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The "Transformative" CFIUS Bill: Not So Fast.

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The Foreign Investment Risk Review Modernization Act ("FIRRMA"), a package of amendments to the national security review process overseen by the Committee on Foreign Investment in the United States ("CFIUS"), has just been signed into law. An overhaul of the CFIUS process was certainly much-anticipated and, many think, long overdue.[1] But did the legislation truly transform CFIUS's authority and process to the degree and in the ways expected by the investment community? In some ways, yes. The statute revamps key aspects of the CFIUS procedure, expands CFIUS powers in certain important respects, and provides the inter-agency body with additional resources to meet an increased caseload. But a closer reading of the lengthy amendments (totaling nearly 100 pages) yields less than meets the eye. Much of what Congress has done in FIRRMA merely codifies CFIUS's current practice of expansively interpreting its jurisdiction, stretching its review timelines, and broadening its focus beyond traditional concepts of national security threat. And those provisions that have the potential to bring real change and added predictability to the CFIUS process won't come into effect for many months, after CFIUS has had an opportunity to develop, publish, and implement new regulations.

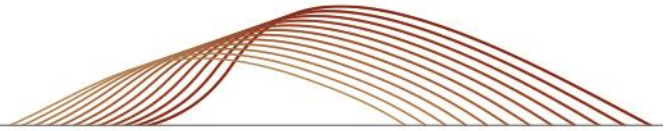
Less Than It Could Have Been

Expectations were high that the CFIUS overhaul would significantly raise the bar on foreign (particularly Chinese) investment in the United States. In recent years, the role of CFIUS has become the subject of significant attention, as dealmakers and their advisors have watched the secretive committee block or scuttle an increasing number of high-profile deals, many involving China, and train its sights on sensitive technologies and large troves of personal data.

The most significant proposal, however, was left out of the final bill. When reform legislation was first introduced over a year ago, it contained language to extend CFIUS's power beyond the review of foreign acquisition of U.S. businesses to include offshore joint ventures and outbound technology licensing arrangements. This would have been a dramatic reinvention of CFIUS's role, and one that some in the U.S. business community viewed with alarm. In the final bill, however, Congress pulled back from this broad expansion, leaving the job of policing outbound technology transfers to the export control regime administered separately by the U.S. Commerce Department. But FIRRMA did task CFIUS with reviewing more types of foreign transactions in the United States, as outlined below.

More Than It Was (to Some Extent)

A key procedural change is the creation of an abbreviated process whereby CFIUS will be required to respond to (and possibly clear) a transaction within 30 days of receiving a short-form "declaration" of the essentials of the deal. This short-form procedure will be available to all parties on a voluntary



basis. More importantly, for the first time, some foreign investments will *require* CFIUS notification, including those in which a foreign government holds a "substantial interest[.]" These mechanisms could greatly streamline or even eliminate the CFIUS review process for some, while concentrating greater scrutiny on foreign government-controlled transactions, particularly those involving strategic rivals of the United States.

FIRRMA gives CFIUS additional review authority primarily by expanding on the definition of what constitutes a "covered transaction," the trigger for CFIUS's jurisdiction. The bill retains the long-existing definition, which includes any merger, acquisition, or takeover that results in "control" of a U.S. business by a foreign person. It also adds several new types of covered transactions, including some real estate deals and certain minority investments by foreign persons. While Congress has given CFIUS some new fields to occupy, the fact is that the Committee had already seized much of that ground on its own. For years, CFIUS has asserted its jurisdiction over real estate deals in sensitive locations and over minority investments accompanied by indicators of control such as board seats and special shareholder rights. Perhaps the most important consequence of the reform is that by having now *prescribed* CFIUS's jurisdiction to review these types of transactions, Congress has also *circumscribed* it, including by incorporating some express limitations.

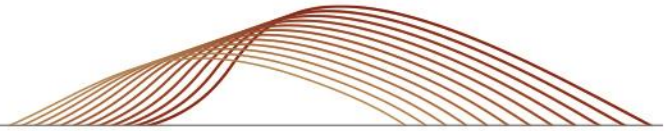
Real Estate Transactions

FIRRMA defines the types of real estate transactions that will trigger CFIUS review, a move that could also be seen as defining those transactions that won't. In a true expansion, the bill extends CFIUS review to covered real estate leases and concessions, not just purchases. (CFIUS's current regulations state that certain concession agreements are not transactions for CFIUS purposes.) Specifically, Congress empowers CFIUS to review a purchase, lease, or concession, by a foreign person that involves property located in the United States and that (i) is located in or functions as an air or maritime port; or (ii) is in "close proximity" to or otherwise poses an espionage or other national security risk, to a U.S. military or national security-sensitive government facility.

However, Congress also limits CFIUS's jurisdiction over real estate transactions in three ways. First, as previously drafted, the DPA could be interpreted to cover any foreign acquisition of real property that constitutes a "U.S. business." This has led to a number of filings for essentially benign commercial real estate deals. The new bill instructs that CFIUS "may not expand the categories of real estate" subject to review beyond those identified in the statute. Second, Congress instructs CFIUS that, in prescribing regulations to interpret those provisions, CFIUS can only define "close proximity" to refer to "distances . . . which could pose a national security risk." The text implies that the Committee can review a transaction that might involve property permitting observation of operations at military installations, but not necessarily one involving acquisition of a commercial building near a U.S. government facility but not so near that it offers an enhanced opportunity to conduct espionage. Finally, the power to review real estate transactions applies only to those involving certain "categories of foreign persons," to be defined by CFIUS. Each of these provisions has the potential to limit the transactions that CFIUS will be empowered to review.[2]

Minority Investments

FIRRMA extends the definition of "covered transaction" to include some minority foreign investments in a U.S. business that: (i) operates in critical infrastructure, (ii) deals in critical technologies; or (iii) maintains or collects personal data of U.S. citizens. Such minority investments will be deemed covered transactions if the foreign person will be granted: (i) access to "material non-public technical information;" (ii) membership or observer rights on the board of directors; or (iii) voting rights or



involvement in decisions about personal data of U.S. citizens, the release of critical technologies, or critical infrastructure. For years, CFIUS has already considered these types of transactions as "covered." Thus, what can be interpreted as an expansion of CFIUS's powers can also be seen as a codification of current practice.

What is new is that Congress:

- Expressly exempts from the definition of "material non-public technical information" certain financial information regarding the performance of the U.S. investment target. To some extent this brings greater clarity, and thus some potential limitation, to the scope of CFIUS's authority to review a minority investment.

- Declares that indirect participation by a foreign person in certain "investment funds" is not necessarily covered, if (i) the fund is managed by a general partner that is not a foreign person, and (ii) the foreign person does not (a) otherwise have the ability to control the fund or participate on any advisory board or committee of the fund with the ability to approve, disapprove, or control investment decisions of the fund or decisions pertaining to entities in which the fund is invested, and (b) have access to "material non-public technical information" regarding the fund's investments and targets.

We believe that private equity sponsors and other financial (as opposed to strategic) investors will benefit from these clarifications to CFIUS's review authority.

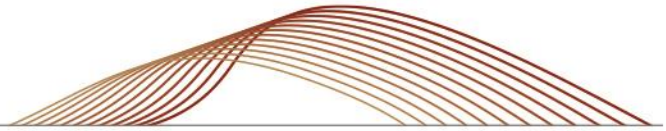
Limits on "Foreign Person"

Under FIRRMA, not all foreign investors are to be treated alike when it comes to review of real estate and minority investment transactions. The statute directs that CFIUS "shall prescribe regulations" to define "foreign person" for purposes of extending its review to these transactions and to "specify criteria to limit the application of" that jurisdiction "to the investments of certain categories" of foreign persons. "Such criteria shall take into consideration how a foreign person is connected to a foreign country or foreign government, and whether the connection may affect the national security of the United States." This injunction could create a category of foreign investors for whom investments in real estate or minority investments in U.S. companies might not warrant a CFIUS filing. Indeed, FIRRMA provides that CFIUS "may waive, with respect to a foreign person, the requirement" that a mandatory declaration be submitted if "the foreign person demonstrates that the investments of the foreign person are not directed by a foreign government and the foreign person has a history of cooperation with the Committee."

The Good Stuff to Come

FIRRMA does promise some true efficiencies. The declaration process (as described above) will streamline many reviews once the implementing regulations and procedures are in place. For certain investors (particularly those from countries traditionally allied with the United States), the abbreviated process could enable an early (30-day) clearance without having to compile a longer notice and submit the transaction to the full review process. We also expect the following additional provisions to improve the overall quality of the process:

- Changes to the statutory periods for initial review (lengthening it from 30 days to 45 days) and follow-on investigation (allowing CFIUS on a case-by-case basis, where needed, to add a 15-day extension to the current 45-day deadline);



- A requirement that CFIUS respond to and provide comments on initial filings within ten business days;
- Increased funding for the Committee, including through fees to be collected from the parties to a transaction; and
- Requirements that CFIUS member agencies designate dedicated personnel to discharge certain functions.
- Increasing the showing that a dissenting agency must make when opposing a consensus that has been developed during the internal decision process.

Conclusion

There is no doubt that, with the forthcoming CFIUS regulations, the CFIUS regime will look different for the first time in a decade; however, not all the changes are transformative. Some reflect the approach that the Committee has taken for years. Others will likely bring needed clarity to the process. But it will take time for many of the more impactful provisions to take shape, and in the interim, parties to foreign investment in the United States should expect "business as usual" at the Committee for many months to come.

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[1] FIRRMA marks the first time in over a decade that Congress has amended the powers and oversight capabilities of CFIUS. Initially established pursuant to an executive order in the mid-1970's, CFIUS's current authority is grounded in Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 and now further amended by FIRRMA. The statute empowers the president, acting through CFIUS, to review on national security grounds certain investments by foreign persons in a "U.S. business."

[2] Also excluded are purchases of single housing units or real estate located in "urbanized areas" as defined by the U.S. Census Bureau (except those urbanized areas that may be carved out in regulations issued by CFIUS in consultation with the Secretary of Defense).