

UPPING THE ANTE

As the United States and China remain locked in a trade standoff, U.S. President Joe Biden has ushered in a fresh set of criteria on foreign investment review on the grounds of national security in a thinly veiled attempt to stymie China's access to core U.S. technology, critical infrastructure, and sensitive data. Lawyers urge investors to come prepared for heightened regulatory scrutiny and steeper challenges ahead. **BY SARAH WONG**

■ Ambitions of geopolitical influence and a race for technological supremacy have pitted the United States against China for some time now, but China's burgeoning economic and military clout has only intensified this competition with the world's top economy in recent years.

The White House under the Biden administration has continued with past U.S. administrations' hawkish stance against Beijing by viewing everything, from academic and cultural exchange to capital and data flows, through the lens of national security. With China's paramount leader Xi Jinping emphasizing the need for domestic technological capabilities, Chinese strategic investment in perceived "high-risk" areas is keeping policymakers in Washington up at night.

With a watchful eye on "competitors" and "adversarial nations," U.S. President Joe Biden in September issued an executive order underscoring the "critical role" of the committee on Foreign Investment in the United States, or CFIUS.

Established in 1975, the interagency committee has been authorised to evaluate certain transactions involving foreign investment to determine whether such transactions put America's national security in peril and if blockage or fencing in of the deal should follow.

"CFIUS maintains fairly broad jurisdiction to review foreign acquisitions of

U.S. businesses. It also has jurisdiction over controlling as well as certain types of non-controlling investments in the U.S.," says Daanish Hamid, a partner and CFIUS specialist at Rimon Law.

Analysts regard the recent order as the most significant non-statutory development in CFIUS reviews in decades. It elaborated and expanded on the existing list of factors that CFIUS will consider when reviewing transactions for national security risks, including critical supply chain resilience, cybersecurity risks and sensitive personal data. Foreign investments containing these elements are more prone to CFIUS scrutiny, which could warrant a mandatory filing to the committee.

"As the national security environment, including the behaviour of countries and individuals that seek to impair U.S. national security, evolves, the review process of CFIUS also must evolve," said the White House in the order. Without explicitly naming countries, the order is widely viewed as targeting Chinese investment, as well as non-Chinese investors perceived to be close to Beijing.

POLICY PRIORITIES

When assessing fresh CFIUS risks in the wake of new White House directives, David Plotinsky, a partner at Morgan, Lewis & Bockius, suggests that businesses and their lawyers focus on sectors where CFIUS's actions and capabilities

are aligned with the Biden administration's policy priorities.

"One example is microcomputing, where the recent executive order highlights the close scrutiny, the committee will give to transactions involving semiconductor technology," Plotinsky notes.

"That scrutiny is consistent with separate new laws enacted through the CHIPS and Science Act, and with the even more recent rules issued by the Department of Commerce expanding U.S. export controls to restrict Chinese activity in advanced computing and semiconductor manufacturing," adds Plotinsky, who was also former acting chief of the U.S. Justice Department's Foreign Investment Review Section.

Another industry that falls under this category is life sciences. Plotinsky points out that closer CFIUS scrutiny of biotechnology transactions is in line with a separate executive order that "directs the U.S. government to take other measures to promote U.S. leadership in biotechnology and biomanufacturing, as well as securing the U.S. supply chain and decreasing dependence on supplies from foreign adversaries."

Carl Valenstein, a corporate partner at Morgan Lewis, notes this new set of considerations has imposed fresh complexities on pre-deal due diligence "not only to determine if a mandatory CFIUS filing is required, but also to assess the risk of CFIUS wanting to review and to mandate mitigation or divestiture post-closing if no filing is made with CFIUS."

"This due diligence focuses on whether the target is a U.S. business with critical technology, critical infrastructure or sensitive personal information as defined by CFIUS," Valenstein explains. "It is also advisable to review whether the target has received funding from the government or has any government contacts, and if it owns any real estate near certain designated ports or military bases."

Valenstein lays out some legal strategies that may help transactions get the green light from CFIUS.

"In non-controlling venture capital transactions, foreign investors often take a less than 10 percent interest and give up any right to a board seat or observer

rights, any right to material non-public technical information and any involvement in substantive decision making to deprive CFIUS of jurisdiction,” explains Valenstein. “CFIUS, of course, reserves the right to review the transaction post-closing to determine if, in fact, it has jurisdiction.”

Valenstein advises that foreign buyers may exclude and spin off non-core assets that may unleash national security scrutiny in a change of control transactions. They can also adopt voluntary mitigation techniques, such as a U.S. citizen board and management or special security committee and self-imposed site access restrictions.

“These techniques may help but it depends upon the industry and identity of the buyer whether they will ultimately be accepted by CFIUS,” he adds, noting that deals in a few critical industries will almost certainly be blocked as the U.S. government is inclined to determine that national security issues arising within cannot be mitigated.

Yet, it’s not all smooth sailing even after businesses enter into mitigation agreements with CFIUS. Plotinsky cautions against potential quagmires in transactions involving sensitive personal data or high-risk investors and countries, including enforcement actions by the U.S. government should companies fail to fulfil the extensive and complicated mitigation obligations that they subscribe themselves to typically in a last-ditch bid for CFIUS approval.

“Even when agreeing to burdensome mitigation measures is feasible, when undertaking such obligations, companies and their counsel need to devote sufficient compliance resources to ensure the ability to meet those obligations,” Plotinsky adds.

CHINA FACTOR

Despite the regulatory headwinds, the U.S. Treasury Department has accepted 272 CFIUS notices and 164 declarations in 2021, a year after the regulations implementing the Foreign Investment Risk Review Modernization Act (FIRRMA) were finalised. The 2018 act further empowered the president and CFIUS to combat national security risks



arising from certain non-controlling foreign investments and real estate transactions involving foreign persons.

“What is interesting is that the most significant number of notices were from Chinese investors,” Hamid of Rimon Law says of the 2021 CFIUS statistics.

According to the U.S. Treasury, last year Chinese investors filed 44 notices, accounting for 16.5 percent of the total volume, more than double of that in 2020, dwarfing America’s close economic allies Canada and Japan to top the chart.

Even throughout the three years from 2019 to 2011, during which the Sino-U.S. trade tussle and diplomatic sabre-rattling frosted the countries’ ties, Chinese investors have filed the second-highest number of notices at 86, only trailing investors from Japan but ahead of those from Canada, Britain and France. Of the Chinese notices, the vast majority – or 91 percent - were filed from the finance, information and services and manufacturing sectors.

“Not all China deals are being blocked by CFIUS contrary to popular perception,” Hamid adds.

CFIUS said no notices were rejected in 2021, although 74 were withdrawn. Most parties involved refiled a notice after adopting mitigation measures identified by CFIUS, with those in two instances abandoning the transactions outright. The geographical breakdown of these instances, however, is unclear.

Yet, Hamid strikes a cautious tone, calling the Biden executive order a “good wake-up call” for investors from China and other Asian jurisdictions to perform appropriate CFIUS due diligence early in their acquisition or investment deals.

“CFIUS has been reviewing Asian and other investors from countries outside of China to see if they have relevant third-party ties with China, including joint ventures, supply chain, or key customer relationships that can be leveraged by the Chinese government to seek insights into U.S. investments,” notes Hamid.

“National security risks need to be identified so that such investors can account for CFIUS concerns as part of the cost-benefit assessment of the deal,” adds Hamid. “Asian parties may even need to consider whether investments need to be restructured so that they are passive in nature and avoid triggering CFIUS jurisdiction altogether,” he adds.

Essential to a successful CFIUS filing, he stresses, is lawyers’ ability to advocate in a clear and deliberate manner their clients’ position to alleviate any potential concerns that CFIUS may have.

“This requires the attorney making the effort to understand the business rationale and mechanics of the deal and then articulating to CFIUS why the deal helps, rather than harms, U.S. interests,” explains Hamid. ^{ALB}