How FIRRMA Will Change National Security Reviews: Part 1
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Within the omnibus John S. McCain National Defense Authorization Act for Fiscal Year 2019 that President Donald Trump signed into law on Aug. 13, 2018, is the Foreign Investment Risk Review Modernization Act, which significantly expands the authority of the U.S. government to review and restrict foreign investments on national security grounds.

Most notably, FIRRMA, which moved through Congress at breakneck speed, empowers the Committee on Foreign Investment in the United States, a U.S. government interagency committee, to review a far broader group of “covered” transactions than ever before to determine if they threaten to impair national security and, therefore, should be prohibited or suspended.

The new range of transactions includes, among others, certain minority foreign investments in critical technology and critical infrastructure companies, and real estate deals near ports and sensitive government installations. The new law also increases the time allowed for these reviews, and makes some notifications of foreign investment mandatory (as compared to the voluntary system of years past).

FIRRMA’s expansive new coverage and rules will require new implementing regulations, and will allow CFIUS to create new exemptions to screen out truly benign investments that will be caught within the law’s expanded scope. Thus, there will be a lengthy rulemaking process in which interested parties can participate and provide views. At this writing, the breadth of potential exemptions from these expanded FIRRMA coverages is very much an open question, of critical consequence to investors.

The bottom line is that FIRRMA is an important development for all parties engaged in foreign investment in the United States — from foreign companies to private equity funds, sovereign wealth funds and real estate investors. These parties need to understand the new rules and take them into account when planning U.S. acquisitions and evaluating their benefits, costs and risks.

FIRRMA has implications for foreign governments and state-owned enterprises as well as a wide range of business sectors, including aerospace and defense, energy, insurance and financial services, firms that
collect personal data and a range of evolving high-tech sectors in areas like artificial intelligence and autonomy. Both mature and fledging high-tech firms need to scrutinize the new law’s expanded coverage, and consider whether to seek regulatory fixes or exemptions for their specific situations.

The Rationale for FIRRMA

It is ironic that one of the broadest expansions of U.S. regulatory authority over business transactions in a generation, and the resulting increase in government personnel and funding to manage this stepped up foreign investment review function, was passed in record time by one of the most conservative, anti-regulation Congresses in history. This legislation was already moving at near light speed through Congress with bipartisan support when U.S. Secretary of Defense James Mattis accelerated its pace by calling for its inclusion in the 2019 NDAA.

Why the Hurry?

The genesis of and the rationale for FIRRMA is the serious concern in Congress over, and a desire to more closely scrutinize, a range of Chinese investments not covered by existing law that the law’s sponsors believe pose national security threats. The legislation is a counterpart to a recent determination by the U.S. Trade Representative under Section 301 of the Trade Act of 1974 that China has adopted laws, policies and practices relating to technology transfer, intellectual property, foreign investment and innovation that are unreasonable and discriminatory, and unfairly result in the transfer of technologies and intellectual property from U.S. companies to China.

While the Trump administration had considered imposing special foreign investment restrictions on China under Section 301, it ultimately decided to rely on the new coverage and disciplines in FIRRMA instead.

The Broad Scope of FIRRMA’s Changes Beyond Chinese Transactions — and When They Become Effective

Despite the legislation’s focus on China, FIRRMA’s reforms apply across the board to all investors in all countries, unless exemptions are created.

Since FIRRMA’s provisions have different effective dates, it is useful for businesses, private equity firms and other foreign investors to focus on the changes and their implications in the order in which they will be implemented.

While some new FIRRMA provisions are effective immediately, others will become effective on the earlier of either 18 days from the date of enactment or 30 days after the staff chair of CFIUS determines that the regulations, organizational structure, personnel and other resources necessary to administer the new provisions are in place.

Review Timelines Have Been Extended

Effective immediately upon enactment, FIRRMA adds to the already lengthy timelines for CFIUS reviews. As a practical matter, potential foreign investors should assume that most cases may now take up to a maximum of 135 days — a 30-day increase over prior law.
This elongated time frame includes:

- Off the clock time (30 days): the informal time that CFIUS typically takes to review draft joint voluntary notifications that parties submit in order to facilitate a determination that they are “accurate and complete,” as required to initiate the review. This phase has no mandatory time frame, but has in practice expanded to as long as 30 days or more in recent years;

- 45-day review: the initial formal CFIUS review after a case is initiated (which has been increased from 30 to 45 days); and

- 45-day investigation, plus 15-day extension: the full 45-day investigation, which CFIUS now has been granted authority to extend up to an additional 15 days in “extraordinary circumstances,” as defined by CFIUS in the regulations.

Of course, cases also could include the subsequent 15-day presidential determination phase (which FIRMA leaves intact), if they last that long. However, in practice, this phase rarely takes place, because most cases conclude before this period.

FIRRMA’s extension of the initial CFIUS review period from 30 to 45 days was adopted to allow more cases to be resolved in this first stage, because CFIUS staff had observed that numerous cases were resolved soon after the 30-day period ended. In 2017, more than 70 percent of the cases went to a full 45-day investigation, which is a significant increase from prior years.

Ironically, however, this reform, which was designed to speed up CFIUS determinations, may in practice slow them down. U.S. government departments and agencies that participate in CFIUS, facing competing demands on their time and resources, are likely to take the full time available for the initial review to make their decisions. Thus, the same issues CFIUS member agencies have faced at the 30-day mark are now likely to occur at the 45-day mark, with the resulting shift of these cases to full investigation.

Covered Transactions Have Been Expanded

At its core, FIRMA expands the range of “covered” transactions subject to presidential suspension or prohibition under current U.S. law, although this expanded scope will only go into effect after 18 months or later, following a rulemaking proceeding.

**Acquisitions of Real Estate Interests at U.S. Ports and Near Military and Sensitive Installations**

FIRRMA fills a gap in CFIUS’s authority by adding the ability to review a foreign person’s purchase, lease or concession with respect to U.S. real estate located at, or that will function as part of, an air or maritime port, or is in close proximity to a U.S. military installation or other U.S. government facilities or properties that are national security sensitive, or could reasonably afford a foreign person the ability to engage in intelligence collections or otherwise expose national security activities at such installations, facilities or properties. Today, CFIUS can only review acquisitions of U.S. businesses and not properties without associated businesses.

Why the expansion? Recent cases involving Chinese acquisitions of businesses adjacent to military facilities (a wind farm near a naval weapons system training facility and a mining company with
properties near a naval air station) have raised questions about whether the investments are being made for legitimate business purposes or for espionage. While CFIUS has been able to effectively deal with these transactions because they have involved the acquisition of a business, these cases have demonstrated the need to add authority for CFIUS to address purchases or leases of property near such facilities (i.e., where no U.S. business changes hands). Similarly, since the Dubai Ports case during the George W. Bush administration, there has been a focus on foreign persons participating in activities in or near U.S. ports.

**Minority Foreign Investments in U.S. Critical Technology and Critical Infrastructure Firms**

Today, CFIUS can only review foreign acquisitions that involve “control” over U.S. businesses. A centerpiece of FIRRMA is its addition of the authority to review “[a]ny other investment” that is not “passive” in nature in a U.S. business that

- Owns, operates, manufactures, supplies or services “critical infrastructure”;
- Produces, designs, test, manufactures, fabricates or develops “critical technology”; or
- Maintains or collects sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security.

In effect, the new law broadly expands the U.S. government’s ability to suspend or prohibit minority, noncontrolling acquisitions that are not passive in this select genre of companies.

In large measure, FIRRMA’s expanded jurisdiction over minority investments reflects concern in Congress that certain foreign investors, including government-owned entities from China and elsewhere, have been making minority acquisitions that are structured to avoid the reach of CFIUS’s jurisdiction but that nevertheless raise national security issues. In particular, the concern focused on a pattern of investments in newly emerging dual-use technologies such as artificial intelligence and autonomy and smaller, startup firms that are focused in these business areas.

**What Are Critical Technology and Critical Infrastructure Firms?**

It will be up to CFIUS to define these key terms in new regulations. But Congress has laid down some markers.

“Critical infrastructure” will include “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.” The term “critical technologies” is even broader in scope. It includes the usual categories: defense articles or services on the U.S. Munitions List, certain dual use items on the Commerce Control List, regulated nuclear facilities, equipment and materials, and various agents and toxins subject to federal regulation.

**What Are Emerging and Foundational Technologies?**

Notably, however, the term “critical technologies” also includes a new concept: “[e]merging and foundational technologies” controlled pursuant to the Export Control Reform Act of 2018, a companion law to FIRRMA which also is part of the 2019 NDAA.
This crucial new list of dual use technologies is designed to include a wide range of new developmental technologies now largely unregulated. Based on congressional hearings and committee discussions, it is a safe bet that areas such as artificial intelligence, autonomy and advanced computing will be covered as “critical technologies.”

**What “Passive Investments” Are Outside the Scope of the Expanded Authority Over Minority Investments?**

The scope of the passive investment exemption is quite narrow. To be “passive” and therefore exempt from review, an investment must not afford the foreign person any of the following: (i) access to material nonpublic information in the possession of a U.S. critical infrastructure or critical technology company; (ii) membership or observer rights on the board of directors or equivalent governing body of such firms, or the right to nominate an individual to such a position; or (iii) any involvement, other than through voting of shares, in substantive decision-making in the management, governance or operation of such firms.

In short, passive means really passive. Any role with a U.S. firm other than a purely financial investment, with no other rights, does not qualify for the exemption.

**What About Private Equity and Venture Capital Investments?**

The good news is that Congress has crafted a carveout for traditional private equity investments that are passive in nature and, therefore, exempt from covered minority investments.

The private equity and venture capital communities, which have raised billions from foreign investors, including sovereign wealth funds, had raised concerns over expanded CFIUS authority. Historically, most of these funds structure equity purchases by foreign and other investors as limited partnerships, under which the investors have no rights to control the fund, its investment decisions or the management of its portfolio companies, and no right of access to the portfolio company’s technology or other nonpublic information. All control rights are generally granted only to the general partner of the fund, which typically is the senior management of the investment fund, wherever located.

- **Traditional funds are exempt.** Congress has made it clear that these investments will be treated as passive, even when the foreign person investing in the fund has membership on a fund advisory board or committee, provided that the fund’s general partner, managing member or the equivalent is not a foreign person; the advisory board or committee has no authority to approve, disapprove or control investment decisions of the fund; and the foreign investor has no control over the fund.

- **Novel fund structures are not exempt.** In recent years, a range of fund structures have afforded Chinese investors, sovereign wealth investors and other foreign investors greater rights to participate in investment decisions of a fund and the governance of the fund’s portfolio of companies. In contrast to traditional equity funds, these types of new investment structures are not exempt, primarily because of a concern by Congress that they are designed to afford control rights to foreign investors while avoiding CFIUS jurisdiction.
The second part of this article will review other aspects of FIRMA, including the possibility of broad country-based exemptions for certain investments, new export controls on transactions involving technology transfers, new authority over asset transfers related to defaults and new declarations and filing fees.

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