

Report from Washington

Congress Enacts CFIUS Reform Bill to Expand Jurisdiction and Modernize the Review Process to Respond to Evolving National Security Threats

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Introduction

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Last week, Congress passed and President Trump will soon sign into law major reform legislation that expands the reach of the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”), increases the burden and cost on many parties subject to CFIUS review, and gives CFIUS enhanced powers to keep up with a changing national security threat landscape. That said, many of the changes effected by the reform bill codify existing practices of the Committee.

The Foreign Investment Risk Review Modernization Act (“FIRRMA”) enables CFIUS to reach an expanded range of transactions, including certain real estate transactions and certain non-controlling “other investments” by foreign persons that were previously not subject to CFIUS review. FIRRMA also imposes a new mandatory pre-closing declaration requirement on parties to certain transactions involving foreign state-owned or controlled entities, subject to some significant exceptions. And to ensure the Committee has the resources necessary to keep up with its expanded mandate, FIRRMA creates a dedicated fund within the U.S. Department of Treasury, authorizes annual appropriations of \$20 million over each of the next five years, and for the first time authorizes CFIUS to begin charging filing fees.

Considering the scope of CFIUS's expanded reach and the revised review framework, including mandatory declarations and filing fees, FIRRMA marks the beginning of a new era in U.S. national security screening of foreign direct investment. That said, the most significant elements of FIRRMA remain subject to the formal regulatory rulemaking process—meaning that many important details are still to be determined over the next six to twelve months.

In effect, FIRRMA raises the bar for foreign investors to demonstrate that their interests are truly passive, although the Committee has increased its scrutiny of passive investments in recent years and so arguably the new standard only codifies the Committee's existing practices.

With FIRRMA, lawmakers and other stakeholders, including President Trump, anticipate that the reformed CFIUS process will help stem the flow of critical technologies from the U.S. while ensuring the Committee has the authority it needs to mitigate any national security threats arising from foreign investment in critical technology or infrastructure companies.

Expanded Reach

Prior to FIRRMA, CFIUS's jurisdiction was limited to a set of "covered transactions" consisting of mergers, acquisitions, or takeovers that could potentially result in foreign control over a U.S. business. That original grant of jurisdiction will continue going forward. FIRRMA, however, alters the definition of "covered transactions" to expand the Committee's jurisdiction in several key ways.

A) "Other Investments" Involving Critical Infrastructure, Critical Technology, and Sensitive Personal Data of U.S. Citizens

FIRRMA authorizes CFIUS to review any "Other investments" by a foreign person in a U.S. business—including those that do not necessarily convey potential "control"—if the U.S. business:

- Owns, operates, manufactures, supplies, or services critical infrastructure;
- Produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies; or
- Maintains or collects sensitive personal data of United States citizens that may be exploited in a manner that threatens national security.

Although limited to U.S. businesses engaged in the above-described activities, the term "Other investments" is broadly defined to include any investment (even if below 10% or less) providing a foreign person: (1) access to material nonpublic technical information; (2) membership or observer rights on the board of directors or equivalent governing body; or (3) "any involvement, other than through voting of shares, in substantive decisionmaking" regarding: (i) the use, development, acquisition, safekeeping, or release of sensitive personal data of U.S. citizens maintained or collected by the U.S. business; (ii) the use, development, acquisition, or release of critical technologies; or (iii) the management, manufacture, or supply of critical infrastructure. In effect, FIRRMA raises the bar for foreign investors to demonstrate that their interests are truly passive, although the Committee has increased its scrutiny of passive investments in recent years and so arguably the new standard only codifies the Committee's existing practices.

FIRRMA was prompted in large part by lawmakers' concerns about the inability of the current legal framework to address issues relating to technology transfer overseas—particularly to countries such as China. With FIRRMA, lawmakers and other stakeholders, including President Trump, anticipate that the reformed CFIUS process will help stem the flow of critical technologies from the U.S. while ensuring the Committee has the authority it

needs to mitigate any national security threats arising from foreign investment in critical technology or infrastructure companies.

Similarly, personal data and privacy concerns are increasingly headline issues for CFIUS, and several major acquisitions in recent years have been rebuffed due to concerns that foreign state actors could potentially access and misuse this type of information for non-commercial purposes. Under FIRRMA, more foreign investments in a broad range of businesses will be subject to CFIUS review, including those in the financial services, insurance and healthcare industries as well as, potentially, the retail consumer sector, among others.

Filings on proposed investments that fall within this additional grant of jurisdiction will still be voluntary unless the requirements for a mandatory declaration are met, which are discussed below.

Exception: Carve-out for U.S. Person Managed Investment Funds

FIRRMA does contain an important carve-out for investment funds. Special provisions added to the bill clarify that limited partner investments through funds managed and controlled by U.S. nationals are excluded from the jurisdictional scope of these “Other investments.”

B) Real Estate

FIRRMA expands CFIUS’s jurisdiction to reach acquisitions by foreign persons of real estate and leaseholds in the United States if located in close proximity to a U.S. military installation or other sensitive U.S. government facility—regardless of whether the transaction involves the acquisition of a U.S. business, as is currently required. Excepted from this jurisdictional expansion are single housing units and real estate in “urbanized areas” as defined by the U.S. Census Bureau. Here too, FIRRMA directs the Committee to promulgate relevant regulations and, in particular, define the circumstances that will trigger jurisdiction.

Prior to FIRRMA, many real estate transactions were already “covered transactions” because they also involved an acquisition, merger, or takeover of a U.S. business such as a hotel or office building. And performing a proximity analysis—comparing a target’s physical locations with known locations of sensitive U.S. government facilities—has long been considered an integral part of the CFIUS diligence process. Nonetheless, this aspect of FIRRMA will reach previously uncovered transactions such as certain “greenfield” investments and leases.

As with “Other investments,” filings with respect to real estate transactions meeting the physical proximity criteria will be voluntary unless the mandatory declaration provisions are triggered.

Exception: Country Specific Considerations

FIRRMA expressly calls on CFIUS to promulgate regulations intended to define the term “foreign person” to limit the scope of the “Other investments” and “Real Estate” jurisdictional expansions discussed above. In preparing the new regulations, CFIUS must consider the extent to which the foreign person is connected to a foreign country or foreign government, and whether the connection may affect the national security of the United States. While it remains unclear how CFIUS will approach these regulations, it is conceivable that investors from certain countries on friendly terms with the United States, including those that provide enhanced security cooperation to the U.S., may be subject to reduced levels of scrutiny.

C) “U.S. Business” Redefined

Finally, a little watched provision of FIRRMA broadly defines “United States Business” to mean “a person engaged in interstate commerce in the United States.” This formulation drops a key qualifier currently appended to the regulatory definition: “but only to the extent of its activities in interstate commerce in the United States.” If this qualifier is not reapplied in forthcoming regulations, the new definition could give the Committee authority to reach an acquisition of a foreign business that merely imports goods or services into the U.S.

Increased Burdens

A) Mandatory Declarations

In a significant departure from the existing “voluntary” CFIUS review framework, FIRRMA introduces a new mandatory “declaration” requirement for certain transactions. Specifically, FIRRMA requires CFIUS to enact regulations obligating parties to notify CFIUS—at least 45 days before closing—of transactions that would result in foreign ownership of a “substantial interest” in a U.S. business where: (i) the U.S. business involves critical infrastructure, critical technology, or sensitive personal data of U.S. citizens; and (ii) a foreign government has a “substantial interest” in a foreign party to the transaction. Notably, FIRRMA tasks the Committee with defining “substantial interest” through the rulemaking process, but makes clear that the definition shall not reach investments falling below a ten percent voting interest. When it was originally proposed, FIRRMA would have triggered mandatory declarations when a foreign government owned a 25% interest in the foreign investor.

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Whether that or a different threshold will be fixed by the Committee in the rulemaking process is unclear.

In addition, as an alternative to filing the new short-form declaration, FIRRMA allows parties subject to the new mandatory declaration obligation to submit a full written notice if that is preferable. And for parties who shirk the new mandatory declaration obligations, FIRRMA allows the Committee to impose civil penalties.

As with the new “Other investments” jurisdictional category discussed above, FIRRMA includes a carve-out for investments by investment funds managed and controlled by U.S. nationals. Further, FIRRMA also allows CFIUS to enact regulations “waiving” the mandatory declaration requirement where the investments of the foreign person are not directed by a foreign government and the foreign person has a history of cooperation with CFIUS.

B) Expanded Review Timelines

FIRRMA adds fifteen days to the initial review period, giving CFIUS 45 days to complete its initial review (up from 30 days). FIRRMA also authorizes the Committee to extend the optional second-stage investigation period (which remains unchanged at 45 days) by an additional 15 days in “exceptional circumstances” to be spelled out in regulations. Overall, this means that a full cycle CFIUS review that is closed without a referral to the President could now take up to 105 days to complete—up from 75 days prior to FIRRMA. This is one of the few provisions of FIRRMA that is immediately effective—applying to any covered transactions “the review or investigation of which is initiated” on or after date of enactment.

Helpfully, FIRRMA also provides new timing requirements affecting when CFIUS must provide comments on draft notices and accept formal filings. Going forward, where parties stipulate that their transaction qualifies as a “covered transaction” within CFIUS’s jurisdiction, the Committee must provide comments on draft notices and accept submission of formal written notices within ten business days. Where CFIUS does not accept submission of a formal written notice within ten business days (i.e., because the notice is incomplete), FIRRMA requires CFIUS to notify the submitting parties in writing and explain all material deficiencies.

C) Obligation to Provide Partnership and Side Agreements

Under FIRRMA, CFIUS will now have the authority to require, through regulation, that parties include copies of any partnership agreements, integration agreements, or other transaction-related side agreements as part of their formal written notice.

D) Filing Fees

Prior to FIRRMA there were no filing fees for CFIUS notifications. FIRRMA, however, now allows CFIUS to begin imposing a fee up to the lesser of \$300,000 or one percent of the transaction value (adjusted for inflation). Such fees will not be required, however, until the completion of the rulemaking process.

Other Noteworthy Changes

A) More Resources

To ensure CFIUS has the resources and leadership necessary to bring FIRRMA's reforms into effect, FIRRMA:

- Establishes a “Committee on Foreign Investment in the United States Fund” and authorizes appropriations of \$20 million annually for fiscal years 2019 through 2023 (which may be transferred to member agencies as needed), in addition to the filing fees authority discussed above;
- Creates two new “Assistant Secretary of the Treasury” positions with CFIUS-related duties, including one—Assistant Secretary for Investment Security—whose duties will principally relate to CFIUS;
- Confers “special hiring authority” on CFIUS member agencies, enabling member agencies to quickly hire additional staff; and
- Blesses CFIUS's use of independent entities (i.e., third-party monitors) to monitor and report on parties' compliance with mitigation agreements.

B) Suspensory Power

Earlier this year, prior to FIRRMA, CFIUS famously used its “interim order” power to suspend Broadcom's acquisition of Qualcomm. Going forward, FIRRMA clearly provides that the Committee can “suspend a proposed or pending covered transaction that may pose a risk to the national security of the United States for such time as the covered transaction is under review or investigation.”

Effectiveness Timing

Although FIRRMA is now enacted, most of FIRRMA's key substantive changes require CFIUS to implement enacting regulations, which will take time.

A) Immediate Applicability

The following changes will have immediate effect:

- Expanded review timelines (effective immediately, the initial review period increases to 45 days, but CFIUS will need to define “extraordinary circumstances” by regulation before it can extend any second-stage 45-day investigation periods by an additional 15-day period);
- Obligation to provide partnership and side agreements (CFIUS needs to implement regulations before parties will be obligated to submit such agreements as a matter of course, but CFIUS may begin requesting such agreements on a case-by-case basis); and
- Suspensory power (CFIUS now has the power to suspend covered transactions pending review or investigation).

B) Delayed Applicability

Most of FIRRMA's changes, however, will not come into effect until the earlier of 18 months from the enactment date or 30 days after publication in the Federal Register of a determination by the CFIUS chairperson that “the regulations, organizational structure, personnel, and other resources necessary to administer the new provisions are in place.” Such changes include:

- The “Other investments” and real estate jurisdictional expansions discussed above, along with FIRRMA's “investment fund” and “country specification” exceptions;
- Mandatory declarations; and
- Filing fees, which CFIUS must establish through regulation.

Conclusion

FIRRMA gives CFIUS greater powers to respond to a constantly evolving national security threat landscape. Many questions remain about the Committee's expansive new jurisdiction that will need to be answered during the rulemaking process, including the extent to which mandatory declarations will be required. Although the new law is not explicitly aimed at investors from countries of special concern (such as China), mounting Executive Branch and

Although the new law is not explicitly aimed at investors from countries of special concern (such as China), mounting Executive Branch and Congressional concern over China's investments in U.S. businesses, particularly critical technology and infrastructure companies and those possessing sensitive personal data of U.S. citizens, was the driving force behind the legislation.

Congressional concern over China's investments in U.S. businesses, particularly critical technology and infrastructure companies and those possessing sensitive personal data of U.S. citizens, was the driving force behind the legislation. The macroeconomic impact of FIRRMA remains to be seen. While Congress included recitals strongly endorsing the benefits of foreign direct investment in the United States, the new law erects additional hurdles for foreign investors that may prove misguided in the long term. Any foreign person contemplating an acquisition or investment in the U.S. and the U.S. targets of those transactions should consult early on with CFIUS counsel in order to develop an optimal strategy for navigating the CFIUS process in the post-FIRRMA environment.

To learn more about our National Security Regulatory Practice and how to navigate key processes, including matters before CFIUS, the Defense Department’s Defense Security Service, the State Department’s Directorate of Defense Trade Controls, and the Treasury Department’s Office of Foreign Assets Control (“OFAC”), please contact the following:

WASHINGTON, D.C.

Peter Thomas
+1-202-636-5535
pthomas@stblaw.com

Abram J. Ellis
OFAC
+1-202-636-5579
aellis@stblaw.com

* * * * *

David Shogren
+1-202-636-5562
dshogren@stblaw.com

Andrew E. Hasty
+1-202-636-5829
andrew.hasty@stblaw.com

Mark B. Skerry
+1-202-636-5523
mark.skerry@stblaw.com

Claire M. DiMario
+1-202-636-5536
claire.dimario@stblaw.com

NEW YORK CITY

George S. Wang
OFAC
+1-212-455-2228
gwang@stblaw.com

Lani E. Lear
+1-202-636-5827
lanilear@stblaw.com

Seth Atkisson
OFAC
+1-202-636-5555
seth.atkisson@stblaw.com

Daniel S. Levien
+1-212-455-7092
daniel.levien@stblaw.com

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Simpson
Thacher
Worldwide



UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000