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SPECIAL BULLETIN

The Elephant in the Room: Senate Legislation Would Make "Economic Security" a Factor in Foreign Investment Reviews

December 4, 2017

Shortly before Senators John Cornyn (R-TX) and Dianne Feinstein (D-CA) introduced their comprehensive bill to reform the process for national security reviews of foreign acquisitions[1], Senators Sherrod Brown (D-OH) and Chuck Grassley (R-IA) introduced legislation that would give the U.S. Secretary of Commerce the power to review foreign investments in the United States to determine their "economic effect." Following that review, the Secretary could order modification of the investment – or prohibit it outright.

The Brown/Grassley bill does not articulate the basis on which investments might be altered or blocked, but instead directs the Secretary to consider "any economic factors the Secretary considers relevant," including:

- "the long-term strategic economic interests of the United States";
- the "history of distortive trade practices in each country in which a foreign party to the transaction is domiciled";
- "control and ownership of each foreign person that is a party to the transaction";
- "impact on the domestic industry, taking into account any pattern of foreign investment in the domestic industry"; and
- "any other factors the Secretary considers appropriate."

The legislation contemplates that Commerce Department reviews may be pursued in tandem with national security reviews by the Committee on Foreign Investment in the United States ("CFIUS"), directing the Secretary of Commerce to "coordinate" with the Secretary of the Treasury, who chairs CFIUS. The bill makes clear, however,

[1] S. 2098, the "Foreign Investment Risk Review Modernization Act of 2017," introduced November 8, 2017, had attracted a bi-partisan group of 10 co-sponsors by the end of November. *See* "Four Things You Need to Know About the CFIUS Reform Legislation," *Stroock Special Bulletin*, November 8, 2017, available at http://www.stroock.com/publications/four-things-you-need-to-know-about-the-cfius-reform-legislation.

that national security reviews are to be exclusively conducted by CFIUS.

Unlike CFIUS national security reviews, the economic reviews authorized by S. 1983 would be mandatory and subject to a de minimis rule – $50 million in the case of transactions by state-owned enterprises, $1 billion in all other cases, and would cover foreign investments that create new entities (*i.e.*, greenfield investments) as well as transactions that could result in foreign control of an existing U.S. "person." (CFIUS only reviews acquisitions that could result in foreign control of a U.S. "business," which may or may not be a legal person.) S. 1983 would also allow Congress a role in the process.

Unlike the statute that governs CFIUS, S. 1983 would require the Secretary of Commerce to initiate an economic review – *without regard to the value of the transaction* – if the Chairman and Ranking Member of the Senate Finance Committee or House Ways & Means Committee requested such review. Under S. 1983, initial reviews would last 15 days, but if not resolved, could be extended for an additional 45-60 days.

On introducing the bill, Senator Brown stated that "[f]oreign investments should lead to good-paying jobs in [the USA] – not huge payouts for the Chinese government," adding that "[s]tate-owned enterprises and foreign investors determined to put American companies out of business should not be able to invest in our economy at the expense of American workers. It's simple – before we do business with a foreign entity, let's make sure it will create jobs and grow the U.S. economy."

For decades, Congress has set aside proposals to expand CFIUS reviews to protect "economic security" – transactions that could threaten U.S. jobs or challenge aging or developing U.S. industries but have no apparent link to U.S. national security or critical infrastructure. The concern has been that legislation that would allow deals to be blocked for economic reasons could fuel retaliation against American businesses looking to invest in foreign markets. For this reason, CFIUS reviews have remained focused on national security, even as reviews expanded to reach critical infrastructure, such as bridges and telecommunications, and critical technologies. Senator Grassley argues, however, that American investors are already disadvantaged in foreign countries and that S. 1983 "further equips the Administration with the ability to fight back against unfair trade barriers to U.S. exports and businesses," noting that "Europe, Canada, Australia and China have similar investment screens already in place." Grassley argues that the United States shouldn't "be left in the dust."

The rise in Chinese investment in the U.S. over the past decade has fueled concern over the pace and reach of foreign investment, but it would be wrong to think that S. 1983 is targeted exclusively at Chinese investment. The bill pointedly directs the Secretary of Commerce to consider the foreign investors' "history of distortive trade practices." China is a frequent target for its trade practices, but it is not alone. Notably, the day after Sherrod Brown introduced S. 1983, he joined his Republican colleague, Rob Portman (R-OH), in urging the International Trade Commission "to rule that workers at Whirlpool's Clyde, OH plant had been hurt by unfair washing machine imports by Samsung and LG [two of South Korea's largest manufacturers]."

Senators Brown and Grassley are no back benchers. Senator Brown is the Ranking Member of the Banking Committee, and a member of the Finance Committee, to which S. 1983 was referred. Senator Grassley is the Chairman of the Judiciary Committee and a long-time critic of the foreign investment review process. Nevertheless, the Brown-Grassley bill has the feel of a "place holder," a bill introduced to prompt discussion and keep "economic security" in the public's eye, rather than a serious effort at legislative reform. For one thing, with little guidance beyond the direction to assess the "economic effect" of a covered transaction, the bill would give extraordinary and unprecedented authority to a single Cabinet member to block significant foreign investments.

No provision is made for judicial review, nor is it clear what standard is to be applied by the Secretary of Commerce in deciding whether a transaction should be allowed to go forward. And all of this is to be accomplished in 15 days – with the possibility of a 45-60 day extension.

CFIUS is a multi-member entity, with decades of experience in evaluating the national security impact of transactions. Nevertheless, roughly half of CFIUS cases now go to full 75-day investigations. Some go through more than one cycle. The bottom line is that foreign investment reviews are challenging. Select USA, the U.S. Government agency that promotes foreign investment, notes that, although the United States is the largest single recipient of foreign direct investment in the world, "the United States must actively compete to retain and attract new investment." CFIUS works to protect national security without discouraging investment. Therefore, since its inception, although scores of transactions have been restructured to clear CFIUS, only four have been vetoed and relatively few abandoned outright over the years. Before granting veto authority to any single Cabinet member, it is likely that Congress (and the Administration) will want to sort out a number of difficult issues, not least among them the proper standard of review.

On introducing his comprehensive CFIUS reform bill, Senator Cornyn took pains to issue a summary that makes clear that the legislation "does not … [r]equire CFIUS to consider investment reciprocity or economic security impacts in its analysis." (Emphasis original.) Nevertheless, since Senator Brown (the co-sponsor of S. 1983) is the ranking Democrat on the Banking Committee – the committee to which Cornyn's bill was referred – it is fair to expect that economic security will be raised by Senator Brown and others during the debate over the Cornyn legislation. (Meanwhile, S. 1983 will be before the Finance Committee, where Senators Cornyn and Brown are both members.)

Opponents have long struggled to keep "economic security" out of foreign investment reviews, given the issue's obvious political appeal and its potential to disrupt investment markets, both in the U.S. and abroad. For this and other reasons, we do not believe that S. 1983 is likely to be enacted. As it is, some members of the business community are already uncomfortable with the Cornyn bill – and the broad reach of the Brown/Grassley bill makes it an easy target, given the extraordinary power it would vest in the Commerce Secretary and its potentially unwieldy mandate.

Nevertheless, chances are very good that Congress will enact CFIUS reform legislation before the end of next year, and there will be pressure to write some measure of economic protection into the bill. As concern rises over the loss of traditional manufacturing jobs in the U.S. and increased foreign competition for new industries, we expect that economic security will be the elephant in the room.

If you have any questions, or for a copy of the Brown/Grassley bill or the Cornyn CFIUS legislation, please contact any member of the National Security/CFIUS/Compliance group.

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