

# Overview of the CFIUS Process

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# Introduction

This guide provides an overview of the Committee on Foreign Investment in the United States (CFIUS or the Committee) — a US federal, interagency group with authority to review certain foreign investments in US businesses to determine whether such transactions threaten to impair US national security — and the process through which CFIUS reviews proposed transactions subject to its jurisdiction. This memorandum is not intended to address the facts of any particular transaction, and we would be happy to discuss how the general considerations in this memorandum might apply in a given situation.

## The Composition and Structure of CFIUS

CFIUS is a US federal interagency committee, chaired by the Secretary of the Treasury. Additional members of CFIUS include the Secretaries of Homeland Security, Commerce, Defense, State, Energy, and Labor, the Attorney General, the Director of National Intelligence, the US Trade Representative, and the Director of the Office of Science and Technology Policy. Representatives from other federal agencies also hold “observer” status.

The day-to-day functions of CFIUS are carried out by administrative staff at the Department of Treasury. Once the CFIUS process begins, Treasury staff handles almost all communications with the parties to the relevant transaction. Indeed, CFIUS policies sharply constrain the ability of the parties to communicate directly with CFIUS’ constituent agencies.



*Composition of CFIUS*

CFIUS' committee structure generates important process implications. For example, because CFIUS operates by consensus, the Committee sometimes is not able to move to decision as quickly as federal agencies that operate under a more unified structure. Parties can also face difficulty obtaining from CFIUS an "advance" read on how the Committee will view a given transaction; because CFIUS is a collection of constituent agencies, the opinion of Treasury or Department of Defense staff, for example, might or might not provide much insight into the likely determination of CFIUS as a whole. For this and other reasons, Treasury or the other agencies are reluctant and generally refuse to give a read on transactions that have not yet been submitted to the Committee for review or to answer questions posed in the context of hypothetical transactions.

## The Scope of CFIUS Jurisdiction

CFIUS was created in 1988 by the Exon-Florio Amendment to the Defense Production Act of 1950. CFIUS' authorizing statute was amended by the Foreign Investment and National Security Act of 2007 (FISIA). This statutory framework authorizes the President of the United States (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." CFIUS' role is to evaluate whether and to what extent such transactions could impact US national security. If a transaction could pose a risk to US national security, the President may suspend or prohibit the transaction, or impose conditions on it.

Although CFIUS' statutory jurisdiction is quite broad, CFIUS' regulations impose important limits on the types of cases subject to its review. First, while CFIUS has interpreted the phrase "merger, acquisition, or takeover" broadly — to include, for example, the acquisition of convertible voting interests and proxy interests — as a general rule the foreign investments CFIUS reviews are "equity-like" in nature. As a consequence, CFIUS generally does not review lending transactions, unless the foreign person acquires financial or governance rights characteristic of an equity investment, or an imminent default could give a foreign person actual control of collateral that constitutes a US business.

Second, CFIUS only has jurisdiction to review transactions involving "US businesses," even if the target's US operations are only a part of a larger international business (Note, however, that CFIUS' authority extends only to the US component of an international business.) Notably, the definition of US businesses encompasses:

- Foreign-to-foreign deals in which the target has one or more US subsidiaries or significant US assets or operations (e.g., merger of a French company with a German company, if the German company has subsidiaries in the United States)
- The formation of joint ventures in which one party contributes an existing US business
- Deals involving long-term leases of US assets that operate as de facto transfers of US businesses

### The CFIUS Safe Harbor

Considerable ambiguity about what types of minority investments can result in a determination of control, mean this safe harbor is not necessarily safe at all. However, the regulations provide in an example that an acquisition of 7% of the voting securities of a US business in an open market purchase solely for the purpose of passive investment, with no other relevant facts, would qualify for the safe harbor. The ambiguity inherent in CFIUS' regulations, coupled with the fact that CFIUS determines the scope of its own jurisdiction in the first instance — and is afforded significant deference by the courts — means that close questions normally should be resolved in favor of jurisdiction. This places a great deal of pressure on the question of whether a given transaction that arguably is within the scope of CFIUS jurisdiction is the type of transaction that should be submitted for CFIUS review.

Because the relevant US business must exist prior to the investment by the foreign person, true “greenfield” investments are not subject to CFIUS review. However, in practice greenfield status is often unclear because the US government may view a collection of assets assembled by investors in anticipation of the formation of a future business (e.g., contracts and intellectual property rights) may be viewed as constituting a US business.

Third, CFIUS only has jurisdiction to review transactions that could result in “control” of the US business by a foreign person. Notably, control in this context does not necessarily require the foreign person acquire a majority interest in the US business; CFIUS’ regulations clarify that minority interests that confer a significant ability to influence “important matters” related to the US business may confer control.

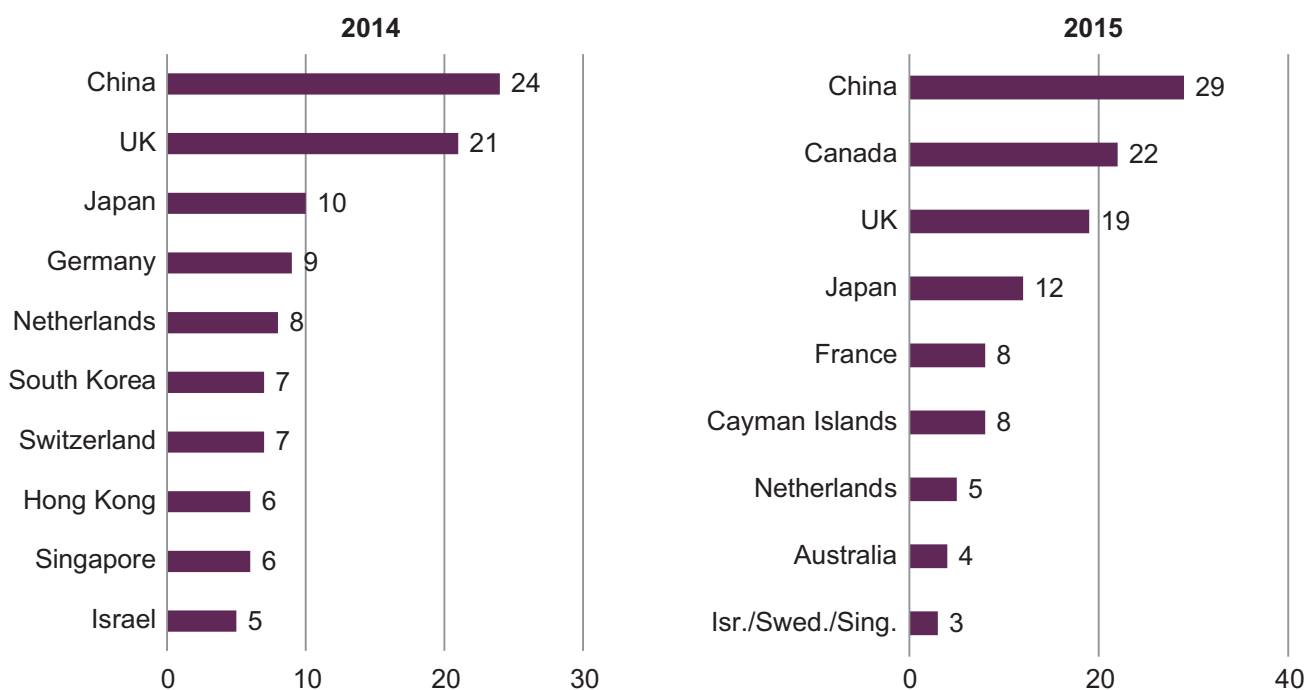
At the same time, the regulations enumerate a list of standard “minority investor protections,” the existence of which, in and of themselves, will not result in control by a foreign person. The minority investor protections are similar to some of those normally reserved for significant minority investors through underlying deal documents. These include, for instance:

- 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
- The power to prevent an entity from entering into contracts with majority investors or their affiliates
- The power to prevent an entity from guaranteeing the obligations of majority investors or their affiliates
- 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
- 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.

Critically, though, there are no bright lines beyond these relatively narrow protections, and CFIUS has significant discretion to determine when a foreign entity has sufficient control to confer jurisdiction

As a practical matter, the scope of CFIUS’ jurisdiction is often ambiguous. This ambiguity is illustrated by the one “safe harbor” explicitly established by CFIUS’ regulations, which provides that investments resulting in a foreign person having an ownership interest of 10% or less of the outstanding voting interests in the US business are not within CFIUS’ jurisdiction, if those investments are held “solely for the purpose of passive investment.” While this formulation appears straightforward, a closer read reveals that the “passive” nature of the investment can be called into question in light of “other” facts deemed relevant by CFIUS — e.g., contractual or other arrangements between the foreign investor and the target.

## CFIUS Covered Transactions by Country (2014-2015)



Source: Committee on Foreign Investment in the United States, Annual Report to Congress, CY 2015

## Prudential Analysis in Connection with Potential CFIUS Issues

Where CFIUS arguably has jurisdiction over a given transaction, the parties “voluntarily” notify CFIUS of the transaction in the first instance (CFIUS also is authorized to commence reviews on its own, although it uses this power infrequently). Parties — and particularly foreign investors — opt to undergo the CFIUS process voluntarily because once a transaction is cleared by CFIUS, it is cleared forever (with some limited exceptions) and CFIUS-related risk is largely eliminated. In contrast, CFIUS can review — at any time — a transaction that it did not clear prior to closing — with uncertain and potentially devastating results, including requiring divestiture many years after the deal has closed (although this is extremely rare).

If a given transaction arguably is within the scope of CFIUS’ jurisdiction, parties normally will file if they perceive a significant level of CFIUS-related risk associated with the target (often referred to as a “vulnerability”) or associated with the foreign investor (often referred to as a “threat”). Many factors inform the parties’ evaluation of the nature and extent of such risk, including (but not limited to):

- The likely impact of proposed transaction on national defense requirements
- The foreign investor’s nationality and the extent of its ownership by foreign governments (e.g., Chinese investments are generally perceived as high-risk)
- The target’s involvement in and ties to national security-related activity and “critical infrastructure” in the United States
- The proximity of the target’s assets to sensitive US government locations, such as military installations (which may be known or unknown to the target)

### Control

These “important matters” include (but are not necessarily limited to): the sale, transfer, or encumbrance of principal assets; merger and dissolution; the closing of facilities; major expenditures; the selection of business lines; the entry into or nonfulfillment of contracts; proprietary information policy; the appointment of senior managers or employees with access to sensitive information; and the amendment of the business’s governing document (e.g., Articles of Incorporation).

In evaluating potential CFIUS-related risk, parties should consider the relevant transaction from the perspective of the US government. Notably, CFIUS has access to classified information not available to the parties, and this information may inform CFIUS' risk analysis. Simultaneously, because CFIUS' principal concern is safeguarding US national security — and not advancing the parties' private economic objectives — CFIUS is likely to place great emphasis on perceived risks that may be objectively remote. As a result, CFIUS may perceive a risk to US national security that outside parties are simply unable to imagine. In addition, CFIUS generally is not transparent and normally does not give parties the opportunity to “debate” its conclusions.

### Proximity Issues

Even if the target's business does not involve national security or critical infrastructure, the proximity of its assets to sensitive US government locations can give rise to CFIUS-related risk. In 2012, President Obama issued an executive order directing Ralls Corporation, a Chinese-owned company, to divest its acquisition of four wind farm projects in Oregon based on the proximity of those facilities to a sensitive naval installation. Ralls sued on due process grounds and, after a partial victory in the DC Circuit, ultimately reached a settlement allowing Ralls to sell its interest in the wind farm projects.

Notably, the parties to the transaction may well have varying levels of tolerance with respect to CFIUS-related risk. As a general matter, the foreign investor has greater incentive than the US target to engage with CFIUS and its review process, because, in the absence of CFIUS clearance, the President (through CFIUS) could require divestiture or impose other adverse conditions after closing. At that point, the previous owners of the US business often are out of the picture (or hold reduced ownership stakes). Moreover, if the remedy involves the imposition of adverse conditions, those conditions typically impact the foreign investor disproportionately (e.g., by limiting the foreign investor's access to information or facilities, or ability to influence certain corporate matters). In many circumstances, US targets and sellers also may have an incentive to engage with the US government through the CFIUS process, for example if they will hold equity interests in the post-transaction company or if they believe that such engagement will benefit other aspects of their businesses.

## The CFIUS Review Process

If the parties decide to submit a CFIUS notice, typically the foreign investor and the target company will jointly prepare the notice. Preparing a filing is a substantial undertaking that requires disclosing a significant amount of information. Although all information filed with CFIUS is accorded confidential treatment by law, parties may find the process of producing this information to be intrusive and burdensome. In particular, in addition to providing general descriptive information about the parties and the transaction, foreign investors must provide detailed “personal identifier information” (including name, address, telephone number, national identity number, passport and visa information, information about foreign government and military service, etc.). The investment vehicle or any other entity in the control chain must provide this personal identifier information for all of its senior officers and directors, as well as shareholders with a 5% or greater ownership interest.

Filing a voluntary notice triggers statutory deadlines within which CFIUS must act. For this reason, in some cases parties would be prudent to engage in informal consultations with CFIUS (or its constituent agencies) prior to submitting the CFIUS notice. These consultations could range from as little as a telephone call with counsel to formal presentations to CFIUS and prolonged negotiations. After those informal consultations have occurred (or are ongoing), the parties are strongly encouraged to submit a draft “pre-filing” version of the notice to CFIUS. This allows CFIUS the opportunity to review the filing and identify any additional information that it would like the parties to include in the formal filing. The pre-filing process also affords CFIUS additional lead time, and therefore relieves some of the pressure imposed by the statutory timeline for CFIUS review.

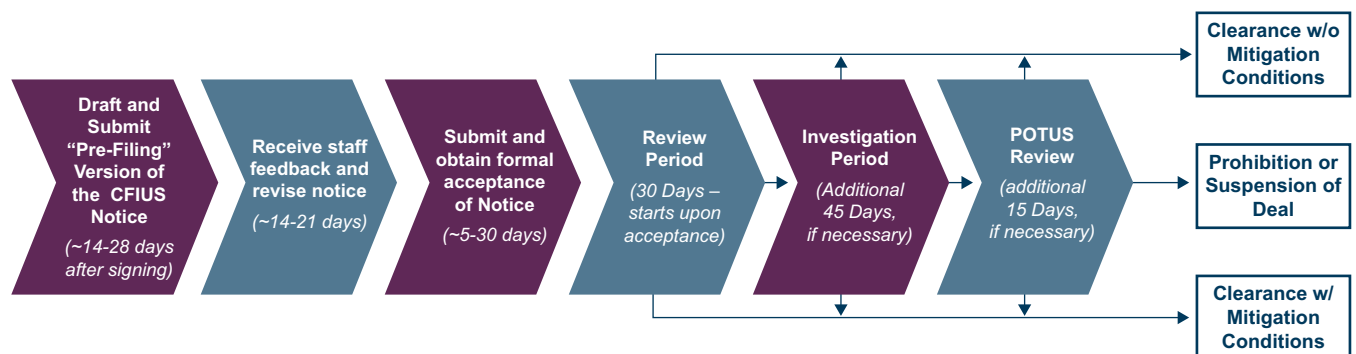


The formal CFIUS notice normally is submitted at least five business days after the draft filing. In recent months, we have seen a marked increase in the amount of time CFIUS takes to review pre-filing notices. As a result, in some cases parties wait weeks to receive feedback from CFIUS staff. Similarly, once the formal CFIUS notice has been submitted, the statutory timeline for review does not commence until CFIUS officially “accepts” the notice by issuing a letter to that effect. Whereas in the past, parties could expect this step to be completed in a day or two in almost all cases, in recent months acceptance has often taken one to two weeks or longer. These changes are largely attributable to a sharp increase in the number of cases filed with CFIUS on an annual basis, and a corresponding increase in the average number of cases a given CFIUS staff member may be managing at any given time.

## Personal Identifier Information (PII)

One of the most burdensome and time-consuming steps in completing the CFIUS notice is the collection of PII for officers, directors, and significant shareholders in the control chain of the foreign investor. Complex ownership structures can make it challenging to identify all individuals for which PII must be provided, and obtaining sensitive personal information from multiple individuals can be difficult.

## Overview of the CFIUS Process



After formally accepting a filing, CFIUS has 30 calendar days to “review” the transaction and decide whether to clear it or commence an “investigation” (essentially, an extension or continuation of the initial review) instead. That investigation can last up to an additional 45 days, although the process can be terminated early, at any point during the 45-day investigation period. If CFIUS still has not resolved any potential national security concerns at the end of the 45-day investigation period, CFIUS is responsible for making a formal recommendation to the President as to whether to clear or block the transaction. The President then has up to 15 additional days to decide whether to suspend, prohibit or impose conditions on the deal. On rare occasions, CFIUS may instead request that the parties voluntarily withdraw and then immediately refile their notice, thereby extending the statutory timeline for CFIUS review. As a practical matter, transactions normally are cleared during the review or investigation phases — potentially through the negotiation of an appropriate mitigation instrument. However, consistent with the processing trends noted above with respect to pre-filing review and formal acceptance, in our experience generally CFIUS has taken longer to clear many cases than it might have in the past.

The number of transactions notified to CFIUS has increased significantly in recent years, and that trend is expected to continue. Much of the growth is attributable to the volume of Chinese investments in the United States and CFIUS’ interest in those transactions, particularly when they involve semiconductors or other sensitive technologies. Because of the number of notices filed and the complexity of many of the transactions that are the subject of those notices, CFIUS is increasingly extending its review into the investigation period as a way of managing its workload.



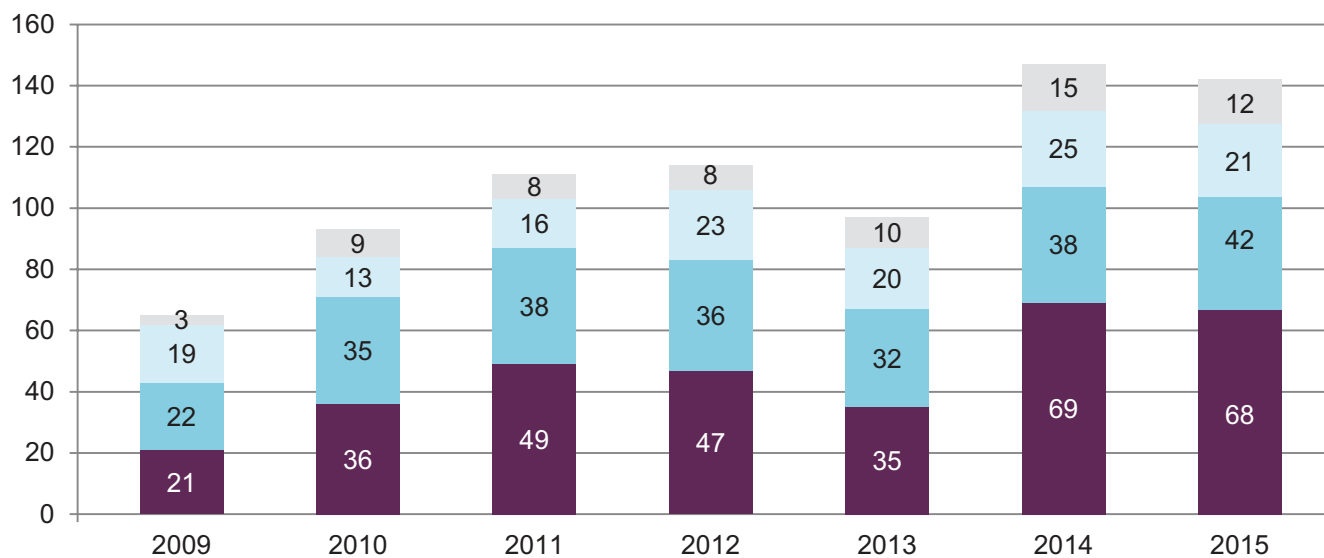
## Covered Transactions, Withdrawals and Presidential Decisions 2009-2015



- Number of Notices
- Notices Withdrawn During Review
- Number of Investigations
- Notices Withdrawn After Commencement of Investigation
- Presidential Decisions

Source: 2015 CFIUS Annual Report to Congress

## Covered Transactions by Sector



- Manufacturing
- Finance, Information and Services
- Mining, Utilities and Construction
- Wholesale, Retail and Transportation

Source: 2015 CFIUS Annual Report to Congress

# Mitigation of Perceived Risks to National Security

A CFIUS determination that a transaction could threaten or impair national security does not necessarily mean that the transaction will not be allowed to move forward. Indeed, very few transactions have ever been rejected outright through the CFIUS process (although from time to time parties have withdrawn their transactions from review and terminated those transactions when the likelihood of an unsuccessful outcome became clear). In many cases, CFIUS can clear a transaction subject to conditions designed to mitigate the perceived risks to US national security the transaction otherwise would pose. If necessary, CFIUS typically will engage with the parties to negotiate such conditions in the form of an appropriate mitigation instrument. If CFIUS foresees potential national security concerns early in the process, it may open such negotiations even in the pre-filing phase, before the parties officially submit their formal CFIUS notice.

Mitigation instruments can range from assurance letters between CFIUS and the parties (whereby the parties undertake minimal corporate steps to address security concerns) to complex agreements that can impose burdensome operational restrictions or even require restructuring aspects of the transaction itself. In all events, the purpose of the underlying conditions is to constrain foreign control that otherwise would result from the transaction. The aim of such conditions can include:

- Limiting access to certain facilities or information to authorized US citizens
- Ensuring that only US citizens handle certain critical functions
- Establishing governance mechanisms to place critical decisions in the hands of US citizens and/or ensure compliance with all required actions
- Imposing reporting and independent audit requirements, or requiring company personnel to meet with US government personnel periodically to discuss the company's products, services and business activities, or market conditions and developments generally
- Establishing guidelines and terms for handling existing or future US government contracts, customer information and other sensitive information
- Providing the US government with the right to review certain business decisions and object if those decisions raise national security concerns

From 2013-2015, 10 cases (10%) resulted in the use of legally binding mitigation measures. In 2015, CFIUS mitigation measures were applied to 11 different covered transactions (8% of total 2015 transactions).

(Source: 2015 CFIUS Annual Report to Congress)

Cases concluded with mitigation agreements can be reopened at any time in the event of material breach — and the US government will monitor compliance closely. In recent years, we have seen an increase in the number of mitigation agreements with “hooks” allowing the US government to monitor the US business on an ongoing basis and reassert jurisdiction in the event of triggering condition(s) that might raise concerns (e.g., an increase in business with certain foreign parties). Because the costs of complying with these conditions can be substantial — and their imposition means that CFIUS-related risk is never entirely eliminated — such conditions can have a significant impact on the economics of the transaction and its underlying rationale.

# The Team

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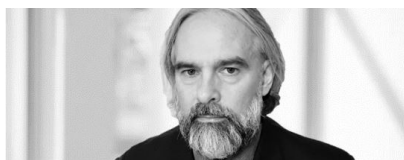
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