platforms used by third parties),[7]

(vi) geolocation data collected using positioning systems, cell phone towers, or WiFi access points such as via a mobile application, vehicle GPS, other onboard mapping tool, or wearable electronic device (*e.g.*, location data on customers collected and maintained for customer marketing or customer experience purposes; or for mobile mapping services)

(vii) biometric enrollment data (*e.g.*, facial, voice, retina and fingerprints),

(viii)data stored and processed for generating state and federal identification cards,

(ix) data concerning U.S. government personnel security clearance, and

(x) data in an application for U.S. government security clearance.

Information that an employer maintains with respect to its own employees (unless the information is about U.S. Government contractor security clearances) generally does not constitute sensitive personal data. However, information collected about customers can trigger the mandatory filing requirement under Part 800, provided the foreign investor gains the rights, access, or voting power required under the Final Rules.

Practice Tip: The broad range of sensitive personal data covered by the Final Rules, potentially implicates many real estate intensive businesses such as hospitals and other health care providers, hotels that may be tracking guest locations for marketing and other purposes, or biometric data for access privileges, data centers storing non-public electronic communications, and others. Foreign investors need to be cognizant of these rules when acquiring interests in data-centric businesses.

Conclusion

While CFIUS has long had authority to review transactions implicating sensitive real estate, the Final Rules clarify the full scope of that jurisdiction, including direct greenfield or raw land acquisitions. While direct real estate transactions will not be subject to mandatory filing requirements under Part 802, investors should be careful to consider FIRRMA and CFIUS risk in doing their due diligence. We expect that FIRRMA will continue to be a key gating issue for foreign real estate investors for foreign real estate investors and will continue to monitor any new FIRRMA developments and CFIUS enforcement.

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Because of the generality of this Alert, the information provided herein may not apply to all situations and may not be relied upon without specific legal or other advice provided in particular structures.

[1] The term "control" 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, in particular, but without limitation, to determine, direct, take, reach, or cause decisions regarding the following matters, or any other similarly important matters affecting an entity: (1) the sale, lease, mortgage, pledge, or other transfer of any of the tangible or intangible principal assets of the entity, whether or not in the ordinary course of business; (2) the reorganization, merger, or dissolution of the entity; (3) the closing, relocation, or substantial alteration of the production, operational, or research and development facilities of the entity; (4) Major expenditures or investments, issuances of equity or debt, or dividend payments by the entity, or approval of the operating budget of the entity; (5) the selection of new business lines or ventures that the entity will pursue; (6) the entry into, termination, or non-fulfillment by the entity of significant contracts; (7) the policies or procedures of the entity governing the treatment of non-public technical, financial, or other proprietary information of the entity; (8) the appointment or dismissal of officers or senior managers; (9) the appointment or dismissal of employees with access to sensitive technology or classified U.S. Government information; or (10) the amendment of the Articles of Incorporation, constituent agreement, or other organizational documents of the entity with respect to the matters described in paragraphs (a)(1) through (9) of this section.

[2] FIRRMA gave CFIUS authority to review non-controlling investments in "TID U.S. Businesses." TID (Technology, Infrastructure, Data) refers to businesses that produce, design, test, manufacture, fabricate or develop one or more critical technologies; perform any of the functions set out in Appendix A to Part 800 with respect to specific critical infrastructure; and companies that maintain or collect, directly or indirectly, sensitive personal data of U.S. citizens.

[3] This includes "large hub airports" listed in the FAA's annual enplanement data, "joint use airports" defined by the FAA, airports with an aggregate cargo landed weight of greater than 1.24 billion pounds, commercial strategic seaports in the National Port Readiness Network, and the top 25 tonnage, container, or dry bulk ports.

[4] Control is a key concept in determining whether a transaction is potentially subject to CFIUS jurisdiction (including, at the target company level, examining whether rights afforded to a foreign person potentially constitutes control under FIRRMA and, at the investing entity level, determining among other things, the foreign person status of such entity under FIRRMA.

[5] "[S]ubstantive decision-making" under the Final Rules is defined as the process through which decisions regarding significant matters affecting an entity are undertaken. The rules provide a non-exhaustive list of the types of significant matters that are covered: (1) involvement in decisions related to pricing, sales and contracts; (2) corporate strategy and business development; (3) research and development; (4) manufacturing locations; (5) access to critical technologies; material non-public technical information or sensitive personal data; (6) physical and cybersecurity protocols; (7) establishment or maintenance of architecture of information technology used in collection or maintaining sensitive personal data; (8) practices and policies regarding collection use or storage of sensitive personal data and (9) strategic partnerships. The rules clarify that strictly administrative decisions do not constitute substantive decision-making.

[6] Under 31 C.F.R. Section 800.225 the "United States" is the United States of America, the States of the United States, the District of Columbia, and any commonwealth, territory, dependency, or possession of the United States, or any subdivision of the foregoing, and includes the Outer Continental Shelf, as defined in 43 U.S.C. 1331(a). For purposes of these regulations and their examples, an entity organized under the laws of the United States of America, one of the States, the District of Columbia, or a commonwealth, territory, dependency, or possession of the United States is an entity organized "in the United States."

[7] CFIUS recently required the divestiture of a Chinese company's investment in Grindr, a dating platform.

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