

The Pandemic's Early Effects On Foreign Trade, Investment

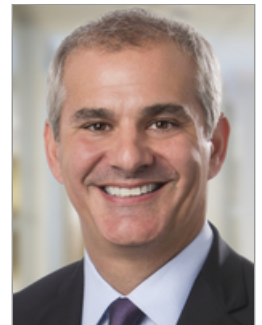
By **Michael Leiter and Daniel Gerkin** (April 3, 2020, 5:59 PM EDT)

As companies and investors navigate the COVID-19 pandemic, they will grapple both with operational disruptions and shifting legal and regulatory environments. On the latter fronts, there is some good news for those involved in cross-border investments and trade.

For the most part, the Committee on Foreign Investment in the United States continues to work without disruption, meaning that the filings made by parties with deals in progress are still being accepted, reviewed and approved.

Moreover, at least thus far, CFIUS' view of national security threats appears relatively steady albeit likely more attune to risks from foreign investment in the U.S. health care, pharmaceutical and related sectors. Although CFIUS has experienced no major disruptions thus far, dealmakers should be mindful of several considerations in this rapidly changing investment environment:

- We expect some delays in CFIUS' acceptance of future filings and potentially longer timelines for negotiating mitigation.
- We anticipate potential delays in further rulemaking, including implementing filing fees.
- CFIUS will continue its focus on China-related transactions, particularly on nonnotified transactions, but likely now with intensified focus on deals in the health and pharmaceutical sectors.
- Other governments, especially in the European Union, are also enacting protectionist measures.
- Some existing investments, whether or not previously approved, could become newly subject to CFIUS' jurisdiction owing to nationalization in Europe and other foreign countries.
- Export-controls reform may continue to lag.



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CFIUS Largely Continues Its Work, With Potential Delays Ahead

Although the cases currently before CFIUS continue apace, the committee may take more time to formally accept and review filings going forward. This delay would most likely result from the challenges CFIUS faces in conducting its more sensitive analysis, including the classified risk-based assessment generated by the U.S. intelligence community that cannot be completed or accessed outside secure government facilities.

Although such tasks have not yet been materially hampered, further spread of the pandemic and extended work-from-home requirements for the government may challenge CFIUS' ability to promptly accept new filings and clear less controversial matters in the initial 45-day review period. The need to triage deals and, potentially, to prioritize review of mandatory filings could also exacerbate delays.

An area where dealmakers could experience a relatively minor impact from COVID-19 is in prolonged timelines for CFIUS' further rulemaking. The comment period for CFIUS' proposed rulemaking on filing fees expires on April 3. Given the focus on keeping existing cases moving, CFIUS may delay publishing a final rule implementing these fees.

Likewise, CFIUS may further delay changes to its critical technology pilot program, whereby many anticipate a move away from using North American Industry Classification System, or NAICS, codes (the NAICS classifies businesses by their type of economic activity) to assess the sensitivity of a critical technology transaction.[1]

In contrast, CFIUS has continued to move forward with implementing its increased jurisdiction under the Foreign Investment Risk Review and Modernization Act of 2018, or FIRRMA. Notably, as part of its expanded jurisdiction over real estate transactions, on March 25 CFIUS released its new online mapping tool to help parties determine whether their transaction implicates sensitive U.S. government installations.[2]

CFIUS Continues Focus on Threats to National Security From Chinese Investment, Increasing Scrutiny on Health Sector and Pharmaceutical Supply Chain

Appreciating the U.S. government's steady attention to stemming the effects of the pandemic, CFIUS' mandate has not changed. The committee will continue to evaluate the risk of each new transaction in the same way it has until now.

Therefore, even in light of current market volatility, foreign investors should not expect CFIUS to relax its assessment of the risk posed by a time-sensitive transaction merely in order to encourage foreign investment — especially investment from Chinese companies and companies with strong ties to China.

CFIUS continues to heavily scrutinize China-connected transactions, including nonnotified transactions.

We expect, however, that the COVID-19 crisis will further accelerate CFIUS' existing focus on health care-related industries and expand its focus to what were previously considered less sensitive industries. In the past, CFIUS has aggressively pursued transactions that implicated U.S. persons' health care information, requiring the divestiture of two U.S. business that had been acquired by Chinese entities.[3]

What we have not previously seen, and may in the future, is a broader focus on sectors such as personal protective equipment, which rely heavily on supply chains based outside the U.S.

Recent statements by executive and legislative branch officials concerning the U.S.' reliance on China for its pharmaceutical supply chain reflect — and will likely increase — CFIUS' sensitivity to such areas.

For example, on March 25, U.S. Under Secretary of Defense for Acquisition and Sustainment Ellen Lord — who oversees the U.S. Department of Defense's CFIUS responsibilities — warned that it "is critically important that we understand that during this crisis, the [defense-industrial base] is vulnerable to adversarial capital, so we need to ensure that companies can stay in business without losing their technology."

Lord further cautioned that small businesses may be more likely to enter problematic arrangements with foreign investors owing to uncertainty surrounding the renewal of their defense contracts. We expect that pressure from lawmakers and attention from CFIUS and its member agencies will largely foreclose any relaxation on the types of deals that will be approved or, if not notified, escape the attention of CFIUS.

Lawmakers have expressed even more pointed concerns about reliance on China for the U.S.' pharmaceutical supply chain. Recently, Sen. Tom Cotton, R-Ark., and Rep. Mike Gallagher, R-Wis., introduced a bill to counter the growing U.S. dependence on Chinese-manufactured pharmaceuticals.

Similarly, in December 2019, Senate Minority Leader Chuck Schumer, D-N.Y., called on the U.S. Government Accountability Office to conduct an investigation into the U.S.' ability to manufacture pharmaceuticals, noting he was "greatly concerned by the strategic vulnerability created by [the U.S.'] reliance on China, a strategic adversary, for the [active pharmaceutical ingredients] used to manufacture a very wide range of lifesaving drugs that are vital to our healthcare system."

Although the current pandemic may have highlighted these tensions, the sensitivity expands beyond COVID-19. For example, according to data from the U.S. Department of Commerce, in 2019, about 80% of the U.S. supply of antibiotics was made in China.

Especially with increased scrutiny from lawmakers, we expect CFIUS and its member agencies to harshly examine any further foreign investments in the U.S. pharmaceutical supply chain, as well as potentially related joint ventures between U.S. and Chinese companies, or other cooperative research and development that CFIUS or other U.S. authorities might investigate.[4]

Non-U.S. Foreign Direct Investment Reviews: COVID-19 Quickens the Pace

As the U.S. looks to protect its own vulnerable businesses and supply chains, other governments are likewise increasing their scrutiny of foreign investment (including investments from the U.S.). Some of these foreign direct investment, or FDI, review measures, such as France's, are the result of long-planned reforms independent of the COVID-19 pandemic.

Others, however, are in direct response to the pandemic's economic and national security effects.[5] Supporting their efforts, the European Commission recently issued updated guidance to its member states regarding the EU's framework for FDI screening.[6]

Last year, the EU used its authority under the Treaty on the Functioning of the European Union to adopt a framework allowing member states to voluntarily adopt measures for screening third-party investments, from non-EU states, in EU companies.

As a direct result of the coronavirus crisis, on March 25, the EU issued further targeted guidance to member states concerning foreign direct investment.[7] Specifically, in light of shortages of medical supplies, interest in technology surrounding a potential vaccine and the financial pressures that EU companies are facing due to market volatility, the commission warned:

Among the possible consequences of the current economic shock is an increased potential risk to strategic industries, in particular but by no means limited to healthcare-related industries. The resilience of these industries and their capacity to continue to respond to the needs of EU citizens should be at the forefront of the combined efforts both at European Union and at Member State levels.

Accordingly, the EU formally requested that member states: (1) make full use of their existing FDI screening mechanisms to prevent or mitigate risks to critical health infrastructure and supplies; and (2) for those member states that have not yet enacted FDI screening, develop a screening mechanism and use any other tools available in the interim.

Given the independence with which each member state operates its own foreign investment reviews, the EU guidance does not result in any binding requirements, but we expect that individual states — as well as CFIUS — will carefully review any related investments.

The most aggressive use of foreign investment limitations related to COVID-19 has appeared in

Spain, which on March 17 adopted Royal Decree-Law 8/2020, which in response to the pandemic imposed new restrictions on foreign investment.[8]

Specifically, the Spanish law requires prior authorization of investments of 10% or more of a Spanish company's equity by non-EU or non-European Free Trade Association entities if the Spanish company operates in key sectors that include critical infrastructure and technology, media, or energy, or if the company has access to sensitive information.

Additionally, for a subclass of investors that includes sovereign wealth funds, all such investments require preapproval regardless of the sector in which the Spanish company operates.

Potential CFIUS Consequences: Non-U.S. Nationalization

Non-U.S. government intervention in response to the pandemic may also trigger CFIUS review, especially given recent CFIUS reforms that provide for mandatory filings for certain substantial government interest investments.

As foreign companies — many of which include U.S. businesses subject to CFIUS jurisdiction — face liquidity issues and the risks of insolvency, some foreign governments are making or increasing investments in said companies to provide greater financial stability.

FIRRMA requires a filing for any transaction in which a foreign government would obtain a substantial interest in a U.S. businesses that deals with certain critical technology, critical infrastructure and U.S. personal data.

For mandatory filings, "substantial interest" includes any situation where a foreign person obtains a 25% or greater voting interest, directly or indirectly, in a U.S. business if a foreign government in turn holds a 49% or greater voting interest, directly or indirectly, in the foreign person.

As foreign governments continue to consider making state investments into private companies, particularly those that have U.S. subsidiaries or own other interests in U.S. entities, companies will need to continually monitor and evaluate whether new CFIUS jurisdiction arises and if so, whether any mandatory filing requirements are triggered.

Thus far, specific plans for foreign governments to nationalize their domestic businesses have been focused on the transportation sector (e.g., airlines and train companies), which is less likely to implicate CFIUS.

More broadly, the additional government assistance being offered in Europe and the U.K. widely centers on tax advantages, grants and loans rather than equity investments; however, in a fluid and rapidly changing environment, nationalization measures could extend to other sectors.

Export Controls: Business as Usual, But Reform May Lag

Although as of March 21, more than 50 countries have imposed export restrictions on certain medical items to bolster their ability to satisfy domestic demand, the U.S. has taken no such steps. The U.S. Department of Commerce, Bureau of Industry and Security, or BIS, which administers the export administration regulations, is continuing its work, though we expect delays in processing and response times.

Some broader BIS initiatives appear to be proceeding without significant disruption, but we expect others will continue to lag. For example, the BIS reportedly has reached agreement on changes to the foreign direct product rule that will inhibit the ability of non-U.S. foundries that use U.S.-origin semiconductor manufacturing equipment to supply chips to Huawei, but these have not yet been released publicly.

The BIS also recently further extended its temporary general license pertaining to Huawei and requested comments from the public related to future extensions of the temporary general license, the deadline for which has been extended until April 22.

Less insight exists on longer-term BIS projects. The BIS has yet to issue any proposed rules

regarding what might be considered emerging technologies, as required by the Export Control Reform Act of 2018, and has yet to issue an advance notice of proposed rulemaking that identifies representative categories of foundational technologies, as also mandated by the ECRA.

The Department of Commerce is also actively reviewing interested party comments pertaining to its proposed rulemaking implementing the May 2019 Executive Order on Securing the Information and Communications Technology and Services Supply Chain, but has made no public statements. We would not be surprised if both initiatives are further delayed.

Other U.S. agencies with responsibility for cross-border trade, however, have actively taken steps to address the pandemic. In particular, the Office of the U.S. Trade Representative has excluded a number of items, including face masks, from the imposition of Section 301 tariffs and has solicited comments (which are due by June 25) on possible further modifications to remove duties from additional medical care products.

In contrast, U.S. Customs and Border Protection has thus far resisted calls from industry for an across-the-board tariff moratorium of three months to enable businesses to reduce costs during the crisis.

Finally, the president recently exercised his authority under the Defense Production Act of 1950 to compel General Motors Corp. to accept, perform and prioritize federal contracts for ventilators.[9] However, he thus far has not issued a proposed executive order that would trigger a reshoring of pharmaceutical and medical supply production and require certain federal agencies to purchase only American-made pharmaceutical ingredients, raw materials, medical equipment and medical supplies.

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[1] Detailed discussion of CFIUS' pilot program for critical technology, including the reference to NAICS codes, is available in our Oct. 11, 2018, client alert "CFIUS Pilot Program Expands Jurisdiction to Certain Noncontrolling Investments, Requires Mandatory Declarations for Some Critical Technology Investments."

[2] Analysis of CFIUS' expanded jurisdiction over real estate and details about FIRRMA are available in our Jan. 16, 2020, client alert "CFIUS' Final Rules: Broader Reach, Narrow Exceptions and Foretelling Future Change." CFIUS' new tool to evaluate whether a transaction involves sensitive real estate is available indirectly through the U.S. Department of the Treasury website.

[3] Analysis of CFIUS' forced divestments of Chinese acquisitions in Grindr (a company that collects personal user data including HIV status) and digital health company Patients Like Me is available in our Jan. 21 client alert "CFIUS' First Full Year Under FIRRMA."

[4] For example, in January 2020, Harvard Professor Charles Lieber was charged by the U.S. government with lying to federal investigators after allegedly agreeing to conduct research, publish articles and open a research lab for China's Wuhan University of Technology in exchange for cash payments, all while concealing this arrangement from Harvard University and the U.S. government.

[5] For more on efforts in Europe and the U.K., see our March 27 client alert "Europe and the UK Race To Protect Businesses Impacted by the Coronavirus Pandemic: Foreign Investment, State Aid and Antitrust Rules Adjusted." For more on French regulations, see our March 30 client alert "France

Completes Major Foreign Investment Reform.”

[6] A more detailed explanation of the existing framework is available in our July 1, 2019, client alert “EU Adopts Regulation on Foreign Direct Investments.”

[7] https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf.

[8] <https://www.boe.es/boe/dias/2020/03/18/pdfs/BOE-A-2020-3824.pdf>.

[9] See our March 20 client alert “President Trump Invokes the Defense Production Act in Response to COVID-19.”