

FIRMMA and Changes to CFIUS Review of Cross-Border Investments

3/20/2019

Practices: Corporate, Finance & Acquisitions

Overview

The Foreign Investment Risk Review Modernization Act of 2018 (“FIRMMA”) was signed into law by President Trump on August 13, 2018. FIRMMA represents the first reform in over a decade of the process by which foreign investments in American businesses are reviewed by the Committee on Foreign Investment in the United States (“CFIUS”). The new law leaves in place much of the existing process by which investors may submit voluntary notice filings to CFIUS for review. However, FIRMMA expands the scope of investments which are subject to CFIUS review and establishes the review process as mandatory for investments in certain businesses which own critical technology or critical infrastructure.

WHAT HAS NOT CHANGED

- ***CFIUS and its basic functions***

CFIUS is a federal multi-agency panel chaired by the Secretary of the Treasury that is charged with the review and investigation of certain “covered transactions” which threaten to impair the national security of the United States. CFIUS investigations may be conducted regardless of whether the parties to the transaction submit a filing to CFIUS. If a CFIUS investigation concludes that the covered transaction poses a threat to national security, it may require that the parties agree to specified mitigating conditions. If these conditions are not agreed, or in any event, if CFIUS elects, it may refer the covered transaction to the President, who has the authority to suspend, prohibit or order the unwinding of the transaction.

- ***Mergers, acquisitions or takeovers of U.S. businesses by foreign persons remain “Covered Transactions”***

Prior to the passage of FIRMMA, the “covered transactions” subject to CFIUS review were limited to “[a]ny merger, acquisition or takeover...by or with any foreign person that could result in foreign control of any United States business, including such a merger, acquisition or takeover carried out through a joint venture.” For purposes of this definition, “foreign person” means any foreign national, government or entity, or any entity controlled by any of them. A “United States business” is any entity to the extent that it is engaged in interstate commerce, regardless of the nationality of the person or persons who control it.

Persons engaged in transactions which may be classified as “covered transactions” under this definition should consider submitting a voluntary notice for review by CFIUS prior to closing the transaction.

- ***Factors considered by CFIUS remain the same***

Section 721(f) of the Exon-Florio Act, which was not amended by FIRRMA, sets forth the following factors which may be considered by CFIUS in its review of covered transactions:

- domestic production and capability and capacity of domestic industries to meet national defense requirements;
- the effect of foreign control of domestic industries and commercial activity on national security;
- potential effects on sales of military goods, equipment, or technology to a country identified as a supporter of terrorism, a country of concern regarding proliferation of missiles or weapons of mass destruction or a potential regional military threat to the interests of the United States,
- potential effects on United States international technological leadership;
- potential national security-related effects on “critical infrastructure” or “critical technologies” (each as defined below);
- whether the covered transaction will result in control of the U.S. business by is a foreign government;
- the subject country’s adherence to nonproliferation control regimes, its record on cooperating in counter-terrorism efforts, and the potential for transshipment or diversion of technologies with military applications; and
- long-term projection of domestic energy and critical resource and material requirements.

Parties considering a voluntary filing should also note that political sensitivities and potential publicity surrounding a transaction may make CFIUS more eager to review or investigate a transaction and, as a practical matter, may affect the outcome of any review or investigation.

- ***Most filings remain voluntary***

Until FIRRMA was signed, the process of submitting notices to CFIUS for review and potential investigation was entirely voluntary. This remains the case for all transactions except those covered by the pilot program described below. CFIUS retains the ability to request that parties file a notice with CFIUS and may take action with respect to a covered transaction regardless of whether a notice is filed. Historically, many (but not all) parties to covered transactions have submitted notice filings in order to avoid the risk of CFIUS imposing unpalatable mitigating conditions on the transaction post-closing or recommending that the President order that the transaction be unwound.

- ***Filings remain confidential***

Information and documentary material submitted as part of a CFIUS filing remain confidential and exempt from public disclosure.

WHAT IS NEW WITH PASSAGE OF FIRRMA

- ***Broader Scope of Investments Subject to CFIUS Review***

Prior to FIRRMA, CFIUS was charged solely with review of transactions which could result in foreign control of a U.S. business. This excluded from CFIUS’s purview non-controlling investments, investments which involved the acquisition of discrete assets or rights (but not a business), and changes in existing investments which

could result in foreign control of a U.S. business. These limitations allowed certain types of sensitive foreign investment to proceed without the same CFIUS scrutiny as a more straightforward asset or equity sale or merger.

FIRRMA addresses this discrepancy by expanding the definition of “covered transaction” substantially, adding the following categories to CFIUS’ jurisdiction:

- **Certain Real Estate:** purchase or investment in U.S. real estate in a port or in close proximity to a U.S. military installation or another property sensitive to national security, if such purchase or investment could reasonably provide the foreign investor with intelligence-collecting abilities or could otherwise expose the property to the risk of foreign surveillance. This category explicitly excludes individual housing units and real estate in urbanized areas;
- **Certain “Other Investments”:** “Other Investments” in certain U.S. businesses which do not rise to the pre-FIRRMA standard of providing control over a U.S. business to a foreign person, but do provide (a) access to material nonpublic technical information, (b) membership or observer rights on a board of directors or the right to nominate a director, or (c) other involvement in substantive decision making regarding the disposition of sensitive personal data of U.S. citizens, critical technologies or critical infrastructure. CFIUS jurisdiction applies to these “other investments” only if the U.S. business in question owns, operates, manufactures, supplies, or services “critical infrastructure”; produces, designs, tests, manufactures, fabricates, or develops “critical technologies”; or maintains or collects sensitive personal data of U.S. citizens. A subset of these “Other Investments” are now subject to mandatory CFIUS filing (see below);
- **Changes to Existing Investments:** changes in a foreign person’s rights respecting an existing investment in a U.S. business that could result in foreign control of the United States business or an investment contemplated in the previous bullet point; and
- **Transactions Designed to Avoid Review:** other transactions, transfers, agreements, or arrangements designed or intended to evade or circumvent CFIUS review.
- ***Timeline for Review Extended; Filing Process Reformed***

FIRRMA includes changes at two stages of the CFIUS review process that are intended to introduce greater efficiency and certainty into the process:

- **Pre-Filing Phase:** parties submitting a transaction for CFIUS review are strongly encouraged to submit a draft of formal notice to CFIUS for consultation prior to formal filing. If the parties stipulate that the transaction is a “covered transaction”, then CFIUS is now required to provide feedback on a draft notice within 10 business days. Practitioners have reported delays of up to 30 days on pre-filing consultations, so this would represent a significant improvement.
- **Filing the Formal Notice:** After the filing parties have revised the draft notice to reflect any comments received during the pre-filing period, they submit a formal notice filing to CFIUS. Practitioners have reported that CFIUS may take up to 30 days to acknowledge receipt of the formal notice filing.
- **Review Period:** CFIUS now has 45 days rather than 30 days to conduct its review of a transaction.
- **Investigation Period:** If, at the conclusion of the review period, CFIUS decides to conduct an investigation of the transaction, it must complete that investigation within a 45-day period. This period may be extended

by an additional period of 15 days in “extraordinary circumstances”. Prior to FIRRMA’s passage, some practitioners reported that CFIUS had requested that the filing parties withdraw and resubmit their notices simply because CFIUS was unable to meet the 45-day statutory deadline.

- ***Certain Investments Require Mandatory Filing of Declaration***

Section 1706 of FIRRMA establishes a new class of transaction for which filing with CFIUS is mandatory rather than voluntary. Affected transactions include investments in the following categories of U.S. businesses by a foreign person:

- A business that owns, operates, manufactures, supplies, or services “critical infrastructure”. “Critical Infrastructure” means “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.
- A business that produces, designs, tests, manufactures, fabricates, or develops one or more “critical technologies,” including defense articles or services on the U.S. Munitions List; items on the Commerce Control List and controlled pursuant to multilateral regimes (including for reasons relating to national security, WMD proliferation, nuclear nonproliferation, or missile technology) or for reasons relating to regional stability or surreptitious listening; certain nuclear equipment, parts and components, materials, software, and technology restricted in federal regulations; select agents and toxins; and emerging and foundational technologies controlled under the Export Control Reform Act of 2018.
- A business that maintains or collects sensitive personal data of United States citizens that may be exploited in a manner that threatens national security.

If a “covered transaction” falls within one of the categories described above, then a mandatory declaration must be filed if it either represents (1) a direct or indirect acquisition of a substantial interest in a U.S. business by a foreign investor in which a foreign government has a substantial investment, or (2) a “pilot program covered transaction”.

“Pilot program covered transactions” are limited to a specific set of industries designated by the Department of Treasury. The regulations approved in connection with the pilot program establish the following as “pilot program industries” within which filing of a declaration is now mandatory:

- Aircraft Manufacturing
- Aircraft Engine and Engine Parts Manufacturing
- Alumina Refining and Primary Aluminum Production
- Ball and Roller Bearing Manufacturing
- Computer Storage Device Manufacturing
- Electronic Computer Manufacturing
- Guided Missile and Space Vehicle Manufacturing
- Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing
- Military Armored Vehicle, Tank, and Tank Component Manufacturing
- Nuclear Electric Power Generation
- Optical Instrument and Lens Manufacturing
- Other Basic Inorganic Chemical Manufacturing

- Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing
- Petrochemical Manufacturing
- Powder Metallurgy Part Manufacturing
- Power, Distribution, and Specialty Transformer Manufacturing
- Primary Battery Manufacturing
- Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing
- Research and Development in Nanotechnology
- Research and Development in Biotechnology (except Nanobiotechnology)
- Secondary Smelting and Alloying of Aluminum
- Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing
- Semiconductor and Related Device Manufacturing
- Semiconductor Machinery Manufacturing
- Storage Battery Manufacturing
- Telephone Apparatus Manufacturing
- Turbine and Turbine Generator Set Units Manufacturing

Regulations issued by the Department of Treasury specifically carve-out investments through certain investment funds and investments involving air carriers.

Filers may submit a short-form declaration (expected to be no more than about five pages in length) for these mandatory filings. Section 1706 of FIRRMA contemplates that any party to a covered transaction will be permitted to file a short-form declaration; however, the regulations approved in connection with the current pilot program state that voluntary declarations are not being accepted at this time. Parties to all types of covered transactions may submit a traditional notice rather than the short-form declaration, at their option.

- ***Filing fees are authorized (but are not yet being assessed)***

Although CFIUS has not yet issued regulations imposing a filing fee, FIRRMA authorizes CFIUS to charge a filing fee equal to the lesser of one percent of transaction value and \$300,000 (subject to annual inflation adjustment).

FACTORS IN DECIDING WHETHER TO FILE A VOLUNTARY NOTICE

Unless a transaction falls within the scope of the new pilot program, CFIUS notice filings remain voluntary. Parties to a cross-border investment should take into account several factors in determining whether to submit a notice filing to CFIUS.

- ***What effect will a CFIUS filing have on the anticipated timeline of the transaction?***

Prior to FIRRMA's enactment, practitioners reported that a CFIUS review could take three to four months even without a subsequent investigation, which could take another month (or more if CFIUS requested that the notice with withdrawn and resubmitted). Portions of this delay were caused by long wait times in the pre-filing process, which FIRRMA now limits to 10 business days. However, the review process has been extended from 30 to 45 days, and investigations can last up to 60 days further under extraordinary circumstances. A delay of

this length can make an investment or acquisition bid by a foreign investor substantially less competitive than one submitted by a domestic buyer.

- ***If the parties do not file with CFIUS, is CFIUS likely to undertake its own investigation?***

CFIUS is able to investigate transactions for which notices were not filed—even after the transaction has closed. If CFIUS conducts its own review and investigation and concludes that the transaction presents national security risks, it may later recommend either that mitigating conditions be imposed or that the President order that the transaction be unwound (likely at great cost to the temporary acquirer). If a transaction is likely to be reviewed regardless of whether a voluntary notice is submitted, the parties may prefer to frame the transaction in the most favorable way possible and demonstrate good faith to CFIUS in order to facilitate a more favorable outcome of the review and investigation.

In determining whether CFIUS is likely to conduct its own review and investigation of a transactions, parties may consider the factors under Section 721(f) of the Exon-Florio Act (as described above). Parties may also consider whether the investment target has material government contracts or if the underlying transaction is likely to be politically sensitive, prominently covered in the media or subject to competing bids by influential domestic parties.

- ***Will obtaining CFIUS clearance make it easier to obtain other necessary regulatory approvals?***

Obtaining CFIUS clearance may make it easier for the parties to obtain approval from other regulatory agencies that consider the impact of investments on U.S. national security.

LIKELY IMPACT ON CROSS-BORDER INVESTMENTS

The most important effect of FIRRMA will likely be the expansion of the set of “covered transactions” that CFIUS may review. In a geopolitical environment in which countries such as China and Russia are identified as strategic competitors and are acknowledged to have an interest in obtaining certain U.S. technological resources, the new powers granted to CFIUS will likely have a chilling effect on investments by Chinese and Russian parties in U.S. businesses that own or operate critical infrastructure and critical technology, or that operate in close relationships with, or proximity to, U.S. government and military installations. Transactions involving these investors will inevitably take longer and cost more to close than transactions involving domestic partners, and they may be subject to unattractive mitigating conditions or prevented from closing at all.

While investments from friendly nations such as Japan, Canada, the United Kingdom and European Union member states may be perceived as less of a threat to national security, these investments will be affected by wider CFIUS jurisdiction, as the timing and transaction costs involved in a CFIUS filing will likely create some competitive disadvantages for these investors, as well. The more streamlined filing associated with the new pilot program may make it easier for these investors to obtain CFIUS clearance for low-profile transactions, but until the scope of the pilot program is expanded beyond select industries, most transactions will be processed within the older filing framework.

Persons contemplating inbound investment to the United States which may be subject to CFIUS jurisdiction should work with their legal and transaction advisors at an early stage of the investment process to evaluate

the costs and risks of making or foregoing a CFIUS filing and to establish expectations and terms relating to the transaction which are favorable to the investor and agreeable to all parties to the deal.