

Report from Washington

Long-Awaited Bipartisan CFIUS Reform Legislation Introduced in Congress Likely to Have Far-Reaching Implications for Foreign Investment Reviews

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Introduction

On November 8, 2017, Congressman Robert Pittenger and Senate Majority Whip John Cornyn introduced long-awaited reform legislation that would considerably expand the scope and jurisdiction of the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”)—the inter-agency committee charged with reviewing foreign investments in U.S. businesses for potential national security implications. The legislation responds to concerns that the CFIUS process has been inadequate to address questions of sensitive technology transfer and expanding cybersecurity and other threats to U.S. national security from countries of concern, chiefly China. With co-sponsors from both sides of the political aisle, passage of the proposed legislation—titled the Foreign Investment Risk Review Modernization Act of 2017 (“FIRRMA”)—appears to be less a question of “if” and more a question of when and in what form.

The Proposed Reforms

Expanded Jurisdiction. FIRRMA would extend CFIUS’s reach beyond its current mandate to review transactions that could result in control of a U.S. business by a foreign person.

- **Real Estate Transactions.** Under FIRRMA, CFIUS’s jurisdiction would cover purchases or leases by a foreign person of private or public real estate located in the U.S. if the real estate is in “close proximity” to a U.S. military installation or other sensitive U.S. government property or facility. As a practical matter, “physical proximity” analysis is today a standard part of due diligence in real estate transactions, especially if the foreign acquirer is from a country of concern such as China, Russia or the Middle East.

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- **Minority Investments in U.S. Critical Infrastructure or Technology Companies.** FIRRMA generally extends CFIUS’s jurisdiction to reach any investment in a U.S. “critical infrastructure company” or a U.S. “critical technology company”—terms that are broadly defined to include any U.S. businesses that own, operate, or primarily provide services to entities that operate critical infrastructure, or U.S. businesses that produce, trade in, design, test, manufacture, service, or develop critical technologies. There is a narrow exemption for passive investments in which the foreign investor does not have any of the following: i) access to non-public technical information possessed by the U.S. business, or nontechnical information not available to all shareholders; ii) membership or observer rights to the board of directors, or the right to nominate a member or observer; iii) involvement (other than through the voting of shares) in substantive decision making; or iv) a parallel strategic partnership or other material financial relationship with the U.S. business.
- **Contributions of Critical Technology and Support.** Joint ventures and other arrangements through which foreign persons receive intellectual property and associated support (other than ordinary customer relationships) from a U.S. “critical technology company” would be subject to CFIUS review under FIRRMA. At the same time, FIRRMA authorizes CFIUS to exclude from this category, through future regulation, contributions of technology determined to be adequately covered by other laws, which would include export control laws.

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Country-Specific Exemptions. While FIRRMA extends the Committee’s jurisdiction to reach the types of real estate transactions, minority investments, and contribution arrangements described above, FIRRMA also authorizes CFIUS to enact regulations exempting some transactions otherwise covered by these new categories based on the identity of the host country. In determining which foreign countries are eligible for exemption, FIRRMA directs CFIUS to consider factors such as whether the U.S. has a mutual defense treaty in effect with the country, or whether the U.S. and the foreign country have a mutual arrangement to safeguard national security as it pertains to foreign investment.

Mandatory Disclosure for Some Foreign Investments. In sharp contrast with the existing voluntary notice framework, FIRRMA mandates that parties disclose their transactions to CFIUS in some circumstances.

- Parties to transactions involving a foreign person’s acquisition of a voting interest of at least 25% in a U.S. business must disclose their transaction to the Committee where a foreign government directly or indirectly owns a voting interest of at least 25% in the foreign person.

- In addition, FIRRMA authorizes CFIUS to designate other transactions for mandatory disclosure based on underlying factors, including the technology, industry, or economic sector of the U.S. business, and the difficulty of remedying the harm to national security caused by the transaction.

Parties subject to the mandatory disclosure requirement have the option of submitting a declaration that provides basic information about the contemplated transaction at least 45 days before closing, or filing a full written notice no later than 90 days before closing.

New Factors to be Considered in Evaluating National Security Risk. FIRRMA identifies additional national security risk factors that reflect publicized and ongoing bipartisan concerns that U.S. primacy in military and defense technology is eroding, and that increasing investment from abroad is exacerbating cybersecurity risk while undermining U.S. institutions. Although these factors have not been articulated precisely in prior legislation or regulations, they generally reflect concerns CFIUS is already considering today, including:

- The degree to which the transaction is likely to increase the cost to the U.S. government of acquiring or maintaining equipment and systems necessary for national security functions;
- The extent to which the cumulative market share held by foreign persons of any one type of infrastructure, energy asset, critical material, or critical technology would impact national security;
- The extent to which any involved foreign parties have a history of complying with U.S. laws and regulations, or adhering to agreements with U.S. government entities;
- The potential for the transaction to create any new cybersecurity vulnerabilities in the U.S. or exacerbate existing cybersecurity;
- The extent to which the transaction could result in a foreign government gaining a significant new capability to engage in malicious cyber-enabled activities against the U.S., “including such activities designed to affect the outcome of any election for Federal office”; and
- Whether the transaction “involves a country of special concern that has a demonstrated or declared strategic goal of acquiring a type of critical technology” possessed by a U.S. business that is party to the transaction.

Authorization to Suspend Transactions Pending Review. FIRRMA would increase the initial review period to 45 days (from 30 days), and provide for an additional 30-day extension in “extraordinary circumstances” to complete the Committee’s investigation—

meaning that some CFIUS reviews could potentially take as long as 120 days. During the Committee's investigation, FIRRMA authorizes CFIUS to "suspend" the transaction, and also contemplates civil penalties where parties violate any "order" issued under the reform statute.

Funding, Fees, and Special Hiring Authority. To address resource concerns, FIRRMA establishes a dedicated fund in the U.S. Treasury, calls for appropriations "as may be necessary to perform the functions of the Committee," authorizes CFIUS to assess and collect fees for written notices filed with the Committee—not to exceed the lesser of one percent of the transaction value or \$300,000 (to be adjusted annually for inflation), and confers special hiring authority on CFIUS member agencies enabling them to shortcut the traditional government hiring process.

Implications

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If enacted in its current form, FIRRMA would dramatically increase the number of transactions that are subject to CFIUS review, including non-controlling minority investments in "critical infrastructure" and "critical technology" companies. Under FIRRMA, certain otherwise benign transactions involving buyers with foreign government ownership, which today practitioners might recommend not submitting for voluntary review by CFIUS, would be subject to mandatory notification and possible suspension pending CFIUS review. Important details are left for CFIUS to determine through regulatory rule-making, including which countries would be placed on a "whitelist" exempting certain transactions by buyers from those countries from CFIUS review. And it remains to be seen how parties will determine if real estate transactions involve properties in close proximity to "sensitive" government facilities.

The most striking and potentially far-reaching aspect of FIRRMA is its expansion of CFIUS's jurisdiction beyond M&A transactions to include IP transfers by U.S. "critical technology companies." It is unclear what incentives parties would have to submit such transfers for pre-approval by CFIUS, or how effective CFIUS-imposed mitigation would be post-transfer.

FIRRMA also enhances the Committee's powers and resources, most notably by imposing a filing fee of up to \$300,000, whereas today there is no filing fee. In contrast to other recent CFIUS reform efforts, FIRRMA notably does not seek to add additional members to CFIUS, reach greenfield investments (other than real estate), require a net economic benefits test, address investment reciprocity, or impose *per se* blocks for investments from specific host countries. Despite the uncertainties raised by FIRRMA, in light of the broad bipartisan support reflected by FIRRMA's numerous co-sponsors and the many months of behind-the-

scenes negotiations that have already taken place, including with the key CFIUS member agencies, it is more clear than ever that significant CFIUS reform is on the horizon, which will increase the types of transactions under CFIUS jurisdiction and alter the process by which they are reviewed.

To learn more about our national security regulatory practice and how to navigate key processes, including matters before CFIUS, the Defense Department's Defense Security Service, the State Department's Directorate of Defense Trade Controls, and the Treasury Department's Office of Foreign Assets Control ("OFAC"), please contact the following:

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