

PRESIDENT TRUMP SIGNS INTO LAW THE MOST SIGNIFICANT CHANGES TO FOREIGN INVESTMENT REVIEWS IN OVER A DECADE

Law Expands CFIUS Jurisdiction and Complicates the Review Process While Providing Less Certainty for Foreign Investors

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On August 13, 2018, President Trump signed the Foreign Investment Risk Review Modernization Act (“FIRRMA”) as part of the National Defense Authorization Act. FIRRMA represents the most significant change to the foreign investment review process of the interagency Committee on Foreign Investment in the United States (“CFIUS”) in over a decade. FIRRMA amends Section 721 of the Defense Production Act (“Section 721”), the statute that governs foreign investment reviews by the CFIUS.

FIRRMA—which codifies many current CFIUS practices—will streamline and expedite the review process for a narrow subset of foreign investments and contains tools to target more effectively emerging national security threats from foreign interests. For most businesses and investors, however, the regulatory landscape will become considerably more complicated and a greater number of investment transactions will be subject to scrutiny from CFIUS based on its expanded jurisdiction. Although FIRRMA is now law, with some provisions taking effect immediately, the Treasury Department must draft implementing regulations with respect to many key aspects of the statute. We expect that implementation process to take at least a year.

1. Overview and Key Elements

FIRRMA contains a number of fundamental changes to foreign investment reviews that are explained in greater detail below. Several of the most prominent reforms include:

- ***Expanded jurisdiction over minority investments.*** FIRRMA expands transactions subject to CFIUS jurisdiction to include: (1) any non-passive investment by a foreign person in any unaffiliated U.S. business involved in critical technology, critical infrastructure, or that maintains sensitive personal data that, if exploited, could threaten national security; (2) the purchase, lease, or concession by or to a foreign person of certain real estate in close proximity to military or other sensitive national security-related facilities (even in the absence of acquisition of other U.S. assets or entities); (3) certain changes in a foreign investor’s rights with respect to a U.S. business; and (4) any other transaction, transfer, agreement or arrangement designed to circumvent or evade CFIUS. The new law also expressly includes any transaction covered by CFIUS that arises pursuant to a bankruptcy proceeding or other form of default on debt.
- ***Mandatory and optional declarations.*** FIRRMA creates a second type of filing—an abbreviated declaration—that will be mandatory for certain investments, including certain transactions where a foreign government owns, directly or indirectly, a “substantial interest.”

- **Timing and fees.** FIRRMA lengthens the overall review period from its 90 days to a total of 120 days (assuming no withdrawal and re-filing), including an initial 45-day review that takes effect immediately. FIRRMA allows CFIUS to assess filing fees for covered transactions up to the lesser of US \$300,000 or one percent of a transaction's value.
- **CFIUS's other expanded powers.** FIRRMA authorizes CFIUS to: seek greater documentary evidence relating to investor entities and transaction agreements and side agreements; exercise heightened enforcement power regarding the imposition of measures to mitigate national security concerns in connection to abandoned and consummated transactions; suspend transactions during the pendency of CFIUS reviews; utilize more robust authorities to monitor mitigation measures; prescribe regulations that could subject foreign investors from countries of "special concern" to greater scrutiny while extending potential relief to foreign investors from U.S. allies); monitor non-notified transactions; and assess an expanded list of national security considerations during CFIUS reviews.
- **Export control reform.** FIRRMA establishes an interagency process to define "emerging" and "foundational" technologies "that are essential to the national security of the United States" and generally expands the authority of the U.S. to impose unilateral measures to control the export of such technologies.

2. Detailed Analysis of Key Provisions

A. Expanded CFIUS Jurisdiction

At present, CFIUS jurisdiction covers only the potential acquisition of control by a foreign person of an existing U.S. business engaged in interstate commerce (known as a "Covered Transaction"). Section 721 defines control broadly to mean the ability to determine, direct, take, reach, or cause decisions of the U.S. business—a threshold much lower than a 50-percent voting interest. The current CFIUS regulations cover joint ventures only to the extent that an existing U.S. business would be contributed and where the joint venture could result in control by a foreign person. To date, an "existing" U.S. business has not included the purchase of assets not operated as a stand-alone business, such as real estate without employees, or other start-up or "greenfield" investments. Each of these scenarios is impacted by FIRRMA.

Minority Investments. Covered transactions would include not only a transaction through which a foreign company could obtain "control" of a U.S. company, but also any other investment (other than passive investment) by a foreign person in any unaffiliated U.S. business involved in critical technology, critical infrastructure, or that maintains sensitive personal data that, if exploited, could threaten national security. To constitute a covered minority investment, the foreign investor would have any of the following: access to material nonpublic technical information ("MNTI"); membership or observer rights on, or the right to nominate an individual to, the board of directors or equivalent governing body of the U.S. business; or any involvement (other than through voting shares) in substantive decision-making related to U.S. businesses regarding critical technology, critical infrastructure, or sensitive personal data of U.S. citizens maintained or collected by the U.S. business.

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- ***Access to MNTI Limits the Range of Passive Investments.*** MNTI includes information on the design, location, or operation of critical infrastructure, and information necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods, but expressly excludes financial information regarding the performance of a U.S. business. This means that a foreign investor in an energy business with access to power grid maps would likely be covered, while the same foreign investor with access only to such company's earnings and other financial information would not be covered.
- ***Scope of Critical Infrastructure Limited.*** FIRRMA tasks the Department of the Treasury with developing implementing regulations that limit the scope of covered critical infrastructure to include only a subset of systems or assets that are so vital to the U.S. that the incapacity or destruction of such systems or assets would have a debilitating impact on national security. Moreover, the law explicitly precludes the use of any definition of critical infrastructure established under any other law to be determinative for purposes of FIRRMA.
- ***Expanded Definition of Critical Technology.*** Critical technology includes items covered by several of the U.S. Government's existing export control regimes and already subject to scrutiny in the CFIUS review process, but also emerging and foundational technologies controlled pursuant to a new interagency process established by FIRRMA (discussed below).
- ***Special Rules for Investment Funds.*** Investments would avoid CFIUS review if they are made through an investment fund controlled exclusively by a U.S. general partner, managing member, or equivalent, so long as the foreign investor's rights are consistent with those of a passive limited partner. A foreign person investor could be a member of a fund advisory board or committee, so long as such board or committee is unable to approve, disapprove, or otherwise control investment decisions or decisions made by the U.S. general partner. Similarly, such foreign investor would not be permitted to control the fund, including through the ability to: (1) approve, disapprove, or otherwise control investment decisions of the fund; (2) approve, disapprove, or otherwise control decisions made by the U.S. general partner related to entities in which the fund is invested; or (3) unilaterally dismiss, prevent the dismissal of, select, or determine the compensation of the U.S. general partner. The right of a foreign investor or an advisory board or committee to waive potential conflicts of interest, waive allocation limitations, or engage in "a similar activity" would not be deemed to be control of the investment decisions of the fund or decisions relating to entities in which the fund is invested.

Real Estate Investments. Covered transactions would also include the purchase, lease or concession by or to a foreign person of private or public real estate in the U.S. that is part of an air or maritime port, or that is in close proximity to a U.S. military installation or another national security-related sensitive U.S. government property that could be subject to foreign intelligence surveillance. Certain real estate transactions are excluded, such as those involving a single housing unit and real estate in urbanized areas (except as determined by CFIUS through implementing regulations).

Changes in the Rights of Foreign Investors. Covered transactions include that change a foreign investor’s rights with respect to a U.S. business that results in control of that business or where the investment (other than passive investment) is made in an unaffiliated U.S. business involved in critical technology, critical infrastructure, or that maintains sensitive personal data that, if exploited, could threaten national security.

Any transaction, transfer, agreement or arrangement designed to circumvent or evade CFIUS. This provision allows CFIUS to review any transaction, transfer, agreement or arrangement if its structure is designed or intended to evade or circumvent CFIUS review.

B. Mandatory and Optional Declarations

In addition to the current option of filing lengthy and burdensome notices, FIRRMA creates a second type of filing—an abbreviated (approximately five pages) declaration—that would be mandatory for certain transactions, including many that involve foreign governments. When a foreign investor acquires a substantial interest in a U.S. business that involves critical infrastructure, critical technology, or the maintenance of sensitive personal information, transaction parties must submit a mandatory declaration if a foreign government (including a state-owned enterprise) holds a “substantial interest” in the foreign investor.

CFIUS will develop implementing regulations to define a substantial interest, but FIRRMA specifies that an investment of less than a 10-percent voting interest is not substantial. Moreover, CFIUS may choose to waive the declaration requirement if it determines that an investment transaction is not directed by a foreign government and the non-U.S. person has a history of cooperation with CFIUS. In addition, investments in investment funds may fall under an exception to the declaration requirement if certain requirements are met (including that the general partner or equivalent is a U.S. person). CFIUS may also provide for additional categories of investment that require mandatory declarations.

For other, less-sensitive transactions, filing a declaration in lieu of a full-fledged notice is optional and could provide a means for an abbreviated CFIUS review. Within 30 days of receipt of a declaration, CFIUS must respond by clearing the transaction, declining to clear a transaction and providing the option for or inviting a notice, or self-initiating a review.

C. Timing, Fees, and Judicial Review

Changes to the CFIUS timeline. FIRRMA extends the initial review period from 30 to 45 days and provides for a further 45-day investigation in certain cases. FIRRMA also permits a 15-day extension following the investigation in “extraordinary circumstances.” If CFIUS decides to refer the case to the President, the President has the 15 days to decide whether to block, restrict, or unwind the transaction. FIRRMA therefore lengthens the overall review timeline from its current 90 days to a total of 120 days. FIRRMA also requires CFIUS to provide comments on a draft or written notice or accept a written notice within 10 business days after submission—providing greater timing certainty absent from the current process.

New CFIUS filing fee. Because FIRRMA significantly expands CFIUS’s jurisdiction and the number of covered transactions is likely to increase, CFIUS will require additional staff to analyze and review transactions, negotiate with parties, and monitor compliance with mitigation measures. FIRRMA authorizes up to US \$20 million per year to fund CFIUS and allows CFIUS to assess filing fees for covered transactions up to the lesser of US \$300,000 or one percent of the value of the transaction. CFIUS is also authorized to study whether to offer parties the option of an additional “prioritization fee.”

Judicial review. FIRRMA provides that the U.S. Court of Appeals for the D.C. Circuit would have exclusive jurisdiction over civil actions challenging an action or finding of CFIUS; the court would have an opportunity for *ex parte* and *in camera* review of the classified record, if the court determines that the use of such information is necessary.

D. CFIUS’s Other Expanded Powers

Submission of Related Agreements. CFIUS can require parties to submit all partnership agreements, integration agreements, and other side agreements relating to a transaction.

Enhanced enforcement powers. FIRRMA empowers CFIUS to:

- Suspend a pending or proposed transaction for the duration of the review process when the transaction involves a risk to national security;
- Impose mitigation conditions on a party that has voluntarily abandoned a transaction for the purposes of effectuating the abandonment;
- Impose conditions on a party to an undeclared or non-notified covered transaction in order to mitigate any interim risk to national security pending completion of a CFIUS review or investigation; and
- Monitor mitigation agreements to ensure compliance and, in the event of noncompliance, impose penalties, require a remediation plan, require the filings of a new notice or declaration in some cases, or seek injunctive relief.

FIRRMA requires CFIUS to establish a process to identify covered transactions for which a notice or declaration was not submitted.

Bias against mitigation. FIRRMA establishes a presumption against the imposition of mitigation measures, unless CFIUS can show that the agreement will be effective, is verifiable, and compliance can be properly monitored. With mitigation disfavored, this presumption could increase the likelihood of Presidential blocking and divestment orders and transaction abandonment by transaction parties in order to avoid issuance of such orders.

Countries of Special Concern. In a departure from earlier versions of the legislation, FIRRMA omits an express definition of either a “country of special concern” or “exempt” allied countries. This avoids placing foreign investors from specifically-named countries under extra

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scrutiny and extending more generous treatment to foreign investors from favored countries. But FIRRMA provides a hook for CFIUS to address specific countries in two ways. First, in expanding CFIUS jurisdiction over transactions involving real estate, critical infrastructure, critical technology or sensitive personal information of U.S. persons, FIRRMA tasks CFIUS with defining “foreign person” in terms of connections to a foreign country or government and potential effects on U.S. national security. Second, CFIUS may consider whether a covered transaction involves a country of special concern that has a demonstrated or declared strategic goal of acquiring a type of critical technology or critical infrastructure that would affect U.S. leadership in areas related to national security.

Additional National Considerations. FIRRMA expands the list of national security considerations that may be assessed during CFIUS reviews. Notably, the list of new factors is included in FIRRMA as a “Sense of Congress” and is hortatory in nature. In addition to countries of special concern, CFIUS may consider the following:

- Foreign investor’s cumulative market share and pattern of recent transactions in any one type of infrastructure, energy asset, critical material, or critical technology;
- Foreign investor’s history of compliance with U.S. laws and regulations;
- Threat to the supply chain for defense, intelligence, or other national security functions;
- Risk of release of sensitive personal data of U.S. citizens; and
- Potential to exacerbate cybersecurity vulnerabilities.

E. Export Control Reform

After considerable pressure from the business community, Congress abandoned attempts to extend CFIUS authority to U.S.-outbound technology transfers. Instead, FIRRMA establishes an interagency process to define “emerging” and “foundational” technologies “that are essential to the national security of the United States” and generally expands the authority of the U.S. to impose unilateral measures to control the export of such technologies.

Once the interagency committee identifies emerging and foundational technologies, the Secretary of Commerce must establish appropriate export controls and licensing requirements under the Export Administration Regulations.

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