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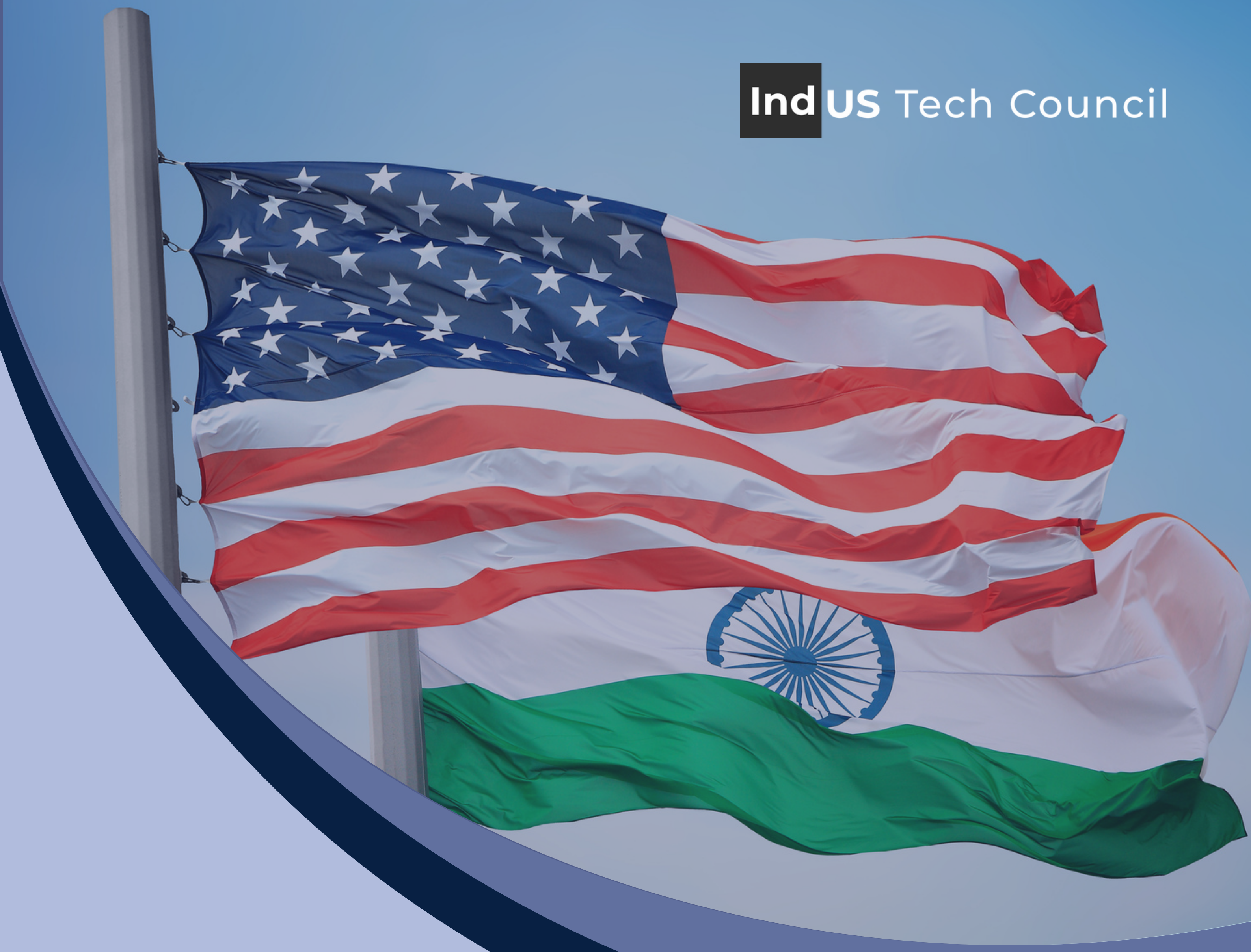

ADAPTING TO THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS): ENHANCING INDIAN HIGH TECHNOLOGY INVESTMENTS IN THE UNITED STATES

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Introduction

The United States attracts the highest foreign direct investment (FDI) globally, with India emerging as one of the fastest-growing investors in the country. According to latest report of Confederation of Indian Industry, Indian companies have invested over $40 billion in the U.S., leading to the creation of more than 425,000 direct jobs. Despite this growth, India's contribution to total FDI in the U.S. remains below one percent, as Western countries, Japan, and China continue to dominate as major investors.

The limited surge in Indian investments in the U.S. can be attributed to the stringent regulatory framework, particularly the Committee on Foreign Investment in the United States (CFIUS) and International Traffic in Arms Regulations (ITAR). These regulations pose challenges for potential investors. The focus of the report is on CFIUS and explores ways for Indian investments to increase in the presence of such regulatory frameworks.

Committee on Foreign Investment in United States

CFIUS, headed by the U.S. Department of Treasury, is an interagency committee authorized to review certain foreign investment and real estate transactions by foreign persons to assess their impact on the national security of the United States.

The committee operates in accordance with the amended 1950 Defense Production Act that empowers the President to suspend, block, or make alterations to transactions, if such transactions threaten the U.S. national security.

Moreover, in cases where transactions have already been finalised, the president can seek divestment or other option if considered necessary for the national security concerns. As seen below in specific instances involving Indian firms, these instances have been applied. However, before examining these cases, the report briefly outlines CFIUS's jurisdiction. It queries whether the committee reviews all foreign investments in the U.S. or targets specific instances. The report also investigates if CFIUS expanded its authority due to increased investments by adversarial actors, notably China. Lastly, it ponders whether U.S. allied investors, like India, should have concerns about CFIUS.

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Jurisdiction of CFIUS

Before the enactment of Foreign Investment Risk Review Modernization Act (FIRRMA) in 2018, the jurisdiction of CFIUS was limited to reviewing transactions that gave foreign entities “control” over a U.S. business. “Control” broadly refers to power, whether exercised or not, to determine, direct or decide significant matters affecting a business unit. For instance, the purchase by a non-U.S. entity of eight percent of a U.S. business with rights to dismiss or appoint officers or to terminate significant contracts, would come under the jurisdiction of CFIUS, regardless of the small percentage purchased.

With FIRRMA and its final rule, CFIUS’s core jurisdiction over “covered transactions” remains largely unchanged. “Covered control transactions,” according to new regulation, refers to transactions involving foreign individuals or entities that might lead to foreign control of a U.S. business.

In addition to the “covered control transactions,” the committee can also review foreign investments that don’t result in foreign “control” of a U.S. business, however, under two conditions. First, the non-controlling foreign investment must be in a U.S. business operating in security sensitive business sectors. The final rule defines such business sectors as “TID U.S. businesses,” (TID refers to the initial capital letters of the words Technology, Infrastructure, and Data). Second, the investment must grant the foreign investor specific rights in the U.S. business.

This expanded framework highlights the significance of analysing all investors in a transaction, including limited partners. However, it's important to note that not every foreign investment in the United States comes under the scrutiny of CFIUS. Instead, the committee's attention is directed towards specific cases that might pose potential national security risks. This targeted approach allows CFIUS to concentrate its resources on transactions and investments that have the potential to impact the country's security landscape.

CFIUS authority and Chinese investments

The table below demonstrates the way CFIUS's authority bolstered with the passage of time:

YEAR	EVENT DESCRIPTION
1975	Establishment of CFIUS.
1988	Enactment of the Exon-Florio Amendment, granting the 'president' authority to block foreign acquisitions.
2007	Dubai Ports World controversy highlights concerns over foreign control of U.S. ports.
2012	President Obama's block of a Chinese-owned company's wind farm acquisition due to national security.
2018	Foreign Investment Risk Review Modernization Act (FIRRMA) expands CFIUS jurisdiction and authority
2020	CFIUS introduces additional regulations and guidelines for implementing FIRRMA changes.
Ongoing	CFIUS evolves to address changing national security challenges and risks from foreign investments.

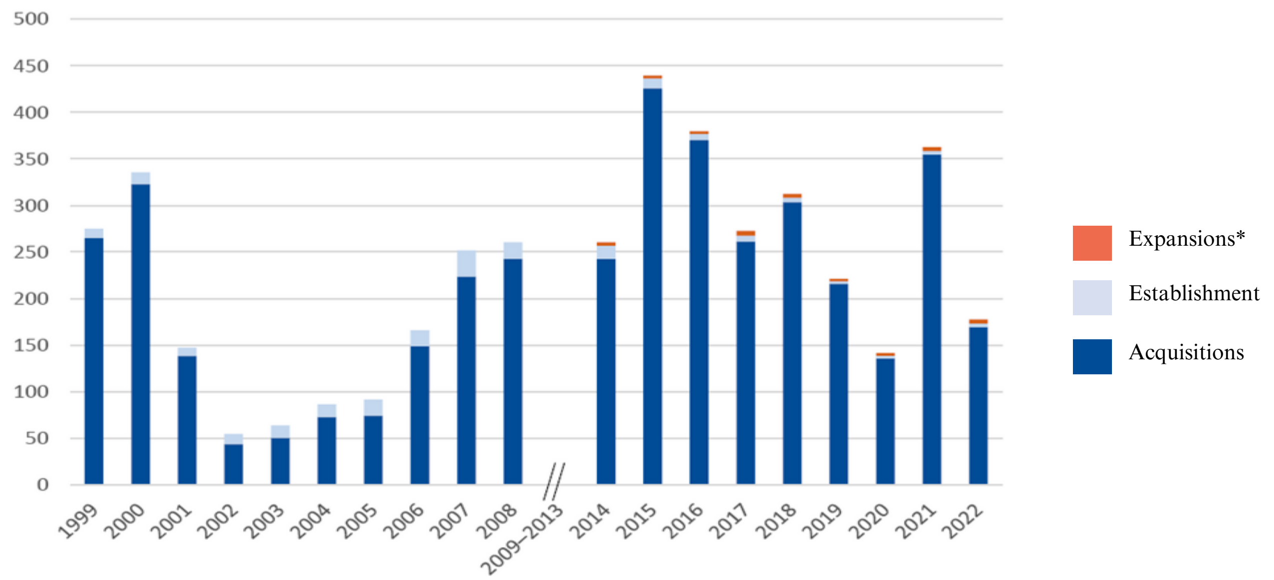
Yes, recent heightened national security concerns regarding rising Chinese FDI have led to the adoption of stringent CFIUS measures.

Over the past decade, there has been a noticeable surge in Foreign Direct Investment (FDI) within the United States, sparking concerns regarding foreign influence over critical U.S. firms. This trend commenced in the 1990s, witnessing a substantial increase in FDI inflow from $71.23 billion in 1990 to its peak of more than $400 billion in 2015. Notably, major investing nations during this period included Japan, Germany, Canada, the United Kingdom, Ireland, and France.

However, a significant shift occurred between 2013 and 2019, characterized by a substantial contribution to FDI growth from countries such as India remained relatively modest, amounting to around $4 billion during the same year (refer to Figure 2).

Furthermore, as depicted in Figure 3, the nature of China's FDI transactions predominantly exhibited a "covered" characteristic, raising concerns regarding national security concern of the United States. Upon comparing the instances of “covered transactions” between India and China, it becomes evident that India's “covered transactions” never exceeded a count of six. In contrast, China consistently maintained a minimum of six covered transactions, highlighting a distinct contrast between the two countries.

Figure 1



Note 1: Expansions are included in 2014 to present

Note 2: The survey used to produce these statics was not conducted between 2009-2013

New FDI by type in United States, 1999-2022

Source: U.S. Department of Commerce

Figure 2

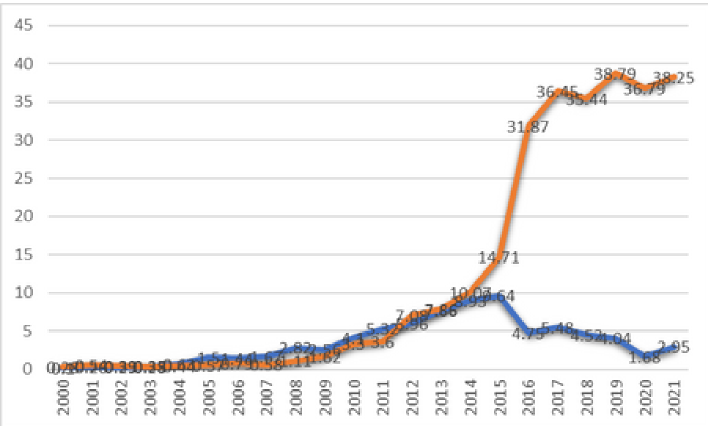


Figure 2 demonstrates the foreign direct investment (in U.S. billion dollars) made by China and India in the United States. The red line represents the Chinese investment, whereas the blue line represents the Indian FDI between the period of 2000-2021. Furthermore, the horizontal and vertical axis represents the years and U.S. billion dollars respectively.

FDI by China and India in the United States, 2000-2001

Source: [Statista]

Figure 3

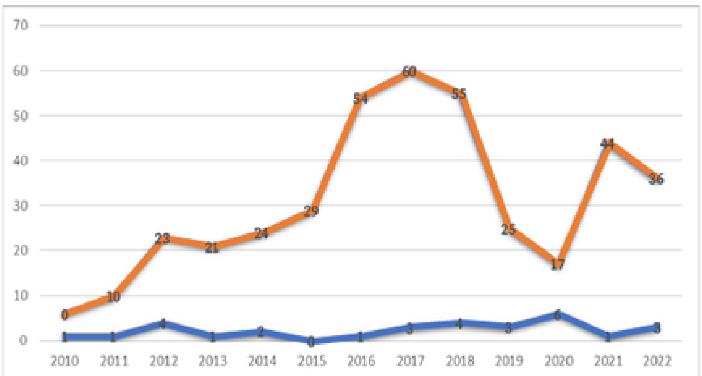


Figure 3 demonstrates the covered transactions in India and China's FDI between 2010-2022. The blue and red line represents the covered transaction by India and China respectively.

Covered transactions by India and China, 2010-2022

Source: [Committee of foreign investment in United States]

The differences are not only evident in transaction types but also in the sectors chosen for investment. According to data from the Rhodium Group, Chinese investments have been notably focused on technology-driven fields like aviation, electronics, healthcare, and Information and Communications Technology (ICT). Over the period from 1990 to 2017, these sectors received a total of $29.3 billion in Chinese investment, which accounted for about 20.9 percent of China's total investment in the U.S.

In 2015, the same year that saw the launch of the Made in China 2025 program, investments in U.S. technology companies experienced a remarkable upswing. The influx of capital into these companies surged to $9.9 billion during that year, a threefold increase compared to the previous year.

Whereas, in comparison, Indian FDI into U.S. is majorly seen as positive, promoting economic ties and collaboration between the two countries while not raising the same level of security concerns.

The differences to investment sectors, with Chinese investments largely focused on technology-driven areas, prompted the introduction and subsequent passage of the bipartisan Foreign Investment Risk Review Modernization Act (FIRRMA) by Congress. FIRRMA bolstered CFIUS against perceived rising national security risks associated with expanding Chinese FDI in the country. Among its multifaceted provisions, FIRRMA notably extended the scope of CFIUS's oversight authority, transitioned specific transactions from voluntary to mandatory filing, established a novel two-track declaration and notice procedure, and reinforced CFIUS through increased funding and staffing.

Should an **Indian investor** be concerned about CFIUS?

CFIUS shares the ability to block or delay a transaction involving a foreign investor if the committee believes that the transaction raises significant national security issues.

For instance, in April 2011, Chennai-based Polaris Financial Technology Ltd. purchased an 85.3 percent stake in California-based IdenTrust Inc., a company offering digital identification authentication services to U.S. government agencies. Surprisingly, Polaris did not submit any notice to CFIUS about the acquisition. Subsequently, CFIUS conducted a review of the deal after it had been finalized. In September 2012, Polaris declared that it was instructed to divest its stake, presumably due to concerns regarding cybersecurity and the target company's government contracts.

Moreover, in July 2007, Mumbai-based Reliance Communications Ltd. announced its acquisition of California-based Yipes Holdings, Inc. for $300 million, a provider of Ethernet services. The deal drew attention due to the sensitive nature of the telecommunications sector and the Indian government's partial ownership in Reliance. CFIUS approval was granted with the condition that Reliance adheres to several mitigation measures.

Increasing Indian investments in the United States

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The report suggests the following ways to boost Indian investment in the United States while navigating the challenges posed by CFIUS.

Way 1: By minimizing CFIUS risk

A foreign investor can take several steps to reduce the risk associated with CFIUS. Here are some strategies:

(a) Pre-Transaction Assessment

Conduct a thorough assessment of the proposed transaction to identify potential national security concerns. Evaluate whether the investment could involve critical technology, infrastructure, personal data, or sensitive sectors.

(b) Engage Early

Consider engaging with CFIUS voluntarily before making the investment. This can provide an opportunity to discuss the transaction, address any concerns, and potentially mitigate issues that might arise later in the review process.

(c) Open Communication

Maintain open and transparent communication with CFIUS throughout the process. Providing accurate and comprehensive information can demonstrate the investor's commitment to addressing national security concerns.

(d) Mitigation Measures

Propose and implement mitigation measures that address identified risks. These measures could involve safeguards to protect sensitive technologies, data, or operations from unauthorized access.

(e) National Security Agreements

Negotiate national security agreements with the U.S. government that outline specific commitments to address potential concerns. These agreements can provide a framework for cooperation and risk reduction.

(f) Security Protocols

Implement strong security protocols within the investor's operations to ensure that sensitive information is appropriately safeguarded and not compromised.

(g) Involvement of U.S.

Partners: Collaborate with U.S. partners, such as joint venture partners or local companies, who have a deeper understanding of the regulatory environment and can help navigate the process.

(h) Engage Legal Experts

Seek guidance from legal experts who specialize in CFIUS matters. They can provide insights into best practices, potential risks, and effective strategies for managing the regulatory process.

(i) Transparency

Be transparent about the investor's ownership structure, funding sources, and ultimate beneficiaries. Providing clear information can help build trust with CFIUS and alleviate concerns about potential hidden agendas.

(j) Explain Economic Benefits

Clearly articulate the economic benefits that the investment will bring to the U.S., such as job creation, technological advancements, and contributions to local communities.

It's important to note that each case is unique, and the level of CFIUS risk and appropriate risk reduction strategies will vary depending on the specifics of the investment and the industries involved. Seeking legal advice and engaging in proactive communication with CFIUS can significantly contribute to reducing risk and ensuring a smoother investment process.

Way 2: By involving in transactions which are beyond the CFIUS' jurisdiction

There are certain transactions which are beyond the reach of CFIUS.

(a) Passive investments with <10 percent interest

CFIUS cannot review a transaction if it is a passive investment and results in a foreign person owning 10 percent or less of the voting interest in a U.S. business. A passive investment means the investor does not intend to control the business and only has voting rights without access to non-public information or governance rights.

(b) Incremental acquisitions

If a foreign investor gained direct control of a U.S. business and CFIUS approved the transaction, then CFIUS might not review later investments by the same investor in the same U.S. business.

(c) Securities underwriter transactions

In general, CFIUS does not review the acquisition of securities by a securities underwriter in the ordinary course of business.

(d) Lending transactions

CFIUS typically does not have jurisdiction over lending transactions, except if the foreign person gains financial or governance rights similar to equity investments, or if an imminent default could give the foreign person actual control of collateral that represents a US business.

(e) Greenfield investments

Generally, greenfield investments, where foreign investors create new U.S. businesses, are not subject to CFIUS review. However, this status might be interpreted narrowly, as CFIUS may consider certain asset collections assembled by investors in anticipation of a new business formation (like contracts and intellectual property) as constituting a U.S. business.

Way 3: By becoming an excepted nation to CFIUS

CFIS expected foreign states

Australia, Canada, and the United Kingdom are the initial excepted foreign states and real estate foreign states. The reason behind the identification of these excepted foreign states lies in their robust intelligence sharing and defense industrial base integration with the United States.

In January 2022, New Zealand was granted the exception to CFIUS on the basis of its intelligence sharing and deeper defense integration with the United States.

However, CFIUS has indicated that the list of excepted foreign status, which forms the basis for excepted investor status, may expand in the near future.

Major advantage for an excepted investor- Excepted investors are not required to follow the mandatory filing rules or come under CFIUS's oversight for non-controlling investments and real estate deals. However, CFIUS can still review transactions that give these exempted investors control.

Way 4: By making selective investment targets

Strategic investment selection stands as a prudent approach for Indian investors seeking to mitigate CFIUS risk. By meticulously choosing sectors that resonate with the U.S. government's strategic objectives are less susceptible to eliciting national security apprehensions, investors can enhance the odds of a smoother investment trajectory. In this pursuit, it's crucial to align investment decisions with sectors that not only correspond to U.S. national interests but also offer potential for positive economic contributions. High-tech industries, including information technology and software development, often hold promise due to their potential for innovation and job creation. Additionally, renewable energy initiatives that contribute to environmental sustainability and align with the U.S. drive for cleaner technologies could be viewed favourably.

Investors would be wise to recognize the significance of research and development fields, which underpin advancements critical to societal progress. Prioritizing these sectors showcases a dedication to collaborative innovation and economic growth, potentially allaying concerns about potential national security implications.

By thoughtfully curating investment targets aligned with U.S. strategic priorities, Indian investors can navigate the regulatory landscape more effectively. The strategic approach aims to minimize the probability of raising national security alarms, fostering positive collaborations and contributing to the growth and vitality of both economies.

Conclusion

In conclusion, India's increasing foreign direct investment (FDI) in the United States has been substantial, yet it remains a minor contributor compared to Western countries, Japan, and China. The rigorous regulatory framework posed by the Committee on Foreign Investment in the United States (CFIUS) and International Traffic in Arms Regulations (ITAR) has created challenges for Indian investors seeking growth in the U.S. market.

CFIUS, led by the U.S. Department of Treasury, assesses foreign investment transactions and real estate deals to safeguard national security interests. While not all foreign investments are reviewed by CFIUS, its focus lies on cases that could potentially raise security concerns. Notably, the strengthening of CFIUS measures, prompted by growing concerns over Chinese foreign direct investment, led to the adoption of the Foreign Investment Risk Review Modernization Act (FIRRMA) to bolster CFIUS's authority and oversight.

Indian investors can enhance their presence in the U.S. by adopting strategic approaches. Minimizing CFIUS risk, engaging in transactions beyond CFIUS jurisdiction, and aligning investments with U.S. strategic priorities are crucial strategies. Furthermore, seeking excepted investor status by building strong intelligence-sharing and defense integration ties with the U.S. could provide distinct advantages.

In light of the evolving landscape, India's progress in expanding its investment footprint in the United States hinges on its ability to navigate the regulatory landscape, harness strategic sectors, and forge deeper alliances that align with both countries' interests. By adopting these strategies, Indian investors can potentially unlock more opportunities and contribute significantly to the U.S. economy while addressing national security concerns in a mutually beneficial manner.

Appendix

How does CFIUS operate?

- As mentioned above, CFIUS reviews and advises the president on " transactions involving foreign entities that could gain control over U.S. businesses," also namely **"covered transaction."** This includes a wide range of transactions, and CFIUS helps the president prevent foreign investments in U.S. businesses on national security grounds.

- When parties involved in a transaction believe they are engaging in a "covered transaction," they can choose to inform CFIUS and ask for its assessment. Transactions involving U.S. businesses with **critical technology, critical infrastructure, or personal data ("TID businesses")** must be notified to CFIUS. CFIUS can also start a review of an alleged "covered transaction" even without the parties' notification.

- Entities involved can notify the committee of a transaction with a declaration(a shorter process) or a joint voluntary notice (a more comprehensive process). Declarations are for simple transactions but if a deal is more complex or worrisome, CFIUS might ask for a notice even after a declaration. In both cases, CFIUS checks if the deal is safe for national security. If there's a problem, CFIUS investigates more. It suggests to the president if the deal should be allowed, blocked, or allowed with changes. Many deals get approved easily, but sometimes big deals need the president's say, like when President Obama stopped a Chinese company from buying a German chipmaker's U.S. business.

What is the process of CFIUS?

- Except for specific transactions subject to mandatory filing rules under FIRRMA, parties typically submit voluntary declarations or notices to CFIUS.

- CFIUS can also review transactions even without voluntary filings if a member believes it falls under CFIUS's jurisdiction and raises national security concerns.

- A "review" of a notified transaction is done within 45 days, and CFIUS can initiate an "investigation" of up to 45 additional days if needed.

- Parties can submit an abbreviated "declaration" instead of a full notice, with CFIUS responding within 30 days.

- After reviewing a declaration, CFIUS can request a full notice, say it can't conclude action based on the declaration, start a review, or conclude all action.

- CFIUS concludes action if there are no national security concerns or if concerns are addressed by other laws or mitigation measures.

- If concerns persist, CFIUS refers the transaction to the President, who can suspend or prohibit it within 15 days after CFIUS's investigation.

- Mitigation measures or referral to the President are based on detailed analysis of national security risks, confirmed by senior-level agencies.

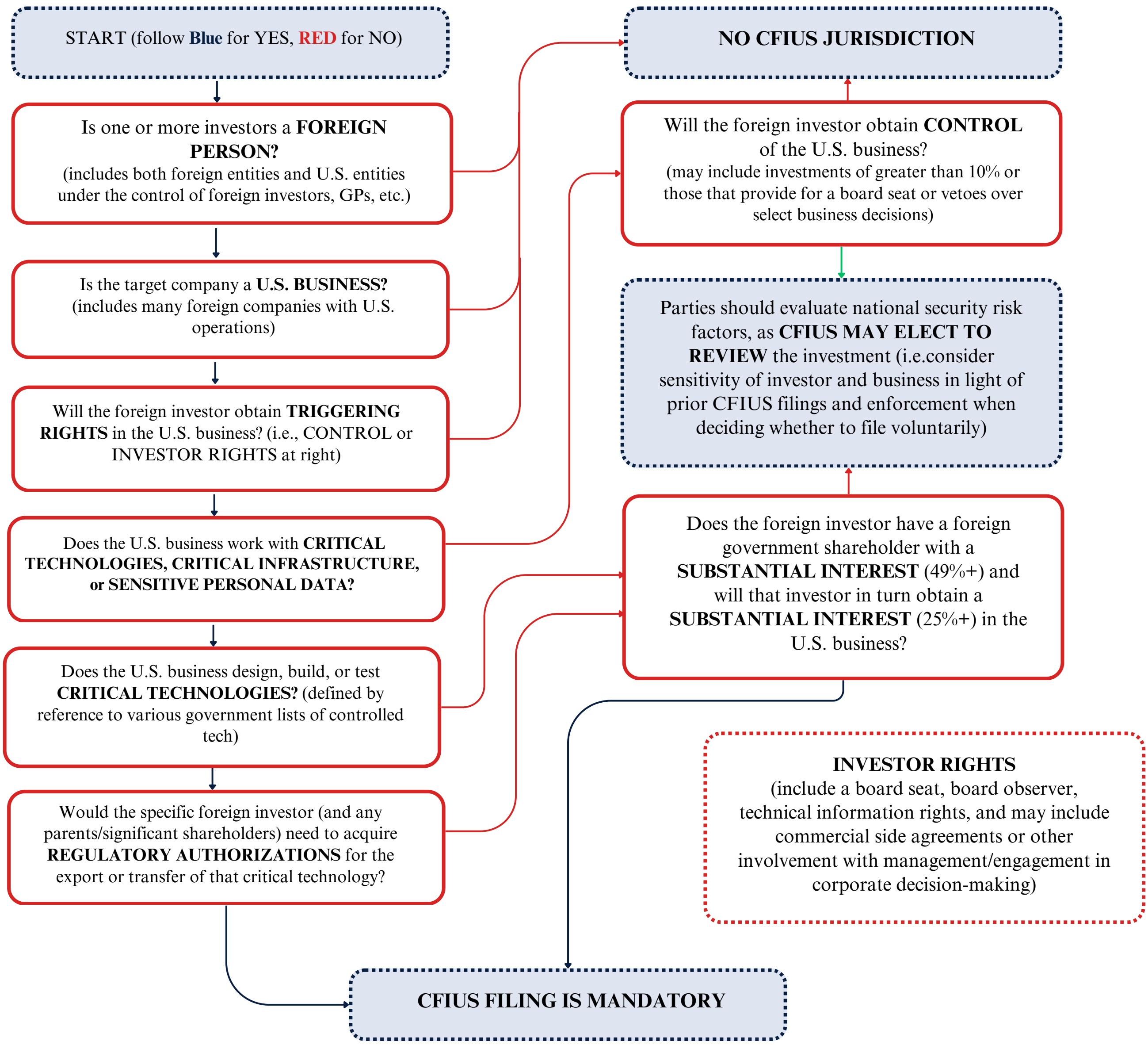
- Covered transactions typically receive a "safe harbor," meaning they won't be reviewed again by CFIUS or the President, except in exceptional cases.

When is CFIUS filing mandatory for an Investor?

Below table suggests when is CFIUS filing mandatory for an investing organisation.

Filing Decision Flowchart

CFIUS Jurisdiction Basics for Dealmakers



Source: Wilson Sonini Goodrich & Rosati

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IndUS Tech Council (IndUS Tech) is a Washington DC and New Delhi-based organization focused on accelerating U.S.-India technology collaboration, innovation, and investments. IndUS Tech's mission is to position the U.S.-India technology ecosystem for global innovation through thought leadership, policy advocacy, and facilitating collaborative partnerships between the two nations' private sectors.