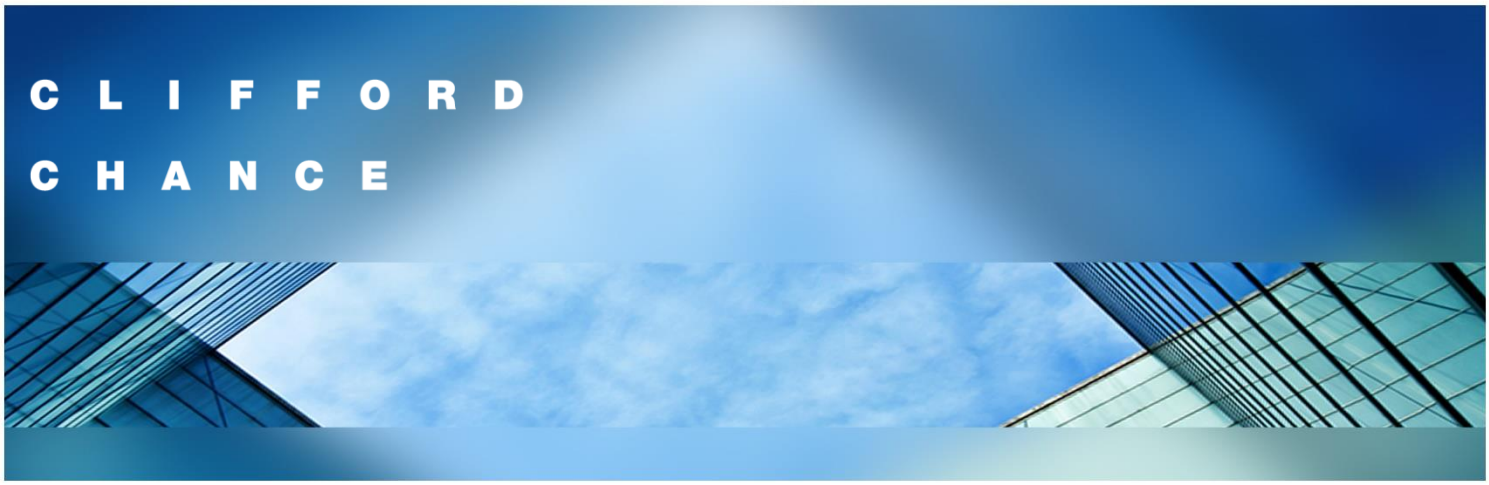

FIRRMA: ADDRESSING THE "WEAPONIZATION" OF CROSS-BORDER INVESTMENT THROUGH CFIUS REFORM?

In response to increased foreign investment in potentially sensitive sectors such as artificial intelligence, robotics, autonomous vehicles and cyber, particularly from China, the U.S. Congress is considering legislation to update the rules governing foreign investment in the United States. The "Foreign Investment Risk Review Modernization Act of 2017" (FIRRMA) as currently drafted would expand the U.S. government's review of such transactions by, among other things, covering non-controlling investments, creating mandatory filing requirements for investors with government ownership, and applying entirely new controls on technical collaboration between U.S. and non-U.S. companies. If enacted, these changes could have broad implications for both overseas investors looking to participate in the U.S. economy and U.S. technology companies seeking access to opportunities outside the United States.

OVERVIEW OF CFIUS PROCESS

Under current law, the President of the United States can block or unwind any investment in a sensitive U.S. business if that investment could result in a foreign person gaining control of the U.S. business. That authority, granted by the "Exon-Florio Amendment," is managed through the Committee on Foreign Investment in the United States (CFIUS).[1] The CFIUS process has traditionally focused on deals involving core national security such as defense, transportation infrastructure, energy and government supply chains. In recent years, CFIUS has also expanded its focus to include the technology and financial sectors.

Participation in the CFIUS review process is currently voluntary, but transactions not submitted for prior review run the risk of CFIUS initiating its own review and possibly reversing the transaction after closing. The review process starts when

[1] P.L. 100-418, Title V, Section 5021, August 23, 1988; 50 U.S.C. Appendix §2170; see also P.L. 102-484, October 23, 1992 (the "Byrd Amendment"); P.L. 110-49, July 26, 2007 ("FINSA").

the parties submit a notice to CFIUS (or when the committee initiates its own review), and concludes – usually some months later – with either clearance to proceed or rejection of the application and potential blocking by the President. In cases where CFIUS perceives a risk to national security or critical infrastructure, the committee may insist on modifications to the transaction to limit foreign control or access to sensitive U.S. technologies or assets before clearing the deal through mitigation agreements with the parties. Recently, however, CFIUS has refused to clear transactions in cases that previously might have cleared with a mitigation agreement, and insisted on mitigation in a broader range of cleared transactions than previously.

GROWTH OF CFIUS'S RESPONSIBILITIES AND POTENTIAL VULNERABILITIES

CFIUS's challenges – whether measured in quantity or complexity – have increased dramatically in recent years. In his January 25, 2018, written statement to the Senate Banking, Housing, and Urban Affairs Committee, Assistant Secretary of the Treasury Heath P. Tarbert provided a number of statistics that illustrate the growth of CFIUS's workload:

- CFIUS went from handling under 100 cases per year in 2009-2010 to over 240 in 2017.
- In 2007, only 4% of cases resulted in investigations; today, closer to 70% do.
- Between 2008 and 2015, less than 10% of all cases brought to CFIUS resulted in mitigations. Today, that figure has doubled, with nearly 20% of cases requiring some level of mitigation.

A significant portion of this increased workload is attributable to growing U.S. investments from China, both directly and through acquisitions of European and other non-U.S. companies that have U.S. business operations. For example, between 2010 and 2015, about 6% of U.S. venture deals in semiconductors, artificial intelligence, autonomous vehicles, robotics, augmented reality, directed energy, and hypersonics included Chinese interests. Between 2015 and 2017, that figured climbed to 16%.[2]

Many in Congress assert that the current CFIUS process leaves critical U.S. industries vulnerable to exploitation by foreign governments, and particularly China. Senator Mike Crapo fears a "multi-layered threat to U.S. national security" arising from a "weaponization of [China's] foreign investment strategy to acquire, by design, dual-use technology and know-how from U.S. companies." Congress therefore appears interested in filling perceived gaps in CFIUS's coverage and the existing export controls rules.

REFORMING CFIUS THROUGH FIRRMA

To address these perceived gaps, Senators Cornyn (R-Texas) and Feinstein (D-California) and Congressman Pittenger (R-NC) are sponsoring FIRRMA, bi-partisan legislation aimed to substantially revise and expand the CFIUS process.

[2] Testimony of Mr. Eric D. Chewning, Deputy Assistant Secretary of Defense for Manufacturing and Industrial Base Policy, Committee on Banking, Housing, and Urban Affairs, U.S. Senate (January 25, 2018).

The bill seeks to modify the overall CFIUS process in dramatic ways. The most prominent proposed changes include:

Controls on outbound transfers

For the first time, FIRRMA would extend CFIUS review to cover exchanges – including outbound transfers – of intellectual property, know-how, and associated support by a U.S. "critical technology company" to a non-U.S. person.[3] FIRRMA leaves it to CFIUS to define the types of transactions involving critical technology companies that would be subjected to review. Under President Trump, we can expect CFIUS to define these broadly. Overseas joint ventures in sensitive emergent technologies, defense, artificial intelligence, cybersecurity, nuclear technology and robotics would almost certainly be covered. Hiring of non-U.S. employees, exports of information and support, and other forms of cross-border collaboration in these sectors could also be caught, potentially duplicating (and expanding) existing export controls. The bill's sponsors assert these new controls are necessary to address emergent technologies and transactions not yet caught by existing export controls, thereby providing a "second line of defense" against the loss of cutting edge technology.[4] U.S. companies have expressed concern that such controls could reduce their access to overseas markets and know-how and rapidly swamp the CFIUS review process with thousands of additional transactions.[5]

Non-controlling investments

FIRRMA also expands CFIUS jurisdiction to include investments in U.S. critical technology and infrastructure sectors even if those investments would not result in foreign control of the U.S. company. Transactions resulting in non-controlling influence over a U.S. company by a foreign party would be subject to review, as would transactions: i) providing access to confidential technical information; ii) providing access to information not equally available to other investors; iii) establishing any board or governance rights; or iv) involving parallel strategic or financial arrangements. Many non-controlling foreign investment could trigger one or more of these criteria. For transactions not covered by the above criteria, CFIUS may establish monitoring or policing mechanisms to enforce the prohibitions reflected in the listed criteria.

Mandatory filings

In another significant change, FIRRMA would make CFIUS filing mandatory for many acquisitions where 25 percent or more of the foreign investor is owned by a foreign government, or in other circumstances as defined by

---

3 FIRRMA defines "critical technologies" to include: i) all defense articles or defense services subject to the International Traffic in Arms Regulations (22 C.F.R. §§120-130); ii) many "dual-use" items subject to the Export Administration Regulations (15 C.F.R. §§730-774); iii) most nuclear equipment, facilities and material; iv) chemical agents and toxins; v) emerging technologies relevant to U.S. national security; and vi) any other technologies identified as relevant by CFIUS.

4 Testimony of Senator John Cornyn, Committee on Banking, Housing, and Urban Affairs, U.S. Senate (January 18, 2018).

5 Testimony of Mr. Christopher Padilla, Vice President, Government and Regulatory Affairs, IBM Corporation, Committee on Banking, Housing, and Urban Affairs, U.S. Senate (January 18, 2018).

CFIUS in regulation.[6] Although under current law CFIUS filing is highly advisable for investments that could raise national security concerns, it has never been mandatory. FIRRMA's mandatory filing provisions have teeth as well. Failure to file could result in substantial civil penalties and blocking or unwinding of the transaction.

"White Listed" Investment

The FIRRMA legislation establishes significant new regulatory requirements for both inbound and outbound investment and collaboration in more sensitive sectors, as described above. Yet it also empowers CFIUS to exempt many transactions subject to these new criteria if they involve countries (a so-called "white list") that have established mutual defense agreements with the United States or foreign investment review regimes deemed sufficient by CFIUS. This provision offers potentially substantial preferences to investors from U.S. allied countries that have bolstered their own foreign investment regimes.

In addition to the dramatic changes noted above, FIRRMA would modify key concepts to the existing CFIUS framework by:

- Creating a simplified notification process and quicker review period for certain types of transactions unlikely to raise national security concerns – a potentially significant benefit;
- Expanding the jurisdiction and types of transactions reviewable by CFIUS to cover purchases of land "in close proximity" to sensitive installations, and other transactions or arrangements designed to circumvent CFIUS controls;
- Increasing the number of factors CFIUS must consider when evaluating a transaction's national security risk;
- Extending the review period from 90 to 120 days. Under the existing process CFIUS reviews have been taking significantly longer than the two to three months outlined in applicable regulations;
- Implementing filing fees of up to $300,000 per transaction, with accompanying mechanisms to improve CFIUS resourcing;
- Increasing CFIUS's ability to monitor and enforce mitigation agreements;
- Further limiting judicial review of CFIUS's actions; and
- Creating processes to assess and monitor transactions that are *not* submitted to CFIUS for review.

Given the amount of discretion left to CFIUS in the FIRRMA text, the cumulative effect of these provisions is still somewhat unclear. They do offer benefits for some transactions, in the form of streamlined review processes and white lists, but an increased burden for many others – most notably emerging technology investment and collaboration with countries of concern to CFIUS, such as China.

---

[6] As currently, drafted, S. 2098 sets the threshold for mandatory filing as "the acquisition of a voting interest of at least 25 percent in a United States business by a foreign person in which a foreign government owns, directly or indirectly at least a 25-percent voting interest." The 25 percent threshold, however, may be subject to revision. For example, Assistant Secretary of Commerce for Export Administration Richard E. Ashooh's written remarks to the Senate's Committee on Banking, Housing and Urban Affairs (January 25, 2018), express concern that "the 25 percent threshold for FIRRMA is too high and that transactions could easily be structured to evade it. We encourage the committee to consider a lower threshold."

What is clear, however, is that the legislation intends to achieve a specific purpose – to create a more flexible, less voluntary system that each Administration can tailor, perhaps on a case-by-case basis, to address the perceived threat posed by inbound investment and outbound technical collaboration. This flexibility may have its benefits, but it also has its risks. We should be prepared for CFIUS priorities to change with different Administrations, and for the cross-border investment landscape to become less predictable for American and foreign business as a result.

CONCLUSIONS

The FIRRMA bill appears to have significant support in Congress and from Executive branch officials. Senator Cornyn's active engagement improves its chances, as do endorsements from a range of Cabinet-level and other senior officials in the Executive branch. Based on testimony at a number of Congressional hearings in the last few weeks, there appears to be momentum for updating CFIUS and providing the committee with more resources to staff its ever-increasing caseload.

Nevertheless, we would expect resistance to certain provisions in the legislation from sectors of the U.S. business community. The strongest concern in industry appears to involve the expansion of CFIUS to cover outbound controls. Placing additional regulatory burdens and delays on U.S. companies seeking to access foreign markets, collaborations and employees could disadvantage them in relation to their non-U.S. competitors, limit their access to non-U.S. technologies and capital, and ultimately encourage the offshoring of research and development by U.S. companies. Moreover, many companies see these new administrative burdens as unnecessary given the existing protections for the export and retransfer of sensitive U.S. technologies provided by the U.S. export control regime. If there are problems with the export control rules already in force, many in industry would prefer to see those controls improved rather than establishing duplicative requirements in the CFIUS process.

While we do not yet know FIRRMA's ultimate outcome, we can make some predictions. National security concerns – especially in relation to China and its increasing role in international technology investment – will remain at the forefront of the debate. Effective management of the CFIUS process will become even more critical to the success of foreign investment in the United States. And export control and sanctions compliance, already central to transnational deals, will gain even more focus within the CFIUS process. To successfully adapt to these changes, non-U.S. companies contemplating investment in the United States will need to focus closely on the evolving CFIUS landscape, while maintaining an effective understanding of how U.S. export controls and sanctions affect their acquisition strategies.

CONTACTS

Joshua Berman
Partner

T +1 202 912 5174
E joshua.berman
@cliffordchance.com

George Kleinfeld
Partner

T +1 202 912 5126
E george.kleinfeld
@cliffordchance.com

Wendy Wysong
Partner

T +1 202 290 7634
E wendy.wysong
@cliffordchance.com

Josh Fitzhugh
Counsel

T +1 202 912 5090
E joshua.fitzhugh
@cliffordchance.com

Jacqueline Landells
Counsel

T +1 202 912 5061
E jacqueline.landells
@cliffordchance.com

Kaitlyn Ferguson
Associate

T +1 202 912 5190
E kaitlyn.ferguson
@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 2001 K Street NW, Washington, DC 20006-1001, USA

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Bangkok • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.