Hogan Lovells

CFIUS reform clears another hurdle–legislation could be on President's desk by August

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Driven by concerns of China's acquisition of advanced U.S. technologies, the U.S. Congress is set to enact the most significant reform to the Committee on Foreign Investment in the United States (CFIUS) in over a decade. CFIUS is the U.S. interagency committee that conducts national security reviews of foreign investments. Once implemented through regulations, the changes would expand the kinds of transactions subject to CFIUS review, place greater scrutiny on inbound investments in and outbound transfers of critical and emerging technologies, and make CFIUS filings mandatory for certain transactions.

On 26 June, the U.S. House of Representatives passed H.R. 5841, the Foreign Investment Risk Review Modernization Act (FIRRMA). This action came on the heels of the U.S. Senate earlier this month passing its own version of FIRRMA, which was incorporated into H.R. 5515, the John S. McCain National Defense Authorization Act for Fiscal Year 2019. A conference committee will reconcile the differences between the two versions of the legislation, which is expected to reach the President's desk for signature around 1 August. CFIUS will then write the statute's implementing regulations, a process that could take up to two years according to a congressional source.

Under the proposed reforms, set forth in companion legislation moving through both chambers of the U.S. Congress, the statute will remain focused on national security rather than incorporating an economic benefits test that the AFL-CIO, the U.S.-China Economic and Security Review Commission, and other parties have advocated for during the legislative process. The national security standard notwithstanding, the prospect of FIRRMA reaching President Trump's desk is sure to further ratchet up tensions over international trade policy between Washington and Beijing.

Perhaps in an attempt to soften the blow of FIRRMA being enacted by the Congress, President Trump announced on 27 June that the U.S. would forego additional planned investment restrictions and enhanced export controls on China. President Trump asserted that, upon reviewing the bill, FIRRMA provides a sufficient basis on which "to combat the predatory investment practices that threaten our critical technology leadership, national security, and future economic prosperity." He further stated that, upon enactment, he would direct his Administration to "implement it promptly and enforce it rigorously, with a view toward addressing the concerns regarding state-directed investment in critical technologies identified in the Section 301 investigation."1

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1 The Office of the U.S. Trade Representative (USTR) is currently conducting an investigation under Section 301 of the Trade Act of 1974 to "determine whether acts, policies, and practices of the Government of China related to technology transfer, intellectual property, and innovation are

Proposed reforms

To more easily understand the state of current law and the proposed changes in the House and Senate bills, the following is an explanation of FIRRMA's most consequential reforms and their significance. Among other related statutes, FIRRMA would amend the statute governing CFIUS, the Defense Production Act of 1950 (DPA).

1. Covered transactions

Current law: CFIUS may review any transaction that could result in "control" of a U.S. business by a foreign person. "Control" in 31 C.F.R. § 800.204(a) is broadly defined as the power to "determine, direct, or decide important matters affecting an entity," meaning the power to take such action as selling principal assets, ordering mergers or reorganizations, firing officers, conducting major expenditures, or selecting new business ventures.

Proposed changes: The House and Senate bills would expand what constitutes a "covered transaction" subject to CFIUS jurisdiction to include not only mergers and acquisitions that result in foreign control of a U.S. business, but also:

1. non-passive investments by a foreign person in any U.S. critical technology or critical infrastructure company;
2. certain changes in a foreign investor's existing rights in a U.S. business;
3. the purchase or lease of certain real estate located at ports or in close proximity to military or other sensitive national security facilities; and
4. transactions designed to circumvent or evade CFIUS review.

Significance: Many non-passive foreign investments arguably are "covered transactions" under current law, but the House and Senate bills now explicitly cover such investments. CFIUS may now have the power to review a foreign person's investment in a U.S. company more than once if the foreign person's rights in the company change.

2. Outbound transfers of emerging and foundational technologies

Current law: Exports and re-exports of dual-use and commercial technologies are regulated by the Commerce Department under the Export Administration Regulations. The DPA does not control export or re-exports of dual-use or commercial technologies.

Proposed changes: FIRRMA, as originally introduced in November 2017, expanded the definition of "covered transaction" to include certain outbound transfers by a U.S. critical technology company to a foreign person of intellectual property and associated support through a joint venture or other arrangement. The House (Sec. 818) and Senate (Sec. 1725) bills stripped out this provision and replaced it with an enhanced export licensing regime for "emerging and foundational technologies" to be identified through a White House-led interagency process. The export licensing review process under the new regime would include a national security threat

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unreasonable or discriminatory and burden or restrict U.S. commerce." If USTR makes an affirmative determination that such conduct is occurring, Section 301 gives USTR broad authority take punitive action against the offending country.

analysis by the Director of National Intelligence and, if the export or re-export involves a joint venture or other collaboration agreement, a potential review of the foreign ownership of the foreign person involved in the transaction. The process will not be run by CFIUS, but instead by an interagency committee chaired by the Commerce Department. The House bill also includes a much broader set of export control reform provisions unrelated to CFIUS (Title VIII).

Significance: The "emerging and foundational technologies" export licensing regime has the potential to significantly restrict U.S. companies' outbound transfers of technologies that are important for commercial, as opposed to national security, reasons. Given the discretion granted to the Executive Branch to define and control the transfer of "emerging and foundational technologies," the legislation is also a leap into the unknown regarding new restrictions on the ability of U.S. companies to transfer key technologies to overseas joint ventures or through licensing agreements with foreign customers and business partners. Because this export licensing regime could hit certain industries harder than others, it will be important for companies to track and submit comments on the administration's efforts to identify and control the export of these technologies. Emerging technologies whose links to U.S. national security the administration and Congress previously have highlighted include the semiconductor, robotics, artificial intelligence, nanotechnology, and biotechnology sectors, among others. It is not clear whether the broader set of export control reform provisions in the House bill will make their way into the final legislation.

3. Passive investments

Current law: CFIUS regulations create a "safe harbor" exception for foreign investments in which the foreign person holds 10 percent or less of the outstanding voting interest in a U.S. business and the investment is "solely for the purpose of passive investment," a term that is not clearly defined in the regulations.

Proposed changes: The Senate bill states that "truly passive" investments pose "little or no risk" to national security (Sec. 1702) and that foreign passive investments in critical technology or critical infrastructure companies are not "covered transactions." Passive investments in the Senate bill include those by foreign persons in U.S. critical technology or critical infrastructure companies whereby the foreign person would not receive or have: access to "material nonpublic technical information"; a governance position or observer rights in a U.S. business; the power to make substantive decisions about the U.S. business, except through the voting of shares; or a material parallel strategic partnership or other material financial relationship with the U.S. business (Sec. 1703). The Senate bill also provides specific criteria for satisfying the passive investment definition, including in the context of foreign companies investing in U.S. investment funds (Sec. 1703). Instead of defining a "passive investment," the House version targets certain transactions from "countries of special concern" that would disclose sensitive personal data or "material nonpublic technical information," or transfer to a foreign person "substantive decision making" over sensitive data, critical technologies, critical infrastructure, or the management or operation of critical infrastructure (Sec. 201).

Significance: The Senate bill's exceptions to the definition of passive investment are aimed squarely at Chinese investors, as Congress and the executive branch have expressed grave concerns about forced technology transfers to China and certain Chinese minority investments in critical technology companies that give investors leverage over U.S. businesses. Nonetheless, the Senate

bill provides greater clarity for U.S. private equity funds, which may be able to be structured in a way that qualifies foreign limited partners as passive investors.

4. From voluntary to mandatory (in some circumstances)

Current law: The DPA does not mandate that parties with "covered transactions" file with CFIUS, although CFIUS may request that the parties file or may review "covered transactions" on its own.

Proposed changes: The House (Sec. 302) and Senate (Sec. 1706) bills provide for a new procedure whereby foreign investors would be required to submit mandatory "light filings" to CFIUS for certain foreign government-backed transactions involving the release of critical technologies (House version) or an investment in a critical infrastructure or critical technology company (Senate version). These mandatory declarations would be limited to five pages, and CFIUS would have 30 days to decide whether to clear the transaction, request that the parties file a full notice, or conduct its own review.

Significance: The mandatory declarations, with their linkage to foreign investors in which foreign governments have a "substantial interest," are also aimed squarely at Chinese investors, among others. Many Chinese companies, including publicly traded ones, have Chinese government shareholders. In the past, foreign investors always had the option of foregoing a CFIUS filing, but under the House and Senate versions, that option will no longer be available for certain foreign investors.

5. Exemptions for "whitelist" countries

Current law: The DPA grants CFIUS jurisdiction over all "covered transactions," regardless of the nationality of the prospective foreign investors.

Proposed changes: One major difference between the Senate and House versions is that the Senate bill contains possible exemptions from the definition of "covered transaction" and from the mandatory declarations for foreign investors from allied countries. Specifically, the Senate bill (Secs. 1703, 1706) directs CFIUS to identify factors to be considered for these exemptions, including foreign investors from: countries with a parallel foreign investment review process (in the sole judgment of the committee); countries that are NATO members or "major non-NATO" allies; countries that adhere to certain nonproliferation regimes; and/or countries whose investments, if excluded, would not further U.S. national security objectives. The House's version does not contain these exemptions.

Significance: If the Senate bill's allied country exemptions are included in the final legislation, they could provide significant regulatory relief to allied country investors and, over time, reduce (or limit the increase in) CFIUS's heavy case load.

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We will continue to monitor this space closely and report back if and when FIRRMA is signed into law. In addition to FIRRMA, we are also closely monitoring activity in the European Union related to enhanced screening mechanisms for foreign direct investment. The European Commission,

European Parliament and Council of the EU are set to begin work on agreeing to legislation that could be formally adopted as early as 2019.

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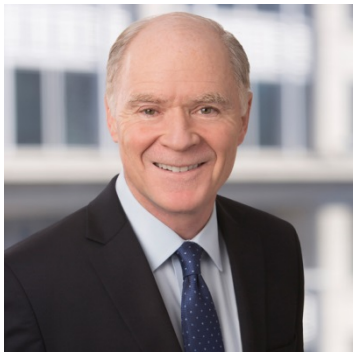

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