



# FIRRMIA GRIP

Tightening controls on investment into critical industries is seen as key to slowing down Chinese advancement in the US and other countries.

**A**s China's wealth has exploded, so has its appetite for investing in or buying cutting-edge tech companies in the United States and Europe, oftentimes to get at the technologies that it craves. To prevent Beijing from reaching into these tech treasure chests, the United States and its allies are expanding and

fortifying investment regulations as one way to slow China's race for tech supremacy.

After its spectacular rise to emerge as the world's second-largest economy in less than a generation, China's leaders want no slowdown in advancement. The Chinese Communist Party ('CCP') has etched out

milestones that industries must meet for the nation to remain on track of its goals. In technology, one milestone is 2030. That is the CCP's deadline for China to become the world leader in artificial intelligence ('AI').

But since that goal was outlined in 2017, the United States and its allies have not only

imposed technology export controls and sanctions on China, they have also raised tough regulations on Chinese investments in companies working on the sensitive technologies that Beijing is after.

In Washington, the watchdog keeping an eye on China is the powerful Committee

around China. She refers to the bipartisan support in the US government for a tough line on Beijing as an indication of where policy is headed under the present administration.

On 8 June, the US Senate overwhelmingly passed the Strategic

equipment) and other kinds of medical/pharmaceutical areas that are not expressly covered by the current CFIUS regulations,' as well as expanded concerns around investments in agriculture and food supply, Townsend says.

Pursuant to FIRRMA, in February 2020, CFIUS gained expanded jurisdiction over the US real estate sector, obtaining the authority to suspend or prohibit foreign investments involving property rights over certain real estate that could pose national security concerns. Not content with cutting China from getting access to US technology, on 3 June President Biden issued an EO making it illegal for US persons to invest in technology in China, specifically in certain companies with alleged links to what the US Treasury refers to as the 'Chinese Military-Industrial Complex Companies.'



**'There is a lot more clarity around the implementation of the FIRRMA rules than there was in the past.'**

**Ryan Fayhee, Hughes Hubbard & Reed**

for Foreign Investment in the United States ('CFIUS'). Since August 2018, when then-President Trump gave it fangs with the Foreign Investment Risk Review Modernization Act ('FIRRMA'), CFIUS has been especially tasked with sniffing out Chinese investments in what it calls 'emerging and foundational technologies.'

In May, Ekso Bionics, a US manufacturer of robotic exoskeletons, disclosed it had received a CFIUS ultimatum to terminate its role in a 2019 joint venture with two Chinese partners. According to the known terms of the deal, in return for a small non-controlling investment by the Chinese parties, Ekso Bionics had licensed certain patented technologies to the joint venture. The plan was to build a manufacturing facility in China and manufacture products incorporating Ekso's technology for the Chinese and other Asian markets.

Tahlia Townsend, a partner at law firm Wiggin and Dana, says one has to guess at the exact rationale behind the ultimatum.

'Reading between the lines, it looks like CFIUS determined that the combination of the fairly modest investment into the US company by the Chinese entities and the IP (intellectual property) rights – the licence going the other way – would give those Chinese investors access to material that is non-public technical information, and thus trigger a CFIUS requirement,' she explains. 'IP licensing is of course a very common strategy, but there are circumstances under which IP licensing in conjunction with certain other things, like an investment by the licensee and concomitant access or other rights, can trigger a CFIUS review issue. I think this case is a pretty salutary example for industry.'

Townsend adds that there are good reasons to believe that CFIUS regulations will be further enhanced in the near future, including with respect to areas of concern

Competition Act of 2021, a bill that sees nearly a quarter-trillion dollars spent over the next five years on scientific research and technology to bolster competitiveness against China. The legislation is not expected to sail unchanged through Congress, but shortly after it passed the Senate, President Biden said he hoped to sign it into law 'as soon as possible.'

'For everything from national security to economic policy, there's a clear and urgent need to reorient the way our country views and responds to the challenge from China,' he said.

Townsend notes that the version that passed the Senate has conflicting provisions regarding a proposed expansion of CFIUS review to certain foreign gifts to, and contracts with, universities, but it looks as though that particular expansion of CFIUS authority won't now make it into law. The impetus that led to inclusion of such authority in an earlier version of the bill, however, is instructive about the temperature around China issues.

Townsend advises that another piece of legislation to watch is the US Pharmaceutical Supply Chain Review Act, introduced in April 2020, which calls for a

### **A little bit more certainty**

'Just the development and the implementation of the [FIRRMA] programme rules has created a little bit more certainty with which to judge Chinese investments,' says Ryan Fayhee, a partner at Hughes Hubbard in Washington, DC. 'There is a lot more clarity around the implementation of the FIRRMA rules than there was in the past.'

Fayhee agrees there are 'significant limitations to do wholesale acquisitions by Chinese companies in the United States and it's still difficult to avoid some of these critical CFIUS touchpoints, in particular companies that maintain significant amounts of personal data, or acquisitions that don't trigger some of the real estate related-rules or don't involve some core IP issues, particularly in the high-tech space.' But, he says, 'That doesn't mean Chinese companies can't invest in the United States and can't make their acquisitions. I think there's some room for investment, there's some room for acquisitions.'



**'Between them, CFIUS and the Commerce Department are trying to control all the routes that can be used to get US technology into Chinese hands.'**

**Barbara Linney, BakerHostetler**

look at the US pharma supply chain to determine over-reliance on foreign countries, especially China. 'We can also expect noises about expanding CFIUS reviews for non-controlling investments to areas like PPE (personal protective

Roy Liu, also a partner at Hughes Hubbard, and a colleague of Fayhee's in the DC office, observes that FIRRMA's mandatory filing rules, which apply to certain investments involving 'critical' technologies or foreign governments, has

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resulted in a 'really significant decline' in Chinese investment in the US technology sector.

'Because of the new FIRRMA mandatory notification rules and some of the adjustments to the other filing requirements, compared to a CFIUS filing, technology transfers are a more straightforward way for Chinese companies to acquire US technology,' Liu says. 'These days, Chinese companies that previously wanted to acquire US technology through acquiring a US technology company now just opt for outright licensed technology transfers,' he says.

Barbara D. Linney, a partner at BakerHostetler in Washington DC, says that CFIUS's long reach is among the top concerns of Chinese investors.

'There is a lot of concern on the Chinese investor side to understand whether a transaction is of a kind that CFIUS would have jurisdiction over, to understand whether the filing might be mandatory, and then to understand the likelihood that CFIUS would come back and review the transaction, even if the parties didn't file a voluntary notice,' she explains. 'The other thing that Chinese clients are very concerned about is what mitigation requirements might be imposed in the event that CFIUS is prepared to clear a transaction, but with conditions. The types of mitigation measures that could be required are an issue that companies do a lot of thinking about,' she explains.

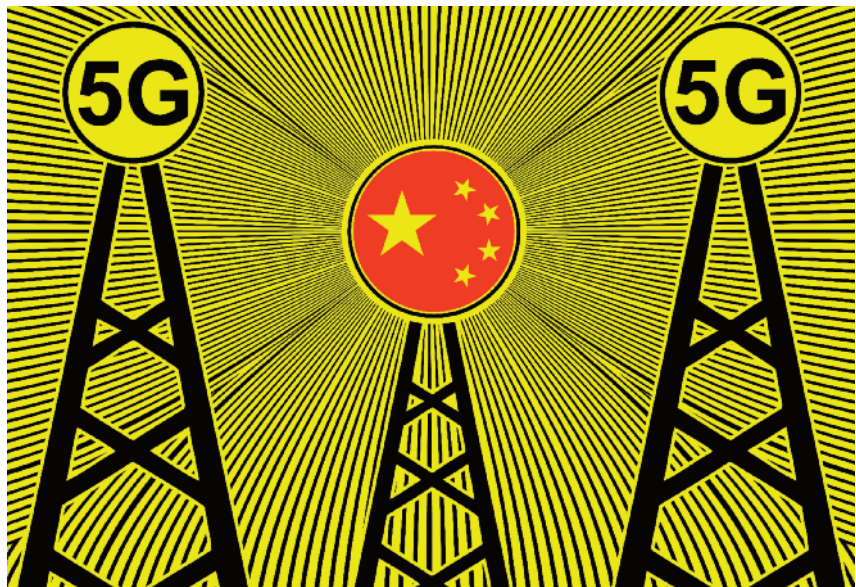
Linney adds that US tech companies looking for buyers or investors are themselves shying away from Chinese buyers or investors. 'What I would say is that most sellers would want to steer away from Chinese investors if they have other alternatives, and for the most part they usually do,' she says.

Linney notes that, between CFIUS and the Commerce Department, 'there's now a very broad net cast to be able to review transactions' by foreign investors.

She agrees with Roy Liu, saying that a Chinese investor may decide to acquire technology from a US company through a licensing agreement instead of investing in or buying the company in order to avoid CFIUS: 'That type of transaction could 'be subject to review by the Commerce Department under the new ICTS review regime,' she explains. 'So between them, CFIUS and the Commerce Department are trying to control all the routes that can be used to get US technology into Chinese hands.'

### CFIUS on the hunt

Brian Egan, a partner at the DC office of



### Onboarding allies

Giovanna M. Cinelli is a partner at law firm Morgan Lewis in Washington, DC and head of the firm's International Trade and National Security Practice. She says she has seen no slowdown in Chinese investments in US technology companies.

'I'm seeing Chinese investments continue, and we are actually seeing CFIUS filings being made for Chinese investments across industries. So, from that perspective, we're not seeing a slowdown,' she says.

'We do note a granular focus on proper export classification to make sure the definitions of critical technology are identified adequately so that parties can rely on those classifications to determine whether mandatory CFIUS filings are needed. And then we're seeing overall a much more refined due diligence process to make sure that any gap or areas of interest for the government can be identified earlier on in the transaction process,' she explains.

'We have identified some shifts in the parties that are making those investments and we're also seeing some phasing in of the investment. So perhaps four years ago we might have seen someone coming in to buy an entire company, for example that's dealing in advanced technologies. Now, we're starting to see in some circumstances that the investor is coming in and making only a partial investment,' she observes.

Cinelli notes that the United States is not alone in toughening regulations on Chinese investments, especially in cutting-edge technologies. Washington has been tremendously successful in engaging with allies and partners to implement their own robust foreign direct investment reviews, she adds. Japan has updated its export control and foreign direct investment regime, as has Australia; the European Union has published its framework and set out implementing regulations; the United Kingdom has established a regime and is in the process of full implementation later this year; France, Italy and Germany have either implemented programmes or expanded them; and Russia has put together a foreign direct investment regime that Cinelli says, 'is as robust as that of the US'.

Cinelli says there has been an 'enormous amount of granular information-sharing' with US partners and allies, which has likely contributed to the decisions they have taken on watching Chinese investments. The Clean Networks Initiative and the China Initiative, which were introduced under President Trump, were both designed to share information, she explains.

'They were designed to share information about the risks, where those risks exist and action for managing those risks,' Cinelli notes.

With the United States leading the way, the pressure on China is growing. In mid-June, the G7 group of rich nations agreed on plans to establish an alternative to China's 'Belt and Road' initiative, part of a push against Beijing that also included pressure on human rights, supply chains, support for Taiwan, and demands that China disclose more information about the origins of the Covid pandemic. The Belt and Road initiative is China's ambitious programme to build physical and digital infrastructure to connect countries from Asia to the Middle East, Africa and Europe.

On 14 June, NATO Secretary-General Jens Stoltenberg joined the chorus of criticism on China, when he called on the alliance to respond to China's economic, political and military rise.

'China is coming closer to us. We see them in cyber space, we see China in Africa, but we also see China investing heavily in our own critical infrastructure,' he told reporters at NATO headquarters before the start of a summit in Brussels.

'We know that China does not share our values ... we need to respond together as an alliance,' he said, adding that China was not an 'enemy or an adversary.'

law firm Steptoe, observes that one reason the United States has encouraged international partners to develop their own foreign investment review regimes to protect sensitive technologies, is to plug the holes where those technologies could escape.

“The concern that the US had sometimes stated is, for example “If we approve a UK investment in the United States, what’s to stop that UK investor from turning around and then selling that investment to a party that would be of concern to the US government,” Egan explains. ‘So they’ve really tried to move a US-style foreign investment review regime out into the world.’

Egan says that investors have had to become savvy about CFIUS regulations: “This has led to investors, either sovereign wealth funds or private equity funds who are frequent players in this space with start-ups or others, asking: “Has the start-up company done what it needs to do to be sure that it’s protected from a CFIUS perspective? Have they gone through filings where they are required or otherwise warranted?”

Egan notes that there have been instances where the CFIUS mandatory filing rules have caused problems among some investors.

“There’s friction that’s been created by

these rules where some parties think, “There is no reason the US government should be concerned about me; why should a filing be triggered just because I’m

already been consummated, some of which are several years old,’ says Egan. ‘There’s no kind of statute of limitations, if you will, on how far CFIUS can go back – and they’re



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**Brian Egan, Steptoe**

investing in a company that manufactures sensitive equipment in the United States?”

Egan adds that concerns over legal costs and filing fees, as well as the time that CFIUS takes to process a query, ‘has created some friction, I think, particularly with European investors who think that some of the rules are really unnecessary, and almost offensive in some cases.’

With the authority to unwind even years-old business ties with foreign partners, CFIUS has made no secret of its hunt for deals that it thinks threaten national security and should never have been made, particularly in relation to China.

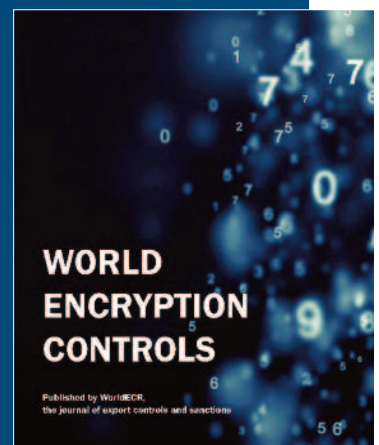
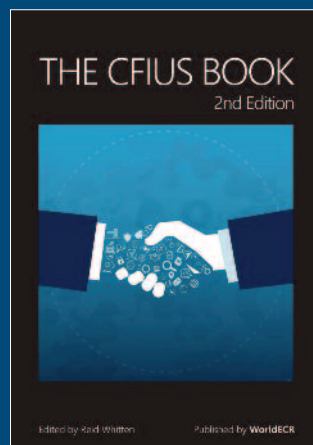
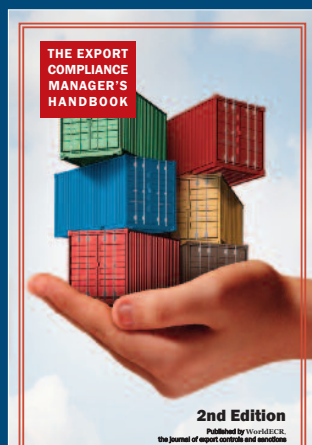
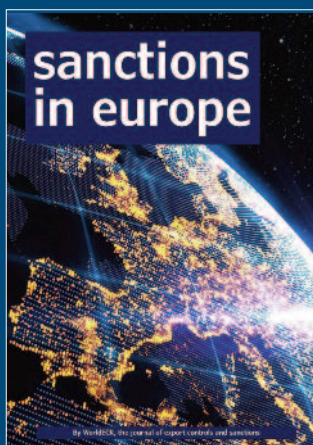
‘It’s absolutely true that CFIUS is investing a lot of resources in identifying and reviewing transactions that have

going back in some cases three, four, five years – maybe even longer.’

Egan adds that, while overall foreign investment in US hi-tech has not fallen due to the tougher regulations, ‘Chinese investment in the United States really has fallen off a cliff.’

‘The publicly reported data reflect that, and I think the reality of the marketplace also reflects that there was at some point in time when Chinese investors were really trying to figure out ways to continue investing without triggering CFIUS review or by avoiding areas where CFIUS would have the greatest interest,’ Egan says. ‘But I think that what we’re seeing increasingly is Chinese investors taking a pass on the US market for other marketplaces,’ he says. □

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