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Stricter Regulation of Foreign Investments Advances on Two Fronts: Congressional Committees Approve CFIUS Reform Legislation, and President Trump Announces Forthcoming Restrictions on Investments from China

May 29, 2018

Today, the White House announced President Trump's decision to impose "specific investment restrictions and enhanced export controls for Chinese persons and entities related to the acquisition of industrially significant technology." These measures "will be announced by June 30, 2018, and they will be implemented shortly thereafter."

This announcement closely follows unanimous votes on May 22, 2018, by each of the Senate Committee on Banking, Housing, and Urban Affairs and the House Financial Services Committee to approve bills to "modernize and strengthen" the Committee on Foreign Investment in the United States (CFIUS) (S. 2098 and H.R. 5841, respectively). Both entitled the "Foreign Investment Risk Review Modernization Act of 2018" (FIRRMA), these bills are based on legislation originally introduced by Senator Cornyn (R-TX), Representative Pittenger (R-NC), and colleagues in November 2017. We described the key features of their proposal in our prior client alert: CFIUS Reform Legislation Unveiled: Senator Cornyn and Representative Pittenger Introduce the Foreign Investment Risk Review Modernization Act (FIRRMA).

President Trump's announcement targets only China, while FIRRMA would apply to all foreign investments. Yet the same primary motivating force propels both initiatives—belief in the urgent necessity of gaining greater regulatory control over access by strategic adversaries to "emerging" or "foundational" technologies developed in the US. Senator Cornyn, Representative Pittenger, and the Trump administration advocated for direct CFIUS jurisdiction over licensing of such technologies by US persons to foreign licensees, while others urged Congress to address the issue through an enhanced export control process. The committees largely chose the latter course, adding robust new authorities to identify and to impose controls on technologies of concern. The President apparently intends to follow the first path by invoking emergency powers to impose direct restrictions on Chinese investments and other transactions.

By early August, both the White House and Congress likely will conclude their work to put the new regulatory schemes in place. Committee leaders have expressed their intent to secure enactment of FIRRMA before the August recess. In the Senate, sponsors seem likely to seek to attach the bill to the FY2019 National Defense Authorization Act, which is often tagged as "must pass" legislation. The scope of the White House action and its timing doubtless will be affected by the status of the trade and investment negotiations ongoing between China and the US, but "shortly after" June 30 signals final action by August as well. Though the negotiators may well achieve some success, it would be excessively optimistic to predict the parties will achieve a comprehensive resolution of their profoundly differing perspectives on Chinese techno-nationalistic policies.

Individually or in combination, the White House action and FIRRMA will mark a pronounced—and probably permanent—departure from the 225-year-old US policy of welcoming foreign investment except in narrow circumstances. By highlighting "industrially significant," "emerging," and "foundational" technologies as specially under CFIUS protection, the government will assume broad new regulatory authority that will set the stage over the long term for future investment controls based more explicitly on economic policy and public interest concerns. More immediately, implementation of the new authorities will significantly impact the financing and exit strategies of early stage US companies, as well as M&A and development partnership transactions involving mature companies that possess technologies fitting the new designations.

The following summarizes key aspects of the White House statement and the versions of FIRRMA that emerged from the Senate and House committees.

The White House Statement

On March 22, 2018, President Trump directed the Secretary of the Treasury to propose "executive branch action, as appropriate and consistent with law, and using any available statutory authority, to address concerns about investment in the United States directed or facilitated by

China in industries or technologies deemed important to the United States." A progress report was due on May 21, and the White House statement confirmed that the Treasury Secretary delivered that report, though it does not disclose the report's contents.

The March 22 directive followed delivery of a comprehensive "Section 301" report from the US Trade Representative detailing extensive Chinese government practices designed to secure technological independence for China. These practices include acquisition of advanced technologies from US and other foreign sources, legally and through intellectual property theft, and forced technology transfer as a condition for foreign company access to the Chinese market.

Section 301 of the 1974 Trade Act[1] empowers the President to use any available existing authority to address such unfair practices. Although it is silent on the authority that the President may invoke to restrict Chinese investment activity, almost certainly that authority will be the International Emergency Economic Powers Act (IEEPA).[2] IEEPA confers broad authority in the President to regulate cross-border trade and investment in response to a declared national emergency. President Trump would doubtless find that prior and potential acquisitions of industrially significant technology by Chinese investors constitute a national emergency.

The term "industrially significant" is broader than "foundational" or "emerging," as used in FIRRMA. The evident intent to capture any commercial technology, whether or not new or critical to future product development, likely signifies a purpose to reciprocate Chinese restrictions on foreign investments, without regard to the national security relevance of the technology.

FIRRMA: Significant Changes to Jurisdiction, Process, and Enforcement

While retaining core concepts of the original bills introduced last November, both S.2098 and H.R. 5841 incorporate important changes to address concerns about the scope of new powers envisioned for CFIUS.

- **Integration of CFIUS with Export Controls**: The most significant change is the addition of export control provisions both to replace and to supplement the CFIUS reforms. Both bills require the President, through the Secretary of Commerce, to identify and control the export, re-export, and transfer of "emerging and foundational technologies" that are essential to national security and are not currently defined in the Defense Production Act. The House bill sweeps more broadly by incorporating the Export Control Act of 2018 (ECA), introduced by Rep. Royce (R-CA) on February 15, 2018. The ECA is intended to provide a comprehensive statutory basis for the US dual-use export control regime, currently authorized by executive orders issued under IEEPA because Congress has failed repeatedly to reauthorize the Export Administration Act. Along with codifying the general authority of the President to control the "export, reexport, and transfer of items subject to the jurisdiction of the

US, whether by US persons or by foreign persons," the ECA would expand the definition of a "technology" covered under export control laws to include "foundational information and information and know-how necessary for the development, production [or] use" of a controlled item. The ECA would also broaden the scope of the US export control regime to encompass "shipment[s] or transmission of [a controlled] item from a foreign country to another foreign country," even where the item does not have an intrinsic connection to the US.

- **Countries of Special Concern**: The Senate bill, like the November draft, would direct scrutiny of various types of transactions where the foreign investor is from a "country of special concern"—"a country that poses a significant threat to the national security interests of the United States." The House bill goes a step further to actually define a "country of special concern" as "[a]ny foreign country subject to certain export restrictions on military end-use items (currently China, Russia, and Venezuela); any state sponsor of terrorism (Iran, North Korea, Syria, and Sudan); and countries that are subject to a US arms embargo and named as a country of special concern."

- **CFIUS Jurisdiction**: A significant provision in the earlier bills expanded CFIUS jurisdiction to include "contributions, other than through an ordinary customer relationship, by a US critical technology company of both intellectual property and associated support to a foreign person through an arrangement such as a joint venture." Both the Senate and House bills replaced this approach through the export control provisions described above. In addition, both bills marginally expand the definition of a "covered transaction" subject to CFIUS jurisdiction to include the purchase or lease by a foreign person of real estate located at or will function as part of an air, land, or sea port, and by clarifying treatment of transactions effected through a bankruptcy proceeding, changes in corporate governance, and other situations.

- **Alternative Short-form Notifications**: Like the November bills, both the House and Senate bills include a new avenue for securing CFIUS clearance: filing "declarations" of no more than five pages. The earlier bills, however, mandated that parties file declarations for transactions involving acquisition of 25% or more voting interests by a foreign investor that is owned 25% or more by a foreign government. Both the new Senate and House bills alter this requirement to require declarations only for "transactions involving acquisition of a **substantial interest** in a US business by a foreign investor in which a substantial interest is owned by a foreign government." The legislation would require CFIUS to promulgate regulations defining "substantial interests" for this purpose.

- **Extended Periods of Review and Investigation**: The Senate bill mirrors the November draft in extending the initial CFIUS review period to 45 calendar days from 30, and authorizes CFIUS to extend the

investigation period 30 calendar days, from 45 days to 75 days, in "extraordinary" cases. The House bill, conversely, would permit an extension of only 15 days.

- **Determining National Security Risk**: The Senate markup removes from the original bill a set of additional factors for CFIUS to consider in analyzing the national security implications of proposed transactions. In contrast, the House bill includes a new set of factors to inform a CFIUS evaluation, including whether the transaction would affect the ability of the US government to acquire national security-related systems; whether the acquiring party has a history of complying with US law; whether the transaction is likely to release personal data of US citizens to a foreign person; and whether the transaction would result in a foreign government gaining a new capability to engage in malicious cyber-enabled activities against the US.

Key Takeaways

- **A Holistic Approach to Trade Controls**: Both bills are intended to address the Committees' belief that, as explained in the House bill, CFIUS is a complement to domestic and multilateral export control regimes and should not be broadened to encompass out-bound transactions or investments. By combining limited CFIUS reforms with a statutory codification and expansion of the Export Administration Regulations, these bills decline to substantively enlarge the scope of CFIUS jurisdiction in favor of strengthening existing controls on export, re-export, and transfer of controlled items.

- **Less Prescriptive Definition of Foreign Control**: The updated bills do not adopt a definitive threshold of foreign control where parties will be required to file a declaration, instead allowing CFIUS to determine an appropriate definition of "substantial interest." This will allow CFIUS greater flexibility, but will result in ambiguity for parties to potentially covered transactions in the near-term.

- **A Need for Reconciliation**: The Senate and House bills diverge on a number of issues, particularly the scope of export control reforms, the inclusion of specific factors to determine a transaction's national security risk, and increases in CFIUS enforcement authority. Assuming the Senate and the House each approves a version of FIRRMA, then the ultimate scope of the legislation will be determined in a conference committee. Given the bipartisan, unanimous support the legislation received in the committees on May 22, and the large degree of commonality between the committee bills on important topics, it is likely that Congress will reconcile the differing bills and act, as leaders have predicted, to send a bill to the President before recessing in August.

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[1] 19 U.S.C. § 2411 *et seq*.

[2] 50 U.S.C. § 1701 *et seq*.

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