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U.S. Foreign Investment Policy Gets A Tougher But More Transparent CFIUS

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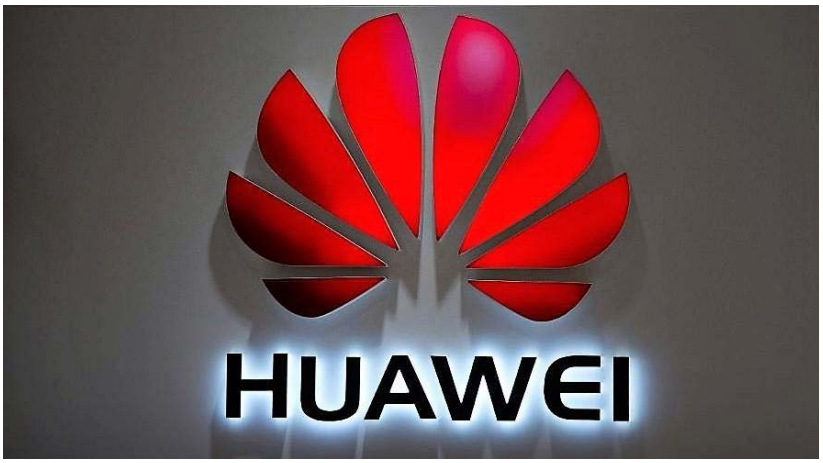

Throughout much of the past century the U.S. was a forceful, if not incessant voice in global fora of the belief that the more liberalized a country's regulatory regime towards foreign investment, the stronger the prospects for economic growth, job creation and productivity. Washington largely walked the talk: U.S. policy towards inbound cross-border capital flows was the world's beacon for market openness. However, judging by some very high-profile policy decisions taken by the Trump Administration over the past two years by the Committee on Foreign Investment in the U.S. (CFIUS)--the interagency entity that assesses the national security implications of investments by foreigners in U.S. businesses--and a newly enacted law that significantly transforms the authority of CFIUS, it would seem that era is all but over.

CFIUS' policy stance is undergoing two seemingly sudden and radical shifts. One is a reversal towards greater *restrictions* as to *which sectors* and limitations on *how much* foreign investment are permitted—frankly, a change that, in certain circumstances, could well prove not to be the wisest course of action for the livelihood of U.S. businesses and workers. The other is to inject far more *transparency* into the rules and procedures governing U.S. inbound foreign investment. Regardless of what one might think of the substance of the new restrictions, bringing about more clarity of the governing process, a long-standing thorn in the side of investors (on both the foreign and domestic sides of a transaction), is a change with which it would be hard to quibble.

CFIUS' Origins

CFIUS was established in 1975 by President Gerald Ford through an executive order. Its initial legal authority stemmed from the U.S. Defense Production Act (DPA) of 1950, which empowered the President, acting through CFIUS, to scrutinize mergers, acquisitions and takeovers involving foreign persons that could result in *foreign control* of any business engaged in matters that could undermine the national security of the U.S.

For many years, the operations of CFIUS were not significantly pronounced, quite similar to those of comparable executive branch entities in other wealthy nations. Where there were differences, they largely reflected the U.S.'s role as the world's standard-bearer for maintaining open market: the posture CFIUS adopted when issues in its jurisdiction arose, its conduct was arguably more reactive than that of most of its foreign analogs.

To that end, under CIFUS' rules a U.S. business involved in a pending transaction that would result in control by a foreign party had the choice to voluntarily submit the transaction to CFIUS for a review if the business believed the deal might have some bearing on U.S. national security. Of course, CFIUS always retained the right to subject any transaction—whether prior to its consummation or anytime thereafter—to a formal review.

The reality was that CFIUS infrequently intervened, let alone halted, transactions from being completed. When I was a member of CFIUS during my time in the White House in the early 1990s it rarely did so. As a result, CFIUS wasn't a well-known agency, and any infrequent press accounts of its activities universally referred to it as a "secretive" organization.

Congress' Politicization Of CFIUS

In contrast, Congress increasingly took an interest in CFIUS and pushed to assign mechanisms to it to become a more proactive body, and needlessly to say, more accountable to the legislative branch. As history teaches us, this is of course Congress's want: to get a bigger seat at the policy decision-making table, especially (though not exclusively) in economic matters.

Congress's campaign for a more proactive CFIUS accelerated at the time when Japanese global dominance in semiconductor production began to emerge and worries about the international competitiveness of the U.S. was center stage. Accordingly, Congress enacted various amendments to the DPA to expand the scope of CFIUS' responsibilities—especially the Exon-Florio provision of the Omnibus Trade Act of 1988. Then, in 2007, Congress enshrined CFIUS in statute and also formalized the President's statutory authority over the agency's operations to outright prohibit foreign transactions or require alteration of their structure through divestiture or other remedies so as to mitigate risks to U.S. national security.

Still, whether through such statutory changes or modifications of CFIUS' own internal processes, reforms of CFIUS' mandates did little to substantially enhance the transparency of the entity's operations.

As I've written in this space earlier, this has fueled the inevitable politicization of CFIUS' actions and, sadly, the naivete of investors and their advisors (notably U.S. attorneys—often the first port of call for parties to a transaction with the potential for a CFIUS review) in failing to recognize that such forces were almost always in play whether explicitly or implicitly. Such were the circumstances in the 2006 acquisition by UAE's Dubai Ports World of several major U.S. port operations and in the 2013 sale of the pork products company Smithfield Foods to the Chinese firm Shuanghui.

The incidence of politicization of CFIUS' decisions has become all the more important over the last decade and a half, when the agency's activities have intensified greatly. One main driver has been the rapid increase in the number of acquisitions (whether consummated or proposed) of U.S. businesses by enterprises owned or controlled by foreign states whose agendas have been devoid of altruistic commercial objectives aimed at the betterment of the U.S., most notably, but not exclusively, China.

The other, especially in the last two years, has been the ascendency in 2017 of the unapologetic "America First" economic, foreign, military and immigration policy stance of the U.S. administration of Donald Trump.

Not surprisingly, Trump's imprint on individual CFIUS cases has been unmistakable. Three high profile CFIUS' decisions are illustrative: its halt in September 2017 of China's Canyon Bridge Capital Partners purchase of Lattice Semiconductor; its prohibition of Alibaba's affiliate's, Ant Financial, to acquire MoneyGram in January 2018, and the blockage by Broadcom of its purchase of Qualcomm in March 2018.

The Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA)

But the most substantial changes to CFIUS have come with the Congress and the White House working in unison. Thus, it was that on August 13, 2018, President Trump enacted into law, for the first time in over a decade, amendments to the core statutory authority of CFIUS; namely, The Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA").

FIRRMA greatly expanded the scope of CFIUS' power in two critical ways: (i) the agency now has the authority to proactively review and prescribe limitations on, including the prohibition of, *non-controlling* investments by foreign persons in U.S. businesses directly related to or potentially affecting "critical technologies"; and (ii) the new law specified the process for *mandatory* filings with CFIUS.

There's little question that the *restrictiveness* of CFIUS' regulatory bite has been significantly sharpened. In this regard, for those of us who have toiled in CFIUS matters for many years, the arrival of FIRRMA has had a rather remarkable

impact: once thought of as almost a cloak and dagger operation, CFIUS has become close to being a household name (that is, at least within the international investment community!).

As I noted above, a policy regime with intensified limitations on inbound foreign direct investment could well have deleterious impacts on the growth prospects and job creation potential of the U.S. economy—an outcome that obviously varies from case to case.

The increase in the *clarity of the procedures* that CFIUS must follow under FIRRMA, however, is a different matter.

In defining "critical technologies" FIRRMA has taken the approach of enunciating a list (published on November 10, 2018) of 15 "pilot program" industries. At the same time, FIRRMA established "interim rules" governing the treatment of proposed investments in these "pilot program" industries. The evaluation of these interim measures ultimately will result in a codified set of permanent rules at a later date.

The pilot program industries include:

1. defense and defense-related industries
2. computer storage device manufacturing
3. electronic component manufacturing
4. alumina refining and primary aluminum production
5. optical instrument and lens manufacturing
6. basic inorganic chemical manufacturing
7. petrochemical manufacturing
8. powder metallurgy parts manufacturing
9. power, distribution, and specialty transformer manufacturing
10. primary battery manufacturing
11. radio, television broadcasting, and wireless communications equipment manufacturing
12. research and development in nanotechnology
13. research and development in biotechnology
14. semiconductor and related device manufacturing; and
15. telephone apparatus manufacturing

To be sure, like all such lists embodied in U.S. regulations, the *product boundaries* of what goods or services are included or excluded in such (rather broad) descriptors are a matter of interpretation, and often ultimately a matter of litigation.

Complicating matters further, the interim rules pertaining to these industry sectors entail a broad *spatial scope* of what are considered to be sensitive interests deemed to protected from activity involving foreigners—in particular the purchase or lease of real estate that is located within or in close proximity to airports; shipping ports; or defense-related installations.

Obviously since FIRRMA broadened CFIUS' authority to include *non-controlling* foreign interests, definitions along these lines were required. However, rather than specifying certain thresholds of ownership, the interim rules stipulate that a transaction would be covered by CFIUS if the investment would result in a foreign person:

> (a) possessing the power to make material decisions about the disposition or management of the investment fund in which the foreign ownership is mediated;
>
> (b) gaining access to "material nonpublic technical information" about the "critical technology" of the U.S. business to be acquired;
>
> (c) acquiring rights to serve on that business' board of directors (whether in a voting or non-voting capacity) or to nominate someone to so serve; or
>
> (d) possessing the authority to make material decisions about the operations of that business related to its "critical technology".

Finally, FIRRMA revised the procedures and timetables governing filings with CFIUS. Under the new law, unless investors choose to file a formal "long-form" notice with CFIUS seeking its review of a proposed transaction that may well fall under the agency's jurisdiction, they are obligated to file a "short-form" declaration with CFIUS 45 days before the transaction is completed. CFIUS then must make a decision within 30 days thereafter as to whether more information is needed from the parties; a formal long-form filing is required; or the investment is "cleared." If these procedures are not

adhered to, CFIUS may impose penalties up to the value of the investment and CFIUS also can block or force the unwinding of the transaction.

Of course, as was the case prior to FIRRMA, parties are always free to voluntarily file a formal long-form notice with CFIUS. And, as before, even if a transaction is cleared, CFIUS always retains the right to open up an investigation at a later date if one is deemed necessary.

Strategies Moving Forward: Alignment With Antitrust Decision-Making Protocols?

It's hard not to welcome the increased transparency introduced by FIRRMA into the CFIUS process—even if the CFIUS of today is a far more proactive agency than when it was launched last century. In fact, regardless of whether CFIUS is reactive or proactive, the experience over the last 40+ years strongly suggests that the wisest course of action if there is even the most remote of chances that participation of a foreign party in the acquisition of a U.S. business may be of interest to CFIUS, is to pre-file with the agency. In this respect, the CFIUS go/no-go decision-making process might be thought of as becoming analogous to the merger guidelines used in antitrust enforcement in the U.S.

In fact, the substantive overlap between those who focus on CFIUS transactions and those who toil on antitrust enforcement is stronger than most observers in either of those two camps might realize. Competition and national security are inextricably linked (an issue that keeps coming up in my own expert witness work in either antitrust or CFIUS matters).

Thus, in their consideration of the economic and social benefits and costs of mergers, acquisitions, market dominance, pricing conduct, etc. that could impair or enhance competition, antitrust officials and lawyers cannot ignore the impacts these actions can have on the country's national security. This is the logical counterpart to the way CFIUS officials and lawyers should be taking into account changes in market competition when making their national security assessments of inbound foreign investment. The oddity of the current FTC vs. Qualcomm antitrust case, where the FTC's key witness against Qualcomm is Huawei--a company the US defense and intelligence agencies believe pose a national security threat to the country--epitomizes the need for this duality perspective.

It would be naïve, of course, to think that politicization will ever be wrung out of whatever framework is set with respect to execution of U.S. policy towards foreign investment, not unlike the U.S. antitrust decision-making process. Thus, aberrant—in fact surprising—decisions with respect to the approval or prohibition of specific transactions will surely always come about. But, if the foundation on which the policy framework rests is logically consistent, well-communicated and, most importantly, generally accepted, these aberrations are likely to be fewer in number.

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