CFIUS at a Crossroads:
Congress considers significant CFIUS reform on heels of CFIUS Annual Report and blocked Chinese semiconductor investment
Introduction

After a summer of discussion surrounding the U.S. government’s ability to control Chinese investment in U.S. companies, members of the House and Senate have introduced new legislation that seeks to improve the government’s national security review process. On November 8, 2017, a bipartisan group led by Sen. John Cornyn (R-TX) introduced the Foreign Investment Risk Review Modernization Act (“FIRRMA”), which would make significant changes to the Committee on Foreign Investment in the United States (“CFIUS” or “Committee”), an interagency committee responsible for assessing threats to U.S. national security posed by acquisitions of control in U.S. businesses by non-U.S. investors.

Among other changes, the bill would expand the scope of transactions subject to CFIUS review to include joint ventures and other transactions involving contributions of U.S. intellectual property, U.S. real estate transactions and other investments in U.S. technology or infrastructure companies. The new legislation seeks to shore up CFIUS jurisdiction by closing what some lawmakers view as a gap in existing authority. Under the current rules, investors have increasingly crafted transactions specifically to avoid the Committee’s reach.

By granting CFIUS the authority to review a wider variety of deals resulting in the transfer of industrial and technological capabilities to foreign investors, FIRRMA would allow the Committee to capture a greater share of the transactions that affect U.S. national security.

Sen. Cornyn and other supporters of the bill have described it as a response to the problem of “potential adversaries, such as China . . . degrading our country’s military technology edge by acquiring, and otherwise investing in, U.S. companies.”

The Senate is considering FIRRMA just weeks after CFIUS released its annual report to Congress detailing the Committee’s activities through 2015, the most recent year for which complete data on foreign investment in the United States is available. CFIUS also released high-level information regarding transactions reviewed in 2016. This information demonstrates a
continuation of recent trends, such as the growing number of reviews, the expanding timeframes of many reviews and the significant number of reviewed transactions involving Chinese investors.

The proposed legislation focuses new attention on CFIUS, which advised President Donald Trump to block a major Chinese investment in a U.S. semiconductor manufacturer in mid-September. After CFIUS conducted an extended review, President Trump blocked the proposed US$1.3 billion acquisition of Lattice Semiconductor, a U.S. chip manufacturer, by Canyon Bridge Capital Partners LLC, a Chinese-backed private equity fund. The action represents only the fourth time that a U.S. President has formally blocked a transaction on CFIUS’ recommendation (though it also represents the second time during the last year that a transaction was blocked due to concerns raised by CFIUS).

This report examines highlights from the CFIUS Annual Report, describes the Lattice Semiconductor transaction in detail and outlines the key changes that will result if and when FIRMA becomes law.

Background on CFIUS

CFIUS is an interagency committee principally comprising nine members, chaired by the Secretary of Treasury and tasked with reviewing transactions that could result in control of U.S. businesses by non-U.S. persons to determine the effect of such transactions on U.S. national security. CFIUS operates pursuant to the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 ("FINSA"), which defines a “covered transaction” as “any merger, acquisition, or takeover . . . by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.”

After receiving notice of a covered transaction, CFIUS commences a 30-day review and is authorized to conduct an additional 45-day investigation if warranted. CFIUS may also negotiate an agreement with any party to a covered transaction to mitigate perceived threats to national security. Once CFIUS completes its review — and at any time during a subsequent investigation — it may conclude that national security concerns raised by a transaction have been addressed adequately. If such concerns remain unaddressed at the conclusion of an investigation, however, CFIUS refers the transaction to the president for a decision. The president enjoys broad discretion in taking actions deemed appropriate to suspend, prohibit or unwind a covered transaction when acting based on credible evidence. The president must announce a decision within 15 days of referral by CFIUS.
Highlights from CFIUS Annual Report

The most recent CFIUS Annual Report covers transactions through 2015 and therefore does not reflect the blocking of proposed Chinese acquisitions of U.S. semiconductor businesses in 2016 and last month. CFIUS also released a table, however, that provides some high-level information regarding transactions reviewed by the Committee during 2016.

Highlights from the most recent report and accompanying table include:

**More covered transactions**

While the number of covered transactions reviewed by CFIUS remained steady from 2014 (147) to 2015 (143), there was a noticeable increase for 2016 (172). Information for 2017 will not be available for at least another year, but CFIUS is on pace to review more than 200 covered transactions during the current year, which would set a new record.

**More investigations**

CFIUS conducted “investigations” of covered transactions — resulting in an additional review period of up to 45 days — at a higher rate in 2015 and 2016 than in prior years. CFIUS conducted investigations of approximately 45% of the 315 transactions it reviewed in 2015 and 2016 combined, representing an increase of nearly 10% from 2014. This trend, combined with recent resource shortages at CFIUS and an increase in transactions being reviewed by the Committee this year, suggests that parties filing notices of covered transactions have less reason to expect CFIUS to conclude its review at the end of the initial 30-day review period and should instead expect that CFIUS will make use of some or all of the subsequent 45-day investigation period.

**More deals withdrawn and abandoned due to CFIUS concerns**

The number of notifications that have been withdrawn, as well as withdrawn and refiled, has steadily increased in recent years. Seven notices were withdrawn and refiled in 2014, a number that rose to nine in 2015 and 15 in 2016. There has also been a steady increase in the number of deals abandoned due to national security concerns raised by CFIUS — from two in 2014 to three in 2015 to five in 2016.
Many reviews pertaining to China, Canada and the United Kingdom

Chinese investors have submitted more notifications to CFIUS each year since 2012, and CFIUS continues to review more transactions involving China than any other country each year. In 2015, Chinese investors submitted 29 transactions for review, up from 24 in 2014. As in 2014, Canada and the United Kingdom submitted the second and third most transactions of any country in 2015, with Canadian acquirers submitting 22 transactions (up from 15) and UK acquirers submitting 19 (down from 21).

Continuing focus on transactions in the manufacturing sector

The annual report’s data on covered transactions by sector indicates the attention that CFIUS continues to pay to manufacturing. In 2009, manufacturing, finance, information and services; and mining, utilities and construction each accounted for around a third of CFIUS’s review total. Since then, the share of manufacturing transactions has grown, with 68 (48% of the total) submitted in 2015. Within the manufacturing sector, computer and electronic products have accounted for by far the most CFIUS filings since 2011, with 33 covered transactions in 2015.
Foreign Investment Reform Efforts

In October and November 2017, the Senate introduced two bills to strengthen the U.S. government’s approach to reviewing the acquisition of U.S. companies by foreign entities. One bill regulates foreign investment based on the economic impact in the U.S., and the other focuses on national security safeguards through CFIUS reform. Reform discussions gathered momentum last summer amid mounting concerns about increased investment by Chinese companies. In 2016, Chinese investment in the United States grew to US$46 billion, with acquisitions ranging from movie theaters to technology start-ups. A March 2017 Pentagon report indicated U.S. government concerns regarding China’s increased interest in technology investment. In a June speech at the Council on Foreign Relations, Sen. Cornyn referred to growing investment by Chinese firms in robotics and artificial intelligence as he described the need for CFIUS reform.

Foreign Investment Review Act

On October 18, 2017, Senators Sherrod Brown (D-OH) and Chuck Grassley (R-IA) introduced the Foreign Investment Review Act (“FIRA”). Under FIRA, the Department of Commerce (“Commerce”) would review certain investments that could result in foreign control of a U.S. entity. Unlike FIRRMA, this bill introduces a review process that is distinct from CFIUS,
focusing on the impact of each proposed transaction on the economic interests of the United States, rather than its national security.

FIRA's proposed review process would apply to all transactions valued at or above US$1 billion that would result in foreign control of a domestic entity. For transactions involving foreign state-owned enterprises, the threshold for notification would be only US$50 million. Unlike existing CFIUS rules, where notification is ostensibly voluntary, FIRA would introduce mandatory notification obligations. In reviewing each transaction, Commerce would consider the long-term economic interests of the United States, the history of distortive trade practices in each country where a foreign party is domiciled and the impact of the transaction on domestic industry, among other factors.

FIRA also relates tangentially to the CFIUS review process, as the bill would allow coordination between Commerce and CFIUS when transactions require both economic and national security review. The most significant collaboration required under FIRA would be between Commerce and the U.S. Trade Representative, who would provide a report regarding the relationship between the United States and the relevant country.

**Foreign Investment Risk Review Modernization Act**

FIRRMA, a proposal to reform CFIUS itself, followed in November. Senators Cornyn, Dianne Feinstein (D-CA) and Richard Burr (R-NC), among others, sponsored FIRRMA in the Senate, and Rep. Robert Pittenger (R-NC) introduced a companion bill in the House of Representatives, also with bipartisan support. Supporters of the bill say that it is intended to prevent China and other potential adversaries from exploiting gaps in the current CFIUS process to siphon off critical U.S. technologies and undermine U.S. military capabilities through transactions that fall outside of CFIUS' current authority.

Congress is expected to hold hearings on the bill within the next few months — based on strong bipartisan support of the bill, it is expected to become law in early 2018. No changes to the CFIUS process will occur, however, until the Treasury Department issues implementing regulations and the Secretary of Treasury affirmatively certifies that CFIUS has adequate resources to enforce its expanded mandate.

The additional resources requirement is expected to be a significant factor — while CFIUS is expected to review more than 200 transactions during 2017 (far surpassing the previous high), it is estimated that the number of annual filings reviewed by CFIUS under the bill's expanded mandate could easily surpass 1,000 per year.

Key provisions of the bill include:

**Expanded jurisdiction for CFIUS**

While current law limits CFIUS' jurisdiction to transactions that would result in the acquisition of foreign control of a U.S. company, the new bill would expand the definition of “covered transactions” to include:

- Purchases and leases of real estate in close proximity to military bases and national security facilities.
- “Non-passive” investments in critical technology and infrastructure companies.
- Changes in investor rights that would result in foreign control of a U.S. business or a non-passive investment in critical infrastructure or technology.
- Joint ventures involving the transfer of “intellectual property and associated support” to a foreign entity.
- Transactions and arrangements otherwise “designed or intended to evade or circumvent” CFIUS review.
New consideration of “countries of special concern”
FIRRMA introduces the concept of “countries of special concern,” defined as those that “pose[] a significant threat to the national security interests of the United States.” CFIUS must make certain assessments with special attention to these countries, as described below.

More factors for CFIUS to consider
Under current law, CFIUS considers a list of 10 factors in assessing transactions. FIRRMA amends some of these factors and expands the list to include nine additional factors. The new considerations include:

- The potential for resulting increases to the U.S. government’s cost of maintaining equipment and systems necessary for defense, intelligence and national security.
- “The 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.”
- The acquirer’s history of compliance with U.S. laws and regulations and adherence to contracts with U.S. government entities.
- The likelihood that the transaction would expose sensitive data of U.S. citizens to foreign governments or persons that may exploit such information.
- The possibility of new or greater cybersecurity vulnerabilities.
- Whether the transaction will result in a foreign government “gaining significant new capability to engage in malicious cyber-enabled activities against the United States,” with specific reference to effects on U.S. elections.
- The involvement of a country of special concern with a “strategic goal of acquiring a type of critical technology” that a U.S. party possesses.
- The likelihood of facilitating “criminal or fraudulent activity affecting national security.”
- The likelihood that the transaction would expose sensitive national security information, procedures, or operations to foreign entities.
Streamlined filing procedures
FIRRMA would enable parties to file “declarations” in place of complete notices to CFIUS. These submissions generally would be voluntary and would not necessarily trigger CFIUS review; rather, the Committee would have the option of requesting more information, launching a review, or notifying the parties of no further action. FIRRMA further specifies that voluntary declarations will generally be no longer than five pages. Notably, such declarations would be mandatory for covered transactions involving the acquisition of a 25 percent or greater voting interest in a U.S. business by any foreign person in which a foreign government holds a voting interest of 25 percent or more.

Discretionary measures
Both CFIUS and the president would receive new discretionary authority under FIRRMA. The law would enable the Committee to promulgate new regulations partially exempting investors from certain countries. To establish such exemptions, CFIUS would need to consider factors such as the country’s involvement in treaties or other national security arrangements with the United States and the country’s own foreign investment review process. In addition to the president’s existing authority to take steps to suspend or prohibit a transaction, FIRRMA would also enable the president to “take any additional action the President considers appropriate to address the risk to the national security of the United States” caused by a proposed transaction.

New risk mitigation and compliance enforcement tools
The bill would give CFIUS new authority to implement risk mitigation measures, including imposing interim mitigation agreements while review is pending and imposing conditions even when parties abandon a transaction. The Committee would also be tasked with establishing new plans for monitoring compliance with such agreements.

Transparency and information sharing
Under FIRRMA, CFIUS would be required to add greater detail to its unclassified annual reports, including descriptions of the outcomes of each review, basic information on transacting parties, the existence of mitigation agreements and data on monitoring and enforcement actions. In addition, new rules would clarify the information that CFIUS can share with other agencies or foreign governments.

Resources
With growing transaction notices each year, FIRRMA would establish a new CFIUS Fund. The Fund would partially draw from new CFIUS filing fees, to be set by regulation at a later date but not to exceed the lesser of (i) one percent of the value of the transaction or (ii) $300,000 (adjusted annually for inflation). CFIUS would use this funding to hire new staff outside the established civil service hiring process.

How Dechert can assist
Parties to transactions involving foreign acquisitions of stakes in U.S. manufacturing, technology, or other industries of concern to CFIUS should strongly consider availing themselves of the voluntary CFIUS notification process. Dechert has represented many clients through CFIUS reviews, including major players in the energy, telecommunications, high technology, defense and infrastructure industries. Dechert regularly advises foreign and domestic entities (“buyers” and “sellers,” as well as other interested third parties) through the CFIUS review process, helping them to: determine whether or not to bring a transaction before the Committee, assemble the required information and materials for a voluntary filing and then (as necessary) negotiate national security agreements with CFIUS in a manner that minimizes both delay and the imposition of conditions that might threaten the transaction. The firm also gives counsel on strategies for identifying and addressing political and policy considerations that may arise.
Contact us

Jeremy B. Zucker  
Partner  
+1 202 261 3322  
jeremy.zucker@dechert.com

Hrishikesh N. Hari  
Associate  
+1 202 261 3347  
hrishikesh.hari@dechert.com

Darshak S. Dholakia  
Associate  
+1 202 261 3467  
darshak.dholakia@dechert.com

Jacob Grubman  
Associate  
+1 202 261 3445  
jacob.grubman@dechert.com

The authors would like to thank Eric Auslander for his contributions to this report.

© 2017 Dechert LLP. All rights reserved. This publication should not be considered as legal opinions on specific facts or as a substitute for legal counsel. It is provided by Dechert LLP as a general informational service and may be considered attorney advertising in some jurisdictions. Prior results do not guarantee a similar outcome. We can be reached at the following postal addresses: in the US: 1095 Avenue of the Americas, New York, NY 10036-6797 (+1 212 698 3500); in Hong Kong: 31/F Jardine House, One Connaught Place, Central, Hong Kong (+852 3518 4700); and in the UK: 160 Queen Victoria Street, London EC4V 4QQ (+44 20 7184 7000). Dechert internationally is a combination of separate limited liability partnerships and other entities registered in different jurisdictions. Dechert has more than 900 qualified lawyers and 700 staff members in its offices in Belgium, China, France, Germany, Georgia, Hong Kong, Ireland, Kazakhstan, Luxembourg, Russia, Singapore, the United Arab Emirates, the UK and the US. Further details of these partnerships and entities can be found at dechert.com on our Legal Notices page.