New CFIUS Legislation Enacted

August 13, 2018

Introduction

For the first time in over a decade, Congress has amended the statutory authority under which the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee") reviews inward foreign investment to protect U.S. national security. The Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") was incorporated into the John S. McCain National Defense Authorization Act for Fiscal Year 2019 and signed into law by President Trump earlier today. Although many of the law's provisions await the publication of implementing regulations, others, including the time period for CFIUS reviews, take immediate effect. FIRRMA, which has been debated and reviewed by congressional committees for nearly a year, will materially expand the scope of CFIUS reviews, particularly for some types of investment structures outside the traditional M&A context. The legislation will likely result in a much wider range of previously exempt transactions falling within CFIUS's jurisdiction, including certain "non-controlling" investments and acquisitions of real estate with no underlying "U.S. business."

Although FIRRMA's substantive provisions mention no country by name, both the text and the subtext suggest that Congress intended to target Chinese investments in the U.S. technology sector and responded to the conviction among at least portions of the U.S. national security community that some Chinese investors structure their investments to evade CFIUS's jurisdiction. Among other things, the law requires the Secretary of Commerce to prepare regular reports on "foreign direct investment made by entities in the People's Republic of China," and provides that it is the sense of Congress that in making national security assessments, CFIUS may consider "whether a covered transaction involves a country of special concern that has a demonstrated or declared strategic goal of acquiring a type of critical technology." More obliquely, FIRRMA authorizes CFIUS to prescribe regulations defining "foreign person" differently in different contexts, which could result in more favorable treatment for investments by companies from U.S.-allied countries. Ultimately, however, FIRRMA formalizes many existing practices contained in neither the 2007 statute[1] nor the current regulations[2] and it generally appears to ratify the recent pattern of ever more detailed examinations of investments that one would previously have expected the Committee to clear within an initial 30-day review period. Investors and practitioners, especially those involved in investments from China, will need some time to adjust to FIRRMA's substantive and procedural changes, which are being implemented against a backdrop of heightened trade tensions between the United States and a number of important trading partners. However, despite the considerable uncertainty associated with the new law and the likelihood that many cases will be subject to more extensive negotiated "mitigation" measures than in the past, we are confident that foreign investment into the United States will remain robust and that CFIUS will continue to clear appreciably more transactions than it suspends, prohibits or forces to be withdrawn.

[1] The Foreign Investment and National Security Act, Public Law No. 110-49, 121 Stat. 246 (2007), which amended section 721 of the Defense Production Act of 1950, currently codified at 50 U.S.C. 4565 ("FINSA").

[2] Regulations Pertaining to Mergers, Acquisitions and Takeovers by Foreign Persons, 31 C.F.R. Part 800.

Notable Changes under FIRRMA

Expanded Jurisdiction for CFIUS

FIRRMA meaningfully expands the definition of "covered transaction" to capture a range of transactions that would previously have been outside of the Committee's jurisdiction. Notably, FIRRMA extends CFIUS's jurisdiction to cover:

- Certain real property transactions
    - The acquisition of an interest in certain real property (by sale, lease, or concession) by a foreign person can constitute a covered transaction under FIRRMA even in the absence of any underlying US business.
    - The real property must be located in the United States and (i) be within or part of an air or maritime base, (ii) be in "close proximity" to a U.S. military installation or other sensitive location, (iii) reasonably provide the ability to collect intelligence related to such an installation or sensitive location, or (iv) otherwise expose national security activities at such an installation or other location to foreign surveillance.
    - CFIUS will prescribe regulations further clarifying the criteria that must be met for such a covered transaction.
    - Acquisitions of an interest in a single housing unit or in real estate in "urbanized areas" (as defined by the Census Bureau) are exempted, except as otherwise provided by regulation.
- Certain non-controlling investments in U.S. businesses
    - An investment by a foreign person that does not result in control of a U.S. business can nevertheless constitute a covered transaction if the U.S. business (i) owns, operates, manufactures, supplies, or services "critical infrastructure"; (ii) produces, designs, tests, manufactures, fabricates, or develops one or more "critical technologies"; or (iii) maintains or collects sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security.
    - To be covered, the investment must afford the foreign person (i) access to any "material nonpublic technical information" in the target business's possession; (ii) membership or observer rights on the board of directors or equivalent body of the business or the right to nominate an individual to a position on the board or its equivalent; or (iii) involvement (other than through voting shares) in substantive decision-making of the business with respect to critical technologies, critical infrastructure, or sensitive personal data that the business collects or maintains.
    - CFIUS must prescribe regulations further defining the type of investments that are covered.
    - Specific rules apply to non-controlling investments in U.S. businesses made through investment funds. Such an indirect investment in a U.S. business made through a fund will not constitute a covered transaction, even if it affords the foreign person

membership as a limited partner or equivalent on an advisory board or committee, provided that:

- The fund is managed exclusively by a general partner, managing partner, or equivalent who is not a foreign person.
- The advisory board or committee does not have the ability to approve, disapprove, or otherwise control (i) investment decisions or (ii) decisions by the general partner (or equivalent) related to entities in which the fund is invested.
- The foreign person does not otherwise have the ability to control the fund, including authority to (i) approve or control investment decisions; (ii) approve or control decisions by the general partner (or equivalent) related to entities in which the fund is invested; or (iii) dismiss, select, or determine the compensation of the general partner (or equivalent).
- The foreign person does not have access to material nonpublic technical information as a result of participation on the advisory board or committee.

- Any transaction the structure of which is designed or intended to evade or circumvent FIRRMA
  - This provision appears intended to capture transaction structures that closely approach—but purposefully fall just short of—the definition of "covered" under existing law. Congress was persuaded that the existing passive investment exemption resulted in some investors gaining access or influence that should be subject to review even if not ultimately prohibited.
- Any "change in the rights" of a foreign person in a U.S. business, if that change "could result" in either control of the business or a covered non-controlling investment
  - A transaction by which a foreign person increases an existing "passive" interest in a U.S. business—for example, from 9% ownership to 15% ownership— would be covered even if the transaction were to appear insignificant in isolation. This principle is not necessarily different from current law, but highlights the scrutiny that will be applied to any transaction or sequence of transactions designed to avoid a filing.
  - CFIUS has not yet provided any information on whether FIRRMA will cause the Committee to amend its December 2008 guidance on reorganizations within a common ownership structure

CFIUS must prescribe regulations that further define the term "foreign person" for purposes of covered real estate transactions and covered non-controlling investments, establishing criteria to limit the application of these two types of covered transactions to investments made by "certain categories of foreign persons." Those criteria must consider the foreign person's connection to a foreign country or foreign government and whether the connection could affect U.S. national security. As a result, the expanded definition of "covered transaction" is unlikely to affect all potential investors equally. In particular, private sector investors based in countries that are close allies of the United States could be exempted from these requirements.

Definitions Related to Expanded Jurisdiction

Close Proximity
CFIUS must prescribe regulations to ensure that this term refers only to a distance or distances within which the purchase, lease, or concession of real estate could pose a national security risk in connection with a U.S. military installation or another facility or property of the U.S. Government.

Critical Infrastructure
The term "critical infrastructure" means, subject to regulations prescribed by the Committee, systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.

U.S. Businesses that Own, Operate, Manufacture, Supply, or Service Critical Infrastructure
CFIUS regulations that define this concept must (i) specify that the critical infrastructure involved must be likely to be of importance to U.S. national security and (ii) enumerate specific types and examples of such critical infrastructure.

Critical Technologies
In general, "critical technologies" refers to controlled exports of various forms, including items on the Commerce Control List to the extent that the item is controlled (i) pursuant to multilateral regimes or (ii) for reasons relating to regional stability or surreptitious listening. This term also includes "emerging and foundational technologies" identified under section 1758 of the new Export Control Reform Act of 2018.[3]

Material Nonpublic Technical Information
This term refers to information that (i) provides knowledge, know-how, or understanding, not available in the public domain, of the design, location, or operation of critical infrastructure or (ii) is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods. Financial information regarding the performance of a U.S. business is expressly excluded.

Declarations and Mandatory Submissions

FIRRMA establishes a new concept known as a "declaration," which is essentially an abbreviated notice. The parties to any covered transaction may elect to file such a "declaration," which will be defined further by regulation but is intended to provide "basic information" about the transaction in five pages or less. Within 30 days after a declaration has been filed, CFIUS must either (i) request a written notice from the parties, (ii) inform the parties that CFIUS is unable to complete action based on the declaration, (iii) initiate a unilateral review of the transaction, or (iv) notify the parties in writing that CFIUS has completed all action with respect to the transaction.

In a marked departure from the 30 years of CFIUS practice to date, declarations will be mandatory under certain circumstances. Specifically, FIRRMA provides that the parties to the covered transaction must file a declaration with CFIUS if a transaction results in the acquisition of a "substantial interest" in a U.S. business by an investor in which a foreign government holds, directly or indirectly, a "substantial interest," and the target U.S. business (i) owns, operates, manufactures, supplies, or services "critical infrastructure"; (ii) produces, designs, tests, manufactures, fabricates, or develops one or more "critical technologies"; or (iii) maintains or collects sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security. The concept of "substantial interest" will be further defined by

[3] The Export Control Reform Act of 2018 was also attached to the National Defense Authorization Act and signed into law today.

regulation, but FIRRMA provides that investments of less than 10 percent voting interest will not be considered "substantial." The timing of mandatory declarations will be set by regulation, but will not be required more than 45 days before closing. FIRRMA also affords CFIUS the latitude to establish other categories of investment as subject to mandatory declarations.

Timing

FIRRMA includes provisions affecting the timing of both the pre-review period (which has lengthened substantially in recent years) and the review period itself. If the parties stipulate that their investment is a covered transaction, FIRRMA requires that CFIUS respond within 10 business days, either by accepting the filing and starting a review or by providing comments on the draft filing. Especially for otherwise non-controversial transactions, this could save significant amounts of time, as current reviews of pre-filings often extend well beyond ten business days. If CFIUS determines that the draft or final notice is not complete, the Committee must notify the parties in writing and provide an explanation of all material respects in which it is not complete. The initial review has now been extended to 45 days, from 30 days.

Investigations under FIRRMA will remain 45 days in most cases. In "extraordinary circumstances," however, CFIUS may extend an investigation by 15 days at the request of the head of the lead agency. The term "extraordinary circumstances" is not defined in FIRRMA, but will be addressed in regulations prescribed by CFIUS. The statute does not mention and CFIUS has not clarified how these new time periods, along with the goal of reducing pre-filing reviews to 10 business days might affect the practice of withdrawing and re-filing cases that cannot be completed within a single review-plus-investigation period.

Interim Actions and Mitigation

FIRRMA expressly authorizes CFIUS to suspend a proposed or pending covered transaction while it remains under review or investigation by the Committee. Alternatively, CFIUS may refer a pending transaction to the President for further action at any time; it need not wait until the end of a review or investigation period to request presidential action.

In addition, with respect to a completed covered transaction that was not previously cleared by CFIUS, FIRRMA authorizes CFIUS to negotiate, enter into or impose, and enforce any agreement or condition with any party to that transaction in order to mitigate any interim risk to U.S. national security that may arise as a result of the transaction. Such agreement or conditions will remain in place until CFIUS has completed its review and/or investigation, or the President has taken final action. For a covered transaction that has been voluntarily abandoned by the parties, CFIUS may negotiate, enter into or impose, and enforce any agreement or condition with any party to that transaction "for purposes of effectuating such abandonment and mitigating any risk to" U.S. national security.

FIRRMA emphasizes ensuring compliance with mitigation agreements and CFIUS's capability to supervise such agreements over the many years they may be in force. The new law expressly provides that CFIUS may not enter into a mitigation agreement unless it determines that the agreement resolves the identified national security concern, specifically taking into account whether compliance is verifiable and whether the mitigation plan will enable effective compliance monitoring. Moreover, whenever a mitigation agreement is in place, CFIUS must formulate, adhere to, and keep updated a plan for monitoring the parties' compliance with the agreement. Widespread concern about the government resources needed to oversee extensive mitigation commitments has prompted Congress to endorse the use of third-party monitors paid for by the parties to the transaction and to require that such monitors expressly owe a fiduciary duty only to the U.S. government and not to the parties.

Funding and Staffing

Through several provisions, FIRRMA seeks to increase the funding available to CFIUS and its constituent agencies. It establishes a new fund, to be used for purposes of administering the requirements of FIRRMA, to which Congress will appropriate $20 million per year from 2019 through 2023. CFIUS may also assess and collect a filing fee (to the extent provided in advance by Congressional appropriation Acts), with the amount not to exceed the lesser of (i) 1% of the value of the transaction or (ii) $300,000. Should CFIUS choose to require such a fee, it will determine the specific amount to be owed in its regulations. All fees collected through this mechanism will be deposited into the new fund.

Interestingly, FIRRMA contemplates the possibility of a "prioritization fee" that parties to a covered transaction may pay to prioritize the timing of CFIUS's response to a draft or written notice, if CFIUS is unable to meet the ordinary deadlines for such a response because of "an unusually large influx of notices, or for other reasons." Before this fee option can be implemented, CFIUS must complete a study on the "feasibility and merits" of the fee concept and submit the report to Congress.

Within 180 days of FIRRMA's enactment, CFIUS must develop plans to implement the new law and must submit to appropriate congressional committees a report that describes, among other things, any additional staff and resources necessary to implement FIRRMA. Likewise, on an annual basis for the next seven years, each member agency of CFIUS must submit a detailed spending plan to Congress that covers estimated CFIUS-related expenditures and staffing needs. The President must also determine whether CFIUS's responsibilities under FIRRMA necessitate additional resources and must include a request for such resources in the budget submission to Congress.

Collectively, these provisions aim to increase the resources available to CFIUS to review and investigate covered transactions in a timely and efficient manner. As noted, the new law requires CFIUS to respond to certain draft notices, and to accept certain formal notices as final, within 10 business days of submission, a schedule that CFIUS might face difficulty regularly meeting given its current staffing situation.

Immediate Effects

Several FIRRMA provisions took immediate effect and so will apply to any review or investigation initiated after today. Other sections of the law, however, will not become effective until the earlier of (i) 18 months after August 13, 2018 or (ii) 30 days after CFIUS publishes a determination in the Federal Register providing that the regulations, organizational structure, personnel, and other resources necessary to administer the new provisions are in place (the "Effective Date"). Given the mixed implementation timing of the law, it is worth discussing how the law will affect deals at varying stages of the process.

Transactions Currently under Investigation

The sections of FIRRMA that took immediate effect upon enactment apply only to transactions for which review or investigation is initiated after August 13. Thus, transactions already under investigation will not be affected by the new law, unless the filing is withdrawn and refiled.

Transactions Currently under Review

Transactions under review with CFIUS, but not yet under investigation, will be affected by FIRRMA in at least some respects. For example, changes regarding mitigation and interim enforcement action took effect on the enactment date, and thus would presumably apply to transactions already under review. Moreover, the provision authorizing CFIUS to extend the investigation period by an additional 15 days could also apply to these transactions, assuming that they progress to an investigation.

Transactions Not Yet Accepted for Review

All provisions of FIRRMA that took effect today will apply to covered transactions not yet accepted for review by August 13. This includes, among other things, the new 45-day review period and the timing requirements for CFIUS's comments on draft filings and acceptance of final filings. Notably, however, neither the mandatory declaration provision of FIRRMA, nor the revised definition of "covered transactions" addressing real estate interests and non-controlling investments, comes into force until the Effective Date. While the filing fee provisions of FIRRMA are effective as of the date of enactment, such fees can be imposed only pursuant to regulations implemented by CFIUS, and thus there will not be a filing fee requirement unless and until CFIUS prescribes these regulations.

FAQs

Within hours of President Trump signing the NDAA and enacting FIRRMA, CFIUS published both **the text** of that statute and **selected FAQs** about the Committee's approach to interpreting and implementing the new law. CFIUS officials have informally indicated that additional FAQs may be forthcoming.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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