Insight

Congress Passes Ambitious CFIUS Reform

THOMAS KINGSLEY, JACQUELINE VARAS | AUGUST 8, 2018

Executive Summary

The Committee on Foreign Investment in the United States (CFIUS) screens the national security implications of transactions in which foreign entities purchase controlling entities of U.S. corporations. The Foreign Investment Risk Review Modernization Act (FIRRMA) made significant reforms to the CFIUS process:

- Before FIRRMA, CFIUS only had the authority to review transactions between U.S. and foreign firms that result in foreign ownership of a U.S. company.
- CFIUS's authority will now expand to cover foreign investments in critical technology and critical infrastructure that do not result in foreign ownership.
- CFIUS will also have authority to review other types of transactions with national security implications, such as the foreign lease of U.S. real estate in close proximity to sensitive military or government facilities.

Introduction

The National Defense Authorization Act of 2019 (NDAA) passed both houses of Congress, with significant implications for foreign investment. Included in the NDAA was the Foreign Investment Risk Review Modernization Act (FIRRMA), a bill reforming the Committee on Foreign Investment in the United States (CFIUS). This committee, led by the Treasury secretary and including representation from State, Defense, Commerce and Justice departments, has the power to review the national security implications of every transaction resulting in a controlling interest by the foreign purchaser. CFIUS sends a recommendation to the president, who then has the power to authorize or deny the acquisition. Recently, CFIUS rulings have prevented several significant transactions, including the $117 billion

takeover of the U.S.'s Qualcomm by Singapore's Broadcomm, and Phillips' attempt to sell off a controlling stake in its U.S.-based LED business to a Chinese consortium.

The Path to CFIUS Reform

CFIUS reform has evolved substantially over the course of development. In June, both the House and the Senate committees passed differing versions of both bills focused on empowering CFIUS to review outbound investment in addition to inbound investment. Inbound investment typically involves a foreign company taking a majority stake in a U.S. company – the traditional jurisdiction of CFIUS. In contrast, outbound investment could refer to the sharing of proprietary technology in a joint venture between a U.S. and foreign firm. Ultimately, the review of outbound investment remained under the jurisdiction of export controls and was struck from both versions of FIRRMA.

Another major change centers around Chinese telecommunications company ZTE. An earlier version of FIRRMA would have reinstated U.S. sanctions on ZTE, which President Trump relaxed in June as a part of trade negotiations with China. This controversial provision was dropped from FIRRMA in conference.

Finally, all mentions of "critical technology companies" and "critical infrastructure companies" in earlier versions of FIRRMA were dropped, removing thousands of U.S. businesses which do not have national security implications from the scope of CFIUS' review. This seems to suggest that CFIUS review will not be mandated based on the specific companies involved in a transaction, but by the type of transaction itself.

Key FIRRMA Reforms

Two major expansions of CFIUS remain in scope. First, investigatory and intervention powers at CFIUS are expanded to cover not only majority investments but also non-controlling interests (i.e. transactions that do not result in foreign ownership of a U.S. firm) if the deal results in foreign acquisitions of "critical technologies." The list of critical technologies will be defined by the Secretary of Defense and refers to any technology qualifying for export controls. Furthermore, non-controlling investments in "critical infrastructure" are now under CFIUS jurisdiction, as well as any investment that "maintains sensitive personal data that, if exploited, could threaten national security" and any other investment "designed to circumvent or evade CFIUS."

Second, CFIUS is granted oversight over real estate transactions near sensitive U.S. government facilities. This includes both the purchase and lease of real estate near military facilities that may expose national security activities to foreign individuals. The basic notion is that CFIUS should not permit foreign control of key strategic regions in the United States.

Implications

What does this mean for the economy? There is cause for concern that these measures will deter foreign investment – and the related economic growth and job creation – in the United States. An estimated 12 percent of productivity gains in the U.S. economy have been driven by foreign investment. In particular, although not named in FIRRMA, the regulation appears to specifically be aimed at deterring the growing global dominance of Chinese tech firms. A successful long-term strategy would require a significant investment in U.S. enterprises. Political pressure applied via the World Trade Organization would also be the most appropriate mechanism to combat Chinese state involvement in Chinese private industry.

FIRRMA has passed the Senate, and President Trump is expected to sign the legislation. The administration has already endorsed CFIUS's expanded powers as the best means to defend U.S. national security and protect intellectual property.