

Trends and Updates in the CFIUS Space

January 16, 2018

Introduction

2018 is shaping up as a potential watershed year for the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”). Within the first two weeks of the new year, CFIUS was the subject (or a significant topic) of two separate Congressional hearings and made headlines for declining to approve yet another significant China-based transaction, Ant Financial’s proposed acquisition of MoneyGram. Additional hearings are imminent and we predict that some form of CFIUS reform legislation will be enacted before the 2018 mid-term elections.

We expect 2018 to focus on CFIUS legislation and further attention to evaluating CFIUS risk and on structuring inbound investments from China.

The Ant Financial - MoneyGram Transaction

On January 26, 2017, Ant Financial, an affiliate of Chinese e-commerce conglomerate Alibaba, signed a deal to acquire MoneyGram for \$880 million, later amending the purchase price to \$1.2 billion.¹ Each of Alibaba and Ant Financial had previously secured CFIUS clearance for other transactions, including Ant Financial’s 2016 acquisition of EyeVerify, a biometric security technology company.² MoneyGram, moreover, was not regarded as particularly sensitive from a national security perspective.

On January 2, 2018, however, the parties announced that CFIUS had refused to approve the deal.³ As suggested in the press, the Committee’s primary concern may have been that sensitive personal information of U.S. citizens held by MoneyGram could be exploited by the Chinese government.⁴ Ant Financial’s assurance that national security interests would be protected because the servers storing the relevant personal information would continue to be maintained in the United States was apparently insufficient to alleviate CFIUS’s concerns.⁵ MoneyGram’s CEO, Alex Holmes, stated that it had become clear that “despite [their] best efforts to work cooperatively with the U.S. government . . . CFIUS will not approve this merger.”⁶

¹ MoneyGram, 8-K Current Report, SEC (Jan. 26, 2017); MoneyGram, *MoneyGram and Ant Financial Enter Into Amended Merger Agreement*, MoneyGram (Apr. 16, 2017), <http://ir.moneygram.com/releasedetail.cfm?ReleaseID=1021415>.

² See MoneyGram, Schedule 14A, SEC (May 8, 2017) (“Ant Financial successfully completed a review by CFIUS last year when it purchased Kansas City-based EyeVerify”).

³ MoneyGram, 8-K Current Report, SEC (Jan. 2, 2018).

⁴ See Bret McLannahan, US doubts on China investments sink Ant Financial-MoneyGram deal, FIN. TIMES (Jan. 2, 2018), <https://www.ft.com/content/b893d7e0-f012-11e7-b220-857e26d1aca4>; Russell Flannery, *End of China’s MoneyGram Deal Highlights U.S. Worries About Private Data*, FORBES (Jan 6, 2018), <https://www.forbes.com/sites/russellflannery/2018/01/06/end-of-chinas-moneygram-deal-highlights-u-s-worries-about-private-data/#4d3de4101ccd>.

⁵ Selina Wang and Matthew Monks, *China’s Ant Financial Pushes U.S. to Approve MoneyGram Deal*, BLOOMBERG (Sept. 15, 2017), <https://www.bloomberg.com/news/articles/2017-09-15/china-s-ant-is-said-to-be-renewing-u-s-review-of-moneygram-sale>.

⁶ Greg Roumeliotis, U.S. blocks MoneyGram sale to China’s Ant Financial on national security concerns, REUTERS (Jan 2, 2018), <https://www.reuters.com/article/us-moneygram-intl-m-a-ant-financial/u-s-blocks-moneygram-sale-to-chinas-ant-financial-on-national-security-concerns-idUSKBN1ER1R7>.

The parties' withdrawal from review reflects the most recent manifestation of a trend in CFIUS to protect U.S. citizens' personal information. One would normally have expected, however, that such concerns could have been addressed through a mitigation agreement among the parties and the U.S. government.

Foreign Investment Risk Review Modernization Act of 2017 ("FIRRMA")⁷

Overview and Background

In November 2017, FIRRMA was introduced in the Senate by Senators John Cornyn (R-TX) and Dianne Feinstein (D-CA) and in the House by Representative Robert Pittenger (R-NC). The bill has attracted substantial bipartisan support in both houses of Congress and from the Trump Administration.

If passed as currently written, FIRRMA would significantly amend CFIUS's authorizing statute, section 721 of the Defense Production Act of 1950 ("**Section 721**"). Some amendments would merely codify CFIUS practices that have evolved since Section 721 was last revised in 2007. Other changes would materially expand CFIUS's reach and its workload. Notable changes would include expanding CFIUS's jurisdiction to cover a range of previously exempt transactions; widening CFIUS's authority to impose injunctive measures on pending transactions; identifying additional national security factors to be considered by CFIUS in conducting its risk assessment; requiring mandatory "declarations" to CFIUS (potentially in lieu of a traditional notice) for certain categories of filers; modifying the timeframe for the review process; adding a filing fee; and further restricting judicial review of the Committee's actions.

Covered Transactions

If enacted, FIRRMA would greatly expand the scope of "covered transactions" that fall within CFIUS's jurisdiction to include, among other things:

- the purchase or lease by a foreign person of private or public real estate that is located within the United States in close proximity to a U.S. military installation or government facility that relates to national security, even if that property does not constitute a "U.S. business";
- a non-passive investment by a foreign person in any U.S. critical technology company or U.S. critical infrastructure company, even if the investment does not confer "control" under current CFIUS regulations;
- any changes in the rights that a foreign person has with respect to a U.S. business in which the foreign person has an investment that could result in:
 - foreign control of the U.S. business; or
 - a non-passive investment by a foreign person in any U.S. critical technology company or U.S. critical infrastructure company;
- the contribution by a U.S. critical technology company of both intellectual property and associated support to a foreign person through any arrangement (such as a joint venture).

There has been appreciable concern that expanding the scope of covered transactions, especially to include contributions of U.S. technology to overseas joint ventures, would move CFIUS beyond the regulation of inward foreign direct investment and overlap with the jurisdiction of U.S. export regulators.

⁷ Foreign Investment Risk Review Modernization Act of 2017, S.2098, 115th Congress (2017); Foreign Investment Risk Review Modernization Act of 2017, H.R.4311, 115th Congress (2017).

Factors to be Considered

FIRRMA would codify a number of new factors that CFIUS may consider when reviewing a covered transaction, including, among others:

- whether the transaction involves a country of “special concern”⁸ that has demonstrated or declared a strategic goal of acquiring a type of critical technology possessed by the U.S. target company;
- the potential effects of the covered transaction on U.S. international technological and industrial leadership in areas affecting U.S. national security, including whether the transaction is likely to reduce the technological and industrial advantage of the U.S. relative to any country of special concern;
- whether the foreign investor has a history of:
 - complying with U.S. laws and regulations, including laws and regulations pertaining to exports, the protection of intellectual property, and immigration; and
 - adhering to contracts or other agreements with the U.S. government;
- the extent to which the transaction is likely to expose personally identifiable information or other sensitive data of U.S. citizens to access by a foreign government or foreign person that may exploit that information in a manner that threatens national security.

Although the concept of expressly designating and applying a heightened review standard to countries of “special concern” would be new, the other factors are already part of CFIUS’s analysis of submitted transactions in practice.

Interim Measures

FIRRMA would expand the tools available to the Committee with respect to proposed, pending, or abandoned transactions:

- FIRRMA would authorize CFIUS to suspend a proposed or pending covered transaction that it determines “may pose a risk to the national security of the U.S.” while the covered transaction is under review or under investigation.⁹
- Where a transaction has been voluntarily abandoned by the parties, FIRRMA would expressly authorize CFIUS to negotiate, enter into or impose, and enforce any agreement or condition with any party to the (since-abandoned) covered transaction for purposes of “effectuating such abandonment” and mitigating any risk to U.S. national security arising from the covered transaction.

⁸ FIRRMA permits CFIUS to identify a list of countries of “special concern,” which should include those countries “that pose[] a significant threat to national security interest of the United States.” No specific countries are identified in the bill, and it expressly does not require CFIUS to maintain a “special concern” list, but the legislation’s chief sponsors have made no secret that their principal concerns are with investments from China. See Press Release, SENATOR JOHN CORNYN (Nov. 8, 2017) (“By exploiting gaps in the existing CFIUS review process, potential adversaries, such as China, have been effectively degrading our country’s military technological edge by acquiring, and otherwise investing in, U.S. companies”), <https://www.cornyn.senate.gov/content/news/cornyn-feinstein-burr-introduce-bill-strengthen-cfius-review-process-safeguard-national>.

⁹ Although CFIUS has long claimed a broad right to exercise the president’s authority to “suspend” transactions, its current legal authority to impose “interim protections” is limited to circumstances where a transaction has been withdrawn pending resubmission.

Mandatory Submissions

FIRRMA would establish an alternative form of review for parties to certain covered transactions, defined as “declarations.” Declarations would not, however, be designed to accelerate the clearance of noncontroversial transactions, but to ensure that particular types of transactions are brought to CFIUS for evaluation. Under FIRRMA, mandatory filings would be required for any transaction that involves the acquisition of a 25% or greater voting interest in a U.S. business by a foreign person in which a foreign government owns, directly or indirectly, a 25% or greater voting interest. The filings would also be prescribed, through regulations, based on the following factors: the technology, industry or economic sector of the U.S. party to the transaction; the difficulty of remedying the harm to national security that would result from the completion of the covered transaction; and the difficulty of obtaining information through other means on the type of covered transaction contemplated. Creating a category of mandatory filings would represent a material change in CFIUS’s fundamental structure.

House Subcommittee Hearing on CFIUS

On January 9, 2018, the Monetary Policy and Trading subcommittee of the House Committee on Financial Services held a hearing on CFIUS challenges in the global economy.¹⁰ The hearing, conducted against the backdrop of the FIRRMA bill and the 2016-2017 surge of technology investments in the United States from China, focused on safeguarding national security while protecting the freedom of investment in innovation that keeps the U.S. economy a vibrant foundation for national defense.¹¹ Witnesses focused on the protection of personal data and intellectual property, among other challenges, and, with the support of Subcommittee Chairman Barr, on avoiding turning CFIUS, with its focus on individual transactions, into an export control authority. The panel echoed concerns about whether CFIUS should be given jurisdiction over U.S. companies seeking to license technology to non-U.S. joint ventures — transactions that are not investments into the United States, but are seen as a point of vulnerability by many in the national security community as well as by FIRRMA’s sponsors. Witnesses emphasized, among other issues, the need for additional resources for CFIUS. Further hearings are planned, and legislation is expected to be presented to the President before the 2018 mid-term elections.¹²

¹⁰ *Evaluating CFIUS: Challenges Posted by a Changing Global Economy*, Hearing on CFIUS Before the Subcomm. on Monetary Policy and Trading, 115th Cong., <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402841>. The following witnesses testified: Admiral Dennis C. Blair, Co-Chair of The Commission on the Theft of American Intellectual Property and former National Intelligence Director on the National Security Council; Mr. Rod Hunter, Partner at Baker & McKenzie LLP and former Special Assistant to the President and Senior Director of the National Security Council; the Honorable Theodore W. Kassinger, Partner at O’Melveny & Myers LLP and former Deputy Secretary of the U.S. Department of Commerce; Dr. Scott Kennedy, Director of the Project on Chinese Business & Political Economy at the Center for Strategic & International Studies; and Dr. Derek M. Scissors, Resident Scholar at the American Enterprise Institute.

¹¹ President’s Council of Advisors on Science and Technology, *Ensuring Long-Term U.S. Leadership in Semiconductors* (Jan. 2017), https://obamawhitehouse.archives.gov/sites/default/files/microsites/ostp/PCAST/pcast_ensuring_long-term_us_leadership_in_semiconductors.pdf.

¹² A House Armed Services subcommittee on Emerging Threats and Capabilities held a separate hearing on January 9, 2018 on the development of China’s military. Although CFIUS was not the primary topic of this hearing, each of the witnesses addressed CFIUS in his written or oral testimony. *See China’s Pursuit of Emerging and Exponential Technologies*, Hearing on emerging Chinese threats Before the Subcomm. on Emerging Threats and Capabilities, 115th Cong., <https://armedservices.house.gov/legislation/hearings/china-s-pursuit-emerging-and-exponential-technologies>.

Broader Trends

The CFIUS process is under significant pressure. The Committee's caseload is larger than it can reasonably handle with existing resources; the government doubts its own ability to monitor rapid technological changes that could present threats to national security; and the fastest growing source of technology investment — China — is becoming the United States' strongest technology competitor but lacks the shared security alliances enjoyed by other countries. In that setting, businesses' ability to assess, accommodate and respond to CFIUS risk has become even more tenuous than in the past. Amending CFIUS's statutory authority could help refocus the process and promote a new equilibrium in which well advised businesses can predict, with manageable uncertainty, which transactions are likely to be routine, which reflect problems that can be solved with less than draconian measures and which are ultimately unlikely to be permitted, calculations that affect bet-the-company decisions by CEOs and company boards. The FIRRMA bill would authorize formal distinctions in the treatment of countries of "special concern," while exempting from certain requirements investors from U.S. treaty allies that maintain CFIUS-like procedures to review inward foreign investment, a pragmatic approach that nonetheless would codify practices that risk being over-inclusive. Meanwhile, anecdotal evidence suggests that the workload at CFIUS, which received over 235 filings in 2017 compared to 172 for 2016 and 143 for 2015,¹³ has resulted in slower handling for all transactions, even relatively less challenging deals. Some participants have even suggested that concern over insufficient government resources to supervise ongoing mitigation agreements has led CFIUS to reject outright some transactions that might previously have been approved with stringent (but resource-intensive) mitigation terms. In cases centering on data protection, cybersecurity or network vulnerability, there may be concern within CFIUS that mitigation is illusory and cannot reliably insulate sensitive data from even passive, minority investors.

On the positive side, the United States commitment to welcoming foreign investment remains genuine and investments, including from China, will continue to be approved. Advocates of even the most aggressive versions of CFIUS reform remain focused on protecting U.S. national security; none proposes using CFIUS to ameliorate trade imbalances, market access restrictions or product dumping. FIRRMA does not propose to evaluate foreign investment for "net benefit" to the United States, as is done in some countries and has been proposed here as well. There is reason to believe that, as a new balance between immediate security risks and long-term entrepreneurial vitality emerges, the CFIUS process will adapt, permitting government the flexibility it needs to respond to shifting threats and businesses the predictability they need to continue innovating.

¹³ CFIUS, *Covered Transactions, Withdrawals, and Presidential Decisions 2014-2016*, U.S. Department of the Treasury, https://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUS_Stats_2014-2016.pdf (last updated Sep. 20, 2017). We note that CFIUS statistics include each case that is withdrawn and refiled as a separate filing. In 2015, nine cases were withdrawn and refiled; in 2016, there were 15 such cases. Data for 2017 is not yet available.

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