Dechert LLP

CFIUS: Recent Developments and Topics to Monitor

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Key Takeaways

- Foreign investment in the United States is on a multi-year growth trend as dealmaking surges to its highest level on record.
- New foreign investment is encountering a less public and more traditional Committee on Foreign Investment in the United States ("CFIUS" or the "Committee") under President Biden as it works to maintain a balance between economic interests and national security concerns.
- Investments in strategically important U.S. sectors by non-U.S. investors remain subject to meaningful scrutiny; dealmakers should evaluate CFIUS considerations early in the transaction process to identify and manage potential impediments to closing.
- Proposals under consideration in Congress and the Administration to create a review mechanism for outbound capital flows from the United States are also worth monitoring.

Background

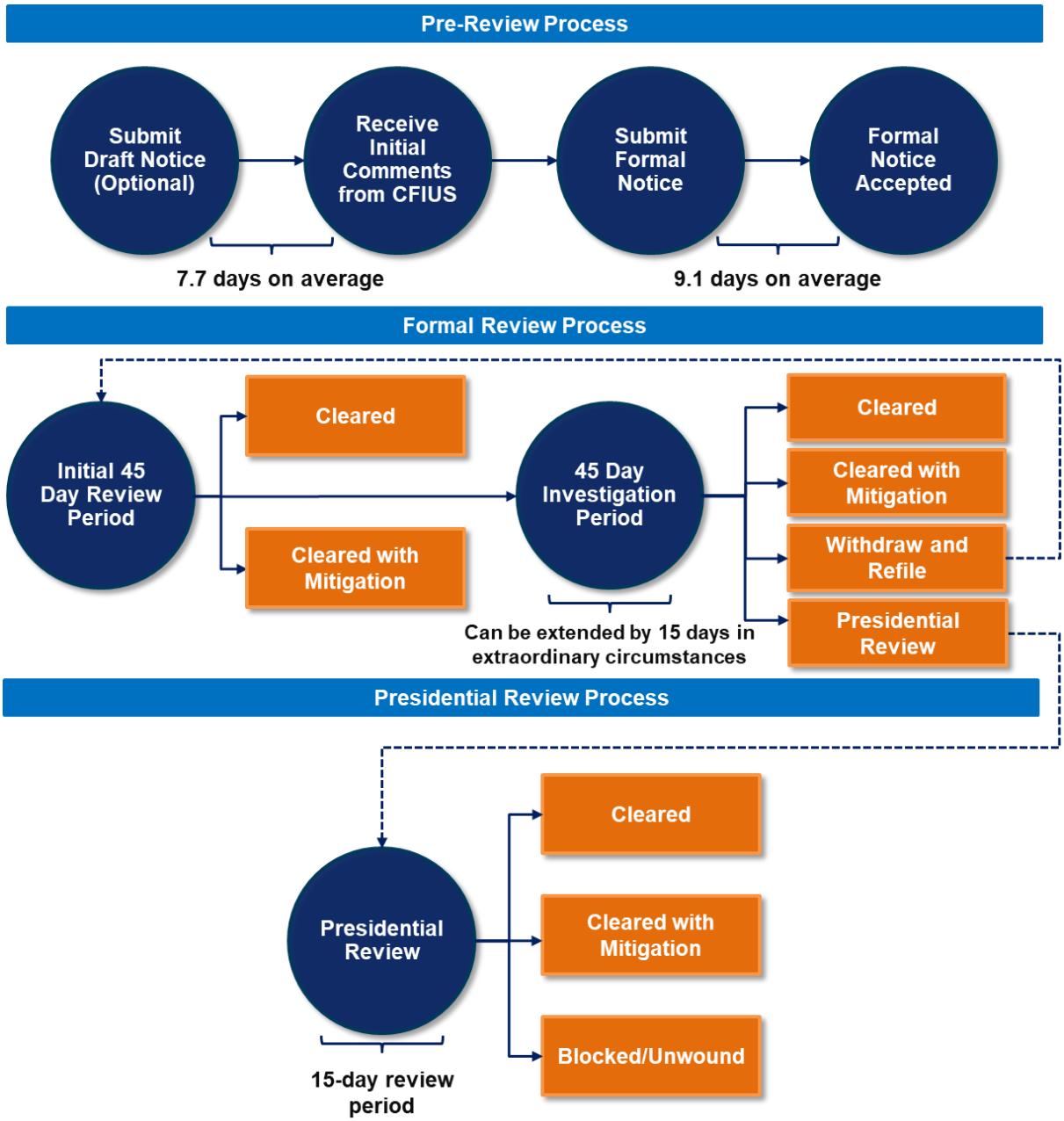
CFIUS is an interagency committee, principally comprising nine members and chaired by the Secretary of the Treasury, which has broad powers to review foreign investments in and acquisitions of U.S. businesses to determine the potential impact on U.S. national security. The Committee has the authority to impose mitigation measures, suspend transactions and, where appropriate, recommend that the President block or unwind transactions.

CFIUS has broad authority (expanded in recent years as a result of the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA")) to review transactions involving U.S. businesses and non-U.S. investors, including:

- Mergers, acquisitions and takeovers that could result in a non-U.S. person acquiring control (defined broadly) of a U.S. business;
- Certain non-controlling investments by non-U.S. persons in U.S. businesses associated with critical technology, critical infrastructure and sensitive personal data (with mandatory filing requirements for transactions involving certain U.S. businesses dealing in critical technologies or non-U.S. persons affiliated with non-U.S. governments); and
- Transactions involving the purchase or lease by, or concession to, a non-U.S. person of certain U.S. real estate that might raise national security concerns.

Transactions are brought to the Committee's attention through filings that take the form of either "notices" or "declarations." It generally takes a few weeks to a month to prepare a filing, though

this timing can be accelerated. Notices are multi-page, in-depth descriptions of the transaction and parties that result in a four- to six-month review process and possible investigation. Following submission of a notice, CFIUS has 45 days to review the notice, after which CFIUS can clear the deal with or without mitigation conditions, or begin an investigation, which gives it 45 more days to review. In extraordinary circumstances, the Committee can take an extra 15 days to review the deal. Notices can result in the deal being cleared to proceed; being subject to mitigation measures to protect national security concerns; or, in rare cases, being blocked or unwound.



Source: CFIUS Annual Report to Congress for CY 2020

Declarations are typically no longer than five pages and present a simplified method of informing CFIUS of a transaction, including (but not only) when a filing is mandated (see our prior OnPoint). Following submission, CFIUS has 30 days to review a declaration. The Committee may respond to a declaration in one of four ways, by informing parties that it: has cleared the transaction; is initiating a unilateral review; is requesting that the parties submit a full formal notice; or is unable to reach a decision regarding clearance based on the declaration alone.

Source: CFIUS Annual Report to Congress for CY 2020

Under the last option, parties do not have the investment protection that accompanies formal CFIUS clearance under a voluntary notice and do not have clear guidance from CFIUS as to how to proceed. As a result, parties should consider whether it is preferable to submit a full formal notice from the outset so as to be guaranteed a final response from CFIUS that will provide certainty, even if this requires additional time (for preparation of a notice and for the longer review/investigation period afforded to the Committee) as well as payment of a filing fee.

Parties should also carefully consider the characteristics of a given deal before choosing to submit a declaration if a formal CFIUS clearance is a desired outcome. Recent public statements from staff of certain CFIUS member agencies have provided insights as to the circumstances in which submitting a declaration likely will not be productive.

Deals and Declarations Soared in 2021

Dealmakers had a record year, approximately $5.1 trillion in deals were agreed worldwide in 2021 and U.S. deals accounted for approximately 60% of all global deals (in announced value). We expect that this resulted in a particularly busy year for the Committee. Based on the latest data available, there is a multi-year trend of transactions increasingly being filed with CFIUS. For example, as of 2020, the most recent year for which data regarding CFIUS filings is available, there were over three hundred transactions reviewed by the Committee in each of the last two years, up approximately 300% from the number of filings in 2010.

The proportion of declarations to notices has also increased. In July 2021, CFIUS published its latest Annual Report to Congress on key activities, including notices, declarations, and withdrawals through 2020 ("Annual Report"). This Annual Report showed a growing trend in the number of short-form declarations that were filed with the Committee in comparison with notices. Of the 313 filings in 2020, approximately 60% (187) were full notices, while 40% (126) were declarations. Declarations were up from approximately 30% (94) in 2019 and 8% (20) in 2018, the first year declarations were accepted.

The greater speed and efficiency of declarations and the advent of "excepted foreign states" (discussed below) likely account for the increased use of declarations.

Tone from the Top: CFIUS Under Biden and Trump

While the Committee sees hundreds of filings each year, it rarely blocks or requires the unwinding of a deal: to date, only seven transactions have ever been formally blocked by Presidential Order. At the same time, mandated blocking/unwinding of deals has occurred more frequently in recent years. President Trump ordered the blocking of two transactions and the unwinding of two others. President Biden did not formally block any transactions during his first year in office, and it remains to be seen how the Biden Administration uses this authority over its remaining term.

Of course, transactions are not only subject to formal disruption via Presidential Order but also may be withdrawn in anticipation of such orders. During 2020, for example, according to CFIUS seven transactions were withdrawn from the CFIUS review process (and ultimately abandoned) because either CFIUS could not identify mitigation measures that would resolve the Committee's national security concerns or the parties were unwilling to accept the mitigation measures presented to them as a condition of clearance.

The differing approaches with respect to CFIUS under the Trump and Biden Administrations can be seen in a number of ways, and they are highlighted by the different approaches taken to addressing the potential national security risks posed by TikTok, the social media platform. CFIUS opened a review of TikTok in 2019 under President Trump. It did so two years after TikTok's Chinese parent company, ByteDance, bought the U.S. company Musical.ly and merged it into TikTok—a reminder that forgoing CFIUS approval can carry infinite tail risk that the Committee will initiate a unilateral review post-close. In 2020, the Trump Administration brought CFIUS into the spotlight (again) by issuing an executive order requiring ByteDance to divest all of its interests in TikTok. The Trump Administration reportedly was concerned that TikTok was sharing Americans' user data with the Chinese government (or could be compelled to do so) and that the Chinese government could influence TikTok to censor certain information and spread disinformation.

By contrast, President Biden's approach has returned national security policymaking to more traditional interagency processes. After U.S. federal courts issued an injunction against President Trump's executive order, President Biden's Justice Department agreed for the case to be held in abeyance while the parties negotiate to determine whether the case may be solved by mutual agreement. However, the Biden Administration reportedly is considering a rule under which the U.S. Commerce Secretary can regulate and/or potentially bar foreign-origin Internet

applications that are deemed to have high security risks. The Proposed Rule would force applications like TikTok to submit to third-party auditing, source-code examination and monitoring of the logs that show user data.

Certain aspects of U.S. national security policy remain consistent across administrations: we see continued heightened scrutiny of certain investments, including those involving foreign acquisitions of target companies associated with critical or sophisticated technology, sensitive personal data, and semiconductors (especially, but not only, when such transactions involve Chinese investors).

The Committee has remained aggressive with respect to monitoring foreign access to sensitive data and has made recent public statements as to its focus on sensitive data deals and use of available tools (such as the mitigation measures described below) to address this area of perceived national security risk. Under the Trump Administration, CFIUS blocked several deals with data-related concerns, such as transactions involving the social networking application, Grindr, and the healthcare website, PatientsLikeMe. While President Biden revoked President Trump's executive order pertaining to TikTok, Biden reiterated the importance of data security to national security and, as discussed above, has initiated an interagency rulemaking process to further regulate foreign access to sensitive personal data.

In addition to personal data deals, the Committee has been focused on the global semiconductor industry and implications for transactions involving semiconductors. In December 2021, South Korean semiconductor chip maker Magnachip Semiconductor Corp. ("Magnachip") and Wise Road Capital ("Wise Road"), a Chinese private equity firm, terminated a $1.4 billion transaction. Magnachip and Wise Road did not submit a CFIUS filing at the time the transaction was announced in March 2021 in the apparent belief that the Magnachip's limited activities in the U.S. were insufficient to confer jurisdiction for CFIUS review or were unlikely to be of national security concern. The parties subsequently received a request from the Committee to submit a filing, and ultimately they were unable to obtain CFIUS approval. Magnachip's August 2021 SEC filing indicated that the Committee was unable to identify "any mitigation measures … that would adequately mitigate the identified risks." The Magnachip transaction is notable because it demonstrates the breadth of the Committee's jurisdiction and the continued heightened sensitivity of the U.S. government to Chinese investments in the semiconductor industry.

The TikTok and Magnachip matters highlight the Committee's focus on China and its broad view of its jurisdiction, requiring only minimal U.S. connections to exercise that jurisdiction in the Magnachip transaction, and exercising its jurisdiction years after the fact in the TikTok transaction.

Investment from China may be subject to particular scrutiny but assessing structures and methods for allaying potential national security concerns can go a long way towards ensuring that a deal is cleared by CFIUS. For example, in 2021 CFIUS cleared a transaction involving a Chinese investment company, Genimous Investment Co., Ltd., which had acquired a U.S. data-driven marketing company, Spigot, in 2016. The parties had not made a CFIUS filing in 2016, but the Committee reportedly subsequently requested a filing, identified a national security risk and required the parties to sign a national security agreement ("NSA") to mitigate the risk that was identified, including requiring that a majority of the boards of Spigot and its immediate

parent companies comprise CFIUS-approved U.S. citizens and that Spigot not transfer any U.S. persons' data outside the United States without prior approval.

Like the Spigot parties, autonomous truck software developer TuSimple Holdings Inc. ("TuSimple") and Chinese technology company Sun Dream Inc. ("Sun Dream") reportedly are also subject to an NSA. At the time of TuSimple's initial public offering in April 2021, Sun Dream held 20% of the equity in TuSimple. The parties did not make a CFIUS filing in connection with Sun Dream's initial acquisition and were invited by CFIUS to make a CFIUS filing. Following the Committee's review, the Committee again identified a risk and required the parties to agree to an NSA as a condition to clearance. The NSA required TuSimple to limit Sun Dream's access to certain data, adopt a technology control plan, appoint a security officer and director, and establish a board-level government security committee. TuSimple will also meet with CFIUS monitoring agencies periodically.

NSAs are an important way for CFIUS to mitigate national security risks and offer the government and transaction parties an off-ramp short of abandoning a transaction or having it forcibly blocked or unwound. NSAs agreed between the U.S. government and the parties to a transaction lay out restrictions and controls that CFIUS imposes as a condition to clearing the deal. Mitigation measures can include prohibiting or limiting the transfer or sharing of certain intellectual property, trade secrets, or know-how; ensuring that only authorized persons have access to certain technology; and prior notification allowing for approval by U.S. government parties in connection with any increase in ownership or rights by the non-U.S. acquirer.

The Spigot and TuSimple transactions, among others of which we are aware, demonstrate that Chinese investments in sensitive U.S. businesses can achieve CFIUS clearance when parties are willing and able to participate in NSAs. These transactions, taken together with the TikTok and Magnachip transactions, reflect the importance of developing in advance a sophisticated strategy for bringing a deal before CFIUS.

A Sophisticated Strategy Can Benefit Investors from All Jurisdictions

The United States remains open to foreign investment; not all investment in sensitive sectors or from Chinese investors is blocked. But a sophisticated CFIUS strategy – one that accounts for an investor's objectives and also anticipates the likelihood that the Committee will identify national security risks as well as the measures that may be required to mitigate such risks – can make a significant difference.

While CFIUS does not disclose which deals it clears from which countries, declassified data published by the Committee makes clear that Chinese investors continue to submit CFIUS filings—investors from China submitted more CFIUS notices than investors from any country other than Japan in 2020.

When contemplating a transaction, investors should conduct due diligence to understand national security touchpoints on all sides of a transaction, including the investors and the investment target. Whether the target business provides products or services to the U.S. Government (whether directly or indirectly), and whether it is involved in critical technology, critical infrastructure, or sensitive data should all be considered.

The nationality of the foreign investor is also a significant factor. In some instances, it can be particularly helpful. Certain investors from countries formally identified as "excepted foreign states"—presently including only Australia, Canada, New Zealand, and the United Kingdom—enjoy benefits not available to other foreign investors. Under certain circumstances, "excepted investors" are not subject to mandatory filing requirements and are shielded from CFIUS' expanded jurisdiction over non-controlling investments in certain U.S. businesses and certain U.S. real estate transactions. This may enable such "excepted investors" to present to their potential transaction partners fewer impediments to closing as compared to other foreign investors who condition their investments on the receipt of CFIUS approval.

In addition, parties can tailor transaction provisions to mitigate risks that are identified. For example, when investment targets involve sensitive data, investors seeking to enjoy the economic benefits of investments in businesses that collect and maintain personal data but who do not have a need to obtain access to such data in connection with their investments can voluntarily restrict their access while still obtaining customary information rights necessary to monitor the performance of an investment.

Areas to Monitor

Outbound Investment Review

On February 4, 2022, the House of Representatives passed legislation that would implement an outbound investment review process. The legislation, part of the America Creating Opportunities for Manufacturing, Pre-Eminence in Technology, and Economic Strength Act of 2022 (H.R. 4521) ("America COMPETES"), would create an inter-agency process headed by the U.S. Trade Representative—the Committee on National Critical Capabilities Reviews ("CNCCR")—to review and regulate outbound investment transactions.

One purpose of such an outbound review process is to ensure that the United States can protect domestic manufacturing capacity and does not become dependent on "foreign adversaries" for "national critical capabilities." Such critical capabilities are described in the legislation as "systems and assets, whether physical or virtual, so vital to the United States that the inability to develop such systems and assets or the incapacity or destruction of such systems or assets would have a debilitating impact on national security or crisis preparedness." It is expected that critical capabilities would capture materials and technologies associated with the manufacture not only of items such as components of weapons and intelligence collection systems but also medical supplies and critical infrastructure materials, as well as related services.

The proposed outbound review committee would have the authority to review certain transactions that could impact the aforementioned national critical capabilities. Specifically, the outbound review committee could review any transaction by a U.S. business that "shifts or relocates to a country of concern, or transfers to an entity of concern, the design, development, production, manufacture, fabrication, supply, servicing, testing, management, operation, investment, ownership, or any other essential elements involving one or more national critical

capabilities," or "could result in an unacceptable risk to a national critical capability." U.S. businesses that engage in such "covered transactions" would be required to submit a written notification of the transaction to the review committee. The committee would then have 60 days to review the transaction for risk to national critical capabilities.

The Senate's equivalent to America COMPETES, the United States Innovation and Competition Act (S. 1260) ("USICA"), was passed in June 2021. It contains many provisions similar to America COMPETES, but it does not contain an outbound investment review provision.

The Senate and House are currently working to reconcile the two bills. It is unclear whether the outbound investment component will remain in the resulting legislation. While there appears to be bipartisan support for an outbound review mechanism, the business community and others are known to have raised concerns. If the CNCCR (or something like it) emerges from reconciliation, it would be the first major outbound investment review process to be adopted by a major Western economy, affecting tens of billions of dollars in annual outbound investment flows.

However, the Treasury Department has proposed an alternative to the House legislation, one which may draw less concern from the business community but would still have an effect on U.S. annual outbound investment flows. The proposal, which is titled The Sensitive Technologies Supply Chain Risk Management Act of 2022, would create a pilot program that gathers information about certain investments made by U.S. persons in "covered foreign persons" (persons from "covered states" as determined by the Secretary of State) that could affect the United States' critical supply chain. The data from the pilot program would then be used to enable the Biden Administration to "understand national security concerns that could arise from such transactions and the extent to which existing authorities are capable of addressing those risks and to identify any new authorities that should be established to address those risks." The pilot program would not authorize Treasury to block those investments. This is in contrast to the Congressional proposal, which *would* include the power to block certain investments. It has also been reported that the White House may be considering executive action on an outbound investment review mechanism if Congress does not act, but Biden Administration officials have not yet agreed on the scope of such action.

Non-Notified/Non-Declared Transactions

One of the key expansions of CFIUS' authority resulting from the passage of FIRRMA was the strengthening and broadening of the Committee's authority to review so-called "non-notified"/"non-declared" transactions, meaning transactions that fall within CFIUS' jurisdiction but were not submitted by the transaction parties to the Committee for review. During 2020, CFIUS identified and requested information regarding 117 non-notified transactions, and the 2020 CFIUS Annual Report identified several methods for improving the Committee's identification of non-notified transactions. Based on recent informal data offered by CFIUS officials, there has been a marked uptick in the number of non-notified transactions that have resulted in Committee requests for information as well as formal CFIUS review; we understand that in the most recent year or so CFIUS member agencies have suggested many thousands of non-notified transactions as candidates for follow-up from the Committee's office of non-notified transactions, resulting in formal requests for information regarding approximately 500 such transactions. It is clear that the Committee has acted on the proposed suggestions

and is actively identifying non-notified transactions for review, further highlighting the importance of including CFIUS considerations early in the transaction planning and diligence process.

Conclusion

CFIUS continues to make use of its enhanced authorities and to pay particular attention to investments in certain sensitive sectors and to investors from China. While the CFIUS review process under the Biden Administration has returned to, and is likely to maintain, an emphasis on a national security review process driven by a rigorous inter-agency process, we also expect continuation of the upward trend in the number of filings brought before the Committee. Given the continued prevalence of NSAs and other mitigation measures, as well as the uptick in activity around non-notified transactions, foreign investors should evaluate potential CFIUS considerations in connection with their transactions from the start of the transaction process.

Dechert regularly advises foreign and domestic entities through the CFIUS review process, helping them determine if they should bring a transaction before the Committee, consider the political and policy considerations that may arise, assemble the required information for a filing, and then (as necessary) negotiate national security agreements with CFIUS in a manner that minimizes both delay and the imposition of conditions that might threaten the transaction.

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