

Client Alert

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US Government Expands the Scope of CFIUS Review

Overview

On August 13, 2018, President Donald Trump signed into law the Foreign Investment Risk Review Modernization Act (FIRRMA), as part of the John S. McCain National Defense Authorization Act (the Act) for fiscal year 2019. The final text of FIRRMA is available [here](#). FIRRMA previously passed the US House of Representatives and US Senate by overwhelming votes.

FIRRMA codifies a variety of current practices of the Committee on Foreign Investments in the United States (CFIUS) and also makes a number of changes to the scope, rules and procedures governing CFIUS and its review of investments in US businesses by foreign persons under Section 721 of the Defense Production Act of 1950 (as amended, the Exon-Florio Amendment or Exon-Florio). As noted below, these changes include an expansion of the transactions potentially subject to CFIUS review, a short-form submission to CFIUS in certain circumstances and an extension to the initial review period.¹

Expanded Jurisdiction

FIRRMA expands the scope of “covered transactions” that are subject to CFIUS review relating to the following:

- ***Investments in critical technology, critical infrastructure and sensitive personal data***

Under Exon-Florio as it existed prior to FIRRMA, investments by foreign persons in critical technology and critical infrastructure required an element of “control” as generally defined under the rules. Those rules did not specifically reference personal data as an element for CFIUS consideration (though in recent years it has become clear that this is a concern for CFIUS).² FIRRMA expands the definition of “covered transactions” as it relates to certain investments in critical technology and critical infrastructure companies and now specifically references sensitive personal data of US citizens.³

¹ While certain provisions of FIRRMA became effective immediately upon enactment, many other provisions will not go into effect until implementing regulations are adopted. The provisions of FIRRMA that will go into effect immediately include, but are not limited to, an extension of the time period for reviews of foreign investments by CFIUS from 30 to 45 days and certain of the definitional changes to scope of covered transactions. Other provisions of the legislation, including most of the significant changes to the “covered transactions” definition and the declaration process described below, will go into effect on either the date that is 18 months after the bill’s enactment or 30 days after a determination by CFIUS that the regulations, organizational structure, personnel and other resources necessary to administer the bill’s provisions are in place. See FIRRMA, § 1727.

² The acquisition of Genworth Financial, Inc. by China Oceanwide, a Chinese company, was delayed for a substantial period while the parties worked out information barriers and other terms satisfactory to CFIUS to avoid US personal information falling into Chinese hands. This transaction received CFIUS clearance in June 2018. The acquisition of Moneygram, Inc. by Ant Financial, a Chinese company, was announced in 2017 and then abandoned in early 2018, reportedly because of personal information issues.

³ See FIRRMA, § 1703 with respect to paragraphs (a)(4)(B)(iii) and (D) of Exon-Florio. These provisions are not immediately effective.

FIRRMA also creates a new defined term—an “other investment”—which is a transaction that involves critical infrastructure, critical technology and/or sensitive personal data if it could afford the foreign person, *directly or indirectly*, (1) access to material nonpublic technical information, (2) board membership or observer rights or the right to nominate a board member⁴ or (3) substantive decision-making involvement (other than through voting of shares) in matters concerning personal data, critical infrastructure or critical technologies.⁵ Under FIRRMA, an “other investment” is considered a covered transaction whether it affords “control” or not. Thus, the provisions relating to critical infrastructure, critical technologies and personal information mark a narrowing of the passive investment exception under the existing CFIUS rules.⁶

Finally, FIRRMA expands the definition of “critical technologies.”⁷ Under current rules, critical technologies are defined as (a) defense articles or defense services on the United States Munitions List, (b) items specified on the Commerce Control List included as part of the Export Administration Regulations that are controlled pursuant to various multilateral regimes as well as those that are controlled for reasons of regional stability or certain other reasons, (c) specially designed and prepared nuclear equipment, parts and components, materials, software and other nuclear facilities and equipment and (d) select agents and toxins.⁸ FIRRMA retains this listing (and makes it statutory) and adds “[e]merging and foundational technologies controlled pursuant to section 1758 of the Export Control Reform Act of 2018.”⁹ This provision will involve CFIUS more closely in the capital markets for start-up and breakthrough technologies.

- **Private Equity and Other Indirect Investments**

Prior to FIRRMA, neither CFIUS nor Congress had provided specific guidance as to when or whether a foreign person’s investment in a private equity or other investment fund (a fund) would or would not constitute *indirect* control over one of the fund’s investments (each a portfolio company).¹⁰ FIRRMA now provides what seems to be a “safe harbor”—subject to final rules on this subject from CFIUS—to the effect that a foreign person’s having board or observer rights on a fund’s advisory board or other committee will not be considered an indirect investment by the foreign person in the portfolio company if a number of conditions are satisfied:

- 1) the fund is managed “exclusively” by a general partner or managing member or equivalent that is not a foreign person;
- 2) the advisory board or committee of the fund on which a foreign person serves does not have the ability to approve, disapprove or otherwise control investment decisions by the fund or by the general partner, managing member or equivalent of the portfolio company;

⁴ Under existing CFIUS rules, the presence of a single board seat in the hands of a foreign person would not necessarily have made the transaction a “covered transaction.” See 31 C.F.R. § 800.302(b) (example #3).

⁵ FIRRMA, § 1703 with respect to paragraph (D) of Exon-Florio.

⁶ See 31 C.F.R. § 800.223.

⁷ See FIRRMA, § 1703 with respect to paragraph (a)(6) of Exon-Florio. This provision is immediately effective.

⁸ See 31 C.F.R. § 800.209.

⁹ Some earlier drafts of FIRRMA included an expansion of CFIUS’s authority to review transactions to include certain technology *export* transactions. In lieu of this expansion, the bill that was passed by both houses of Congress and signed by the president includes a provision specifically directing an interagency task force under the aegis of the Department of Commerce to identify technologies that are deemed “emerging and foundational.” Such technologies would include technologies that are essential to the national security of the United States but do not fall within any of the other categories of “critical technologies” in FIRRMA. In addition, FIRRMA gives the chairperson of CFIUS the authority to identify further technologies and to recommend them to the Department of Commerce for inclusion in this last category.

¹⁰ See FIRRMA, § 1703 with respect to paragraph (a)(4)(D)(iv) of Exon-Florio. This provision is not immediately effective.

- 3) the foreign person does not otherwise have the ability to control the fund (including the ability to control the employment, dismissal or compensation of the general partner, managing member or equivalent); and
- 4) the foreign person does not have access to material nonpublic technical information of the portfolio company.

Although this provision of FIRRMA may thus provide a clear guide to funds as to how to protect themselves from claims of foreign control, this may also signal a more searching inquiry by CFIUS to determine whether these standards are met. Among other things, FIRRMA specifically gives CFIUS the authority to require the description and disclosure of partnership and “side” agreements.¹¹

- ***Real Estate Transactions***

Although CFIUS has long regarded real estate transactions involving properties located near critical infrastructure and sensitive facilities to be within its purview, FIRRMA codifies CFIUS review responsibilities with respect to real estate and broadens them in some respects.¹² FIRRMA provides that any purchase or lease of, or concessions related to, real estate in the United States is a covered transaction under Exon-Florio if: (1) the real estate is, is located within or will function as part of an air or maritime port; (2) the real estate is in close proximity¹³ to a US military installation or another US government facility or property that is sensitive for reasons relating to national security; (3) the real estate could reasonably provide the foreign person the ability to collect intelligence on activities being conducted at such an installation, facility or property or could otherwise expose national security activities at such an installation, facility or property to the risk of foreign surveillance; or (4) the real estate meets other criteria specified by CFIUS. This provision will likely involve CFIUS in review of more real estate deals.¹⁴

- ***Transactions Intended to Evade CFIUS Review***

FIRRMA gives CFIUS authority to review any transaction “designed or intended to evade or circumvent” CFIUS jurisdiction. This broad provision potentially enables CFIUS to scrutinize all manner of transactions, including complex investment vehicles and outbound transactions, where CFIUS finds an intent to evade its review.¹⁵ This provision may give rise to disputes over what steps amount to permissible structuring and what steps constitute evasion, a distinction that has proved difficult to describe in precise terms in other regulatory areas.

- ***Changes to Existing Rights***

FIRRMA gives CFIUS express authority to review any change in the rights that a foreign person has with respect to a US business that could result in foreign control of that business or that would constitute an “other investment” as described above.¹⁶

¹¹ See FIRRMA, § 1705 with respect to paragraph (b)(i)(C) of Exon-Florio. This provision is immediately effective.

¹² See FIRRMA, § 1703 with respect to paragraphs (a)(4)(B)(ii) and (C) of Exon-Florio. These provisions are not immediately effective.

¹³ FIRRMA directs CFIUS to prescribe regulations to ensure that “the term ‘close proximity’ 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 United States military installation or another facility or property of the United States Government.” FIRRMA, § 1703 with respect to paragraph (C)(ii) of Exon-Florio.

¹⁴ According to a recent news report, CFIUS has told a Chinese company that purchased in 2016 an office building a few blocks from Trump Tower in New York that it must sell the building. See Keiko Morris, et al., “U.S. Orders Chinese Company to Sell Manhattan Building Near Trump Tower,” *Wall St. J.*, Aug. 10, 2018, <https://www.wsj.com/articles/u-s-orders-chinese-company-to-sell-manhattan-building-near-trump-tower-1533917797>.

¹⁵ See FIRRMA, § 1703 with respect to paragraph (a)(4)(B)(v) of Exon-Florio. This provision is immediately effective.

¹⁶ See FIRRMA, § 1703 with respect to paragraph (a)(4)(B)(iv) of Exon-Florio. This provision is immediately effective as it relates to “control” but is not immediately effective as it relates to “other investments.”

Extended Timing of Review

FIRRMA expands the statutory timeline for the CFIUS process for the initial review period from 30 calendar days to 45 calendar days. In addition, insofar as the 45-day investigation time period is concerned, FIRRMA allows CFIUS to extend an investigation for one 15-day period in “extraordinary circumstances” (to be defined by CFIUS in regulations).¹⁷ Thus, the minimum time to complete a CFIUS review has been increased from 75 to 90 (and potentially to 105) days.

Abbreviated Declarations Filing

FIRRMA provides for a new “declaration” process, which allows for shorter filings than a traditional CFIUS notice and a potentially expedited process for obtaining CFIUS clearance of a transaction.¹⁸ In addition, declarations for certain foreign government-backed transactions involving the acquisition a substantial interest¹⁹ in a business that involves critical infrastructure, critical technology or personal information will be *mandatory*. This is the first time that Exon-Florio has included a provision making it unlawful not to file a notice or other submission prior to closing a transaction.

Declarations will provide basic information regarding the transaction and generally will not exceed five pages in length. Within 30 days of the submission of a declaration, CFIUS will: (1) request that the parties file a written notice; (2) inform the parties that it is unable to complete action with respect to the transaction on the basis of the declaration alone; (3) initiate a unilateral review of the transaction; or (4) notify the parties in writing that it has completed all action with respect to the transaction. Parties will be able to file a formal notification to CFIUS in lieu of any declaration and thus skip the declaration process entirely.

Country Differentiation

FIRRMA expressly authorizes CFIUS to treat persons from different countries differently.²⁰ While current law does not specifically address such a risk-based approach, practitioners before CFIUS know that this is already the *de facto* practice. Under this provision, we would expect CFIUS to limit the effect of certain new provisions with respect to other investments to Chinese investors and perhaps investors from certain other countries of concern.

Added Enforcement Powers

FIRRMA formally grants a number of additional enforcement and monitoring powers to CFIUS, including:²¹

- if CFIUS determines the parties are not in compliance with a mitigation agreement or condition, (1) to initiate a review of a previously reviewed transaction, (2) to impose penalties and/or (3) to negotiate a plan to correct any noncompliance;
- to suspend a proposed or pending covered transaction that may pose a risk to US national security while the covered transaction is under review or investigation; and
- to enter into and impose mitigation agreements and conditions in cases where a party to a covered transaction has voluntarily chosen to abandon the transaction if such abandonment alone does not resolve the US national security risks.

¹⁷ See FIRRMA, § 1709. This provision is immediately effective.

¹⁸ See FIRRMA, § 1706 with respect to paragraph (b)(1)(C) of Exon-Florio. This provision is not immediately effective.

¹⁹ FIRRMA largely leaves this definition to CFIUS to develop and propose.

²⁰ See FIRRMA, § 1703 with respect to paragraph (a)(4)(E) of Exon-Florio. This provision is not immediately effective.

²¹ See FIRRMA, § 1718. This provision is immediately effective.

Judicial Review

The law allows parties to challenge CFIUS actions and findings by bringing a civil action only in the US Court of Appeals for the DC Circuit. It also establishes procedures for the review of privileged or protected information in judicial proceedings.²² Formal actions of the president under Exon-Florio remain excluded from judicial review.

Hiring, Funding and Filing Fees

FIRRMA establishes senior-level positions at each CFIUS member agency and department and provides CFIUS agencies and departments with special hiring authority to appoint candidates directly to positions in the competitive service in order to carry out their CFIUS-related functions.²³

Under the legislation, the president must assess the extent to which the expansion of CFIUS's responsibilities under FIRRMA requires additional resources and to include such additional resources in the president's annual budget request. The bill also appropriates \$20 million to a new "Committee on Foreign Investment in the United States Fund" for each of fiscal years 2019 through 2023 to enable CFIUS to carry out its functions. In addition, FIRRMA permits CFIUS to impose filing fees for the first time. The filing fee may not exceed the lesser of \$300,000 or 1 percent of the value of the transaction.²⁴

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²² See FIRRMA, § 1715 amending paragraph (e) of Exon-Florio. This provision is immediately effective.

²³ See FIRRMA, § 1717 amending paragraph (k) of Exon-Florio. This provision is immediately effective.

²⁴ See FIRRMA, § 1723 creating new paragraph (p) of Exon-Florio. This provision is immediately effective.