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House Committee on Financial Services Considers Updates to CFIUS Reform Language

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CFIUS

We are writing to report on the latest Congressional hearing related to reform of the Committee on Foreign Investment in the United States ("CFIUS").

On April 12, 2018, the Monetary Policy and Trade Subcommittee of the House Committee on Financial Services (the "Subcommittee") held an open hearing entitled "H.R. 4311, the Foreign Investment Risk Review Modernization Act of 2017." This remains an active legislative subject, with Congress considering further amendments to the bill as introduced. We expect the debate over the next several weeks to shape the ultimate form of the bill.

In the meantime, the hearing on April 12 was the Subcommittee's fourth since Congress began its consideration of the Foreign Investment Risk Review Modernization Act of 2017 ("FIRRMA"), legislation introduced by Senator John Cornyn (R-TX) in the Senate and Congressman Robert Pittenger (R-NC) in the House to reform CFIUS. Reports of the prior hearings are available here, here, and here. The Subcommittee heard from a panel of five witnesses reflecting a mix of industry and government service backgrounds.

Members participating in the hearing included Chairman Andy Barr (R-KY), Denny Heck (D-WA), Rep. Pittenger, Roger Williams (R-TX), Al Green (D-TX), Tom Emmer (R-MN), Warren Davidson (R-OH), and Trey Hollingsworth (R-IN). The Subcommittee also invited Ed Royce (R-CA), Chairman of the House Foreign Affairs Committee. In February 2018, Chairman Royce introduced the Export Control Reform Act of 2018 ("ECRA"), a House bill to update the statutory authority underlying the Export Administration Regulations. Our prior reports on ECRA are available here and here. The hearing provided an opportunity for members to discuss FIRRMA and to debate the appropriate role for CFIUS in preventing transfers of potentially sensitive technologies.

Questions about the regulation of outbound transfers of intellectual property were a central feature of the hearing. Members expressed concern that current U.S. regulatory authorities, including CFIUS, are not sufficient to prevent U.S. know-how from being forcibly shared with foreign countries through business arrangements such as joint ventures. Rep. Heck characterized these business arrangements as a "loophole" threatening U.S. intellectual property. Rep. Green asked how FIRRMA would specifically address situations in which technology might be transferred even though no U.S. merger takes place.

Witnesses differed as to how best to address this concern. Several panelists noted that expanding CFIUS jurisdiction to cover outbound investments might duplicate existing authorities

under the U.S. export controls regime. To this end, witnesses noted that the export control system is best positioned to prevent potentially sensitive transfers given its emphasis on regulating technologies, not transactions.

Witnesses also expressed concern about the business impact of potential CFIUS jurisdiction over outbound investment. In particular, there was concern that expanding CFIUS's review to include certain outbound IP transfers would add "thousands" of new cases to CFIUS's workload, delaying processing and creating uncertainty in the CFIUS process, which could discourage U.S. companies from engaging in legitimate business transactions with foreign parties.

However, a witness representing Department of Defense interests suggested that Congress should permit CFIUS to review certain outbound transfers, despite the potential overlap with export control laws. The witness expressed concern that many small technology startups currently risk inadvertently transferring sensitive technology due to a lack of familiarity with U.S. export controls laws. Reps. Davidson and Hollingsworth echoed this concern.

Beyond these concerns related to FIRRMA's application to outbound IP transfers, members who attended the hearing also expressed reservations about the ambiguity of certain terms in FIRRMA. Rep. Emmer voiced particular concern over the breadth of the terms "critical technology" and "emerging technology." While Rep. Emmer noted that additional clarity might be provided through the rulemaking process, he worried that such expansive definitions would lead to the overregulation of industries which are predominantly commercial in nature, such as the medical device industry. In colloquy on this point, witnesses noted that some ambiguity for FIRRMA's technology terms may be desired in order to provide CFIUS with the flexibility needed to determine when a commercially useful technology might also threaten national security.

Additionally, Rep. Davidson questioned whether the breadth of similar FIRRMA terms would place private entrepreneurs at risk of having their technology deemed "critical" at a later point and restricted for transfer, catching the entrepreneurs off-guard. Rep. Davidson reiterated prior witnesses' concern that U.S. inventors and entrepreneurs would be unlikely to intuit government regulators' security interests, leaving them susceptible to such regulatory "whiplash." To address this issue, one of the witnesses suggested that FIRRMA could establish a list of technologies of special concern to CFIUS. By marketing this list to industry, CFIUS could reduce the odds that unexpected regulatory restrictions would dampen the innovative spirit.

Other notable comments in the hearing included:

- Rep. Sherman cited China's barriers to entry for many of its markets and asked whether the United States should consider doing the same to protect its domestic technology industries. However, the witnesses' responses stressed that CFIUS reform should continue to encourage open markets and healthy foreign investment in the United States, including from China.
- Relatedly, Rep. Sherman asked whether FIRRMA should direct that CFIUS's threat analysis consider Chinese companies, by default, as extensions of the Chinese government. Multiple witnesses suggested that CFIUS should retain its case-by-case analysis and should not otherwise establish a bright-line rule regarding Chinese companies.

- Members and witnesses agreed on the need to continue investing in U.S. science and technology as an important element of U.S. national and technological security. Rep. Heck voiced strong support for government funding of new technologies and sought feedback from witnesses as to how the U.S. could continue to lose its technological advantage if it merely considered ways to prevent the loss of existing technological expertise, as opposed to further developing it.
- Chairman Barr asked witnesses how FIRRMA could reduce unnecessary overlap between CFIUS and the U.S. export control laws. In response, one witness suggested the creation of a subcommittee within CFIUS that could serve as a liaison to the export controls authorities. Under the proposal, the subcommittee would bear primary responsibility for coordinating with the export controls authorities to ensure that matters and technologies did not receive redundant review.
- Lastly, there was broad consensus on the need to reform both CFIUS and the U.S. export controls regimes. In his opening remarks, Chairman Royce expressed his view that an appropriate "whole of government" approach to competitors' technological advancement would continue to require the work of both CFIUS and export controls as complementary authorities. Rep. Pittenger agreed, noting that, while he is sponsoring CFIUS reform, he continues to view export controls as the "first line of defense" in protecting U.S. technological security.

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We hope that you find this report 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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