

A Modern Approach to Tackling CFIUS Concerns

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Foreign direct investment (FDI) into American businesses is a major component of the U.S. economy. American companies use FDI to fund domestic manufacturing plants, research and development facilities, and support the growth of American jobs. However, due to the ownership and control restrictions placed on FDI participants, accommodating FDI into American businesses requires a deep understanding of the Committee on Foreign Investment in the United States (CFIUS). This understanding allows practitioners to counsel clients seeking approval for FDI transactions that may be impactful upon U.S. national security. The remainder of this article provides a roadmap to navigate CFIUS and analyze transactions subject to CFIUS review, as well as an update as to some recent transactions affecting Chinese investors.

Technically part of the U.S. Department of Treasury, CFIUS is an inter-agency committee authorized to review the national security effect of transactions that could result in control of a U.S. business by a foreign person (Covered Transaction).¹ CFIUS operates pursuant to section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (FINSAs) (section 721), and as further implemented by Executive Order 11858 and the regulations at 31 CFR Part 800 (CFIUS Regulations). CFIUS is chaired by the Secretary of the U.S. Department of Treasury. Parties to a transaction may submit a joint notice containing the transaction details so that the committee may assess if the transaction poses a national security concern.² Notices to the committee are received, processed, and coordinated at the staff level by the Staff Chairperson, who also serves as the Treasury Department's Director of the Office of Investment Security.

The CFIUS committee members include the following U.S. Government department heads:

1. Department of the Treasury (Chairperson of CFIUS)
2. Department of Justice
3. Department of Homeland Security
4. Department of Commerce
5. Department of Defense
6. Department of State
7. Department of Energy
8. Office of the U.S. Trade Representative
9. Office of Science and Technology Policy³

The following U.S. Government offices also observe and participate in CFIUS reviews:

1. Office of Management and Budget
2. Council of Economic Advisors
3. National Security Council

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4. National Economic Council
5. Homeland Security Council⁴

The CFIUS process continues to be the subject of significant informal reforms including numerous improvements to internal CFIUS procedures, along with formal reforms through the enactment of FINSA in July 2007, the amendment of Executive Order 11858 in January 2008, the revision of the CFIUS regulations in November 2008, and the publication of guidance on CFIUS's national security considerations in December 2008.⁵

After a CFIUS notice is officially accepted by the committee, the timeline for the review periods begin with the 30-day initial review period.⁶ The majority of transactions are either cleared during the 30-day initial review or determined not to be covered transactions subject to CFIUS review. If the transaction is not cleared within the 30-day initial review period, then CFIUS may institute a 45-day secondary investigation period.⁷ The 45-day secondary investigation period is required if a transaction involves foreign government control or the acquisition of Critical Infrastructure (defined below). Only the deputy heads of the co-lead agencies reviewing the transaction may waive the 45-day secondary investigation period. If CFIUS cannot reach a consensus as to the transaction, or recommends a Presidential rejection, the transaction is sent to the President of the United States for a final decision during a 15-day review period, which is followed by a report to the Congress.⁸

I. Analyzing a Potential Transaction

As a starting point, to analyze the need for a CFIUS filing as to a potential transaction, parties should determine that the transaction represents (i) a Covered Transaction, involving (ii) Critical Infrastructure, or (iii) Critical Technologies (defined below), which (iv) results in a potential national security threat.

COVERED TRANSACTION

Any transaction that may result in the control of a U.S.-based business by a foreign person is a Covered Transaction under 31 CFR §800.207. A foreign person means any foreign national, government, or entity, or a business entity over which control is exercised or exercisable by a foreign national, government, or entity.⁹

Under the CFIUS Regulations, even a 50/50 Joint Venture (JV) can be a Covered Transaction, unless the parties carefully structure the transaction to avoid coming within the definition.¹⁰ For example, the creation of a JV may be a CFIUS Covered Transaction under 31 CFR §800.207 if the 50/50 JV partners are each provided veto power over matters affecting the JV and essentially providing both parties with the ability to control the JV.

The analysis for determining whether a JV is foreign-controlled under CFIUS is essentially the same as analyzing the foreign control under CFIUS for any business entity type. A key to the foreign control analysis is reviewing the matters for which veto powers are granted to the foreign person. Veto powers relating to the following matters are examples satisfying the CFIUS control thresholds:

1. The sale, lease, mortgage, pledge, or other transfer of any of the tangible or intangible principal assets of the entity, whether or not in the ordinary course of business;

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2. The reorganization, merger, or dissolution of the entity;
3. The closing, relocation, or substantial alteration of the production, operational, or research and development facilities of the entity;
4. Major expenditures or investments, issuances of equity or debt, or dividend payments by the entity, or approval of the operating budget of the entity;
5. The selection of new business lines or ventures that the entity will pursue;
6. The entry into, termination, or non-fulfillment by the entity of significant contracts;
7. The policies or procedures of the entity governing the treatment of non-public technical, financial, or other proprietary information of the entity;
8. The appointment or dismissal of officers or senior managers;
9. The appointment or dismissal of employees with access to sensitive technology or classified U.S. Government information; or
10. The amendment of the Articles of Incorporation, constituent agreement, or other organizational documents of the entity with respect to the matters described in paragraphs (a)(1) through (9) of this section.¹¹

If a transaction is carefully structured without veto powers or similar features providing foreign control, then a JV or business entity may not transfer the necessary control to a foreign person resulting in a Covered Transaction. If the transaction is not a Covered Transaction, then a CFIUS review is not required.

CRITICAL INFRASTRUCTURE

Second, CFIUS provides close scrutiny to the acquisition of Critical Infrastructure under 31 CFR §800.208. “Critical Infrastructure” is defined within the CFIUS Regulations to cover any system or asset so vital that incapacitation or destruction of the item would have a debilitating impact on national security.¹² In 2003 President George W. Bush assisted in defining Critical Infrastructure by publishing the “National Strategy for the Physical Protection of Critical Infrastructure and Key Assets” (Critical Infrastructure Strategy) outlining eleven sectors of Critical Infrastructure:

1. Agriculture and food;
2. Water;
3. Public health;
4. Emergency services;
5. Defense industrial bases;
6. Telecommunications;
7. Energy;
8. Transportation;
9. Banking and finance;

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10. Chemical industry and hazardous materials; and,
11. Postal services and shipping.¹³

CFIUS continues to actively review sectors providing Critical Infrastructure Strategy. Specifically, recent CFIUS reviewed transactions as to People's Republic of China state-owned entities include the following sectors: agriculture and food; defense industrial bases; and, telecommunications.

CRITICAL TECHNOLOGIES

As part of its charge, CFIUS must provide Congress with an annual report detailing information as to the Covered Transaction notices received and mitigation enacted for the prior year (Annual Report).¹⁴

Within the Annual Report, CFIUS compiles and reports information as to "Critical Technologies" which includes the following:

1. Defense articles or defense services covered by the United States Munitions List (USML), which is set forth in the International Traffic in Arms Regulations (ITAR) (22 CFR parts 120–130);
2. Those items specified on the Commerce Control List (CCL), set forth in Supplement No. 1 to part 774 of the Export Administration Regulations (EAR) (15 CFR parts 730–774), that are controlled pursuant to multilateral regimes (i.e., for reasons of national security, chemical and biological weapons proliferation, nuclear nonproliferation, or missile technology), as well as those that are controlled for reasons of regional stability or surreptitious listening;
3. Specially designed and prepared nuclear equipment, parts and components, materials, software, and technology specified in the Assistance to Foreign Atomic Energy Activities regulations (10 CFR part 810), and nuclear facilities, equipment, and material specified in the Export and Import of Nuclear Equipment and Material regulations (10 CFR part 110); and
4. Select agents and toxins specified in the Select Agents and Toxins regulations (7 CFR part 331, 9 CFR part 121, and 42 CFR part 73).¹⁵

Although Critical Technologies are highlighted within the CFIUS Regulations, Critical Technologies do not independently present a CFIUS review requirement. Rather, the committee is charged with reporting transactions involving Critical Technologies within its Annual Report.¹⁶ Since there is no single source for information regarding Critical Technology acquired by foreign persons, CFIUS utilizes information from the Departments of State, Commerce and Energy, while cross-checking the agency information with publicly announced mergers and acquisitions to fulfill its charge to include a Critical Technologies report within the Annual Report.

The recent advent of the 600 Series to the Commerce Control List has made the CFIUS process more complex. By definition, the 600 Series is a class of Critical Technologies consisting of munition items subject to less control than USML defense articles regulated under the ITAR. Future transactions involving 600 Series items should highlight how CFIUS will coordinate with the Bureau of Industry and Security of the Department of Commerce to mitigate arising national security concerns.

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NATIONAL SECURITY THREAT

Ultimately, the CFIUS review is designed for the Department of the Treasury and the lead agency¹⁷ to determine, at the Deputy Secretary level or above, whether the transaction will or will not impair national security. CFIUS is charged with focusing on genuine national security concerns, not broader economic or other national interests. It is the longstanding policy of the U.S. Government, which was reaffirmed in the President's Statement on Open Economies on May 10, 2007, to welcome foreign investment.¹⁸ Executive Order 11858, as amended, declares the U.S. Government's longstanding policy is "to support unequivocally [international] investment, consistent with the protection of the national security."¹⁹ The CFIUS charge is to execute this national security review on a case-by-case basis.

II. Recent CFIUS Reviews of Transactions involving Chinese Investors

Chinese FDI into the U.S. reached an all-time high during 2013, with a total deal value of \$14 billion.²⁰ Chinese ownership of American businesses continues to be a CFIUS focus, as highlighted by the following transactions:

- Wanxiang Group Co., China's biggest auto-parts maker, received approval from CFIUS to purchase the majority of assets from A123 Systems Inc. for about \$256.6 million during 2013. A123 was a bankrupt electric-car battery maker supported by U.S. government subsidies. The bankruptcy file indicates that items excluded from Wanxiang's asset purchase include the following: International Traffic in Arms Regulations controlled assets; Department of Defense and USG Contracts; Research and Development facilities in Ann Arbor; and, "other facilities and assets" identified by CFIUS as integral to the Government Research Team or performance of the USG Contracts.²¹ A123 and Wanxiang mitigated congressional anxiety by excluding the battery maker's government business from the deal, and selling those assets to Navitas Systems LLC for about \$2.25 million.
- Procon Resources Inc.'s acquisition of the Lincoln Mining Corporation, where it was reported the Chinese National Machinery Industry Corporation owns 60 percent of Procon's shares. Procon's acquisition of Lincoln was approved, however, subject to mitigation so that certain assets close to a U.S. military base were excluded from the assets transferred in the transaction.
- CNOOC Limited's acquisition of the oil and gas company Nexen, Inc., where it was reported that the China National Offshore Oil Corporation is a controlling shareholder of CNOOC. CNOOC's acquisition of Nexen was approved subject to the implementation of foreign control mitigation measures. Specifically, as a mitigation measure, reports indicated CNOOC ceded operating control of certain oil exploration and production assets in the U.S. portion of the Gulf of Mexico.
- Shuanghui International Holdings Limited received notice that CFIUS concluded its review of Shuanghui's acquisition of Smithfield Foods, Inc., with reports indicating that the committee cleared the transaction without material mitigation measures. Smithfield is a Virginia-based company, and the world's largest hog producer and pork processor. Closing of the transaction was initially conditioned upon CFIUS clearance, with the parties submitting a notice to CFIUS in June 2013.
- Dalian Wanda Group Co., Ltd. (Wanda), a leading Chinese private conglomerate and China's largest investor in cultural and entertainment activities, and AMC Entertainment Holdings, Inc., a preeminent U.S. movie exhibitor received necessary regulatory approvals from CFIUS. It is assumed that the Wanda transaction was submitted to CFIUS for review based upon the enormous size of a U.S. company being purchased by a Chinese rival. Wanda paid

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approximately \$2.6 billion and absorbed approximately an additional \$2 billion in liabilities. The acquisition resulted in the world's biggest cinema owner, active in two of the three biggest markets (U.S., China, and Japan). CFIUS cleared the transaction. There is no indication in the reports that (i) the transaction was bound over beyond the initial 30-day review period, or (ii) mitigation was required.²²

The Critical Infrastructure Strategy remains applicable, as each of the above noted Chinese FDI CFIUS reviewed transactions (except Wanda) involves Critical Infrastructure categories described within the Critical Infrastructure Strategy.

As the pace of Chinese investment continues to expand, the number of CFIUS reviews pertaining to Chinese investments also expands. Between 2005 and 2007, Chinese investors submitted only four total transactions for CFIUS review.²³ By contrast between 2010 and 2012, Chinese investors submitted 39 transactions for CFIUS review, accounting for 12% of the total number of CFIUS notices filed.²⁴ The trends show closer CFIUS scrutiny when a Chinese business entity is involved in the transaction; however, experience teaches that actively seeking solutions and potential mitigation to U.S. national security concerns throughout a transaction can lead to a successful investment strategy when faced with CFIUS scrutiny. Despite the heightened national security concerns associated with certain Chinese investments, careful strategic planning continues to provide Chinese investors with successful opportunities within the United States.

Conclusion

Careful strategic planning for a Covered Transaction must include a thorough review of potentially affected Critical Infrastructure and Critical Technologies. To best prepare for a CFIUS review, parties to Covered Transactions should consider the impact of CFIUS mitigation, government contracts of the target, and business mitigation requirements during transactional due diligence.

About the Author

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Endnotes

¹ 31 CFR Part 800.207.

² 31 CFR Part 800.501(a)(2).

³ See the CFIUS membership list provided by the U.S. Department of Treasury available at <http://www.treasury.gov/resource-center/international/foreign-investment/Pages/cfiusmembers.aspx>, last visited 2/3/2015.

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⁴ Id.

⁵ See list of CFIUS reforms available at <http://www.treasury.gov/resource-center/international/Pages/Committee-on-Foreign-Investment-in-US.aspx> last visited 2/3/2015

⁶ 31 CFR Part 800.502.

⁷ 31 CFR Part 800.505.

⁸ 31 CFR Part 800.506.

⁹ 31 CFR Part 800.216.

¹⁰ See definition of (i) Covered Transaction at 31 CFR Part 800.207, and (ii) Control at 31 CFR Part 800.204.

¹¹ 31 CFR Part 800.204.(a)(1)-(9).

¹² 31 CFR Part 800.208.

¹³ See "The National Strategy for the Physical Protection of Critical Infrastructure and Key Assets," published February 2003, pages 35-70 available at https://www.dhs.gov/xlibrary/assets/Physical_Strategy.pdf last visited 2/3/2015.

¹⁴ See Federal Register, Vol. 73, No. 226, Friday, November 21, 2008, 70703 which states "[i]n addition to the certifications described previously, which CFIUS must provide to Congress after concluding action on a transaction under section 721 [Foreign Investment and National Security Act of 2007 (FINSA), Public Law 110-49, 121 Stat. 246, which amends section 721 of the Defense Production Act of 1950 (DPA) (50 U.S.C. App. 2170)], CFIUS also must provide annual reports on its work, including a list of the transactions it has reviewed or investigated in the preceding 12 months, analysis related to foreign direct investment and critical technologies, and a report on foreign direct investment from certain countries."

¹⁵ 31 CFR Part 800.209(a)-(d).

¹⁶ See Federal Register, Vol. 73, No. 226, Friday, November 21, 2008, 70703.

¹⁷ See Federal Register, Vol. 73, No. 226, Friday, November 21, 2008, 70702 which states FINSA further provides that, for each transaction before CFIUS, the Department of the Treasury shall designate, as appropriate, one or more lead agencies. The lead agency, on behalf of CFIUS, may negotiate, enter into or impose, monitor, and enforce mitigation agreements or conditions with parties to a transaction to address any threats to national security posed by the transaction." The lead agency is appointed after a notice is filed. The lead agency may be appointed from the participating agencies. Further see endnote 2 for list of participating agencies.

¹⁸ See President Bush's Statement on Open Economies released May 10, 2007, U.S. Department of State Archive.

¹⁹ Executive Order 11858 (as amended by Executive Order 13456), available at <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/EO-11858-Amended.pdf> last visited 2/3/2015.

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²⁰ See Rhodium Group Report.

²¹ In re: A123 Systems Inc., U.S. Bankruptcy Court, District of Delaware, No: 12-12859, see Wanxiang America Corporation, Asset Purchase Agreement, Doc 640-1, 640-2, and 640-3.

²² CFIUS does not report on individual cases. The information cited as to these individual cases is anecdotal, taken from press or professional reports.

²³ See Committee On Foreign Investment In The United States Annual Report To Congress (2008), page 20.

²⁴ See Committee On Foreign Investment In The United States Annual Report To Congress (2013), page 22.