

Update on CFIUS Developments: Proposed Legislation and Reflections on CFIUS Under the Trump Administration

June 23, 2017

CFIUS

We are writing to provide our perspective on recent developments regarding the Committee on Foreign Investment in the United States (“CFIUS”), including the plans of Senator John Cornyn (R-TX) to introduce significant legislation to reform CFIUS, and the operation of CFIUS in the first six months of the administration of President Donald Trump.

Senator Cornyn’s Proposal to Reform CFIUS

Senator Cornyn, the second-highest-ranking Republican Senator, publicly announced on June 22 his intention to introduce a bill to reform the authority and operation of CFIUS. The proposed bill (the “Cornyn Bill”), which Cornyn said would be called the Foreign Investment Risk Review Modernization Act, represents the most significant effort to revise the CFIUS process since the passage of the Foreign Investment and National Security Act of 2007 (“FINSA”), which has governed CFIUS for nearly a decade.

Senator Cornyn’s bill represents the most significant effort to revise the CFIUS process in the last decade.

According to Senator Cornyn, his effort to reform CFIUS is motivated by his view that the Committee is outdated and ill-equipped to handle new threats to U.S. national security, especially from China. In a speech Thursday at the Council on Foreign Relations, the Senator stated that China has sought to “weaponize” investment as part of a strategy to leapfrog the United States’ advantages in technology. He further suggested that there is broad consensus within the U.S. defense and intelligence communities that “gaps” in CFIUS’s authorities present risks to U.S. national security. The proposed bill is intended to fill those gaps.

The concerns driving Senator Cornyn’s reform effort relate in part to a belief within some parts of the U.S. government that China is circumventing CFIUS to gain access to technologies that may have current or future military applications. In particular, Senator Cornyn cited minority investments by Chinese parties in technology start-up companies engaged in developing commercial technologies that may also have defense or intelligence applications. He referred to

a report prepared earlier this year (but not publicly released) by the Defense Innovation Unit Experimental, or DIUx, a component of the Department of Defense, that raised concerns about Chinese investment in early-stage technologies in the areas of robotics, artificial intelligence, automation, and semiconductors, among others.

While we will not know the precise language and effect of the Cornyn Bill until it is introduced, based on Senator Cornyn's description, the bill would have the following effects:

- **Expand CFIUS's jurisdiction to review non-control transactions that result in access to technology.** CFIUS currently has jurisdiction to review transactions that result in foreign control of a U.S. business. While the scope of that jurisdiction is extremely broad—extending to minority investments of as little as ten percent equity interest (or less)—it does not currently extend to transactions that result in technology transfers, such as the licensing of intellectual property, that occur outside the context of a controlling investment. The Cornyn Bill apparently would expand CFIUS's jurisdiction to review such transfers, though it is not clear how broad the authority would be.
- **Expand authority to review overseas joint ventures (“JVs”).** CFIUS already has jurisdiction to review JVs that result in foreign control of U.S. businesses, but Senator Cornyn made clear that he intends for the bill to expand the Committee's jurisdiction to review JVs that result in technology transfers even where those JVs do not result in control of a U.S. business, such as to JVs outside the United States that involve a transfer of U.S. technology.
- **Increased scrutiny of real estate acquisitions.** Senator Cornyn also suggested that the bill will expand CFIUS's authority to review real estate transactions. It is unclear exactly what the bill would cover that is not already within CFIUS's remit, but presumably it would encompass certain real estate outside the context of a transaction resulting in control of a U.S. business.
- **Countries of concern and broader trends.** CFIUS currently reviews transactions on a case-by-case basis, and factors into consideration the threat posed by an acquiror. In that context, CFIUS's analysis already covers the country of origin for the acquiror, starting with a presumption of approval. Senator Cornyn indicated his bill would add an explicit new country-specific framework that would require the Committee to apply heightened scrutiny to transactions involving certain countries of concern—which he suggested would include China and Russia, but possibly others—that are perceived to present the most serious threat to U.S. national security. He also indicated that he believed the Committee should take into consideration broader trends from the activities of certain countries.

While these would be substantial changes to CFIUS that would materially impact the Committee's authority and operation, Senator Cornyn expressly rejected other potential reforms:

- **Continued focus on national security; no “net benefit” or “reciprocity” test.** There have been a number of proposals over the years to expand CFIUS's remit to address economic issues, such as requiring that transactions present a “net benefit” to the United States (akin to the requirements of the Investment Canada Act), or requiring CFIUS to consider whether a foreign investor's home country would permit a reciprocal investment by a U.S. company in the same industry. Senator Schumer (D-NY), the senior-most Senate Democrat, reportedly is working on such a bill, as is Senator Grassley (R-IA).

Senator Cornyn stated that his bill, by contrast, is “laser focused” on U.S. national security.

- **No expansion to cover greenfield investment.** The Cornyn Bill would maintain CFIUS’s focus on transactions involving existing U.S. businesses. It would not expand the Committee’s jurisdiction to cover startup—or “greenfield”—investments.
- **Voluntary filing framework retained.** Filing with CFIUS currently is voluntary, although the potential consequences of not filing a transaction that later is determined to have an impact on U.S. national security can be quite severe. As such, the process is designed to incentivize parties to notify CFIUS of transactions that could implicate national security interests. The Cornyn Bill apparently will not alter this fundamental framework.
- **No new CFIUS members.** There have been several proposals over the years to add new members to CFIUS. Most recently, Senator Grassley co-sponsored a bill with Senator Stabenow (D-MI) that would give the Secretary of Agriculture and the Secretary of Health and Human Services (who oversees the Food and Drug Administration) permanent seats on CFIUS and would expressly require the Committee to assess the potential impact of transactions on the security of the United States’ food supply. Senator Cornyn stated that his bill would not add new members to CFIUS.
- **No “calling out” specific countries.** While Senator Cornyn made clear that his focus is on China, he also noted that the legislation would not identify any country by name. He suggested the country-specific framework discussed above should be durable and, therefore, it should be up to the Executive Branch, not the Congress, to identify on an ongoing basis countries of concern.
- **No ban on investment.** Senator Cornyn also said that while he is concerned about certain Chinese investments, he believes in preserving an open investment environment, and the bill would not call for a “ban” on any particular investment or from particular countries.

Senator Cornyn indicated that he is putting the finishing touches on the bill and hopes to introduce it soon. He also indicated that it will be a bi-partisan bill that seeks support from Democrats as well as Republicans. We understand that Senator Cornyn has been in discussions with other senators to co-sponsor the bill, and also is working to ensure the introduction of a companion bill in the U.S. House of Representatives.

To be sure, there are strong potential challenges to passing any significant legislation. In the most bi-partisan of times, it is not easy to move legislation; the current environment in Washington is, to say the least, something less than bi-partisan. Plus, other issues wholly unrelated to investment or CFIUS are occupying, and will continue to occupy, Congressional attention for the rest of this year.

But there are also reasons to believe that the bill (or a version of it) may ultimately become law. Senator Cornyn is among the most influential members of the Senate, and there appears to be an emerging bi-partisan consensus that CFIUS should be strengthened, principally to address growing concerns about Chinese investment. Senator Cornyn also has been discussing the bill with key members of the Trump Administration, including Treasury Secretary Steven Mnuchin. Within the last several weeks, all the leaders of the U.S. intelligence community, as well as Secretary of Defense Mattis, Secretary of Commerce Ross, and Secretary of the Treasury Mnuchin, have expressed support for CFIUS reform. These comments from Administration

officials indicate potential momentum behind Senator Cornyn's efforts to reform CFIUS. For these reasons, we believe Senator Cornyn's effort merits close attention.

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Reflections on CFIUS Under the Trump Administration

Senator Cornyn's announcement comes at a time of dramatic change in the composition of foreign investment in the United States and also in the early days of a new presidential administration that in most respects marks a radical change from the administration of former President Barack Obama. These shifts are impacting CFIUS itself as well as parties who bring transactions to the Committee for review.

With respect to the composition of the investments that CFIUS reviews:

- CFIUS's caseload has increased considerably, even over what likely was a record year in 2016. Through today, CFIUS has accepted notices of over 120 transactions in 2017, on pace to set an all-time record; by comparison, the Committee received notices of just 97 transactions in all of 2013. This increase is the result of a variety of factors, including strong merger and acquisition activity in general, greater awareness of CFIUS among transaction parties, more aggressive efforts by CFIUS in pursuing certain non-notified transactions, and more transactions involving investors from countries that tend to receive greater scrutiny from CFIUS.
- There now is a much greater proportion of investment from developing markets, especially China. While the numbers of CFIUS cases and specific countries from 2015 and 2016 are not available, our estimation is that CFIUS likely reviewed as many as 80 to 90 Chinese transactions in 2016, as compared with just four Chinese transactions in total from 2005 to 2007.
- Compared with several years ago, the Chinese investment activity is more diverse, covering more sectors, with varied transaction structures, and is often multi-national in scope.

These factors result in an extremely busy and challenging docket for CFIUS at a time when the Trump Administration still is filling many of the key positions responsible for overseeing CFIUS.

The effect is that CFIUS currently is lacking clear policy direction and is more risk adverse, resulting in a harder road to approval for some transactions.

We expect the next six months, at a minimum, to be a very challenging time for CFIUS transactions, particularly those from China.

In sum, since President Trump's inauguration, we have seen a reduced willingness on the part of CFIUS to attempt to resolve national security risks through negotiated mitigation, and a greater ability among the security agencies to obtain consensus decisions within the Committee to simply prohibit challenging transactions. This tougher line likely is being driven by multiple factors, including resource constraints arising from the sheer volume of transactions under consideration, greater risk aversion among agencies driven in part by continuing widespread vacancies in senior political positions (and a resulting lack of political direction and accountability), and more significant national security issues presented by some transactions. We expect the next six months, at a minimum, to be a very challenging time for CFIUS transactions, particularly those from China.

At the same time, we do not yet see a fundamental change in the policy underlying CFIUS's consideration of cases. Thus, notwithstanding vigorous anti-trade rhetoric during the campaign and positions held by some senior Administration officials, there is not yet an affirmative departure from the United States' longstanding policy of openness to foreign investment. In addition, we are cautiously optimistic that as additional senior policy positions are filled, firmer views about the overall approach to investment will take hold, and the CFIUS officials will be better equipped to engage in a more timely manner in transactions, and to seek solutions to national security concerns. The Congressional debate, however, around China and the prospect for CFIUS legislation bears monitoring, as it could significantly shape the United States' approach to investment from China in certain areas.

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We hope that you find this analysis useful. Please do not hesitate to contact the following members of our CFIUS practice if you would like to discuss any aspect of the foregoing in further detail:

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