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## Congress Passes Landmark CFIUS Reform Bill

On July 26 and August 1, 2018, Congress passed the Foreign Investment Risk Review Modernization Act (“FIRRMA”) as part of the Fiscal 2019 National Defense Authorization Act. FIRRMA broadens the authority of the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”) to determine whether foreign investments in U.S. businesses pose a risk to national security. President Trump is expected to sign the bill shortly.

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Introduced in November 2017, FIRRMA represents the most significant effort to revise the CFIUS process since the passage of the Foreign Investment and National Security Act of 2007. A key motivation behind FIRRMA is the view among U.S. national security figures that the Committee was not equipped to handle new threats to U.S. national security posed by foreign investment, particularly from China.<sup>1</sup> Among other steps, FIRRMA expands the scope of transactions potentially subject to CFIUS review, requires mandatory filing for certain transactions involving foreign government-affiliated investors, and grants CFIUS the authority to suspend transactions mid-investigation.

### Overview of the CFIUS Review Process

President Gerald Ford established CFIUS in 1975 to monitor foreign direct investment in the United States. In 1988, President Ronald Reagan delegated to the Committee the authority to review foreign transactions, following passage of the Exon-Florio Amendment, 50 U.S.C. § 2170, which amended Section 721 of the Defense Production Act of 1950 and granted the President authority to block foreign investment in the United States when “the transaction threatens to impair the national security of the United States.” 50 U.S.C. § 4565(b)(2)(B)(i)(I).

CFIUS has the authority to review any “covered transaction” which, prior to FIRRMA, meant “any transaction . . . by or with any foreign person[] which could result in control of a U.S. business by a foreign person.” 31 C.F.R. § 800.207. Historically, the CFIUS review process has been voluntary, and parties to a covered transaction were not required to notify CFIUS of the transaction unless specifically directed by the Committee. CFIUS may impose mitigating measures on the parties to a covered transaction—or recommend that the President block a transaction entirely—if the Committee determines that the foreign investment threatens to impair U.S. national security.

### Significant Reforms Introduced by FIRRMA

FIRRMA introduces several major changes to key aspects of the Committee’s review authority and process.

1. **Extends CFIUS’s jurisdiction to any non-passive foreign investments in a U.S. “critical technology company” or “critical infrastructure company.”** Prior to FIRRMA, CFIUS’s jurisdiction was limited to transactions that could result in “foreign control” of a U.S. business. FIRRMA expands CFIUS’s jurisdiction to transactions that involve a “critical technology company” or “critical infrastructure company,” unless the transaction involves a purely “passive investment.”

<sup>1</sup> David McLaughlin, Saleha Mohsin, and Billy House, *China U.S. Buying Spree Prompts Move to Toughen Deal Reviews*, BLOOMBERG (Oct. 26, 2017), <https://www.bloomberg.com/news/articles/2017-10-26/china-s-u-s-buying-spree-prompts-move-to-toughen-deal-reviews>.

Importantly, the term “passive investment” is narrowly interpreted—the foreign investor may have no:

- Access to any non-public technical information (i.e., either information that “provides knowledge, know-how, or understanding, not available in the public domain, of the design, location, or operation of critical infrastructure” or that “is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods”) of the U.S. business, other than financial information regarding the performance of the U.S. business;
- Board or board observer rights;
- Involvement in substantive decision-making of the U.S. business; or
- Parallel strategic partnership or other material financial relationship with the U.S. business.

As a result of this change, many investments in critical technology or infrastructure companies—previously outside the scope of CFIUS’s jurisdiction—will be subject to Committee review. Nonetheless, this definition provides guidance on how certain investors, such as private equity funds, may be able to structure transactions with foreign partners in a manner that qualifies as passive investment.

2. **Broadens the definition of “critical technology” to include emerging technologies.** Prior to FIRRMA, the term “critical technology” was defined to include items covered by the United States Munitions List, items on the Commerce Control List, certain nuclear-related materials, and items covered by the Select Agents and Toxins regulations. 31 C.F.R. § 800.209. FIRRMA expands the definition of “critical technology” to include “[o]ther 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.” Such broad language will provide CFIUS with greater latitude to conclude that a particular transaction implicates “critical technology” and, therefore, may pose a risk to U.S. national security.

Further, what constitutes “emerging and foundational technologies” will be determined through a new interagency process led by the Departments of Commerce, Defense, and State, as well as other federal agencies. This new process has the potential to limit significantly overseas technology transfers, including joint ventures or licensing arrangements, through enhanced export controls and other restrictions.

3. **Codifies CFIUS’s focus on the acquisition of personal identifier information (“PII”) of U.S. citizens.** In recent years, CFIUS has carefully scrutinized transactions that may result in foreign investors’ access to large volumes of sensitive PII of U.S. citizens, as implicating significant national security concerns, and has blocked transactions on that basis.<sup>2</sup> FIRRMA codifies this practice and clarifies that any non-passive investment by a foreign person in a U.S. business that “maintains or collects sensitive personal data of

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<sup>2</sup> For example, in early 2018, CFIUS refused to approve a deal for Chinese Ant Financial Services Group to buy MoneyGram International Inc. due to concerns that Ant Financial would have acquired significant PII as a part of the transaction. Peter Rudegeair and Kate O’Keeffe, *U.S. Bars Merger of MoneyGram, China’s Ant Financial*, THE WALL STREET JOURNAL (Jan. 3, 2018), <https://www.wsj.com/articles/moneygram-and-ant-financial-halt-merger-deal-1514931496>. Even in cases where CFIUS clearance is ultimately received, such as China Oceanwide Holdings Group Co.’s acquisition of Genworth Financial, Inc., mitigation measures to prevent “personal consumer information becoming more vulnerable” have been necessary prerequisites to approval. Katherine Chiglinsky et al., *Genworth Wins U.S. National Security Approval for Chinese Sale*, BLOOMBERG (June 9, 2018), <https://www.bloomberg.com/news/articles/2018-06-09/genworth-wins-u-s-national-security-approval-for-chinese-sale>.

United States citizens that may be exploited in a manner that threatens national security” is now a covered transaction.

4. **Makes certain real estate transactions subject to review.** Under the prior rules, CFIUS had jurisdiction over real estate transactions only in circumstances where the acquisition of a U.S. business involved physical properties in close proximity to sensitive installations. FIRRMA now specifies that real estate transactions are deemed covered transactions if the property at issue (1) “is, is located at, or will function as part of, an air or sea port”; (2) is “in close proximity to a United States military installation or another facility or property of the United States Government that is sensitive for reasons relating to national security”; (3) could “reasonably provide the foreign person the ability to collect intelligence on activities being conducted at such installation, facility, or property”; or (4) could “otherwise expose national security activities at such an installation, facility, or property to the risk of foreign surveillance.” However, the bill also incorporates exemptions for certain real estate transactions involving (1) a single “housing unit,” as defined by the U.S. Census Bureau; or (2) real estate located in “urbanized areas,” as defined by the U.S. Census Bureau, subject to exceptions that CFIUS may determine in consultation with the Secretary of Defense.
5. **Clarifies that changes in rights can constitute a covered transaction.** Prior to FIRRMA, CFIUS had jurisdiction over “any transaction . . . by or with any foreign person[] which could result in control of a U.S. business by a foreign person.” 31 C.F.R. § 800.207. Under FIRRMA, the Committee’s jurisdiction is no longer limited to acquisitions. Instead, CFIUS jurisdiction will be triggered by “[a]ny change in the rights that a foreign person has with respect to a United States business in which the foreign person has an investment” that (1) results in foreign control of the United States business; or (2) falls within the newly created categories of covered transactions (*e.g.*, critical technology or critical infrastructure companies; or companies that collect PII of U.S. citizens). This expansion will necessitate careful review of intracompany transfers of shares and control rights to assess whether certain restructuring could result in CFIUS’s jurisdiction.
6. **Makes certain bankruptcy-related transactions subject to review.** Historically, CFIUS concerns have arisen predominantly in the mergers and acquisitions context. FIRRMA empowers CFIUS to scrutinize bankruptcy purchases, which could introduce new complications for, *inter alia*, U.S.-based debtors seeking to sell distressed assets. In particular, FIRRMA provides that CFIUS “shall prescribe regulations that clarify that the term ‘covered transaction’ includes any transaction” generally meeting the definition “that arises pursuant to a bankruptcy proceeding or other form of default on debt.”
7. **Clarifies treatment of certain indirect investment fund investments.** Importantly, FIRRMA clarifies that indirect investments by foreign persons through investment funds in the newly created categories of covered transactions will not automatically result in CFIUS jurisdiction, even if the foreign investor obtains representation on an advisory board or a fund committee. Indirect investments will not automatically trigger CFIUS jurisdiction where (1) the fund is managed by a U.S. general partner or a U.S. managing member (or equivalent); (2) the relevant advisory board or committee does not approve, disapprove, or control the fund’s investment decisions; (3) the foreign person does not otherwise have the ability to control the fund; and (4) the foreign person does not have access to material nonpublic technical information as a result of its advisory board or committee representation.
8. **Makes certain filings mandatory.** Prior to FIRRMA, the CFIUS regime was a voluntary process, meaning that no party was obligated to make a filing and seek pre-clearance. Under FIRRMA, parties are obligated to make filings before closing under certain circumstances, including an acquisition of a substantial interest in a United States critical technology company, a critical infrastructure company, or a company that maintains personal data of U.S. citizens, by a foreign person in which a foreign government has, directly or indirectly, a substantial interest. The bill states that CFIUS will define the term “substantial interest” later, and, in doing

so, directs the Committee to consider “the means by which a foreign government could influence the actions of a foreign person, including through board membership, ownership interest, or shareholder rights.”

9. **Extends the review process for most investors.** Prior to FIRRMA, CFIUS had 30 days to complete its initial review of a transaction, upon completion of which CFIUS could either clear the proposed transaction or proceed to a more detailed, 45-day follow-up investigation. Under FIRRMA, the initial 30-day review period is extended to 45 days. The 45-day investigation that follows the initial review period will remain unchanged, but the bill allows an additional 15-day investigation to be added in “extraordinary circumstances.” The net effect will be to extend the maximum review period from 75 days to 105 days.<sup>3</sup> Further, for transactions the Committee determines pose a risk to national security, CFIUS may now suspend the transaction until CFIUS completes its review. The consequence of these changes is that the CFIUS review process, and its attendant uncertainty, could stretch on longer (which may present a significant obstacle for non-U.S. investors participating in competitive bidding processes).
10. **Imposes a filing fee.** Parties previously did not have to pay a fee to submit a transaction to CFIUS for review. FIRRMA institutes a filing fee based on the value of the transaction, taking into consideration the effect of the fee on “small business concerns,” the expenses of the Committee, the effect of the fee on foreign investment, and “other such matters as the Committee considers appropriate.”
11. **Exemption of Intellectual Property Licensing and Support Transactions.** FIRRMA’s expansion of CFIUS review powers will not extend to “[t]he contribution (other than through an ordinary customer relationship) by a United States critical technology company of both intellectual property and associated support to a foreign person through any arrangement[.]” This decision ameliorates concerns expressed by the technology industry about routine licensing and support transactions being caught up in the CFIUS process. However, as noted above, the interagency review process on emerging and foundational technologies could create certain export control limitations on technology transfers. Technologies that may be a focus of this enhanced review process include robotics, semiconductors, and artificial intelligence, among others.
12. **Clarifies Unilateral Review of Transactions.** FIRRMA clarifies the circumstances in which CFIUS may initiate a unilateral review of a previously reviewed transaction.
  - Prior to FIRRMA, CFIUS could review a previously reviewed transaction if any party submitted false or misleading material information—or omitted material information or documents—*during the review or investigation phase*. Under FIRRMA, CFIUS may review a previously reviewed transaction if any party submits false or misleading material information—or omits material information or documents—*at any point in connection with CFIUS’s consideration of a transaction*.
  - Prior to FIRRMA, CFIUS could initiate a review of a previously reviewed transaction if any party *intentionally* committed a material breach of a mitigation agreement or condition. Under FIRRMA, CFIUS may review a previously reviewed transaction if any material breach of a mitigation agreement or condition occurs, *even if the breach was not intentional*.

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<sup>3</sup> In practice, both before and under FIRRMA, the review process can take significantly longer. Frequently, parties to a covered transaction will submit a draft joint voluntary notice to CFIUS, which will be resubmitted as a final joint voluntary notice upon receipt of feedback from the Committee. CFIUS may submit questions and information requests to the parties, which generally must be answered within three business days (or CFIUS may reject the parties’ voluntary notice, restarting the entire process). In addition, at any point, CFIUS may request that the parties refile their request for pre-clearance, which effectively restarts the entire process.

FIRRMA also requires CFIUS to establish a mechanism for identifying covered transactions for which a notice or declaration has not been filed and on which information is reasonably available.

- 13. Addresses Attempts to Circumvent or Evade CFIUS Review.** Prior to FIRRMA, the CFIUS regulations stated that the Committee will disregard “[a]ny transaction or other device entered into or employed for the purpose of avoiding” CFIUS review. In other words, where the parties to a covered transaction attempted to evade CFIUS review through restructuring or informal agreements, the Committee could look through such arrangements to assess the underlying transaction. FIRRMA expands the definition of “covered transaction” to include any “transaction, transfer, agreement, or arrangement . . . which is designed or intended to evade or circumvent” CFIUS review. This standard is subjective and, if broadly interpreted, could significantly expand CFIUS’s jurisdiction.

### Effective Date

Transactions completed before enactment of FIRRMA will not be subject to the new law. However, FIRRMA generally applies to any covered transaction for which CFIUS has not initiated an investigation or review, meaning, importantly, the certain key provisions—such as the modification of what qualifies as “critical technology”—apply immediately. Other provisions—including the mandatory filing requirements and the new rules with respect to real estate—will not take effect until the earlier of (i) the date that is 18 months after enactment, or (ii) 30 days after the Secretary of the Treasury certifies that the new regulations, and the organizational resources called for by the bill, are in place.

### Conclusion

FIRRMA represents the most significant effort to revise the CFIUS process in more than a decade. Although it will take time to determine the full effect of the new law, it is foreseeable that FIRRMA could present significant new obstacles to foreign investment in the United States.