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CFIUS Introduction and Trends.pdf


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CFIUS Introduction and Trends
International Law Institute




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Road Map

- ▣ Intro to CFIUS: purpose, history, statutes, membership, contract issues
- ▣ CFIUS process
- ▣ CFIUS standards
- ▣ CFIUS results
- ▣ China-related controversies
- ▣ Recent changes and trends
 - ▣ New statute, FIRRMA, August
 - ▣ New regulations, October

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Part 1 - Introduction

Purpose, history, statutes, membership, contract issues

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CFIUS Overview

- Committee on Foreign Investment in the US (CFIUS)
- Reviews inbound investment for national security concerns
- President has power to stop or unwind certain deals
- Reviews are becoming increasingly rigorous, especially (but not only) for investment from China
- More filings, more delays and uncertainty

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Purpose: National Security

- ▣ Determine if “credible evidence to support a belief” a foreign investor “might take action that threatens to impair the national security of the US”
- ▣ “Narrow focus on national security alone,” focusing “solely” on “genuine national security concerns” without regard to “other national interests”
- ▣ Key debate: What is “national security”?
 - ▣ Not defined
 - ▣ Changes over time
- ▣ Economic security? Food security? Industrial capacity? Technological leadership? Critical infrastructure?

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National Security over Time

- ▣ Cold War
- ▣ Homeland Security
- ▣ China as a rising power
- ▣ Trump Administration
 - ▣ More assertive / Less constrained
 - ▣ Growing concern about China
 - ▣ Trade cases and export control developments
 - ▣ Manufacturing base / Tech superiority

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History: Deals stopped



All deals formally stopped ever are China-related

- ▣ 1990 - China National Aero-Technology Import and Export Corp. / MAMCO Mfg
- ▣ 2012 - Ralls Corp. / Four Oregon wind farms
 - ▣ Lawsuit
- ▣ 2016 - Fujian Grand Chip Investment Fund / Aixtron's U.S. subsidiaries
 - ▣ Formally limited to US subsidiaries, but really stopped the whole deal in Germany
- ▣ 2017 - Canyon Bridge Capital / Lattice Semiconductor
 - ▣ After three 75-day investigations
- ▣ 2018 - Broadcom / Qualcomm
 - ▣ Quick (42 days) and unilateral

Many other companies voluntarily end their own deals

- ▣ "Nearly half" of investigations, 1990-2018




History: Drivers

- ▣ Arab petrodollars in the 1970s
- ▣ Japanese investment in the 1980s
- ▣ 9/11
- ▣ Dubai Ports World
- ▣ Chinese investment in the 2010s

Chinese investment in the U.S. and Western Europe from 2008 to August 2018*



Year	United States (\$b)	Western Europe (\$b)
2008	0.7	17.9
2009	~10	~15
2010	~10	~15
2011	~10	~15
2012	~10	~15
2013	~10	~15
2014	~10	~15
2015	~10	~15
2016	~70	~90
2017	~30	~40
2018	9.7	49.0

* Data show pending and completed deals. Sources: Bloomberg

statista



Legal authority

- ▣ 1988: Exon-Florio Amendment to the Defense Production Act of 1950 (Section 721)
 - ▣ Created national security reviews
 - ▣ Pres. Reagan assigned to CFIUS
- ▣ 1992: Byrd Amendment
 - ▣ Presumption of 2d-stage investigations for state-owned investors
- ▣ 2007: Foreign Investment and National Security Act (FINSA)
- ▣ 2018: Foreign Investment Risk Review Modernization Act (FIRRMA)
- ▣ CFIUS Regulations
 - ▣ Including Oct. 2018 interim amendments and pilot program

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Interagency Committee

- ▣ Treasury, Chair
- ▣ Commerce
- ▣ Defense
- ▣ Energy
- ▣ Homeland Security
- ▣ Justice (incl. FBI)
- ▣ Science & Tech Policy
- ▣ State
- ▣ Trade Representative
- ▣ Observe & Participate as Appropriate:
 - ▣ Management & Budget (OMB)
 - ▣ Council of Economic Advisers
 - ▣ National Security Council
 - ▣ National Economic Council
 - ▣ Homeland Security Council
- ▣ Non-Voting:
 - ▣ Labor
 - ▣ Intelligence
- ▣ Others added case by case, e.g.:
 - ▣ Agriculture
 - ▣ Health & Human Services
 - ▣ Transportation

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Contract issues

- ▣ Condition of closing
- ▣ Due diligence / reps & warranties
- ▣ Best efforts
 - ▣ Lawsuit: Ness Tech v. HNA
- ▣ Mitigation within limits
- ▣ **Reverse termination fees** / escrow
 - ▣ Market accounting for CFIUS risk
- ▣ Governing law / choice of court or arbitration

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Part 2 – CFIUS Process

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Considering whether to file

- ▣ Filing traditionally was voluntary, but...
 - ▣ Value of no action letter
 - ▣ Threat of CFIUS self-initiation
- ▣ Substantive considerations
 - ▣ Within CFIUS jurisdiction?
 - ▣ Any apparent national security concerns?
- ▣ Other considerations
 - ▣ Cost
 - ▣ Timing
 - ▣ Commitment to necessary degree of disclosure and cooperation
 - ▣ Confidentiality

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Coming: Mandatory Filings

- ▣ FIRRTA requires CFIUS filings in some cases
- ▣ Pilot program starting November 10
- ▣ Mandatory for initial group of 27 industries
 - ▣ May be full notice or 5 page "declaration"
 - ▣ May expand to other concerns like infrastructure and data
- ▣ Applies to some investments absent control
 - ▣ Access to tech
 - ▣ Board rights
 - ▣ Decisions re tech
- ▣ Penalties for failure to file up to value of the deal

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Initiation

- ▣ Normally starts with joint “notice” by the parties
 - ▣ Requires extensive details about the parties and the deal
 - ▣ Supplemental questions
 - ▣ Filing may be rejected if not sufficiently forthcoming
- ▣ CFIUS can self-initiate
- ▣ Any party can file alone
- ▣ FIRRTA allows for a short “declaration” instead of a “notice”
 - ▣ Generally only 5 pages

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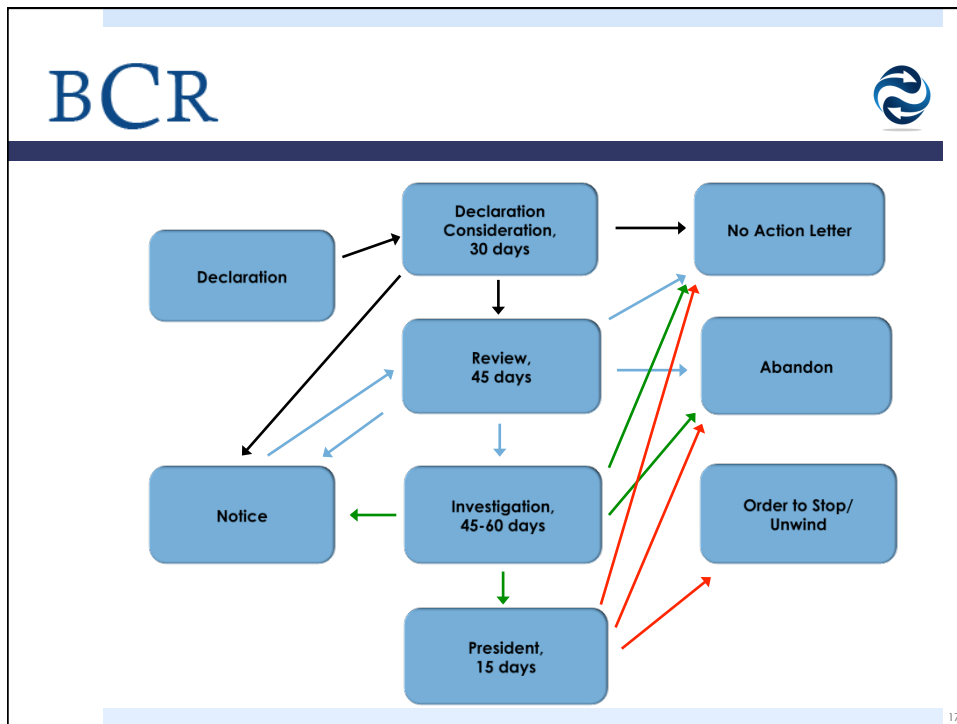
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Timeline

- ▣ Pre-notice consultation
- ▣ Mini declaration. **New** - 30 days.
- ▣ Notice
- ▣ Up to 10 days: accept notice or reject if incomplete. **New**.
- ▣ 45 days: initial review. **New** - up from 30 days.
- ▣ 45 days: formal investigation. **New** - may add 15 days.
- ▣ 15 days: Presidential decision
- ▣ 115 days total. **Informally, can take much longer.**

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Judicial Review

- ▣ Judicial review of Presidential actions and findings is prohibited by statute
- ▣ Ralls v CFIUS, DC Cir 2014
 - ▣ Allows Due Process claims re failure to show Ralls unclassified evidence used by CFIUS and to allow Ralls to respond
 - ▣ Case settled, terms unknown
- ▣ FIRRMA allows suits to be brought only to the DC Circuit
 - ▣ Accepts possibility of new cases, presumably limited like Ralls, and limits where they may be filed

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Part 3 – CFIUS Standards

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Jurisdiction

- ▣ Jurisdiction had been limited “covered transactions,” where a foreign person obtains control over a US business
 - ▣ Direct or indirect control
 - ▣ Not greenfield investment
 - ▣ Not passive investments up to 10%
 - ▣ Some JV's
 - ▣ No dollar threshold
- ▣ Expanding under FIRRMA
 - ▣ Real estate
 - ▣ Some investments short of control

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CFIUS's Basic Function

- ▣ Review and investigation. Then:
 - ▣ No action
 - ▣ Mitigation agreement
 - ▣ Recommend Presidential action
 - ▣ Also, interim orders – codified in FIRRMA
- ▣ President may “suspend or prohibit” a “covered transaction” if “there is credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security”
 - ▣ Includes power to seek order of “divestment relief” in court if a deal already closed
 - ▣ Only applies where no other law (besides IEEPA) provides adequate authority for the President to protect US national security

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National security assessment

Buyer side	Target side
<ul style="list-style-type: none"> ▣ Details of ownership, control, and financing, esp. relationships with government and military ▣ Diplomatic issues ▣ Economic issues ▣ Special concerns 	<ul style="list-style-type: none"> ▣ Sensitive sectors ▣ Government contracts ▣ Security clearances ▣ Controlled goods & tech ▣ Sensitive data ▣ Proximity ▣ Critical infrastructure ▣ Cyber security

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Industries/Concerns

- ▣ Tech
- ▣ Natural resources
- ▣ Government contracts
 - ▣ Including sub-contracts
- ▣ Proximity
- ▣ Private data


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Critical Technology

- ▣ ITAR controls
- ▣ Some items under EAR controls
- ▣ Nuclear items
- ▣ Toxins and some chemical agents
- ▣ “Emerging and foundational technology”
 - ▣ To be defined

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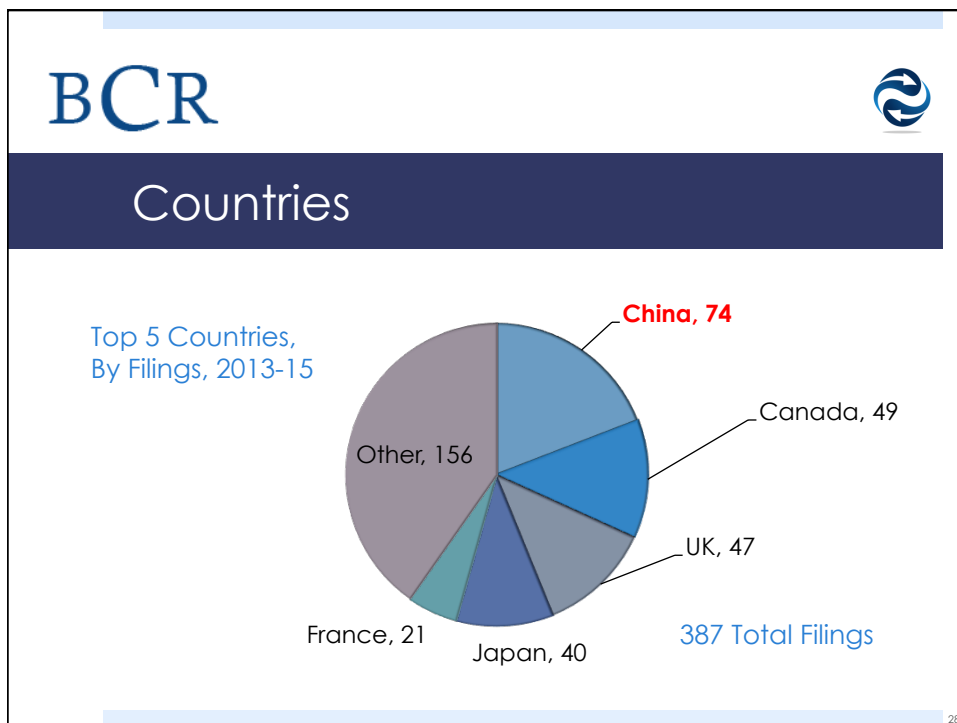
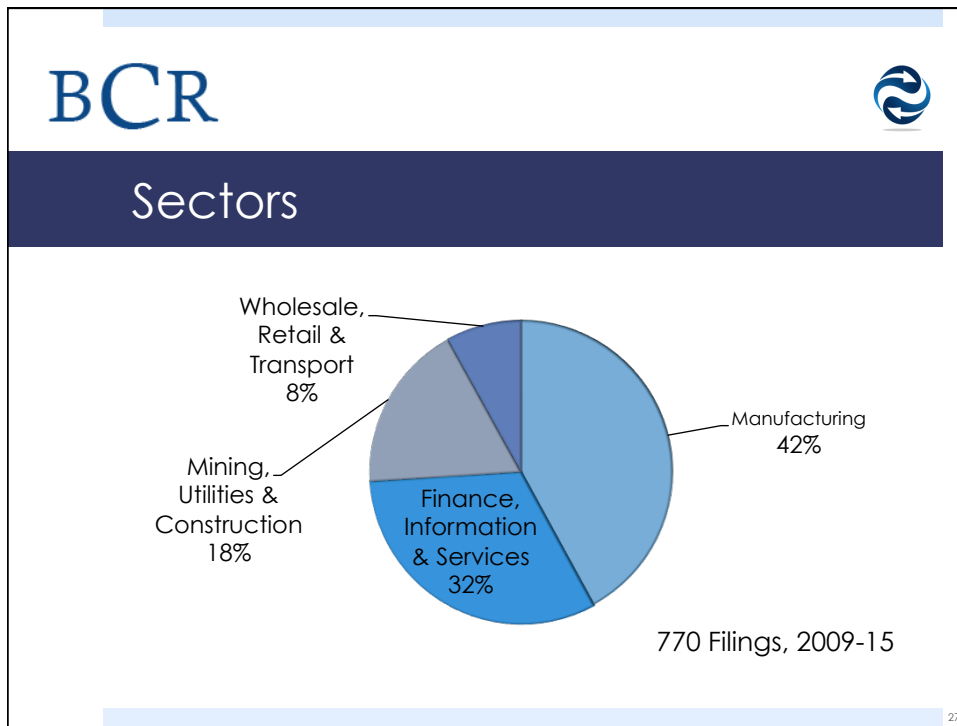
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Critical Infrastructure

- ▣ “System or asset, whether physical or virtual, so vital to the United States that the incapacity or destruction of the particular system or asset ... would have a debilitating impact on national security”
- ▣ Department of Homeland Security –

▣ Chemical	Commercial	Communications
▣ Critical Mfg	Dams	Defense Industrial Base
▣ Emergency Svcs	Energy	Financial Svcs
▣ Food & Ag	Govt Facilities	Health
▣ IT	Nuclear	Transportation
▣ Water & Wastewater		

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Other national security issues

- Economic sanctions
- Export controls
- Security clearances
- Terrorist financing

Need coordinated strategies, focus on assuring compliance. Consider possible look-backs and disclosures.

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Part 4 – Rising Scrutiny

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Investigations

- ▣ 1998-2005: 17 2d stage after c.1600 1st stage (1.5%)
- ▣ 2005-2008: 37 / 468 (8%)
- ▣ 2009-2012: 145 / 383 (38%)
- ▣ 2013-2016: 244 / 559 (44%)
- ▣ 2017: "Approximately 70%"

Year	Investigations	Reviews
2005	5	60
2006	5	110
2007	10	140
2008	20	160
2009	25	70
2010	35	90
2011	40	110
2012	45	115
2013	50	95
2014	55	145
2015	65	140
2016	80	175

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Withdrawals

- ▣ 2012 - 22 notices withdrawn / 12 refiled
 - ▣ +Ralls order
- ▣ 2013 - 8 / 1
- ▣ 2014 - 12 / 7
 - ▣ +1 rejected
- ▣ 2015 - 13 / 9
 - ▣ +1 rejected
- ▣ 2016 - 27 / 15
 - ▣ +Aixtron order

After Withdrawal

- ▣ 2014
 - ▣ 2 abandoned for CFIUS reasons
 - ▣ 3 abandoned for other reasons
- ▣ 2015
 - ▣ 3 abandoned for CFIUS reasons
 - ▣ 1 abandoned for other reasons
- ▣ 2016
 - ▣ 5 abandoned for CFIUS reasons
 - ▣ 7 "other," maybe some refiled in 2017

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Mitigation Agreements

- ▣ CFIUS may negotiate a "mitigation agreement" with the parties to a deal
- ▣ Goal to resolve any national security concerns
- ▣ May impose various conditions or limitations
- ▣ Enforceable by civil penalties up to \$250,000 and breach-of-contract provisions for payment of actual or liquidated damages
- ▣ Some legal limits:
 - ▣ Must be based on "on a risk-based analysis," to determine the terms are reasonably necessary and appropriate
 - ▣ Only pursue if other laws are not adequate to address the risk
 - ▣ Cannot require a party to "recognize, state its intent to comply with, or consent to the exercise of any authorities under existing provisions of law," except in "extraordinary circumstances"

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Mitigation Agreements


- ▣ 2012-14: 29 mitigation agreements (8%)
- ▣ 2015: 11 (8%)
- ▣ Examples in 2015:
 - ▣ Limiting access to tech and data
 - ▣ Compliance mechanisms, like USG-approved security measures and independent audits
 - ▣ Rules for government contracts
 - ▣ Review by USG of certain business decisions
 - ▣ Exclusion of sensitive assets
- ▣ Mitigation fatigue?

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Part 5 – China-Related Controversies

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China-related controversies

- China National Aerotech / MAMCO
- CNOOC / UNOCAL
- Huawei deals
- Lenovo / IBM acquisitions
- Ralls Corp wind farms
- Shuanghui / Smithfield Ham

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More - Tech

- ▣ Tsinghua / Micron
- ▣ Fujian Grand Chip / Aixtron (Germany)
- ▣ GO Scale / Lumileds 80% from Philips (Dutch)
- ▣ Tsinghua / Western Digital
- ▣ ChemChina / Syngenta (Swiss)
- ▣ Canyon Bridge / Lattice Semiconductor
- ▣ Naura Microelectronics / Akron
- ▣ China Heavy Duty Truck / UQM Tech (electric vehicles)
- ▣ Marvell (Tsinghua minority) / Cavium


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More - Finance

- ▣ China Oceanwide / Genworth Financial
- ▣ Ant Financial (Alibaba) / Moneygram
- ▣ HNA / SkyBridge Capital (Anthony Scaramucci)
- ▣ Chongqing Cassin / Chicago Stock Exchange
 - ▣ Approved by CFIUS under Pres. Obama
 - ▣ Rejected by SEC under Pres. Trump

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More - HNA

- ▣ Early successes
 - ▣ Ingram Micro (\$6BB)
 - ▣ c.25% of Hilton Hotels
- ▣ Recent failures
 - ▣ Global Eagle
 - ▣ Skybridge Capital
 - ▣ Ness Technologies - Lawsuit
 - ▣ Jan. 2018 suspended from future consideration by CFIUS pending clarity about its ownership

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Still More - Other

- ▣ Anbang / Waldorf Astoria hotel
- ▣ Anbang / Hotel del Coronado (San Diego)
 - ▣ Excluded from a package with 15 other hotels
- ▣ Cosco Shipping / Long Beach terminal from OOIL (HK)
 - ▣ Put in trust pending sale as condition of acquiring OOIL
- ▣ Dalian Wanda / Hollywood investments (mixed success)

... and many more!

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Part 6 – CFIUS Trends & Developments

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Recent Trends

- ▣ Record number of filings
- ▣ More re-filings
- ▣ Heightened scrutiny, esp. China
 - ▣ But: Steep drop in Chinese investment in 2018
- ▣ Mitigation fatigue?

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IEEPA to Restrict Chinese Investment?

- International Emergency Economic Powers Act
 - Statute generally used to invoke economic sanctions, such as Iran and Russia
- Trump Administration concerns about China's trade, investment, tech transfer, and IP practices (Section 301)
- Novel and controversial
- Threatened, then forestalled (at least for now)
- Decided in June to rely on coming FIRRMA instead

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FIRRMA Themes

- Approving and encouraging CFIUS practices
 - Includes clear (albeit not express) reference to China as a "country of special concern"
- Expanding jurisdiction
- Increasing funding and staffing
- Rhetorical emphasis on critical infrastructure & tech

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More about FIRRMA

- ▣ Some in effect immediately, rest phased in over 18 mos.
- ▣ Mandatory filing in some cases
- ▣ Short extension of deadlines
- ▣ Filing fees
- ▣ More coordination with other governments
- ▣ More detailed reporting, including China-specific report

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Pilot Program

- ▣ Starts Nov. 10, 2018, Ends by Mar. 5, 2020
- ▣ Applies to deals signed after Oct. 11, 2018 that close after Nov. 10, 2018
- ▣ Applies to investments in US businesses with “critical tech” in 27 industries plus either control or
 - ▣ Access to tech;
 - ▣ Board rights, including observer rights; or
 - ▣ Decisions re tech
- ▣ Starts mandatory filings


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27 Industries in Pilot Program

- Aircrafts (2)
- Computer Storage
- Armored Vehicles, Tanks
- Inorganic Chemicals
- Transformers
- Nanotech
- Telephone Apparatus
- Search, Detection, Navigation, Guidance, Aeronautical, and Nautical Systems & Instruments
- Aluminum (2)
- Computers
- Nuclear Power
- Petrochemicals
- Batteries (2)
- Biotech
- Turbines & Generators
- Ball & Roller Bearings
- Guided Missiles & Space Vehicles (3)
- Optical Equipment
- Powder Metallurgy Parts
- Broadcasting & Wireless
- Semiconductors (2)

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Thank you!

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