STROOCK
SPECIAL BULLETIN

Four Things You Need to Know About the CFIUS Reform Legislation

November 8, 2017

On November 8, 2017, Senator John Cornyn (R-TX) and a bi-partisan group of co-sponsors, including Dianne Feinstein (D-CA), Richard Burr (R-NC), Marco Rubio (R-FL), Amy Klobuchar (D-MN) and others, introduced the long-awaited *Foreign Investment Risk Review and Modernization Act* ("FIRRMA"). A companion bill was introduced in the House of Representatives by Cong. Robert Pittenger (R-NC9) and a bi-partisan group of co-sponsors, including Dave Loebsack (D-IA2).

This **Stroock Special Bulletin** provides an overview of the proposed legislation, which would greatly expand the power and reach of the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee"), the multi-agency panel that vets foreign acquisitions to address national security concerns. Unless withdrawn or satisfactorily modified, transactions deemed a threat by CFIUS may be blocked or unwound by the President.

The proposed legislation arrives in an environment characterized by extraordinary Chinese investment and several highly visible deals, including ChemChina's acquisition of Syngenta AG, President Trump's veto of Canyon Bridge's proposed purchase of Lattice Semiconductor, and Ant Financial's attempted acquisition of MoneyGram International, Inc. The bill chiefly seeks to address transactions that lie outside CFIUS jurisdiction – namely, investments that provide access to sensitive technology but do not entail "control" of a United States business – the current requirement for CFIUS jurisdiction.[1] In a speech at the Council on Foreign Relations, Senator Cornyn stated that the bill is intended to "plug the gaps" in CFIUS so that "aggressive" countries, such as China, do not "degrade our nation's military superiority" and "undermine our defense industrial base."[2]

Although several bills have been proposed in this Congress to reform or remake CFIUS, the Cornyn bill is the most sweeping, and would significantly broaden the Committee's power and scope, changing the landscape for national security reviews for years to come. Notably, it also would give CFIUS expanded resources. Here are the key takeaways from the Cornyn bill:

[1] *See also*, Background on Foreign Investment Risk Review and Modernization Act ("FIRRMA") – Sen. John Cornyn, p. 4.

[2] Council on Foreign Relations, "Foreign Investments and National Security: A Conversation with Senator John Cornyn," (June 22, 2017).

I. More Transactions Will Get CFIUS Review

The bill would extend CFIUS review to *any* non-passive foreign investment in a "United States critical technology company" or "United States critical infrastructure company." This provision alone would alter the scope and dynamic of CFIUS reviews – reaching certain targeted investments that fall well short of control – the long-time predicate for CFIUS review. Under the stringent definition used in the bill, few investments in critical technology or infrastructure companies are likely to be deemed "passive." Among other things, foreign investments in such companies will *only* be deemed "passive" if the investor will have no membership or observer rights on the Board, no access to non-public information, no access to nontechnical information that is not available to all investors, no involvement (other than by voting of shares) in substantive decision-making, and no "parallel strategic relationship" or "other material financial relationship" (terms to be defined in regulations) with the U. S. business.

The bill also would clarify the treatment of transactions pursuant to bankruptcy proceedings or other forms of default on debt and would expressly extend CFIUS reviews to:

- the contribution by a critical technology company of both intellectual property and associated support to a foreign person through any type of arrangement, such as a joint venture;
- the purchase or lease by a foreign person of U.S. property (public or private) in close proximity to a U.S. military or other U.S. government national security property or facility;
- any changes in the rights of a foreign person in the U.S. business in which the foreign person has an investment – if the change results in foreign control of, or a passive investment in, a critical technology or infrastructure company; and
- any other transaction designed or intended to "evade or circumvent" the application of the statute or regulation.

As noted, the bill seeks to capture certain "under-the-radar" investments in companies with nascent technology – for example, artificial intelligence, and joint ventures involving such technology. Noting a recent DoD study that highlighted the risk of Chinese access to the "crown jewels" of U.S. innovation, Senator Cornyn has targeted what he calls China's "aggressive" investment in "technologies that will be foundational" for future commercial and military applications."[3]

Accordingly, the bill expands the existing definition of critical technologies to include "other emerging technologies that could be essential for maintaining or increasing the technological advantage of the United States or giving such advantage to 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." Without naming names, the bill defines "countries of special concern" as countries posing a "significant" threat to the national security interests of the United States. Although the bill does not require a formal list of such countries, China is certain to be on any informal list.

The bill gives broad authority to CFIUS to define critical terms in the legislation, such as "non-public technical information." In addition, CFIUS would have the authority to exempt certain otherwise covered transactions (described above) if *all* foreign investors are from a country that meets certain criteria, such as a U.S. treaty ally or a country having a mutual investment security arrangement with the U.S. How these terms are

[3] Council on Foreign Relations, "Foreign Investments and National Security: A Conversation with Senator John Cornyn," (June 22, 2017), transcript available at: https://www.cfr.org/event/foreign-investments-and-national-security-conversation-senator-john-cornyn.

ultimately defined and which transactions are exempted will clearly have significant impact.

II. Some CFIUS Filings will be Voluntary and Some Not. Some Reviews will be Shorter and Some Longer, Demand More Information, and Cost More. Mitigation will be Tougher to Come by and Policed Closely

The bill would:

- provide for the voluntary filing of "CFIUS-lite" declarations – abbreviated notices that could allow for quick reviews, for example, of notices from "frequent filers" that are low risk and routinely approved;
- provide for *mandatory* filings (by declaration or written notice) *before closing* (i) for acquisitions of a 25% or greater voting interest in a U.S. business by a foreign person in which a foreign government owns, directly or indirectly, at least a 25% voting interest, and (ii) for select transactions (as determined by the Committee) based on certain factors, including "technology, industry, economic sector, or economic subsector." After receiving a declaration, CFIUS may, at its discretion, request a written notice, initiate a unilateral review, or approve the transaction;
- lengthen the longstanding initial 30-day review period to 45 days. In cases leading to investigations (now roughly half of all filings) the total review and investigation period would extend to 90 days, barring Presidential review. The bill also provides, however, that an investigation can be extended by the lead agency for one 30-day period in "extraordinary circumstances" (to be defined in regulation);
- for transactions "that may pose a risk" to U.S. national security, taking into account a risk-based assessment by the Director of National Intelligence, the Committee would have authority to suspend the transaction pending review (thereby preventing the transaction from closing before CFIUS review is concluded);
- require CFIUS to provide copies of the CFIUS report to Congressional intelligence committees after CFIUS concludes action;
- authorize filing fees up to $300,000 (adjusted for inflation) or one percent of the value of the transaction, whichever is less, to defray the cost of CFIUS operations (subject to Congressional appropriations). Currently, there is no cost to file;
- require consideration of several new factors, including whether the transaction is likely to: contribute to the loss of, or other adverse effect on, technologies that provide strategic national security advantage to the United States, expose personal identifying or genetic information, create new or exacerbate existing cybersecurity vulnerabilities, reduce the technological and industrial advantage of the United States relative to countries of special concern, or involve the potential national security-related effects of the cumulative market share of any one type of infrastructure, energy asset, critical material, or critical technology by foreign persons, thereby making clear that CFIUS is not limited in its review to the case before it;
- bar mitigation unless CFIUS determines that the mitigation or condition "resolves the national security concerns posed by the transaction," taking into consideration whether the agreement or condition is "reasonably calculated" to be effective and is both verifiable as well as enforceable;
- expressly authorize CFIUS to impose mitigation agreements or conditions on *completed* transactions, and on parties who abandon a transaction; and
- authorize CFIUS to remediate noncompliance with mitigation agreements, including revised remedies for breach, regardless of intent,

which may include injunctive relief, re-opening review, re-writing the mitigation agreement, and mandatory filing of future covered transactions for five years.

Repeat filers from allied countries may welcome the advent of abbreviated declarations. Nevertheless, with CFIUS "endeavoring," but not committed to take action within 30 days of receiving a declaration, some filers may prefer the certainty of a traditional (if burdensome) written notice rather than risk a request for a formal filing after filing a declaration. Although China is not singled out in the bill as a "country of special concern," the requirement to file transactions involving foreign government interests may well have the practical effect of subjecting many Chinese acquisitions to mandatory review.

Several changes, if adopted, could slow the timing of deals and add new uncertainty regarding timing and the finality of CFIUS review. The prospect of an additional 30-day review under "extraordinary circumstances" risks slower reviews. Depending on how this authority and the authority to suspend transactions is used, it may be harder to predict the length of reviews. Moreover, sanctions for material breach of mitigation agreements would no longer require the government to demonstrate intent, thereby opening negligent breach to potential sanction. This could result in longer reviews as parties seek to clarify the terms of mitigation, rather than face the challenge of compliance with uncertain standards.

With all of this change, the government and investors alike will need time to adjust. Although many provisions of the bill are to be effective upon enactment (*e.g.*, the authority to suspend transactions pending review and the new time frames for review), provisions requiring new regulations or special staffing are deferred for thirty days after formal confirmation by the Secretary of the Treasury (as Chair of CFIUS) that "the regulations, organizational structure, personnel, or other administrative resources are in place" to carry out the amendments.

III. Confidentiality will be Less Certain: There will be More Congressional Involvement, and Information in Notices may be Shared with Foreign Countries

The bill would give CFIUS explicit authority to share information with domestic and foreign governmental entities "to the extent necessary for national security purposes and pursuant to appropriate confidentiality and classification arrangements." Under the bill, the Senate and House Intelligence Committees will receive copies of certifications, threat assessments, and, in certain cases, additional analyses for approved deals. With more information getting shared, the risk of leaks can only go up. Further, fearful of being second-guessed, agencies may be quicker to find threats, knowing that threat assessments will be getting a wider audience. This may contribute to the politicization of threat assessments.

IV. The Cornyn Bill Is Not Alone

The Cornyn bill reflects the input of the Treasury Department, which chairs CFIUS, as well as other key CFIUS agencies. At various times over the past several months, key members of the Administration have signaled support for CFIUS reform, suggesting an alignment of the Executive Branch and Congress. The Cornyn bill, however, is only one among several CFIUS reform bills now before Congress, including legislation that would add new agencies to CFIUS, mandate review of the health and safety implications of deals, and highlight real estate transactions for special scrutiny.[4] Perhaps most important, S. 1983, the "United States Foreign Investment Review Act of

[4] *See Stroock Special Bulletin*: "Real Estate in the Crosshairs: Congressional Calls to Step Up Scrutiny of Foreign Investment," (June 1, 2017), available at: http://www.stroock.com/siteFiles/Publications/RealEstateCrosshairs.pdf; *see also Stroock Special Bulletin*: "Second Helpings: New Legislation Would Give Agriculture and HHS Secretaries Seats at the CFIUS Table," (March 21, 2017), available at: http://www.stroock.com/siteFiles/Publications/SecondHelpingsNewCFIUSLegislationAg.pdf.

2017," a bipartisan bill introduced by Senators Sherrod Brown (D-OH) and Chuck Grassley (R-IA) on October 18, 2017, would set up a parallel review process at the Commerce Department to assess the economic impact of significant foreign investments, and give the Secretary of Commerce authority to modify or veto transactions, regardless of their impact on national security.[5]

In one form or another, some of these proposals may well end up in the final reform bill. Meanwhile, a Government Accountability Office review, requested last year by Congressional critics of the investment review process, chugs quietly along, pending its likely release later this year. Although its conclusions are not yet known, it is virtually certain to fan the flames for reform. All of this activity makes it very likely that reform legislation will be enacted in the 115th Congress, which ends in 2018, an election year.

For More Information

For additional information on the Cornyn legislation, or for a copy of the bill, please contact any member of the Stroock National Security/CFIUS/Compliance Group.

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[5] We will review S. 1983 in a later *Stroock Special Bulletin*.

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