

Greater Scrutiny on Foreign Inbound Investments: Update on the Foreign Investment Risk Review Modernization Act of 2018

by Lawrence Ward and T. Augustine Lo

After months of deliberation, Congress has passed the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”) as Title XVII in the John S. McCain National Defense Authorization Act for Fiscal Year 2019 (“2019 NDAA”). President Trump signed the 2019 NDAA into law on Monday, August 13.

FIRRMA is compromise legislation between the Senate and the House that attempts to address perceived weaknesses in existing federal law regarding review and approval of foreign investments that may implicate U.S. national security. FIRRMA will likely have broad effects on foreign investment in the United States generally and will especially impact Chinese investments.

Background of CFIUS

FIRRMA amends significantly Section 721 of the Defense Production Act of 1950¹ (“Section 721”) which authorizes the President to investigate, suspend or prohibit any transaction resulting in control of a U.S. business by a foreign person where the President determines such transaction threatens to impair U.S. national security and no other adequate means are available to address the identified threat. Since 1988, Section 721 has governed the work of the Committee on Foreign Investments in the United States (“CFIUS”), a federal interagency committee. CFIUS is comprised of cabinet-level executive officers from the Departments of the Treasury, Homeland Security, Commerce, Defense, State, Justice, and Energy. The Secretary of Labor and Director of National Intelligence also have roles in CFIUS as nonvoting, *ex officio* members.

Under Section 721 and the pre-FIRRMA regulations (“Regulations”),² the President already has vast power to investigate and to prevent, amend or even dissolve and reverse a transaction covered by Section 721. A “covered transaction” under the Regulations means “any merger, acquisition, or takeover ... by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.” This broad definition effectively captures all foreign

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investments or acquisitions that could lead to a change in control of a U.S. company. Importantly, “control” is defined as “the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity.”³ The Regulations also provide an extensive list of factors that CFIUS may consider when determining if the transaction will result in foreign control of a U.S. company.

The majority of cases reviewed by CFIUS begin when the transaction parties submit a joint voluntary notice to CFIUS asking for such a review and clearance under the Regulations. Under the pre-FIRRMA rules, once a voluntary notice was submitted, CFIUS had a 30-day “review” period to raise any questions from its member agencies. At the end of that initial 30-day review period, CFIUS could have either allowed the transaction to proceed as the parties intended or moved the transaction into a further 45-day “investigation” period. During that investigation period, CFIUS could have continued to request additional information from the parties and could have requested an actual meeting. If, at the end of the 45-day investigation period, CFIUS had not reached a determination, then it would have recommended to the President whether to allow the transaction to proceed. The President then had an additional 15 days to make a final determination. While almost all notified transactions reached a final disposition within the 45-day investigation period, the whole process under the pre-FIRRMA rules could have potentially taken 90 days after the parties had filed their voluntary notice.

Significant Changes after FIRRMA

Filing Fees Authorization. Since 1988, the Department of the Treasury has not charged any filing fee or processing charge to handle a CFIUS notice filing despite the many hours of government personnel time needed to manage such a filing and the obvious financial gain that the parties hope to achieve through the transaction. In FIRRMA Section 1723, Congress did not mandate a filing fee but has now authorized CFIUS, at its discretion, to add to the Regulations the requirement for such a filing fee. If CFIUS were to decide to require a filing fee, Congress has stipulated that such a fee may not exceed an amount equal to the lesser of (a) one percent of the value of the transaction or (b) \$300,000, adjusted annually for inflation. It is not clear whether the Administration will use this authority, but, since the number of such filings is expected to rise due to the increased jurisdiction of CFIUS over more transactions, the imposition of such fees might help to offset the costs of the likely additional staff that the Treasury Department and other agencies may now need to handle that higher volume of cases.

Expanded Jurisdictional Scope. FIRRMA amends the threshold definition of “covered transactions.” FIRRMA Section 1703(a)(4) specifically adds the following categories of transactions by foreign persons that are subject to review by CFIUS:

- Section 1703(a)(4)(B)(ii) will cover real property transactions that relate to any real estate “located within, or [that] will function as part of, an airport or maritime port” in the United States;

- Real property transactions (that is, both sales and leases) relating to property⁴ that either is “in close proximity” to any military or other national security installations or allows spying on such locations, although the definition of “close proximity” in this context will not be specified until CFIUS adopts new implementing regulations later this year⁵;
- “Any other investments” in an unaffiliated U.S. enterprise that “owns, operates, manufactures, supplies, or services critical infrastructure”; “produces, designs, tests, manufactures, fabricates, or develops” critical technologies; or “maintains or collects sensitive personal data of U.S. citizens”; and
- Any change in rights of a foreign person in a U.S. business that results in a change in control of the U.S. business or an unaffiliated business that relates to “critical infrastructure,” “critical technology,” or the storage of sensitive personal data listed above.

Evasion or Circumvention. FIRRMA Section 1703(a)(4) also includes a catch-all clause that captures all other transactions that are “designed or intended to evade or circumvent” the CFIUS jurisdiction over “covered transactions.”

“Critical Technologies” Definition. FIRRMA Section 1703(a)(6) amends the definition of “critical technologies” to specifically adopt the definitions in the current Regulations, which include items that are subject to export controls (e.g., the U.S. Munitions List under the International Traffic in Arms Regulations; the Commerce Control List under the Export Administration Regulations; nuclear materials regulated by the Department of Energy or the Nuclear Regulatory Commission, etc.). In addition, Section 1703(a)(6) identifies “[e]merging foundational technologies” as a new and separate category of “critical technology” that could trigger a CFIUS review. (This provision is a cross-reference to the new export control provisions that separately appear in the 2019 NDAA, which will cause new legal changes to the Export Administration Regulations (“EAR”) administered by the Bureau of Industry and Security (“BIS”) in the U.S. Department of Commerce.)

Mandatory “Declarations”. Another major change to the CFIUS process is to reduce somewhat the reliance on voluntary notices by the transaction parties and, for the first time since CFIUS was put into operation in 1988, to require mandatory “declarations” for certain types of transactions. Such “*declarations*” to CFIUS will now be required in any “investment that results in the acquisition, directly or indirectly, of a substantial interest in a United States business ... by a foreign person in which a foreign government has, directly or indirectly, a substantial interest.”⁶ Such required declarations are intended to compel notifications to CFIUS of transactions where it is likely the foreign party is significantly influenced by a foreign government.

Declarations differ from the current system of notice filing in a number of ways. First, as previously mentioned, the CFIUS notice filing process has historically been mostly a voluntary system, but now, under FIRRMA, certain covered transactions will require the parties to submit a “declaration.” Second, such declarations are intended to be significantly shorter than full standard notice filings (Congress has recommended that such a required “declaration” be no longer than five pages) and provide CFIUS with only the most basic information regarding the transaction, while, in contrast, a typical joint

voluntary notice filing might exceed 40 pages of text with dozens or even hundreds of pages of exhibits. The Congressional intent is that the declaration process might allow CFIUS to make an abbreviated (and faster) initial check of certain transactions that can be resolved within the initial “review” period. However, CFIUS could also potentially respond to such a “declaration” filing by indicating to the parties that such a truncated declaration does not provide enough information to CFIUS to make a proper informed decision, and so CFIUS could just direct the parties to move on to a full notice filing. Such a reaction would then require the parties to begin a new and additional initial “review” period (and, potentially, an additional “investigation” period as well, which could significantly lengthen the total process in some cases involving foreign government-related transactions).

Extended Timeline. FIRRMA also extends the voluntary notice filing timeline with CFIUS, since a major concern about the pre-FIRRMA procedures was that the previously set Congressional deadlines within CFIUS were deemed to be too short and did not allow enough time for considered judgments to be made in complex international transactions. Under FIRRMA, the initial 30-day CFIUS review period will now be extended to 45 days followed by, if necessary, a 45-day investigation period. Notably, FIRRMA also permits CFIUS to tack on another additional 15 days to that investigation period under “extraordinary circumstances,” which has yet to be fully defined. Following such a 15-day extension, if the matter is referred to the President, another 15-day period will commence to allow the President to make the final decision. Thus, these changes will now collectively extend the entire CFIUS process from a maximum 90 days before FIRRMA to potentially 120 days after FIRRMA if CFIUS chooses to use all its statutorily granted days once a voluntary notice is filed. Furthermore, FIRRMA also adds a new provision that allows for the tolling of these deadlines if there is a lapse in CFIUS appropriations by Congress (for example, due to a temporary government shutdown).

Judicial Review. Whereas the pre-FIRRMA Section 721 did not provide for any judicial review of CFIUS decisions, FIRRMA Section 1715 now expressly allows the judicial review of CFIUS decisions through a civil action filed directly in the U.S. Court of Appeals for the Federal Circuit. This FIRRMA provision specifically authorizes that court to review *ex parte* and *in camera* any classified information or privileged materials to resolve disputes over the disclosure of such material in such an action.

Special CFIUS Reports on Chinese Investment Activity. FIRRMA Section 1719(b) also adds a new biannual CFIUS reporting requirement that is specifically directed at investments from China. The new reporting requirement relates to all “foreign direct investment transactions made by entities of the People’s Republic of China,” regardless of whether those Chinese parties are purely private or are affiliated in any way to a state-owned enterprise or the Chinese government. The requirement specifically asks for CFIUS to provide Congress with breakdowns by industrial sector, list of companies invested in by the Chinese government, information on affiliates in the United States, and an analysis of any relationship between investments and China’s “Made in China 2025” national industrial policy.⁷

Implications for Future Foreign Investments in the United States

FIRRMA will likely be a watershed development in the field of future foreign direct investments or acquisitions in the United States in several visible ways:

- The new law codifies the trend towards covering all foreign transactions that involve properties judged to be proximate to “sensitive” installations, going beyond just military bases or Department of Energy facilities to include, for instance, real estate that is within every U.S. airport and seaport, such as the commercial lease of a large container terminal to a foreign-owned shipping company. More than ever before, foreign investors and U.S. companies will need to weigh the precise location of the U.S. real property that may be affected by or involved in such investment transactions and to take into careful consideration the proximity of such property to such military or other critical facilities;
- FIRRMA significantly expands the scope of “covered transactions” to include other types of investments that would not necessarily confer actual legal control over a U.S. business but would nonetheless provide opportunities for the foreign person to access “critical infrastructure” or “critical technologies.” This expanded definition reflects public concern that foreign investments and acquisitions in the United States are allowing potential adversaries to conduct economic espionage or other adversarial activities by other covert means. The pre-FIRRMA law exempted investments that were below a *de minimis* 10% ownership threshold (Regulations Section 800.302), being mainly concerned with actual foreign control or influence over a U.S. company. The new changes in scope made through FIRRMA will likely now affect many more equity investments that potentially confer access to “critical technologies” but that involve no issues as to foreign “control” of the U.S. business at all;
- Under the pre-FIRRMA Section 721, Congress had denied the federal courts any statutory jurisdiction to hear cases that challenged the President’s “action” to “suspend or prohibit any covered transaction” or the President’s findings that supported such action. The statute was silent, however, regarding other aspects of the CFIUS process. The 2014 *Ralls*⁸ case in the D.C. Circuit determined that federal courts could entertain a very limited challenge under the Administrative Procedure Act and the Constitution’s Due Process Clause and required CFIUS to disclose to the parties any non-privileged, unclassified evidence that it had considered in its decision to allow some potential rebuttal. However, since the bulk of evidence considered by CFIUS is likely privileged or classified (or both), that 2014 decision offered little practical value to most dissatisfied parties. FIRRMA Section 1715 now affirmatively grants the power of judicial review through a civil action filed in a single federal court, the U.S. Court of Appeals for the D.C. Circuit. The FIRRMA changes also allow this court to accept and consider classified or otherwise confidential evidence on an *ex parte* basis and *in camera*.⁹
- The reporting requirement on future Chinese investment in the United States under Section 1719(b) is what remains in the FIRRMA compromises of the main motivation that had propelled FIRRMA’s passage in the first instance, which was growing concern about the role and effect of Chinese investments in virtually all sectors of the American economy, especially in advanced technologies such as telecommunications and artificial intelligence. Although FIRRMA does not target Chinese investments specifically for any more stringent CFIUS reviews and investigations, the required reports by CFIUS to Congress every two years may yet provide fuel for future legislative action against further Chinese investments. From the perspective of Chinese investors who might still wish to pursue opportunities in the U.S. market and for American enterprises yet eager to attract such Chinese investments, however, this

reporting requirement may seem preferable to the alternative that President Trump had previously suggested in some of his earlier public statements (i.e., unilateral executive action simply to block most Chinese investments outright, especially those by Chinese state-owned enterprises).

The Department of the Treasury should be announcing its new CFIUS regulations to implement FIRRMA within 180 days, and it is likely the Administration will not wait that long to issue its new proposed rules. Both U.S. companies and foreign investors should be on alert for those new proposed rules to be published in the Federal Register in the coming months and should file comments and suggestions about those proposals if they appear to unduly burden international investments without commensurate benefit to enhance U.S. national security.

¹ 50 U.S.C. § 4565.

² Regulations Pertaining to Mergers, Acquisitions and Takeovers by Foreign Persons, 31 C.F.R. Part 800.

³ 1 C.F.R. § 800.204.

⁴ The purchase, lease or concession of real estate are all treated equally and could be considered under FIRRMA Section 1703(a)(4)(B)(ii) to be a “covered transaction,” but there is an ostensible exclusion in Section 1703(a)(4)(C) for a “single ‘housing unit’” or “real estate in ‘urbanized areas.’” It will remain to be seen under the new CFIUS regulations how that exclusion would or would not affect a foreign person’s (or even a foreign government official’s) purchase of, say, a large house that may be within a mile or even within a few blocks from the front gate of a major military facility if the motivating concern in FIRRMA is whether such a private property could be used to conceal electronic surveillance equipment that could seek to spy on the military activities of such a facility.

⁵ Notably, for nearly a decade, CFIUS has used a 50-mile (approximately 80.5 km) radius rule in measuring the proximity of a target company’s office, factory or other facility location in relation to any U.S. military or Department of Energy facility. Whether that current metric will remain the legal standard under the new regulations will be a key factor in assessing the increased scope of CFIUS jurisdiction under FIRRMA.

⁶ 50 U.S.C. 4565(b)(1)(C)(v)(IV)(bb)(AA).

⁷ This new CFIUS reporting requirement to Congress mirrors to a certain extent a similar requirement that the U.S. Secretary of Defense must submit an annual report to Congress (in both classified and unclassified forms) on military and security developments involving the People’s Republic of China. Section 1246 of the National Defense Authorization Act for FY 2010, P.L. 111-84, amending Section 1202 of the National Defense Authorization Act for FY 2000, P.L. 106-65. Each such report by the Secretary must address numerous subjects about the path of military and security developments in China, military organizations and operational concepts supporting such developments, U.S.-China security engagement and cooperation, and military-to-military contacts.

⁸ *Ralls Corp. v. CFIUS*, 758 F.3d 296, 317-21 (D.C. Cir. 2014).

⁹ Interestingly, the D.C. Circuit includes some judges who already are equipped and

experienced to handle cases involving national security information under the Foreign Intelligence Surveillance Act (“FISA”), but Section 1715(4) expressly provides that the “use of information” provisions in FISA will not apply to any civil action brought to challenge a CFIUS ruling under Section 1715.