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CFIUS 101: A Primer on the “new” Committee on Foreign Investment in the United States

The Committee on Foreign Investment in the United States, or “CFIUS,” until recently was an obscure regulatory body in the U.S. A number of high-profile actions, including unprecedented action by President Trump to block Broadcom’s proposed acquisition of Qualcomm in March 2018, have recently captured the attention of the global business community. Further, in July of 2018, Congress enacted a sweeping overhaul of CFIUS’s statutory authority (known as the Foreign Investment Risk Review Modernization Act of 2018, or “FIRRMA”), expanding its jurisdiction and reforming the process for the first time in more than a decade. Under that authority, CFIUS announced a “Critical Technologies Pilot Program,” effective November 10, 2018 which mandates filings in a broad swath of transactions.

CFIUS is now a modernized regulatory body designed to meet the specific national security policy concerns regarding foreign investment in U.S. businesses, while maintaining America’s historically open posture towards such investment.

Given the importance of CFIUS to cross-border investment and the significant changes that have taken place within the CFIUS statutory and regulatory regimes, this document is meant to provide transaction parties with a general understanding of the “new” CFIUS, its mission, and how its process unfolds. Of course, a specific analysis of any particular transaction must be carefully undertaken before deciding on a filing strategy.

WHAT IS CFIUS?

The Committee on Foreign Investment in the United States, or CFIUS, is a federal regulatory panel composed of the heads of various federal agencies, chaired by the Secretary of the Treasury. CFIUS reviews investments by foreign persons or companies into U.S. businesses and determines the impact of those investments on U.S. national security. Where a transaction could threaten to impair U.S. national security, CFIUS may place conditions on the transaction prior to approving it, or, if the threat cannot be sufficiently addressed through conditions, CFIUS refers the transaction to the President of the United States to block the transaction. CFIUS also has authority to unwind or impose conditions on transactions that close without CFIUS approval.

It is important to note that the overwhelming majority of cases filed with CFIUS are approved without conditions (known as “mitigation” measures). The need to file a transaction with CFIUS does not necessarily signify a risk to successful closing of the transaction, but rather that the transaction is likely of sufficient interest to CFIUS that failure to file may increase the risk of adverse action by CFIUS.

The following federal bodies are voting members of CFIUS:

- Department of the Treasury (serves as the chair of CFIUS and formal point of contact during the process)
- Department of Justice
- Department of Homeland Security
- Department of Commerce
- Department of Defense
- Department of State
- Department of Energy
- Office of the U.S. Trade Representative
- Office of Science & Technology Policy

The following offices also observe and/or participate in the CFIUS process:

- Office of Management & Budget
- Council of Economic Advisors
- National Security Council
- National Economic Council
- Homeland Security Council

WHAT TYPES OF TRANSACTIONS DOES CFIUS REVIEW?

CFIUS reviews two types of transactions. First, CFIUS reviews acquisitions of “control” of U.S. businesses by foreign persons or companies. The CFIUS standard for control is very low, however, and not subject to a bright-line rule. The CFIUS regulations explicitly exempt any equity investment under 10% that is held for solely for the purpose of passive investment. Investments of 10% or greater in voting securities, in particular if they afford the investor any governance rights in the target, warrant careful examination to determine whether CFIUS jurisdiction may apply.

Second, under its recently expanded purview, CFIUS is authorized to review four additional types of transactions:

- (1) real estate transactions (including leases and other conveyances) where the real estate is located in proximity to sensitive government facilities;
- (2) “other investments” in certain U.S. businesses that afford a foreign person any of the following:
 - access to material nonpublic technical information in the possession of the U.S. business,
 - membership on the board of directors, or
 - any other involvement in substantive decision-making;
- (3) any change in an existing foreign investor’s rights that result in foreign control of a U.S. business or an “other investment” in certain U.S. businesses; and
- (4) any other transaction designed to circumvent CFIUS jurisdiction.

While CFIUS generally does not have direct jurisdiction over debt transactions, it may have jurisdiction over transactions involving convertible debt instruments, or debt transactions that trigger other CFIUS jurisdictional hooks, such as membership on the board of directors or the ability to influence substantive decisionmaking.

WHAT INDUSTRIES DOES CFIUS COVER?

Companies with any of the following factors should pay careful attention to CFIUS issues when considering investment from abroad:

- operation within the U.S. “critical infrastructure” (e.g., energy, financial, transportation, and telecommunications sectors, among many others);
- possession or use of any export-controlled technologies in its operations;
- access to consumer data such as personally identifiable information, credit information, protected health information or other sensitive data;
- provision of services or goods, directly or indirectly, to the U.S. government;
- possession, development or contribution to products, technology or projects of strategic importance to the U.S. national security;
- possession of “emerging” or “foundational technology” (i.e. sensitive or “cutting-edge” technology, which is in the process of being defined by certain CFIUS member agencies) that may bear on U.S. national security; or
- locations near U.S. government installations.

These are factors that indicate that CFIUS is an issue to consider in a transaction, but transaction-specific factors always must be considered as well. Additionally, the identity of the buyer can impact the relative need to file.

WHAT DOES THE CFIUS PROCESS ENTAIL?

The CFIUS process is being revised pursuant to new CFIUS statutory authority, and the new process will include a number of improvements over the current process. Generally speaking, however, the core of the process will remain consistent with the current practice. The process typically involves a post-signing, pre-closing review, similar to other regulatory reviews such as antitrust, Federal Communications Commission or state public utility regulatory reviews.

The process is typically initiated voluntarily by the parties to a transaction by their filing a draft notice with CFIUS (commonly referred to as a “joint voluntary notice” or “JVN”). As specified in the CFIUS regulations, the JVN provides CFIUS high-level information about the parties and the transaction, including a general description of the transaction, the business activities and operations of the parties and their ownership structures. Treasury reviews the JVN for completeness, and the parties work with Treasury to resolve any outstanding issues. At the end of this stage, the parties submit the “formal” JVN. Once CFIUS accepts the notice, the review

lasts 45 calendar days. During the review, any agency may pose written follow-up questions to any party.

During the review, the Office of the Director of National Intelligence develops a “risk-based assessment” of the transaction. The RBA describes the threat posed by the acquirer, the risks attributable to the U.S. business and the consequences to U.S. national security of malicious use of or disruption to the U.S. business. The RBA is classified and is not made available to the parties.

If the CFIUS agencies do not identify issues of concern, Treasury will issue a letter, typically on Day 45 of the review, stating that there are “no unresolved national security concerns” with respect to the transaction, and thus CFIUS is concluding action.

If on Day 45 the CFIUS agencies have not resolved all issues, or need more time to conduct diligence, the agencies will send the review into a second-stage investigation that lasts an additional 45 days. Approximately half of all cases proceed to investigation, and while timing to close the transaction is impacted, investigation does not necessarily signal a problem in the process. To the parties, the process will continue as during the review stage—when agencies have follow-up inquiries, Treasury will send written inquiries.

At the end of the investigation, CFIUS either clears the transaction (by sending a “no unresolved national security concerns” letter) or refers the case to the President for final adjudication. Presidential reviews are exceedingly rare, and the President has never approved a case that has been referred by the agencies.

HOW LONG DOES THE CFIUS PROCESS TAKE?

The formal process typically takes either 45 or 90 days, depending on whether an investigation is required. However, the amount of time after signing that elapses before CFIUS accepts a notice and starts the clock on the review can vary significantly among transactions for a variety of reasons. It is common for the full process to take 4 to 6 months. In rare instances the process can extend much longer.

IS FILING MANDATORY?

Under the new “pilot program,” in many instances, filing is mandatory. In other instances, filing may be advisable even if not mandatory.

Pursuant to a newly launched pilot program, authorized under FIRRMA, CFIUS has set forth rules that require filings for the following transactions:

1. The investment is by a “foreign person” (i.e., a person or entity that is foreign or a one who can be controlled or influenced by a foreign person);

2. The investment transfers “control” to the foreign person or provides the foreign person (i) access to material nonpublic technical information,¹ (ii) a board seat or a board observer seat or (iii) involvement in substantive decisionmaking regarding critical technology; and
3. The U.S. business either (a) deals with “critical technology²” in connection with its activity in one of 27 identified industries (see Annex A hereto) or (b) produces, designs, tests, manufactures, fabricates or develops a “critical technology” for use specifically in one or more identified industries.

These transactions must be filed at least 45 days prior to the anticipated completion date of the transaction, and the filing for the pilot program is a streamlined version of the more “formal” filing in ordinary transactions. Parties that do not file these transactions may be subjected to civil penalties up to the value of the transaction itself.

Apart from transactions requiring mandatory filing, a host of other transactions may warrant a filing. In any situation where a foreign investor’s rights may trigger CFIUS jurisdiction, parties should confirm with counsel whether a CFIUS filing is warranted. Failure to file non-mandatory transactions may result in adverse action by CFIUS, notwithstanding the fact that the filing was not mandatory.

WHY WOULD I FILE IF IT IS NOT MANADATORY IN MY TRANSACTION?

While transaction parties are typically reluctant to introduce an additional regulatory dimension to a transaction, there are several compelling reasons to proactively engage with CFIUS and voluntarily file a notice:

Manage Substantive Risk

CFIUS authority to mitigate or unwind a transaction extends in perpetuity. If the parties close a transaction without filing with CFIUS, CFIUS has authority to take adverse action post-closing. Conversely, by filing, the parties avail themselves of the “safe harbor” provided in the law, which prevents any further action by CFIUS after it has reviewed and approved a transaction.

Manage Timing Risk

¹ “Material nonpublic technical information” means information that is not available in the public domain, and is necessary to design, fabricate, develop, test, produce, or manufacture critical technologies, including processes, techniques, or methods. Material nonpublic technical information does not include financial information regarding the performance of an entity.

² Critical technology includes technology controlled by the International Traffic in Arms Regulation, certain items covered by the Export Administration Regulation, certain nuclear items, select agents and toxins and “emerging and foundational” technologies.

By proactively filing with CFIUS, parties exert maximum control over the timeframe of their review. The inter-agency process required to compel parties to file can be slow, and, if ignored, can surprise parties in the late stages before closing. On the other hand, by proactively filing, the parties eliminate the risk of CFIUS intervention and initiate the process themselves as soon as possible after signing.

Maintain Relationships with the U.S. Government

For a target that has relationships (regulatory or commercial) with the U.S. government, protecting those relationships should be a priority. Filing with CFIUS demonstrates good faith and a desire to be a reliable partner with the U.S. government, and filing assures customers that any risks associated with the investor will be addressed. Similarly, overseas companies wishing to do business in the U.S., or potentially acquire additional U.S. businesses, should prioritize their reputation for openness and transparency with the U.S. regulatory regime. Failure to do so can make future business plans more difficult to carry out.

Establish and Maintain a Relationship with CFIUS

Proactive engagement with CFIUS yields better results than engagement only after request or compulsion by CFIUS. By proactively filing, the parties begin the process from a position of transparency, which engenders trust with CFIUS. Many of the decisions CFIUS makes depend upon their ability to rely on companies as trustworthy parties in the process. In fact, the revised CFIUS statute explicitly allows CFIUS to consider a party's "history of cooperation with the Committee" in adjudicating certain cases. Similarly, a significant component of the CFIUS reform legislation was to put resources into its ability to monitor transaction activity and take action where parties have failed to file.

Manage Public and Customer Relations

Some transactions garner attention from trade and popular press. Competitors may seize on a foreign investment as an opportunity to pursue a company's customers. Customers themselves may have questions about operational continuity and security in light of overseas investment. Proactively filing with CFIUS is a sturdy pillar to a public and customer relations strategy.

Adopt a General Posture of Transparency

In the global marketplace, a transparent approach to regulators helps to guard against unintended consequences. CFIUS is one of the preeminent national security review panels in the world, and the recent statutory changes encourage it to work with allied nations as they expand their national security transactional review processes. Review and clearance by CFIUS helps to assure other regulatory bodies, as well as future customers and targets, that a company and its parent entities are sophisticated, transparent participants in the global economy.

WHAT IS MITIGATION?

Mitigation refers to conditions CFIUS may require parties to accept before CFIUS will clear the transaction. Where CFIUS has identified a threat to U.S. national security, it must mitigate that threat through an agreement with the transaction parties (typically either a Letter of Assurance or a National Security Agreement). Occasionally, parties can informally commit to take certain steps to avoid a formal agreement with CFIUS.

The nature of mitigation varies extensively depending on the transaction. A common component of most mitigation agreements is restrictions on the investor's access to all or parts of the U.S. business. In rare instances, CFIUS requires that the purchaser place the target into a voting trust or proxy structure, to be managed entirely by independent third-party directors, rendering the business inaccessible to the purchaser. Mitigation can significantly impact the ability of the purchaser to realize the expected economic benefits of a transaction, and should be a central component of the parties' CFIUS analysis at the outset of a transaction.

MY TRANSACTION SIMPLY CANNOT BE DELAYED FOR A CFIUS REVIEW. WHAT SHOULD WE DO?

Proactively filing with CFIUS is the ideal scenario to manage CFIUS-related risk. There are, however, ways to manage the risk of adverse CFIUS action within the timing constraints of any particular transaction. These are highly case-specific considerations, and require a full review of CFIUS strategic options balanced against transactional necessities. Of course, in transactions where a filing would be mandatory, there is little additional flexibility to be found.

IS THERE ANYTHING ELSE I SHOULD KNOW ABOUT CFIUS?

Yes. A number of transactions that undergo CFIUS reviews have related issues. For example, the target's technology may be regulated by U.S. export control regulations or the regulations applicable to military technology (the International Traffic in Arms Regulations). Or the target may have access to classified U.S. government information. In such cases, engagement with additional regulators is necessary to ensure a successful closing.

Annex A: CFIUS Pilot Program Industries

Aircraft Manufacturing <i>NAICS Code: 336411</i>	Nuclear Electric Power Generation <i>NAICS Code: 221113</i>	Research and Development in Nanotechnology <i>NAICS Code: 541713</i>
Aircraft Engine and Engine Parts Manufacturing <i>NAICS Code: 336412</i>	Optical Instrument and Lens Manufacturing <i>NAICS Code: 333314</i>	Research and Development in Biotechnology (except Nanobiotechnology) <i>NAICS Code: 541714</i>
Alumina Refining and Primary Aluminum Production <i>NAICS Code: 331313</i>	Other Basic Inorganic Chemical Manufacturing <i>NAICS Code: 325180</i>	Secondary Smelting and Alloying of Aluminum <i>NAICS Code: 331314</i>
Ball and Roller Bearing Manufacturing <i>NAICS Code: 332991</i>	Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing <i>NAICS Code: 336419</i>	Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing <i>NAICS Code: 334511</i>
Computer Storage Device Manufacturing <i>NAICS Code: 334112</i>	Petrochemical Manufacturing <i>NAICS Code: 325110</i>	Semiconductor and Related Device Manufacturing <i>NAICS Code: 334413</i>
Electronic Computer Manufacturing <i>NAICS Code: 334111</i>	Powder Metallurgy Part Manufacturing <i>NAICS Code: 332117</i>	Semiconductor Machinery Manufacturing <i>NAICS Code: 333242</i>
Guided Missile and Space Vehicle Manufacturing <i>NAICS Code: 336414</i>	Power, Distribution, and Specialty Transformer Manufacturing <i>NAICS Code: 335311</i>	Storage Battery Manufacturing <i>NAICS Code: 335911</i>
Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing <i>NAICS Code: 336415</i>	Primary Battery Manufacturing <i>NAICS Code: 335912</i>	Telephone Apparatus Manufacturing <i>NAICS Code: 334210</i>
Military Armored Vehicle, Tank, and Tank Component Manufacturing <i>NAICS Code: 336992</i>	Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing <i>NAICS Code: 334220</i>	Turbine and Turbine Generator Set Units Manufacturing <i>NAICS Code: 333611</i>