

Decoupling From China Part 1: Legislation And Funding

By **Jamie Gorelick, Stephen Preston and Matthew Ferraro**

The COVID-19 pandemic and the serious supply chain vulnerabilities it exposed have led to a seismic shift in U.S. policy and regulation, from stepped-up measures to protect U.S. technology, intellectual property and data from theft or acquisition by China to a new national imperative to end U.S. dependence on China for strategically important materials, components and products.

In this three-part article, we provide a comprehensive discussion of the security-driven, China-focused policy and regulatory developments affecting private sector businesses, with particular attention to recent changes addressing U.S. supply chain concerns. We discuss key U.S. policy and regulatory developments and the consequences for private sector businesses, focusing on potential opportunities, as well as regulatory and enforcement risks.

Part one focuses on legislation and federal funding to promote onshoring and Committee on Foreign Investment in the United States review of foreign direct investment to impede offshoring.

Part two focuses on security requirements to protect supply chains, U.S. export controls to protect technologies and consequences for international trade.

Part three focuses on oversight and enforcement, and the impact of the 2020 U.S. presidential election.

These policy changes have not appeared out of thin air. Beginning in 2018, the U.S. government launched a broad and sustained campaign to block China's access to advanced U.S. technologies and counter its efforts to compromise sensitive government information and defense systems.[1]

Over the past two years that campaign has grown so much in scope and intensity that it has become a distinct phenomenon: a determined, wide-scale and bipartisan movement to revisit the globalization of supply chains integral to the free trade regime that has prevailed, with the support of both U.S. political parties, for decades, seeking to reverse in significant respects the integration of the American and Chinese economies.

Beyond increasingly robust efforts to protect existing U.S. advantages in technology, the government is now trying to regain what the U.S. has lost to China — critical production capability — and otherwise ensure that the country will have or can get what it needs in the future without relying on China-controlled supply chains. The intended result has been described as an economic decoupling from China and the onshoring of industries, to eliminate vulnerability to single points of failure and provide reliable domestic — or at least friendly — sources of supply.[2]

Legislation and Federal Funding to Promote Onshoring



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The Coronavirus Aid, Relief and Economic Security, or CARES, Act and the Defense Production Act — through the U.S. International Development Finance Corporation — provide businesses the opportunity to obtain federal funding to build or rebuild industrial-base capabilities and supply chains in the U.S.

Additional opportunities may be presented by provisions addressing U.S. dependence on foreign manufacturing in the next National Defense Authorization Act for fiscal year 2021 and in proposed follow-on COVID-19 relief legislation, some industry specific — for example, medical supplies, semiconductors, rare earth minerals.

In recent years, both Congress and the Trump administration have acted to promote the onshoring of U.S. manufacturing, particularly as related to such industries as pharmaceuticals, semiconductors, aluminum and steel. The COVID-19 pandemic has accelerated these onshoring efforts, particularly given China's dominance of certain medical-supply markets.

For example, Congress has included provisions intended to discourage outsourcing in its COVID-19 relief efforts, and the Trump administration has used the DPA to encourage domestic production and support domestic supply chains for resources needed to combat the pandemic.

Congress has also included proposals to promote onshoring in pending legislation, such as the National Defense Authorization Act for fiscal year 2021. Although congressional Republicans and Democrats differ on some of the specifics, as a general matter, there is wide bipartisan support for these types of initiatives.

In March, Congress passed and the president signed into law the CARES Act, a \$2.2 trillion economic stimulus bill to address the economic impact of the COVID-19 pandemic. The law represented the largest economic stimulus package in American history,[3] and it included explicit efforts to prevent the offshoring of American economic activity.

Specifically, in Title IV of the CARES Act, Congress authorized the U.S. Department of the Treasury to implement a program to provide direct loans to midsize businesses negatively impacted by the pandemic. However, the CARES Act requires the Treasury to condition the loans on certifications that loan recipients will not outsource or offshore U.S. jobs.

In May, the president took a more overt step to promote onshoring by issuing an executive order delegating authority under the DPA to the U.S. International Development Finance Corporation to support domestic industrial base capabilities needed to respond to COVID-19. The order provided the IDFC with authority to make loans that would create, maintain, protect, expand or restore domestic industrial base capabilities that support the national response to and recovery from the COVID-19 outbreak or "the resiliency of any relevant domestic supply chains." [4]

And in August, President Donald Trump signed an executive order requiring the federal government to purchase certain essential drugs from U.S. manufacturers rather than from overseas companies, particularly in China.[5]

In July, the U.S. House of Representatives and the U.S. Senate passed their respective versions of the fiscal year 2021 NDAA, and both bills include provisions to promote onshoring.

For example, the Senate bill would afford new authority to the U.S. Department of Commerce to provide grants to covered entities to construct, expand or modernize facilities related to semiconductor manufacturing and research and development.

The House bill includes a similar provision. While the two bills must be reconciled in conference, the conferees are expected to retain the semiconductor provisions in the final bill.[6]

Congress also considered the inclusion of onshoring provisions in a follow-on round of coronavirus relief legislation, which has stalled as of this writing.

Finally, Congress has adopted other laws that promote the onshoring of foreign supply chains. For example, the Secure and Trusted Communications Networks Act, which Congress enacted in March, requires the Federal Communications Commission to publish a list of communications equipment or service providers determined to pose a national security risk, prohibits the use of federal funds to purchase communications equipment or services from those providers and calls for the removal of existing equipment from those providers.[7]

CFIUS Review of Foreign Direct Investment to Impede Offshoring

Through reform legislation enacted in 2018, Congress greatly expanded the jurisdiction of CFIUS. Member agencies are, in turn, dramatically increasing the number of personnel devoted to reviewing transactions reported to CFIUS and investigating deals of national security interest that the parties did not notify.

Nearly all corporate transactions with foreign acquirers or investors now merit some level of CFIUS risk analysis to determine whether a deal triggers a mandatory filing or presents a risk of CFIUS attention. And China deals, especially those involving the health sector, advanced technology or information about U.S. persons, are increasingly likely to be reviewed by CFIUS before or after closing.

Regulatory scrutiny of foreign investment in the U.S. has been steadily growing for several years, and that trend is unlikely to change in the near term, regardless of what happens in the November elections. With enactment of the Foreign Investment Risk Review Modernization Act in 2018, Congress expanded CFIUS' jurisdiction. At the same time, CFIUS agencies are dramatically increasing the number of personnel devoted to reviewing transactions and investigating deals that fall within CFIUS' jurisdiction.

Just a few years ago, the Treasury had fewer than 30 people devoted to CFIUS reviews. Today, there are more than 100, and the Treasury's CFIUS staff count is likely to approach 200 next year. The recent growth of CFIUS authorities and resources reflects a bipartisan belief that some foreign investment represents a threat to U.S. strategic dominance of key technologies. This perceived threat is particularly acute relative to China.[8]

Many in the defense community in Washington assess that Chinese advancements in critical technology represent a zero-sum calculus for the U.S. In this environment, it is no surprise that Chinese investment in the U.S. is particularly fraught. Deals that are not reported to CFIUS may prompt attention from it, and deals submitted to CFIUS are likely to encounter substantial problems as part of the review process.

Although it's possible that a new administration will lower the temperature on U.S.-China relations, former Vice President Joe Biden has shown no interest in curtailing the foreign

investment review processes. He has called for new approaches on supply chain security so neither the U.S. nor its allies will be dependent on critical supplies from China and Russia.[9]

Today, CFIUS effectively has three separate jurisdictional regimes: a voluntary regime that captures a substantial amount of foreign investment in the U.S.; a mandatory regime that requires foreign investment in certain advanced technology companies to be reported to CFIUS in advance; and a new real estate regime that gives CFIUS special authority to review the foreign acquisition of lease or ownership interests in property in close proximity to over 100 specially identified federal installations.

For the voluntary CFIUS regime, the committee has the power to review:

- Any control transaction to determine the effect of a foreign person having control of a U.S. business on the national security of the U.S.; or

- Any covered investment, which is any direct or indirect investment by a foreign person in a technology, infrastructure, or data U.S. business that does not result in control of the U.S. business but affords the foreign person with:
 - Access to material nonpublic technical information, personal data or critical infrastructure information;
 - Membership or observer rights on the board of the U.S. business; or
 - Any other involvement in the operation of the U.S. business, other than with respect to voting shares.

CFIUS has broad authority to initiate an investigation of any covered transaction over which it has jurisdiction that has not been notified to CFIUS and that may raise national security issues.

In particular, if parties do not file with CFIUS, and the committee concludes that it may have jurisdiction, the committee retains the ability to examine the transaction after closing and to potentially impose mitigation measures for any national security concerns — or in rare cases, order divestment of businesses if the transaction is sensitive.

The mandatory regime is different. Transaction parties must formally notify CFIUS before closing of two types of transactions. Failure to report a deal covered by these rules can result in a fine of up to the value of the transaction.

First, mandatory notification to CFIUS is required for certain transactions involving U.S. businesses that produce, design, test, manufacture, fabricate or develop critical technology.

Second, parties must notify CFIUS of any covered control transaction or covered investment that results in a foreign government having a substantial interest in certain companies associated with advanced technology, critical infrastructure or large amounts of sensitive personal data.

Together, the voluntary and mandatory regimes give CFIUS powerful tools to review a broad spectrum of foreign investment activities that may pose potential threats to the U.S., including those related to medical supplies.[10] For example, CFIUS is reportedly reviewing a past Chinese investment in a pharmaceutical company that may develop devices related to a coronavirus vaccine.[11]

CFIUS' new authorities to review deals — and to require notification before closing — speak to the growing complexity around transactions involving foreign investors.

Nearly all corporate acquisition and investment transactions now merit some level of CFIUS risk analysis to determine whether a deal triggers a mandatory filing or presents a risk of CFIUS attention. And China deals, especially those involving the health sector, advanced technology or U.S.-person information, are increasingly likely to be reviewed by CFIUS before or after deal closing.

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[1] Jamie Gorelick and Stephen Preston, Regulatory Efforts to Protect U.S. Innovation From China: Implications for Private Sector Businesses, WilmerHale Client Alert (Jan. 10, 2019), <https://www.wilmerhale.com/en/insights/client-alerts/20190110-regulatory-efforts-to-protect-us-innovation-from-china-implications-for-private-sector-businesses>.

[2] Onshoring is used broadly to refer to the movement back to the U.S. of production capability that has been relocated overseas (also known as reshoring) or otherwise building domestic production capability that has atrophied in the U.S. and/or developed abroad.

[3] Sarah D. Wire, Senate Passes \$2-Trillion Economic Stimulus Package, Los Angeles Times (March 25, 2020), <https://www.latimes.com/politics/story/2020-03-25/vote-senate-on-2-trillion-economic-stimulus-package-coronavirus>.

[4] Executive Order on Delegating Authority Under the DPA to the CEO of the U.S. International Development Finance Corporation to Respond to the COVID-19 Outbreak, The White House (May 14, 2020), <https://www.whitehouse.gov/presidential-actions/eo-delegating-authority-dpa-ceo-u-s-international-development-finance-corporation-respond-covid-19-outbreak>.

[5] Executive Order on Ensuring Essential Medicines, Medical Countermeasures, and Critical Inputs Are Made in the United States, The White House (August 6, 2020), <https://www.whitehouse.gov/presidential-actions/executive-order-ensuring-essential-medicines-medical-countermeasures-critical-inputs-made-united-states>.

[6] Other FY21 NDAA provisions aim to reduce reliance on China for "critical minerals" and "rare earth elements."

[7] In 2018, Congress also enacted the Strengthening and Enhancing Cyber-capabilities by

Utilizing Risk Exposure, or SECURE, Technology Act, which established the Federal Acquisition Security Council to develop a strategic plan to address supply chain risks posed by the acquisition of certain information technology and telecommunications equipment.

[8] Defense Innovation Unit Experimental (DIUx), China's Technology Transfer Strategy (2018) (China is "investing in the critical future technologies that will be foundational for future innovations both for commercial and military applications").

[9] The Biden Plan to Rebuild U.S. Supply Chains and Ensure the U.S. Does Not Face Future Shortages of Critical Equipment, <https://joebiden.com/supplychains>.

[10] European Commission, Guidance to the Member States Concerning Foreign Direct Investment and Free Movement of Capital From Third Countries, and the Protection of Europe's Strategic Assets, Ahead of the Application of Regulation (EU) 2019/452, https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf (emphasis is omitted).

[11] Himamauli Das, Five CFIUS Enhanced Enforcement Trends During COVID-19, Bloomberg Insights (May 19, 2020), <https://news.bloomberglaw.com/white-collar-and-criminal-law/insight-five-cfius-enhanced-enforcement-trends-during-covid-19>; Kate O'Keefe, U.S. National Security Panel Examining Chinese Investors' Purchase of Pharma Firm, Wall Street Journal (July 10, 2020), <https://www.wsj.com/articles/u-s-national-security-panel-examining-chinese-investors-purchase-of-pharma-firm-11594406334>.