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. Limited partner direct investments. 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. Scope of "Material nonpublic technical information." 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. Offshore fund incorporation. 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. Mandatory filing premised on limited partner access to material non-public technical information. 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.