LATHAM & WATKINS LLP

Committee on Foreign Investment in the United States

Key Questions Answered On CFIUS

What is CFIUS?

CFIUS stands for the Committee on Foreign Investment in the United States. It is 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. If a transaction could pose a risk to US national security, the President of the United States may suspend or prohibit the transaction. Notably, the President can unwind transactions even after they close if they have not previously been submitted voluntarily to CFIUS by the parties and cleared through the CFIUS process.

Which US Agencies Make Up This Committee and How Do They Work Together?

CFIUS, which is chaired by the Secretary of the Treasury, includes 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, including several White House offices, also hold observer status.

Composition of CFIUS

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. CFIUS policies sharply constrain the ability of the parties to communicate directly with CFIUS' constituent agencies.

The CFIUS committee structure results in important process implications, including:

- The consensus-driven Committee is often not able to move to a decision as quickly as federal agencies that operate under a more unified structure.
- Receiving an advance and informal read on whether CFIUS will view a given transaction as challenging can be difficult; because CFIUS is a collection of constituent agencies, the opinion of one such agency does not necessarily provide much insight into the likely determination of CFIUS as a whole.
- In an effort to manage the committee structure, Treasury staff serve as gatekeepers and prevent parties from speaking directly to constituent agencies about CFIUS-related matters once the process has begun.

From Where Does CFIUS Derive its Power?

CFIUS was originally established by the President of the United States through executive power in 1975. At the time, the Committee was constituted to "review [foreign] investments in the United States which, in the judgment of the Committee, might have major implications for United States national interests." In 1988, the Exon-Florio Amendment to the Defense Production Act of 1950 (*i.e.*, Section 721 of the Act) authorized 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. The Foreign Investment and National Security Act of 2007 (FINSA) codified the then-existing CFIUS practice, and CFIUS issued amended regulations in November 2008. The CFIUS regulations are found in Title 31, Subtitle B, Chapter VIII, Part 800, of the Code of Federal Regulations.

When Can CFIUS Claim Jurisdiction to Review a Foreign Investment in the US?

Although CFIUS' statutory jurisdiction is quite broad, the Committee's regulations impose important limits on the types of cases subject to its review. CFIUS can review transactions that could result in "**control**" of a "**US business**" by a "**foreign person**." CFIUS reviews investments that are equity-like in nature, including the acquisition of convertible voting interests and proxy interests. CFIUS can reach out to one or both of the parties to a deal to "invite" a filing. At that stage, the CFIUS process is no longer voluntary.

- **Control** does not necessarily require the acquisition by the foreign person of a majority interest in the US business; CFIUS' regulations specify that minority interests that confer a significant ability to influence "**important matters**" related to the US business may confer control. Important matters include (but are not 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
  - The amendment of the business governing document (*e.g.*, Articles of Incorporation)

  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 target of the foreign investment must be a **US business** engaged in interstate commerce in the United States. This means the entity and/or assets being acquired can support a viable business in the United States. Notably, this includes (a) foreign-to-foreign deals in which the target has one or more US subsidiaries, or significant US assets or operations (*e.g.*, a French company's acquisition of a business in Germany that has an operating subsidiary in the US); (b) the formation of joint ventures in which one party contributes to an existing US business (*i.e.*, which can include operating permits and not much else); and (c) deals involving long-term leases of US assets that operate as de facto transfers of US businesses.
- A **foreign person** for CFIUS purposes is (a) a foreign national, foreign government, or foreign entity; or (b) any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity. For example, under such a broad definition, US-based operations of foreign companies fall within the reach of CFIUS' jurisdiction, even if the deal involves the merger of two non-US companies.

As a practical matter, the scope of CFIUS' jurisdiction is often ambiguous. 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. Therefore, the critical question arises of whether a given transaction, which arguably is within the scope of CFIUS jurisdiction, is in fact the type of transaction that *should* be submitted for CFIUS review

Are Certain Transactions Beyond the Reach of CFIUS Review?

Yes – the below three types of transactions generally are beyond the reach of CFIUS:

- Lending transactions cannot be reviewed by CFIUS, 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.
- "Greenfield" investments — involving US businesses that did not exist prior to investment by a foreign person — are generally beyond the reach of CFIUS review. However, in practice, the greenfield status is often unclear, and should be interpreted narrowly, 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) as constituting a US business.
- CFIUS jurisdiction includes a safe harbor that excludes from scope any transaction in which a foreign person acquires an ownership interest of 10% or less of the outstanding voting interests in the US business and holds that interest "solely for the purpose of passive investment." For example, the regulations provide that an acquisition of 7% of the voting securities of a US business in an open market purchased solely for the purpose of passive investment, with no other relevant facts, would qualify for the safe harbor. However, this "harbor" is less "safe" than it might at first appear; the regulations potentially allow the otherwise passive nature of an investment to be negated by any number of actions — and ultimately CFIUS determines what is truly passive and what is not.

How Do Parties Submit Their Transactions for Review by CFIUS?

Parties file a joint voluntary notice, which responds to a number of questions set out in the regulations about the US business and the foreign investor. This written notice is a single document that incorporates the answers from both the US business and the foreign investor. The foreign investor will also provide certain "personal identifier information" under separate cover. The US business and the foreign investor usually hire separate CFIUS counsel, which work collaboratively to prepare and file the joint notice.

Why Submit a Transaction Voluntarily to CFIUS?

Parties are not affirmatively required to submit a transaction for review by CFIUS in the first instance. But if a transaction is subject to CFIUS jurisdiction and has not been cleared already, CFIUS has the power to order the parties to submit the transaction for the Committee's review; a power CFIUS can exercise before or after a transaction has closed. Once CFIUS has cleared a transaction, 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. In the extreme case, the CFIUS process could result in the foreign party being forced to divest its interest in the US business (although such situations are extremely rare).

Parties normally file voluntarily with CFIUS when they perceive a significant level of CFIUS-related national security risk. For CFIUS, risk consists of a combination of the "threat" posed by the buyer and the "vulnerability" to exploitation associated with the target. Many factors inform the parties' evaluation of the nature and extent of such risk, including (but certainly not limited to):

- The foreign investor's nationality and the extent of its ownership by foreign governments (*e.g.*, Chinese and Russian investors, among others are generally perceived as higher risk)
- The likely impact of the proposed transaction on national defense requirements
- The export control status of the target's products, software, and technology
- The target's contractual relationships with the US government and the role of the target's products in the supply chain relating to products eventually used by the US government
- The target's involvement in and ties to national security-related activity and critical infrastructure in the United States (such as ports, airports, pipelines, rail systems, the power grid, telecommunication systems, *etc.*)
- The target's storage and access to detailed personal/customer information (*e.g.*, credit card information, social security numbers)
- 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)
- Potential close business relationships between the buyer and third-party entities or persons that pose national security risks

When evaluating potential CFIUS-related risk, parties should consider the relevant transaction from the perspective of the US government.

- CFIUS has access to classified information not available to the parties, and this information may inform the Committee's risk analysis.
- 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.

- CFIUS' national security concerns may touch on business activities that are very small from a revenue perspective, but are material to US government interests (*i.e.*, there is no dollar threshold or economic materiality test for CFIUS concerns).
- CFIUS generally is not transparent and normally does not give parties the opportunity to debate or appeal its conclusions.

Which Party Generally Bears CFIUS-Related Risk?

The parties to the transaction will have varying levels of tolerance with respect to CFIUS-related risk. As a general matter, the foreign investor has more incentive to engage with CFIUS and its review process, because — in the absence of CFIUS clearance — the President (through CFIUS) typically would 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 imposing adverse conditions, those conditions typically impact the foreign investor disproportionately (*e.g.*, by limiting the foreign investor's access to information or facilities, or limiting the foreign investor's ability to influence certain corporate matters). That said, US targets and sellers may also have an incentive to engage with the US government through the CFIUS process, for example, if the US parties will hold equity interests in the post-transaction company or if they believe that such engagement will benefit other aspects of their businesses.

> Between 2009-2015, companies filed 770 notice of transactions that CFIUS determined covered. Of those, about three percent were withdrawn during the review stage, seven percent were withdrawn during the investigation stage and 40 percent resulted in investigation.
>
> (Source: CFIUS Annual Report to Congress for CY 2015)

Who Prepares the CFIUS Notice?

The foreign investor and target company typically prepare a CFIUS notice jointly. Preparing a filing is a substantial undertaking that requires the disclosure of a significant amount of information. Although all information filed with CFIUS is accorded strict confidential treatment by law, parties may find the process of producing this information to be intrusive and burdensome.

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.*) for all senior officers and directors of, and shareholders with a 5% or greater ownership interest in, the investment vehicle or any other entity in the control chain.

How Long Does CFIUS Take to Review a Transaction?

Filing a voluntary notice triggers statutory deadlines within which CFIUS must act. In some cases, parties would be prudent to engage in informal consultations with CFIUS (or its constituent agencies) prior to submitting the CFIUS notice (*e.g.*, if a transaction involves complex issues or is likely to raise US national security concerns). These consultations could range from as little as a telephone call with counsel, to formal presentations to CFIUS, and prolonged negotiations.

Pre-Filing the CFIUS Notice:

After 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. Recently, this pre-filing period has taken several weeks, and the parties should generally count on four to six weeks, or longer in certain cases. At this stage of the CFIUS process, no official clock has started under the statute.

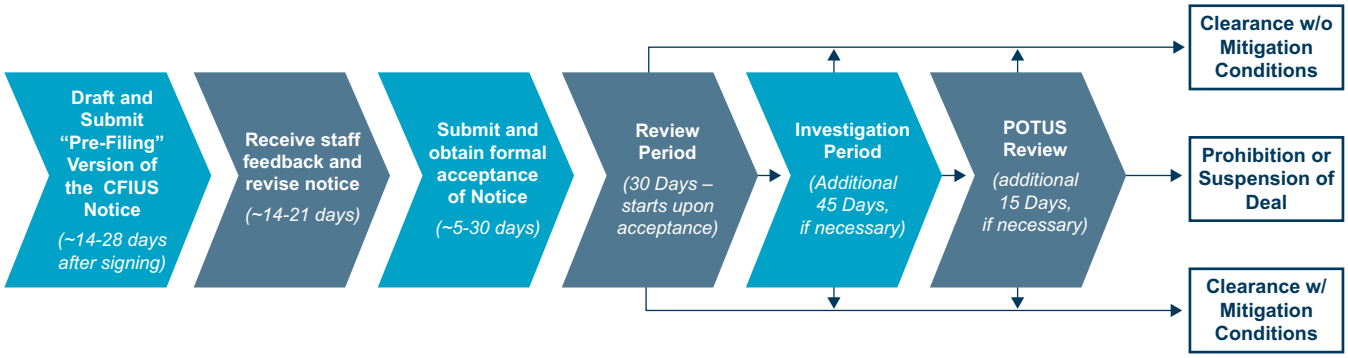
From 2013-2015, 40 cases (10%) resulted in the use of legally binding mitigation measures. In 2015, CFIUS mitigation measures were applied to 11 different covered transactions (8% of total 2015 transactions).

(Source: CFIUS Annual Report to Congress for CY 2015)

Filing the Formal CFIUS Notice:

Once the parties receive any feedback that CFIUS staff may provide, they typically will revise the pre-filing version of the notice to reflect that feedback. At that point, the parties will file a formal version of the notice with CFIUS. The statutory timeline for review does not commence until CFIUS officially accepts the notice by issuing a letter to that effect. Historically, that acceptance has taken place a few days after CFIUS has received the formal CFIUS notice. More recently, this step has taken longer. The more drawn-out pre-filing and acceptance periods 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 is managing at any given time.

Overview of the CFIUS Process



Transaction Review, Investigation, and Clearance:

Once a filing has been formally accepted, 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). 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. During the review and investigation periods, any one of the agencies that makes up CFIUS can submit written questions to the parties through the Treasury Department case officer. When a party receives questions from CFIUS, the party has three business days to respond. Absent an extension of the three-day response period, the failure to submit a timely response could lead CFIUS to terminate the filing.

If CFIUS still has not resolved any potential national security concerns at the end of the 45-day investigation period, it must make a formal recommendation to the President as to any action to take with respect to the transaction. The President then has up to 15 additional days to decide whether to clear, 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 are normally cleared during the review or investigation phases — potentially through the negotiation of an appropriate mitigation instrument during the 45-day investigation period.

Can the CFIUS Process Result in Conditions Being Imposed on a Transaction?

Yes. 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 has become 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. Such conditions may aim to:

- Limit access to certain facilities or information to authorized US citizens
- Ensure that only US citizens handle certain critical functions
- Establish governance mechanisms to place critical decisions in the hands of US citizens and/or ensure compliance with all required actions
- Impose reporting and independent audit requirements, or require 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
- Establish guidelines and terms for handling existing or future US government contracts, customer information, and other sensitive information
- Provide the US government with the right to review certain business decisions and object if those decisions raise national security concerns

What Can Happen if the Parties Fail to Comply With a Mitigation Agreement?

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, an increasing number of mitigation agreements include "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). Indeed, in certain recent cases CFIUS has required the parties to hire a third-party compliance monitor to audit compliance with the mitigation agreement and report its findings to CFIUS. Because the costs of complying with the conditions imposed by a mitigation agreement are substantial — and their imposition means that CFIUS-related risk is never entirely eliminated — they can have a significant impact on the economics of the transaction and its underlying rationale.

Do Other US Agencies Separately Review the Impact of Foreign Investment on US National Security?

Yes. The types of regulatory processes implicated by a given transaction generally turn on the nature of the target's operations and the degree to which it is subject to regulation in the US as a result. For example, a company with a facility security clearance must notify the Department of Defense's Defense Security Service (DSS) when entering into negotiations that could result in certain types of foreign investment. Similarly, if a transaction involves the transfer to a foreign person of ownership, or control of an entity registered with the Department of State's Directorate of Defense Trade Controls (DDTC) under the International Traffic in Arms Regulations (ITAR), or a subsidiary of the registrant, the registrant must notify DDTC at least 60 days before closing. And a foreign investor in a US telecommunications business generally must obtain advance approval from the Federal Communications Commission (FCC), and the FCC will not make a decision until an informal group of government agencies known as Team Telecom reviews the transaction for foreign policy, national security, or law enforcement risks. Other examples abound.

Will Clearing the CFIUS Process Become More Difficult Under President Trump?

How the CFIUS process will change under the new administration remains unclear. Although President Trump focused on the importance of job growth and international trade agreements as key components of his election campaign, the President has said little about foreign investment in the United States. That said, economic security issues (*e.g.*, trade imbalances) could possibly be reviewed as part of the CFIUS process, perhaps as a component of national security broadly construed. Discussions in Congress have also covered amending the statute to allow consideration of the economic effects of the transaction or the openness of the investor's home country to US investment in the same sectors (*i.e.*, foreign investment reciprocity). The Trump Administration's focus on jobs suggests it may be sympathetic to those proposals, and Secretary of the Treasury Steven Mnuchin, who chairs CFIUS, referred in his confirmation hearing to the Committee's role in "protecting American workers."

Are There CFIUS-Type Reviews in Other Countries?

Yes. Several other countries, including Australia, Canada, China, France, Germany, and Russia conduct similar reviews of foreign investments in businesses with operations in their jurisdictions. Multinational transactions may need to undergo separate national security reviews in more than one country.

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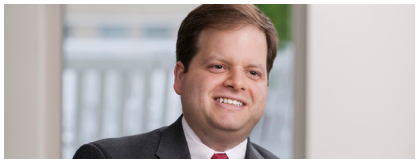

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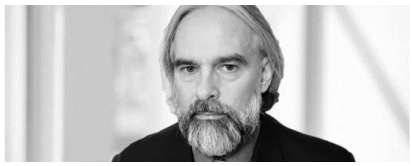

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