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# Foreign Investment Update: CFIUS Reform

## U.S. TECH LAW UPDATE<sup>1</sup>

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### 1. Introduction.

Amid the ongoing trade war with China, the U.S. has enacted legislation to reform the Committee on Foreign Investment in the United States (“CFIUS”), which is the government authority tasked with reviewing proposed foreign investments into the U.S. that might endanger national security. On August 13, 2018, President Trump signed into law the Foreign Investment Risk Review Modernization Act (“FIRRMA”), doing so as part of the National Defense Authorization Act for Fiscal Year 2019 (“NDAA”).<sup>2</sup> FIRRMA aims to modernize CFIUS to address the changing national security landscape.

FIRRMA’s passage is largely related to current concern regarding growing foreign investments in U.S. critical technologies, particularly investments from China. The act aims to broaden CFIUS’s jurisdiction in order to address these concerns, and even specifically takes aim at China through a new Chinese Investment Report included in the Act.<sup>3</sup> At the same time, in FIRRMA’s “sense of congress section” the act reiterates the U.S.’s commitment to an open investment policy by emphasizing the benefits of foreign investment and noting that an open investment policy encourages other countries to reciprocate. Notwithstanding the significant reforms, CFIUS still remains limited in scope to issues of national security, and the committee will not consider issues of national interest absent a national security nexus. We have previously summarized the CFIUS review process [here](#).

### 2. Bipartisan Support.

FIRRMA was first introduced on November 8, 2017 in both the House and the Senate. In an era of strong partisan politics, FIRRMA passed both the House and the Senate with bipartisan support. The Senate’s version of FIRRMA (S. 2987) was added to the NDAA which originally passed the Senate by a vote of 85 to 10. The House stand-alone version of FIRRMA (H.R. 5841) passed the House by a vote of 400 to 2. After completing the reconciliation process with respect to the two versions, the reconciled bill was included in the NDAA, which passed the House on July 26<sup>th</sup> by a vote of 359 to 54 and the Senate on August 1<sup>st</sup> by a vote of 87-10, showing strong support from both sides of the aisle.

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<sup>2</sup> The full text of FIRRMA is available here: [TITLE XVII—REVIEW OF FOREIGN INVESTMENT AND EXPORT CONTROLS](#)

<sup>3</sup> H.R. 5515-539. Sec. 1719. Modification of Annual Report and Other Reporting Requirements.

### Changes since Introduction.

Since FIRRMA was first introduced there have been several changes, the most significant of which was the removal of a provision which would have extended CFIUS’s jurisdiction to include technology transfers under agreements entered into by U.S. businesses, including joint ventures. This provision was ultimately removed after strong objections from the business community. Instead as part of the Export Control Reform Act (“ECRA”), the U.S. Commerce Department will administer a new export control process aimed at protecting “emerging and foundational technologies.”<sup>4</sup>

### **3. Changes to the CFIUS Review Process.**

#### Increased Jurisdictional Scope.

##### 1. Expanded Definitions.

One of the most significant changes implemented by FIRRMA is the increase in jurisdictional scope of CFIUS review. CFIUS retains its authority to review any transaction which could result in control of a U.S. business by a foreign person, or “covered transactions.” Previously, this included mergers, acquisitions or takeovers, but did not include minority investments that didn’t establish foreign control. FIRMMA expands the definition of “covered transactions” to include the following four new types of transactions:

- Real estate transactions including the purchase, lease or concession of certain real estate properties in close proximity to a U.S. airport, sea port, military or other sensitive national security government property.<sup>5</sup>
- All “other investments” by a foreign person in any unaffiliated U.S. business which deals with (i) “critical infrastructure,” (ii) “critical technology,” or (iii) sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security.<sup>6</sup>
- Changes in existing ownership related rights that could result in either (i) foreign control or (ii) an “other investment” in a U.S. business.<sup>7</sup>
- Any transactions whose aim is to circumvent or evade CFIUS review.<sup>8</sup>

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<sup>4</sup> H.R. 5515-539. Sec. 1755. Administration of export controls.

<sup>5</sup> H.R. 5515-539. Sec. 1703(a)(4)(B)(ii). Definitions.

<sup>6</sup> H.R. 5515-539. Sec. 1703(a)(4)(B)(iii). Definitions.

<sup>7</sup> H.R. 5515-539. Sec. 1703(a)(4)(B)(iv). Definitions.

<sup>8</sup> H.R. 5515-539. Sec. 1703(a)(4)(B)(v). Definitions.

FIRRMA introduces a number of new defined terms that play a key role in understanding the expansion of CFIUS’s scope, including “other investment,” “critical infrastructure,” and “critical technology,”

- “Other investment” means a direct or indirect investment by a foreign person in a U.S. business that affords the foreign person (i) access to material nonpublic technological information, (ii) membership, observer rights, nomination rights on the board of directors or equivalent governing body, or (iii) any involvement, other than through voting shares, in substantive decision making in a U.S. business in connection with “critical infrastructure,” “critical technology,” or the sensitive personal data of a U.S. Citizen.<sup>9</sup> In forthcoming regulations, CFIUS will provide further guidance on the types of transactions that CFIUS will consider to be “other investment.”
- “Critical infrastructure” means systems and assets, whether physical or virtual, so vital to the U.S. that their incapacity or destruction would have a debilitating impact on national security.<sup>10</sup>
- “Critical technologies” means (i) defense articles or defense services included on the U.S. Munitions list, (ii) items included on the Commerce Control List and controlled pursuant to multilateral regimes or for reasons relating to regional stability or surreptitious listening, (iii) specially designed and prepared nuclear equipment, parts, and components, materials, software and technology regulated in relation to assistance to foreign atomic energy activities, (iv) Nuclear facilities, equipment, and materials regulated in connection with the import and export of nuclear equipment and material, (v) select agents and toxins, and (vi) “emerging and foundation technologies controlled pursuant to ECRA.”<sup>11</sup>

## 2. Exception for Certain Investment Fund Investments.

FIRRMA specifically limits CFIUS’s jurisdiction with respect to “other investments” made by a foreign person through certain investment funds. These investments will not be considered to be an “other investment” if the foreign person is a limited partner or equivalent on an advisory board or committee, and the following criteria are met: (i) the fund is managed exclusively by a general partner, managing member, or equivalent who is not a foreign person, (ii) the advisory board or committee does not have the ability to approve, disapprove or otherwise control investment decisions of the fund, or decisions made by the general partner or equivalent, (iii) the foreign person does not otherwise have the ability to control the fund, or have the authority to approve, disapprove or control the investment decisions of the fund, decisions made by the general partner or equivalent, or to unilaterally dismiss, prevent the dismissal of, select or determine the compensation of the general partner or equivalent, and (iv) the foreign person does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee. Both U.S. investment funds and foreign

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<sup>9</sup> H.R. 5515-539. Sec. 1703(a)(4)(D). Definitions.

<sup>10</sup> H.R. 5515-539. Sec. 1703(a)(5). Definitions.

<sup>11</sup> H.R. 5515-539. Sec. 1703(a)(6). Definitions.

investors in U.S. investment funds will likely need to consider these requirements and their implication for both fund structure and fund governance.

### Expanded Remedies.

FIRRMA expands CFIUS's possible responses to transactions which raise national security risks to include suspending the transaction while under review, cutting short its investigation to refer the transaction to the president, and imposing agreements or conditions on the transaction to mitigate risk.<sup>12</sup> Any such agreement or condition must include specifics on compliance, including the frequency of compliance reviews, details on how compliance will be monitored and penalties if parties fail to comply. Furthermore, in the event a party abandons a transaction, CFIUS is now vested with the power to negotiate and enter into any agreement to effectuate a party's abandonment of a transaction.

### Procedural Changes.

#### 1. Notices & Declarations.

FIRRMA retains CFIUS's current procedures allowing any party to a transaction to initiate CFIUS review by submitting written notice. FIRRMA also creates an expedited process in the form of an abbreviated five page or less "declaration," as an alternative to a formal written notice.<sup>13</sup> A party to any covered transaction may submit to the Committee such a declaration detailing the basic information regarding the transaction. In forthcoming regulations, CFIUS will further establish the requirements for these declarations. After a declaration has been received, CFIUS may (i) request the parties file a written notice, (ii) initiate unilateral review of the transaction, or (iii) notify the parties in writing that the CFIUS has completed all action with respect to the transaction.<sup>14</sup>

While participation in the CFIUS review process has historically been voluntary, declarations are now mandatory with respect to certain covered transactions where a foreign government has a "substantial interest." In the alternative to the mandatory declaration, the party may elect to submit a formal notice instead.<sup>15</sup> The scope of mandatory declarations will be set forth in forthcoming CFIUS regulations.

#### 2. Review Period.

Under FIRRMA, CFIUS's 30 day initial review period has been extended to 45 days.<sup>16</sup> Additionally, CFIUS's 45-day investigation stage now includes a possible one-time 15 day extension period for "extraordinary circumstances."<sup>17</sup>

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<sup>12</sup> H.R. 5515-539, Sec. 1718. Actions by the Committee to Address National Security Risks.

<sup>13</sup> H.R. 5515-539, Sec. 1706. Declarations for Certain Covered Transactions.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> H.R. 5515-539, Sec. 1709. Timing for Reviews and Investigations.

<sup>17</sup> *Id.*

### 3. Increased Reporting.

FIRRMA substantially increases the required disclosures in the CFIUS annual report to Congress. The report traditionally focused on aggregate statistics, but will now include details on each CFIUS case involving a full CFIUS notice, and include “basic information” on the parties and the results of the case.<sup>18</sup>

FIRRMA requires two additional congressional reports from other departments. The U.S. Secretary of Commerce is required to submit biennial reports to Congress and CFIUS on Chinese direct investment in the United States, and how it compares to the objectives of the Made in China 2025 plan, and U.S. foreign investment in China.<sup>19</sup> The U.S. Secretary of Homeland Security is required to submit a report to Congress on the risk related to foreign government investments in the U.S. rail industry, and how CFIUS can respond to any such security threats.<sup>20</sup>

#### Institutional Changes.

##### 1. Expanded Staff.

FIRRMA creates two new Senate confirmed positions responsible for overseeing CFIUS operations, requires a dedicated CFIUS staff, including an assistant secretary or equivalent position at other member agencies.<sup>21</sup> In addition, FIRRMA allows agencies to appoint new staff for CFIUS.

##### 2. The CFIUS Fund.

Along with the expansion of CFIUS staff, FIRRMA establishes a CFIUS fund under which CFIUS may receive appropriated funds and fees for CFIUS related functions.<sup>22</sup> Effective immediately, CFIUS may impose filing fees not to exceed the lesser of 1 percent of the value of the transaction or \$300,000.<sup>23</sup> Additionally, FIRRMA permits CFIUS to study the implementation of a “prioritization fee” that could be paid in addition to the filing fee in order for CFIUS to prioritize a response.<sup>24</sup> CFIUS related functions and their associated fees will be further specified in CFIUS regulations.

### 4. ECRA and Emerging and Foundational Technology.

The U.S. enacted ECRA alongside FIRRMA with both acts being included in the NDAA.<sup>25</sup> ECRA directs the president to establish a regular ongoing interagency process to identify “emerging and foundational technologies” that (i) are essential to the national security of the United States, and (ii) are not already designated as “critical technologies” under FIRRMA.<sup>26</sup> Once identified as an “emerging and foundational technology,” the technology would be subject

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<sup>18</sup> H.R. 5515-539. Sec. 1719. Modification of Annual Report and Other Reporting Requirements.

<sup>19</sup> H.R. 5515-539. Sec. 1719(b). Modification of Annual Report and Other Reporting Requirements.

<sup>20</sup> H.R. 5515-539. Sec. 1719(c). Modification of Annual Report and Other Reporting Requirements.

<sup>21</sup> H.R. 5515-539. Sec. 1717. Membership and Staff of Committee.

<sup>22</sup> H.R. 5515-539. Sec. 1723. Funding.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> H.R. 5515-539. Sec. 1723. Funding.

<sup>26</sup> H.R. 5515-539. Sec. 1758. Requirements to Identify and Control the Export of Emerging and Foundational Technologies.

to controls on exports, reexports or in-country transfers. At a minimum any designated “emerging and foundational technology” would be subject to a license requirement in connection with its export, reexport or in-country transfer to a country subject to an embargo, including an arms embargo imposed by the United States.<sup>27</sup> Because China is currently subject to a U.S. arms embargo, these ECRA’s license requirements will apply to technology export, reexport or in-country transfers involving China. As mentioned in the previous section, once a technology is identified as an “emerging and foundational technology,” the technology will also be subject to CFIUS review as a “critical technology.” ECRA does not identify any specific “emerging and foundational technologies,” however based upon a recent report from the Department of Defense, technologies in the following areas might be reviewed for a “critical technology” designation: (i) artificial intelligence, (ii) robotics, (iii) augmented and virtual reality, and (iv) financial technology.<sup>28</sup>

## 5. Implications of CFIUS Reform.

FIRMA implements significant changes to the CFIUS review process. While some of the FIRMA changes take effect immediately, most will not become effective until 18 months after the law’s August 13<sup>th</sup> signing date. The CFIUS chairperson may accelerate this deadline if the chairperson declares that all necessary structures and regulations are in place to begin enforcement.

Many of these reforms will have a significant impact on deal structuring and deal risk analysis. Given the expanded scope of “covered transactions,” a number of transactions involving foreign persons will now be subject to CFIUS review, including certain real estate transactions. Parties to these transactions will now need to consider the need for potential CFIUS review. Therefore, parties to deals involving foreign parties should carefully consider the statutory scope and definitions of the key terms including “other investment,” “critical infrastructure,” “critical technology, and sensitive personal data of U.S. Citizens when considering deal structure.

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<sup>27</sup> *Id.*

<sup>28</sup> For more information see the report: [China’s Technology Transfer Strategy: How Chinese Investments in Emerging Technology Enable A Strategic Competitor to Access the Crown Jewels of U.S. Innovation.](#)