



CFIUS 101:

A Primer on the “New” Committee on Foreign Investment in the United States

A number of high-profile actions, including the forced divestitures of U.S. businesses Grindr, PatientsLikeMe and Cofense, as well as the unprecedented action by President Trump to block Broadcom’s proposed acquisition of Qualcomm, have put a spotlight on the role of the Committee on Foreign Investment in the United States (“CFIUS”) in cross-border mergers and acquisitions.

Further, on February 13, 2020, CFIUS enacted a sweeping overhaul of its regulations pursuant to its expanded authority under the Foreign Investment Risk Review Modernization Act of 2018, or “FIRRMA.”

Given the importance of CFIUS to cross-border investment and the significant changes that have taken place within the CFIUS statutory and regulatory regimes, this document provides transaction parties with a summary of the “new” CFIUS, its mission, and how its process unfolds.

WHAT IS CFIUS?

CFIUS is a federal regulatory panel composed of the heads of various federal agencies, including the departments of Defense, State, Justice, Homeland Security, Energy and Commerce. It is chaired by the Secretary of the Treasury. CFIUS reviews investments by foreign persons or companies into U.S. businesses and determines the impact of those investments on U.S. national security.

CFIUS can block pending investments, unwind consummated transactions at any point in the future, or place conditions on them to address particular national security concerns. To eliminate these risks, parties proactively request that CFIUS review and clear their transaction. Clearance from CFIUS generally provides parties a “safe harbor” from future adverse action.

WHAT TRANSACTIONS DOES CFIUS REVIEW?

CFIUS is empowered to review acquisitions of “control” of U.S. businesses by foreign persons. The CFIUS standard for control is very low, however, and not subject to a bright-line rule. Generally speaking, any investment of 10% or greater in a target’s voting securities, in particular if they afford the investor any governance rights in the target, warrant careful examination to determine whether CFIUS jurisdiction may apply.

Under its expanded jurisdiction, the bar for CFIUS jurisdiction is even lower if the target is a “Technology, Infrastructure or Data” U.S. business (a “TID U.S. Business”). In the first instance, any of the following types of transactions can trigger CFIUS jurisdiction:

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- (1) Investments that provide the foreign investor membership on the board of directors;
- (2) Investments that provide the investor access to material nonpublic technical information in the possession of the U.S. business;
- (3) Investments that provide the investor any other involvement in substantive decision-making;

Additionally, any change in an existing foreign investor's rights that provides the investor any of these rights can trigger CFIUS jurisdiction.

Importantly, real estate transactions (including leases and other conveyances) where the real estate is located within 100 miles of certain government facilities can also trigger CFIUS jurisdiction.

WHAT IS A "TID U.S. BUSINESS"?

The determination of whether a business qualifies as a "TID U.S. Business" typically requires careful analysis. As a general rule of thumb, if any of the following factors apply to the target, further diligence is warranted:

- Ownership of, operation within, or service to, the U.S. "critical infrastructure" (e.g., energy, financial, transportation, telecommunications and technology sectors, among many others);
- Access to personal data of U.S. persons, including credit information, protected health information or other sensitive data;
- Development (including design, testing or production) of technologies that require any export licenses from any federal authority (e.g., the Department of Commerce (the Export Administration Regulations), Department of State (the International Traffic in Arms Regulations), Department of Energy (nuclear licensing authorities), etc.).
 - This includes companies that produce "emerging" or "foundational" technologies, which are yet to be defined by the Department of Commerce.

Importantly, a business not meeting the exact definition of a TID U.S. Business is likely to still be of interest to CFIUS. These definitions are intended to articulate specific concerns at a high level, but not to rule out the potential for issues in companies that operate similarly to, but not formally as, a TID U.S. Business.

WHAT OTHER COMPANIES DOES CFIUS COVER?

CFIUS technically has jurisdiction over any investment by a foreign person into any U.S. business that meets the structural criteria outline above (including the lowered threshold for TID U.S. Businesses). For “control” acquisitions, jurisdiction attaches irrespective of the target’s bearing on U.S. national security; however, targets meeting any of the following criteria should pay careful attention to CFIUS issues when considering investment from abroad:

- Any TID U.S. Business;
- Businesses adjacent to TID U.S. Businesses that may not be fully captured by the relevant definitions;
- Any provider of services or goods, directly or indirectly, to the U.S. government;
- Any business that has taken grants or loans from the U.S. government or academic institutions;
- Any developer or distributor of technology that can be widely available in the enterprise or personal markets (e.g., operational software for businesses, consumer or enterprise cybersecurity software, social media software applications, etc.)
- Any business with a substantial user base, in particular if users register their products or otherwise establish accounts with the business;
- Any business that develops, distributes or uses technology or projects of strategic importance to the U.S. national security;
- Any business that develops technology that requires substantial R&D spending

These factors indicate that CFIUS is an issue to consider in a transaction, but transaction-specific factors always must be considered as well. Additionally, the identity of the buyer can impact the relative need to file.

WHAT COUNTS AS A “FOREIGN” INVESTOR?

This is often one of the more complex questions in a CFIUS analysis. Generally, a foreign investor is (a) any foreign citizen; (b) any entity ultimately “controlled” (see below) by foreign citizen(s); or (c) any investment fund that (i) has one or more foreign persons as managers/principals of the fund; (ii) has a substantial amount of foreign capital or that otherwise affords foreign investors substantial formal or informal influence over the fund’s operations; or (iii) affords foreign investors access to nonpublic information about portfolio company technology.

For this analysis, the threshold of “control” can be any interest that is not explicitly passive. Thus, a foreign person who has an 8% equity stake in a business and a seat on its board may cause that business to count as “foreign” for CFIUS purposes. There is no bright-line rule here.

WHAT DOES THE CFIUS PROCESS ENTAIL?

There are two primary forms of CFIUS review. First, there is a “short form” process, whereby the parties voluntarily submit a “declaration” to CFIUS that provides high-level information about the transaction. After 30 days, CFIUS can clear the transaction, request a “long form” notice or unilaterally initiate a review of the subject transaction. CFIUS also has the authority to take no action, which does not provide the parties the desired “safe harbor” but also does not require them to provide further information (they may on their own proceed to submit a “long form” notice, discussed below).

Second, there is a “long form” process, whereby the parties file a full “notice” to CFIUS that provides a more detailed set of information about the transaction. This process includes a 45-day review of the transaction and, potentially, an additional 45-day investigation. During investigation, if there is an issue of concern, the agencies may negotiate a package of conditions with the parties prior to clearing the transaction.

HOW LONG DOES THE CFIUS PROCESS TAKE?

A short form process typically takes approximately 30 days (the staff takes a short amount of time to confirm the contents of the declaration before starting the clock).

The formal long form process typically takes either 45 or 90 days, depending on whether an investigation is required. However, the amount of time that elapses before CFIUS accepts a notice and starts the clock on the review can vary significantly among transactions for a variety of reasons. It is common for the full process to take 3 to 6 months. In rare instances the process can extend much longer.

IS FILING MANDATORY?

A small subset of cases require filing. In most other instances, parties file voluntarily due to transaction-specific risks. Absent a mandatory filing requirement, CFIUS still retains significant enforcement authority. This firm has worked on a number of enforcement matters, including one stemming from an investment that occurred nine years prior to when CFIUS took action.

WHY WOULD I FILE IF IT IS NOT MANDATORY IN MY TRANSACTION?

The mandatory filing program articulates parameters for filing where CFIUS was able to clearly articulate its interest. However, transactions routinely present specific issues that also may trigger CFIUS interest. Failing to file those transactions may subject the parties to undue risk of adverse action. Accordingly, there are several compelling reasons to proactively engage with CFIUS and voluntarily file a notice:

Gain an Advantage in Acquisition Negotiations

Acquirers that have a record of approval from CFIUS are in a stronger position in auction processes than those that are unknown to CFIUS. This typically helps to assure the seller that the target does not present undue CFIUS risk, which strengthens the acquirer's bid and helps the acquirer to negotiate more favorable provisions in transaction documents.

Assure Investors of Compliance

Early-stage companies with limited resources often prioritize operational necessities over compliance issues. As companies evolve from seed rounds into later rounds, investors increasingly want assurances that they are not buying into latent regulatory time bombs. Filing with CFIUS in early rounds demonstrates to sophisticated investors that the target has identified issues of concern to investors and preemptively addressed them

Additionally, filing with CFIUS early in a company's life cycle carries three distinct advantages: (1) small companies are typically less sensitive to CFIUS because the scope any issue is not as large (e.g., it has far fewer customers than a later stage company); (2) if there are any operational measures CFIUS requires to address concerns, they are far easier to implement while operations are still relatively simple; and (3) filing early helps to "build a file" with CFIUS, making later filings easier.

Manage Substantive and Timing Risks

CFIUS authority to mitigate or unwind a transaction extends in perpetuity. If the parties close a transaction without filing with CFIUS, CFIUS has authority to take adverse action post-closing. Conversely, by filing, the parties avail themselves of the "safe harbor" provided in the law, which prevents any further action by CFIUS after it has reviewed and approved a transaction.

Further, by proactively filing, the parties eliminate the risk of CFIUS intervention prior to closing and initiate the review themselves as soon as possible in the acquisition process.

Establish and Maintain a Relationship with CFIUS

Proactive engagement with CFIUS yields better results than engagement only after request or compulsion by CFIUS. By proactively filing, the parties begin the process from a position of transparency, which engenders trust with CFIUS. CFIUS considers a party's history of cooperation with it in adjudicating cases, so building a good track record is important.

Maintain Relationships with the U.S. Government

Targets that have relationships (regulatory or commercial) with the U.S. government should prioritize maintaining those relations. Filing with CFIUS demonstrates good faith and a desire to

be a reliable partner with the U.S. government, and filing assures customers that any risks associated with the investor will be addressed. Similarly, overseas companies wishing to do business in the U.S., or potentially acquire additional U.S. businesses, should prioritize their reputation for openness and transparency with the U.S. regulatory regime.

Manage Public and Customer Relations

Some transactions garner attention from trade and popular press. Competitors may seize on a foreign investment as an opportunity to pursue a company's customers. Customers themselves may have questions about operational continuity and security in light of overseas investment. Proactively filing with CFIUS is a strong pillar in a public and customer relations strategy.

Adopt a General Posture of Transparency

In the global business community, a transparent approach to regulators helps to guard against unintended consequences. Recent statutory changes encourage CFIUS to work with allied nations as they expand their national security transactional review processes. Review and clearance by CFIUS helps to assure other regulatory bodies, as well as future customers and targets, that a company and its parent entities have a strong posture of compliance.

MY TRANSACTION SIMPLY CANNOT BE DELAYED FOR A CFIUS REVIEW. WHAT SHOULD WE DO?

Proactively filing with CFIUS is the ideal method of managing CFIUS-related risk. There are often ways, however, to manage these risks within the timing constraints of any particular transaction. These are highly case-specific considerations.

WHAT SHOULD I DO IF I MIGHT HAVE A CFIUS ISSUE, OR IF I'M NOT SURE?

Seek counsel. Any experienced CFIUS practitioner can efficiently determine if a transaction is likely to trigger CFIUS jurisdiction or entail CFIUS risk.

IS THERE ANYTHING ELSE I SHOULD KNOW ABOUT CFIUS?

Yes. A number of transactions that undergo CFIUS reviews have related issues. For example, the target's technology may export licensing, or the target may have access to classified U.S. government information. In such cases, engagement with additional regulators may be necessary to ensure a successful closing.