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CFIUS and Silicon Valley: We're Still Trying to Find a Cure!

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EXECUTIVE SUMMARY

The Committee on Foreign Investment in the United States (CFIUS) is the mechanism by which the United States Government (USG) reviews foreign investments for issues/concerns involving "national security." CFIUS is an inter-agency USG committee that consists of 12 USG Departments (i.e., the Departments of State, Justice, Defense, Treasury, Commerce and Homeland Security) and White House offices (i.e., the National Security Council, the National Economic Policy Council, the Office of the United States Trade Representative, the Office of Management and Budget, the Council of Economic Advisors and the Office of Science and Technology Policy).

Early last August Congress passed the Foreign Investment Risk Review Modernization Act (FIRRMA), making significant changes to CFIUS. The article covers (1) what changes have been made by the new law and (2) what to expect with CFIUS going forward.

Who should be interested in these changes? The short answer is Silicon Valley! The "New CFIUS" rules are particularly important to the high tech and associated venture capital communities in Silicon Valley (and elsewhere in the United States).

There are two major expansions of CFIUS's scope: (1) investigatory and intervention powers cover not only majority foreign investments in US companies, but now also non-controlling interests if the deal results in the acquisition of influence involving "critical technologies;" and (2) oversight now extends to real estate transactions near sensitive U.S. government facilities.

Additionally, the separation between Export Controls and CFIUS, may not be as clear as Congress thought when it enacted CFIUS changes. Congress originally objected to certain off-shore technology-based joint ventures as "*de facto*" acquisitions of US technology assets....*and it is on "acquisitions" that CFIUS focuses its attention!* Also interesting is the possibility of CFIUS re-opening past transactions not previously reviewed by CFIUS. Private sector mechanisms are being devised to assign CFIUS risk among parties (whether the transaction is being filed under CFIUS or not).



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INTRODUCTION

The Committee on Foreign Investment in the United States (CFIUS) is the mechanism by which the United States government (and ultimately the President of the United States) reviews foreign investments for issues/concerns involving "national security" broadly defined (i.e., including cyber-security, homeland security, possible vulnerability to espionage, etc.).

It is the place where the United States' traditional commitment to being open to investment (as expressed in numerous Open Investment Policy Statements issued by a succession of US Presidents) meets our most important national security concerns.

Over the years, our nation's commitment to openness to foreign investment has been the subject of a *multi-party* consensus (and by *multi-party*, I include not just the Republicans and Democrats, but also the Whigs and the Federalists...).

This longstanding consensus has been based on an essential recognition of the value to the United States of being open to international investment. These benefits include not just the infusion of additional capital into the economy, but also the benefits arising from the introduction of new technologies and new production and distribution techniques from abroad, etc.

This traditional commitment to being open to international investment expresses key elements of *US investment policy*, something related to (but not identical to) US trade policy....

Trade and investment policy are cousins,...not identical twins!

How we traditionally view these two policy areas is not identical....For example, trade policy is typically based on principles of bi-lateral or multi-lateral reciprocity; investment policy on the other hand is just as typically based on the *unilateral* opening of the US market to foreign investment.

When foreign governments act to limit or exclude the US and/or other nations from investment opportunities in their countries, the US may object and seek to negotiate an improvement in that state of affairs, but it does not typically act to close the US market to investment from those countries in response.

This is because the US has long recognized that ***being open to international investment benefits almost everyone*** (direct domestic competitors to specific foreign investments being the principal exception).

Investment flows are typically also greater in magnitude than trade flows and typically are more volatile!



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CFIUS is constructed as an inter-agency and inter-departmental committee of the Federal Government. It traditionally consists of 12 United States Government (USG) Federal Departments (i.e., the Departments of State, Justice, Defense, Treasury, Commerce and DHS) and Executive Branch White House offices (i.e., the National Security Council, the National Economic Policy Council, the Office of the United States Trade Representative (USTR), the Office of Management and Budget (OMB), the Council of Economic Advisors (CEA) and the Office of Science and Technology Policy (OSTP)).

The office of the Director of Central Intelligence (which oversees the CIA and the other intelligence agencies) plays a formal staff role advising the committee, principally concerning what is known about the acquiring companies, individuals or governments. Other USG departments and agencies (e.g., the Departments of Energy and Agriculture, etc.) participate in the deliberations of the committee when and where appropriate (i.e., on an *ad hoc* basis).

While the CFIUS committee has been in place and utilized since 1974 (when it was established by Executive Order by President Ford), **early this last August Congress passed the new Foreign Investment Risk Review Modernization Act (FIRRMA)**, which makes significant changes (i.e., reforms) to CFIUS. President Trump declared his support for this legislation well in advance of passage and signed the new legislation shortly after Congress passed it.

So what is "new CFIUS" and where is it headed?

The answer to those questions requires more than just an expert's description of what is in the new law....It requires a sense of how CFIUS works, its traditions and a sense of how US Executive Branch entities operate....and in this case, a sense of what the Trump Administration might intend to do with CFIUS....once the new law and its supporting regulations are in place. It also requires a sophisticated sense of how the President (and the Executive Branch) and the Congress interact.

This article is written in two parts which address the implications of "new CFIUS" as follows:

PART I: NEW CFIUS (WHAT IS CHANGED?). *What changes have been made to CFIUS in the new law and, more recently, by the new "temporary" regulations and "Pilot Program" put in place by Treasury to implement the new law? (This assessment is supplemented by various informal insights and other information available from CFIUS experts (i.e., from persons who follow CFIUS developments in Washington, DC and elsewhere); and*

PART II: WHAT TO EXPECT WITH NEW CFIUS GOING FORWARD. *This includes a set of projections based on personal experience which contain insights (many of which are not written down) that have been acquired over the last 15-20 years concerning:*



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- (a) *how CFIUS operates from the inside (based on time spent overseeing the CFIUS process as Deputy Assistant Secretary (DAS) at Treasury for International Trade and Investment policy (2003-2007));*
- (b) *the nature of Federal Executive Branch agencies (and their bureaucratic imperatives and traditions....particularly as compared to those of the Congress); and*
- (c) *the significant difference in the approach to both international investment and trade policy that is being taken by the Trump Administration (as compared to the approach taken by previous administrations and particularly the three prior Republican Administrations (Reagan and Bush I & II)).*

One important conclusion that can be drawn is that "new CFIUS" developments are particularly important for the high tech and associated venture capital communities of Silicon Valley (and other such pockets of technology-driven innovation in the United States).

PART I: NEW CFIUS (WHAT IS CHANGED?)

The new CFIUS legislation passed by Congress makes many important adjustments around CFIUS's edges; the main parts of CFIUS, however, remain unchanged.

CFIUS is still led and chaired by Treasury, with the active participation of the other CFIUS committee members, such as DOJ, State, DOD, DHS, NSC, Commerce, etc.

One of the most recent important changes that *preceded* the recent CFIUS legislation was the creation in 2002 of the Department of Homeland Security (DHS) focused primarily on domestic security, as well as the creation and/or expansion since 9/11 of several national internal security-focused offices and programs *within* each of the various CFIUS member departments (and particularly in those economically focused agencies whose presence on the committee originally was intended to be to weigh in on behalf of "open investment").

Treasury itself, for example, has traditionally been chartered to have certain specific national security functions (e.g., FinSen and OFAC, and, before the creation of DHS, Treasury contained Customs, the Bureau of Alcohol Tobacco and Firearms (ATF), the Secret Service, etc.).

However, first with the initial removal of most of Treasury's core national security responsibilities after 9/11 (with the creation of DHS in 2002-2003) and then with the subsequent formal re-establishment in 2005 of a Treasury Office for Enforcement (headed by a new Treasury Undersecretary for Enforcement) you find a good example of this phenomenon. There are several other such examples in the various economic-focused Departments (such as Commerce and State).



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The consequence of these organizational and jurisdictional developments has been to strengthen the national security side of the inter-agency discussions within CFIUS.

CFIUS traditionally has had the power to review the national security implications of any transaction resulting in the purchase or other acquisition of a "controlling interest" in a US business by a foreign purchaser. This holds even though filing a CFIUS review petition was formally a voluntary act undertaken in pursuit of a "safe harbor" approval.

The "flex points" in the CFIUS approval process tended to involve such things as what constituted "control" or what exactly rose to the level of a "national security concern" (or how such national security concerns might effectively be "mitigated") with those definitions alternately narrowing or expanding over the years since CFIUS came into existence.

CFIUS is also a process that is designed ultimately to lead to an up-or-down recommendation on any given transaction to the President of the United States (POTUS). It is the President who then has the power to authorize or deny the acquisition.

If CFIUS finds that the transaction poses a risk to national security, it can recommend to the president that the proposed transaction be blocked. It can also recommend that the transaction be approved if certain steps are taken in mitigation of the identified national security concerns, including the imposition of formal conditions designed to mitigate national security risks that must be met before the merger or acquisition can go through.

To be clear, if foreign companies did not voluntarily submit their transactions for review, CFIUS has always retained the authority to review covered transactions on the committee's own initiative at any time, sometimes years later, to ensure they do not threaten national security. Although this rarely happens, it has been the case that CFIUS has acted after the fact to require divestment (unscrambling a transaction after the fact,...sometimes several years after the fact).

More recently (but again prior to FIRRMA), CFIUS decisions prevented significant transactions from going forward, including the \$117 billion 2018 takeover of US-owned Qualcomm by Singapore's Broadcomm, and Phillips' attempt to sell a controlling stake in its U.S.-based LED business to a Chinese consortium.

It is also worth noting that CFIUS cases are considered sensitive and not subject to public disclosure....*unless the parties discuss the case publicly*, in which case the case to some extent enters the public domain. The initial obligation to keep CFIUS cases confidential is only with the government participants, not the parties to the transaction.



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THE CHANGE: CONGRESS CHANGES CFIUS LAW

As CFIUS has operated over the years, there has been an ongoing, simmering level of Congressional (as well as public) dissatisfaction with CFIUS.

This has typically been due to the public disclosure after the fact of the outcomes in certain cases that allowed certain foreign purchases of US companies (e.g., Dubai Ports, Uranium One, etc.) that then provoke a significant level of populist disapproval in certain circles of CFIUS decisions.

The textbook case is the *Dubai Ports* case, a 2006 acquisition by a UAE port services operator; an international company which was well known to both DOD and DHS. DOD had used Dubai Ports to service the Navy's fleet in Dubai when the Navy left Yemen and moved to Dubai after the *USS Cole* was bombed in Yemen by middle-eastern terrorists. DHS had previously worked with the Dubai company as one of the earliest volunteer international company participants in DHS's strategically important program to use new technologies to move all cargo inspection to the originating foreign port rather than in the US port where cargo was to arrive. Both DOD and DHS signed off on the proposed transaction, as did the entire CFIUS Committee at the staff level.

The acquired company in the case was a British ports services company that had certain operations and joint ventures in different US ports, most particularly in Miami where the company being acquired's joint venture partners were dissatisfied with their current arrangements. Those joint venture partners wanted to use the transaction to undo the joint operating restrictions they had voluntarily assumed when they went into business with the UK company several years before.

After the transaction was approved, a representative of the Miami joint venture ports operator made the rounds in Washington (most particularly on Capitol Hill), with a "one if by land; two if by sea" warning that Arabs were in the process of taking over our ports!

In his memoir of his time as the Undersecretary for International Policy at DHS, Stewart Baker (a former General Counsel of NSA....in other words, "a grown up") famously (at least within CFIUS circles) observed that this particular Miami joint venture ports operator representative was perhaps "the greatest over-achiever" he had ever met.

Dubai Ports famously erupted into the kind of public relations conflagration for which Washington, DC is famous! In this case, the fire burned perhaps more brightly and intensely than it typically does. It was something special to live through if you were part of the Executive Branch at the time, even if you weren't directly part of the CFIUS process.

The joke, in fact, during the George W. Bush Administration was that the CFIUS decision in *Dubai Ports* did more to advance *bipartisan cooperation* in Congress than any other act or



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activity of the Administration; both Democrats and Republicans in Congress were dissatisfied with how CFIUS (a formally quite secret and non-transparent) process had operated in that case.

Important members of Congress representing both parties came to the conclusion that something needed to be done to adjust how CFIUS operated, both generally and particularly with respect to keeping the Congress better informed.

Sens. Cornyn of Texas and Crapo of Idaho were primarily responsible for putting forward the Foreign Investment Risk Review Modernization Act (FIRRMA) that has now made significant reform-minded adjustments to the CFIUS process.

In parallel, the Trump Administration initially had come on the scene with a strong public policy interest in "changing the game" on trade (primarily), but the Trump Administration soon discovered that investment policy was also an important additional potential tool for addressing some of the imbalances with other countries that they sought to correct.

Initially, the Administration apparently considered using the President's emergency economic authority (which formally underlies CFIUS and Congress' authorizing legislation) *directly* to engage on international investments (particularly those undertaken by China). They subsequently decided not to go in that direction, however.

Instead the Trump Administration decided to sign on to Congress' effort to influence foreign investment through new CFIUS legislation, in particular through the new legislation being put forward by Sen. Cornyn and his committee (there were other bills being considered).

Last August, the National Defense Authorization Act (NDAA) of 2018 passed both houses of Congress, with significant implications for foreign investment. Included in the NDAA was the Foreign Investment Risk Review Modernization Act (FIRRMA), a bill reforming the Committee on Foreign Investment in the United States (CFIUS).

- Before FIRRMA, CFIUS only had the express authority to review transactions between U.S. and foreign firms that would result in foreign control of a U.S. company. ***CFIUS's authority is now expanded to cover foreign investments in critical technology and critical infrastructure that do not result in foreign control where certain facts are present.***
- ***CFIUS also now has the authority to review other types of transactions with national security implications, such as a foreign lease of U.S. real estate in close proximity to sensitive military or government facilities.***
- ***CFIUS reform as envisioned by the Congress evolved substantially over the course of the legislation's development.*** In June, the relevant House and Senate committees



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passed different versions of bills focused on empowering CFIUS to review "outbound investment" in addition to CFIUS's traditional role reviewing inbound investment.

- ***Ultimately, a formal CFIUS review of "outbound investments" remained, in Congress' view, under the jurisdiction of US technology export controls programs*** and was struck from both the Senate and House versions of FIRRMA; critics had argued that outbound investment should be subject to traditional export controls only and not CFIUS controls.
- ***The House Financial Services Committee's contribution to the new FIRRMA legislation was to include the Export Control Reform Act (ECRA) in the new law. ECRA is a separate piece of legislation introduced by Congressman Ed Royce to expand the U.S. export control regime's authority independent from CFIUS.***
- ***Given these changes and the overall CFIUS reform efforts underway, it is important to appreciate this intended distinction between CFIUS and export controls as well as the purposes and distinctive features of each such process.***
- Finally, all mentions of "critical technology companies" and "critical infrastructure companies" in earlier versions of FIRRMA were dropped, removing thousands of U.S. businesses which do not have national security implications from the scope of CFIUS' review.
- ***Given these changes and the overall CFIUS reform efforts underway, it is important to appreciate this intended distinction between CFIUS and export controls as well as the purposes and distinctive features of each such process.***
- ***Treasury was also authorized to propose and develop new rules and regulations governing the CFIUS process aimed at implementing the new legislation (and to develop "pilot programs" aimed at areas of possible transactions that it feels merit special consideration and special treatment).***

TREASURY ISSUES NEW INTERIM REGULATIONS

In late October, Treasury issued "temporary" new rules governing CFIUS procedures and proposed a new "pilot program" covering several specific technology-related investments.

At the same time, Treasury also launched a long term proposed rulemaking process for CFIUS (i.e., one where the new rules would eventually be permanent) that is expected to be developed over the next two years to fully implement the requirements of the new CFIUS legislation.

The new "temporary" rules became effective on November 10 and the business and investment communities (both domestic and international) immediately began paying



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attention, reaching out to their legal and banking representatives seeking guidance both on how the new rules might effect their different businesses and under what circumstances they should now file under CFIUS.

These new "temporary" rules and the details of the Pilot program are quite detailed and likely require legal guidance from a CFIUS practitioner.

That said, the following abbreviated summary of the new rules and "pilot" program is worth reviewing.

- *First, the pilot program expands CFIUS's jurisdiction to give the Committee authority to review certain non-controlling US investments made by foreign persons where the US business "produces, designs, tests, manufactures, fabricates, or develops a critical technology" that is used in connection in one or more of the "pilot program industries."*
- *A complete list of these "pilot program industries" appears in the temporary rules and includes such areas as defense articles or defense services included on the U.S. Munitions List set forth in the International Traffic in Arms Regulations (ITAR).*
- *The pilot program industries list was developed so as to include industries where certain strategically motivated foreign investment might pose a threat to US national security.*
- *The types of non-controlling investments by foreign persons that are covered are ones which would give the foreign investor access to any material non-public technical information by way of possible membership or observer rights on the board of directors (or its equivalent).*
- *This includes the right to nominate an individual to a position on the board; or any involvement in the substantive decision-making of the pilot program US business regarding critical technology.*
- *The purpose of implementing the pilot program, which is expected to provide CFIUS with valuable insights to help shape the final regulations implementing new CFIUS, is to confront rapidly changing critical technology industries; the significant growth of certain types of foreign investment in areas relevant to national security; and CFIUS's current inability to effectively review non-controlling transactions.*
- *The pilot program currently is set to end no later than March 5, 2020.*

A word about "mandatory filings".... As noted above, the pilot program also makes mandatory (i.e., *requires*) the submission of new CFIUS-related declarations for certain foreign transactions involving US "pilot program" industry businesses, unless, of course, the parties elect to file a full



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CFIUS notice instead. This requirement applies to all foreign investments within the scope of the pilot program.

These mandatory declarations are abbreviated notices and are generally not expected to exceed five pages in length. They must be filed at least 45 days prior to a transaction's expected completion date. The Committee then will have 30 days to act on the declaration.

FIRMA then gives CFIUS the following options: (a) resolve the declarations; (b) request that the parties file a CFIUS notice; (c) inform the parties that CFIUS cannot complete action on the basis of the declaration and that they may file a notice regarding the transaction; (d) initiate a unilateral review of the transaction; or, finally, (e) notify the parties that CFIUS has completed all action on the matter.

Importantly, parties required to file with CFIUS which do not do so can be assessed a civil monetary penalty up to the value of the transaction.

NEW CFIUS HAS INTERESTING IMPLICATIONS WITH RESPECT TO FEDERAL HIRING

Some of the more interesting implications of these developments involve the new levels of Federal hiring that is already underway with respect to staffing up at all Departments and White House agencies materially involved in CFIUS.

For example, in the Treasury General Counsel's office, which as recently as 2006 employed one lawyer part time on CFIUS matters, is now said to be in the process of hiring 11 new lawyers to staff this activity. Significantly, those specific new hires are for the General Counsel's staff only; i.e., they are in addition to anticipated new hires in the various offices in the Treasury Office of International Affairs (OIA) deputate that directly oversees the CFIUS process.

Interestingly, in that regard, what once was a single deputate, managed by the Deputy Assistant Secretary (DAS) for International Trade and Investment Policy, has now morphed into three separate new offices, each headed by its own DAS (with the trade and investment policy portfolios now separate from each other and each also standing separate from a third new deputate for "investment security" that manages the CFIUS process. The Investment Security deputate also leads Treasury's open investment initiatives and dialogues with other countries, particularly as they relate to foreign investment review processes, to promote open investment policies and discourage foreign barriers to U.S. investment.

There are also other additional full time equivalent employees (FTE's), consisting mostly of young lawyers, who are being hired into Treasury (particularly in Treasury's Office of Enforcement), who will be to a greater or lesser extent be devoted to CFIUS work.



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And that doesn't include the additional staff that has been employed in each of the other Departments and White House agencies that participate in CFIUS decision making.

Yes, *Dubai Ports* and the other controversial CFIUS cases have yielded a substantial growth in staffing to handle the expanding work in this area.

PART II: WHAT TO EXPECT WITH NEW CFIUS GOING FORWARD

As indicated above, the second half of this paper is based on personal experience and insights (many not written down) acquired over the last two decades concerning (a) how CFIUS operates from the inside; (b) the nature of Executive Branch agencies (and their bureaucratic imperatives and traditions (particularly as compared to those of the Congress)); and (c) the significant difference that is being played by the Trump Administration (as compared to the role played by previous administrations and particularly the three prior Republican Administrations (Reagan and Bush I & II)).

THE LEGAL STANDARD OF CFIUS REVIEW HAS NOT CHANGED

CFIUS review still represents an attempt to strike an appropriate balance between traditional *Open Investment policy* preferences and the needs of national security.

The process is also still designed to make those arguing either for restrictions on a particular transaction or disapproval of a transaction on national security grounds justify and narrow their concerns and, where possible, come up with alternatives designed acceptably to mitigate them.

Congress did not change those elements in CFIUS. They also decided that the basic CFIUS organizational structure did not need to change to accomplish Congressional goals aimed at improving how CFIUS works. Treasury still serves as the CFIUS chair and manages the day to day work of the committee.

...BUT MANY ASPECTS OF CFIUS REVIEW HAVE BROADENED

For starters, certain filings under CFIUS are now mandatory. Most CFIUS filings in the past were made voluntarily in return for Safe Harbor treatment. Under new CFIUS, certain specified transactions are now required to be the subject of a CFIUS filing.

Additionally, there are two major expansions of CFIUS's scope:

(1) Investigatory and intervention powers at CFIUS have been expanded to cover not only majority investments in US companies, but now also non-controlling interests (i.e. transactions that do not result in foreign control of a U.S. firm) if the deal results in the acquisition of influence involving “critical technologies.”



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(2) CFIUS is now also specifically granted oversight over real estate transactions near sensitive U.S. government facilities (this includes both the purchase and lease of real estate near military facilities that may expose national security activities to foreign individuals).

The definition of what constitutes "*control*," is also considered likely to become broader in the ordinary course of CFIUS case law development, bringing in many more areas of interest-concern into CFIUS' purview.

Similarly, in the current context, the definition of what constitutes "*national security*" is also likely to broaden, but just how much it will broaden over time is an open question.

"*Economic security*," while not formally mentioned as a factor, appears (at least arguably) to be in the process of increasingly becoming a consideration, although it is not anticipated that things would ever get to the point that they have in the past in Europe (e.g., the French Government once famously disapproved Pepsico's proposed acquisition of Dannon yogurt on the grounds that Dannon was inextricably bound up as a protected part of French "culture" (which is amusing in the context of a yogurt company)...and this was the case even though Dannon was originally a Swiss company that a French company had earlier acquired).

Overall, it's probably safe to say that while certain things may not be completely clear at the moment, we should never ignore the "law of unintended consequences. There are many things that can be expected to influence the evolution of CFIUS going forward.

EXPORT CONTROLS AND CFIUS GOING FORWARD MAY BE AN AREA WHERE THERE IS THE POTENTIAL FOR CONTROVERSY

In addition to the new CFIUS rules and regulations, there are also areas of CFIUS case law that can be expected to be engaged in the months ahead. One important example will likely involve the interaction between Export Controls and CFIUS that those in Congress thought they were being so clear about.

Immediately prior to the new CFIUS legislation being passed, I wrote to the following in an email to several CFIUS-savvy colleagues:

"I have recently been thinking about the anticipated changes to CFIUS and how they might interact with the USG's various technology export control regimes (those at State and Commerce in particular).

I would anticipate that with the broader focus that is expected concerning transactions covered, as well as with the expanded "control" definitions that are expected to be part of the CFIUS mix going forward, that there has been some discussion as to how CFIUS and the export control regime interact and, ultimately, come together going forward.



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This would, I imagine, particularly be a factor in the area of putting together international joint ventures where American technology is being exported for purposes of being developed overseas with international co-investors.

You will recall that one of the most "objected to" practices driving CFIUS reform was the idea of taking critical US technology off-shore as part of an international joint venture where foreign money is contributed to develop the technology to address challenges in international markets.

Perhaps we can expect things in this area to evolve to include the possibility of an export control license application morphing into a CFIUS case (each process having it's own underlying statute and requirements to be met)."

It is worth remembering that when it first addressed this area, Congress strongly objected to these off-shore technology-based joint ventures as constituting "de facto" acquisitions of US technology assets....and it is on "acquisitions" that CFIUS focuses its attention!

EQUALLY INTERESTING IS THE POSSIBILITY OF NEW CFIUS RULES BEING APPLIED TO PAST TRANSACTIONS NOT PREVIOUSLY REVIEWED BY CFIUS

In the same communication quoted above, I continued,

"The more interesting question I have been grappling with, however, has to do with the question of previously approved export control licenses in this context and how they might get pulled into CFIUS afresh under the new law.

I would imagine that this could arise conceivably in the light of the new broader definition of what constitutes a national security interest (e.g., economic significance), as well as in connection with the new "elements of control" definitions to be developed.

Think "China," in particular.....

I know that under the "old CFIUS rules," we had no theoretical problem at all with the idea of finding that a deal that had been done several years before where no CFIUS filing had been made and pulling it into CFIUS with the implicit prospect of finding it in violation and "unscrambling" the transaction after the fact.

I can't imagine that any "safe harbor" has been provided in the new statute for previously approved export control license applications for purposes of shielding a company from potential CFIUS liability when the transaction was never reviewed under CFIUS in the first place.

On the other hand, I find it hard to imagine that CFIUS or export control practitioners would ever have imagined that there was anything further to do with respect to CFIUS once they obtained their export control license in a given case.



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It would seem that this potential liability for prior technology based joint ventures could, at least in theory, be a concern going forward for US and other companies....

I am curious if you see this as an issue as well or if you understand that this issue has somehow been dealt with in the new legislation."

That several members of Congress formally expressed the view that they had addressed this issue and drawn a clear line between CFIUS reviewing "inbound" and not reviewing "outbound" investment is clear. It is worth noting, however, that this distinction between "inbound" and "outbound" investment exists primarily by *implication and inference*, not by clear lines of legislative demarcation.

THE EXECUTIVE BRANCH TYPICALLY HAS IT'S OWN IMPERATIVES AND UNDERSTANDINGS

I think the key here is that those members of Congress who care about this topic neglected to consider two important factors.

The first factor is that individual Executive Branch agencies and departments each have their own imperatives and understandings of their respective roles and jurisdictions with respect to CFIUS (and you are talking about *multiple departments and agencies* with CFIUS).

By definition, *Export Control License decisions are made by just one agency* and the CFIUS process consists of 11 other participants, each with their own equities that are likely to become increasingly relevant as the definitions of key CFIUS terms (such as what constitutes "national security" and "control") broaden as they are expected to do. When pressed, these other agencies and departments are unlikely to feel bound by the prior decision made by just one of their fellow CFIUS members.

.....AND REMEMBER THAT IT IS THE TRUMP ADMINISTRATION THAT IS THE "EXECUTIVE BRANCH" WHICH WILL IMPLEMENT NEW CFIUS!

The second thing that I believe Congress neglected to fully factor into it's analysis is that it is the Trump Administration that will be implementing the new Executive Branch authorities granted under the new CFIUS law.

Let's begin by stipulating that the Trump Administration has proven itself to be fundamentally different in it's approach to international trade and investment policy as compared to prior Presidential administrations and particularly with respect to the three *Republican* Presidential Administrations that preceded it (Reagan and Bush I & II).



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In the beginning, the Trump Administration came into office seemingly ready to fight with anyone and everyone (even with our traditional allies, such as Europe, Japan, Korea, Australia, Mexico and Canada). They proceeded to terminate the Trans Pacific Partnership (TPP) then awaiting final approval and also sought to "boil the ocean" by picking fights with just about everyone.

This said (and no matter what your opinion of the Trump White House), the Trump Administration has been (and is) clearly learning on the job on matters involving trade and foreign investment.

At this stage in the Trump Administration, the focus is now clearly on China (look at recent developments concerning NAFTA and the EU....where recent standard operating procedure has been for the Administration to negotiate incremental changes to prior agreements and then declare victory....it has been noted that Mexico solved some of its NAFTA problems by substituting in previously negotiated TPP terms and conditions....the announcement that Mexico had agreed to Trump Administration demands followed shortly thereafter).

Additionally, the Trump Administration apparently has also discovered that their ability to get an envisioned adversary's attention through engaging them on investment transactions is even greater than it is with trade!.....and while they have already used CFIUS to turn down several transactions (that prior Republican administrations would not necessarily have rejected).....they still seem to be keeping their powder dry.

I think the key question, as the new law is more fully implemented, will be just how aggressive the Administration will get with China in this area?

Recall that international investment is considered the area where "the goose lays the golden eggs," which is another way of saying that the Administration will likely be "playing with fire" in this area.

WHO SHOULD BE INTERESTED? WHO IS MOST EFFECTED?...THE LONG ANSWER MAY BE ALMOST EVERYONE, BUT THE SHORT ANSWER IS SILICON VALLEY!

On the national origin side of the equation, it is undeniable that those with investment capital based in Asia (and China in particular) and those who have partnered with China will need to be seriously attentive to CFIUS going forward.

On the technology side of the equation (recognizing that it is high tech that is the source of most national security focus and development when it comes to innovation) there is the high tech community, which consists not just of high tech companies themselves, but also of numerous others in that quite fertile eco-system, including venture capital firms, law firms and other service industry participants focused on venture backed companies.



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Prior to the arrival of the Trump Administration, the CFIUS cases involving high tech venture capital and Silicon Valley were few in number and relatively straight forward. The system does not operate in a totally opaque manner. However, CFIUS filers can typically count on the expert CFIUS lawyers to de-code the problem areas, even when the USG isn't willing to discuss what those concerns are.

The anticipated impact on high tech companies resulting from the changes associated with new CFIUS is relatively clear to those who are watching the process unfold. **There will likely be an increasing number of joint ventures, acquisitions and other such transactions that will raise both traditional and new CFIUS issues going forward.**

THE PRACTICAL IMPLICATIONS OF DEALING WITH CFIUS RISK AS BETWEEN PRIVATE PARTIES

One of the most interesting developments in this area is the increasing importance of "assigning CFIUS risk" as part of the now ordinary course of trans-border related transactions.

Innovative new legal and financial structuring mechanisms are being devised to handle both real and potential adverse developments when CFIUS concerns are raised. For example, one proposed arrangement that has been discussed would involve the parties writing a pre-negotiated "put" that would, if exercised (at either or both parties option) undo the proposed (or completed) transaction, even after the fact, thus at least theoretically resolving the areas of concern.

Interestingly, some in the CFIUS regulatory community apparently object to such mechanisms on public policy grounds (because they fear allowing such prior arrangements increase the risk that the parties will proceed with potentially otherwise unacceptable transactions once such negotiated protections are in place).

Also interesting is how it is currently unclear whether it is more important to have such "CFIUS risk assignment" provisions in place in cases where a CFIUS filing is NOT contemplated than in cases where it is contemplated?

A WHOLE NEW WORLD OF CONCERNS FOR VENTURE CAPITAL FIRMS....

In the area of venture capital, the areas of possible concern have multiplied under "new CFIUS!"

In addition to the areas of "plain vanilla" concern (e.g., the simple sale of a portfolio company), there are now multiple new areas of CFIUS concern for America's most innovative "company and job creation" sector (*a sector that is the envy of the world....the often imitated but never quite duplicated world of Silicon Valley*)!



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First, it is worth noting that the Silicon Valley (and broader US) venture capital community successfully undertook an effort to get a clear "exception/exemption" to the CFIUS control concerns for foreign limited partnership interests.

While this is a significant accomplishment, it is worth noting that limited partnership interests come in many flavors.....What do you do with a foreign limited partner investor who wants direct "co-investment rights" in the portfolio company or a "observation only board seat" or its equivalent? What about the foreign limited partner who is a regular source of deal flow, financing or customers for a portfolio company or companies?

The National Venture Capital Association (NVCA) recently released an outstanding paper describing five questions which every VC should know the answer to. See <https://nvca.org/blog/foreign-investment-scrutiny-5-questions-every-venture-investor-know-answer/>.

The key section in that paper is Question 4, ***What should venture investors be doing?***

"Right now, venture investors should be assessing how FIRRMA (and particularly the pilot rules) affects their business and consulting counsel.

If you have foreign LPs, you will need to evaluate what type of information you share with these LPs. The most common tripping point is likely to be whether any information you share is "material nonpublic technical information." As discussed..., the statute and regulation give us a little insight about what this is (necessary to design, develop, etc. critical technologies) and is not (financial information), but many questions will arise given the ambiguity of the term.

If you are or have foreign co-investors, you will need to evaluate what information or rights pass to the investor due to the investment in a critical technology startup. Receipt of a board seat or board observer status is a cut-and-dry case, and investors will need to decide going forward whether the right is worth the trouble of CFIUS. Access to "material nonpublic technical information" or "substantive decisionmaking" about the business is less clear, but investors will still need to decide whether these rights are essential enough to warrant the time, burden, and cost of the CFIUS process.

NVCA will remain engaged on FIRRMA and its rules on your behalf. We see our role as simultaneously advocating for fair and workable foreign investment rules and educating the industry on how your world will be impacted."

There were also a number of key points made at a recent NVCA-sponsored conference on CFIUS and international investment in US venture funds:

- ***A key insight was that limited venture capital fund partners (LP's), absent special additional factors, tend to have extremely little to do with the high tech companies***



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that VC's invest in. Essentially, in most cases, they are fiduciaries (like CALPERS or the Princeton University endowment) that come in for general review meetings only once or twice a year. It was mentioned that this is the reason that Congress was comfortable creating a general CFIUS exemption from filing along the lines NVCA had requested for international limited partners.

- **Even the general partners in venture capital firms typically have little to do with the sensitive technology-related aspects of their venture investments (and this is true even if they sit on a start-ups board).** The key comment was that any insights a start-up company might have about their product or service is not based on the "what," but on the "how!" With respect to their portfolio companies, venture capital investors tend to know a lot about the "what," but relatively little about the "how," (and certainly not enough to replicate any given company's "secret sauce").

- **My sense is that it is just a question of time before CFIUS administrators come to appreciate the essential truth of these insights (and begin to draw comfort from it). Even so there will also still exist a natural "bureaucratic" sensitivity arising from a reasonable fear of being faulted for accepting as benign, relationships that others (and especially members of Congress) might not instinctively see as being that way;** i.e., the CFIUS administrators at Treasury and in the national security agencies can be expected to error on the side of caution for quite some time in this area.

- **It was particularly interesting that concerns in this area were much more with the venture funds general partners than with their LP's; it is an area that NVCA is beginning increasingly to focus on and where there are tangible issues to consider.** For example, several such VC general partners are non-US citizens (or even once were non-US citizens) and concerns will almost certainly arise involving all aspects of the national security spectrum of concerns (e.g., technology theft; espionage; compromise of critical infrastructure; classified information access, etc.).

- **It was also observed that the costs (both direct and indirect) associated with a CFIUS filing represent a substantially larger percentage of the overall investment being made.** This is true whether you are considering high tech venture capital investing, which can span from investments of small amounts (e.g., accelerators, angel investors, etc.) to more traditional venture investment amounts (i.e., totaling millions of dollars) to more recent examples of much larger amounts in later stage companies who are holding off on going public (and yet far enough along so that their cash "burn rate" needing to be financed is substantially larger than the traditional venture investment levels (but those investments are also seen as being less risky in terms of achieving a major (and marquee) payoff by way of an eventual initial public offering (IPO) or sale to a FANG (i.e., Facebook, Amazon, Netflix and Google) or other successful established high tech company for a substantial multiple.



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- ***It was also observed that CFIUS is in the process of becoming a much more systematic and paper-based process; some observers predicted that we are only one additional future Congressional enactment away from CFIUS coming to resemble the Hart-Scott-Rodino anti-trust pre-merger notification process. Hart-Scott-Rodino (Hart-Scott) filings are based on a straightforward commonly used set of forms and rely on industry census data to categorize the different industries being evaluated for industry concentration and anti-competitive behavior.***
- ***It was also the subject of some speculation whether eventually once this occurs, if the CFIUS process will come to take the same amount of time as Hart-Scott-Rodino cases that fall into the areas of DOJ and FTC interest (those being the two anti-trust agencies that oversee Hart-Scott). If so, like Hart-Scott, CFIUS would have the potential to end up on the "critical path" that determines how long it ultimately takes before the parties are free to close a transaction (rather than falling inside the broader set of deadlines for the regulatory approvals that are required, but which typically take longer to perform before a transaction can close).***
- ***It was also an expressed view that CFIUS would eventually develop various procedures that would allow investors from what are generally seen as countries friendly to the US to clear the CFIUS process more quickly. This was also seen as becoming likely for specific investor companies and individuals who are regularly in front of CFIUS (i.e., companies and individuals that become well known to CFIUS).***

It is worth noting that a CFIUS review can go well beyond an assessment of the intentions of a particular country with respect to any given investment or acquisition....it can also go to the background of specific individuals (regardless of which foreign country they are from) with respect to their intentions vis-a-vis the national security interests of the United States.

My "if I had to bet" answer is that a "rule of reason" is on the horizon for such matters, but you can never be certain.

Finally, another interesting area where the "assignment of CFIUS risk" discussion (above) might prove very relevant is with respect to the negotiation of the investment terms, where the companies being invested in by VC's, angels and others, will want some assurance that those investors are themselves in compliance with the new law.

Clearly, the new world of CFIUS in Silicon Valley is just beginning to be understood, but it's significance is now clearly "front and center."

THERE ARE ALSO OTHER AREAS TO BE EXPLORED INVOLVING NEW CFIUS

I have found it particularly interesting to reflect on how new CFIUS will impact the world of intellectual property....and patents in particular, given that they are property rights relating to



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inventions that are embodied in the world of technology....and the more advanced the technology involved, the more likely it is to wander into CFIUS areas.

As a starting point, the basic issues are the generic CFIUS issues surrounding foreign investment transactions (which necessarily include the IP assets as part of the broader whole).

But US patent assets relate to the right to exclude competitors and others from the US market. That is not only important for purposes of prospective revenue, but in today's globally competitive world, the US market often holds a key market share element that if you cannot access it, you will find it hard to achieve the manufacturing volume needed to become the low cost provider in an industry.

There are several interesting issues involving intellectual property (and patents in particular) that may arise under new CFIUS that are worth exploring further (and a subsequent article devoted to that topic is contemplated).

CONCLUSIONS

At moments like this it is often well advised to keep in mind the old adage of how "*the road to hell is paved with good intentions.*"

Similarly, the essential principles of *Murphy's Law* should be kept in mind....as well as the observation (based on painful experience) that in the view of many...."*Murphy was an optimist!*"

The history of economic regulation (which would include mechanisms for reviewing international investment, such as CFIUS) is littered with examples of well intended regulation gone awry....

One of the best examples of what can go wrong was the US experience with regulating the introduction of cell phone service in the United States (which was originally invented in Bell Labs here in the US). The FCC's painfully cumbersome chosen licensing procedures, at first requiring lengthy "comparative hearings," which later went to a lottery system in the 1980's (rather than to a more economically and time efficient auction allocation system). That set of regulatory choices unnecessarily delayed the introduction of cell phone service in the US for decades (!), allowing the Japanese, Germans and Scandinavians to move past the US simply by moving forward and implementing the technology in their home markets and elsewhere around the world....and with that came world leadership in cellular telephony and handset and systems manufacturing. It's was undeniably what the English often like to call an "own goal!"



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The next 18 months to 2 years will largely determine whether or not we get CFIUS right.....There is nothing inherently wrong in the new law....but as always, "*the devil will be in the details!*"

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