

# Client Alert

February 2018

## Foreign Investment in the US: An Overview of CFIUS

### Purpose

Established in 1975, the Committee on Foreign Investment in the United States (CFIUS) is a federal, interagency committee with the authority to review certain foreign investments in US businesses to determine whether such investments could threaten or impair the national security of the United States. The committee is chaired by the secretary of Treasury and composed of nine cabinet members, two ex officio members, and other members appointed by the president of the United States.<sup>1</sup> CFIUS's statutory regime authorizes the president, through CFIUS, to review "any merger, acquisition, or takeover ... by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States." If a transaction poses such a risk, the president may, through CFIUS, prohibit or suspend the transaction or impose certain conditions on the transaction (such as mandatory divestiture of business operations) before the transaction may be consummated.

### Jurisdiction and the Definition of "Control"

CFIUS has broad oversight authority over foreign investment transactions, including mergers, acquisitions, and takeovers. CFIUS's jurisdiction also extends to transactions in which the foreign investor acquires financial or governance rights that are characteristic of an equity investment, including transactions in which a default or other event (e.g., a credit default under a lending agreement) would result in control of the US entity. Coupled with this understanding, and given that the term "US business" generally includes any entity that is engaged in interstate commerce in the United States, CFIUS has the discretion to review, among other transaction forms, joint ventures with US entities, foreign acquisitions of foreign entities that have US subsidiaries (though such review is limited to the US component of such businesses), and the operation of a collection of assets by an entity as a business.

A fundamental element to CFIUS's oversight of a transaction is whether the foreign entity will "control" the US entity. Generally, CFIUS defines "control" as the direct or indirect power (regardless of whether the power is actually exercised) to make important decisions affecting an entity, including to make decisions regarding certain matters listed in the relevant enabling statute.<sup>2</sup> Notably, CFIUS's definition of "control"

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<sup>1</sup> CFIUS members include the heads of the Department of Justice, the Department of Homeland Security, the Department of Commerce, the Department of Defense, the Department of State, the Department of Energy, the Office of the US Trade Representative, and the Office of Science & Technology Policy. The following offices hold "observer" status: the Office of Management & Budget, the Council of Economic Advisors, the National Security Council, the National Economic Council, and the Homeland Security Council.

<sup>2</sup> 31 C.F.R. § 800.204(a) lists, without limitation, the following matters for which control is important: (i) the sale, lease, mortgage, pledge, or other transfer of any of the tangible or intangible principal assets of the entity, whether or not in the ordinary course of business; (ii) the reorganization, merger, or dissolution of the entity; (iii) the closing, relocation, or substantial alteration of the production, operational, or research and development facilities of the entity; (iv) major expenditures or investments, issuances of equity or debt, or dividend payments by the entity, or approval of the operating budget of the entity; (v) the selection of new business lines or ventures that the entity will pursue; (vi) the entry into, termination, or non-fulfillment by the entity of significant contracts; (vii) the policies or procedures of the entity governing the treatment of non-public technical, financial, or other proprietary information of the entity; (viii) the appointment or dismissal of officers or senior managers; (ix) the appointment or dismissal of

is not defined in terms of a specified percentage of shares or number of board seats. While ownership and board seats are relevant to a control analysis, neither factor is necessarily determinative. Instead, all relevant factors are considered together in light of their potential impact on a foreign person's ability to determine, direct, or decide important matters affecting the US business.

The regulations do provide a list of minority investor protections that are not in themselves deemed to confer control over an entity,<sup>3</sup> and they also provide that a foreign person does not control an entity if such person holds 10% or less of the voting interest in the entity "solely for the purpose of passive investment." Importantly, however, whether a foreign person holds 10% or less of the voting interests in an entity is not dispositive, and an acquirer of less than 10% of a US business's voting interests may be subject to CFIUS's jurisdiction if, for example, the foreign person also acquires the right to determine, direct, or cause decisions regarding important matters affecting that business that suggest the investment is not passive. Other potential exemptions from CFIUS review include "greenfield" investments and asset acquisitions where the assets acquired by the foreign person do not constitute a "US business."

### Filing Notice

The decision to file a notice with CFIUS is voluntary, and notice may be filed before or after a transaction is complete. In most cases, however, it is strongly advised that the notice be filed prior to the transaction's consummation. Filings that are made post-closing are typically made due to an oversight on the part of the parties or at the request of CFIUS, and a post-transaction review may result in CFIUS imposing adverse conditions on the parties or requiring divestitures that could be difficult to implement. Further, CFIUS has the authority to review transactions even when the parties did not file a notice. Given these risks, a foreign investor usually has a significant incentive to engage with CFIUS and its review process prior to closing. This is because once a transaction is cleared by CFIUS, the transaction is considered to be cleared in perpetuity.

Typically, parties file a notice with CFIUS based on their assessment of whether the transaction falls within CFIUS's jurisdiction. When considering whether a transaction may fall under the purview of CFIUS, parties should consider numerous factors, including (i) whether the transaction may impair US national defense requirements; (ii) the potential effects of the transaction on sales of military goods, equipment, or technology to any country; (iii) the nationality of the foreign investor and the extent to which the investor is controlled by a foreign government; (iv) the relationship of the foreign country with the United States, specifically on its record of cooperating in counterterrorism efforts; and (v) whether the transaction will result in foreign control over critical infrastructure or critical technologies that, in CFIUS's view, could impair national security. In addition, parties should consider whether there are similar transactions that involved a CFIUS filing or otherwise received scrutiny from the US government. When making this assessment, it is important to review the transaction objectively from the perspective of the US government and also take into account the risk that CFIUS may undertake a review after closing.

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employees with access to sensitive technology or classified US government information; or (x) the amendment of the articles of incorporation, constituent agreement, or other organizational documents of the entity with respect to the matters described in clauses (i) through (ix).

<sup>3</sup> 31 C.F.R. § 800.204(c) provides the following investor protections: (i) the power to prevent the sale or pledge of all or substantially all of the assets of an entity or a voluntary filing for bankruptcy or liquidation; (ii) the power to prevent an entity from entering into contracts with majority investors or their affiliates; (iii) the power to prevent an entity from guaranteeing the obligations of majority investors or their affiliates; (iv) the power to purchase an additional interest in an entity to prevent the dilution of an investor's pro rata interest in that entity in the event that the entity issues additional instruments conveying interests in the entity; (v) the power to prevent the change of existing legal rights or preferences of the particular class of stock held by minority investors, as provided in the relevant corporate documents governing such shares; and (vi) the power to prevent the amendment of the articles of incorporation, constituent agreement, or other organizational documents of an entity with respect to the matters described in clauses (i) through (vi).

## **Notice Requirements, Timing, and Process**

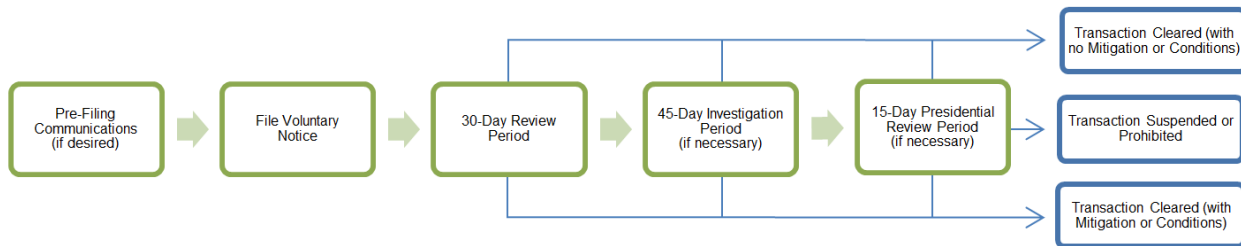
While CFIUS does not provide advisory opinions on whether a transaction will implicate national security concerns or whether CFIUS has jurisdiction over the transaction, parties may consult with CFIUS in advance of their filing and may file a draft notice with CFIUS. Such consultation and filings assist CFIUS members in understanding the form of the transaction, the identity of the parties, and whether the proposed transaction may raise national security concerns. Further, these preliminary communications provide CFIUS with an opportunity to ask the parties to include additional or clarifying information in their formal notice filing. If the parties desire to engage with CFIUS in advance, such communications should take place at least five business days prior to the filing of the voluntary notice. Notably, CFIUS does not publicly disclose information provided to it or that the parties filed such notice.

The notice requirements are extensive, and usually require joint participation between the foreign acquirer and the seller due to the breadth of the required information. The notice must include, among other information, a detailed description of the transaction; a description of the parties and their affiliates (including a description of their respective business activities and market shares, a list of certain contracts such entities have with the US government, and whether the US business being acquired produces or trades in defense products and defense services); and whether the US business has any technology that has military applications. Further, the notice must include the personal information of certain individuals (e.g., the directors and officers of the acquiring foreign entity and any individual having an ownership interest of 5% or more in the acquirer). Such personal information should include a professional synopsis and detailed “personal identifier information.” The collection of this information can be time consuming when the foreign acquirer has multiple affiliates subject to the disclosure requirements. Like the preliminary communications, voluntary filings are accorded confidential treatment.

With respect to the filing timeline, subject to certain procedural exceptions, CFIUS is required by law to review the transaction and make a determination within 30 calendar days of CFIUS’s formal acceptance of the filing, which is delivered in the form of a letter issued to the parties confirming such acceptance. During the 30-day review period, CFIUS will make a determination to clear the transaction or proceed with a formal investigation. If CFIUS determines to proceed with an investigation, CFIUS has an additional 45 calendar days to complete such investigation. There is a presumption favoring a 45-day investigation if the foreign acquirer is affiliated with a foreign government or the transaction involves “critical infrastructure.” During the review and investigation periods, CFIUS members may request additional information from the parties, and the parties must respond to such requests within three business days or within a longer time frame with the CFIUS staff chairperson’s consent. The parties may withdraw the notice filing at any time during either of these periods, though such withdrawal must be approved by CFIUS and such approval may include conditions on the parties (e.g., a requirement that the parties keep CFIUS informed of the status of the transaction or that the parties refile the transaction notice at a later time). During the investigation stage, the parties may discuss mitigation actions to alleviate any CFIUS concerns.

Generally, CFIUS concludes action on a large majority of filings within the initial 30-day review period. If CFIUS, however, has proceeded to the 45-day investigation period and is then unable to conclude action at the end of the investigation period, CFIUS must make a formal recommendation to the president on whether to suspend or prohibit the transaction. Thereafter, the president must announce a decision to suspend or prohibit the transaction within 15 days. The president’s decision is final and cannot be appealed.

**Illustrative CFIUS Filing Timeline**

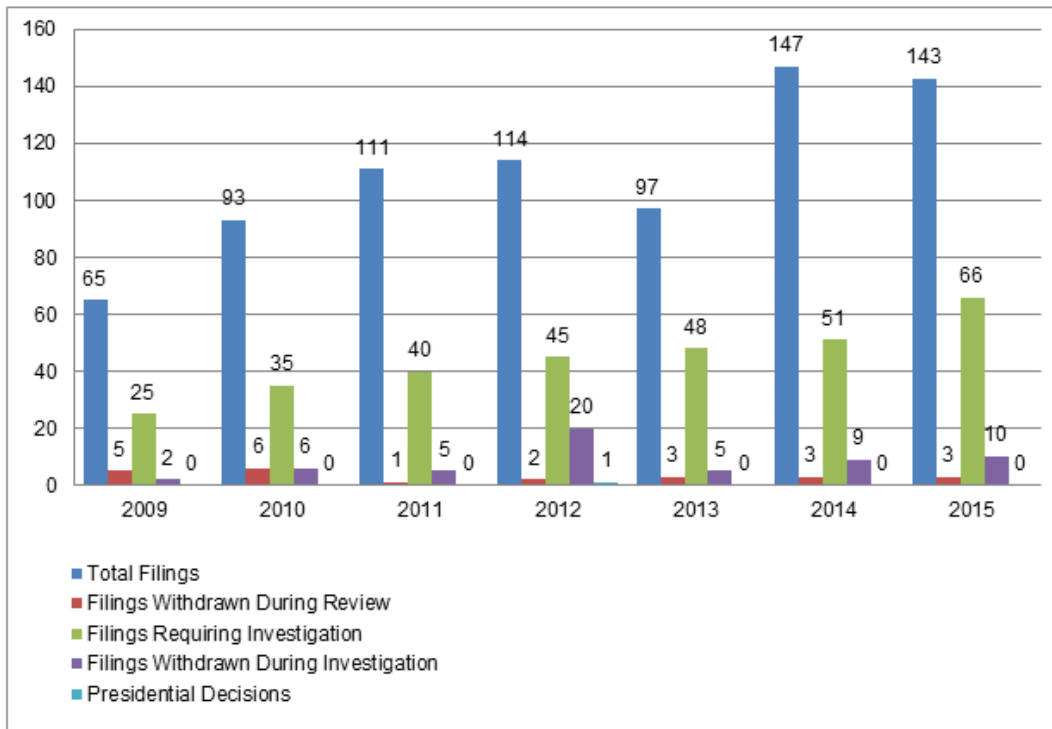


If, on the one hand, CFIUS finds that the transaction does not present any national security risks, or that other provisions of law address the risks, then CFIUS will clear the transaction by delivering written notice to the parties. If, on the other hand, CFIUS makes a determination that the transaction presents a national security risk, then CFIUS may negotiate and enter into an agreement with the parties or impose conditions on its clearance of the transaction to mitigate such risks. These conditions vary and are unique to the specific transaction. Generally, however, such agreements or conditions can include (i) ensuring that only US citizens handle certain products or services; (ii) ensuring that certain activities are only conducted in the United States; (iii) notification to and consultation with CFIUS prior to making certain business decisions, with certain rights available to CFIUS if the company decides to exit certain markets; or (iv) excluding certain sensitive assets from the transaction. CFIUS has a variety of means to monitor compliance with such agreements or conditions, including by requiring periodic reporting by the company, third-party auditing, and on-site compliance reviews by federal agencies.

**Trends and Developments**

In 2015, CFIUS received 143 notices of transactions that were subject to CFIUS’s jurisdiction. While the number of filings slightly decreased from 2014 (147 filings), the number of filings each year has increased significantly, to more than double the number of filings in 2009.

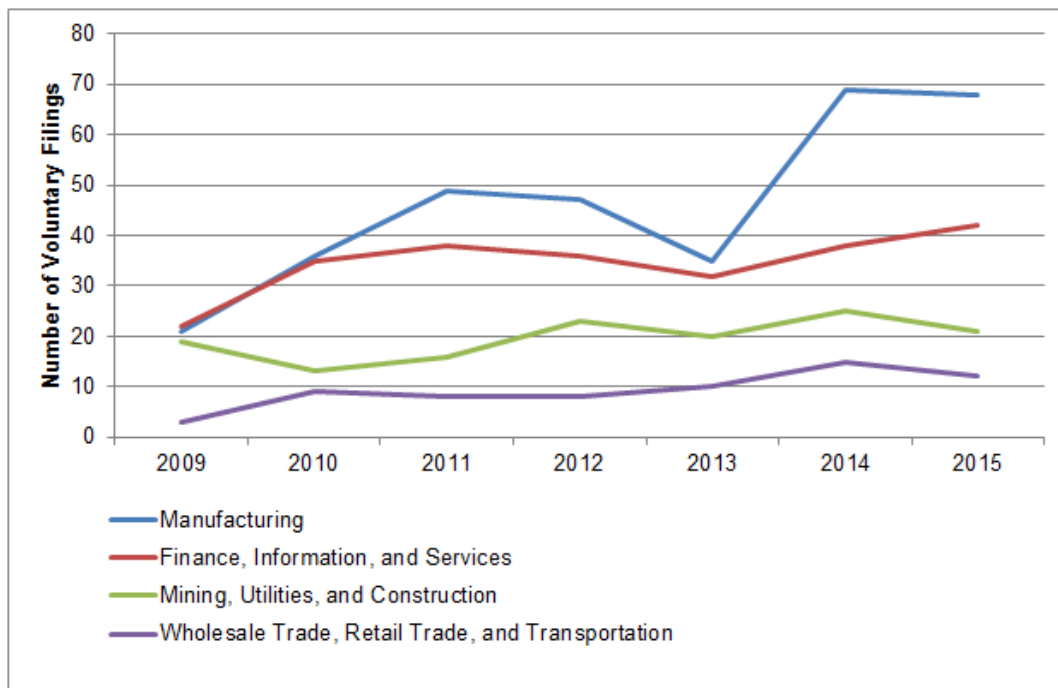
**Voluntary Notice Filing Breakdown from 2009–2015**



Of all filings made in 2015, approximately 46% proceeded to the investigatory stage. Of the 143 filings, three notices were withdrawn during the review stage and 10 notices were withdrawn during the investigation stage. Of these, nine were eventually refiled with CFIUS, one was withdrawn and the transaction abandoned for commercial reasons unrelated to the CFIUS review, and three were withdrawn and the transactions abandoned after either CFIUS informed the parties that it was unable to identify any appropriate mitigation measures or the parties were unwilling to accept such mitigation measures. Because of the increase in the number of voluntary filings, CFIUS has taken longer to respond and has utilized the investigation period more often to provide additional days to review each filing. Thus, parties are experiencing longer wait times for CFIUS clearance than in prior years.

In 2015, nearly half of all filings (48%) came from parties engaging in a transaction in the manufacturing sector (a significant proportion increase since 2009 (32%)); followed by the finance, information, and services sector (29%); the mining, utilities, and construction sector (15%); and the wholesale trade, retail trade, and transportation sector (8%). With respect to the manufacturing sector, nearly half of those filings (49%) were in the computer and electronic manufacturing space, followed by chemical manufacturing (12%) and machinery manufacturing (12%). With respect to the finance, information, and services sector, a large portion (29%) of the filings were in the professional, scientific, and technical services space.

**Change in Sector Investment from 2009–2015**



### Effects of Chinese Investment

While there are many factors causing the increase in voluntary CFIUS filings, much of the growth is due to increased investment activity from China-based investors. Acquisitions by Chinese investors accounted for the largest share of notices from 2013–2015, totaling 74 notices (19%). Over half of filings came from entities in the manufacturing sector.

Currently, there are indications that CFIUS may become more protective of US interests under President Donald Trump, especially with respect to Chinese investors and their interests in tech-based companies. As an example, in September 2017, President Trump blocked a China-backed investor from acquiring a

US semiconductor company, and it has been reported that CFIUS has objected to at least nine deals in 2017, many of which are in the technology sector. While an objection from CFIUS is not determinative of whether the transaction will be consummated, such an objection will likely require the parties to propose mitigation measures or abandon the deal. As such, there are reports that the parties to several transactions have withdrawn and refiled their notices to provide CFIUS with additional time to review the proposed transaction and negotiate possible mitigation agreements or conditions before CFIUS has to make a recommendation to the president.<sup>4</sup>

While acquisitions of military assets, for example, would clearly implicate CFIUS review, there have also been cases in which CFIUS expressed concern about Chinese investment in the United States based on the proximity of the acquired business to sensitive US military bases. In addition, China-based investors may be subjected to additional political scrutiny. For these and other reasons, there are indications that Chinese investors are filing more voluntary notices for transactions that are not obviously tied to US national security interests. These filings are being made to avoid the risk of CFIUS intervention after closing in case CFIUS were to assert jurisdiction. Further, it has been reported that President Trump's administration is reviewing the strategic and economic relationships the United States has with China, and there is a perception that CFIUS's review of Chinese investments in US business will be conducted through a "protectionist lens." Parties may face severe challenges if they do not give notice and are then contacted by CFIUS after it learned of the proposed transaction. Given the breadth of CFIUS's jurisdiction and the potential for media spotlight and political involvement, it is likely that investors will continue to proceed cautiously, and even defensively, by filing voluntary notices for many US transactions even where national security concerns are not readily apparent.

It also bears noting that, on November 8, 2017, members of the US Congress introduced the Foreign Investment Risk Review Modernization Act of 2017 (FIRRMA) that would, among other things, (i) increase the time CFIUS has to review each filing (extending the current 30-day period to 45 days, with an option to extend such period an additional 30 days in "extraordinary circumstances"); (ii) expand CFIUS's jurisdiction to cover purchases of real estate located near sensitive US locations (e.g., military bases or power plants) and contributions of intellectual property and associated support by a US critical technology company; and (iii) establish a process by which certain transactions can receive expedited review. There are strong indications that at least some of these modifications will be enacted, as FIRRMA currently enjoys bipartisan support in Congress and is expected to receive support from President Trump and his administration.

## **Conclusion**

The CFIUS notice process requires careful analysis of the proposed transaction, detailed drafting of the required information to be included in the notice, and an understanding of the complex criteria CFIUS uses in reviewing the proposed transaction and whether the transaction raises national security concerns. Parties should, collectively, consult with their respective counsel with regard to the voluntary filing to ensure the notice and related processes are prepared and executed in accordance with CFIUS's laws and regulations so that parties may achieve clearance of the transaction prior to its consummation and avoid some of the foregoing pitfalls.

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<sup>4</sup> For example, the parties to the Broadcom Ltd. and Brocade Communication Systems Inc. transaction and the Ant Financial, an affiliate of Alibaba, and MoneyGram International Inc. transaction withdrew and refiled their voluntary notices, in each of the cases, to provide additional time for CFIUS to review the transactions. On January 2, 2018, Ant Financial and MoneyGram International Inc. abandoned their proposed transaction after CFIUS refused to approve the deal.

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