



CFIUS/National Security: 2023 Year-in-Review and 2024 Predictions

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It's been another big year on the national security front. The Biden administration finally published its long-awaited Executive Order (E.O.) restricting U.S. investors from making investments in Chinese companies working on certain technologies and products. Evidence is mounting that the Committee on Foreign Investment in the United States (CFIUS or the Committee) is taking longer than ever to process transactions and, even when foreign investors can avoid CFIUS review, local communities are starting to fill the gaps in CFIUS's authorities by making certain investments untenable. Finally, the Department of Energy (DOE) issued proposed guidance on its interpretation of "foreign entity of concern" (FEOC), a term that is becoming popular in national security-related statutes and regulatory frameworks.

In this post, we recap these and other major national security-related developments from the past year, and we offer a few predictions for 2024.

1. GRAND FORKS CITY COUNCIL BLOCKS FUFENG PROJECT

Fufeng USA is the U.S. subsidiary of Fufeng Group, Ltd., a Chinese food manufacturer. In 2022, Fufeng USA purchased approximately 300 acres of land in North Dakota and announced plans to build a corn mill processing plant at that location. The transaction raised national security alarms because the proposed site for the corn mill processing plant was located approximately 12 miles from Grand Forks Air Force Base, which is reportedly home to top-secret drone technology.

In late 2022, Fufeng USA announced that CFIUS had conducted a review of the transaction and concluded that it did not have jurisdiction over Fufeng USA's acquisition of land near the Grand Forks Air Force Base, which meant that the project could go forward.

CFIUS's lack of jurisdiction was surprising given that CFIUS has authority to review real estate deals near military bases identified as sensitive. CFIUS's real estate regulations include two lists of bases: a sensitive base list and a highly sensitive base list. CFIUS has jurisdiction over any transaction where a foreign person buys real estate within one mile of a base on the sensitive base list, and it has jurisdiction over similar real estate deals within 99 miles of bases on the highly sensitive base list.

Fufeng USA purchased real estate approximately 12 miles from Grand Forks Air Force Base. If that base was included on the list of highly sensitive bases in CFIUS's regulations, then CFIUS would have had jurisdiction to review the transaction and force Fufeng USA to sell the land. But the Department of Defense (DoD) had not included the Grand Forks Air Force Base on the highly sensitive base list. In fact, DoD had not even included the Grand Forks Air Force Base on the sensitive base list. Because the Grand Forks Air Force Base was not included on either list, CFIUS had no way to assert jurisdiction over the real estate transaction.

Because CFIUS could not act, local officials took matters into their own hands. On February 6, 2023, the Grand Forks City Council reportedly voted to block the project. According to news reports, the city council does not have authority to force Fufeng USA to sell the 300 acres of land that it has already purchased, but it can refuse to grant building permits and deny access to infrastructure, making it untenable for Fufeng USA to go forward with the project.

As the Fufeng transaction illustrates, foreign investors need to understand the legal rules governing foreign investment in the United States, but they also need to pay attention to the business climate. One of the key lessons of the Fufeng transaction is that even if the federal government does not have authority to block or mitigate a transaction, state and local governments are starting to fill the gaps, using authorities unrelated to foreign investment to make investments untenable.

2. CFIUS ADDS EIGHT MILITARY BASES TO CFIUS'S JURISDICTION

Following the Fufeng transaction, DoD moved quickly to add the Grand Forks Air Force Base, and several other Air Force bases, to CFIUS's list of highly sensitive bases. On May 5, 2023, CFIUS proposed to add eight new bases to the highly sensitive base list, and on September 22, 2023, the changes became final.

Under CFIUS's revised regulations, it now has jurisdiction over any transaction wherein a foreign person acquires real estate within 99 miles of the following bases:

- Air Force Plant 42, located in Palmdale California
- Dyess Air Force Base, located in Abilene, Texas
- Ellsworth Air Force Base, located in Bad Reichenhagen, South Dakota
- Grand Forks Air Force Base, located in Grand Forks, North Dakota
- Iowa National Guard Joint Force Headquarters, located in Des Moines, Iowa
- Lackland Air Force Base, located in San Antonio, Texas
- Laughlin Air Force Base, located in Del Rio, Texas
- Luke Air Force Base, located in Glendale, Arizona

Foreign investors looking to acquire real estate near these bases need to account for CFIUS's new real estate jurisdiction when they conduct due diligence on potential investments. Moreover, foreign investors looking to purchase existing U.S. businesses with operating locations near these bases are on notice that CFIUS may have national security concerns with their transactions. By placing these bases on the list of highly sensitive bases, DoD is making clear to foreign investors that it will likely scrutinize foreign investments anywhere near these locations.

3. CFIUS PUBLISHES NEW FAQs REGARDING MANDATORY FILINGS AND DISCLOSURE REQUIREMENTS FOR INVESTMENT FUNDS

On May 11, 2023, CFIUS published two new frequently asked questions (FAQs) on its website. The new FAQs provide additional guidance on (1) timing for mandatory filings and (2) ownership disclosure requirements for investment funds. CFIUS does not have many FAQs—and they are not frequently updated—so the new FAQs are particularly noteworthy and provide helpful insight into the areas where CFIUS is most focused.

One new FAQ makes clear that transaction parties are required to submit a mandatory CFIUS filing at least 30 days before closing, even if the transaction parties have deliberately structured the transaction so that the foreign

investor only obtains passive economic rights at closing and will not obtain any other governance or contractual rights (e.g., control rights, boards seats, access to information) until after the transaction clears a subsequent CFIUS review.

For example, if Company A acquires a 25% ownership interest in Company B on July 1, but its right to control Company B is deferred until after CFIUS reviews the transaction, the transaction parties must still submit a mandatory filing by June 1. The transaction parties cannot close the transaction on July 1 and then submit a CFIUS filing 30 days before the foreign investor obtains its right to control Company B. If the transaction parties fail to submit a mandatory filing by June 1, they will have breached the mandatory filing provision, making them subject to a potential enforcement action.

The other new FAQ makes clear that CFIUS has the right to request information about all foreign investors that are involved in a transaction, directly or indirectly, including limited partners (LPs) in an investment fund. The FAQ notes that CFIUS expects to receive information about LPs even if the investment fund made prior arrangements to limit disclosure of the identity of the foreign LPs, such as in a nondisclosure agreement. The FAQ further notes that CFIUS may also request information with respect to any governance rights and other contractual rights that the foreign LPs may have in the fund or the fund's portfolio companies.

For more information about CFIUS's new FAQs, please see our [blog post](#) from earlier this year.

4. GOTION SAYS CFIUS HAS NO JURISDICTION OVER PROPOSED BATTERY PLANT

On or about June 13, 2023, Gotion, Inc., the U.S. subsidiary of Chinese company Gotion High-Tech, an electric vehicle manufacturer headquartered in China, announced that it had notified CFIUS of its plans to build a US\$2.4B electric vehicle battery plant in Mecosta County, Michigan, and that CFIUS had determined that it did not have jurisdiction over the transaction, allowing the project to move forward.

CFIUS has jurisdiction when a foreign person makes an equity investment in an *existing* U.S. business. CFIUS does not have jurisdiction, however, when a foreign person builds a new business in the United States, commonly referred to as a "greenfield" investment. The only time that CFIUS has jurisdiction over a "greenfield" investment is when a foreign person buys real estate within a certain distance of sensitive military installations (as noted above). But the proposed Gotion plant was not close enough to any military bases to give CFIUS real estate jurisdiction over the transaction, leaving CFIUS unable to prevent or mitigate the Gotion investment.

According to [news reports](#), in November 2023, all of the board members of a local township were recalled because of their support for the Gotion battery plant, and at a meeting in December 2023, a newly elected township board [voted](#) to rescind official support for the project.

The Gotion transaction, like the Fufeng transaction, is another data point showing that state and local government leaders are getting involved in policing foreign investments in their areas, especially when CFIUS does not have jurisdiction to review a transaction. Accordingly, foreign investors need to understand more than just CFIUS authorities if they want to make successful investments in the United States.

5. CFIUS'S ANNUAL REPORT SHOWS TROUBLING SIGNS FOR DEALMAKERS

On July 31, 2023, CFIUS published its annual report providing statistics for calendar year 2022, and the statistics were not great for dealmakers. We're not going to review all of the takeaways from this year's annual report. If you want a complete overview, please see the [client alert](#) we published earlier this year in *Financier Worldwide*. For this year-in-review, we focus on three main points:

First, in 2022, CFIUS set a new record for the highest number of withdraw-refiles in a single year. As most CFIUS watchers know, the CFIUS process ordinarily takes up to 90 days. At the 90-day mark, CFIUS is supposed to either clear the transaction (with or without mitigation) or refer the transaction to the President. However, when CFIUS reaches the 90-day deadline, it can ask the parties to withdraw their Notice and refile it, which restarts the 90-day clock. This is commonly referred to as a "withdraw-refile." There is no limit on the number of times that CFIUS can do this, and some cases have to go through multiple withdraw-refiles before they clear the CFIUS process. The 2022

spike to the highest number of withdraw-refiles indicates that CFIUS is struggling to get its work done within the 90-day statutory deadline.

Second, the Committee set a new record in 2022 for the highest number of mitigation agreements. CFIUS reviews transactions for national security risks. If the Committee identifies a risk, then it has two main options. It can either refer the transaction to the President with a recommendation to block the deal, or it can enter into a mitigation agreement with the transaction parties. A mitigation agreement is a contract between the transaction parties and the government where the transaction parties agree to do certain things to reduce the risk to U.S. national security arising from the transaction. Setting a new record for the highest number of mitigation agreements in CFIUS's history means that CFIUS is finding more national security risks when it reviews transactions.

Third, the Committee set a new record for the highest number of Notices requested for transactions that were originally filed as Declarations. In 2020, CFIUS unveiled a new, streamlined process (often referred to as the Declarations process), wherein transaction parties can submit a shorter filing and CFIUS has only 30 days to decide on whether to clear the transaction. While the Declarations process seems like it would be faster (and more preferable) than the regular 90-day process for Notices, that's not always the case. At the end of the Declarations process, the Committee can request that the parties submit a Notice. If that happens, then the transaction parties haven't really accomplished anything by submitting the Declaration other than to add 30 days to the regular 90-day clock. CFIUS requesting Notices at the end of the Declarations process makes the Declarations process less efficient for transaction parties, and this record indicates that the efficiency of the Declarations process is suffering.

Notably, CFIUS set these new records for withdraw-refiles, mitigation agreements, and Notice requests at the same time that Chinese companies appear to be filing fewer transactions with the Committee, which means the Committee is spending more time and resources picking apart transactions from countries regarded as neutral, or even as partners and allies.

Overall, the annual report for 2022 shows that the CFIUS process is becoming more difficult to negotiate in a timely and predictable manner and—in some cases—transactions can get bogged down in the CFIUS quagmire for several months.

6. U.S. ANNOUNCES NEW RESTRICTIONS ON OUTBOUND INVESTMENT TO CHINA

On August 9, 2023, the Biden administration issued its long-awaited E.O. announcing new restrictions on the ability of U.S. investors to invest in Chinese companies developing certain types of sensitive technologies and products.

The new E.O. is titled "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern." The only "country of concern" identified in the E.O. is the People's Republic of China (including the Special Administrative Regions of Hong Kong and Macau). Thus, although China is not mentioned in the title of the E.O., it appears to be the new E.O.'s main focus.

The E.O. directs Treasury to identify sensitive technologies and products within the following three industry sectors: (1) semiconductors and microelectronics; (2) quantum information technologies; and (3) artificial intelligence.

If China's development of a technology or product in one of these three sectors would present an "acute" threat to U.S. national security, then the E.O. directs Treasury to publish regulations *prohibiting* U.S. persons from making outbound investments in Chinese companies working on those technologies and products.

If China's development of a technology or product would not present an "acute" threat but may "contribute" to the threat to U.S. national security posed by China, then the E.O. directs Treasury to issue regulations requiring U.S. persons to *notify* Treasury of such investments.

In other words, the E.O. requires Treasury to issue regulations that would prohibit U.S. investors from investing in certain Chinese companies. The E.O. also requires Treasury to issue regulations that would require U.S. investors to notify Treasury if they have invested in other Chinese companies.

The same day that the White House issued its new E.O., Treasury published an Advance Notice of Proposed Rulemaking (ANPRM) providing an initial framework for the regulations required by the executive order. Treasury

refers to this entire project as the “outbound investment program.”

The ANPRM notes that unlike CFIUS, the outbound investment program will not review transactions on a case-by-case basis. Rather, investors will be responsible for reviewing the regulations and making their own determinations on whether a particular investment is prohibited, requires notification, or can be made without notification.

The ANPRM further notes that the outbound investment program is not intended to prohibit all investments in China. Nor is it intended to create sector-wide bans on all investments in (1) semiconductors and microelectronics, (2) quantum information technologies, and (3) artificial intelligence. Rather, per the ANPRM, the program will be designed to prohibit or require notification of investments in Chinese companies working on a narrow, targeted set of technologies and products within those three industry sectors. The ANPRM included an initial list of technologies and products that will be subject to a prohibition or notification requirement so the private sector could get an early look at, and provide feedback on, the types of technologies and products that could be covered by the program.

The new outbound investment program envisioned by the E.O. and ANPRM will obviously have significant implications for U.S. private equity and venture capital firms that do business in China, particularly those that invest in the semiconductor and microelectronics industry.

For a more detailed overview of the E.O. and ANPRM, please see our [client alert](#) published earlier this year.

7. WALL STREET JOURNAL REVEALS DETAILS OF INTERNAL CFIUS DELIBERATIONS

On August 12, 2023, the *Wall Street Journal* published an article titled, “[A DuPont China Deal Reveals Cracks in U.S. National-Security Screening](#).” The article reveals fairly detailed information about a transaction wherein the U.S. chemical company DuPont sold its sustainable-materials business to a Chinese entity.

According to the article, following a cabinet-level meeting that included Secretary of Defense Lloyd Austin and Secretary of the Treasury Janet Yellen, members of CFIUS were split on whether to prohibit the transaction or approve the transaction subject to a mitigation agreement. Pentagon officials seeking to block the deal requested a meeting with President Biden, but the request was declined. The officials spoke to National Security Advisor Jake Sullivan, but he instructed the agencies to work it out themselves.

Ultimately, CFIUS agreed to clear the transaction subject to a mitigation agreement. But shortly after the deal was signed, the parties notified CFIUS that the mitigation agreement was allegedly breached. According to the article, Pentagon officials suspected the breach was intentional, causing DoD and DOE to refer the matter to the Federal Bureau of Investigation.

The article is noteworthy because CFIUS is supposed to be a highly confidential process, and government officials can be subject to criminal penalties if they leak information about a CFIUS matter. As a result, articles like this that give a detailed, blow-by-blow account of internal CFIUS deliberations are rare. The Wall Street Journal article also highlights some of the dysfunction that is causing the number of withdraw-refiles, mitigation agreements, and Notice requests to spike, as reflected in this year’s annual report.

8. PRESIDENT BIDEN RELEASES NEW EXECUTIVE ORDER ON ARTIFICIAL INTELLIGENCE

On October 30, 2023, President Biden issued a sweeping E.O. on Artificial Intelligence (AI), titled, “[Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence](#)” Given the potential risks posed by AI, the E.O. attempts to create a framework for a coordinated, federal government-wide approach to developing AI in a safe, secure, and trustworthy manner.

Specifically, the E.O. directs federal agencies to perform certain tasks relating to AI. For example, the National Institute of Standards and Technology (NIST) is directed to develop industry standards for the safe development of AI systems, including generative AI and dual-use foundation models. The E.O. also requires NIST to establish guidelines for AI developers to conduct AI red-teaming tests, meaning structured tests for finding flaws and vulnerabilities in an AI system.

Similarly, the Department of Commerce (Commerce) is tasked with requiring companies to submit reports to the government whenever they intend to develop dual-use foundation models or acquire a large-scale computing cluster. Commerce is also required to propose regulations that would require Internet-as-a-Service providers (e.g., AWS, Microsoft Azure) to report to the government whenever a foreign person trains AI models on the servers in their data centers that could be used in malicious cyber-enabled activity.

Finally, among other things, the Department of Homeland Security is required to submit a report to the President on AI models that may present a chemical, biological, radiological or nuclear (CBRN) threat to the national security of the United States.

These are just some of the tasks included in the E.O. The E.O. is 36 pages long. Under the E.O., virtually every federal agency is required to conduct a study, submit a report, or draft regulations relating to AI. The Biden administration is clearly using the E.O. to jumpstart the federal government's regulation of the development and use of AI.

9. DOE PUBLISHES GUIDANCE ON “FOREIGN ENTITIES OF CONCERN”

On December 4, 2023, DOE published its proposed interpretation of the statutory definition of FEOC in the Infrastructure Investment and Jobs Act of 2021, commonly known as the Bipartisan Infrastructure Law (BIL). For a detailed review of DOE's proposed interpretation, please see the [client alert](#) we published earlier this month.

This definition is important because the BIL and the Inflation Reduction Act of 2022 (IRA), provide significant government subsidies for companies operating in the advanced battery supply chain in the United States. But the government subsidies are not available for companies that have FEOCs in their supply chain. Accordingly, companies in the advanced battery supply chain that want access to BIL or IRA money need to know how to identify whether any of their upstream suppliers are FEOCs.

Per DOE's proposed guidance, a FEOC is a foreign entity that is subject to the jurisdiction of a covered nation government, which effectively means China. An entity is subject to the jurisdiction of the Chinese government if the entity is incorporated in China, has its principal place of business in China, or is a non-Chinese entity that processes or manufactures battery components and materials in China. In other words, the proposed guidance makes clear to manufacturers that removing FEOCs from their supply chain means not only removing Chinese entities but also removing battery materials and components made in China (regardless of who made them).

Per DOE's proposed guidance, a FEOC is also a foreign entity that is controlled by a covered nation government, where control is defined to mean 25%. Thus, under DOE's proposed interpretation, a foreign entity qualifies as a FEOC if 25% or more of the equity, voting rights, or board seats of the entity are owned (directly or indirectly) by the Chinese government. Under DOE's proposed guidance, a foreign entity would also qualify as a FEOC if it has entered into a contract or licensing agreement with a FEOC (controlled by a foreign government), and the contract or license gives the FEOC the ability to exercise “effective control” over the non-FEOC's operations. In other words, DOE's proposed interpretation of FEOC would not only consider whether the Chinese government owns equity in an entity, but would also look to see whether the Chinese government can exercise effective control over an entity via contractual or licensing arrangements.

10. HOUSE COMMITTEE FOCUSED ON CHINA RELEASES YEAR-END REPORT

Finally, on December 12, 2023, the Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party (the China Select Committee) issued a major new [report](#) calling for a new strategy for America's economic and technological competition with the People's Republic of China (PRC). Drawing upon a year of public hearings and events, the China Select Committee's report contains a list of policy recommendations for how the United States can (1) reset the terms of its economic relationship with the PRC, (2) stem the flow of U.S. capital and technology fueling the PRC's military modernization and human rights abuses, and (3) invest in technological leadership and build collective economic resilience in concert with allies.

If anything, the China Select Committee's report makes clear that “U.S. competition with China,” “national security,” and “geo-political risk” are terms that will remain front and center in 2024.

PREDICTIONS FOR 2024

- 1. Dealmakers will continue to have trouble negotiating the CFIUS process in a predictable and timely manner.** Over the past several years, CFIUS has grown significantly. At the same time, the number of transactions involving Chinese investors appears to have declined. If there are fewer Chinese transactions, what is CFIUS doing with all its new resources? The answer is: it is scrutinizing transactions not involving Chinese investors, searching for anything that looks like a national security risk. That means that transactions that do not appear to raise national security issues are getting caught in the CFIUS quagmire more frequently, as CFIUS's national security concerns become more and more speculative.
- 2. CFIUS will issue new regulations updating FIRRMA.** At this year's annual CFIUS conference, Treasury announced that changes to the 2018 Foreign Investment Risk Review Modernization Act (FIRRMA) regulations were forthcoming, and that Treasury would likely be issuing one or more Notices of Proposed Rulemaking in 2024.
- 3. CFIUS will publicize enforcement actions.** At this year's annual CFIUS conference, Treasury also announced that it has already issued two new penalties and that other potential penalties were pending.
- 4. Treasury will continue to advance new regulations for outbound investment program.** Treasury issued its ANPRM for the outbound investment program on August 13, 2023. The next step is for Treasury to issue a Notice of Proposed Rulemaking and, after its reviews all comments, issue a final rule. We predict that Treasury will look to issue its final rule before the end of next year. After the rule becomes final, we expect that U.S. investors will need to perform due diligence on whether investment targets are subject to a prohibition or notification requirement under Treasury's outbound investment program. We further predict that U.S. investors will start to request representations and warranties from investment targets that they do not fall within the scope of the outbound investment program.
- 5. DOE will issue final rules on its interpretation of FEOC.** In 2024, we predict that companies in the advanced battery supply chain will start performing due diligence on whether their suppliers and business partners qualify as FEOCs, and transaction documents and contracts will likely start to contain representations and warranties that the relevant parties are not FEOCs. We do not anticipate that there will be significant changes from DOE's proposed guidance, so companies should start performing due diligence on their supply chains using the definition of FEOC set forth in DOE's proposed guidance.

Please contact the authors or your Winston & Strawn relationship attorney if you have any questions or need further information.

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