

# Intellectual Property and Technology Law Journal

## FIRRMA Becomes Law, Reforming CFIUS, Export Controls, and Forever Changing Diligence in Foreign Direct Investment and Structuring of Public and Private Equity Deals

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In June 2018, the White House<sup>1</sup> outlined the threats posed by China's investment in and acquisition of U.S. companies, noting that China is engaged in "state-sponsored IP theft through physical theft, cyber-enabled espionage and theft, evasion of U.S. export control laws, and counterfeiting and piracy."<sup>2</sup> Apparently, someone recognized that those \$1 million- to \$5 million-dollar companies in Silicon Valley may be getting capital injections from folks who are not in it simply for the investment return. Worse still, until now, the United States has had no mechanism to review or prevent such foreign investment and resultant control.

On August 13, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), became law. FIRRMA concerns itself primarily with Chinese investment and technology transfer, particularly in artificial intelligence, augmented reality/virtual reality, robotics, and financial technology. The China-specific concerns were first raised in an unpublished 2017 Defense Innovation Unit Experimental report<sup>3</sup> with a specific recommendation that, due to the fact that China is "weaponizing" its investments, said investment ought to be reviewed as one would review any aspect of U.S. global political-military strategy. Ostensibly, that ought to be something that the Committee on Foreign Investment in the United States (CFIUS) has authority over. Particularly, since CFIUS is the only interagency committee that conducts national security reviews of investments that may result in a foreign person's ability to control a U.S. entity, CFIUS had the authority to initiate reviews of transactions, impose measures to mitigate national

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security concerns, and, if said measures could not mitigate those concerns, CFIUS would recommend that the president block pending transactions or order the unraveling of the completed transactions.

CFIUS, however, had jurisdiction solely over "covered transactions" which included a review of a specific subset of transactions that involved Export Controlled commodities and technology.<sup>4</sup> FIRRMA sought to fill the gap by including emerging and foundational technologies not yet subject to U.S. export controls that may have been transferred to China through foreign investments in the United States. This is partly achieved through the passage of the Export Control Reform Act of 2018 (ECRA), which used the same vehicle as FIRRMA, namely the John S. McCain National Defense Authorization Act for Fiscal Year 2019 (FY 2019 NDAA).

### Expansion of CFIUS Review

The mechanics of FIRRMA will remain largely vague until implementing regulations are passed within the next 18 months by the Department of the Treasury. What is certain is that CFIUS jurisdiction now extends to nearly all nonpassive investment by a foreign person in any U.S. business involved in critical infrastructure or the production of critical technologies. On the whole, CFIUS may review any transactions affecting national security, including transfers of minority interests in entities that make critical technology or are a part of critical infrastructure.

### Expansion of "Covered Transactions"

*Real Estate Transactions.* CFIUS now has the authority to review the purchase or lease by, or con-cessions to, a foreign company of U.S. real estate that is:

- (i) located within or will function as part of, an air or maritime port; or
- (ii) in close proximity to a U.S. military installation or another facility or property of the United States government that is:
  - (a) sensitive for reasons relating to national security;
  - (b) could reasonably provide the foreign person the ability to collect intelligence on activities being conducted at such an installation, facility, or property; or
  - (c) could otherwise expose national security activities at such an installation, facility, or property to the risk of foreign surveillance.

The major exception the foregoing are real estate transactions involving the purchase, lease or concession of a single “housing unit” or real estate in “urbanized areas” are excepted. FIRRMA leaves it to the CFIUS regulations to define “close proximity” but not to expand the categories of real estate to which this provision applies.

*Noncontrolling Investments (Other Investments).* CFIUS now has express jurisdiction to review any “other investment” by a foreign person in any unaffiliated U.S. business that:

- (i) owns, operates, manufactures, supplies, or services critical infrastructure;
- (ii) produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies; or
- (iii) maintains or collects sensitive personal data of U.S. citizens that may be exploited in a manner that threatens national security.

Such “other investment” will be covered only if it affords the foreign person:

- (i) access to any material nonpublic technical information possessed by the U.S. business;
- (ii) membership, observer, or nomination rights for the board (or equivalent body) of the U.S. business; or
- (iii) any involvement, other than through voting of shares, in substantive decisionmaking related to sensitive personal data, critical technologies, or critical infrastructure.

The foregoing includes any change in rights that a foreign person has with respect to a U.S. business in

which the foreign person has an investment, if that change could result in foreign control of the U.S. business or an “other investment.” FIRRMA leaves it to the CFIUS regulations to define the terms “unaffiliated” and “material nonpublic technical information.”

*Transactions Structured to Evade CFIUS Review.* In an effort to address investments deliberately structured to remain outside of CFIUS purview, CFIUS will not have the ability to review any transaction designed or intended to evade its jurisdiction. It is, as yet, unclear how CFIUS will determine when a transaction is structured to evade.

## **New Export Control and Related Reforms**

ECRA requires the president to establish, in coordination with the Secretaries of Commerce, Defense, Energy, and State, a “regular, ongoing interagency process to identify emerging and foundational technologies” that are essential to national security but not are not “critical technologies” subject to CFIUS review. Ostensibly, regulations will be drafted to establish controls on the export, re-export, or in-country transfer of emerging technologies. ECRA also directs the Secretary of Commerce to regulate exports to preserve the qualitative military superiority of the United States, to regulate exports in ways that build and maintain the U.S. defense industrial base, and to deny license applications when the proposed export would have a “significant negative impact” on the U.S. defense industrial base.

Part I of ECRA is titled “Export Controls Act of 2018” (ECA). Therein, Section 1758 of ECA provides the Commerce Department with the authority to impose controls over the export of any previously uncontrolled commodity, software or technology that provides the United States with at least a significant military or intelligence advantage, or for any foreign policy reason. Although Congress has not defined the terms “emerging” or “foundational” technologies, a review of the Congressional record hints at, inter alia, the following: AI, AR/VR, additive manufacturing, autonomous vehicles, advanced battery technology, biotechnology, genome editing, hydrogen and fuel cells, integrated circuits, semiconductors and microelectronics, intelligent mobile terminals, nanotechnology and robotics.

## **Declarations for Certain Covered Transactions**

FIRRMA established a voluntarily “declaration,” generally no longer than a five-page filing with “basic

information regarding the transaction.” FIRRMA directs CFIUS prescribe the requirements for said declarations. FIRRMA mandates that a declaration be submitted to CFIUS whenever transactions include the acquisition, by a foreign person in which a foreign government has a substantial interest, of a substantial interest in certain categories of U.S. businesses that relate to critical infrastructure,<sup>5</sup> critical technology,<sup>6</sup> or personal data of U.S. citizens that may be exploited in a manner that threatens national security. FIRRMA authorizes CFIUS to identify through regulations other categories of transactions that will also require mandatory declarations, but only for investments that involve critical technologies.

For purposes of the mandatory declaration, the term “substantial interest” is to be defined by CFIUS regulations. In developing those regulations, the Committee is required to consider the means by which a foreign government could influence the actions of the foreign person, including through board membership, ownership interest, or shareholder rights. FIRRMA, however, specifies that an interest that is excluded from the term “other investment” or that is less than a 10-percent voting interest will not be considered a “substantial interest.”

### **Timing of Review and Fee Collection**

FIRRMA extends the initial review period from the current 30 to 45 days and authorizes CFIUS to extend the investigation period from the current 45 days by an additional 15 days in certain circumstances. As such, in its entirety, the CFIUS review process may now take as long as 105 days or a full 30 days longer than allowed under the current regulations.

FIRRMA authorizes CFIUS to assess and collect filing fees for covered notices not higher than one percent of the value of an investment transaction or \$300,000, whichever is less. FIRRMA also establishes the “Committee on Foreign Investment in the United States Fund” and authorizes \$20 million in appropriations to this fund for each of fiscal years 2019 through 2023 to enable the Committee to perform its functions.

### **Key Takeaways for Mergers and Acquisitions**

The impact of FIRRMA and ECRA cannot be fully determined until the implementing regulations are published. What is certain is that you ought to make friends with an export control attorney. More than ever, you must understand, fully, the technology and assets in any transaction because the stakes have never been higher. This means understanding export controls and their respective application, appropriately

identifying “critical technologies,” and evaluating the nature and extent of CFIUS risk are key to any deal. Similarly, CFIUS will request information regarding a foreign buyer’s business dealings with U.S.-sanctioned countries and entities. Be prepared to produce it.

Anticipate that CFIUS will request information regarding limited partners and their control rights, especially when they are foreign government—controlled entities (regardless of the size of their investment). Much like critical technologies, CFIUS is interested in all government contracts (yes, purchase orders are contracts). Any meaningful assessment requires the U.S. entity or its counsel to understand whether they have contracts with the U.S. government and be able to identify them.

Do not fail to notify CFIUS. Until now, CFIUS filings have been voluntary. It appears likely that certain transactions would trigger a mandatory filing. CFIUS is likely to ramp up the monitoring of announced deals and issue inquiries about transactions of which CFIUS is not notified. CFIUS retains the power to require that a transaction be submitted for review even after the deal has closed (assuming no notice was submitted beforehand). Allow for more time and possibly more money (aside from the legal fees) for CFIUS due diligence, filing, and review. Anticipate possible CFIUS review if you are involved in outbound technology transfers, as they soon may be subject to new export controls.

Finally, although it may be most immediate, participate in the rulemaking process and provide comments to the Departments of Treasury and Commerce as they publish the proposed rules.

### **Notes**

1. <https://www.whitehouse.gov/wp-content/uploads/2018/06/FINAL-China-Technology-Report-6.18.18-PDE.pdf>.
2. *Id.*
3. Brown, Michael and Pavneet Singh, China’s Technology Transfer Strategy: How Chinese Investment in Emerging Technology Enable a Strategic Competitor to Access the Crown Jewels of U.S. Innovation, Defense Innovation Unit Experimental, February, 2017. Although the report is unpublished, it is available as part of the Congressional Record as part of the Hearing Before The Committee On Banking, Housing, And Urban Affairs United States Senate, One Hundred Fifteenth Congress, First Session On Examining The Role Of The Committee On Foreign Investment In The

United States, September 14, 2017: [https://fas.org/irp/congress/2017\\_br/cfius.pdf](https://fas.org/irp/congress/2017_br/cfius.pdf).

4. Existing statutory language is “the transaction threatens to impair the national security of the United States.” See 50 U.S.C. § 4565.
5. As set forth in 42 U.S. Code § 5195c (e), critical infrastructure means systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters.
6. Critical technologies include:
  - (i) defense articles or defense services included on the United States Munitions List set forth in the International Traffic in Arms Regulations;
  - (ii) items included on the Commerce Department’s Commerce Control List and controlled pursuant

- to multilateral regimes, including for reasons relating to national security, chemical and biological weapons proliferation, nuclear nonproliferation or missile technology, or for reasons relating to regional stability or surreptitious listening;
- (iii) specially designed and prepared nuclear equipment, parts and components, materials, software and technology covered by part 810 of title 10, Code of Federal Regulations (relating to assistance to foreign atomic energy activities);
  - (iv) nuclear facilities, equipment and material covered by part 110 of title 10, Code of Federal Regulations (relating to export and import of nuclear equipment and material);
  - (v) certain select agents and toxins; and
  - (vi) emerging and foundational technologies identified pursuant to Section 1758 of the Export Control Reform Act of 2018.