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To: Hannah Munizza
Subject: NVCA ALERT: Final CFIUS rules issued; impacts VC and startups



Final CFIUS Rules Issued; Impacts VC and Startups

Just a few hours ago, the Treasury Department issued its [final rules](#) implementing the *Foreign Investment Risk Review Modernization Act* (FIRRMA), which provided CFIUS significant new powers to police investments into U.S. companies. **The rules announced today will continue to have a significant impact on venture capital, but key changes were made in the final rules that may alleviate headaches for the startup ecosystem. These changes are a direct result of NVCA's [sustained efforts](#) to impact FIRRMA and its implementing regulations.** The final rules maintain the basic structure that has been in place since the Pilot Rules, i.e. mandatory filings for certain non-controlling investments by a foreign entity that gives certain rights (e.g. board seat). But the final rules provide additional detail in important areas and will affect how VCs and startups navigate the rules.

Here is a quick rundown of a handful of issues on which NVCA has advocated:

Foreign entity

NVCA has focused on two areas that are wrapped up in the foreign entity definition. First, ensuring that U.S. VC funds organized outside the laws of the U.S. (e.g. Cayman fund) are *not* considered to be a foreign entity. Second, gaining clarity that non-U.S. partners of a venture fund will *not* make an otherwise U.S. fund into a foreign

entity.

We are preliminarily pleased that CFIUS addressed our concerns around funds organized outside the U.S. Under present CFIUS rules, if an entity can establish that its "principal place of business" is in the U.S. then it will not be considered a foreign entity. Making that demonstration is tricky for a fund, which does not have a legal headquarters in the way a corporation does. As recommended by our formal [comments](#), CFIUS has set forward a definition of principal place of business that focuses on where the entity "directs, controls, or coordinates" activity, which should be helpful to NVCA members organized under the laws of another country but that run the firm in the U.S. **However, CFIUS added one caveat:** the regulations say that if an entity has asserted to the government that its principal place of business is offshore then the fund cannot claim that its principal place of business is in the U.S. for CFIUS purposes. We are working to understand the impact of this subsection but are **hopeful this will not mute** the benefit of the new principal place of business definition.

NVCA has also been focused on obtaining guidance for **venture funds with non-U.S. partners** that are concerned the fund may be considered a foreign entity under CFIUS rules. CFIUS did not redefine foreign entity to take account of this scenario but NVCA is evaluating the rules to determine whether changes were made elsewhere that may benefit some venture firms.

Sensitive personal data

The statute gave CFIUS jurisdiction over investments into companies with "sensitive personal data" of U.S. citizens. That aspect of the statute was not included in the Pilot Program, but CFIUS has implemented that requirement in the final rules. NVCA encouraged CFIUS to narrow the scope of what is considered to be "sensitive personal data" and the final rules appear to make changes to the proposed rules in several important ways. Of particular interest, CFIUS has recalibrated the provision dealing with genetic information in what appears to be a helpful direction. It has also provided an example that may help companies determine whether a company has a "demonstrated business objective to maintain or collect data" of U.S. citizens (see example 5, p. [94-95](#)).

Definition of "material, nonpublic technical information"

This definition is incredibly important as access to "material nonpublic technical information" is one of the rights that can trigger a CFIUS

filing (if other factors are met). We recommended narrowing the definition to ensure that CFIUS picks up information that allows for reverse engineering of technology and does not unnecessarily pull in transactions with no national security concern. The final rules do not alter the definition, but **CFIUS provided two illustrative examples that may help VCs and startups navigate the rules** (see [p. 86](#)). Under the first example source code is determined to meet the definition and under the second example a company milestone (absent technical details) is determined *not* to meet the definition. These examples may spring from direct advocacy by NVCA members sharing their experience in navigating the Pilot Program. As a reminder, due to NVCA's advocacy, the statute specifies that the definition does *not* include financial information of an entity.

Excepted investor concept

NVCA has been the leading organization advocating that CFIUS establish an "Excepted Investor" process that reduces the impact of the rules to U.S. allies. Under the final rules, to be an Excepted Investor an entity must be closely connected to an "Excepted Foreign State" and meet certain requirements. CFIUS has initially selected **Australia, Canada, and the United Kingdom as excepted states. CFIUS notes in the final rules that it may expand the list in the future.** While NVCA's proposal argued for a more expansive group of countries, we are pleased to see relief for certain investors from these countries. As a practical matter, investors from these countries are exempted from the expansion of jurisdiction to non-controlling investors *if* they can meet the other requirements under the Excepted Investor concept. These requirements are discussed on [p. 73-78](#) of the rules. It appears CFIUS – at the encouragement of NVCA – revised various thresholds that make the Excepted Investor concept more usable, but additional analysis is necessary before determining the implications of this section.

What's next and how a related rulemaking could shuffle the deck:

The rules issued today go **into effect on February 13, 2020**. The venture industry must navigate these rules going forward. We're here to help and here is what's happening in the near-term.

- Join our webinar on "CFIUS Final Rules & VC Impact" on January 28 at 11:00 am PT/2:00 pm ET. Jeff Farrah, NVCA General Counsel, will be joined by our outside CFIUS lawyers at Wilson Sonsini to explain the final rules and key changes made to the Pilot Program. [Register here](#).

- Every Friday, our Series D.C. newsletter hits your inbox and we will include the latest on how the rules impact you.
- NVCA will evaluate whether the changes made to our Model Legal Documents due to CFIUS must be altered. The LPA-insert NVCA provides as part of the Model Legal Documents was created immediately after the FIRRMA Pilot Program went into effect and changes may need to be made to reflect the final rules.
- We are working on opportunities for top CFIUS officials to speak to VCs and will circle back as those opportunities come together.
- Finally, keep in mind that the related "[emerging and foundational technologies](#)" rulemaking is still ongoing and could significantly open the aperture of the types of companies that may be subject to a CFIUS filing and expose VC-backed companies to export controls (including [restrictions on foreign nationals](#) working at startups). The first tranche of "emerging technologies" could come at any time and according to Commerce Department officials is likely to relate to AI, robotics, and 3D printing. We continued to be active in that process on your behalf.

As always, we stand ready to help your firms and portfolio companies navigate changing waters. Please reach out to Jeff Farrah, NVCA General Counsel (jfarrah@nvca.org), with any questions or comments.



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