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Committee on Foreign Investment in the United States: Background and Recent Developments

Ted Kassinger

David J. Ribner

June 19, 2018

Agenda

- **U.S. Regulation of Foreign Direct Investments (FDI)**
- **Committee on Foreign Investment in the United States (CFIUS)**
  - What is CFIUS?
  - How does CFIUS work?
- **Proposed CFIUS Reform Legislation**
  - Foreign Investment Risk Review Modernization Act (FIRRMA)

U.S. Regulation of Foreign Direct Investments

The United States has few restrictions on FDI

- No general federal or state affirmative approval requirements of FDI
- Some statutory limitations on foreign ownership. Examples:
  - No more than 25% ownership or control of a U.S.-domestic air carrier
  - No more than 25% ownership or control of most types of licensed wireless or wired communications companies
  - No foreign ownership or control of a company handling nuclear source materials or operating nuclear production or utilization facilities. Minority, non-controlling investments may be authorized.
  - Special rules in banking industry, with oversight by Federal Reserve. Some states prohibit foreign ownership of their state-chartered banks
- Defense sector regulations
  - 5% of more foreign investment in companies that have classified contracts
  - Companies registered under the International Traffic in Arms Regulations (ITAR)

What is CFIUS?

Evolution of CFIUS

- Created by Executive Order in 1975, in response to wave of investments from the Middle East
- 1980s: Japanese acquisitions sparked fear of foreign takeovers of U.S. advanced technology companies (*e.g.,* Fujitsu/Fairchild Semiconductor)
- 1988: Congress broadly authorized the President to block foreign investments on national security grounds
  - Section 721 of the Defense Production Act of 1950
- 2007: Congress extensively amended Section 721
  - Response to several controversial transactions, including CNOOC's bid for Unocal and Dubai Ports World transaction
- 2018?: FIRRMA legislation pending in Congress
  - Response to concerns about Chinese investment, especially in critical technologies

Committee on Foreign Investment in the United States

- Implements Section 721 by reviewing “covered transactions” and assessing national security risks
- Does not “approve” transactions; it only evaluates national security issues
- CFIUS may:
  - Clear or block transactions
  - Negotiate agreements to mitigate national security concerns
  - Permit parties to withdraw with no action
  - Refer the case to the President for decision (with its recommendation)
- Decisions are entirely discretionary. President’s decisions are generally not subject to judicial review

Which Transactions are Covered?

- CFIUS only reviews transactions in which a foreign person acquires “control” of an existing U.S. business
  - “Control” may result from minority investments, regardless of % stake
  - Only a few assets may constitute a “business”
- JVs are covered where a party contributes a U.S. business
- Changes in ultimate foreign parent of a U.S. business are covered
- For transactions outside the United States, CFIUS is only concerned with any U.S. businesses of the foreign target
- Greenfield investments are not covered
- Loans generally are not covered
- Convertible instruments: depends on convertibility features
- Long-term leases: depends on facts

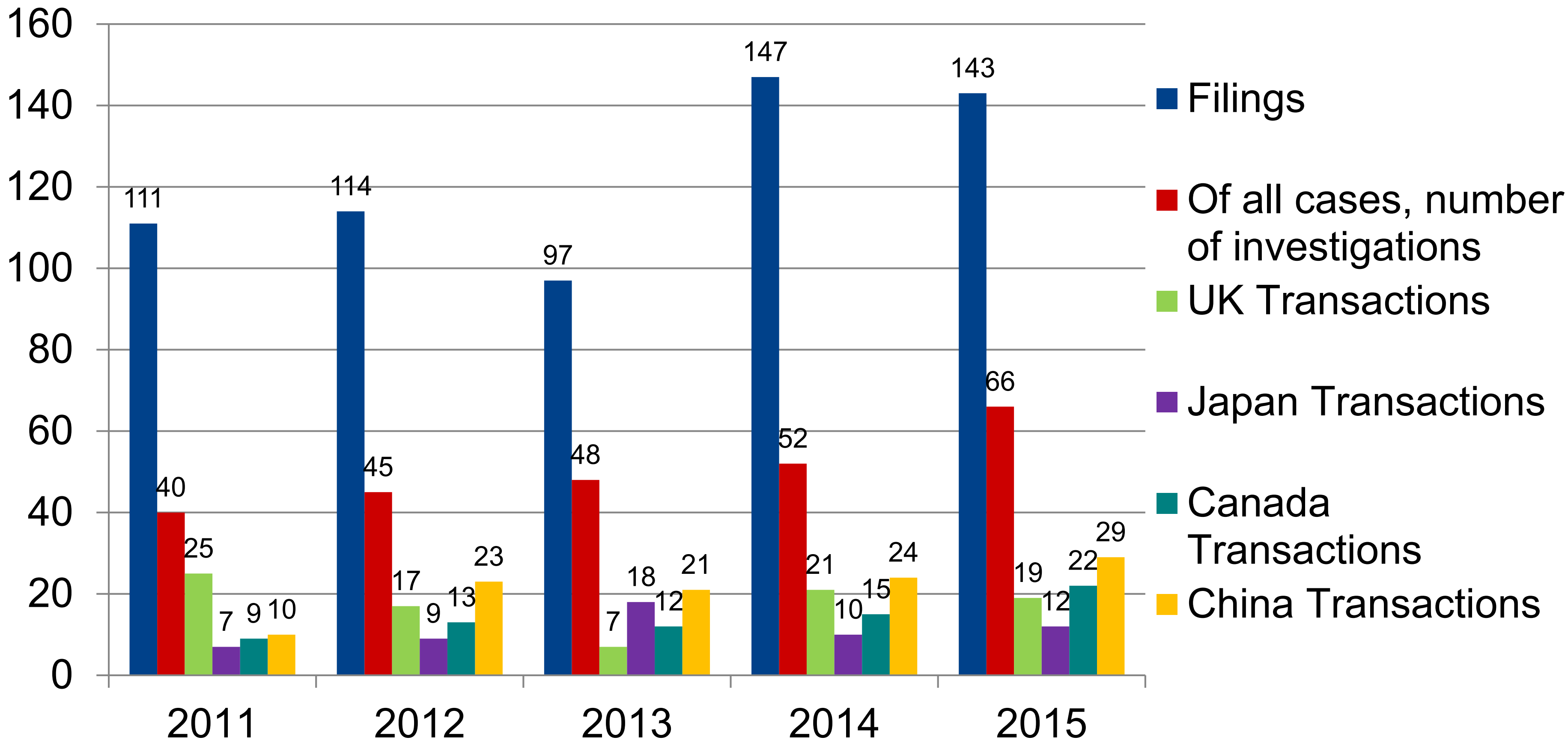
CFIUS Membership

- Chaired and administered by the Department of the Treasury
- Other members:
  - Departments of Commerce, Defense, Energy, Homeland Security, Justice, and State; Labor (*ex officio)*
  - Office of the U.S. Trade Representative
  - Office of Science and Technology Policy
  - Director of National Intelligence (also *ex officio*)
  - National Security Council, National Economic Council, Homeland Security Council, Office of Management and Budget, and the Council of Economic Advisors (*Observer status)*
  - Other agencies on an *ad hoc* basis

Historic CFIUS Experience

- CFIUS reviews relatively few in-bound deals – 147 filed in 2014; 143 in 2015; 172 in 2016
  - Unofficial estimate of 238 cases in 2017
  - During the past five years, the total number of in-bound M&A transactions that were potentially reviewable likely exceeded 2,000 annually
- Since 1988, the President has officially blocked only five transactions out of 2,000+ CFIUS cases
  - But three in the past 18 months (Obama – 1; Trump – 2)
  - In several cases, CFIUS or Presidential orders occurred post-closing, forcing divestitures
- In numerous cases, parties either have withdrawn transactions or restructured deals in response to CFIUS objections (12 withdrawals in 2014, 13 in 2015)
- It is common to resolve issues through mitigation measures embodied in enforceable agreements

CFIUS Caseload 2011 - 2015



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How Does CFIUS Work?

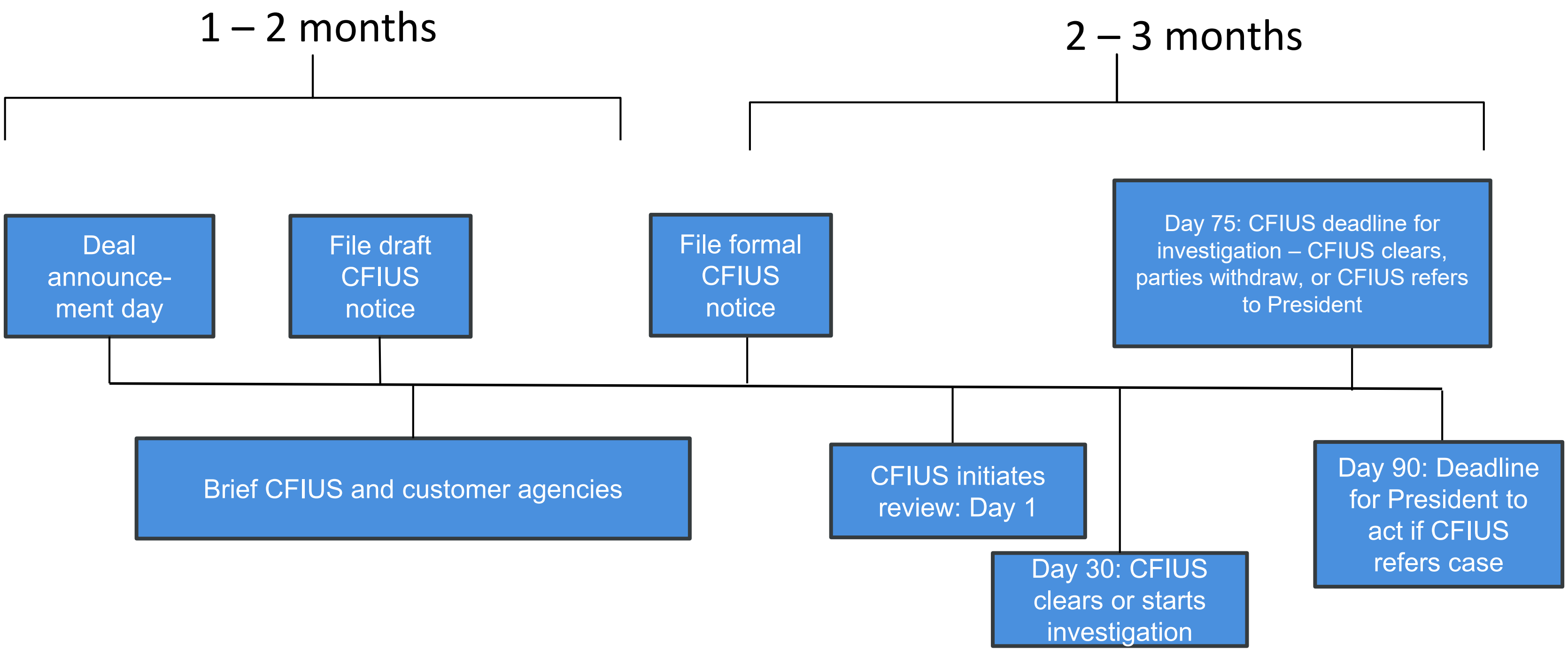
Three-Phase Process

- Statute provides for decision in three stages, within total of 90 calendar days:
  - **First:** Initial 30-day review. Most cases are completed at the end of this stage.
    - *Director of National Intelligence delivers threat assessment at Day 20*
  - **Second:** At end of the initial review stage, CFIUS may initiate a full investigation, lasting up to another 45 days.
    - *Presumption of investigation if case involves government-controlled acquirer or critical infrastructure*
  - **Third**: If case remains unresolved, then CFIUS may refer the matter to the President, who has 15 days to act.
    - *CFIUS itself may take action at end of second stage, without referral to the President*

Time Limits May Be Extended

- CFIUS proceedings may be extended by an agreed withdrawal and re-filing of the notice
  - Parties may request withdrawal; CFIUS must agree
  - CFIUS may impose conditions on withdrawal
  - Clock restarts upon re-filing
- Numerous cases over the past two years have extended through two or three cycles

Illustrative Timeframe



CFIUS Focus: Sensitive Sectors

- Historically, CFIUS was particularly concerned with acquisitions in the defense field
- Broad homeland security concerns are now equally paramount
  - Telecommunications carriers and equipment manufacturers
  - Critical infrastructure, including transportation facilities and utilities
  - Protection of U.S. citizen data and personally identifiable information (“PII”)
- Intense focus on supply chain, cybersecurity vulnerabilities, and “continuous proximity”
- “Economic security” emerging as distinct concern
  - Preservation of the “National Security Innovation Base” (*e.g.*, semiconductors)
  - Emerging technologies (*e.g.*, AI, autonomous vehicles, virtual/augmented reality, robotics, IoT)

CFIUS Analytical Approach

- Threat posed by the investor
  - Nationality, government control, corporate compliance record, *etc*.
- Vulnerability of target
  - Critical infrastructure, defense supplier, sensitive technology, proximity to sensitive assets, *etc*.
  - DNI threat assessment addresses threat plus vulnerability
- National security consequences of foreign control
- If a national security risk exists, how can it be resolved?
  - Existing statutory authorities (*e.g.*, export controls)
  - Mitigation agreements
  - Blocking transaction is least-favored option

Mitigation

- National security issues may be addressed through “mitigation agreements”
- Wide range of possible measures:
  - Divestiture of sensitive businesses
  - Structures to isolate foreign influence, creating passive investment position
  - Simple technology control plans and procedures
- Third-party audit requirements
- Appointment of “security directors”
- Mitigation agreements are principally a problem for the investor or acquirer, not the seller

CFIUS: Recent Developments

- Frequent long delays, particularly regarding China transactions, and many have failed to receive clearance
  - Blocked or terminated since December 2016: Infineon/Cree; Aixtron/Fujian; Canyon Bridge/Lattice; Ant Financial/MoneyGram; Broadcom/Qualcomm; HNA/SkyBridge
- But more recently, some China-related transactions cleared
  - Bison Holding/Cinedigm; Naura Microelectronics Equipment/Akrion Systems; China Oceanwide/Genworth
- CFIUS reform legislation advances in Congress
- President Trump announced intent to impose limitations on Chinese investments in “commercially significant” U.S. companies, but then determined CFIUS reform legislation addressed concerns.

CFIUS: Foreign Investment Risk Review Modernization Act (FIRRMA)

- Broadens export control regime over “emerging and foundational technologies” essential to national security
- Increased scrutiny of foreign investors from a “country of special concern”
- Authorizes CFIUS to exempt certain transactions if all foreign investors are from a NATO country or major non-NATO ally with investment security review processes that safeguard mutual national security interests
- Creates short form “declarations” that would be mandatory for certain transactions and available to expedite review of straightforward transactions
- Authorizes filing fees
- Lengthens investigation and review periods
- Most changes will take effect on passage of the legislation but certain provisions will require CFIUS rulemaking including: declarations, filing fees, countries exempt from certain transactions, and certain definitions (e.g. “substantial interest,” “passive investment,” “critical infrastructure”).

Thank you!

Ted Kassinger

David J. Ribner

O'Melveny & Myers LLP

1625 Eye Street, NW

Washington, DC 20006

202-383-5170

202-383-5507

tkassinger@omm.com

dribner@omm.com

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