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United States Strengthens National Security Review of Foreign Direct Investment

On August 13, 2018, President Trump signed into law the Foreign Investment Risk Review Modernization Act (FIRRMA) as part of the John S. McCain National Defense Authorization Act for Fiscal Year 2019. FIRRMA expands the authority of the Committee on Foreign Investment in the United States (CFIUS) to determine if investments by foreign nationals and state owned entities in U.S. businesses pose risks to U.S. national security.

FIRRMA effects a myriad of changes to both the substantive scope and procedural aspects of the CFIUS regime intended to address emerging threats to national security posed by foreign investment including, in particular, investments by economic, geopolitical and military rivals. Among these changes, two are of particular significance:

- First, FIRRMA substantially broadens the spectrum of activities and technologies engaged in by U.S. companies which will trigger national security review by CFIUS. FIRRMA expands the concept of “critical technologies” within the purview of CFIUS and adds to the list of U.S. national security concerns the potential for foreign exploitation of U.S. citizens’ personal data.
- Second, FIRRMA expands CFIUS’ jurisdiction – previously limited to transactions which transferred “control” of a U.S. business – to include the review of all foreign investments in U.S. companies involved with critical infrastructure, critical technologies or exploitable personal data of U.S. citizens, other than investments which are entirely passive and do not afford the foreign investor access to sensitive information.

These two enhancements to the authorities exercised by CFIUS enable a substantial enlargement of CFIUS’s involvement in the conduct of foreign direct investment in the U.S., potentially heightening barriers to entry in terms of transaction costs, complexity and timing, as well as completion risk.

The CFIUS Regime

CFIUS is an interagency committee of the U.S. government chaired by the Secretary of the Department of Treasury. Its other members include the Secretaries of State, Defense, Homeland Security, Commerce and Energy, the Attorney General and, on an *ex officio* basis, the Director of National Security and the Secretary of Labor. Historically, CFIUS has reviewed foreign direct investment (FDI) transactions to identify and address national security risks that could result from foreign control of U.S.

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businesses which own or operate critical infrastructure in the U.S. or which develop and utilize technologies that are critical to national defense. Submission of proposed transactions for review by CFIUS has been voluntary, with approval providing a safe harbor against subsequent CFIUS action. CFIUS may otherwise, on its own initiative, investigate acquisition transactions consummated without the parties having applied for prior approval. CFIUS conducts initial reviews of all applications and may conduct deeper investigations employing risk-based analysis of the threat, vulnerabilities, and potential consequences to national security of a proposed transaction. CFIUS is required to investigate any takeover of U.S. businesses by “a foreign government or an entity controlled by or acting on behalf of a foreign government.”

CFIUS will approve the acquisition of a U.S. business by a foreign party where it determines national security is not implicated. If CFIUS identifies a national security risk, it can require that mitigation measures be taken as a condition to its approval of the transaction – for example, by pre-acquisition divestiture of a sensitive asset or business, or post-acquisition monitoring of a technology’s use and transfer. CFIUS also can recommend that the President block or order the unwinding of a transaction on national security grounds. Action by the President to prohibit or unwind a transaction generally is not subject to judicial review.

CFIUS’ Evolving Role

The role of CFIUS has developed over time in response to the emergence of new technologies, the expanding conduct of governmental actors in the global economy, changes in investment structures, and the evolving implications for U.S. national security resulting from these changes. President Ford established CFIUS by Executive Order in 1975 as an oversight and advisory group, the primary focus of which was the risk of nuclear weapons proliferation. CFIUS was assigned "primary continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment."

In 1988, in light of the growing importance to national security of computer technologies and the emerging threat of foreign control over U.S. businesses in the sector – as evidenced at the time by the proposed purchase of Fairchild Semiconductor by Fujitsu – Congress enacted the Exon-Florio Amendment to the Defense Production Act of 1950 giving the President the authority, exercised with the advice of CFIUS, to block foreign takeovers that threaten U.S. national security interests. The role of CFIUS was further expanded by the Byrd Amendment in 1992 which requires that CFIUS conduct a national security investigation of any transaction where the potential acquirer of a U.S. business is acting for the benefit of a foreign government. In 2007, the Foreign Investment and National Security Act (FISIA) codified the composition of CFIUS,

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formalized its review and investigative processes, and provided for enhanced Congressional oversight of CFIUS' activities.

In general, CFIUS has sought to balance the United States' commitment to a free, fair and open cross-border investment environment against the need to maintain U.S. national security. With the enactment of FIRRMA, that balance is shifted decidedly in favor of national security interests.

Expansion of CFIUS' Transactional Jurisdiction

The jurisdiction of CFIUS previously extended only to transactions by which a foreign actor would obtain control of a U.S. business. The term "control" is defined by implementing regulations to mean "the power, direct or indirect, ...to determine, direct, or decide important matters affecting an entity..." FIRRMA expands the scope of transactions within CFIUS' jurisdiction to include any investment, regardless of size, by a foreign party in a U.S. business which:

- "owns, operates, 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."

Such non-control investments are referred to as "other investments." FIRRMA, however, provides an exception for other investments which do not afford the foreign investor any of the following:

- access to "material nonpublic technical information" of the U.S. business;
- representation or observer rights on the board of directors or equivalent body of the U.S. company; or
- involvement, other than through the voting of shares, in the company's substantive decision making concerning its critical infrastructure, critical technologies, or sensitive personal data of U.S. citizens.

The term "material nonpublic technical information" does not include financial information regarding a U.S. business, but includes any information which:

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- “provides knowledge, know-how, or understanding, not available in the public domain, of the design, location, or operation of critical infrastructure;” or
- “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.

FIRRMA, therefore, excludes from CFIUS review entirely passive investments, including investments made through the public securities markets. And, unlike review based on the acquisition of control, which applies to any U.S. business, “other investments” are subject to CFIUS scrutiny only if the U.S. business involves critical infrastructure, critical technologies or the personal data of U.S. citizens. The term “investment” is limited to “the acquisition of equity interest, including contingent equity interest,” and so does not include straight debt.

Broadening of CFIUS’ Substantive Scope

FIRRMA broadens the scope of CFIUS review by including, as noted above, the U.S. national security implications posed by potential foreign exploitation of U. S. citizens’ personal data. Congress likely had in mind specifically the possible exploitation of personal data gleaned by foreign interests from social media sources in connection with U.S. national elections. This new authority, however, may as easily apply, for example, to such risks as that posed by a malevolent foreign actor’s access to an email database storing damaging information with which a public official might be blackmailed, or an adversarial government’s access to human genomic data that might be useful in weaponizing some new biologic agent.

In addition to this new authority relating to personal data, FIRRMA expands, and makes more adaptable, the CFIUS jurisdictional concept of “critical technologies.” FIRRMA provides a new definitional approach and regulatory mechanism enabling CFIUS to take into account the emergence of new technologies – such as artificial intelligence, high-speed computing, advanced materials, robotics, 3-D printing, and bioengineering – which, in the hands of a foreign adversary, could be employed to degrade U.S. defense capabilities, damage the U.S. economy, or disrupt governmental or societal function and order. Importantly, under FIRRMA, the concept of “critical technologies” is no longer tethered to national defense alone, but rather is bounded, together with “critical infrastructure,” only by the broader concept of national security.

FIRRMA retains the existing definition of “critical infrastructure” as including “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such assets or systems would have a debilitating impact on national

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security.” With respect to “critical technologies,” however, the prior statutory definition was specifically limited to “items essential to national defense.” FIRRMA amends the definition to codify what was previously a regulatory reference to items identified pursuant to various other government programs – covering the export of weapons and other military goods, nuclear material and equipment, certain biologic agents and toxins, and their related technologies. More significantly, FIRRMA now provides CFIUS with express authority to expand the list of critical technologies through an interagency process to identify “emerging and foundational technologies... that are essential to the national security of the United States.” That process is set out in the Export Control Reform Act of 2018 (ECRA), which was enacted along with FIRRMA as a part of the Fiscal 2019 National Defense Authorization Act.

ERCA states that: “The national security of the United States requires that the United States maintain its leadership in the science, technology, engineering, and technology sectors, including foundational technology that is essential to innovation.” Section 1758 of the ERCA allocates responsibility for identifying “emerging and foundational technologies” – for purposes of export controls and foreign investment – to the Emerging Technology and Research Advisory Committee, which is comprised of representatives from the Departments of Commerce, Energy, Defense and State, overlapping substantially with CFIUS. This committee considers information from multiple sources within the U.S. government, including classified information from the Department of Defense and the Director of National Security. With the intent of staying at the leading edge of the technology development curve, the committee is directed, among things, to consider technologies which “may be developed” within a five to ten-year time frame.

The Scope of National Security

FIRRMA does not provide any new or improved definitional scope, much less limitation, on the concept of “national security,” the foundational objective of the CFIUS regime. FIRRMA does not amend the statutory list of factors to be taken into consideration in assessing the requirements of national security. This, of course, is likely by design, intended to avoid tying the hands of CFIUS, and the President, if and when confronted by the next unanticipated threat to national security. But it leaves open the risk that national security could become too broadly construed, at the expense of the countervailing governmental objective of maintaining a free, fair and open cross-border investment and trade environment.

The “sense of Congress” expressed in FIRRMA’s prefatory provisions counsels that CFIUS should “review transactions for the purpose of protecting national security and should not consider issues of national interest absent a national security nexus.” But the line between national security and national interest, if it can be drawn at all, is very

much a line to be discerned through the lens of a particular administration, and the drawing of which is confounded by the nature of the technologies and infrastructure now at the forefront of national security challenges – the same algorithms, computer code, sensors and processing chips that enable a car to drive itself across the country might equally enable a malicious foreign interest to guide an explosive drone into an office building; the same GPS satellite and telecommunications systems that enable us to map a route home at rush hour might as easily yield an aviation disaster if disrupted by a cyberattack enabled by a foreign actor’s access to such systems. As the role of technology and data in societal activity continues to expand, the involvement of CFIUS can be expected to enlarge proportionally.

Other Changes to the CFIUS Process

FIRRMA makes a number of additional important changes to the CFIUS regime. These include, among others, the following:

- Under FIRRMA, prior application to CFIUS for its approval is mandatory where a foreign government has a “substantial interest” in the investor and the U.S. business involves critical infrastructure, critical technologies or exploitable personal data of U.S. citizens. The term “substantial interest” will be defined in FIRRMA’s implementing regulations, but will focus on “the means by which a foreign government could influence the actions of a foreign [investor], including through board membership, ownership interest, or shareholder rights.” FIRRMA also allows CFIUS, by regulation, to expand the categories of transactions subject to mandatory application to CFIUS.
- FIRRMA now gives CFIUS the authority to review the purchase or lease of real estate in “close proximity” to military installations, air and maritime ports, intelligence facilities, and other properties posing the risk of foreign surveillance of U.S. military and intelligence operations.
- Any changes in the rights of a foreign investor in a U.S. business now will be treated under FIRRMA as equivalent to a new investment – if the change provides the foreign investor with “control” or constitutes an “other investment” – requiring CFIUS review on the same bases.
- FIRRMA limits CFIUS’ jurisdiction in cases of investments by U.S.-controlled investment funds having foreign limited partners, or their equivalent, provided the foreign investors do not have investment decision-making rights in connection with the fund’s investments.

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- FIRRMA clarifies that acquisitions made in connection with the U.S. bankruptcy process are subject to CFIUS review where its jurisdiction otherwise applies.
- CFIUS is required by FIRRMA to develop criteria which will limit the definition of “foreign persons” whose investments may be subject to CFIUS review in connection with “other transactions” and certain real estate acquisitions. This provision addresses Congressional concern that investors from EEOC countries, NATO and other allies should not be unduly burdened.
- FIRRMA establishes a process for filing a short-form “declaration” with CFIUS, which can avoid the requirement for a more extensive “notice” in cases where basic information is sufficient for CFIUS to conclude that no investigation of national security implications is warranted.
- The period within which CFIUS is required to complete its initial review of a noticed transaction is extended from 30 to 45 days. FIRRMA also requires that CFIUS respond to draft notices within a ten-day period in cases where the parties to the proposed transaction stipulate that it is a “covered transaction” within CFIUS’ jurisdiction.
- FIRRMA provides for filing fees up to the lesser of one percent of the value of a transaction and US\$300,000. Filing fees were not previously assessed. These fees, together with an annual appropriation, will fund the additional administrative costs of fulfilling CFIUS’ expanded activity.
- Certain of FIRRMA’s provisions take effect immediately with respect to transactions reviewed after its enactment date, August 13, 2018. Other provisions, in particular those requiring regulatory development, will take effect on the earlier of eighteen months from FIRRMA’s enactment and thirty days after the Secretary of the Treasury determines that the necessary regulations, personnel, administrative structure, and other resources necessary to implement the new CFIUS authorities all are in place.

Implications for FDI

FIRRMA’s changes to CFIUS’ jurisdiction and review process have significant implications for the structuring, terms, and conditions of investments involving foreign parties in a widening array of U.S. businesses. Early consideration, including the advice of counsel, will be required for any foreign investment involving the acquisition of control or where the U.S. business involves any type of critical infrastructure, critical technologies or the personal data of U.S. citizens, as well as any purchase or lease of real estate in a sensitive location. Determinations with respect to any “substantial interest”

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by a foreign government in an investor will be of particular importance and require heightened diligence. While FIRRMA expands the role of CFIUS, at the same time, it provides significant clarifications, improves the application and review process, and offers a better road map to achieving approval of foreign investments in the U.S.

Just how deeply the CFIUS process may intrude into the ordinary course of foreign direct investment in the U.S., however, is a question which necessarily will be answered only with the promulgation by CFIUS in the coming months of FIRRMA's implementing regulations and, more significantly, revealed based on precedents established by CFIUS over the course of the coming years. Given that the CFIUS process rests ultimately on assessments of "national security" consequences, it will be particularly important to see how the administration employs the greater latitude now afforded it under FIRRMA.

CFIUS FAQs

Following President Trump's signing, CFIUS published on its website the full final [text of FIRRMA](#) together with [initial FAQs](#) about its interpretation and implementation.

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Please feel free to contact any of the persons listed below if you have any questions on this important development:



Daniel R. Lenihan

Partner
dlenihan@curtis.com
New York: +1 212 696 6949



James Durling

Partner
jdurling@curtis.com
Washington, DC: +1 202 452 7328



Matthew McCullough

Partner
mmcullough@curtis.com
Washington, DC: +1 202 452 7327



Valerie Ellis

Counsel
vellis@curtis.com
Washington, DC: +1 202 452 7345