



## CFIUS Reform and its Likely Impact on Inward-Bound US Investment

The *Foreign Investment Risk Review Modernization Act (FIRRMA)* was signed into law by US President Donald Trump in August 2018. It is the first change to be made to the *Committee on Foreign Investment in the United States (CFIUS)* regime in more than a decade. It broadens the scope of the *CFIUS* review process beyond simply transactions that could result in a foreign person gaining the ability to control a US business.

Currently, *CFIUS* filings are voluntary unless the committee requests or initiates a review in a specific case. *FIRRMA*, however, will require filings in deals where a foreign government will obtain a “substantial interest” in a US business, and potentially in transactions involving certain critical technology. As a result, *CFIUS* filings may become mandatory for many more investment deals.

The committee will also have authorisation to review:

- (a) foreign investments in real estate located in sensitive locations even when no US business is acquired;
- (b) certain non-controlling foreign investments in US companies involved in “critical infrastructure”, “critical technologies” and “sensitive personal data”; and
- (c) changes in investor rights that could lead to foreign control or covered non-controlling investments.

The review’s broader scope could also cover transactions in which the foreign investor would get non-public technical information, a place on the board of directors, or involvement in decision-making.

In an interview with *HKTDC*’s Assistant Principal Economist (Global Research) Louis Chan, Tatman R. Savio, a partner with *Akin Gump Strauss Hauer & Feld LLP*, and a registered foreign lawyer in the firm’s Hong Kong office, shared with us her views on the short-term and long-term effects on the *CFIUS* filing process and on what Hong Kong and mainland Chinese companies can do to improve their chances when investing in the US in the future.



**Chan:** What are the main changes brought forward by the *CFIUS* reform?

**Savio:** *FIRRMA* will make some fundamental changes to the *CFIUS* regime. Pre-*FIRRMA*, *CFIUS*'s review jurisdiction was limited to "covered transactions," which were defined as "any transaction[s] . . . that could result in foreign control of any US business." *FIRRMA* broadens the scope of transactions potentially subject to *CFIUS* review and makes other significant modifications to what was previously a voluntary review process.



Akin Gump Strauss Hauer & Feld LLP partner Tatman R Savio

For example, *FIRRMA* expands the scope of transactions potentially subject to *CFIUS* review to cover real estate transactions located near sensitive US government locations and ports, even when they don't result in foreign control of a US business.

It includes certain non-controlling foreign investments in US companies related to what the law terms "critical infrastructure," "critical technologies" and "sensitive personal data", and changes in foreign investor rights that could result in control of a US business. It also allows any transaction or arrangement designed to evade the *CFIUS* regulations to be reviewed.

In certain cases, *FIRRMA* makes what has until now been a voluntary filing process a mandatory one. Specifically, under *FIRRMA*, transactions involving foreign government investors and, potentially, US critical technology will trigger mandatory *CFIUS* filings.

Furthermore, it amends the filing process by allowing companies to submit short-form declarations or "light filings" to *CFIUS*. These can be processed more quickly. It provides for a longer review timeline for transactions. Specifically, it increases the timeline for *CFIUS* review and investigation from 75 days to 105 days. And it authorises filing fees for *CFIUS* reviews for the first time, which will help pay for more staff to handle the expected increased workload, and provides for extra appropriations funding for *CFIUS*.

Finally, it also modifies *CFIUS*' annual reporting requirements by imposing new obligations for its reports to Congress. Specifically, *CFIUS* must include significantly more information in its annual reports, including detailed information on the outcome of reviews, the parties involved, the nature of the businesses at issue, and any withdrawals from the review process. The new requirements should result in greater visibility into the *CFIUS* process and the committee's national security concerns.

**Chan:** What do you think will be the immediate impacts of the *CFIUS* reform?

**Savio:** Most *FIRRMA* provisions won't come into effect until the *Department of Treasury* publishes its final regulations on implementing *FIRRMA* requirements. That has to happen no later than February 2020.

Many *FIRRMA* provisions simply codify or clarify *CFIUS*'s current internal practices. However, other provisions and *CFIUS*'s recently announced pilot programme under *FIRRMA* will directly impose new requirements and impact the review process, resulting in potentially more *CFIUS* filings, longer review timelines, and for the first time, penalties for failure to meet mandatory filing obligations.



*FIRRMA*'s new timeline for *CFIUS* review went into effect immediately. It extends the initial review period from 30 calendar days to 45 calendar days and permits the addition of 15 calendar days to the end of an investigation in "extraordinary circumstances." With these changes, the *CFIUS* review cycle may now be as long as 105 days, as opposed to 75 days.

In this regard, however, it's worth noting that even though the review timeline was shorter pre-*FIRRMA*, the committee was often unable to complete its reviews within those time constraints. This meant that companies were often compelled to withdraw their *CFIUS* notices and re-file them in order to restart the review clock. For that reason, it could be the case that even though the review period is theoretically longer post-*FIRRMA*, *CFIUS* may be able to conclude its reviews within the time available, especially given that it will also have additional resources resulting from new funding, filing fees and corresponding staffing increases.

**Chan: How about in the longer run?**

**Savio:** From a legal perspective, *FIRRMA* makes more transactions "covered transactions," including certain non-passive, non-controlling investments in US businesses associated with sensitive personal data, "critical infrastructure" or "critical technology".

There is still the potential for some protection of passive investments. Although *FIRRMA* doesn't use the term "passive investment," it does require that for non-controlling investments to be covered, they must give the foreign person access to "material non-public technical information" of the US business; membership, observer or nomination rights for the board or equivalent body of the US business; or any involvement, other than through voting of shares, in substantive decision-making related to sensitive personal data, critical technologies, or critical infrastructure.

In this way, the new law may provide some insulation for transactions that are solely for the purpose of passive investments, which reflects the approach of the existing *CFIUS* regulations towards these sorts of transactions.

Making it mandatory to submit a *CFIUS* notice under *FIRRMA*, and putting penalties in place for failing to meet this requirement, will make a difference to the volume of filings being made. Pre-*FIRRMA*, many companies would analyse their transactions and then decide not to file *CFIUS* notices, because they concluded that a particular transaction didn't meet the definition of a "covered transaction", or that a filing was not warranted based on an internal evaluation of perceived national security risk. With *FIRRMA*, these two fundamentals of the approach to *CFIUS* review and analysis have changed. It is now the case that more transactions will be covered transactions and that parties may have no discretion as to whether or not they submit a filing.

This will almost certainly result in a greater number of filings to the committee. Before *FIRRMA*, *CFIUS* filings were already increasing in both numbers and complexity. *FIRRMA* looks to address those issues by implementing funding and other reforms.

**Chan: Which types of investments will be impacted most?**

**Tatman:** *CFIUS*'s new pilot programme, which began on 10 November 2018, has already impacted certain types of investments. Under the pilot programme, *CFIUS* has expanded its jurisdiction to focus on certain non-controlling investments in US businesses that



produce, design, test, manufacture, fabricate or develop a “critical technology” (i.e., most export-controlled technology) associated with any of 27 industry sectors under specific North American Industry Classification System (NAICS) codes. They’re called “Pilot Program US Businesses.”

“Critical Technology” Industries under FIRRMA Pilot Program		
	NAICS Code	Industry
1.	336411	Aircraft Manufacturing
2.	336412	Aircraft Engine and Engine Parts Manufacturing
3.	331313	Alumina Refining and Primary Aluminium Production
4.	332991	Ball and Roller Bearing Manufacturing
5.	334112	Computer Storage Device Manufacturing
6.	334111	Electronic Computer Manufacturing
7.	336414	Guided Missile and Space Vehicle Manufacturing
8.	336415	Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing
9.	336992	Military Armoured Vehicle, Tank, and Tank Component Manufacturing
10.	221113	Nuclear Electric Power Generation
11.	333314	Optical Instrument and Lens Manufacturing
12.	325180	Other Basic Inorganic Chemical Manufacturing
13.	336419	Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing
14.	325110	Petrochemical Manufacturing
15.	332117	Powder Metallurgy Part Manufacturing
16.	335311	Power, Distribution, and Specialty Transformer Manufacturing
17.	335912	Primary Battery Manufacturing
18.	334220	Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing
19.	541713	Research and Development in Nanotechnology



20.	541714	Research and Development in Biotechnology (except Nanobiotechnology)
21.	331314	Secondary Smelting and Alloying of Aluminium
22.	334511	Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing
23.	334413	Semiconductor and Related Device Manufacturing
24.	333242	Semiconductor Machinery Manufacturing
25.	335911	Storage Battery Manufacturing
26.	334210	Telephone Apparatus Manufacturing
27.	333611	Turbine and Turbine Generator Set Units Manufacturing

Source: Determination and Temporary Provisions Pertaining to a Pilot Program to Review Certain Transactions Involving Foreign Persons and Critical Technologies, Federal Register

Parties must make a *CFIUS* filing, either in short or long form, for investments that could result in control of the Pilot Program US Business or would give a foreign person access to particular information or governance or decision-making rights, even if the investment in the Pilot Program US Business is non-controlling. *CFIUS* may impose substantial civil penalties, up to the value of the transaction, for failing to make such a filing in advance of closing (that's 45 days beforehand, if filing a short-form declaration). The pilot programme doesn't apply to transactions for which the parties have executed a binding written agreement or other document establishing the material terms of the transaction before October 11, 2018. But otherwise, the parties involved will now have compliance risk associated with failing to meet the mandatory reporting requirement.

In order to meet their obligations and risks under the pilot programme, the parties will need to conduct due diligence to determine whether the target US business comes within its scope. This is likely to require a detailed export control analysis to identify any potential critical technologies. Assuming that a US company is or could be captured, the parties will then need to decide if there is a way of achieving what they want from the proposed transaction while also satisfying *CFIUS* requirements.

**Chan:** Which economy or country will be impacted most?

**Savio:** The pilot programme applies to all foreigners and is not country-specific. *CFIUS* has said that no countries were exempted from the programme because it was intended to be a comprehensive examination of the nature of foreign direct investment in relation to critical technologies and the industries in the pilot programme.

However, the discussion about *CFIUS* reform has centred on China and China's Made in China 2025 industrial policy, which is focused on expanding its high-technology sectors and developing its advanced manufacturing base. Various stakeholders in the US government, including the US Congress, have been concerned about trends in Chinese investments and the way in which China has been able to use passive or minority investments, joint venture arrangements, and other mechanisms to make successful



investments in the US economy and obtain critical technology, or access to critical infrastructure, or other sensitive assets or information. The concern is that China's development and dominance in this high technology area in a programme subsidised by the state could affect US leadership in areas related to national security. *FIRMA* looks to address this perceived national security threat by filling in the so-called gaps where China has been acquiring technology.

In this context, it is worth noting that for several years now Chinese companies have dominated *CFIUS* reviews, as *CFIUS*'s annual reports to Congress make clear. According to *CFIUS's Annual Report to Congress* for 2015 (the most recent year for which such data is available), acquisitions by investors from mainland China accounted for a larger share of the notices filed for the three-year period from 2013 to 2015 than those from any other single country. 74 notices involved Chinese investors – that's 19% of the total. That's ahead of Canadian investors, who accounted for 49 notices, investors from the UK who accounted for 47, and those from Japan who were responsible for 40. Chinese investors also accounted for the most notices filed in each individual year in this period – 21 in 2013, 24 in 2014 and 29 in 2015.



### Covered Transactions by Acquirer Home Country or Economy, 2013-2015

Country/Economy	2013	2014	2015	Total
Australia	0	4	4	8
Belgium	0	0	1	1
Brazil	1	0	0	1
British Virgin Islands	0	1	0	1
Canada	12	15	22	49
Cayman Islands	1	3	8	12
Chile	1	0	0	1
China	21	24	29	74
Denmark	0	0	1	1
Finland	0	1	2	3
France	7	6	8	21
Germany	4	9	1	14
Hong Kong	1	6	2	9
India	1	2	0	3
Indonesia	0	1	2	3
Ireland	1	1	2	4
Israel	1	5	3	9
Italy	0	0	2	2
Japan	18	10	12	40
Liechtenstein	0	1	0	1
Luxembourg	1	0	2	3
Mexico	2	0	0	2
Netherlands	1	8	5	14
New Zealand	0	0	0	0
Norway	1	1	0	2
Portugal	0	0	1	1
Qatar	0	1	0	1
Russian Federation	1	1	0	2
Saudi Arabia	2	1	1	4
Singapore	3	6	3	12
South Africa	0	0	2	2
South Korea	1	7	1	9
Spain	1	2	2	5
Sweden	2	2	3	7
Switzerland	3	7	2	12
Taiwan	1	0	0	1
Turkey	0	0	2	2
United Arab Emirates	2	1	1	4
United Kingdom	7	21	19	47
<b>Grand Total</b>	<b>97</b>	<b>147</b>	<b>143</b>	<b>387</b>

Source: CFIUS Annual Report to Congress, CY 2015 (published in September 2017)

Chan: Any tips for prospective Hong Kong or mainland Chinese investors to mitigate the



### possible adverse impacts?

**Savio:** While some of *FIRRMA*'s provisions came into effect straight away, significant changes to *CFIUS*'s scope and structure will not become effective until February 2020, or 30 days after *CFIUS* publishes a determination that the regulations and necessary resources to administer *FIRRMA* are in place, whichever is sooner. In the meantime, prospective investors, companies and other affected parties will have an opportunity to comment on the forthcoming proposed regulations, including definitions of key terms that will ultimately determine the scope of *CFIUS* review powers. Companies' experiences in the pilot programme are likely to affect the feedback that they are able to provide during the notice and comment period that will follow the publication of proposed regulations.

While *FIRRMA* makes many changes to the *CFIUS* regime, it doesn't alter the committee's case-by-case approach to reviewing foreign investment transactions. For every transaction that it evaluates, *CFIUS* will continue to look at the potential threat posed by a particular investor, the vulnerability of the investment target, and the consequences of the transaction. *FIRRMA* does not change this. In this regard, there may be cases where *CFIUS* sees no national security issues associated with a particular transaction, or sees ones that can be mitigated somehow.

Finally, it is important not to view *FIRRMA* in isolation. One needs to understand it in relation to wider issues, including the broader Sino-US trade dispute, and also a new export control reform law that passed at the same time as *FIRRMA* to control so-called "emerging" and "foundational" technologies. Both this new export control law and the trade dispute are underpinned and motivated by concerns about China's acquisition of US technology and theft of IP in the context of the Made in China 2025 industrial policy.

While *CFIUS* is a legal process, it can become politicised, as we have seen in many prior transactions. Because of this, it's important when dealing with *CFIUS* issues to have a clear overall strategy – not just a legal strategy but a public policy and public relations one as well.

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