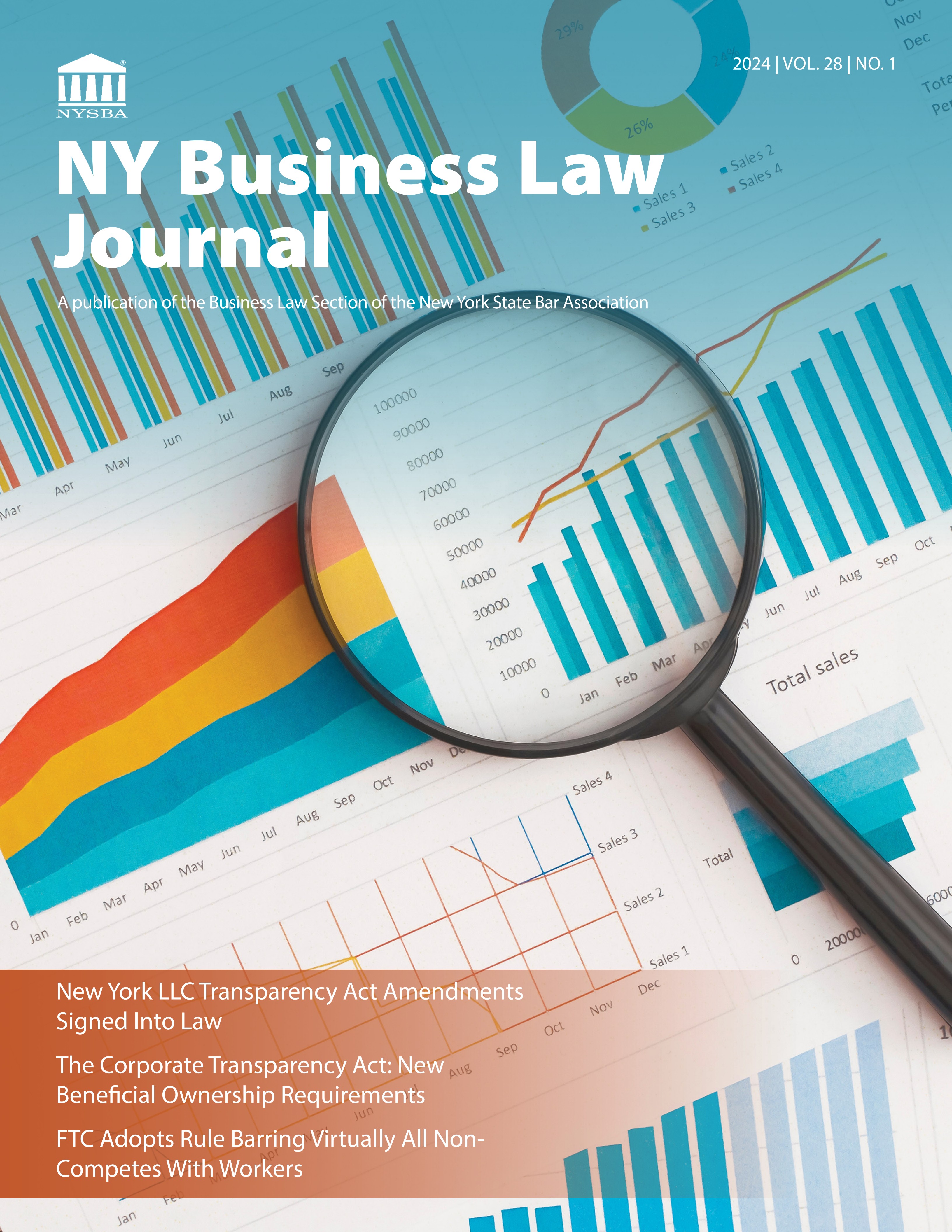

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Navigating CFIUS: Ensuring Compliance and Success in Cross-Border M&A and Investments

By Doreen Edelman, Christian Contardo, and Kei Komuro

Introduction

Businesses often engage in cross-border transactions to expand their operations, access new markets, and leverage technological advancements. However, such transactions can raise national security concerns, prompting regulatory scrutiny from agencies like the Committee on Foreign Investment in the United States (CFIUS). Understanding CFIUS regulations and navigating its review process are crucial for companies involved in M&A and investments where a buyer or investor is a non-U.S. person. This article explores the impact of CFIUS on business transactions and provides guidance on how to mitigate associated risks.

Understanding CFIUS

Established in 1975 by Executive Order 11858 and chaired by the U.S. Department of the Treasury, CFIUS reviews foreign investments in U.S. businesses in order to assess their potential impact on national security. Initially, CFIUS focused on transactions involving controlling interests in, and acquisitions of, U.S. companies by foreign entities.[1] CFIUS had authority to review any Covered Transaction. A Covered Transaction was any transaction that would result in a foreign person having control over a U.S. business. CFIUS could require the parties to implement measures to mitigate any known national security risks. If CFIUS determines that it is unable to mitigate a risk, it may recommend that the President of the United States block the transaction. In cases where the parties did not file and completed the transaction, the President could direct the foreign buyer to divest from the U.S. business. In many cases, parties would file voluntarily with CFIUS to obtain clearance of the transaction and a "safe harbor" that CFIUS would not review the transaction again in the future.

In 2018, the landscape shifted with the enactment of the Foreign Investment Risk Review Modernization Act (FIRRMA). FIRRMA codified CFIUS national security concerns around critical technologies, critical infrastructure, sensitive personal data and real estate transactions near sensitive locations such as miliary bases and ports.[2] FIRRMA also amended the CFIUS regulations to require parties to file with CFIUS in certain cases where a transaction a U.S. business involved in critical technologies, critical infrastructure, or sensitive personal data (known as a TID U.S. business).[3]

FIRRMA significantly expanded CFIUS's authority, extending it to certain non-controlling investments (Covered Investments) and certain real estate transactions. The amended regulations granted CFIUS authority to reviewed Covered Transactions. Covered Transactions included (i) Covered Control Transactions (i.e., the traditional authority authorizing reviews of any transaction in which a foreign person acquired control of a U.S. business); and (2) Covered Investments. Covered Investments were non-controlling investments a TID U.S. business in which a foreign person would receive access to non-public technical information in the possession of the U.S. business; membership or an observer status on the board of the U.S. business or certain involvement in the substantive decision-making of the U.S. business.

In 2022, President Biden emphasized in Executive Order 14083 the importance of CFIUS's role in addressing evolving national security threats and vulnerabilities posed by foreign investments. This order elaborated on the factors considered by CFIUS and described potential national security implications across various areas, including supply chain resilience and security, technological leadership, cybersecurity risks, and concerns surrounding sensitive data[4].

John's Dilemma: A Hypothetical Scenario

To understand the practical implications of CFIUS regulations, let's consider John, the owner of a successful coffee supply company in the United States. John's company has been actively engaged in M&A, acquiring several technology companies to enhance its efficiency and transportation companies (including cargo shipping and cargo airlines) to streamline delivery and better serve more customers. These strategic decisions have expanded his company significantly, so that it now serves millions of clients and operates multiple offices across the US. Notably, his company also serves the U.S. military, with offices near military installations. Now, John is contemplating selling his coffee business to a foreign corporation.

At first glance, an ordinary businessman might not expect the concept of national security to be relevant to what John does—after all, he simply sells coffee. However, John's situation presents several complexities from a CFIUS perspective.

CFIUS Filing Requirements

When considering a transaction involving a foreign entity, it is crucial to understand the occasions when a business needs to file with CFIUS. There are two types of CFIUS filing—voluntary filings and mandatory filings. Moreover, a business may choose not to notify CFIUS at all, although not filing also can have implications that we will discuss below.

Mandatory filings are required for certain transactions. These include Covered Transactions resulting in the acquisition of 25% or more in a TID U.S. business by a foreign person,[5] where foreign governments have a 49% or more interest in the foreign person.[6] Parties must make a mandatory filing in any Covered Transaction involving a TID U.S. business producing, designing, testing, manufacturing, fabricating, or developing 'critical technology,' where U.S. regulatory authorization would be required for export, reexport, transfer (in-country), or retransfer of such critical technology to the foreign person.[7] Parties are required to make a mandatory declaration at least 30 days prior to completion of the transaction.[8]

Voluntary filings allow parties to proactively submit a notice to CFIUS in order to seek a safe harbor for a transaction, addressing potential national security concerns upfront so as to protect the transaction from future CFIUS action. This proactive approach demonstrates the parties' commitment to transparency and cooperation with CFIUS. It also provides an opportunity to engage with CFIUS early in the process, potentially expediting the review and approval process.[9] When a voluntary filing is submitted, CFIUS initiates a process to evaluate the transaction's national security implications. This process involves assessing various factors, including the nature of the business, its products or services, its customer base, and its proximity to critical infrastructure to determine whether the transaction poses any national security risks.[10] During this period, CFIUS may request additional information from the parties involved, engage in discussions with the parties and other government agencies, and assess potential mitigation measures to address identified risks.

In John's case, the sale of his business to a foreign owned entity[11] would result in the foreign party gaining full control over the U.S. business. In other words, the transaction is a Covered Control Transaction subject to CFIUS review. While his main business is in coffee supply, his company also owns technology and transportation companies, and his company also maintains data on over a million customers. John believes that he has the technology, infrastructure, and personal data that could trigger CFIUS. However, he is unsure whether he possesses "critical" technology, "critical" infrastructure, and "sensitive" personal data. He is also uncertain if his business produces, designs, tests, manufactures, fabricates, or develops "critical" technologies. To determine his transaction might trigger a CFIUS review, he needs to delve deeper into each area.

CFIUS Filing Options

Traditionally, parties to a transaction involving a foreign buyer could choose whether to notify CFIUS of the transaction. There are two forms of CFIUS filings: declarations and notices.

Declarations are shorter and less formal, with a 30-day assessment period, and may be either voluntary or mandatory.[12,13] The parties notify CFIUS of a transaction and may result in a "safe harbor" letter (which restricts CFIUS from later initiating a review of the transaction except under specific conditions).[14]

Notices, on the other hand, start a formal review process with a statutory maximum 45-day period and may lead to a 45-to-60-day investigation.[15] Notices are more detailed and require filing fees based on transaction value, ranging from \$750 to \$300,000, while declarations do not require a fee.[16] Both options allow withdrawal and refiling, but with different consequences.

Critical Areas of Concern

Understanding critical technology, critical infrastructure, and sensitive personal data is vital for parties involved in cross-border transactions to anticipate potential national security issues and address them proactively.

Critical Technology

Critical technology generally includes items that are subject to U.S. export controls, including Defense Articles or Defense Services listed on the United States Munitions List (USML) in the International Traffic in Arms Regulations, and items listed on the Commerce Control List of the Export Administration Regulations (EAR), specially designed and prepared nuclear equipment, parts and components, materials, software, and technology covered by regulations pertaining to assistance to foreign atomic energy activities,[17] nuclear facilities, equipment, and material covered by regulations relating to the export and import of nuclear equipment and material,[18] select agents and toxins, and emerging and foundational technologies.[19,20] Transactions involving companies that develop or possess critical technologies may attract CFIUS attention due to the potential national security implications. Additionally, as discussed above, if a license would be required to export the critical technology to the buyer/investor's country of nationality, the parties must make a mandatory CFIUS filing.

John's main business is in coffee, but his past technology acquisitions may trigger attention from CFIUS, depending on the nature of the technologies he has acquired. Specifically, he needs to determine if the technology he owns is a critical technology and if so, whether that technology is controlled for export to the country of the buyer's nationality.

Critical Infrastructure

Business transactions in sectors like telecommunications, utilities, energy, and transportation undergo CFIUS review if they're seen as crucial to national security.[21] Appendix A to the CFIUS regulations outlines Covered Investment Critical Infrastructure and associated functions. This list includes a wide range of critical assets and systems, such as internet protocol networks, telecommunications services, submarine cable systems, data centers, satellites, industrial resources for defense programs, specialty metal manufacturers, financial market utilities, energy systems like electric power generation and oil pipelines, transportation infrastructure including airports and maritime ports, and essential public services like water treatment facilities.[22]

John's company, due to its involvement in transportation services, could fall within the critical infrastructure sectors. Past acquisitions of cargo shipping and cargo airlines could be subject to CFIUS scrutiny if these companies own a part of an airport identified as a "large hub airport," with substantial all-cargo landed weight, a joint-use airport, or a commercial strategic seaport within the National Port Readiness Network,[23] or any individual terminal at such maritime ports, as defined by the Department of Transportation.[24] CFIUS considers the transportation systems sector, where John's company operates, responsible for moving millions of goods across the country every day and facing numerous threats and risks.

Sensitive Personal Data

CFIUS is increasingly concerned about transactions involving sensitive personal data, such as financial information, health records, and geolocation data.[25] A U.S. company that retains or gathers sensitive personal data on U.S. citizens will be classified as holding sensitive personal data if it: (i) targets products or services at specific groups, such as U.S. military personnel and federal employees with national security duties, (ii) gathers or maintains such information on at least one million people, or (iii) has a clear business purpose to collect or retain such information on more than one million individuals, and this information is a fundamental part of the company's main products or services. Genetic test data also is covered by this definition regardless of whether it meets (i), (ii), or (iii).[26]

Because John's company supplies coffee to military installations, his company's access to sensitive data, particularly related to military contracts, may trigger CFIUS scrutiny, especially if the data shows a pattern relating to location data for military officials. Furthermore, aside from military data, the fact that John's company has millions of customer records could also raise concerns for the CFIUS review.

John's first step is to determine if his transaction involves critical technology. If John's company possesses critical technology, he needs to consider whether an export license is necessary for the buyer's country of nationality. In other words, John needs to determine if an export license is required to share the technology with the potential foreign buyer. If U.S. government approval is needed, then John has no choice but to make the mandatory filing with CFIUS because the licensing requirement makes the technology "critical" technology for CFIUS purposes. If it doesn't (and if his company's buyer does not involve a foreign government, as discussed in the previous section), he can choose to file a voluntary notice if he wants to take advantage of the safe harbor and avoid any concern that CFIUS will investigate the transaction in the future (See non-notified transaction reviews discussed below).

Exceptions and Exemptions

Certain transactions may qualify for an exemption from making a mandatory filing, offering relief for the parties involved. Currently, investors from countries such as Australia, Canada, New Zealand, and the United Kingdom may be excepted investors if certain conditions are met.[27] These exemptions for certain countries reflect the strategic alliances and partnerships between the United States and these nations. Other exceptions also exist, such as transactions involving investment funds with foreign limited partners that are managed exclusively by non-foreign entities that meet specific criteria.[28] However, parties should carefully assess whether they qualify for exceptions or exemptions, because falling under an exception or exemptions does not necessarily mean the end of CFIUS analysis. In fact, the United Kingdom and Canada are among the top 10 countries in terms of the number of filing notices with CFIUS, even though they fall within the exemptions.[29]

CFIUS Analysis for John and the Potential Buyer

John, having consulted with an experienced CFIUS lawyer, learned that his technology does not fit within the CFIUS definition of critical technology and the buyer isn't associated with a foreign government. Thus, John and the foreign buyer are not required to make a CFIUS filing.

However, John is not finished with the CFIUS analysis. Non-TID U.S. businesses may still be of concern to CFIUS.

John is also concerned about the lengthy review process, which could take three months to actually prepare the filing with the buyer, wait for the pre-file approval, actually file the voluntary filing and wait for the process to be completed. Meanwhile, he is being bombarded with emails from the buyer to finalize the agreement. Note that a CFIUS filing is a joint filing, so John must discuss the outstanding CFIUS considerations with the foreign buyer so that the foreign buyer can assess its risks relating to CFIUS and they can decide together if they want to make a voluntary filing. As John has already determined that no mandatory filing is applicable, John discusses the two options: making a voluntary filing or opting not to file and taking the non-notifying transaction risks. It's important to note that even if they choose to not file with CFIUS, it does not necessarily mean that CFIUS will stay away; CFIUS has the right to inquire about transactions that have not made with CFIUS to consider the national security risks.[30]

Non-Notified Practice of CFIUS

As mentioned above, CFIUS may actively identify transactions that may raise national security concerns, even without formal filings. This proactive approach allows CFIUS analysts to gather information, potentially leading to a request for information and even for a request that transaction parties to file a full CFIUS notice. Recently, the Department of the Treasury has further attempted to accelerate this movement to enhance monitoring and enforcement abilities. For instance, the recently proposed amendments in April 2024 are aimed at strengthening CFIUS's ability to identify and address potential national security risks by enabling the Committee to request information from transaction parties and others.[31] These changes would expand access to information to assist CFIUS in compliance monitoring, violation identification, and national security risk assessment. The Department of the Treasury has also attempted to apply by setting higher standards for the parties, particularly by substantially increasing penalties for noncompliance (explained below) and establishing a three-business-day deadline for responding to proposed mitigation terms.[32]

In John's case, the possibility that part of his business, the one that specializes in transportation services crucial for moving millions of goods across the country every day, could fall under the critical infrastructure definition, especially concerning transportation infrastructure such as airports and maritime ports, might attract CFIUS's attention without a formal filing. This is particularly true given his past acquisitions of cargo shipping and cargo airlines, potentially subjecting his company to CFIUS scrutiny due to ownership of assets within large hub airports or commercial strategic seaports identified by the Department of Transportation. Moreover, because his main coffee business serves millions of customers and holds their data, including financial information and geolocation data, it could fall under the sensitive personal data category, potentially drawing CFIUS's attention, as discussed above. Thus, there is a concern that CFIUS could be interested in John's sale to a foreign buyer.

Penalties for Non-Compliance

Under FIRRMA, parties that fail to make mandatory filings can face penalties of $250,000 or up to the value of the transaction, whichever is greater.[33] The proposed amendments in April 2024 would increase this maximum amount to $5,000,000 or the value of the transaction, whichever is greater. Additionally, parties may face civil monetary penalties for material misstatements or omissions, whether during the review process or in compliance with mitigation agreements.[34]

Mitigation Measures

When CFIUS identifies national security risks, it may impose mitigation measures to address those concerns. These measures might involve safeguarding data and information and addressing proximity issues.[35] Mitigation measures are negotiated between the parties and CFIUS to address specific national security concerns identified during the review process. The goal is to mitigate risks while allowing the transaction to proceed. These agreements are legally binding and may include monitoring and reporting requirements to ensure compliance.[36]

If CFIUS finds serious national security risks relating to critical infrastructure or sensitive personal data, mitigation measures may be necessary. For instance, the buyer may need to agree to restrictions on sharing certain customer data with the foreign buyer. Additionally, the buyer could be required to implement measures to ensure that sensitive information is securely stored and accessed only by authorized personnel. This could involve implementing encryption protocols, access controls, and regular security audits. Furthermore, the buyer may need to establish protocols for reporting any attempts at unauthorized access or breaches of security to CFIUS or relevant authorities. By implementing these measures, the buyer can demonstrate his commitment to safeguarding national security while proceeding with the sale of his coffee business.

Conclusion

Navigating CFIUS regulations is essential for businesses involved in cross-border transactions. Understanding filing requirements, mitigating risks, and complying with CFIUS requirements are crucial steps in ensuring the smooth execution of mergers, acquisitions, and investments. By following best practices and seeking expert guidance early in the transaction process, businesses can successfully navigate the complexities of CFIUS review and safeguard national security interests while pursuing their strategic objectives.

In John's case, considering the possibility that his business could fall under the definition of a TID U.S. business, making a voluntary notice filing is advisable if he and the buyer want to take a risk-averse approach. Making the voluntary filing will ensure that the transaction has a safe harbor from CFIUS review of the transaction in the future. That said, it is worth noting that the voluntary notice filing involves a fee (unless it falls under certain exception[37]), which can range from $750 to $300,000, depending on the transaction value.[38] On the other hand, the parties could choose to file a declaration form instead of a full notice, or even decide not to file. The risk with a declaration is that CFIUS can request that the parties file a full notice. In such a case the parties have wasted time with the declaration process and should have just made the full notice filing. CFIUS can also rather respond to the declaration with a shrug. This means it has no comment and this doesn't provide any protection for the transaction and CFIUS can review the transaction in the future. It really depends on both parties' risk tolerance.

In the end, John and the buyer decide to make a full notice filing. During the wait for the CFIUS' decision, he and the buyer finalize the transaction documents and they can prepare to implement any mitigation measures that CFIUS may require to address identified national security risks regarding the sensitive personal data and critical infrastructure issues. These measures could involve safeguarding sensitive data, addressing proximity issues, and limiting technology transfers.[39]

By following best practices and proactively engaging early in the CFIUS process, they can safeguard national security interests while pursuing their business objectives, such as further expanding John's coffee business!

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