

August 13, 2018

President Trump Signs CFIUS Reform Legislation

President Trump today signed the John S. McCain National Defense Authorization Act for Fiscal Year 2019 (“FY 2019 NDAA”) (H.R. 5515). One subtitle of the FY 2019 NDAA, entitled the “Foreign Investment Risk Review Modernization Act of 2018” (“FIRRMA”), reforms the current interagency process for reviewing foreign investments that raise national security issues. After a lengthy House-Senate conference to resolve differences between the versions of the legislation that had passed the House of Representatives in May and the Senate in June, the House passed the compromise version of the FY 2019 NDAA on July 26 and the Senate did likewise on August 1.

FIRRMA will cause fundamental changes in the foreign investment review process overseen by the interagency Committee on Foreign Investment in the United States (“CFIUS”), including the broadest expansion in CFIUS jurisdiction since this interagency committee was reconstituted in 1988. This memorandum discusses a number of these fundamental changes and their practical significance to the CFIUS review process. However, a number of important questions related to the impact of these changes cannot be answered until such time as implementing regulations have been issued.

In the final section of this memorandum, we discuss briefly other parts of the FY 2019 NDAA that address reforms to the U.S. export control system and procurement restrictions directed at certain Chinese companies, as well as the role that Congressional concerns about China have played in shaping both the CFIUS and export control reform efforts.

I. The Foreign Investment Risk Review Modernization Act of 2018

A. Expansion of CFIUS Jurisdiction

Prior to the enactment of FIRRMA, CFIUS jurisdiction – and the related ability of the President to block or unwind a transaction – was limited to acquisitions, investments and joint ventures that could result in foreign control over any U.S. business (direct or indirect). Subject to implementing regulations, FIRRMA expands the range of transactions subject to CFIUS jurisdiction (“covered transactions”) to include the following:

- a non-controlling investment by a foreign person in any unaffiliated U.S. business that meets the following criteria:
 - the U.S. business (i) owns, operates, manufactures, supplies or services critical infrastructure, (ii) produces, designs, tests, manufactures, fabricates or develops one or more critical technologies, or

(iii) maintains or collects sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security (in each of these three cases, “a sensitive U.S. business”); and

- the investment provides the foreign person with any of the following: (i) access to any material nonpublic technical information related to critical technologies or critical infrastructure, (ii) membership or observer rights on the board of directors or equivalent governing body of the U.S. business, or (iii) any involvement (other than through the mere voting of shares) in decision-making of the U.S. business with respect to critical technologies, critical infrastructure or sensitive personal data of U.S. citizens;
- the purchase or lease by a foreign person of real estate located either (i) at an air or maritime port or (ii) in close proximity to a U.S. military base or other U.S. government facility that is sensitive from a national security perspective; and
- any transaction or arrangement that is designed or intended to evade or circumvent the jurisdiction of CFIUS.

B. Mandatory Filings with CFIUS

FIRRMA introduces for the first time a category of mandatory filings with CFIUS. Specifically, FIRRMA introduces a new category of short form filing called a “declaration” (generally not to exceed five pages in length), which is intended to give transaction parties a faster and less costly mechanism for obtaining CFIUS’s reaction to a transaction that appears to fall under CFIUS’s jurisdiction. If a transaction party chooses to file a declaration with CFIUS, then FIRRMA provides that CFIUS is required to respond within 30 days and that CFIUS may respond by clearing the proposed transaction at the end of the 30-day period.

FIRRMA also provides that the filing of a declaration with CFIUS is mandatory in the case of a transaction that results in the acquisition of a substantial interest in a sensitive U.S. business by a foreign person in which a foreign government has, directly or indirectly, a substantial interest. FIRRMA leaves it to CFIUS to define “substantial interest” by regulation, but FIRRMA provides that none of the following should be considered a “substantial interest”:

- a voting interest of less than 10 percent (at least in terms of what constitutes a “substantial interest” in a sensitive U.S. business);
- an investment in a sensitive U.S. business that does not provide the foreign person with:
 - access to any material nonpublic technical information related to critical technologies or critical infrastructure;

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- membership or observer rights on the board of directors or equivalent governing body of the U.S. business, or
 - any involvement (other than through the mere voting of shares) in decision-making of the U.S. business with respect to critical technologies, critical infrastructure or sensitive personal data of U.S. citizens; or
 - a foreign government interest in a foreign person where the foreign person is an investment fund that meets the following criteria:
 - the fund is managed exclusively by a general partner, managing member or equivalent person and that general partner, managing member or equivalent person is not a foreign person; and
 - if the foreign government has a representative on an advisory board or committee of the fund, then (i) the advisory board or committee does not have the ability to control either investment decisions of the fund or decisions with respect to operations of the entities in which the fund is invested, and (ii) the foreign government does not have the ability to control such decisions by the fund or decisions with respect to selection, dismissal, or compensation of the general partner, managing member or equivalent person.

Since failure to comply with this mandatory filing requirement is subject to civil penalties, this requirement adds a new area of risk and uncertainty in the CFIUS context, particularly given that it will be impossible for CFIUS to eliminate all ambiguities by means of implementing regulations. One thing that FIRRMA does make clear, however, is that transaction parties can always choose to make a traditional CFIUS filing – that is, to file a formal notice with CFIUS – instead of submitting a declaration. In practice, we do not expect transaction parties to make substantial use of declarations, for the following reasons:

- Where there are any identifiable national security issues, CFIUS is unlikely to clear a transaction based on a five page declaration, and is instead likely to ask the parties to submit a formal notice. Consequently, if a covered transaction raises any identifiable national security issues, it is probably more efficient for the transaction parties to use the time associated with preparing and submitting a declaration (and waiting for a CFIUS response) to prepare a draft notice.
- Few transactions that meet the criteria for a mandatory filing are likely to raise no identifiable national security issues. As a consequence, we anticipate that mandatory filings will generally be handled by means of formal notices rather than declarations.

C. Time Frames for CFIUS Action

FIRRMA changes CFIUS time frames in the following respects:

- Assuming that the transaction parties stipulate that a transaction is subject to CFIUS jurisdiction, FIRRMA imposes time limits for the first time on CFIUS action in response to submission of draft and formal notices by the transaction parties:
 - CFIUS is required to provide comments on a draft notice within 10 business days after submission; and
 - assuming a formal notice meets all of the regulatory requirements, CFIUS is required to accept the formal notice (and start the statutory time clock) within 10 business days after submission.
- The initial CFIUS review period, following CFIUS acceptance of a formal notice filed by the transaction parties, is expanded from 30 to 45 days.
- The 45-day formal investigation phase, which follows the initial review phase if CFIUS does not clear the transaction at the end of the initial phase, can now be extended for another 15 days at the discretion of the Secretary of the Treasury and the head of the lead agency on a given CFIUS case (acting together).

A key rationale for providing CFIUS with more review time was to reduce the number of cases in which the transaction parties have to pull and re-file their formal notices (starting the statutory time clock all over again). To what degree CFIUS's expanded statutory review time will in fact reverse the increasing use of the "pull and re-file" option in the last couple of years remains to be seen.

D. CFIUS Authority to Impose Interim Conditions

FIRRMA clarifies the interim powers of CFIUS by providing that CFIUS has the power to:

- suspend a proposed or pending covered transaction for such time as the transaction is under review or investigation by CFIUS; and
- in the case of a covered transaction that has closed without being notified to CFIUS, impose on the foreign buyer or investor and the U.S. business any conditions that it believes are needed to mitigate any risk to U.S. national security until such time as CFIUS and, as appropriate, the President has completed action with respect to the transaction.

E. CFIUS Resources

FIRRMA for the first time authorizes CFIUS to impose a filing fee for the submission of a formal notice by the transaction parties, subject to ongoing approval by Congress of such a filing fee through annual appropriations acts. Any such fees that are collected are to be deposited into a newly created Treasury Department Committee on Foreign Investment in the United States Fund (“CFIUS Fund”), and such fees are to be used solely for the purposes of supporting the activities of CFIUS. FIRRMA provides CFIUS with discretion to set the amount of the filing fees, but subject to the requirement that the fees may not exceed the lesser of:

- 1 percent of the value of a transaction; or
- \$300,000 (which amount is to be adjusted annually for inflation).

FIRRMA also authorizes the appropriation of \$20 million to the CFIUS Fund in each of fiscal years 2019 through 2023; provides for a new Assistant Secretary of the Treasury for Investment Security, whose responsibilities will focus on CFIUS; and requires each CFIUS agency to submit annually to Congress a detailed spending plan for meeting CFIUS’s obligations. While both staffing levels and funding related to CFIUS can be expected to increase to a meaningful degree in the coming period, we anticipate that the increased workload brought about by FIRRMA will present significant challenges for CFIUS staff going forward.

F. Delayed Effectiveness

In light of the substantial changes that are brought about by FIRRMA and the large increase in the CFIUS workload that is anticipated, a number of the provisions in FIRRMA will not go into effect immediately. Among the provisions whose effectiveness is delayed are those that (i) increase the scope of transactions subject to CFIUS jurisdiction, (ii) introduce declarations and mandatory filings for certain transactions, and (iii) impose a time limitation on CFIUS commenting on draft notices and accepting formal notices. These provisions will not go into effect until the earlier of:

- the date that is 18 months after the date of enactment of FIRRMA (i.e., 18 months after August 13, 2018); and
- the date that is 30 days after publication in the Federal Register of a determination by the Secretary of the Treasury that the regulations, organizational structure, personnel and other resources necessary to administer these provisions are in place.

II. Other Elements of the FY 2019 NDAA

The FY 2019 NDAA also contains the “Export Control Reform Act of 2018” (“ECRA”), which reforms the current U.S. export control system. ECRA is the outcome of a long and tortured Congressional effort to update the U.S. export control system, and constitutes the first time that most of the U.S. export control system has been maintained on a legal basis other than the President’s national emergency powers since the Export Administration Act expired in 2001. Together, FIRRMA and ECRA also represent the outcome of disagreement within Congress over whether to expand CFIUS’s jurisdiction to cover exports of technology. Congress ultimately decided not to incorporate such an expansion into FIRRMA and instead to leave export control issues to the existing interagency export control process (as updated by ECRA) – but with coordination between CFIUS and the export control agencies, especially in connection with identifying emerging and foundational technologies that merit consideration for export control restrictions.

Concerns regarding China played a key role in the generation of both FIRRMA and ECRA, particularly in terms of access by Chinese companies to U.S. technology and know-how. Nonetheless, China is not specifically targeted for special treatment in terms of either foreign investment restrictions or export controls. Moreover, the provision in the Senate-passed version of the FY 2019 NDAA that endeavored to force reimposition of the Commerce Department order denying ZTE access to all U.S. goods and technology was dropped during the House-Senate conference. However, the FY 2019 NDAA does impose a number of restrictions on the ability of U.S. government agencies to procure or obtain, or to provide loans or grants to companies to support procuring or obtaining, telecommunications equipment or services sourced from ZTE or Huawei, as well as video surveillance or telecommunications equipment or services sourced from Hytera Communications Corporation, Hangzhou Technology Company or Dahua Technology Company to be used for public safety or national security purposes.

We will monitor developments related to implementation of FIRRMA, and we will provide further updates as appropriate.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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