

**Morgan Lewis**

together

## **The CFIUS Review Process**

**Presentation to State-owned Assets Supervision and  
Administration Commission (SASAC), People's Republic of  
China, and Officials of Certain State-owned Enterprises**

**December 13, 2010  
Washington, D.C.**

**Stephen Paul Mahinka  
Sean P. Duffy**

**(202) 739-5205  
(202) 739-5603**

**mahinka@morganlewis.com  
sduffy@morganlewis.com**

[www.morganlewis.com](http://www.morganlewis.com)

# CFIUS: Authority

- Section 721 of the Defense Production Act (“DPA”), as amended by the Foreign Investment and National Security Act of 2007 (“FINSA”) establishes the process for reviewing the national security impact of foreign mergers, acquisitions, and certain joint ventures of U.S.-located firms under the interagency Committee on Foreign Investment in the United States (“CFIUS”).
  - Applies to all foreign investments in defense and critical infrastructure-related firms regardless of whether the U.S.-located firms have classified contracts
  - President of the U.S. has the authority to suspend or terminate such transactions if they present “credible threats” to national security that cannot be adequately mitigated under other laws, excluding the International Economic Emergency Powers Act

# CFIUS: Covered Transactions

- **“Covered Transaction”** is defined as any transaction “by or with any foreign person, which could result in control of a U.S. business by a foreign person.”
- **“Foreign Person”** is defined as any “foreign national, foreign government, foreign entity,” or “any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity.”
  - This broad definition includes U.S. companies or entities with foreign parents or significant foreign shareholders

# CFIUS: Composition

- **Permanent members of CFIUS (from FINSA)**
  - Treasury Department (chair)
  - State Department
  - Commerce Department
  - Department of Defense
  - Department of Justice
  - Department of Homeland Security
  - Department of Energy, and
  - Department of Labor (*ex officio*)
  - Director of National Intelligence (*ex officio*)
- **White House, by Executive Order, added:**
  - US Trade Representative, and Office of Science and Technology Policy as members; and
  - National Security Council, Council of Economic Advisors, Office of Management & Budget, and others, as non-voting participants
  - Other agencies participate as relevant to particular cases

# CFIUS: Filing Process

- The CFIUS review process typically begins with the parties filing a voluntary joint notice with the Committee.
  - It is common practice to notify the Committee of a pending transaction and provide a detailed “pre-filing” at least one week prior to the contemplated filing date.
  - CFIUS may ask questions of the parties or request additional information, either as part of the pre-filing process or after accepting the joint notice.
  - A pre-filing allows the parties to gather any requested information and incorporate it into the joint notice without being subject to any regulatory time constraints.
  - After filing a joint notice, the parties are required to respond to CFIUS’s requests for additional information within three business days.
- CFIUS also can unilaterally initiate a review of any defense or critical infrastructure-related transaction, so parties to such transactions ordinarily file a joint notice voluntarily.
- Under the National Information Security Program Operating Manual (NISPOM), when a government contractor with a facilities security clearance enters into negotiations for a proposed transaction, it must notify the Defense Security Service (DSS) of the commencement of the negotiations.

# CFIUS: Timing

- **30 Day Initial Review**
  - The majority of transactions filed with CFIUS are approved at end of this period or determined not to be “covered transactions” subject to CFIUS jurisdiction
- **45 Day Investigation Period**
  - If CFIUS still has concerns about the transactions after the 30 day initial review, they may initiate a second, 45 day, investigation period
  - Pursuant to FINSA, a 45 day investigation is mandatory when a transaction involves foreign government control and/or the acquisition of critical infrastructure. This requirement can only be waived by the deputy heads of the co-lead agencies reviewing the transaction. The co-lead agencies are CFIUS and the member agency most related to the industry involved.
- **15 Day Presidential Review Period**
  - If CFIUS cannot reach a consensus to allow the transaction, or recommends a Presidential block, or in other special circumstances, the transaction goes to the President for a final decision, followed by a report to the Congress

# CFIUS: Timing

- **“Pull and Refile”** - During initial review or investigation, if the parties determine after communications with CFIUS that there will be insufficient time to resolve any national security issues before a case is required to go to the President, they can voluntarily withdraw and refile
  - Refiling will automatically restart the 30-day clock
  - New review may be terminated early if all remaining issues are resolved

# CFIUS: FOCI Mitigation

- If CFIUS determines that the transaction will result in foreign ownership, control, or influence (“FOCI”) over a company that has access to classified information or that FOCI might adversely affect the performance of classified contracts, the Committee ordinarily will require the parties to enter into a mitigation agreement prior to approving the transaction.



# CFIUS: FOCI Mitigation Agreements

- There are different types of mitigation agreements that CFIUS may require the parties to enter into depending on the level of foreign ownership, control, or influence:
  - Board Resolution
    - Available when minority foreign investor does not have power to appoint a member to the board of directors. Resolution prevents company from sharing classified information with foreign investor.
  - Special Control Agreement (“SCA”)
    - Required when minority foreign investor has power to appoint a board member. Requires the appointment of an approved outside director to the board with responsibility for monitoring compliance with SCA.

# CFIUS: FOCI Mitigation Agreements

- Special Security Agreement (“SSA”)
  - Requires appoint of several approved outside directors to serve on board along with inside/foreign directors. Procedures must be established to regulate communications and visits between company covered by SSA and foreign parents/affiliates. A National Interest Determination (“NID”) is required before a company under an SSA may receive access to certain “proscribed” classified information.
- Proxy Agreement or Voting Trust Agreement
  - Foreign parent foregoes direct control over U.S. company, which is managed by approved outside directors. Procedures must be established to regulate communications and visits between company covered by agreement and foreign parents/affiliates. No NID is required before company covered by a proxy agreement or voting trust agreement receives access to classified information.

# CFIUS: Practical Considerations

- What happens if the parties don't file a voluntary notice and CFIUS decides to investigate the transaction?
  - FINSA does not apply only before closing of a transaction; if security issues are raised post-closing, and CFIUS calls the parties requesting a filing, it could then review and force dissolution of the deal.
  - If CFIUS calls the parties before closing and requests a filing, the closing of the deal could be delayed or compromised if the purchase agreement does not contemplate such government clearance or filings and the 30-day review extends beyond the purchase agreement's closing date.
  - As a practical matter, if a voluntary filing is not made, CFIUS may learn of any security concerns from other sources (*e.g.* competing bidders who may complain to Congressional representatives; public notices required by U.S. securities law; CFIUS's own monitoring of acquisitions)
    - *NOTE: Many government-supply contracts contain provisions requiring notification to the relevant agency in the event of a transfer of control.*

# CFIUS: Practical Considerations

- What if the transaction is a foreign company acquiring a U.S. asset from another foreign company?
  - FINSAs applies not only to the transfer of control of a national security asset or critical infrastructure to a foreign owner, but also to the transfer of a U.S. security asset or critical infrastructure from one foreign owner to another foreign owner.

# CFIUS: Practical Considerations

- How do you know whether the contemplated transaction involves “national security assets” or “critical infrastructure”?
  - The definition of national security and critical infrastructure assets is vague and imprecise.
  - In practice, it clearly covers traditional categories such as military weapons and technology, but also covers:
    - Items and materials used in weapons research;
    - Certain computer software;
    - Bioterrorism agents, such as certain drugs, facilities, equipment, material and technologies;
    - Natural gas and oil transmission lines;
    - Oil reserves and refineries;
    - Telecommunications and broadcast facilities;
    - Certain computer and information technology products;
    - Bridges and ports.

# CFIUS: Practical Considerations

- Questions that are critical to determining whether CFIUS likely would want to review a transaction, and thus whether the parties should decide to voluntarily file, are:
  - Is the foreign purchaser a private or public (*i.e.* government controlled) entity (if the latter, special rules of review apply);
  - What is the nationality of the purchaser (for example, China, Israel, and France can be expected to raise more interest in review than Great Britain, Italy, or Japan), including that of sovereign wealth funds;
  - Do the facilities or personnel of the acquired entity have security clearances and, if so, at what level;
  - Are the products or services direct or indirect components of weapons systems or critical infrastructure and, if indirect, how many steps removed they are from the final product or service and the degree of modification of the components in final assembly;

# CFIUS: Practical Considerations

- (Continued)
  - What government supply contracts exist, with what security classifications, and with what obligations of confidentiality and restrictions on the ability to transfer such contractual obligations to others without notice and/or permission;
  - Whether production or research facilities to be acquired will be closed or removed from the U.S. post-acquisition;
  - Has the foreign acquirer or one of its affiliates ever taken action adverse to U.S. national security policy or interests;
  - Whether any ancillary agreements required to be entered into as conditions of the acquisition raise concerns.

# CFIUS: Practical Considerations

- What should the parties do if they are unsure whether a filing is required?
  - A first course of action in such cases can be to discuss with CFIUS staff, either anonymously or with disclosure of company names, whether the agency believes a filing is warranted.
  - It is also generally advisable for officials of the US target company, and the foreign purchaser to alert the government purchasing and Defense Security Services officials to the potential transaction to obtain their views as to whether a FOCI mitigation agreement appears necessary or warranted and determine if there appear to be any initial concerns regarding the potential transaction.
  - In certain circumstances, it may also be advisable for the parties to inform appropriate Congressional representatives and state and local government officials of the proposed transaction and whether or not a filing with CFIUS is intended.



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