

# PUBLICATION

---

## Sweeping Implications for CFIUS Reform: Bipartisan FIRRMA Legislation Gains Traction

December 05, 2017

**As President Trump met with Chinese President Xi Jinping on November 9 at the Great Hall of the People in Beijing, he surprised many by giving China "great credit" for "taking advantage of" the United States on key international trade issues. The day before, on Capitol Hill back in Washington, D.C., leading lawmakers in the House and Senate proposed new legislation to reform, strengthen, and modernize the process by which the Committee on Foreign Investment in the United States (CFIUS) reviews foreign investments in the U.S. for national security concerns. The Senate version, introduced by Majority Whip John Cornyn and co-sponsored by powerful bipartisan legislators including Senators Richard Burr, Diane Feinstein, Marco Rubio, and Amy Klobuchar, is titled the Foreign Investment Risk Review Modernization Act (FIRRMA). Rep. Robert Pittenger introduced companion legislation in the House, with equally bi-partisan support and stronger rhetoric regarding international economic rivals of the U.S. such as China.**

The CFIUS review process has not been updated in nearly a decade, and many leading legislators believe that gaps in the current process have allowed foreign governments – in particular, China – to gain access to sensitive technologies and critical intellectual property in a manner contrary to the national security and economic interests of the U.S. This article will briefly provide a primer on the role of CFIUS, an overview of the recent push for reform, and a breakdown of the legislation currently gaining traction to overhaul and modernize the review process.

### **I. CFIUS Background**

CFIUS is an interagency committee that reviews the national security risks of certain forms of foreign direct investment in the U.S. economy. Initially established by Executive Order in 1975, the current iteration of CFIUS is chaired by the U.S. Secretary of the Treasury and includes representatives from 16 U.S. departments and agencies. Its voting members include the heads of the Departments of Justice, Homeland Security, Defense, State, and Energy; the U.S. Trade Representative; and head of the White House Office of Science and Technology. CFIUS has the authority to review any "covered transaction," which includes any transaction "by or with a foreign person, which could result in control of a U.S. business by a foreign person." This includes proposed or completed mergers, acquisitions, or takeovers by foreign governments, entities, and those controlled by foreign governments and entities. If CFIUS determines that a covered transaction presents a national security risk (a term currently not defined by statute or regulation), it has the authority to impose certain mitigating conditions before allowing the deal to proceed, and may also refer the transaction to the President, who has sole authority to unilaterally block a potential transaction or unwind a completed transaction. The current CFIUS review process can be broken down into three steps: 1.) an informal review process; 2.) a formal review period; and 3.) a Presidential determination.

First, because CFIUS has the authority to commence reviews of transactions on its own, parties to a potentially covered investment transaction are advised to first seek an informal CFIUS review by filing a draft notice with the Committee to ensure that any potential review proceeds as efficiently as possible.

Generally, the review process then formally begins when parties to a proposed or pending merger, acquisition, or takeover jointly file a voluntary notice with the Committee. If the notice is complete, a 30-day review period

begins whereby CFIUS's members examine the transaction using 12 factors mandated by Congress to determine if any national security concerns would arise were the transaction completed as planned. If any member of the Committee determines the investment could harm U.S. national security, a 45-day investigative period is triggered. In addition, the 45-day investigation period becomes automatic if one of three conditions arises: 1.) CFIUS determines that the transaction threatens to impair the national security of the United States and that the threat has not been mitigated during or prior to a review of the transaction; 2.) the foreign person is controlled by a foreign government; or 3.) the transaction would result in the control of any critical infrastructure by a foreign person, the transaction could impair the national security, and such impairment has not been mitigated. If the investigation results in a conclusion that the transaction presents national security risks, CFIUS may then impose certain conditions before allowing the deal to proceed or require the parties to enter into a mitigation agreement to address specific security concerns.

Finally, the President has a 15-day period for review if CFIUS refers a transaction for a decision on whether to suspend or prohibit it. The President is the only officer capable of suspending or blocking such covered mergers, acquisitions, and takeovers.

To date, there have been merely four investments blocked by sitting Presidents, although this number does not reflect past proposed transactions that parties self-terminated to avoid having their transaction formally blocked. In 2012, President Obama blocked an American firm owned by Chinese nationals from acquiring a U.S. wind farm located near a Department of Defense facility, and then in 2016 blocked a Chinese investment firm from acquiring the U.S. business of German semi-conductor company Aixtron SE. Most recently, in September, President Trump blocked the acquisition of Lattice Semiconductor by the Chinese investment firm Canyon Bridge Capital Partners, noting the national security risk posed by the potential transfer of intellectual property and the importance of semiconductor supply chain integrity.

## **II. Push for Reform**

The last significant CFIUS reform legislation was the 2007 Foreign Investment and National Security Act (FINSAs), which was prompted by a transaction involving the ownership of management contracts for six major U.S. ports. The contracts were held by the British-owned P&O Steam Navigation Company until the company was taken over by Dubai Ports World, a United Arab Emirates company. The transaction cleared the CFIUS review process; however, it raised national security concerns in the intelligence community and on Capitol Hill because Dubai Ports World was a state-owned enterprise. The result was the drafting and implementation of FINSAs, which increased Congressional oversight and transparency of the CFIUS review process. FINSAs also codified CFIUS, gave it statutory authority, and designated the Secretary of Treasury to serve as the chairman.

Recent push for reform has been largely underscored by legislators and intelligence community officials who view the current CFIUS review process as inadequate to face modern geopolitical threats posed by foreign direct investment in U.S. companies, in particular Chinese foreign investment, which has increased more than 900 percent between 2010 and 2016. According to FIRRMA's architect Sen. John Cornyn, the United States' "potential adversaries, such as China" have been "exploiting gaps in the existing CFIUS review process" to degrade its military and technological edge. Senator Cornyn, along with Senator Dianne Feinstein, have been working on FIRRMA for the past eight months to address the widespread concerns of the intelligence community. Among those who have called for CFIUS reform include key national security leaders such as Secretary of Defense James Mattis, who stated CFIUS "needs to be updated to deal with today's situation," Director of National Intelligence Dan Coats, who called for a "significant review" of the current process, and the National Security Agency Director Michael Rogers, who stated that the process must be reassessed to ensure it is "optimized for the world of today."

With this background in mind, the next section will detail the key features of FIRRMA and explain how the modernization of CFIUS will affect future foreign direct investment in the United States.

### **III. FIRRMA**

FIRRMA was formally introduced on November 8 and contains several changes intended to overhaul the current review process. The most critical updates include: 1.) the expansion of CFIUS's jurisdiction to conduct reviews; 2.) revised definitions to key terminology; 3.) increased national security measures; and 4.) streamlined filing and review procedures.

#### **i. Expanded Jurisdiction**

The first notable changes proposed by FIRRMA include an expanded scope of transactions subject to CFIUS jurisdiction. FIRRMA would allow CFIUS to review a number of new types of transactions between U.S. business and foreign entities, including certain joint ventures, strategic IP licensing agreements, acquisitions designed to circumvent CFIUS review, and certain types of real estate and leasing transactions.

##### *Joint Ventures and Intellectual Property*

Although CFIUS already has the jurisdiction to review joint ventures that result in foreign control of U.S. businesses, FIRRMA proposes an expanded jurisdiction that would allow the Committee to review any joint venture or "type of arrangement" that results in technology transfers of U.S. intellectual property and associated support, even when those joint ventures do not result in control of a U.S. business. This would allow CFIUS to review any IP licensing arrangement or joint venture outside the United States that involves a transfer of critical U.S. technology. This proposal is likely in response to joint ventures and associated technology transfers that U.S. companies have, in recent years, been forced to enter into with Chinese entities in order to gain access to the Chinese market.

##### *Anti-Circumvention*

FIRRMA additionally proposes that CFIUS may review any "transaction, transfer, agreement, or arrangement" that is designed to "evade or circumvent" CFIUS jurisdiction, potentially giving the Committee broad jurisdiction to dictate on its own terms whether a particular transaction falls within its purview.

##### *Real Estate Transactions and Leases*

Also included under the proposed expanded CFIUS jurisdiction are real estate purchases or leases of property located "in close proximity to a United States military installation or to another facility or property of the United States Government that is sensitive for reasons relating to national security." This could be problematic for conducting proper due diligence, as often times such military facilities and installations have classified locations.

#### **ii. Key Definitions and Critical Technologies**

FIRRMA also proposes to update key definitions within the CFIUS authorization legislation, which would similarly expand the jurisdictional basis for a Committee review, including definitions of "passive investment," "control," and "critical technologies."

##### *"Passive Investment," "Control," and CFIUS Safe Harbors*

Some of the proposed definitions affect the joint venture and IP licensing arrangements discussed above. Currently, CFIUS rules provide safe harbors for certain "passive investments" and other minority investments in U.S. companies that are not considered "dominant" and will not give the foreign entity any governance rights with respect to their investment. In practice, this safe harbor has been construed rather narrowly and the scope

of jurisdiction has been broadly exercised, extending to minority investments of as little as ten percent equity interest. However, as mentioned above, current rules do not extend to transactions that result in technology transfers, such as the licensing of intellectual property, that occur outside the context of a controlling investment. The proposed legislation would expand CFIUS's jurisdiction to cover more than transactions that result in "control" by a foreign person of a U.S. business and would allow CFIUS to define when an investment becomes more than "passive"; for example, if the foreign investor is given a board seat, has substantive decision-making authority, or has access to certain types of information. CFIUS would then have jurisdiction over any non-passive investment by a foreign person in any U.S. critical technology or infrastructure company.

### *Critical Technologies*

FIRRMA would expand the definition of "critical technologies" to include "emerging technologies that could be essential for maintaining or increasing the technological advantage of the United States over countries of special concern with respect to national defense, intelligence, or other areas of national security, or gaining such an advantage over such countries in areas where such an advantage may not currently exist." This would codify the importance to the Committee of protecting essential technologies that contribute to U.S. technological superiority from a national security standpoint. The bill would also expand the definition of "critical infrastructure." These changes could potentially affect U.S. businesses in the thriving start-up community that seek Chinese venture capital, as the broad definition would enable CFIUS to involve themselves if the technology transfer could manifest in some form of foreign advantage.

### **iii. National Security Concerns**

Along with building upon key definitions related to national security concerns, FIRRMA would enable CFIUS to focus on countries of special concern, expand the list of security factors taken into consideration during a review, and increase the significance of international cooperation for countries that meet certain criteria.

#### *Countries of Special Concern*

While no country, including China, is mentioned by name in FIRRMA, the bill would allow CFIUS to focus on a potential transaction's nexus with "countries of special concern," defined as those that pose "a significant threat to the national security interests of the United States." CFIUS will not be required to maintain a list of these countries, and it already heavily scrutinizes investments from China, Russia, and the Middle East; however, FIRRMA will further impact how CFIUS conducts reviews from such sensitive regions. Both the House and Senate sponsors of the bill explicitly referred to Chinese investment as an impetus for reform, and transactions involving Chinese parties or that could result in technology transfers into the Chinese market will certainly require careful due diligence.

#### *Updated Security Factors*

The bill would also expand the current list of factors CFIUS can use when considering a transaction's national security implications, supplementing four of the current factors and adding nine new ones, including U.S. cybersecurity vulnerabilities, the foreign investor's history of compliance with U.S. regulations, the potential to expose sensitive data of U.S. citizens, the aforementioned "countries of special concern" that have a demonstrated goal of acquiring critical U.S. technology, and the potential effect on U.S. technological and industrial leadership. CFIUS already incorporates many of these factors into their analysis, and thus this expansion will not drastically alter the current review process, but rather serves to codify our 21st century concerns.

#### *International Cooperation and Cross-Border Transactions*

FIRRMA would also give CFIUS the authority to *exempt* from review certain transactions that do not implicate national security concerns from U.S. allies that utilize their own CFIUS-style procedures for reviewing foreign investment. Investors from such "identified countries," which are not explicitly named in the bill, would gain strategic advantages in making transactions and investments, as they would not be subject to the scrutiny of a CFIUS review.

#### **iv. Updated Filing and Review Process**

Finally, FIRRMA would change several of the administrative processes involved in a CFIUS review, including the timing of investigations, the process for an expedited determination, updated filing fees, and expanded CFIUS legal authority.

##### *Timing of Review Period*

FIRRMA proposes to extend the initial formal review period from 30 to 45 days, retains the current second 45-day investigative review period, and authorizes CFIUS a one-time 30-day extension for an investigation in certain "extraordinary circumstances."

##### *New Declaration Process*

There is no current CFIUS filing procedure that allows for an investor to obtain an expedited review. FIRRMA proposes to create a new process that would allow for such a determination, known as a "declaration." First, it would allow parties to submit a "light filing" called a voluntary declaration, limited to five pages in length, that would allow CFIUS to conduct an expedited review on whether a formal review is necessary. It would also make certain declarations *mandatory*, such as if a transaction involves the acquisition of a voting interest of at least 25 percent in a U.S. business by a foreign person in which a foreign government owns at least a 25 percent voting interest. CFIUS could also specify further mandatory declarations by considering factors such as the technology, industry, or sector in which the U.S. business operates; the difficulty of remedying the harm to national security resulting from the transaction; and the difficulty of obtaining information on the transaction through other means. Mandatory declarations would have to be submitted at least 45 days before the completion of a transaction. This would be the first time certain CFIUS filings would be considered statutorily mandatory.

##### *Expanded Authority*

The legislation further provides CFIUS with the authority to suspend a proposed or pending transaction during the pendency of CFIUS review or investigation, and allows CFIUS to refer a matter to the President at any time during a review or investigation. In addition, actions and findings by the President and CFIUS would not be reviewable in court. However, a party would be able to appeal a CFIUS ruling that it believes restricted a constitutional right, power, privilege or immunity by filing a petition with the U.S. Court of Appeals for the D.C. Circuit. FIRRMA also authorizes CFIUS to assess and collect a fee equal to one percent of the value of the transaction, subject to a maximum fee of \$300,000. There currently is no fee for filing a CFIUS notice.

#### **IV. Conclusion – Key Takeaways**

Due to the bipartisan support from leading lawmakers, it is likely that some iteration of FIRRMA will pass in the near future. While Chinese investment will certainly be in the crosshairs of the updated CFIUS review process, investors from around the world should be wary of the implemented changes, particularly regarding the broadened jurisdictional scope of review, the streamlined procedures, the new mandatory filings, the "countries of special concern" and the proposed exemptions for investors from countries with their own CFIUS-style processes. Both the E.U. and [China](#) have recently drafted foreign investment legislation with CFIUS-like review

mechanisms, and it will be critical to keep an eye on how CFIUS responds to such measures under FIRRMA's guidance. U.S. companies and foreign investors must be aware of whether their products and technologies fall under the new definitions for covered transactions, and whether potential overseas licensing agreements could fall within CFIUS's purview despite a lack of foreign control that has traditionally subjected it to CFIUS jurisdiction. The impact of FIRRMA, if signed into law, will be to effectively and substantially modernize, update, and streamline the CFIUS review process.

If you have any questions regarding CFIUS, please contact any member of the Baker Donelson's [Global Business Team](#).