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CFIUS Reform Gathers Strength, with Private Equity and China Looming Large

On May 22, 2018, the Senate Committee on Banking, Housing, and Urban Affairs will hold a hearing to mark up its draft proposed amendment to the *Foreign Investment Risk Review Modernization Act* ("FIRRMA"). Initially introduced on November 6, 2017, with strong bipartisan support, FIRRMA would — for the first time since 2007 — reform the process by which the Committee on Foreign Investment in the United States ("CFIUS") assesses "covered transactions." Proposed in response to a new and evolving macro security environment, FIRRMA would radically impact planning for long-term enterprise investment strategy as well as discrete transactions for U.S. and non-U.S. parties alike.

Given the broad support for FIRRMA from diverse U.S. government policy and political stakeholders, we anticipate that the legislation will pass in some form this year, if not in August.

The View from Washington

In the words of FIRRMA sponsor Sen. John Cornyn (R-TX), "*The context for this legislation is important and relatively straight forward, and it's China*." In light of the U.S.' increasingly turbulent bilateral trade and security relationship with China, it is not surprising that FIRRMA has received vocal support from President Trump's administration. Since FIRRMA's introduction, Congress has held multiple hearings on CFIUS reform and related topics (for example, export control reform), and 42 members of Congress have signed up to co-sponsor the bill alongside the bill's initial 22 sponsors. Moreover, during that time, a number of public transactions have been delayed, restructured or abandoned due to CFIUS concerns; one was blocked outright. Perhaps most importantly, national security themes animating the push for CFIUS reform, including strategic competition with China and the preservation of U.S. technological leadership, have intensified.

Directionally, the new draft amendment of FIRRMA largely tracks the prior version, with several important changes that have been prompted by industry concerns. FIRRMA's proponents have called for the legislation to pass by August. Given the broad support for FIRRMA from diverse U.S. government policy and political stakeholders, we anticipate that the legislation will pass in some form this year, if not in August.

Key Takeaways From the Draft FIRRMA Amendment

1. **Notifications to CFIUS would become mandatory for certain types of transactions.**

   Currently, most CFIUS filings are initiated when parties to a transaction voluntarily file a draft joint voluntary notice. FIRRMA would make short-form "de-

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clarations" mandatory for certain transactions involving acquirers in which a foreign government holds a "substantial" interest. This provision may have an outsized impact on, for example, sovereign wealth funds and public pension funds that frequently co-invest alongside U.S. private equity sponsors in whose funds they also participate as limited partners.

Additionally, FIRRMA would require parties that have previously failed to comply with terms of a mitigation agreement to notify CFIUS of all of their covered transactions for five years after the date of the determination of non-compliance.

U.S. funds could be deemed "foreign" based on foreign investors' participation in decision-making about investments or positive or negative rights relating to the fund's management.

2. **The Department of Commerce would have broad new authority to review and regulate technologies identified as "emerging" or "foundational."**

   Provisions in the November 2017 draft of FIRRMA would have, for the first time, extended CFIUS' jurisdiction to regulate outbound investment (e.g., non-U.S. joint ventures, licensing arrangements). These have been removed, and replaced by a proposal that the president establish, with interagency input, "a regular, ongoing interagency process to identify emerging and foundational technologies" deemed to be "essential" to U.S. national security that would not be subject to CFIUS' jurisdiction. Such technologies would then become subject to the jurisdiction of the Department of Commerce, which would have the authority to implement appropriate export controls (including by imposing export license requirements) for such technologies, with certain exceptions (for example, where the non-U.S. party involved has limited to no rights to utilize the technology beyond that of a general customer).

3. **U.S. funds could be deemed "foreign" based on foreign investors' participation in decision-making about investments or positive or negative rights relating to the fund's management.**

   It is well-established that a U.S. fund may be a "foreign person" for CFIUS purposes if, regardless of the fund's place of incorporation, one or more foreign persons controls or could exercise control over the fund. The new draft of FIRRMA offers some handrails to funds specifying that a foreign person would not "control" a fund if, for example, the foreign person did not have the authority to approve, disapprove or "otherwise control" certain decisions by the fund, general partner or managing member. Similarly, the new draft confirms that a foreign person's ability to unilaterally terminate the general partner or managing member would confer "control" for CFIUS purposes on the foreign person.

4. **CFIUS could collect filing fees for transactions.**

   The new draft of FIRRMA would empower CFIUS to assess fees for reviews based on the value of the underlying transaction. It further directs CFIUS to assess fees in light of:

- The potential effects on small businesses;
- The impacts on foreign investment;
- The expenses associated with CFIUS' review; and
- Any other factors that CFIUS deems appropriate.

This fee would be updated on a periodic basis to ensure that it remained appropriate.

5. While certain real estate transactions would be exempt from CFIUS review, others would be newly subject to CFIUS' jurisdiction.

The acquisition of a single housing unit or of real estate property in "urbanized areas" as defined by the U.S. Census Bureau would not be subject to CFIUS' jurisdiction. However, in practice, these explicit exemptions may have less of an impact than the extensions of CFIUS' jurisdiction relating to real estate transactions elsewhere in FIRRMA. The legislation would codify and extend CFIUS' "co-location" assessment, providing that transactions involving sensitive U.S. government sites as well as those connected to air, land and sea ports would be subject to CFIUS' review.

This focus on real estate is not surprising: CFIUS' concerns regarding acquisitions of real estate or business assets located in close proximity to sensitive U.S. government facilities and military bases have derailed a number of high-profile deals, and U.S. government stakeholders have previously cited sensitivities in real estate transactions as grounds for CFIUS reform.

Transaction parties should dynamically assess in "real time" how the U.S. policy and political context may impact the CFIUS profile of their deal.

Importantly, while FIRRMA would change the CFIUS process in a number of ways, the statute remains only a starting point. Transaction parties should dynamically assess in "real time" how the U.S. policy and political context may impact the CFIUS profile of their deal. Private equity sponsors in particular should carefully evaluate how FIRRMA could be expected to impact their investment and co-investment strategy, future fundraising, and fund design. Likewise, sellers should assess CFIUS as they contemplate exits, ensure their bankers are focused on a realistic universe of buyers, and understand how CFIUS can impact deal feasibility, certainty, timing, costs and competitive tension in a sales process.

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