Podcast Transcript

The Now and Next in International Trade: 5 Fast Facts About CFIUS - a National Security Agency You Should Know

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Rubenking: The Committee on Foreign Investment in the United States, or CFIUS, is a group of U.S. government agencies that reviews foreign investments into, and purchases of, U.S. businesses for national security risks. It is the United States's Foreign Direct Investment Review, or FDI Review. CFIUS has been high profile lately for a number of reasons, including because its jurisdiction was recently expanded and some filings are now mandatory, but also because it is central to the U.S. government's national security concerns relating to social media. But CFIUS, which started in the 1970s, has been around for years and has impacted all sorts of industries, including technology, energy, data, Hollywood, and more, and continues to do so.

I'm Randall Rubenking, and you are listening to BakerHosts. Joining us to discuss the latest CFIUS developments are Melissa Mannino, the co-chair of BakerHostetler's International Trade and National Security team, and Orga Cadet, an associate on that team since 2019. Welcome to both of you.

Cadet: Thanks for having us.

Mannino: Thank you. Thank you. Good to be here.

Rubenking: Let's get started. Orga, what is CFIUS?

Cadet: Well, at its core, CFIUS is a national security agency. Its main goal is to review foreign investments in the United States for national security risk. Specifically, it reviews foreign purchases of U.S. businesses, foreign investments in or funding of U.S. businesses, and even foreign purchases or leases of real estate in the United States.

CFIUS isn't a single agency. It is actually a committee of 16 different government agencies. There are nine core members who do most of the work. Those include some of the biggest government agencies, like the Treasury Department, which chairs CFIUS. But those nine core members also include the Defense Department, the State Department, the Commerce Department, the Justice Department, the Department of Homeland Security, even the White House is directly involved. So, CFIUS is a whole-of-government process. But even though so many agencies are involved, CFIUS is still a relatively little-known national security agency. Even then, it has existed for almost 50 years and has enormous impact on business, technology, and geopolitics.

Rubenking: Melissa, can you tell us why CFIUS is so important?

Mannino: CFIUS is so important for foreign investments into U.S. businesses or foreign acquisitions U.S. businesses, or as Orga mentioned as well, foreign acquisition on leases of U.S. real estate, for a number of reasons. First, CFIUS can impact not only the timing of the transaction but also the outcome of the transaction. CFIUS has the ability to clear the foreign investment. CFIUS has the power to block the transaction and not allow it to proceed, or CFIUS can clear it with conditions. The conditions are having the parties enter into an agreement with the U.S. government to mitigate and address national security concerns.

Additionally, as we'll discuss a little bit later on, a CFIUS review takes time, and how long that process is, is not always clear. Additionally, CFIUS filings can be mandatory. So, parties must understand early on whether their transaction is going to be a covered transaction, one subject to CFIUS jurisdiction, and whether it needs to be filed. Penalties can be imposed up to the value of the transaction for CFIUS filings that are not made and that are required.

Additionally, CFIUS is important because they have the ability to reach out and pull in transactions that were subject to face jurisdiction and that were not filed with CFIUS. And as we'll talk about, this ability of CFIUS to pull in non-notified transactions can happen years and years after the transaction closes. One would ask why would parties choose to voluntarily file with CFIUS, and the reason is to address this non-notified risk, to go through CFIUS, hopefully get CFIUS clearance and safe harbor from CFIUS reaching out later and compelling the parties to file.

Rubenking: Alright. Well, building on that, Melissa, what matters are subject to CFIUS jurisdiction or review?

Mannino: A lot of matters are subject to CFIUS jurisdiction or review. In 2018, the scope of transactions subject to CFIUS jurisdiction grew dramatically. Prior to 2018, CFIUS only had jurisdiction over controlled transactions in which set a foreign investor acquired control over a U.S. business, which is a very low threshold. Even though it is control, it is generally 10% or more of the voting equities of a U.S. business, or less than 10% in some control rights, such as a board of director's seat or special shareholder rights, such as a veto right. CFIUS now has jurisdiction not only over the control transactions, but also certain non-controlling transactions. Those non-controlling transactions up to CFIUS jurisdiction involve what we call TID U.S. businesses, which Orga will discuss later. And CFIUS also now has jurisdiction over certain real estate transactions as you heard.

Additionally, it is very important to understand what is a U.S. business and what is a foreign person. Both those terms are very broadly defined in the CFIUS regulations, and CFIUS has a great deal of discretion in determining whether an investor is a foreign person and the target is a U.S. business. A foreign person is defined as any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity. Thus, a U.S. business controlled by foreign persons can be a foreign investor for CFIUS purposes. U.S. subsidiaries of foreign entities can be foreign persons for CFIUS purposes. U.S. business is also broadly defined. It means any entity, irrespective of the nationality of the persons that control it, engaged in the interstate commerce of the United States. So, acquisition of a foreign entity by a foreign person that has significant operations or footprint in the U.S. could also include an investment in the U.S. business subject to CFIUS jurisdiction.

As I mentioned, parties also need to determine whether you have a mandatory or voluntary filing. So, there are now instances where the parties do not have a choice whether to file. And now parties also have an option about how to proceed with filing with CFIUS. There is two different forms, a CFIUS declaration and a CFIUS notice, and Orga will discuss those and other details.

Cadet: There is a big difference between filing a CFIUS declaration, which is typically shorter, and a CFIUS notice, which is typically longer. Declarations involve a 30-day review process, which could either end up in CFIUS clearing the transaction at the end of the 30 days, which would be typically the best-case scenario. Or CFIUS could issue a letter stating that CFIUS is unable to clear the transaction. This is commonly known as a shrug letter and does not prevent CFIUS from coming back later to review the transaction again. And the third thing CFIUS could do, essentially require the parties to submit a notice. Notices require more information for the initial filing. And instead of a 30-day review process, there is a 45-day initial review process, followed by potentially another 45-day investigation period. So, notices can be a lot longer than declarations. The main benefit of a notice is that CFIUS must, at the end of the notice, review and/or investigation period, make a decision about whether to clear the transaction or attempt to block it or require some mitigation.

How do you decide which filing to submit? Parties typically consider the timing, the costs, and risks that CFIUS might perceive. The timing of the filing can closely affect closing, which is a key part of a deal, typically. Costs come into play because the longer a filing is, the more costs are involved, and notices involve a filing fee, depending on the value of the transaction. And if CFIUS might perceive some national security risk, it might be best to file because CFIUS very well could come back later on in time and potentially require a filing and/or require the unraveling of the transaction.

How do you know what is a high-risk deal? Many types of deals can be high risk. The deals most recently that CFIUS has viewed as high risk involve data such as social media apps; financial services; medical and healthcare services; energy, such as wind farms; oil and gas companies; and high tech, such as semiconductors, quantum technology, autonomous vehicles, drones; and anything in the space sector. If CFIUS wants to find a national security risk, typically it can find it.

Rubenking: Orga, continuing with that, what kinds of deals does CFIUS most focus on?

Cadet: Well, there is no definition for national security in the CFIUS regulations. So, CFIUS says wide latitude to determine what national security is. Typically, CFIUS takes a totality-of-the-circumstances approach based on any threat posed by the buyer, for example, a Chinese buyer; any vulnerability based on the U.S. businesses, products, and services; and potential consequences to national security if the buyer could exploit those vulnerabilities.

There is a special category of U.S. businesses known in the CFIUS world as TID U.S. businesses. T stands for critical Technology, I is for critical Infrastructure and D is for Data, specifically sensitive personal data. Critical technology are various items that are subject to U.S. export controls, either because they are military items or items that can be used in the military context, even if they can also be used in a civil context. Critical technology can also include nuclear items and certain other technology. Critical infrastructure are a wide range of protected infrastructures, such as the electrical grid, oil and gas refineries, ports, and the water system. Sensitive personal data includes identifiable data on U.S. citizens such as healthcare data, financial data, geolocation data, communications, and more.

But beyond these TID U.S. businesses, CFIUS looks at a wide range of factors, like whether the U.S. business provides products or services to the U.S. government. So, the types of deals that CFIUS is most focused on typically are those TID U.S. businesses, but they can also be much broader than that.

Rubenking: All right, then. I wonder if each of you could give us an idea where you believe CFIUS is headed. Melissa?

Mannino: I believe that CFIUS's powers and authorities will continue to grow and that we'll see more filings with CFIUS as CFIUS continues to grow its staff and increase its outreach for non-notified transactions. Indications of an increase in CFIUS's powers and authorities are illustrated by the executive order issued by President Biden in late 2022 on CFIUS. In it the President directed CFIUS to focus not only on protecting the data of American persons from foreign persons. It also directed CFIUS to focus on international supply chains for U.S. businesses, repeated foreign investments into certain sectors of the U.S. economy, artificial intelligence, quantum computing, advanced clean energy, and climate adaptation technologies and more. One of these that really sticks out to me, too, is the repeated foreign investments into certain sectors of the U.S. economy. This is particularly interesting as a CFIUS review is supposed to focus on the transaction before it. But with this directive, it is showing CFIUS to look again at the sector as a whole and what other potential investments are going to be there. One foreign investment could be impacted by other U.S. or other foreign investments into that same sector.

There is also several bills working their way through Congress that would give CFIUS more authority, notably over agricultural related transactions, such as deals affecting U.S. farms and food processing facilities, as well as legislation that potentially gives CFIUS jurisdiction over green-field investments, which would be foreign investment starting a new business in the U.S. And this is a small but important area that is currently outside the scope of CFIUS jurisdiction. So that would be significant for CFIUS to get jurisdiction over green-field investments.

Cadet: Yeah, and I think we can expect CFIUS to conduct more and more outreach on transactions that were not notified to it. CFIUS officials have spoken publicly about being on a hiring spree to build up its capacity to identify such non-notified transactions. There are teams of analysts within CFIUS that scrub public press releases and SEC filings for news about foreign investments in the United States. They also rely on classified sources to learn about such foreign investments, and then they conduct outreach to some of those parties and potentially require them to file a notice or declaration with CFIUS.

Also, this year CFIUS released a report of its activities in 2022. It is required to release these reports on an annual basis, though Congress gets a classified report and the public receives an unclassified report. This year's report showed that in 2022, CFIUS's review of non-notified transactions became more effective because the percentage of non-notified transactions that CFIUS did outreach about resulted in a filing more than twice as often as it did in previous years. This year's annual report also revealed that CFIUS is requiring mitigation agreements twice as often for notices compared to previous years, and these mitigation agreements are designed to mitigate risks that CFIUS has identified with respect to national security.

Rubenking: Alright. Well, keeping in mind everything we've discussed, what would each of you recommend to parties in cross-border deals? Orga?

Cadet: Definitely consider CFIUS risk as a key part of your due diligence. Whether you are a U.S. business considering selling to a foreign person or accepting investment from one, or you're a non-U.S. person interested in buying or investing in a U.S. business. In either of these cases, CFIUS can have a huge impact on the timing and costs of the deal, and whether the deal can even happen at all. So, it is important to do your CFIUS homework as early as possible.

Mannino: And as we've discussed, there is many factors to consider when deciding whether to ultimately file with CFIUS, if it is a voluntary filing. And those factors can change drastically depending upon the specific transaction. An important point to highlight is we talked a lot about non-notified transactions. And if parties choose not to voluntarily file with CFIUS now and there is a risk that they could get pulled in later for non-notified transaction for which CFIUS has no statute of limitations, it can require parties to file years after closing. CFIUS will then review that transaction based upon the national security risks at the time of its review. Thus, a deal that closed four years ago that is now pulled in for a CFIUS review will be viewed based upon the national security risk today, which can be drastically different than at the time of closing. And so just, that is just another important point we want to highlight in deciding whether to make a voluntary filing if your transaction is subject to CFIUS jurisdiction.

Rubenking: Thank you, Melissa and Orga.

Mannino: Thank you.

Cadet: Thank you for having us.

Rubenking: I learned a lot today and I'm sure everyone listening in did too. Thank you all for joining BakerHosts. If you have any questions or comments, please feel free to email Melissa and/or Orga through their profiles available in the show notes or on the BakerHostetler website.