



THE CHINA QUESTION

A **WORLD***ecr* SPECIAL REPORT

Edited reprint for Hughes Hubbard & Reed

The growing and continued focus on Chinese investment in CFIUS reviews

By Ryan Fayhee, Roy Liu and Tyler Grove, Hughes Hubbard & Reed

The Committee on Foreign Investment in the United States (CFIUS or 'Committee') has been a long-standing institution, but until recently was treated by some as merely a 'check-the-box' exercise in merger and acquisition activity involving US businesses. However, with growing bipartisan anxiety over strategic competition with China, CFIUS has transformed in recent years into one of the tools at the forefront of US foreign policy. Although this trend became even more pronounced during the Trump administration, there appears to be broad bipartisan appetite to continue to use CFIUS to aggressively target investment by Chinese companies and individuals.

CFIUS background

CFIUS was originally organised by President Ford via executive order in 1975, but initially served a largely advisory function. In 1988, CFIUS was authorised to review and potentially prohibit transactions by non-US investors when Congress passed the Exon-Florio amendment to the Defense Production Act.

Between 1988 and 2018, the jurisdiction of CFIUS was limited to transactions where a non-US investor would acquire control of a US business. During this time, all filings with CFIUS were voluntary, although the Committee could itself initiate a review of a transaction where no voluntary notice was filed, and potentially require post-closing action to mitigate any national security concerns, up to and including recommending that the President order divestment. However, this power was rarely invoked, with only three transactions blocked by a president through the Obama administration (although a number of other transactions were quietly abandoned by the parties because of CFIUS's opposition).

However, during the 2010s, Chinese

investment in the United States increased dramatically. According to the Office of the US Trade Representative, between 2010 and 2018, transactions involving Chinese venture capital firms increased more than eight times. At the same time, in 2015, the 'Made in China 2025' plan was released, which details the Chinese government's intention to transition the Chinese economy from low-value goods to technology-focused high-value manufacturing and services. Additionally, the Chinese government continued to strengthen its policy of 'civil-military

fusion' to reduce barriers between the private sector and military industrial base.

As a result, US policymakers increasingly grew concerned that Chinese investment in US companies could be a potential vector for transfers of technology. There were also concerns that Chinese investors set out to structure transactions to avoid CFIUS jurisdiction, for example, through significant minority investments, formation of joint ventures, and the purchase of real estate assets.

In response to these concerns, in August 2018 Congress passed the Foreign



Investment Risk Review Modernization Act ('FIRRMA'). While all controlling investments in US businesses remain subject to the Committee's jurisdiction, FIRRMA's implementing regulations create a new emphasis on 'TID US businesses' – that is, US businesses that develop 'critical technologies', perform functions related to 'critical infrastructure', or maintain or collect 'sensitive personal data' of US citizens. Specifically, under FIRRMA, certain non-passive minority investments in TID US businesses are now subject to CFIUS review. In addition, the FIRRMA implementing regulations created a mandatory filing requirement for transactions involving a TID US business by (1) certain state-owned investors, or (2) investors who would gain control or access to 'critical technologies' that would require an export licence for the country of the investor's nationality.

Impact on Chinese companies

Although China is not explicitly mentioned in FIRRMA, it is clearly the target of the reforms and Chinese companies have accordingly avoided investments that could fall within the Committee's expanded jurisdiction since FIRRMA's passage. According to CFIUS statistics through 2019 (the most recent available), investors from China filed the most voluntary notices with CFIUS by far in 2017, with nearly three times the number of notices (60) of the next closest countries, Canada (22) and Japan (20). However, this number sharply dropped off in 2019, the first year after FIRRMA, with Chinese investors filing nearly half the number of notices (25) of the most active country, Japan (46).

At the same time, CFIUS enforcement against Chinese companies increased. FIRRMA authorised increased funding for CFIUS, and the Committee's budget increased from \$15 million in 2019 to over \$44 million in 2021. The number of full-time employees correspondingly increased from 32 in 2019 to 120 in 2021. FIRRMA also authorised CFIUS to charge a filing fee, which has created an additional source of revenue. Although CFIUS does not publicly release its decisions, between 2019 and 2020, CFIUS cleared or approved with mitigation five publicly known transactions involving Chinese investors, with four publicly known transactions either abandoned or blocked, for an approval rate of only 56%.

This build-up of funding and personnel has allowed CFIUS to engage in a look-back analysis of investment by Chinese companies in US tech start-ups reportedly going back as far as ten years. It has also

allowed the Committee to review compliance with mitigation agreements from cleared transactions. In 2018, CFIUS assessed a \$1 million fine for violations of a 2016 mitigation agreement, and in 2019 assessed a \$750,000 fine for violations of a 2018 mitigation agreement.

Perhaps the most well-publicised result of this look-back analysis is CFIUS's review of Chinese company Bytedance's 2017 acquisition of Musical.ly, another Chinese company with US operations (which ultimately created the popular TikTok app). US officials were concerned that the personal data of many millions of Americans would come into Chinese hands. That review demonstrates both the breadth and limitations of the current CFIUS regime – it occurred nearly two years after the acquisition was closed and culminated in a recommendation from CFIUS that President Trump order divestment of Musical.ly's US assets. President Trump accepted the recommendation and ordered the divestment in August 2020. The post-closing divestment was difficult: a proposed deal was negotiated whereby Oracle and Walmart would each take a minority position and Oracle would provide cloud hosting services for the app to ensure data privacy protections. Ultimately, the deal fell through in September 2020. Despite numerous missed deadlines and subsequent extensions, the divestment order remains pending. It is not yet clear whether the Biden administration intends to withdraw the order or pursue the divestment.

Another complication with the Bytedance CFIUS review is that President Trump issued an executive order prohibiting US persons from engaging in

transactions involving TikTok one week before the CFIUS divestment order. That ban, however, was made under the International Emergency Economic Powers Act ('IEEPA'), which serves as the statutory authority for most US sanctions programmes, and broadly grants the president the authority to block transactions without the jurisdictional

The build-up of funding and personnel has allowed CFIUS to engage in a look-back analysis of investment by Chinese companies in US tech start-ups.

constraints applicable to CFIUS. Although courts tend to be deferential to presidential action under IEEPA, Bytedance filed litigation to challenge the order on the grounds that, among others, it restricted speech protected under the First Amendment. Ultimately, the district court issued a preliminary injunction preventing the US government from enforcing the ban, and on 9 June 2021, President Biden revoked the underlying executive order.

Potential future changes

There remains some consideration by the Biden administration for a two-pronged



approach using both the Defense Production Act and IEEPA authorities. Notably, the Trump administration had created under the IEEPA authorities a CFIUS-like review mechanism for the Secretary of Commerce to review transactions involving so-called Information and Communications Technology and Services (‘ICTS’) sold by a ‘foreign adversary’, inclusive of China. In the same executive order revoking the TikTok ban, President Biden directed the Secretary of Commerce to consider additional measures under the ICTS rule. While there has not yet been any public enforcement under the ICTS review process and very little guidance, it could evolve as a shadow review process to potentially capture transactions that would

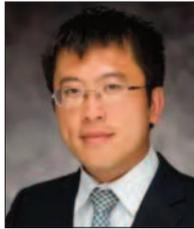
otherwise be outside of the Committee’s jurisdiction.

While FIRRMA has drastically cut Chinese tech investment in the United States, some areas of Chinese funding and influence remain, and this is attracting the bipartisan attention of US lawmakers. In particular, the proposed Strategic Competition Act – which was recently passed by the Senate as part of the omnibus US Innovation and Competition Act and awaits House of Representatives action – would expand CFIUS’s jurisdiction to allow review of certain foreign gifts and grants awarded to US universities.

Proceed with caution

Concern about Chinese strategic objectives has been the driving force in the rapid

transformation of CFIUS since 2018, and is likely to be the primary impetus for future reviews before the Committee. Although expanded CFIUS jurisdiction under FIRRMA has significantly depressed Chinese investment in the United States, additional areas of concern remain and are likely to continue. There appears to be broad support within the US government to creatively use a variety of remedies – from increased resourcing to executive action to legislative solutions – to close perceived gaps. Chinese companies with investments in the United States and US companies that receive Chinese investments should track developments in US policy regarding foreign investment review and exercise caution in increasing or making new investments in the future. □



Ryan Fayhee leads the Sanctions, Export Controls & Anti-Money Laundering practice group at Hughes Hubbard & Reed in Washington, DC, where Roy (Ruoweng) Liu is a partner and Chair of the firm’s Greater China practice group, and Tyler Grove is an Associate.

www.hugheshubbard.com

WorldECR, the journal of export controls and sanctions



Subscribe today. Visit www.worldecr.com/subscribe



Hughes Hubbard & Reed

World-Wide Experience Trusted Compliance Advice Global Sector Strength

We represent many of the world's leading international businesses, providing advice on compliance with applicable extraterritorial sanctions, export and re-export controls, and anti-money laundering. We are experienced and trusted advocates in conducting internal investigations and shepherding our clients through complex compliance audits, voluntary disclosures, and civil and criminal enforcement actions before the Commerce, State and Treasury Departments and the Department of Justice. We also represent foreign and U.S.-based businesses in transactions subject to review by the Committee on Foreign Investment in the United States (CFIUS), as well as in transactions involving classified information requiring Foreign Ownership, Control, or Influence (FOCI) review.

Our team includes experienced attorneys, many of whom have held prior positions at key government agencies, who are thought leaders within their fields. Through our core team based in Washington, D.C., we offer practical, business-oriented advice from a global perspective.

**“Hughes Hubbard has
an especially strong U.S.
investigations practice.”**

—Global Investigations Review

**“...unwavering focus on client
needs and sober assessments
of what the issues are.”**

—Chambers USA

We serve our global clients through our offices in the U.S. and Paris, and through our cooperation agreement with Saud Advogados in Brazil and our longstanding relationships with leading local firms in countries across the world.

Ryan Fayhee • Washington, D. C.
+1 (202) 721-4691
ryan.fayhee@hugheshubbard.com

Roy Liu • Washington, D. C.
+1 (202) 721-4621
roy.liu@hugheshubbard.com

A **WORLD***decr* SPECIAL REPORT

WorldEcr is published by D.C. Houghton – the world's leading specialist publisher of trade compliance publications.

D.C. Houghton produces:

COMPLIANCE JOURNALS: Export Compliance Manager and FISC - Financial Institutions Sanctions Compliance; WorldEcr, the journal of export controls and sanctions

BEST-SELLING BOOKS: Export Compliance Manager's Handbook; Sanctions in Europe; World Encryption Controls; Dual-use Export Controls in International Transit and Transshipment; Dual-use Export Controls of the European Union; Asia Pacific Strategic Trade Controls; The CFIUS Book

**COMPLIANCE CONFERENCES AND WEBINARS AND TRAINING
BESPOKE RESEARCH PUBLISHING**

Please visit our websites worldecr.com and exportcompliancemanager.com for more information.