

CFIUS Reform: The Foreign Investment Risk Review Modernization Act of 2018

FIRRMA Significantly Expands CFIUS Jurisdiction and Makes Certain Transactions Subject to Mandatory Declarations; Significant Details to Follow in Forthcoming Regulations

SUMMARY

The Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”) has jurisdiction to review any transaction, by or with any foreign person, that could result in control of a U.S. business by a foreign person, in order to identify and address any national security concerns that may be presented as a result of the transaction.

In June 2017, Senator John Cornyn (R-TX) publicly announced an initiative to pursue the most significant amendments to the statute that governs the CFIUS process, section 721 of the Defense Production Act of 1950 (the “DPA”), since passage of the Foreign Investment and National Security Act of 2007 (“FINSAs”). Senator Cornyn’s remarks made clear that the effort to reform CFIUS was motivated by a concern that there were gaps in CFIUS’s jurisdiction that needed to be addressed in order to counter new threats to U.S. national security. Such threats include, in particular, those presented by foreign-government investment that is part of a strategy to neutralize or surpass the United States’ advantages in technology and gain access to technologies with current or future military applications, including developing commercial technologies that may also have defense or intelligence applications, such as robotics, artificial intelligence and automation.

On August 1, 2018, the Senate joined the House of Representatives in passing the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”) as part of the conference report to the John S. McCain National Defense Authorization Act for Fiscal Year 2019. In order to address the concerns that the sponsors of this legislation have identified, FIRRMA significantly expands CFIUS jurisdiction to include new types of

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"covered transactions" beyond those that could result in control of a U.S. business by a foreign person. Under FIRRMA, CFIUS jurisdiction extends to non-passive investment by a foreign person in any U.S. business involved in critical infrastructure or the production of critical technologies or that maintains sensitive personal data that, if exploited, could threaten national security. The Committee's jurisdiction further extends to the purchase, lease or concession by or to a foreign person of certain real estate in close proximity to military or other sensitive national security facilities. FIRRMA also provides CFIUS with additional time to review transactions, and requires mandatory declarations (a short-form notification of a transaction) in certain cases. Notably, the legislation includes Congressional findings that recognize the benefits of foreign investment in the United States, and expresses the view of Congress that "it should continue to be the policy of the United States to enthusiastically welcome and support foreign investment, consistent with the protection of national security."

On August 3, the legislation was presented to President Trump for signature. Reportedly, the legislation was developed in close coordination with representatives of the Trump Administration, and is expected to become law in the first half of August. Upon enactment, certain provisions of FIRRMA will go into effect immediately.¹ However, many provisions of the legislation require regulations to be prescribed by the Committee, which presumably will afford companies and other parties opportunities to engage with the Committee through formal comment as it moves through the rulemaking process.

SUMMARY OF SIGNIFICANT AMENDMENTS MADE BY FIRRMA

1. New Categories of "Covered Transactions"

CFIUS has and retains jurisdiction to review any transaction, by or with any foreign person, that could result in control of a U.S. business by a foreign person, in order to identify and address any national security risk that arises as a result of the transaction. FIRRMA clarifies that such transactions carried out through a joint venture are covered transactions, and it significantly expands the potential scope of CFIUS's jurisdiction by adding four new categories of "covered transactions."² Covered transactions added by FIRRMA include:

- **Real Estate Transactions.** The purchase or lease by a foreign person of, or a concession offered to a foreign person with respect to, private or public real estate located in the United States that (i) is located within, or will function as part of, an air or maritime port, or (ii) is in "close proximity" to a U.S. military installation or another facility or property of the United States Government that is (a) sensitive for reasons relating to national security, (b) could reasonably provide the foreign person the ability to collect intelligence on activities being conducted at such an installation, facility or property or (c) could otherwise expose national security activities at such an installation, facility or property to the risk of foreign surveillance. Real estate transactions involving the purchase, lease or concession of a single "housing unit" or real estate in "urbanized areas" are excepted, subject to regulations that CFIUS may adopt in consultation with the Department of Defense. FIRRMA further provides that CFIUS regulations are to ensure that the term "close proximity" refers only to a distance or distances within which the purchase, lease or concession of real estate could pose a national security risk in connection with the U.S. military installation or another facility or property of the U.S. Government, and authorizes CFIUS to add other criteria (but not to expand the categories of real estate to which this provision applies).

- **Non-controlling Investments in Companies that Deal in Critical Technology, Critical Infrastructure and Personal Data of U.S. Citizens.** FIRRMA provides CFIUS with express jurisdiction to review any “other investment” by a foreign person in any unaffiliated U.S. business that (i) owns, operates, manufactures, supplies or services critical infrastructure,³ (ii) produces, designs, tests, manufactures, fabricates or develops one or more critical technologies,⁴ or (iii) maintains or collects sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security.

“Other investment” means any non-controlling investment,⁵ direct or indirect and regardless of size, that affords the foreign person: (1) access to any material nonpublic technical information⁶ in the possession of the U.S. business; (2) membership or observer rights on the board or equivalent governing body of the U.S. business or the right to nominate an individual to a position on the board of directors or equivalent governing body; or (3) any involvement (other than through voting of shares) in substantive decision-making regarding critical infrastructure, critical technologies or sensitive personal data of U.S. citizens.⁷
- **Changes in Rights of a Foreign Person with Respect to its Investment in a U.S. Business.** Any change in the rights that a foreign person has with respect to a U.S. business in which the foreign person has an investment, if that change could result in foreign control of the U.S. business or an “other investment.”
- **Transactions Structured to Evade CFIUS Review.** Any other transaction, transfer, agreement, or arrangement the structure of which is designed or intended to evade or circumvent the application of this section, subject to regulations prescribed by the Committee.

Another potentially significant jurisdictional expansion relates to the definition of “U.S. business.” FIRRMA defines “U.S. business” to mean “a person engaged in interstate commerce in the United States.” In contrast, the current definition in CFIUS regulations includes a limiting clause “but only to the extent of its activities in interstate commerce.” Without this limiting clause from the current CFIUS regulations, FIRRMA on its face appears to have the potential to provide CFIUS with jurisdiction to review elements of a transaction affecting an entity that provides goods or services in the United States without limiting that review to the entity’s U.S.-based activities. Depending on the regulations that are promulgated by the Committee under FIRRMA, this definition of “U.S. business” could entail oversight over transactions with much less of a U.S. nexus than is currently the case.

2. Clarification of “Other Investment” for Investment Fund Investments

FIRRMA clarifies and limits CFIUS’s jurisdiction over investments by U.S.-controlled investment funds that may receive capital contributions from foreign limited partners or the equivalent. Subject to regulations prescribed by the Committee, FIRRMA provides that an indirect investment by a foreign person in a U.S. critical infrastructure, critical technology or personal data business through an investment fund that affords the foreign person (or a designee of the foreign person) membership as a limited partner or equivalent on an advisory board or committee of the fund will not be considered an “other investment” as long as (i) the fund is managed exclusively by a general partner or equivalent that is not a foreign person; (ii) the advisory board does not have the ability to approve, disapprove or otherwise control investment decisions of the fund or decisions made by the general partner or equivalent related to entities in which the fund is invested; (iii) the foreign investor does not otherwise have the ability to control the fund, including the authority to

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approve, disapprove or otherwise control investment decisions of the fund or decisions made by the general partner or equivalent related to entities in which the fund is invested, or to unilaterally dismiss, prevent the dismissal of, select or determine the compensation of the general partner or equivalent; and (iv) the foreign person does not have access to material nonpublic technical information as a result of its participation on the advisory board or committee. Accordingly, subject to those provisos, investments in the types of sensitive businesses identified by FIRRMA by U.S.-controlled investment funds with foreign limited partners will not necessarily be subject to CFIUS review. These provisions will have potentially significant implications for structuring U.S.-controlled investment funds that receive investments from foreign investors, and both U.S.-controlled funds and foreign investors will need to understand and consider the governance and other implications of these rules.

FIRRMA further provides that a waiver of a potential conflict of interest, a waiver of an allocation limitation, or a similar activity, that is applicable to a transaction pursuant to the terms of an agreement governing an investment fund will not constitute “control of investment decisions” of the fund or “decisions relating to entities in which the fund is invested,” subject to exceptions that may be provided by the Committee in regulations.

3. Potential Exception or Clarification for Transactions Involving Certain Foreign Persons

FIRRMA directs CFIUS to prescribe regulations that further define the term “foreign person” for purposes of the real estate and “other investment” jurisdictional expansions described above. FIRRMA requires that the Committee, in prescribing those regulations, specify criteria to limit the application of those provisions to the investments of certain categories of foreign persons, and that such criteria should take into consideration how a foreign person is connected to a foreign country or foreign government, and whether that connection may affect U.S. national security.

4. Declarations and Mandatory Declarations

Any party or parties to any covered transaction may initiate a CFIUS review of the transaction by submitting a written notice of the transaction to the Committee chairperson. FIRRMA establishes a new form of “light” filing, called a “declaration,” that would contain basic information regarding the transaction. FIRRMA directs CFIUS to prescribe regulations establishing requirements for declarations, but CFIUS is required to ensure that declarations are submitted as abbreviated notifications that would not generally exceed five pages in length.

Upon receiving a declaration, CFIUS may request that the parties to the transaction file a written notice, initiate a unilateral review of the transaction, notify the parties in writing that the Committee has completed all action with respect to the transaction, or inform the parties that the Committee is unable to complete action with respect to the transaction on the basis of the declaration alone and invite the parties to the transaction to file a written notice. The Committee is required to take action in respect of a declaration within 30 days following receipt.

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FIRRMA requires that a declaration (or, at the election of the parties, a written notice in lieu of a mandatory declaration) be submitted to CFIUS in respect of certain defined transactions. These transactions include those that involve the acquisition, by a foreign person in which a foreign government has a substantial interest, of a substantial interest in certain categories of U.S. businesses that relate to critical infrastructure, critical technology or personal data of U.S. citizens that may be exploited in a manner that threatens national security. FIRRMA authorizes CFIUS to identify through regulations other categories of transactions that will also require mandatory declarations, but only for investments that involve critical technologies (i.e., not critical infrastructure or sensitive data on U.S. citizens).

For purposes of the mandatory declaration, the term “substantial interest” is to be defined by CFIUS regulations. In developing those regulations, the Committee is required to consider the means by which a foreign government could influence the actions of the foreign person, including through board membership, ownership interest or shareholder rights. However, FIRRMA specifies that an interest that is excluded from the term “other investment” or that is less than a 10-percent voting interest will not be considered a “substantial interest.” Mandatory declarations also will not be required for investment funds that are structured consistent with the clarification of “other investment” discussed in Section 2 above, and FIRRMA authorizes CFIUS to waive, with respect to a foreign person, the requirement to submit a mandatory declaration if the Committee determines that the foreign person has demonstrated that the investments of the foreign person are not directed by a foreign government and that the foreign person has a history of cooperation with the Committee. This waiver provision could potentially benefit government-sponsored pension funds.

Under FIRRMA, CFIUS may not require mandatory declarations to be submitted more than 45 days before the completion of the transaction, and FIRRMA provides CFIUS with authority to impose civil penalties on any party that fails to comply with a mandatory declaration requirement. CFIUS may not request or recommend that a mandatory declaration be withdrawn and refiled, except to permit the parties to correct material errors or omissions.

5. Additional Time for CFIUS Review

The CFIUS review process currently consists of a 30-day review period, potentially followed by a 45-day investigation period. Although parties to a transaction may in certain cases withdraw and refile the notice at the end of the investigation period, and thus start a new sequence of review and investigation periods, the core CFIUS review process currently lasts for up to 75 days.

FIRRMA extends the initial review period to 45 days and authorizes CFIUS to extend the investigation period by an additional 15 days in “extraordinary circumstances,” to be defined by CFIUS regulations. With these modifications, the CFIUS review process could take as long as 105 days, as opposed to 75 days under current law.

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6. Filing Fee

Currently, there is no filing fee associated with any notification to CFIUS. FIRRMA authorizes CFIUS to impose a fee of no more than one percent of the value of the transaction or \$300,000 (adjusted annually for inflation pursuant to regulations prescribed by the Committee), whichever is less.

In addition, FIRRMA establishes a fund, to be known as the “Committee on Foreign Investment in the United States Fund” to be administered by the CFIUS chairperson, and authorizes \$20 million in appropriations to this fund for each of fiscal years 2019 through 2023 to enable the Committee to perform its functions.

7. Additional Changes

FIRRMA includes a number of other modifications to current CFIUS practice.

- **Timing for Review of Draft Filings and Acceptance of Filings.** FIRRMA requires that CFIUS provide comments on draft notices submitted by the parties to a transaction in advance of a formal filing within 10 business days, and further requires CFIUS to accept formal filings—and thus start the review period “clock”—within 10 business days following submission. If CFIUS determines that the submission is incomplete, it must explain to the parties why the filing is incomplete. In order for the 10-day deadlines to apply, the parties must stipulate that the transaction is a “covered transaction” subject to CFIUS jurisdiction.
- **Requirement to Include Partnership and Side Agreements.** FIRRMA authorizes CFIUS to require that a written notice include a copy of any partnership agreements, integration agreements or other side agreements relating to the transaction, as specified in regulations to be prescribed by the Committee.
- **Reopening Transactions for which Action was Completed.** FIRRMA retains CFIUS’s authority to initiate a review of a transaction for which action had been completed if any party to the transaction submitted false or misleading material information to the Committee in connection with the Committee’s consideration of the transaction or omitted material information, including material documents, from information submitted to the Committee. However, FIRRMA modifies the Committee’s authority to “reopen” a transaction if any party to the transaction or the entity resulting from consummation of the transaction materially breaches a mitigation agreement or condition, the breach is certified to the Committee by the lead department or agency monitoring and enforcing the agreement or condition as a material breach, and the Committee determines that there are no other adequate and appropriate remedies or enforcement tools available to address the breach, even if the breach is not “intentional,” as it must be under current law.
- **Process for Identifying Non-notified and Non-declared Transactions.** In support of FIRRMA’s expansion of the scope of CFIUS’s authority to review transactions, FIRRMA requires CFIUS to establish a process to identify transactions for which information is “reasonably available” but for which the parties have not filed a notice or declaration.
- **Information Sharing.** FIRRMA provides that the CFIUS chairperson, in consultation with other members of the Committee, should establish a formal process for the exchange of information important to the national security analysis or actions of the Committee with governments of countries that are allies or partners of the United States, in the discretion of the chairperson, in order to protect the national security of the United States and of those countries. The process should be designed to (i) facilitate the harmonization of action with respect to trends in investment and technology that could pose risks to the national security of the United States and countries that are allies or partners of the United States, (ii) provide for the sharing of information with respect to specific technologies and entities acquiring such technologies, as

appropriate to ensure national security, and (iii) include consultations and meetings with representatives of the governments of such countries on a recurring basis.

- **Authority to Suspend Transactions or Refer Transactions to the President Prior to Completion of Review or Investigation.** FIRRMA confirms CFIUS's authority to review and investigate any pending transaction, and to impose interim mitigation measures to address national security concerns in the event that a covered transaction has closed without filing with CFIUS. FIRRMA further provides that CFIUS may suspend a transaction during its review and investigation, or cut short its investigation and refer the matter directly to the President for action such as a Presidential prohibition or divestiture order. FIRRMA also provides CFIUS with expanded authority to impose interim mitigation measures during the period of time that a transaction is before the Committee, and expressly provides that if a party to a covered transaction has voluntarily chosen to abandon the transaction, CFIUS or the CFIUS lead agency may negotiate, enter into or impose and enforce any agreement or condition with any party to the covered transaction for purposes of effectuating the abandonment and mitigating any risk to U.S. national security.
- **Expanded Reporting Requirements, Including with Respect to Chinese Investment.** FIRRMA expands CFIUS's Congressional reporting obligations. FIRRMA also requires the Secretary of Commerce to produce a report biannually, through 2026, that includes information on foreign direct investments in the United States by Chinese entities. The report must include the total amount of such foreign investment, as well as breakdowns of the total based on (i) beneficial owner, (ii) size category, (iii) North American Industry Classification System ("NAICS") code, (iv) investment type, classified as "businesses established" or "business acquired" and (v) government versus non-government investments, and further by volume, sector and type of investment within each category. The Secretary of Commerce must also analyze patterns of Chinese investment across the above-listed categories and the extent to which those patterns align with China's Made in China 2025 plan.⁸

IMPLICATIONS

FIRRMA makes significant amendments to the CFIUS review process, many which of are likely to have a significant impact on deal structuring considerations and analyses of deal risk where foreign parties are involved in a transaction. Given the expansion of the definition of "covered transactions," transactions involving foreign parties are significantly more likely to be subject to CFIUS review than they have been in the past. Parties will need to consider carefully both the statutory and regulatory definitions and examples of key terms such as "critical technology," "critical infrastructure" and "sensitive personal data" to determine whether the nature of the U.S. business brings the transaction under CFIUS's purview. Real estate transactions that previously were not subject to CFIUS review because they did not involve a U.S. business will potentially be subject to CFIUS jurisdiction. Parties to transactions will need to analyze whether a foreign government has a "substantial interest" in any foreign party to the transaction, as well as whether that foreign party is acquiring a substantial interest in a U.S. business involved in one of the specified categories, to determine whether a declaration of the transaction to CFIUS is mandatory.

Certain provisions, such as the introduction of declarations as a form of "light" filing or the specification of a time period during which CFIUS must comment on draft notices or accept certain formal notices, may serve to reduce the length of the CFIUS review process for parties to certain transactions. However, FIRRMA's extension of the initial review period to 45 days and introduction of the possibility that parties'

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submission of a declaration may be followed by a request from the Committee for a full notice filing means that in other cases parties will certainly face a longer review process than they would have under current law.

In addition, since FIRRMA leaves many details to be prescribed by Committee regulations, the full implications of the CFIUS reform affected by FIRRMA will not be known for many months. However, parties will have substantial opportunities to engage with the Committee throughout the rulemaking process and to provide the Committee with valuable insight into essential aspects of transactions involving foreign investment in the United States.

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ENDNOTES

- ¹ Certain provisions of FIRRMA are effective immediately and apply with respect to any covered transaction the review or investigation of which is initiated on or after the date of its enactment. The remaining provisions take effect on the earlier of the date that is 18 months after the date of FIRRMA's enactment or the date that is 30 days after publication in the Federal Register of a determination by the CFIUS chairperson that the regulations, organizational structure, personnel, and other resources necessary to administer the new provisions are in place.
- ² FIRRMA directs CFIUS to prescribe regulations to clarify that the term "covered transaction" includes any transaction that arises pursuant to a bankruptcy proceeding or other form of default on debt.
- ³ The term "critical infrastructure" means, subject to CFIUS regulations, systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.
- ⁴ The term "critical technologies" means: (i) defense articles or defense services included on the United States Munitions List set forth in the International Traffic in Arms Regulations; (ii) items included on the Commerce Department's Commerce Control List and controlled pursuant to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation or missile technology, or for reasons relating to regional stability or surreptitious listening; (iii) specially designed and prepared nuclear equipment, parts and components, materials, software and technology covered by part 810 of title 10, Code of Federal Regulations (relating to assistance to foreign atomic energy activities); (iv) nuclear facilities, equipment and material covered by part 110 of title 10, Code of Federal Regulations (relating to export and import of nuclear equipment and material); (v) certain select agents and toxins; and (vi) emerging and foundational technologies identified pursuant to section 1758 of the Export Control Reform Act of 2018.
- ⁵ Under FIRRMA, the term "investment" means the acquisition of equity interest, including contingent equity interest, as further defined in regulations prescribed by the Committee.
- ⁶ Subject to regulations to be prescribed by the Committee, the term "material nonpublic technical information" means information that provides knowledge, know-how or understanding, not available in the public domain, of the design, location or operation of critical infrastructure, or that is not available in the public domain, and is necessary to design, fabricate, develop, test, produce or manufacture critical technologies, including processes, techniques or methods. FIRRMA provides an exclusion for financial information regarding the performance of a U.S. business.
- ⁷ FIRRMA directs CFIUS to prescribe regulations providing guidance on the types of transactions that the Committee considers to be "other investments," and that enumerate specific types and examples of critical infrastructure likely to be of importance to U.S. national security.

FIRRMA includes an exception from "other investment" for investments involving an air carrier, as defined in section 40102(a)(2) of title 49 of the United States Code, that holds a certificate issued under section 41102 of that title.
- ⁸ Made in China 2025 is a Chinese government-proposed initiative to upgrade Chinese industry. The stated objective of the program is for China to become a major competitor in advanced manufacturing, a goal that will bring the country increasingly into direct competition with the United States. See <https://wapo.st/2KmKSYD>.

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