

# Potential CFIUS Implications of Proposed Strategic Competition Act of 2021

**The Strategic Competition Act of 2021,<sup>1</sup> approved by the Senate Foreign Relations Committee on April 21, 2021, signals continued bipartisan consensus to orient U.S. policy towards aggressive action to counter China.** Given the broad bipartisan support in Washington to address China's malign activities, the bill will likely pass the Senate and House of Representatives. This bill is a useful barometer of congressional sentiment towards China and may guide the Biden administration's future China-related actions. The bill recognizes that U.S. ability to effectively compete with China requires domestic support for competitive industries and engagement with international partners to counter Chinese influence in international institutions and on international standards. The bipartisan support for the bill signals that Congress will continue a confrontational approach to U.S.-China relations.

**If enacted, the bill would direct the Executive branch to impose further sanctions in response to China's actions in Xinjiang, bolster oversight of foreign gifts and contracts to U.S. universities and colleges, and help small- and medium-sized U.S. companies diversify their supply chains outside of China.** The bill also includes broader measures such as increased military spending in the Indo-Pacific, authorizing funds to promote democracy in Hong Kong, and establishing a program to help Indo-Pacific countries develop infrastructure to counter China's Belt and Road Initiative. The bill should be viewed in tandem with the Endless Frontier Act,<sup>2</sup> which was referred to the Senate Committee on Commerce, Science, and Transportation on April 20, 2021. The Endless Frontier Act would significantly increase federal investment in domestic science and technology research, supply chain resiliency and diversification, crisis response, and jobs training to allow the United States to compete more effectively with China. The Strategic Competition Act and the Endless Frontier Act are part of a broader U.S. strategic realignment towards the Indo-Pacific that aims to leverage international support to deter Chinese malign activities, while also making the necessary domestic investments in education and research so that the U.S. maintains a competitive edge in critical sectors

of the future.

## Summary

- **The Strategic Competition Act includes the following key components:**
  - **The bill would require the Committee on Foreign Investment in the United States (CFIUS) to review the national security implications of certain foreign gifts or contracts to federally-funded universities and colleges.** CFIUS would be able to review these gifts or contracts in two circumstances: (1) those that relate to critical technologies and provide the foreign person with access to material nonpublic technical information possessed by the university or college; and (2) those that include certain conditions that give the foreign person control over the institution. U.S. institutions of higher learning have expressed concerns that these provisions would stifle innovation and reduce important sources of funding.
  - **The bill would require the Executive branch to impose sanctions against certain Chinese entities that are determined to be engaged in forced labor and other activities in Xinjiang.** Specifically, the bill would require the President to freeze the assets of persons that are engaged in: (1) serious human rights abuses in connection with forced labor in Xinjiang; and (2) systematic rape, coercive abortion, forced sterilization, or involuntary contraceptive implantation policies and practices in the region. The bill reflects congressional concerns that more aggressive implementation is required counter China's malign activities and adds to prior measures to address forced labor and human rights issues in Xinjiang such as the U.S. Customs and Border Protection's January 2021 Withhold Release Order<sup>3</sup> banning cotton imports produced in the region.
  - **The bill also places a spotlight on abuses committed by Chinese companies that are active in U.S. stock exchanges.** The bill would require the Executive branch to prepare an annual report that publicly identifies Chinese companies listed or traded on U.S. stock exchanges that have contributed to activities that undermine U.S. national security, serious abuses of internationally recognized human rights, or substantially increased financial risk exposure for U.S.-based investors. The legislation includes a non-exhaustive list of factors for identification, notably, whether the company has failed to comply fully with Federal securities laws, including audits by the Public Company Accounting Oversight Board (PCAOB). The bill may be a precursor for additional congressional action but does not impose specific sanctions or countermeasures for listed companies. The bill would build on

the Holding Foreign Companies Accountable Act, enacted in 2020, which bans state-owned companies from U.S. stock exchanges if the PCAOB is unable to audit the issuer's public accounting firm for three consecutive years, and the trading bans imposed by the Trump administration under Executive Order 13959.<sup>4</sup> The U.S. Department of the Treasury's Office of Foreign Assets Control has delayed the implementation of the trading ban until May 27, 2021, while the Biden Administration undertakes a review of the Trump Administration's China-related policies.<sup>5</sup>

- **The bill also includes measures to help U.S. companies diversify their supply chains outside of China.** The bill would authorize the Secretary of State to establish a program for U.S. embassies to contract with experts to help micro-, small-, and medium-sized U.S. companies with supply chain management issues related to China. The experts may help U.S. companies exit the Chinese market, relocate production facilities outside of China, diversify input sources to locations outside of China, and identify alternative markets for production or sourcing outside of China.
- **This bill can be viewed as a counterpart to the Endless Frontier Act, a proposed bill that would significantly increase federal investment in science and technology research, supply chains, and training to better compete with China.** Among other things, the Endless Frontier Act would provide the National Science Foundation with \$100 billion over five years and would prioritize research and funding in ten key areas, including artificial intelligence, high performance computing and semiconductors, quantum computing, robotics and automation, biotechnology, cybersecurity, and advanced materials. The Endless Frontier Act would also provide the Department of Commerce with \$10 billion over five years to designate at least ten regional technology hubs as well as establish a Supply Chain Resiliency and Crisis Response Program to monitor supply chain vulnerabilities and provide investments to diversify supply chains in critical products.

## Proposed Expansion of CFIUS Jurisdiction

**The Strategic Competition Act uses the CFIUS process to address two national security concerns: (1) concerns related to access by foreign persons to critical technologies at U.S. universities and colleges and (2) concerns related to foreign influence in academia.** U.S. policymakers continue to be concerned<sup>6</sup> with China's exploitation<sup>7</sup> of the open research and development environments of U.S. higher education institutions. This comes on the heels of an October 2020 U.S. Department of Education report<sup>8</sup> that found

that U.S. universities and colleges routinely failed to comply with a longstanding legal requirement<sup>9</sup> to report gifts or contracts from foreign persons at or above \$250,000 in value.

- **The bill would require “institutions of higher education”<sup>10</sup> to submit mandatory declarations for certain foreign gifts or contracts that relate to critical technologies.** Covered transactions would include contracts or gifts<sup>11</sup> that: (1) are equal to or greater than \$1 million in value in the aggregate over a two-year period and (2) relate to research, development, or production of critical technologies<sup>12</sup> and provide the foreign person with potential access to any material nonpublic technical information in the possession of the institution. In addition, the bill would expand the membership of CFIUS to include the Secretary of Education in the case of covered transactions involving an institution of higher education. To implement these proposed changes, the bill would direct CFIUS to conduct a pilot program to assess methods for implementing the review of these transactions, which would account for any burdens on institutions of higher education. This pilot program is expected to be published in the Federal Register up to 270 days following the date of the bill’s enactment.
- **It would also expand the ability of CFIUS to review controlling gifts to or contracts by foreign persons to U.S. universities and colleges.** Covered transactions would also be defined to include a “restricted or conditional gift or contract,” as defined in the Higher Education Act of 1965, that establishes control over the institution of higher education. Colleges and universities would need to assess whether to submit a joint voluntary notice and consider risks related to CFIUS actions to mitigate or prohibit the contract or gift.
- **The bill would promote transparency with respect to foreign involvement in the U.S. academic research community.** The bill would require CFIUS to report on “whether there are foreign malign influence or espionage activities directed or directly assisted by foreign governments against institutions of higher education aimed at obtaining research and development methods or secrets related to critical technologies.” It would also make explicit the ability of CFIUS to consider the ways that a foreign person’s contracts with and gifts to U.S. universities or colleges may limit academic freedom in the United States and this consideration is likely to be an added focus of agencies. This would appear to address longstanding concerns<sup>13</sup> related to the Chinese government’s Confucius Institute Program. In fact, the FBI has highlighted

that foreign adversaries may use funding and donations to universities to “place stipulations on how the [academic] programs or centers function or install its own recruits in positions with little or no university oversight.”<sup>14</sup>

- **Universities and colleges can expect that CFIUS could impose conditions on sensitive grants and contracts to mitigate perceived national security risks or require cancellation of a grant or contract.** While it is currently unclear how CFIUS will impose mitigation on grants and contracts, universities and companies should look to current CFIUS mitigation for potential guidance on what mitigation may look like in the context of contracts and gifts. This means that CFIUS mitigation will likely include access restrictions on sensitive technology or information or even the outright prohibition of such gifts or contracts if they pose a high risk to national security.
- **There are concerns, however, about negative consequences of the additional CFIUS mandate and implications for university research and innovation.** On April 20, 2021, representatives from the U.S. higher education community wrote a letter to the Chairman and Ranking Member of the Senate Foreign Relations Committee strongly opposing the proposed expansion of CFIUS’ jurisdiction.<sup>15</sup> Among other things, the letter states that the expansion of CFIUS jurisdiction would disincentivize philanthropic giving, damage U.S. research and economic competitiveness, and burden CFIUS with a high number of expected mandatory filings. The letter also casts doubt on the technical expertise of the Department of Education to assess risks related to critical technologies.

## Implications for Private Sector

- **Legislative developments for the bill will provide a useful barometer of congressional sentiment towards China and guide towards possible future China-related actions.** The Senate Foreign Relations Committee approved the bill by 21-1 on April 21, and the bill will likely be sent to the full Senate for consideration in the coming weeks as part of a push on China-related legislation by Senate Majority Leader Schumer of New York.<sup>16</sup> Although the expanded CFIUS jurisdiction is unlikely to impact foreign investors, the bill should be viewed in the broader context of the U.S.-China relationship and the potential for reciprocal actions by China. It may also signal future actions by the Biden administration to both counter China’s influence and to stay ahead of congressional developments.

- **If enacted, CFIUS decisions, to the extent made public, can also help inform companies of particular CFIUS focus areas or sensitive research and development.** University and colleges may have less incentive to maintain confidentiality around CFIUS decisions involving potential foreign funding than companies undergoing the CFIUS process. If universities and colleges provide greater transparency around CFIUS decisions, it may provide useful indications of CFIUS priorities with respect to basic research and critical technologies.
- **The bill also places a spotlight on abuses committed by Chinese companies that are active in U.S. stock exchanges.** Some Chinese companies listed on U.S. stock exchanges have previously engaged in fraudulent activities as well as activities contrary to U.S. national interests, such as Luckin Coffee, which in 2019 fabricated its sales figures by about \$310 million,<sup>17</sup> or Weibo Corporation, which works under Chinese government direction to censor posts on its blogging platform.<sup>18</sup> Congress has continued to send strong signals that it is aware of and actively scrutinizing the financial and national security-related risks posed by U.S.-listed Chinese companies. As a result of this increased congressional scrutiny, U.S. investors may wish to assess their risk appetite with regard to owning shares of Chinese companies listed in the United States.
- **The bill would also include measures to help U.S. companies diversify their supply chains outside of China.** The COVID-19 pandemic exposed U.S. reliance on Chinese companies for critical pharmaceutical ingredients and related medical equipment, which in turn spurred a bipartisan effort to review U.S. supply chains with China for vulnerabilities and to increase resources to reshore critical industries. As demonstrated by the Biden Administration's recent executive order on supply chains, the executive branch is currently reviewing supply chains in other sectors that are deemed crucial for national security, such as semiconductors, high-capacity batteries, and critical minerals, among others.<sup>19</sup> This supply chain review is occurring alongside U.S. designations of Chinese entities for malign activities including forced labor practices, technology transfer, and espionage,<sup>20</sup> which creates additional regulatory and reputational risks for U.S. companies that maintain supply chains in China. As a result of this increasingly contentious U.S.-China relationship, companies that are involved in the production of "critical goods and materials"<sup>21</sup> as defined in the executive order may wish to consider whether Chinese involvement in their supply chain may raise U.S. national security or reputational concerns, and may want to

consider consulting with third-party experts to conduct appropriate due diligence.

- **Market participants should take note of the risks arising from a broader decoupling of the U.S. and Chinese economies, which parallels similar efforts by Australia, Japan, the United Kingdom, and Canada.** The bill's measures to crack down on sensitive technology transfers to China, its broadened sanctions designation authorities for human rights abuses, its measures aimed at Chinese companies listed on U.S. stock exchanges, and its efforts to diversify U.S. companies' supply chains highlights a continued and growing rift between the U.S. and China. U.S. allies such as the United Kingdom<sup>22</sup> and Canada<sup>23</sup> have similarly imposed sanctions on Chinese entities for human rights abuses in Xinjiang, and Australia is reportedly considering imposing sanctions<sup>24</sup> on Chinese entities for the same practices. Investors should be aware that these measures may result in reciprocal actions by China that further exacerbate U.S.-China relations as well as relations between China and U.S. allies.

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## Endnotes

<sup>1</sup> U.S. Senate. Committee on Foreign Relations. "Strategic Competition Act of 2021," (April 15, 2021), available at <https://www.congress.gov/117/bills/s/1169/BILLS-117s1169is.pdf>.

<sup>2</sup> U.S. Senate. Committee on Commerce, Science, and Transportation. "Endless Frontier Act," (April 20, 2021), available at <https://www.congress.gov/bill/117th-congress/senate-bill/1260/text>.

<sup>3</sup> U.S. Customs and Border Protection. "CBP Issues Region-Wide Withhold Release Order on Products Made by Slave Labor in Xinjiang," (January 13, 2021), available at <https://www.cbp.gov/newsroom/national-media-release/cbp-issues-region-wide-withhold-release-order-products-made-slave>.

<sup>4</sup> The Executive Office of the President. "Executive Order 13959 of November 12, 2020, Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies," (November 12, 2020), available at <https://www.govinfo.gov/content/pkg/FR-2020-11-17/pdf/2020-25459.pdf>.

<sup>5</sup> U.S. Department of the Treasury, Office of Foreign Assets Control. "General License No. 1A, Authorizing Transactions Involving Securities of Certain Communist Chinese Military Companies," (January 26, 2021), available at [https://home.treasury.gov/system/files/126/ccmc\\_gl1a\\_01272021\\_1.pdf](https://home.treasury.gov/system/files/126/ccmc_gl1a_01272021_1.pdf).

<sup>6</sup> U.S. Department of Education. "U.S. Department of Education Launches Investigation into Foreign Gifts Reporting at Ivy League Universities," (February 12, 2020), Available at <https://www.ed.gov/news/press-releases/test-0>.

<sup>7</sup> U.S. Senate. Permanent Subcommittee on Investigations. "China's Impact on the U.S. Education System," (February 22, 2019), available at <https://www.hsgac.senate.gov/imo/media/doc/PSI%20Report%20China%27s%20Impact%20on%20the%20US%20Education%20System.pdf>.

<sup>8</sup> U.S. Department of Education. "Institutional Compliance with Section 117 of the Higher Education Act of 1965," (October 2020), available at



<https://www2.ed.gov/policy/highered/leg/institutional-compliance-section-117.pdf>.

<sup>9</sup> Section 117 of the Higher Education Act of 1965, 20 U.S. Code § 1011f.

<sup>10</sup> i.e., a federally funded college or university.

<sup>11</sup> The Strategic Competition Act would add definitions of “contracts” and “gifts” to the DPA. “Contract” would mean “any agreement for the acquisition by purchase, lease, or barter of property or services by a foreign person, for the direct benefit or use of either of the parties.” “Gift” would mean “any gift of money or property.”

<sup>12</sup> “Critical technologies” is defined in 31 C.F.R. Part 800.215.

<sup>13</sup> U.S. Senate. Permanent Subcommittee on Investigations. “China’s Impact on the U.S. Education System,” (February 22, 2019), available at <https://www.hsgac.senate.gov/imo/media/doc/PSI%20Report%20China%27s%20Impact%20on%20the%20US%20Education%20System.pdf>.

<sup>14</sup> The Federal Bureau of Investigation. “China: The Risk to Academia,” available at <https://www.fbi.gov/file-repository/china-risk-to-academia-2019.pdf/view>, p. 6.

<sup>15</sup> Association of American Universities, Association of Public and Land-grant Universities, American Council on Education, Association of American Medical Colleges. “Letter to Senate Foreign Relations Leaders Opposing Section 138 of the Strategic Competition Act,” (April 20, 2021), available at <https://www.acenet.edu/Documents/Letter-Senate-Foreign-Relations-Strategic-Competition-Act-042021.pdf>.

<sup>16</sup> Steven T. Dennis. “Schumer Set to Move on China Bill with Sprawling Agenda Ahead,” Bloomberg News, (March 25, 2021), available at <https://www.bloomberg.com/news/articles/2021-03-25/schumer-set-to-move-on-china-bill-with-sprawling-agenda-ahead?sref=Pw1Mp35R>.

<sup>17</sup> Weizhen Tan. “Fraud at China’s Luckin is a ‘great morality tale’ for investors, says analyst,” CNBC, (July 6, 2020), available at <https://www.cnbc.com/2020/07/06/investing-fraud-at-china-luckin-coffee-fraud-case-warning-for-investors.html>.

<sup>18</sup> U.S.-China Economic and Security Review Commission. “Chinese Companies Listed on Major U.S. Stock Exchanges,” (October 2, 2020), available at [https://www.uscc.gov/sites/default/files/2020-10/Chinese\\_Companies\\_on\\_US\\_Stock\\_Exchanges\\_10-2020.pdf](https://www.uscc.gov/sites/default/files/2020-10/Chinese_Companies_on_US_Stock_Exchanges_10-2020.pdf).

<sup>19</sup> The Executive Office of the President. “Executive Order 14017 of February 24, 2021, On America’s Supply Chains,” (February 24, 2021), available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-americas-supply-chains/>.

<sup>20</sup> Bojan Pancevski. “U.S. Officials Say Huawei Can Covertly Access Telecom Networks,” The Wall Street Journal, (February 12, 2020), available at <https://www.wsj.com/articles/u-s-officials-say-huawei-can-covertly-access-telecom-networks-11581452256>.

<sup>21</sup> “Critical goods and materials” means goods and raw materials currently defined under statute or regulation as “critical” materials, technologies, or infrastructure.

<sup>22</sup> Government of the United Kingdom. “UK Government announces business measures over Xinjiang human rights abuses,” (January 12, 2021), available at <https://www.gov.uk/government/news/uk-government-announces-business-measures-over-xinjiang-human-rights-abuses>.

<sup>23</sup> Government of Canada. “Canada announces new measures to address human rights abuses in Xinjiang, China,” (January 12, 2021), available at <https://www.canada.ca/en/global-affairs/news/2021/01/canada-announces-new-measures-to-address-human-rights-abuses-in-xinjiang-china.html>.

<sup>24</sup> Natasha Kassam. “Australia is Under Pressure to Implement Magnitsky-Style Laws,” Foreign Policy, (April 2, 2021), available at <https://foreignpolicy.com/2021/04/02/australia-china-sanctions-magnitsky-law/>.