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Legislative Overhaul of CFIUS National Security Reviews Takes Shape

By Ted Posner

On November 8, 2017, much-anticipated legislation was introduced in the Senate and the House of Representatives that would overhaul the way in which national security reviews of mergers and acquisitions of U.S. businesses by non-U.S. investors are conducted by the Committee on Foreign Investment in the United States (CFIUS). The chief architect of the legislation is Senator John Cornyn (R-Texas), the Senate Majority Whip, who introduced his bill (S. 2098) with both Democratic and Republican co-sponsors. An identical bill was introduced in the House (H.R. 4311) by Congressman Robert Pittenger (R-North Carolina), also with bipartisan support.

The bill is known as the Foreign Investment Risk Review Modernization Act of 2017 (FIRRMA). Given bipartisan support from senior lawmakers in both chambers of the U.S. Congress, there is a high likelihood that FIRRMA will be enacted, albeit subject to amendments that may modify the bill as introduced. The consequences will include –

- a dramatic expansion of the kinds of transactions reviewed by CFIUS;
- a greater degree of scrutiny given to such transactions;
- making notification of certain kinds of transactions mandatory rather than voluntary;
- expansion of the information to be included in a CFIUS notice; and
- expansion of the tools available to CFIUS to manage national security concerns that may arise in the course of a review.

Companies involved on both sides of investments in U.S. businesses by non-U.S. investors will need to pay close attention to the new legislation and develop appropriate CFIUS strategies for their impending deals.

Current law and practice

By way of background, the statute governing CFIUS reviews is section 721 of the Defense Production Act of 1950 (50 U.S.C. § 4565) (DPA Section 721). It originally was enacted as the Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988. DPA Section 721 authorizes the President to “take such action for such time as the President considers appropriate to

suspend or prohibit any covered transaction that threatens to impair the national security of the United States."

(50 U.S.C. § 4565(d)) A "covered transaction" for this purpose is "any merger, acquisition, or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States." (50 U.S.C. § 4565(a)(3))

The determination whether a covered transaction (whether proposed or concluded) could threaten to impair U.S. national security is made through reviews and investigations by CFIUS, a committee consisting of the heads of nine Executive Branch departments and offices, chaired by the Secretary of the Treasury. (Five other offices participate in CFIUS as observers; the Director of National Intelligence and the Secretary of Labor participate in an *ex officio* capacity; and other departments and agencies may be brought into CFIUS on an *ad hoc* basis, depending on the subject-matter of a particular transaction.)

Ordinarily, CFIUS reviews a transaction on the basis of a joint voluntary notice submitted by the parties to the transaction. Although such a notice usually is submitted before a transaction closes, it may be submitted after closing. Where parties consider that CFIUS is likely to view a transaction as a covered transaction that may implicate U.S. national security, they often will notify the transaction to CFIUS in order to obtain a formal review. The benefit of doing this is that a conclusion by CFIUS following a review that there are no outstanding national security concerns with a transaction results in a safe harbor, such that the President cannot later force the parties to unwind the transaction on national security grounds. (31 C.F.R. § 800.601(a))

When CFIUS accepts a joint voluntary notice (following a determination that it contains all of the information required by regulation (in particular, 31 C.F.R. § 800.402)), it initiates a first-stage "review" of the transaction, which can last up to 30 days. If at the end of this period CFIUS considers that it has questions that still need to be addressed, it will initiate a second-stage "investigation," which can last an additional 45 days. If, following an investigation, CFIUS identifies national security concerns related to a transaction, it ordinarily will work with the parties to put in place mitigation measures to eliminate those concerns. However, if CFIUS determines that the concerns identified cannot be mitigated, then (absent abandonment of the transaction by the parties) it refers the matter to the President at the end of the 45-day investigation period, and the President has 15 days in which to decide whether to take action to suspend or prohibit the transaction.

Following its enactment in 1988, DPA Section 721 was amended twice in the early 1990s, including through insertion of the so-called Byrd Amendment, which required a greater level of scrutiny of foreign government-controlled transactions. But it was not until 2007, in the aftermath of the 2006 acquisition of the UK-based Peninsular & Oriental Steam Navigation Company by UAE-based Dubai Ports World, that DPA Section 721 received its first major overhaul, with enactment of the Foreign Investment and National Security Act of 2007 (FINSA). With FINSA (and consequent amendments to CFIUS's governing regulations (31 C.F.R. pt. 800) and executive order (E.O. 11858)) came an expansion in the kinds of transactions that CFIUS considered to implicate U.S. national security, a more intense scrutiny of transactions notified to CFIUS, expanded use of mitigation measures by CFIUS, and closer oversight of CFIUS by Congress.

Highlights of FIRRMA

This brings us to FIRRMA, which would go even further than FINSA in affecting the kinds of deals CFIUS reviews, how it identifies national security concerns, and how it addresses those concerns short of referring transactions to the President for a decision. Here we summarize highlights of the newly introduced bill.

Findings: The bill begins with an expression of the sense of the Congress that provides context for the bill's operative provisions. The sense of the Congress affirms the economic benefits of welcoming foreign investment into the United States, while at the same time recognizing that "the national security landscape

has shifted in recent years" and calling for "a modernization of the processes and authorities of [CFIUS]" to respond to that shift.

"Country of special concern": A number of the major reforms to be brought about by FIRRMA are signaled in the definitions of key terms. One of these is "country of special concern," which is defined to mean "a country that poses a significant threat to the national security interests of the United States." Operative provisions of the bill impose special requirements for reviews involving countries of special concern. For example, the concept of threat to national security is expanded to include "whether the transaction is likely to reduce the technological and industrial advantage of the United States *relative to any country of special concern*." (Emphasis added.) Although no country is named by name, it is widely understood that China is chief among those considered to be countries of special concern.

Expansion of "covered transaction": One of FIRRMA's most significant innovations is expansion of the threshold concept of a transaction being a "covered transaction." This concept is key, since CFIUS is authorized to review the national security effects of a transaction only if it is a covered transaction. As noted above, under current law, a transaction is a covered transaction if it could result in foreign control of a U.S. business. (50 U.S.C. § 4565(a)(3))

Given the current law requirement that a transaction involve potential acquisition of control of a "U.S. business," so-called "greenfield investments" – *e.g.*, acquisitions of bare real estate with no improvements that could constitute an existing U.S. business – are outside the scope of CFIUS review. FIRRMA would change that by bringing purchases or leases of real estate in close proximity to military installations or other sensitive U.S. government facilities within the scope of "covered transactions."

"Covered transaction" would be further expanded to include any non-passive investment in a "critical technology company" or "critical infrastructure company," regardless of whether the investment could confer control on the foreign buyer.

"Covered transaction" also would include a U.S. "critical technology company's" contribution "of both intellectual property and associated support to a foreign person through any type of arrangement, such as a joint venture."

Moreover, the concept of what constitutes an acquisition of "control" of a U.S. business would be expanded as a practical matter as the result of a narrowing of the concept of "passive investment." In particular, for an investment to be passive (and thus not result in a foreign person's potentially acquiring control), the foreign investor would have to be denied access to non-public information, have no membership or observer rights on the U.S. company's board of directors, and have no involvement in substantive decision making other than through voting of shares, and there could be no "parallel strategic partnership or other material financial relationship" between the foreign investor and the U.S. company.

Exemption for investors from trusted countries: FIRRMA authorizes CFIUS to provide by regulation that, notwithstanding the expansion of the concept of "covered transaction," a transaction will not be covered if "each foreign person that is a party to the transaction is organized under the laws of, or otherwise subject to the jurisdiction of" certain trusted countries, as identified by CFIUS. Such countries would be identified by CFIUS based on the existence, for example, of a mutual defense treaty or other mutual arrangement for safeguarding national security.

Expansion of factors implicating national security: FIRRMA explicitly embraces a broader understanding of "national security" than that articulated in current law. That is signaled early in the bill through definitions of terms such as "critical materials" and "malicious cyber-enabled activities," and (as already noted above) a broadening of the definition of "critical technologies." Later, the bill enumerates additional national security factors including:

- "whether the covered transaction is likely to result in the increased reliance by the United States on foreign suppliers to meet national defense requirements";

- "whether the transaction is likely to reduce the technological and industrial advantage of the United States relative to any country of special concern";
- effects on "transportation assets" as an element of "critical infrastructure" (in addition to "major energy assets" as provided for in current law);
- whether the transaction "is likely to contribute to the loss of or other adverse effects on technologies that provide a strategic national security advantage to the United States";
- impact on "cost to the United States Government of acquiring or maintaining the equipment and systems that are necessary for defense, intelligence, or other national security functions";
- effects of "cumulative market share of any one type of infrastructure, energy asset, critical material, or critical technology by foreign persons" (suggesting that a given covered transaction will be scrutinized not only for its own effects, but also for its effects relative to other covered transactions in the same sector, regardless of whether such transactions have been coordinated with one another);
- the acquirer's history of complying with U.S. laws and regulations and adhering to contractual obligations to the U.S. Government;
- risk of a foreign person's gaining access to and then using "personally identifiable information, genetic information, or other sensitive data of United States citizens" to threaten national security;
- impact on cybersecurity vulnerabilities;
- "whether the covered transaction is likely to result in a foreign government gaining a significant new capability to engage in malicious cyber-enabled activities against the United States, including such activities designed to affect the outcome of any election for Federal office";
- "whether the covered transaction involves a country of special concern that has a demonstrated or declared strategic goal of acquiring a type of critical technology that a United States business that is a party to the transaction possesses";
- impact on "criminal or fraudulent activity" affecting national security; and
- risk of "expos[ing] any information regarding sensitive national security matters or sensitive procedures or operations" to unauthorized persons.

Increased information requirements: FIRRMA would add to the information required to be contained in a notice submitted to CFIUS, in particular requiring the inclusion of "any partnership agreements, integration agreements, or other side agreements relating to the transaction, including any such agreements relating to the transfer of intellectual property."

Abbreviated declaration in lieu of or in addition to notice: FIRRMA would create a mechanism whereby parties to a transaction may submit to CFIUS an abbreviated declaration (ordinarily not exceeding five pages) with basic information about the transaction in lieu of a full notice. Upon receiving a declaration, CFIUS could (i) request that the parties submit a full notice, (ii) inform the parties that they may submit a full notice if they so choose, (iii) self-initiate a review of the transaction, or (iv) inform the parties that CFIUS has concluded all action on the basis of the abbreviated declaration. Ordinarily, CFIUS would decide which course of action to follow within 30 days of receiving a declaration (though FIRRMA does not obligate CFIUS to meet that deadline).

Declaration mandatory in some cases: In certain specified cases, submission of a declaration would be mandatory. One such case expressly identified in the bill is acquisition of a 25% or greater voting interest in a U.S. business by a foreign person in which 25% or more of the voting interest is owned, directly or indirectly, by a foreign government. FIRRMA would authorize CFIUS to identify other categories of transaction for which submission of a declaration would be mandatory, applying criteria such as "technology, industry, economic sector, or economic subsector"; "difficulty of remedying the harm to

national security that may result from completion of the transaction"; and "difficulty of obtaining information on the type of covered transaction through other means."

Where a declaration is mandatory, parties could opt to submit a full notice instead of a declaration. A mandatory declaration would have to be submitted at least 45 days before closing, and a notice in lieu of a mandatory declaration would have to be submitted at least 90 days before closing.

FIRRMA would empower CFIUS to impose civil penalties on parties that fail to submit a mandatory declaration or notice in lieu of a mandatory declaration.

Time periods extended: FIRRMA would extend the period for first-stage reviews to 45 days (from 30 days under current law). It also would authorize CFIUS to extend the period for second-stage investigations (45 days under current law) by one 30-day period under "extraordinary circumstances" (to be defined by CFIUS in regulations). FIRRMA provides a corresponding extension of the deadline for the Director of National Intelligence to produce the threat analysis that is generated in all CFIUS reviews. That deadline would be extended to 30 days (from 20 under current law). Further, FIRRMA would provide for the tolling of deadlines during a lapse in appropriations, which could subject transaction parties to the unpredictability of the legislative process.

Confidentiality: As a general matter, information provided to CFIUS is confidential and exempt from disclosure under the Freedom of Information Act. Current law provides exceptions for disclosures that "may be relevant to any administrative or judicial action or proceeding" and disclosures to Congress. (50 U.S.C. § 4565(c)) FIRRMA would expand the exceptions to include disclosures "to any domestic or foreign governmental entity, under the direction of the chairperson, to the extent necessary for national security purposes and pursuant to appropriate confidentiality and classification arrangements." An exception also would be made for "[i]nformation that the parties have consented to be disclosed to third parties."

Expansion of President's authority: When it is determined that a transaction threatens to impair U.S. national security, current law authorizes the President to "take such action for such time as the President considers appropriate to suspend or prohibit" the transaction. (50 U.S.C. § 4565(d)(1)) FIRRMA would expand that authority by empowering the President to "take any additional action the President considers appropriate to address the risk to the national security of the United States identified during the review and investigation."

Judicial review: Current law provides that the actions and findings of the President under DPA Section 721 are not subject to judicial review. (50 U.S.C. § 4565(e)) FIRRMA would extend this provision to the actions and findings of CFIUS, with a narrow exception for certain constitutional claims. That exception appears to grow out of the 2014 decision of the U.S. Court of Appeals for the D.C. Circuit in *Ralls Corp.* v. *CFIUS*, 758 F.3d 296 (D.C. Cir. 2014), which held that, in the circumstances of that case, the district court had jurisdiction to hear a Fifth Amendment denial of due process claim, and the claim was justiciable. Under FIRRMA's provision for judicial review of allegations of "violation of a constitutional right, power, privilege, or immunity," a party would have to submit a petition to the U.S. Court of Appeals for the D.C. Circuit within 60 days of the relevant action by CFIUS or the President. The provision imposes strict limits on a petitioner's access to information, including a prohibition on discovery. It further provides that the reviewing court must either affirm the challenged action or remand to CFIUS for further action. That is, there is no possibility of awarding monetary damages or other injunctive relief.

Authorization for CFIUS to suspend transactions: Under current law, CFIUS is authorized to "negotiate, enter into or impose, and enforce any agreement or condition with any party to [a] covered transaction in order to mitigate any threat to the national security of the United States that arises as a result of the covered transaction." (50 U.S.C. § 4565(l)) Current law is not explicit as to the exercise of this authority

on an interim basis (as opposed to at the end of a review or investigation), except in the context of a notice being withdrawn in anticipation of resubmission. (50 U.S.C. § 4565(l)(2)(A)(i)) In particular, current law does not give CFIUS the authority to suspend a transaction pending completion of a review or investigation. FIRRMA would give CFIUS that authority.

Accelerated referral to the President: FIRRMA would authorize CFIUS to accelerate referrals to the President, rather than waiting for conclusion of an investigation as under current law.

Threat mitigation with respect to abandoned transactions: FIRRMA would authorize CFIUS to negotiate or impose threat mitigation measures with respect to covered transactions that the parties voluntarily abandon.

Limitations on use of mitigation measures: FIRRMA would limit CFIUS's use of threat mitigation measures (as opposed to abandonment of a transaction or referral to the President for action) to circumstances in which such measures "resolve[] the national security concerns posed by the transaction," taking into account the measures' effectiveness and the ability to verify and monitor compliance. The bill also mandates precise elements to be included in a plan for monitoring compliance with any threat mitigation agreement.

Penalties for non-compliance with threat mitigation measures: Under current law, a party's failure to comply with threat mitigation measures may result in re-opening of CFIUS review of the underlying transaction and/or monetary penalties. (50 U.S.C. §§ 4565(b)(1)(D)(iii) & (h)(3)) FIRRMA would require negotiation of a remediation plan and would expand the penalties to include a requirement that for a five-year period any covered transaction involving the breaching parties be notified to CFIUS.

Independence of third-party monitors: Under current practice, when review or investigation of a covered transaction leads to the imposition of threat mitigation measures, CFIUS sometimes relies on third parties to monitor compliance with those measures. FIRRMA would require that CFIUS ensure that such third parties have no conflict of interest in performing this function.

Reports to Congress: FIRRMA expands the level of detail to be included in CFIUS's annual report to Congress, including detail pertaining to the imposition and monitoring of threat mitigation measures. Further, FIRRMA would require submission of a separate report by the Director of National Intelligence every two years.

Filing fees: Under current law, parties submitting a joint voluntary notice to CFIUS pay no fee. FIRRMA would authorize CFIUS to assess a fee for submission of notices (but not abbreviated declarations) no greater than the lesser of (i) 1% of the value of the transaction, or (ii) $300,000 (adjusted annually for inflation). FIRRMA does not specify whether "value of the transaction" for this purpose is focused exclusively on the U.S. portion of the transaction, as opposed to the global transaction in the case of deals involving assets both inside and outside the United States.

Allocation of resources: FIRRMA would establish a CFIUS Fund in the U.S. Treasury. The CFIUS chairperson would be authorized to transfer amounts from the Fund to other CFIUS departments and agencies for purposes of carrying out their roles under DPA Section 721.

Effective date: Most provisions of FIRRMA would take effect immediately upon enactment. Certain provisions would be delayed until 30 days after the CFIUS chair publishes a Federal Register notice certifying that the resources necessary to administer the new provisions are in place.

If you have questions concerning the contents of this issue, or would like more information about Weil's International Arbitration & Trade practice group, please speak to your regular contact at Weil, or to:

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