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8 Common Misconceptions of CFIUS Review

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Mergers, acquisitions, joint ventures and other forms of investment by foreign persons in the United States continue to increase in the current global economy. The concept of national security and its tie to economic security in these types of transactions has been confirmed, and that tie is reflected, in part, through the authority of the Committee on Foreign Investment in the United States ("CFIUS" or "the Committee"), an executive branch organization originally formed to opine on the impact of foreign investment on U.S. national security interests.

CFIUS, which is chaired by the Department of the Treasury, comprises 15 executive agencies, as well as a number of consultative agencies that review transactions when appropriate. The CFIUS review process is a voluntary process through which parties to a transaction whereby a foreign person will acquire control of a U.S. business may seek clearance for the proposed transaction from the Committee.

In 2007 legislation, Congress broadened the authority of the Committee and expanded the areas in which "national security" issues may arise. Based on this expansion and the approach CFIUS has taken to reviewing transactions within the last few years, several misconceptions exist that would benefit from clarification. We examine below eight common misconceptions parties routinely have regarding the CFIUS review process.

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1. "This deal is too small."

Some believe that the value of a transaction matters in deciding whether to file a CFIUS notification. However, the law does not limit CFIUS jurisdiction on the basis of dollar value. Unlike, for example, antitrust considerations, the actual dollar value invested or the purchase price alone are not driving factors. Elements of a deal that do affect any CFIUS assessment, however, include the nature of any national security or critical infrastructure concerns raised by the target's business and the rights the investor or purchaser obtains over that business as a result of the transaction.

2. "This is not high-tech stuff the U.S. government worries about."

Parties previously decided whether to file a CFIUS notification based, in part, on whether the U.S. business in question made weapons, tanks, military products or classified items. However, "national security" is not defined so narrowly. Further, the 2007 changes to the law expanded the areas of interest to the United States to include "critical infrastructure," which includes not only classic defense or military items, but telecommunications, energy, financial and other systems upon which the United States relies. With such a broad definition, a potential investment by a non-U.S. person in the smart grid structure of the United States or in any investments in the U.S. financial industry that would result in foreign control could be of interest to CFIUS.

3. "If CFIUS cares about this stuff, why have we done X deals and not heard from the Committee?"

Simply because parties have not notified CFIUS of past deals or CFIUS has not reached out to request a filing does not mean that a current deal is not of interest to CFIUS and/or does not implicate U.S. national security or critical infrastructure concerns. First, the Committee has limited resources and relies on the parties to a transaction to file notices in appropriate circumstances. Second, CFIUS does not have access to nonpublic information that could bring transactions to its attention. For example, the Committee reviews press releases, Securities and Exchange Commission filings, and other public notifications and government filings to understand what transactions have occurred or are in process. But, a transaction or investment consummated between two private parties for which no press releases or other announcements exist would not necessarily come to the Committee's attention. Third, within the U.S. government, not all agencies share information with CFIUS. For example, when non-U.S. purchasers or investors acquire U.S. entities or organizations, notifications regarding export license transfers may be filed with the Depart-

ments of Commerce and State. Both agencies are members of CFIUS, but whether each agency notifies Treasury is unclear.

4. "It's only an investment, and the foreign investor/purchaser does not gain any rights until later."

Some transactions or investments reflect a long-term commitment by a foreign purchaser in the target or entity. Long-term commitments may be included in transaction documents that identify a current investment position and subsequent investment positions over time. For example, a non-U.S. purchaser may invest $100 million in a U.S. target and receive a 9.8 percent ownership interest and no board seat. However, related investment documents note that for that $100 million investment, ownership increases each year for the next five years and, at the end of the five-year period, the non-U.S. purchaser will own 59 percent of the U.S. target. Some parties may decide that the transaction results in ownership of 10 percent or less, while others would look at the overall transaction and find that the $100 million investment buys a 59 percent ownership stake in the U.S. target. In one circumstance, no filing will be made pursuant to an exemption in the CFIUS regulations, and in another circumstance, a filing could be deemed prudent. Under this example, a careful analysis would be necessary to determine whether the "slice-in-time" approach would be viewed as a potential circumvention of the CFIUS regulations.

5. "There's nothing classified now, and the classified stuff ended a few years ago."

CFIUS requests that any filings include a complete listing of any classified contracts or subcontracts completed or handled in the five years prior to the notification. Nonetheless, instances exist where parties may decide not to make a CFIUS filing because the classified work has ended. One of the quintessential national security concerns for the United States is improper access to classified information. That importance and the concomitant damage that would arise to U.S. national security interests if the information is released improperly forms the foundation for the security classification. This certainly suggests that a company that has been in a business requiring classified access in the past likely continues to involve national security issues.

6. "What the non-U.S. purchaser or investor does in other countries should not be of concern to CFIUS because it's not a direct U.S. transaction."

Some argue that the purchase of a U.S. business by a foreign party should be reviewed in light of what the foreign party intends to do with the U.S. business and not in light of what type of business the foreign party conducts outside the United States. From a CFIUS perspective, however, the ability of a foreign party to purchase a U.S. business or asset and to determine how those assets will be used or that business will be conducted could result in transfers to countries of concern simply because the foreign party already transacts with those countries. Absent restrictions in the purchase or investment documents, or other self-implementing limitations of law or regulation, CFIUS would not be incorrect in assuming that the purchase or investment could allow the investor to transfer assets or technologies to countries of concern to the United States. Such transfers could result in harm to U.S. national security.

7. "Even if the target or seller supplies the U.S. government or exports, it's all EAR99."

These statements are not always well researched or well supported. In addition, in some instances, companies simply make mistakes, a not uncommon situation even for the most informed, given the complexity of the U.S. export control laws. From a CFIUS perspective, the export classification and licensing of products, technology and services is directly relevant to a national security assessment. First, the CFIUS regulations specifically request details of export classifications and licensing related to the target. Second, in some circumstances, if a foreign purchaser or investor acquires a U.S. business that is subject to the International Traffic in Arms Regulations, licenses that were in the target business's asset base may not be able to transfer. Third, a misclassification of products, technology or services could result in the transfer of these items to parties or countries with which the U.S. government has serious concerns. Fourth, a purchaser may not have been approved as an end user on an export license, but that same purchaser could buy the entire asset and, thereby, obtain the items or technologies that could not be exported to them under U.S. export laws. The purchase, therefore, circumvents the export denials and potentially adversely affects U.S. national security interests. A CFIUS filing will bring these issues to light.

8. "This is just an asset deal."

For a variety of reasons, including efforts to minimize the potential for successor liability, corporate transactions sometimes are structured as asset purchases. In such cases, parties may think that the transactions are not within the jurisdiction of CFIUS because a foreign person is not acquiring a U.S. business. Take, for example, the acquisition of a building adjacent to a sensitive military facility in the United States. Deals often involve more than just the building, including leases for current tenants. Those additional aspects of the transaction cause the "asset" to look and feel more like a "business." In addition, those assets may have characteristics important for CFIUS review – such as access or proximity to sensitive U.S. facilities. In those cases, deciding not to make a CFIUS filing on the basis that the transaction is an asset deal would not be prudent.