

THE NEW LEGAL LANDSCAPE FOR CROSS-BORDER INVESTMENT IN THE UNITED STATES: WHAT INVESTORS IN EUROPE AND ASIA NEED TO KNOW

As part of President Trump's continuing trade policies and the US government's efforts to restrict foreign control of US national security and infrastructure assets—with particular attention to China—President Trump has signed legislation¹ imposing significant new restrictions on inbound investment into the United States. While the final version of the legislation, entitled the Foreign Investment Risk Review Modernization Act (FIRRMA), did not go as far as earlier drafts considered by Congress or some of the statements made by legislators, it does intensify the foreign investment review process run by the Committee on Foreign Investment in the United States (CFIUS) in important ways. These changes include:

- A sharper focus on investments that present less obvious strategic threats, but which are viewed as of concern over the longer term, particularly in new economic sectors that have not historically been a focus of CFIUS review;
- Expanded CFIUS jurisdiction to review "passive" or non-controlling investments and investments in real estate;
- Enhanced attention to countering what is perceived to be China's efforts to develop its own know-how at the expense of US firms;
- Modification of CFIUS timelines to expedite simpler reviews while potentially slowing down others (once again, with a likely focus on certain investments from China);
- Introduction of mandatory filing requirements for transactions where a non-US government-owned or -controlled enterprise has a significant interest in the transaction; and
- Filing fees up to \$300,000 per transaction (and, depending on the CFIUS implementing regulations to be issued, an additional optional "fast track" fee for an expedited review process).

For investments from allied countries, FIRRMA implementation is likely to result in a CFIUS process that applies to more transactions but may move more quickly and easily, and provides a more formal and (usually) predictable process. For

¹ During the legislative process FIRRMA was incorporated into the John S. McCain National Defense Authorization Act for FY 2019, H.R. 5515, 115th Cong. (2018).

many transactions from China or other countries of concern to the US Government, the process may take longer. Investments that involve such countries will likely face a lengthier review process and increased scrutiny, particularly in emerging or high-technology sectors.

CFIUS Overview

Under current law, the President of the United States can block or unwind any investment in a sensitive US business if that investment could result in a foreign person gaining control of the US business and the associated threat to US national security cannot otherwise be mitigated. That authority, granted by the "Exon-Florio Amendment," is managed through CFIUS.² The CFIUS process has traditionally focused on deals involving core national security such as defense, transportation infrastructure, energy and government supply chains. In recent years, CFIUS has also expanded its focus to include the technology and financial sectors.

Requesting a pre-closing clearance from CFIUS has always been voluntary, but transactions not submitted for prior review run the risk of CFIUS initiating its own review and possibly blocking or reversing the transaction after closing. The formal review process starts when the parties submit a notice to CFIUS (or when the Committee initiates its own review), and concludes—usually some months later—with either clearance to proceed or rejection of the application and potential blocking by the President. In cases where CFIUS perceives a risk to national security or critical infrastructure, the Committee may also require mitigation and modifications to the transaction to limit foreign control or access to sensitive US technologies or assets through mitigation agreements with the parties. Recently, however, CFIUS has refused to approve transactions in cases that previously might have cleared with a mitigation agreement, and insisted on mitigation in a broader range of cleared transactions than previously.

In the last few years, the CFIUS process has been strained by an increase in the number of notified cases and by increasing sensitivity in the US Government to perceived national security threats from certain types of investment, including in emerging high-technology sectors, personal data, and infrastructure. Moreover, US legislators as well as the Trump Administration have continued to focus on China as a country of concern.

The CFIUS Process After FIRRMA

FIRRMA altered the CFIUS process in important ways and will lead to additional changes over the next eighteen months as additional FIRRMA provisions come into effect. We provide below a summary of what the CFIUS process will now look like, with FIRRMA changes highlighted in **bold**. Changes that will become effective only once the Treasury Department issues new implementing regulations—likely to happen at some point in 2019—are highlighted in ***bold italics***.

WHEN DOES CFIUS APPLY: CFIUS applies to certain new investments by non-US (referred to in CFIUS legislation as "foreign") persons in the United States,

² P.L. 100-418, Title V, Section 5021, August 23, 1988; 50 U.S.C. Appendix §2170; see also P.L. 102-484, October 23, 1992 (the "Byrd Amendment"); P.L. 110-49, July 26, 2007 ("FIRSA").

including: 1) investments that would result in majority ownership or control by a foreign person of an existing US business, whether directly or through a joint venture; 2) **acquisition of rights in sea or air ports or near sensitive installations**; 3) **non-controlling investment in "critical infrastructure"³ and "critical technology"⁴ businesses, and businesses that maintain sensitive data about US citizens, if the investment could provide the foreign person with rights to observe or join the board, nominate any board member, access any material non-public technical information⁵ from the US business, or influence any substantive decisions of the US business.**

The FIRRMA legislation initially included a proposal to treat investment from certain US allies who align their foreign investment regimes with that of the United States more favorably than other investments. That provision, referred to as the "white list" process, was removed from the bill before final passage. However, **FIRRMA as passed, empowers CFIUS to exempt from or limit review of real estate transactions and investments in critical infrastructure or critical technology companies (items 2 and 3 above) where the non-US parties are determined to be of low national security risk to the United States because of "how they are connected to" foreign countries or non-US governments.** The FIRRMA legislation provides additional legislative support for CFIUS to monitor for transactions that are not filed with the Committee.

FIRRMA creates two significant carveouts from the general rules of CFIUS jurisdiction noted above. The first is for non-controlling investments by foreign persons in airlines and other air carriers. The second is for non-controlling investments by foreign persons in investment funds that invest in critical infrastructure or critical technology companies, even if the foreign person has the right to participate as a limited partner or equivalent on an advisory board or a committee of the fund, if: i) the general or managing partner of the fund is a US person; ii) the foreign person cannot otherwise control the investment decisions or management of the fund or its general manager; and iii) the foreign person does not have access to material nonpublic technical information as a result of its participation as a limited partner or advisory board member.

OBLIGATION TO NOTIFY CFIUS: While CFIUS notification is often recommended for transactions that could raise any US national security concerns, it remains voluntary in most cases. However, **notification is now required for transactions that result in a foreign government obtaining a "substantial interest" (to be defined in regulations, but excluding any interest below ten**

³ Critical infrastructure is defined as "systems and assets ... 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 Critical technology is defined as defense articles subject to the US International Traffic in Arms Regulations, 19 C.F.R. §§120-130 (ITAR); more sensitive dual-use items subject to the US Export Administration Regulations, 15 C.F.R. §§730-774 (EAR); nuclear materials and toxins controlled by other regimes; and **"emerging and foundational technology" essential to US national security. The list of "emerging and foundational technologies will be defined through an inter-agency process, and will continue to evolve over time as new technologies emerge and their national security implications are identified.**

⁵ "Material nonpublic technical information" is defined as information that provides "knowledge, know-how, or understanding, not available in the public domain, on the design, location, or operation of critical infrastructure;" or 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." Material nonpublic technical information does not include "financial information regarding the performance of a United States business."

percent) in a critical infrastructure or critical technology company or a company that maintains sensitive data about US citizens. Failure to file can result in penalties to be defined by CFIUS in the regulation.

FILING FEES: Submission of CFIUS filings has never required payment of a filing fee. Instead, the cost of the process was typically felt through delays in closing the transaction and legal and related fees for managing the CFIUS process. **FIRRMA has authorized CFIUS to collect filing fees equal to one percent of the transaction value up to a maximum of \$300,000 per transaction.**⁶ In addition, **Congress has authorized CFIUS to establish a "fast track" fee. While the fee remains undefined pending the issuance of new regulations by CFIUS, it would presumably establish a process to expedite filings where the parties pay an additional fee.** Those unwilling to pay the fee would have their filings reviewed under the standard process.

FILING PROCESS: Once the parties have decided to notify CFIUS of a transaction (or where CFIUS notification is mandatory), the parties now have a number of choices to make early in the transaction process. First, they will need to decide whether to submit the traditional written notification, which can often be 20 or 30 pages, **or a simplified "short form" declaration of no more than 5 pages.** The short form declaration offers a number of potential advantages, including (presumably) less effort to collect the required information, and a potentially abbreviated 30-day review period from CFIUS. This may be a promising option for transactions that pose no national security concerns, including investments with a substantial foreign government interest that are nonetheless non-contentious (for example, because the investing government is closely aligned with the United States and the investment is in support of priorities shared with the US Government). However, parties choosing the short form declaration run the risk that CFIUS will be unwilling to approve the transaction based on a short form review alone. Short form reviews not cleared by CFIUS must either be withdrawn or go through the standard CFIUS review process, including the preparation and submission of a full written notification. Such a result could potentially delay the CFIUS process as a whole by five or six weeks.

If the parties choose to file a standard written notification, the filing process has now been formalized. Historically, parties have provided CFIUS with a draft of their joint written notification in advance of filing, allowing CFIUS staff an opportunity to comment on the draft and the parties a chance to address questions and issues before the CFIUS process officially began. In addition, while CFIUS reviews operated on a 30-day statutory deadline, CFIUS staff would only start that timeline once they officially acknowledged receipt of the filing. FIRRMA now acknowledges those practices in statute, **and requires CFIUS to respond to both draft and final written notifications within 10 business days in most cases.**

TIMELINES: CFIUS has typically taken about five months in recent years, roughly broken down as: one month to prepare the draft written notification; two weeks for CFIUS to review the draft; two weeks for revisions, resubmission and acceptance of the filing; 30 calendar days for the initial review; 45 calendar days for the full

⁶ While "transaction value" is not fully defined in the legislation, it is likely to be interpreted as the purchase price for the transaction as a whole as reflected in the purchase agreement.

investigation; and 15 calendar days for the President to take action if CFIUS makes a recommendation to the President. While cases can close more quickly if CFIUS decides against a full investigation, the majority of CFIUS clearances in recent years have taken the full allotted time, and increasingly, parties have been encouraged to withdraw their applications and refile when CFIUS deems the existing information insufficient or needs additional time to finalize a Letter of Assurance or other mitigation agreement.

FIRRMA extends the existing review timeline by at least two weeks, and potentially longer. **The standard review process should now take up to six months** – one month to prepare the written notification; **10 business days for CFIUS to review the draft**; one week to revise and resubmit the final notification; **10 business days for CFIUS to accept the notification**; **45 calendar days (instead of 30) for CFIUS to conduct its initial review**; an additional 45 calendar days for a full investigation; and 15 calendar days for the President to take action if CFIUS makes a recommendation to the President. In some cases, however, it may take two to three months longer, if you add time to prepare a short form declaration and 30 calendar days for CFIUS' review of short form declaration review on the front end and a **15 calendar day extension of the investigation on the back end in the case of "extraordinary circumstances."**

SUBSTANCE OF THE CFIUS REVIEW: The CFIUS review process has always focused on risks to US national security. Over the past few decades, what qualifies as a national security risk has expanded significantly to include national infrastructure, telecommunications, and most recently financial services and personally identifiable data. Under the Trump administration, the sharpest focus has been on investment from China across a broad range of sectors. FIRRMA codifies and perhaps even strengthens the existing scrutiny on Chinese-backed investment, **and encourages CFIUS to track and address acquisition patterns in specific industries.** In addition, **the law now instructs CFIUS in its reviews to weigh the purchaser's history of compliance, the US target's access to sensitive personal data about US citizens, and how the proposed transaction might create cyber risk for the United States.**

NATIONAL SECURITY CONCERNS AND MITIGATION MEASURES: CFIUS has had few formal tools to address national security concerns during a review in the past. In practice, if the Committee had immediate concerns about a deal, it could conclude its review on an expedited basis and recommend to the President that he block the deal. Under FIRRMA, **CFIUS may suspend the deal while under review or impose temporary conditions on a completed transaction to mitigate national security risks while the CFIUS review is ongoing, and without having to go to the President.** Even if the parties abandon a proposed transaction before completion, CFIUS may impose conditions on the parties to ensure abandoned deals do not risk national security going forward.

Where CFIUS identifies national security concerns in a particular deal, it can recommend the President block or unwind the deal in extreme cases. More frequently, however, it will require the parties to agree measures to mitigate the national security risks. These measures frequently include provisions that guarantee continued supply of critical parts to the US Government or its

contractors; require that those parts continue to be manufactured in the United States; mandate the establishment of programs that restrict foreign-person access to certain facilities, systems or information; or commit the acquired and acquiring entities to limit influence by the foreign parent over the acquired US entity. Monitoring of these commitments has often been informal. **FIRRMA now requires that CFIUS establish and maintain formal plans to monitor the parties' compliance with these provisions. CFIUS is also now empowered to impose penalties and additional compliance conditions on parties who fail to comply with mitigation conditions agreed during the CFIUS clearance process.**

Conclusions

Global companies, investors, funds, and individuals looking to acquire US assets that potentially implicate US national security and infrastructure considerations now have to navigate an enhanced set of regulatory requirements as part of the new FIRRMA legislation. CFIUS continues to be alive and robust, and the legislation makes clear that CFIUS and the US government will continue to closely scrutinize not only China investments and acquisitions, but also a broader range of global deals. Continued pre-transaction diligence as it relates to national security, infrastructure, and foreign control remains at a premium. Investors and purchasers, along with their counsel, should continue to closely examine deals for any potential CFIUS concerns and proceed accordingly.

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