

CFIUS Reform and U.S. Government Concerns over Chinese Investment: A Primer

By Robert D. Williams

While U.S. President Donald Trump was in Beijing last week for his first **state visit** to China, back in Washington, a bipartisan group of legislators **introduced** a bill aimed at protecting the United States against “**potential adversaries, such as China**” that might attempt to acquire critical U.S. technologies and know-how through investment in U.S. companies. The legislation would reform the Committee on Foreign Investment in the United States (CFIUS), an interagency body responsible for reviewing inbound foreign investment for national security risks.

The bill, known as the **Foreign Investment Risk Review Modernization Act (FIRRMA)**, was spearheaded by Sen. John Cornyn of Texas, the second-ranking Republican in the Senate, and co-sponsored by a bipartisan group of senators including Dianne Feinstein, D-Calif., and Richard Burr, R-N.C., the chairman of the Senate intelligence committee. Rep. Robert Pittenger, R-Charlotte, introduced an identical bill in the House, also with bipartisan cosponsorship.

Below, I offer a brief overview and analysis of the CFIUS reform legislation and the strategic context in which it arises.

What Is CFIUS?

CFIUS (the Committee) is an interagency committee that exercises delegated presidential authority to review “covered transactions,” which are currently **defined** by statute as mergers, acquisitions, and takeovers by or with any foreign entity that could result in foreign “control” of a U.S. business, to determine the effect of the proposed deal on U.S. national security. The Committee is chaired by the Secretary of the Treasury, and its voting members include the heads of the Departments of Commerce, Defense, Homeland Security, Justice, State, and Energy; the U.S. Trade Representative; and head of the White House Office of Science and Technology. The Director of National Intelligence (DNI) and the Secretary of Labor serve as non-voting, ex officio members. Other White House offices and personnel may act as observers and participate in CFIUS reviews on an ad hoc basis.

Under existing law and regulations, the CFIUS review process begins with the parties to a transaction making a voluntary filing of notice. CFIUS also has the authority to compel such a filing if it determines that a transaction poses a potential risk to national security. The process generally ranges from 30 to 90 days, with an initial 30-day review following CFIUS' receipt of the notice; an investigation period of up to 45 days for transactions requiring additional investigation after the 30-day review; and a 15-day period for presidential review if CFIUS refers a transaction to the President for a decision on whether to suspend or prohibit it.

If CFIUS finds that a covered transaction presents national security risks, it may impose certain conditions before allowing the deal to proceed or require the parties to enter into a mitigation agreement to address security risks. It may also refer the transaction to the President, as noted above, who has authority to block transactions that pose a threat to national security. In some cases, proposed deals are withdrawn voluntarily by the parties prior to such presidential actions.

CFIUS regulations (and the new FIRRMA bill) define "control" as the "power...to determine, direct, or decide important matters affecting an entity." National security is not defined in the current CFIUS statute, but the law provides 10 specific factors the Committee may consider when analyzing the national security implications of a transaction.

Why CFIUS Reform, and Why Now?

Worries about the surge of Chinese investment in the United States, particularly in high-tech industries, has driven much of the recent discussion around proposals to reform CFIUS. The bill's chief architects make no secret of their concerns about recent trends in Chinese investment in the United States, and have described China's approach as "weaponizing" investment to accomplish strategic objectives. This bill is, first and foremost, about China.

The issue is not simply the volume of investment coming from China. (According to Rhodium Group, Chinese investment in the U.S. tripled in 2016 to \$46 billion, and although new Chinese government capital controls have slowed the pace of Chinese foreign investment growth in 2017, the long-term growth potential is clear.) Policymakers worry that the Chinese government is directing outbound investment in early-stage, cutting-edge U.S. technologies with potential military applications—including artificial intelligence and robotics—in part to advance China's military modernization and diminish America's technological advantage. Some of this investment is done by nominally private firms that nonetheless maintain close links to the Chinese government and the Chinese Communist Party.

Evidence for this approach has been steadily accumulating. In 2015, China's State Council released a major industrial policy plan known as "Made in China 2025." According to the U.S. Chamber of Commerce, the initiative includes measures to provide domestic Chinese companies with preferential access to capital to support acquisition of technology from

overseas. A January 2017 report by then-President Barack Obama's Council of Advisors on Science and Technology similarly found that Chinese industrial policies, including investment in the U.S. semiconductor industry, "are distorting markets in ways that undermine innovation, subtract from U.S. market share, and put U.S. national security at risk." On the domestic front, China systematically conditions market access to foreign firms on technology transfer, joint venture arrangements, and local content requirements.

Many such deals involving technology transfer avoid CFIUS review because they are structured as joint ventures or minority investments outside of the Committee's current jurisdiction. At its core, FIRRMA is an effort to close the gaps in CFIUS that Congress fears China is exploiting.

What Would FIRRMA Do?

To fill gaps in the investment review process, FIRRMA would expand CFIUS's jurisdiction to include a broader range of transactions. These include non-passive, minority-position investments in critical technology or infrastructure; joint ventures involving technology transfers to a foreign entity; and real estate investments near military or other national security facilities. The bill also includes a provision addressing concerns about acquisition of early-stage technologies by unspecified "countries of special concern" that pose a significant national security threat. It would nearly double the list of national security factors for CFIUS to consider in its risk reviews, incorporating attention to "countries of special concern" in the security analysis.

In addition to expanding CFIUS's jurisdiction and the factors it considers in carrying out national security review, the bill also gives CFIUS additional tools to mitigate national security risks and to monitor and enforce compliance with risk-mitigation protocols. These include, for example, new authorities to suspend transactions or impose conditions pending review, and new requirements to develop and implement plans to monitor compliance with mitigation agreements. In addition, the bill would create a new mechanism to monitor and identify transactions within CFIUS's jurisdiction but for which CFIUS has not received any filing from the transacting parties.

The bill's architects apparently sought to balance these measures to enhance scrutiny of foreign investment with a desire to maintain an open and efficient U.S. investment climate and to limit CFIUS's operational burden. In tandem with the expansion of CFIUS's review authority, FIRRMA would allow the Committee to exempt certain categories of transactions. It would also create streamlined filing procedures to allow the Committee to filter out transactions that do not warrant extensive review or investigation. Filing would remain voluntary except for certain acquisitions by state-owned enterprises—though CFIUS would have new discretion to mandate filing for other categories of investment.

The legislation also gives the Committee a bit more time for review, perhaps lessening the need for investors to withdraw and refile notices for transactions requiring more extensive

scrutiny. FIRRMA extends the initial transaction review period from 30 to 45 days, and for transactions subject to an investigation, the bill allows for a one-time, 30-day extension in “extraordinary circumstances” at the request of a federal agency head.

Several new provisions aim to provide increased transparency around CFIUS’s decision-making, while others seek to promote information-sharing with U.S. partners and allies. Finally, to ensure sufficient resources, the bill introduces a new stream of funding—filing fees—and confers special authority to directly hire candidates for CFIUS jobs.

Initial Observations

First, this legislation has traction. The list of Senate co-sponsors is sufficiently powerful and bipartisan, the reforms sufficiently tailored, and the concerns informing those measures sufficiently well grounded that some version of this bill seems highly likely to be adopted.

Second, the bill is as interesting for what it doesn’t do as for what it does. FIRRMA does not fundamentally change the structure of CFIUS and imposes no categorical ban on any particular type of investment or any particular country. The drafters wisely chose not to incorporate an “economic security” or “net benefits” test in CFIUS review, and similarly excluded considerations of investment policy reciprocity from decisions on whether to approve investment from a foreign country. This is not to say that such issues are unimportant, but the bill recognizes that CFIUS—an interagency body with a limited national security mission—is not the most appropriate forum for dealing with them. (Of course, the decision to exclude reciprocity may be of little comfort to U.S. firms dependent on operating in or exporting to the Chinese market; such entities may be predictably concerned about facing **reprisal** in China if this bill passes.)

Third, despite the absence of economic security or reciprocity tests, the FIRRMA bill provides further evidence that the concept of “national security” is nearly impossible to define with precision or to disentangle from notions of economic advantage. (For his part, President Trump may be prepared to set aside any pretense to such a distinction, tweeting on Nov. 10 that “[E]conomic security is not merely RELATED to national security – economic security IS national security.”) On the one hand, the CFIUS bill takes aim at Chinese industrial policies—whether “**military-civil fusion**” or “Made in China 2025”—that blur the lines between national security and economic goals as well as the defense and civilian industrial bases. (Notably, China’s official legal conception of national security under its 2015 **National Security Law** explicitly contemplates economic security.) On the other hand, various provisions in the bill inescapably sound in the language of economic competition. For example, under FIRRMA, the factors for CFIUS’s consideration would include “the technological and industrial advantage of the United States relative to any country of special concern,” and the bill would seek to protect early-stage technologies that may not currently but one day “*could* be essential” for maintaining national security advantages.

Fourth, the effort to protect early-stage technologies is likely to generate further debate. FIRRMA defines “critical technologies” to include “emerging technologies that could be essential for maintaining or increasing the technological advantage of the United States over countries of special concern with respect to national defense, intelligence, or other areas of national security, or gaining such an advantage over such countries in areas where such an advantage may not currently exist.” The spirit of this provision makes perfect sense given the potential dual-use applications of various emerging technologies, as noted above. It may be a challenging standard to administer in practice, however, since the national security implications of early-stage technologies can be difficult to predict ex ante. And Silicon Valley may fear a world in which its startups are effectively cut off from the deep pockets of Chinese venture capital.

Fifth, a common complaint among Chinese investors is that CFIUS is a “black box” process subject to politicization. This bill would go some way toward increasing transparency around CFIUS reviews—for example, by including more detail on the factors that inform the Committee’s security analyses and more information about the deals the Committee reviews and acts upon every year. But these reforms may not be terribly comforting to Chinese investors, since the bill makes little secret of the fact that China is a “country of special concern” and that Chinese industrial policies related to U.S. technology acquisition are central targets of the legislation.

Sixth, on first review, this legislation seems broadly consistent with maintaining an open U.S. investment policy that welcomes productive capital from all nations, China included. Indeed, some version of CFIUS reform may be essential for keeping America’s doors to foreign investment open. Investors have been frustrated by delays in CFIUS reviews in recent months, and the reforms contemplated in this bill—heightening scrutiny for certain categories of investment while creating exemptions for other types of investment, streamlining procedures, and ensuring that CFIUS is better resourced to carry out its mission—may go some way toward alleviating those concerns.

Finally, many other questions remain to be answered concerning the impact of CFIUS reform on U.S.-China ties. Will we see any effects on China’s new market-opening initiatives, such as Friday’s announced plan to increase foreign ownership limits in the Chinese financial sector? What about on China’s draft Foreign Investment Law (or related pilot measures), which would create a new CFIUS-like review mechanism for foreign investment in China? And to what extent will CFIUS reform factor into discussions over a possible U.S.-China Bilateral Investment Treaty? These and other issues will be worth closely following in the coming months.

An appendix of the bill's key provisions can be found [here](#).

