Annual Survey of CFIUS Law and Practice

International Corporate Compliance Executive Webinar

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Agenda

- CFIUS Overview
- Filing Considerations and Recent Trends
- CFIUS Executive Order
- CFIUS Monitoring and Enforcement
- Reverse CFIUS

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Why are FDI Review Regimes Important to Understand?

- There is ***always*** a cross-border aspect to M&A transactions
- Affects domestic deals also if foreign ownership
- Government consents are potential legal requirements and closing conditions
- Vital national interests may be implicated, which means enhanced scrutiny by regulators and substantial enforcement consequences
- Risks can often be effectively mitigated with proper awareness, attention, and planning

The Committee on Foreign Investment in the United States (CFIUS)

- The goal of CFIUS is to safeguard national security
  - The term "national security" is not defined in statutes or regulations
- CFIUS is charged with reviewing **"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"** to determine whether such transaction presents any national security risks; if so, CFIUS is responsible for addressing any national security risk that arises
- A "national security risk" is a combination of an identifiable national security "threat" and an identifiable national security "vulnerability"
- CFIUS analyzes a wide variety of national security factors to determine whether a national security risk exists in connection with a transaction. The President has the authority to block or unwind a transaction

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Covered Control Transactions

- **Covered Control Transaction** means "any transaction that is proposed or pending after August 23, 1988, by or with any foreign person, which could result in foreign control of any U.S. business, including such a transaction carried out through a joint venture"
  - Foreign Person: (a) any 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
  - Control: the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity
  - U.S. Business: any entity, irrespective of the nationality of the persons that control it, engaged in interstate commerce in the United States

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Covered Investments

- CFIUS also has jurisdiction over **non-control transactions involving a "TID U.S. business" ("covered investments")** that afford the foreign person:
  - Access to any material non-public information in the possession of the U.S. business;
  - Membership or observer rights on the board of directors of the U.S. business, or the right to nominate an individual to a position thereto; or
  - Any involvement, other than through voting of shares, in substantive decision-making of the U.S. business regarding critical technology, critical infrastructure, or sensitive personal data

- **"TID U.S. business"** includes U.S. businesses that:
  - Produce, design, test, manufacture, fabricate, or develop critical technologies; (**T**echnology)
  - Own, operate, manufacture, supply, or service certain critical infrastructure; (**I**nfrastructure)
  - Maintain or collect sensitive personal data of U.S. citizens that may be exploited in a manner that harms national security (**D**ata)

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Mandatory Filings

- **Control or non-control transactions involving critical technologies** for which a license would be required for the export or transfer of such critical technology to the foreign investor or persons that hold, individually or in a group, a direct or indirect >25% voting interest in the investor

- A transaction that results in:

  - a foreign person obtaining a substantial interest (a direct or indirect voting interest of 25% or more) in a **TID U.S. business**, and

  - a **foreign government** (other than of an excepted state) has a substantial interest (a direct or indirect voting interest of 49% or more) in that foreign person

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Private Funds

- Passive private equity investments by foreign LPs do not trigger CFIUS jurisdiction in certain circumstances:
  - The foreign person cannot have access to any material nonpublic technical information;
  - No observer or membership rights to the BOD and no substantive decision making power; and
  - No material parallel strategic partnerships with the company in addition to the investment
  - If the foreign LP is a member of an advisory board (LPAC):
    - The fund is managed exclusively by a GP that is not a foreign person;
    - The advisory board cannot approve / control the fund's investment decisions or the GP's decisions;
    - Foreign person has no ability to control the fund, including approval / control of investments or GP; and
    - Foreign person does not have the ability to influence the selection of the GP or the GP's compensation
- However, there is an informal CFIUS practice of considering a fund "foreign" due to *de facto* control if a single foreign LP has a very large economic interest

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Excepted Investor Status

- Investors from certain countries with robust intelligence sharing and FDI regimes may qualify for excepted investor status
  - No CFIUS jurisdiction over covered investments or real estate transactions
  - Not subject to mandatory filing requirements
- Current excepted foreign states: **Australia, Canada, New Zealand, and the UK**
  - The EFS status for all four countries has been finalized as of February 10, 2023
- Requirements for excepted investor status (for an investor and its parents):
  - POI / PPB: Must be organized and have its primary place of business in the U.S. or an excepted foreign state
  - Board of Directors: 75% or more of the board (including observers) must be U.S. nationals or nationals of an excepted foreign state
  - Ownership: Any foreign national with a 10%+ interest must be a national of or an entity organized in the U.S. or an excepted foreign state
  - Minimum Excepted Ownership: For public entities traded on U.S. exchanges, at least 50% of the ownership must be held by a national of or an entity organized in the U.S. or an excepted foreign state. For all other entities, this threshold is set at 80%

Real Estate Transactions

- FIRRMA gave CFIUS the ability to review real estate transactions in which the foreign person will acquire certain property rights in real estate that:
  - is located within or will function as an airport or maritime port identified by the Department of Transportation,
  - is within one mile of a designated military installation,
  - is within 100 miles of certain designated military installations, or
  - is within a county or geographic area identified in connection with a designated military installation
- The real estate transaction regulations (31 CFR Part 802) only apply when the main CFIUS regulations do not. Therefore, they are generally limited to certain rentals and concessions, and investments in undeveloped property that does not constitute a U.S. business
- There are a number of exceptions, including real estate located in urban centers (unless it is within one mile of a designated military installation), retail space, single housing units, and certain air carriers
- There is no mandatory filing requirement for covered real estate transactions. As with traditional transactions, non-notified covered real estate transactions can be reviewed by CFIUS even after closing

CFIUS Filing Process and Timing

- Parties may file a CFIUS notice (voluntary or mandatory), or CFIUS may, upon independently learning about a transaction (*e.g.*, through public reports), request that the parties submit a formal notice
- CFIUS Timeline
  - 45-day initial review period
  - Additional 45-day investigation period (if CFIUS determines the transaction warrants additional review)
  - Additional 15 days in "extraordinary circumstances" (which are necessary and appropriate "due to a force majeure event or to protect the national security")
  - Pre-Filing
    - Typically parties submit a pre-filing notice with CFIUS that is substantially in the form of the final notice
    - CFIUS provides initial comments on the draft, and requests clarifications and additional information as warranted
    - CFIUS will provide comments on a draft or accept a notice within 10 business days of receiving the draft or notice if the parties stipulate that it is a covered transaction
  - At the end of the review or investigation, CFIUS approves the transaction, with or without mitigation measures, or refers the transaction to the President with a recommendation to block the transaction

CFIUS Declarations

- Parties have the option to file a declaration, a "short-form" filing that triggers a 30-day review process, after which CFIUS may (i) approve the transaction, (ii) request that the parties file a full notice, (iii) inform the parties that it is unable to clear the transaction on the basis of the declaration alone, or (iv) unilaterally initiate a full review
    - When CFIUS gives a "shoulder shrug" and informs the parties that it cannot conclude action on the basis of the declaration alone, parties have met any mandatory filing obligation. They can voluntarily file a full notice in order to receive the certainty of a formal CFIUS approval
- In 2021, CFIUS completed assessments of **164 declarations**, including two real estate declarations
    - Cleared **120 transactions**,
    - Requested the parties file a written notice for **30 transactions**, and
    - Informed the parties that CFIUS could not conclude action for **12 transactions**
    - Reject the declaration for **two transactions**
- For low-risk transactions, a declaration may save time and avoid a full filing

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Current CFIUS Trends

Covered Transactions, Withdrawals, and Presidential Decisions* 2012-2021					
Year	Number of Notices	Notices Withdrawn During Review Phase	Number of Investigations	Notices Withdrawn After Commencement of Investigation	Presidential Decisions
2012	114	2	45	20	1
2013	97	3	49	5	0
2014	147	3	52	9	0
2015	143	3	67	10	0
2016	172	6	79	21	1
2017	237	4	172	70	1
2018	229	2	158	64	1
2019	231	0	113	30	1
2020	187	1	88	28	1
2021	272	2	130	72	0
Total	**1829**	**26**	**953**	**329**	**6**

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Current CFIUS Trends (Cont'd)

- Timing of CFIUS cases has stabilized and improved in many cases
  - Under FIRRMA, timing on draft comments and formal acceptance of the CFIUS notice is limited
  - Fewer cases rolling over into investigation when review period increased to 45 days
  - Risk of extended process if a full notice is required after a declaration
- Increased scrutiny of Chinese acquisitions and access to sensitive technology and personal data with multiple blocked or unwound transactions involving concerns over access to sensitive personal data
- Expanded view of jurisdiction, including foreign acquisitions of foreign companies with some U.S. presence
- Implicit consideration of effects on the U.S. economy
- Monitoring for non-notified transactions: In 2021, CFIUS identified 135 non-notified transactions (up from 117 in 2020) and requested a filing for 8 (down from 17 in 2020)

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National Security Factors to Guide CFIUS Review

- On November 15, 2022 President Biden issued an Executive Order ("the CFIUS EO") identifying five specific areas that CFIUS should consider and focus on in its review of transactions. The CFIUS EO **did not** expand CFIUS' jurisdiction or alter the CFIUS review process.
  - Supply chain resilience and security
  - Effect on U.S. technological leadership
  - Aggregate industry investment trends
  - Cybersecurity risk
  - Access to sensitive personal data
- Industry focus: microelectronics, artificial intelligence, biotechnology and biomanufacturing, quantum computing, advanced clean energy, climate adaptation technologies, critical materials (*e.g.*, lithium and rare earth elements), and elements of the agriculture industrial base that implicate food security sectors

CFIUS Considerations

- Whether to file with CFIUS
  - Is it a mandatory filing?
  - National security risk of investor, including foreign government control
  - Whether investor is “known entity” / publicly-traded
  - Future U.S. investment plans and relationship with USG
- Whether to file a notice or declaration
- What level of control triggers CFIUS jurisdiction?
  - Only “safe harbor” is below 10% passive ownership
  - Other equity, board seats, and minority rights are considered
- One foreign co-investor could bring entire transaction under CFIUS jurisdiction
- Timing issues
  - Financing
  - Certainty / predictability of CFIUS timing
- What outcomes will constitute CFIUS approval? Will the parties accept a “shoulder shrug”?

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Why is CFIUS Important to U.S. Companies?

- CFIUS may have jurisdiction over the sale (of all or part) of a U.S. company to a foreign buyer or receipt of foreign investment
- Foreign investment may render a U.S. company “foreign” for CFIUS purposes when it acquires other U.S. companies
- A foreign co-investor or consortium member may bring an entire transaction under CFIUS jurisdiction
- CFIUS may be a deal point (a competitive disadvantage) if other bidders are foreign or foreign-controlled
- Important consideration for private equity fund formation, investments, and stakes deals

CFIUS Enforcement

- Marked increase in formally and informally blocked Chinese investments since 2010 has lead to decreased Chinese investment in the U.S.
- Increased focus on, and devotion of resources to, non-notified transactions:
  - ByteDance ordered to divest Musical.ly (TikTok) over PII concerns (August 2020)
  - Beijing Shiji forced to divest StayNTouch due to PII concerns (March 2020)
  - iCarbonX forced to divest PatientsLikeMe due to PII concerns (April 2019)
  - Pamplona Capital forced to divest Cofense due to Russian backing (April 2019)
  - Kunlun Group forced to sell Grindr due to PII concerns (March 2019)
  - HNA forced to sell 850 Third Ave. in NY due to proximity to Trump Tower (August 2018)
- President blocked Broadcom's attempt to buy Qualcomm over concerns that the transaction would harm U.S. innovation and leadership in 5G technology (March 2018)
- Monetary penalties:
  - 2018: $1 million penalty for repeated breaches of mitigation agreement, including failure to establish required security policies and provide adequate reports to CFIUS
  - 2019: $750,000 penalty for violations of a 2018 CFIUS interim order, including failure to restrict and adequately monitor access to protected data

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CFIUS Enforcement and Penalty Guidelines

- In October 2022, CFIUS released its first-ever enforcement and penalty guidelines
- **Types of conduct that may constitute a violation**
  - Failure to timely submit a mandatory declaration or notice
  - Failure to comply with the terms of any CFIUS mitigation agreements, conditions, or orders
  - Material misstatements or omissions in information filed with CFIUS
- **CFIUS penalty process**
  - **Step 1:** CFIUS sends the enforcement target ("Subject Person") a notice of penalty, which includes a written explanation of the alleged violation and the amount of any monetary penalty that CFIUS intends to impose
  - **Step 2:** Within 15 business days of receiving a notice of penalty the Subject Person may submit a petition for reconsideration to the CFIUS Staff Chairperson. This petition can include any defense, justification, mitigating circumstances, or other explanation for the conduct at issue
    - The 15-business day period can be extended by mutual agreement
  - **Step 3:** Within 15 business days of CFIUS's receipt of a petition for reconsideration, it will issue a final penalty determination. This period can also be extended by mutual agreement

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CFIUS Enforcement: Aggravating & Mitigating Factors

- Non-exhaustive list of aggravating and mitigating factors, although no explicit penalty amount ranges
  - **Accountability and future compliance:** The effect the enforcement action will have on holding the Subject Person accountable and on incentivizing compliance, including through self-disclosures
  - **Harm:** The extent to which the conduct at issue impaired or threatened to impair national security
  - **Negligence, awareness, and intent**: Was conduct the result of simple negligence, gross negligence, intentional action, or willfulness
    - Any effort to conceal or delay the sharing of relevant information with CFIUS, and the seniority of personnel that knew or should have known about the conduct
  - **Persistence and timing:** The frequency and duration of the conduct and the amount of time that has elapsed between the Subject Person becoming aware of CFIUS becoming aware of the conduct
  - **Response and remediation**: Self-disclosure, cooperation with CFIUS's investigation, the promptness of full remediation of the conduct, and any internal review or investigation into the conduct
  - **Sophistication and record of compliance:** History and familiarity with CFIUS and, if applicable, past compliance with CFIUS mitigation agreements

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"Reverse" or "Outbound" CFIUS

- Congress and the President have been considering proposals for an outbound investment review regime for national security purposes
- These proposals, which **have not** yet been implemented, either through an executive order or through an act of Congress, have been popularly dubbed "reverse CFIUS" or "outbound CFIUS"
- An Executive Order and regulations are reported to be planned for this month, and are expected to be limited to certain foreign countries and specific technologies/industries
- The impact of any reverse CFIUS regime depend on a number of yet unspecified factors:
  - Who will have to comply
  - What types of investment / trade will be covered
  - What sectors will be covered
  - Whether any filing requirements are mandatory or voluntary

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Michael T. Gershberg represents foreign and domestic clients regarding the application of economic sanctions, export control laws and regulations, and the CFIUS review process.

Much of Michael's work involves offering practical guidance on the Export Administration Regulations (EAR), International Traffic in Arms Regulations (ITAR), and economic sanctions administered by the Office of Foreign Assets Control (OFAC). Clients also seek Michael's counsel in connection with their obligations under the anti-boycott and anti-money laundering rules.

Clients of Michael's export control and economic sanctions practice rely on his advocacy before governmental agencies, and turn to him to conduct internal investigations and prepare voluntary self-disclosures and other legal submissions. Michael also assists clients in connection with export transactions and enforcement issues, due diligence for mergers and acquisitions, economic sanctions and export control training, determining export jurisdiction and classification, developing compliance plans and providing compliance counseling, and export licensing.

Michael also advises clients concerning regulatory issues related to foreign investment transactions, including proceedings before the inter-agency Committee on Foreign Investment in the United States (CFIUS). Foreign investors and US sellers engage his representation throughout the CFIUS process, from negotiating CFIUS risk allocation with transaction counterparties to preparing CFIUS filings and negotiating mitigation agreements. Michael also advises public and private companies and investment managers regarding CFIUS jurisdiction and national security risk, and he prepares related provisions in M&A transaction agreements and private fund formation documents.

Chambers Global and *Chambers USA* recognize Michael among the world's leading lawyers for business in International Trade: Export Controls & Economic Sanctions, where clients enthuse "Michael is an excellent attorney and is super responsive," "his expertise in trade compliance is invaluable," and "his deep experience in sanctions and export compliance and his ability to break down complex concepts are his individual strengths." Other clients note that "Michael is a key provider of advice with respect to economic sanctions," and "he is commercially oriented and knows his stuff." Michael has also been named by *Chambers USA* as a "Recognized Practitioner" in International Trade: CFIUS Experts, and he was selected as a "Global Leader" by *Who's Who Legal: M&A and Governance* in the Foreign Investment Review Chapter. Michael was also named a 2019 *Law360* "MVP" in International Trade. Additionally, Michael has been named in *Thomson Reuters* 2023 Stand-Out Lawyers List.

Michael is the editor of the *ITAR Enforcement Digest* and a contributor for the CFIUS chapter of the *M&A treatise Takeover Defense: Mergers and Acquisitions*. He is also a co-author of *Fried Frank's International Trade and Investment Alert®*, which reports on significant developments regarding CFIUS, economic sanctions, export controls, and other regulatory compliance matters affecting business activities.

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