

Client Alert

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New CFIUS Legislation Proposed in Response to Chinese Investment

Chinese investment in the United States continues to grow—and has resulted in legislation that would significantly expand the reach and authority of the Committee on Foreign Investment in the United States (CFIUS), an interagency committee charged with reviewing foreign investment in the United States for national security concerns. Their statistics highlight the recent growth of Chinese investment in the United States. In 2010, less than 7 percent of CFIUS notices filed (6 notices out of 93 total) related to Chinese investment. By 2015, the number rose to just over 20 percent (29 notices out of 143 total). According to Rhodium Group, Chinese investment in the United States [tripled](#) in 2016 to \$46 billion.¹ Policymakers are concerned that the Chinese government is [directing](#) outbound investment in early-stage, cutting-edge US technologies with potential military applications, in part to advance China's military modernization and diminish America's technological advantage.² Some of these Chinese companies, while private entities, nonetheless maintain close [links](#) to the Chinese government. Also, the level of scrutiny being applied by CFIUS generally to all covered transactions, including many involving Chinese companies, has intensified. The number of cases that proceeded to a 45-day investigation, following the initial 30-day review, increased from 34.7 percent in 2014 to 46 percent in 2015 (46.1 percent) and remained steady in 2016 (45.9 percent).³

In recent years, transactions involving Chinese companies have come under greater scrutiny by CFIUS. For example, a Chinese investment fund failed to win approval for its acquisition of Lattice Semiconductor Corporation due to a myriad of concerns, including the transfer of sensitive technology and Chinese state-ownership of the investment fund—factors that trigger heightened scrutiny by CFIUS. Other deals face similar hurdles in the CFIUS process.⁴

As a result of these and other concerns, on November 8, 2017, a bipartisan group of lawmakers introduced the Foreign Investment Risk Review Modernization Act of 2017 in order to strengthen and expand the authority of CFIUS, representing the most significant effort to revise the CFIUS process since the passage of the Foreign Investment and National Security Act of 2007 (FISIA). As currently drafted, the legislation would make key changes to both the scope and process of CFIUS reviews, including:

- Extending jurisdiction of CFIUS to include review of joint venture agreements that occur outside the context of a controlling investment and acquisitions/licensing/transfers of intellectual property rights so long as they implicate “critical technologies” or “critical infrastructure” (unless the

¹ See <http://rhg.com/notes/record-deal-making-in-2016-pushes-cumulative-chinese-fdi-in-the-us-above-100-billion>.

² See <https://www.lawfareblog.com/cfius-reform-and-us-government-concerns-over-chinese-investment-primer>

³ See https://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUS_Stats_2014-2016.pdf.

⁴ See <https://ca.reuters.com/article/businessNews/idCAKCN1BR00M-OCABS>.

transaction involves a purely passive investment), and acquisitions of real estate near sensitive facilities, such as military bases;

- Broadening the definition of “critical technologies” to include emerging technologies, i.e. those technologies essential for maintaining or increasing the technological advantage of the United States with respect to national defense, intelligence or other areas of national security, thereby expanding CFIUS review to a greater range of technology-related deals;
- Creating new national security factors to consider in the review process (currently, CFIUS is required to consider a list of 12 factors when evaluating whether a proposed transaction poses a national security risk. The legislation would add several new factors, including whether the covered transaction would contribute to the loss of technologies that are advantageous to US national security, whether the covered transaction would risk exposing personal identifying data or genetic information, and cybersecurity risks);
- Allowing CFIUS to suspend proposed transactions (an authority that currently only resides with the president);
- Lengthening the time period of the CFIUS review process (under the proposed bill, the initial 30-day review period would be extended to 45 days and the 45-day investigation period would be supplemented by an additional 30-day investigation in cases of “extraordinary circumstances”);
- Making certain filings mandatory (currently, CFIUS filings are voluntary. Under the proposed legislation, in certain circumstances, including when a deal involves an acquisition of 25 percent or more voting interest in a US target by a foreign entity that itself is owned 25 percent or more by a foreign government, parties would be required to make a filing with CFIUS in order to consummate the transaction);
- Imposing filing fees to the process set at the lesser of 1 percent of the transaction size or \$300,000; and
- Allowing CFIUS to exempt certain transactions if all foreign investors are from a country that meets certain criteria, such as being a US treaty ally and having a mutual investment security arrangement.

The legislation has both bipartisan and bicameral support, and is cosponsored by 10 senators and 14 representatives.

Only a week after the legislation was introduced, the US-China Economic & Security Review Commission released its annual report to Congress. The report found that strategic economic sectors are more likely to be targets of Chinese investments in the United States. Yet, these investments often are not subject to CFIUS review because (1) US-based shell companies are used to circumvent CFIUS review; (2) many investments are greenfield investments, which are not subject to CFIUS review; and (3) Chinese state-owned-enterprises (SOEs) may be used to invoke the Foreign Sovereign Immunities Act and avoid CFIUS scrutiny. The commission recommends the following CFIUS updates:

- Prohibit Chinese SOEs or state-controlled entities from making acquisitions of US assets;
- Require mandatory CFIUS review of any acquisition of a controlling interest in US assets by Chinese entities;
- Require review of US-based greenfield investments by Chinese entities;

- Expand definition of “control” to include joint ventures, licensing agreements and other arrangements;
- Prohibit any transaction that would confer control of critical technology or infrastructure;
- Add a net economic benefit analysis to ensure acquisitions advance US national economic interests;
- Assess media acquisitions for the acquiring entity’s previous compliance with Chinese propaganda objectives in the United States;
- Authorize an independent review panel of CFIUS on an ongoing basis; and
- Allow any CFIUS member agency to bring a transaction up for review.

The report also recommends altering the Foreign Sovereign Immunities Act to allow US courts to hear cases against a foreign state’s corporate affiliates and require Chinese firms to waive potential claims of sovereign immunity in order to do business in the United States.

Conclusion

While the legislation still has a long way to go, including the congressional committee process, before it can be enacted into law, it must be taken seriously given the bipartisan support that it currently enjoys. There will likely be modifications and changes to the legislation. However, if enacted with some of the more substantive provisions intact, it will have major ramifications on foreign investment in the United States, particularly those involving Chinese entities.

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