

# CHANGES TO CFIUS REVIEWS ARE COMING, LIKELY SOONER THAN LATER

Proposed legislation that would sharpen the law governing U.S. national security reviews by the Committee on Foreign Investment in the United States (CFIUS) continues to move through Congress with bipartisan support, and seems destined to become law in the next several months. Bills approved recently by committees in both houses of Congress continue to focus on increasing scrutiny of foreign investments in U.S. critical technology companies and investments by Chinese companies, although some of the more draconian measures included in the original bill have been stripped. Most noticeable among the changes is a retreat from an attempt to extend CFIUS jurisdiction to outbound investments such as joint ventures located abroad. The committee bills would instead address such extraterritorial concerns by making changes to U.S. export control laws.

In many ways, the committee-approved legislation gives CFIUS more authority to accomplish what it already has been doing-- focusing on technology sectors, China, access to personal information and investments in companies in proximity to sensitive U.S. Government facilities. Among the more important proposed changes to U.S. law are the following:

## OUTBOUND INVESTMENT

The original bills in both Houses of Congress included a controversial provision that would have extended CFIUS jurisdiction to certain outbound investments, including joint ventures when they include the “contribution by a United States critical technology company of both intellectual property and associated support to a foreign person.” A range of U.S. companies lobbied against this provision. As a result, the committee-approved bills would instead address this issue through U.S. export controls, focusing on emerging and foundational technologies that are essential to national security. The Senate bill requires the Secretary of Commerce to establish appropriate export controls regarding such technologies that at a minimum require licenses for exporting emerging and foundational technologies to a country “subject to an embargo, including an arms embargo, imposed by the United States.” That provision is clearly aimed at China, which has been subject to a U.S. arms embargo dating back to 1989, and also would apply to Russia. The bill instructs the President to

# SHEARMAN & STERLING

create an interagency process to identify emerging and foundational technologies that “are essential to the national security of the United States” and are not already identified by current U.S. law governing CFIUS.

While moving away from asserting extraterritorial jurisdiction, it is clear that Congress wants to have an impact on the transfer of technology and intellectual property in certain sectors and to certain countries. The proposed legislation seems to give the Administration broad latitude in identifying emerging and foundational technologies. While it will take some time for the U.S. Commerce Department, which administers the Export Administration Regulations, to go through the process of making any changes to existing practice, those changes could affect a wide range of transactions. It will be important for U.S. and foreign companies entering joint ventures or similar business arrangements to consider all export control implications before closing a transaction.

## US Critical Infrastructure and Critical Technology Companies

Both committee-approved bills focus extensively on foreign investments in U.S. critical technologies and critical infrastructure. The Senate bill would extend, with potentially some exceptions for U.S. allies, CFIUS jurisdiction to all foreign investments in U.S. critical technology or critical infrastructure companies except “passive investment.” That exception would only apply when the investor would not have access to non-public technical information, could not appoint a board member or board observer to the U.S. business and would have no governance rights beyond voting its shares. The Senate bill defines critical technologies as “technology, components, or technology items that are essential or could be essential to national security.” The definition includes, among other things, emerging and foundational technologies and articles and services subject to the International Traffic in Arms regulations.

Under current law, CFIUS jurisdiction extends to transactions that could result in control of a U.S. business by a foreign person, an analysis focused on whether the foreign person could make major decisions for the U.S. business. The Senate bill would eliminate the control analysis for certain critical infrastructure and critical technology investments and provide a narrow approach to passivity. It is clear that Congress wants to define critical technologies and emerging technologies as broadly as possible, and the Trump Administration will certainly accommodate Congress in proscribing implementing regulations. All investments in technologies that arguably have a connection to national security could be drawn into the new restrictions.

## CHINA

As demonstrated above, the committee-approved bills are still clearly focused on Chinese investment. The Senate bill includes a “Sense of the Congress” that CFIUS should consider “whether a transaction involves a country of special concern that has a demonstrated or declared the strategic goal of acquiring a type of critical technology or critical infrastructure that would affect United States technological and industrial leadership in areas related to national security.” It defines country of special concern as “a country that poses a significant threat to the national security of the United States.” The original author of the Senate bill has made clear that this is focused on China, although in practice CFIUS does apply closer scrutiny to Chinese investments, anyway. The Senate committee-approved legislation also directs the U.S. Department of Commerce to send to Congress a biennial report on Chinese direct investment in the United States, while at the same time tasking CFIUS with coming up with regulations that would in certain cases exempt U.S. allies from having to make a

# SHEARMAN & STERLING

CFIUS filing. The House bill is not identical to the Senate, but both have a focus on China and “countries of special concern.”

This does not mean that no Chinese investments will be approved by CFIUS, but it does mean that Chinese investors will have to look carefully at the sector in which they are investing, and may have to compromise on the extent to which they acquire governance in such investments, and consider structures that include U.S. persons as general partners, as discussed below. Investments in critical and emerging technologies will be especially difficult.

## REAL ESTATE TRANSACTIONS

Both the Senate and House bills retain, with limited exclusions, provisions that would make certain real estate transactions subject to CFIUS jurisdiction, including those involving property located at U.S. ports; or those in close proximity to U.S. military installations or sensitive U.S. Government facilities when such proximity could expose national security activities there.

This is another example in which the proposed bills would extend CFIUS jurisdiction without a control analysis. Again, CFIUS was already headed in this direction, having twice stopped Chinese investments in businesses located near sensitive U.S. Government facilities. Parties to transactions involving real property assets spread across a wide swath of the United States, such as wind farms, apartment complexes and retail chains, should as part of due diligence investigate the locations of each of those assets to check for proximity to sensitive U.S. facilities. Certain investors may have to divest any interest in properties located in sensitive locations. The provision does not apply to sale or lease of single housing units or those in urban areas as defined by the proposed legislation.

## PERSONAL INFORMATION AND CYBER SECURITY

The Senate-committee bill expresses the sense of Congress that the factors to be considered by CFIUS in making a national security determination should be expanded to include the following: the extent to which the covered transaction is likely to expose identifiable information, genetic information, or other sensitive data of United States citizens to foreign investors; and, whether the covered transaction is likely to have the effect of creating any new cyber security vulnerabilities in the United States or exacerbating existing cyber security vulnerabilities. The House bill would mandate that CFIUS consider similar factors.

Parties involved in foreign investments in U.S. cloud-computing companies or companies that have access to consumer or health data and personal information of U.S. citizens must consider the CFIUS implications such investments, which along with critical technology companies could be the next intense focus of the committee.

## PASSIVE INVESTMENTS

Although CFIUS has extraordinary discretion under U.S. law, one bright line has been the regulatory “safe harbor” for ownership interests of ten percent or less voting interest in a U.S. business as long as the interest is otherwise passive. The Senate bill specifically rejects any definition of passive investment defined by any lower equity limit in transactions involving critical infrastructure or critical technologies. It does, however envision exemptions in certain cases in which a foreign investment is

# SHEARMAN & STERLING

made through an investment fund managed exclusively by a general partner that is not a foreign person.

This will further limit those situations in which foreign investments are beyond the reach of CFIUS. Businesses should note, however, that foreign investments in many sectors and from private companies from most countries will still be subject to traditional control and national security analyses.

## INVESTMENTS INVOLVING FOREIGN GOVERNMENTS

Adding to existing rules requiring different treatment for investments by foreign governments, the Senate bill requires short-form filings for acquisitions of U.S. critical infrastructure or critical technology companies by foreign companies with substantial foreign-government ownership. CFIUS can require that the parties to such a transaction later submit a full CFIUS notice.

This is an extension of one of the primary focuses of the Foreign Investment and National Security Act of 2007, which was the last time Congress amended the statute governing CFIUS.

## FILING CHANGES

The Senate bill requires parties to a covered transaction to include a copy of any partnership agreements, integration agreements, or other side agreements relating to the transaction, including agreements relating to the transfer of intellectual property. The bill would, for the first time, require substantial fees for companies engaged in a CFIUS review.

This is designed to give CFIUS more resources and an indication of the increase in reviews and investigations Congress is expecting to result from the proposed legislation. Without such funding, whether through fees or appropriations, the proposed legislation is likely to further bog down the CFIUS process.

## ECONOMIC IMPACT

The most important amendment coming out of the parallel House markup would require CFIUS to consider the impact of a proposed transaction on U.S. employment levels and skill retention.

This would be a major leap for national security legislation and would seem to be something more appropriately handled through U.S. trade laws. It may not survive in whatever version of this legislation reaches the President's desk. Congress is of several minds on this issue, however. The Trump Administration has clearly made economic impact a national security consideration in the context of investigations on imports of steel, aluminum, autos and auto parts. Some in Congress are proposing legislative change to narrow the definition of national security in this context, others are proposing Congressional oversight over this growing trend and still others are proposing to take no action at all.

## CONCLUSION

While timing is unclear, enactment of CFIUS reform legislation is very likely. It is an election year, and both parties and both houses of Congress want to show their constituents that they support CFIUS

# SHEARMAN & STERLING

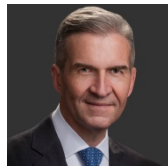
reform legislation. The Trump Administration shares this enthusiasm. The Senate bill has been attached to the defense spending bill and the House legislation is a stand-alone bill. It is expected that the two bills will be reconciled in conference and the final version attached to the defense spending bill, which is critical legislation that will almost certainly be signed into law, likely before the mid-term elections.



**ROBERT LARUSSA**  
Counsel, Litigation  
+1 202 508 8180  
rlarussa@shearman.com



**LISA RAISNER**  
Head of Government  
Relations  
+1 202 508 8049  
lraisner@Shearman.com



**GEORGE CASEY**  
Global Co-Managing Partner  
Head of Global M&A  
+1 212 848 8787  
gcasey@shearman.com



**SCOTT PETEPIECE**  
Head of Americas M&A  
+1 212 848 8576  
spetepiece@shearman.com



**ROBERT KATZ**  
Partner, M&A  
+1 212 848 8008  
rkatz@shearman.com



**RICHARD FISCHETTI**  
Partner, M&A  
+1 212 848 5179  
rfischetti@shearman.com

ABU DHABI • AUSTIN • BEIJING • BRUSSELS • DUBAI • FRANKFURT • HONG KONG • HOUSTON • LONDON • MENLO PARK • MILAN • NEW YORK  
PARIS • ROME • SAN FRANCISCO • SÃO PAULO • SAUDI ARABIA\* • SHANGHAI • SINGAPORE • TOKYO • TORONTO • WASHINGTON, DC

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

Attorney Advertising. This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

@ 2018 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong. Attorney Advertising — Prior results do not guarantee a similar outcome. \*Dr. Sultan Almasoud & Partners in association with Shearman & Sterling LLP