Regulatory update on CFIUS national security review and proposals for new EU and UK foreign investment regimes

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Introduction

Recently, a number of proposed cross-border acquisitions were aborted reportedly due to delays and difficulties in securing regulatory approval from the Committee on Foreign Investment in the United States (CFIUS), an inter-agency committee responsible for national security review in the US. This article discusses the latest developments on CFIUS review, reasons for delays and possible strategies to mitigate CFIUS-related risks in managing outbound transactions.

The need for foreign investment approvals and increased scrutiny for national security risks appears to be a growing global trend; this article also discusses recent reforms of the CFIUS process introduced before the US Congress and proposals for new foreign investment screening regimes that are in the pipeline in the European Union and United Kingdom.

CFIUS

CFIUS and its jurisdiction

CFIUS has jurisdiction to review any merger, acquisition or takeover, by or with any foreign (non-US) person, which could result in foreign control of any person engaged in interstate commerce in the US in order to investigate the effects on the national security of the US. CFIUS may refer a transaction to the US President, who may, by issue of an executive order, suspend, prohibit or unwind a transaction.

Even though the CFIUS notification is voluntary, it is common to submit a notification to CFIUS in view of the risk of being investigated by CFIUS and, in the worst case scenario, being required to unwind the transaction. In September 2012, Ralls Corporation, a US-based company owned by two Chinese nationals, was ordered to divest four wind farm projects in Oregon despite the projects having been completed six months earlier.

Review period

Under the statutory timeframe, the initial review period (upon acceptance by CFIUS) is 30 calendar days and, in cases involving concerns that the transaction threatens to impair national security, is a foreign government controlled transaction or would result in foreign control of critical infrastructure, CFIUS may initiate an investigation which will extend the review period by 45 calendar days. In 2016, out of 172 notifications, 79 (46%) investigations were initiated, which suggests that the majority of cases (54%) were concluded within 30 calendar days, and 46% of cases took at least two and a half months.[1]

However, the CFIUS process has recently, in cases where there are national security concerns, taken significantly longer than the statutory period and may even exceed six months. This is because

[1] Statistics published by the US Department of the Treasury for 2014 to 2016

CFIUS often invites parties to withdraw and refile to allow more time for review, in which case the 75-day statutory clock would re-start. In 2016, 27 (16%) companies withdrew their notifications and 15 (9%) refiled, which suggests that 12 (7%) transactions were either delayed or aborted after withdrawing the notification.

Recent aborted transactions

Recently, a lengthy CFIUS review has presented timing challenges in certain high profile outbound transactions and even led parties to walk away from the deal in a few cases. In June 2017, Inseego Corp terminated its proposed US$50 million sale of Novatel Wireless, its MiFi business, to Chinese TCL Industries Holdings (H.K.) Limited and Jade Ocean Global Limited, despite having pulled and refiled on two prior occasions and the case being first accepted for review by CFIUS in November 2016. In July 2017, Shareco Group of America, Inc, a subsidiary within the HNA Group, abandoned its proposed US$416 million investment in US-based in-flight entertainment services from Global Eagle Entertainment Inc. In September 2017, Chinese owned NavInfo called off the proposed US$330 million acquisition of a 10% stake in Amsterdam-based HERE Technologies due to failure to obtain CFIUS clearance despite having answered ten rounds of questions during a five-month review period.

Furthermore, two proposed transactions were recently prohibited by the US President upon recommendation from CFIUS: (i) the US$715 million sale of German semiconductor equipment supplier Aixtron to Chinese owned Grand Chip Investment (blocked in December 2016); and (ii) the US$1.3 billion sale of US-based semiconductor manufacturer Lattice Semiconductor to US-headquartered but Chinese-backed private equity firm Canyon Bridge (blocked in September 2017). Even though this presidential power was traditionally exercised sparingly, these two recent prohibitions in less than ten months indicate that the risk of prohibition can no longer be ignored. It is nevertheless interesting to observe that, in the Aixtron case, Aixtron subsequently changed the transaction structure to an asset sale (limited only to its ALD (atomic layer deposition) and CVD (chemical vapour deposition) memory product lines), and the buyer to a South Korean party (Eugene Technology). For this revised transaction, Aixtron was able to obtain CFIUS approval within ten months after the original prohibition decision.

Reasons for delays

A cause for concern is the lack of transparency and predictability behind recent delays in the CFIUS review. A likely objective reason for delay is the lack of manpower within CFIUS to handle an increasing number of notifications (from 143 in 2015 to 172 in 2016) and investigations (from 66 in 2015 to 79 in 2016). Others have perceived CFIUS delays to be attributable to political considerations and scepticism towards Chinese buyers in particular because several of the recent prohibited transactions involved Chinese investors (although that is not exclusively the case).

Strategic considerations

In light of recent delays, it would be prudent to plan for a potentially lengthy CFIUS investigation, especially where the sector or technology involved is potentially sensitive and the buyer is controlled by a foreign government. Transaction parties should consider strategies to mitigate related risks and contractual options to protect their respective interests. The appropriate strategy would depend on the facts and circumstances of the individual transaction.

One option is to allow ample time within the transaction timetable for obtaining CFIUS clearance (although often this is very difficult to achieve). Another is to facilitate the CFIUS review by proactively volunteering additional information in certain cases and offering appropriate mitigation proposals to pre-empt and address CFIUS' potential concerns in a timely manner. Apart from agreeing on a realistic longstop date, another common contractual protection that sellers often bargain for is a break fee arrangement to protect its interests against lengthy delays. Due to the voluntary nature of the notification system, parties may weigh the risks of CFIUS delays against the risk of a possible CFIUS investigation and (in the worst case) an order to unwind the transaction should they choose not to submit a CFIUS notification.

Proposed CFIUS Reforms

In November 2017, the proposed Foreign Investment Risk Review Modernization Act (FIRRMA) was introduced, with the support of a bi-partisan group of co-sponsors, before the US Congress. FIRRMA is intended to strengthen the existing CFIUS process in an attempt to guard more effectively against perceived risks to the national security of the US posed by certain types of foreign investment, particularly those involving sensitive technology transfers. FIRRMA would expand CFIUS's jurisdiction and scope in a number of respects.

First, FIRRMA would introduce a mandatory declaration requirement for transactions involving acquisition of a 25% voting interest in a US business by a foreign person in which a foreign government owns, directly or indirectly, at least a 25% voting interest. CFIUS also may issue regulations to require mandatory declarations for other transactions. Parties to such transactions would have to submit either: (i) a mandatory declaration containing basic information at least 45 calendar days before closing; or (ii) a more detailed written notice 90 calendar days before closing.

Second, FIRRMA would widen the jurisdiction of CFIUS to include:

- investments (without the need for an acquisition of control) by a foreign person in any US critical technology company or US critical infrastructure company[2];
- purchases or leases by a foreign person of real estate that is located in the US and in close proximity to a US military installation or sensitive US government property for national security reasons; and
- contributions by a US critical technology company of both intellectual property and associated support to a non-US person through any type of arrangement (including joint venture, but excluding an ordinary customer relationship).

Under FIRRMA, CFIUS may identify a list of countries based on criteria such as mutual defence and national security arrangements such that investments will be exempted from the above three additional categories if they come from a foreign person organised under the laws of, or otherwise subject to the jurisdiction of, such countries.

FIRRMA proposed to increase the statutory review period, extending the initial review period from 30 to 45 calendar days and allowing CFIUS in "extraordinary circumstances" to extend the investigation period by 30 calendar days. In other words, the statutory review period would potentially increase to 120 calendar days in total.

European Union

There is currently no equivalent EU-wide national security review regime. However, in September 2017, the European Commission published a proposal for a Regulation which establishes an EU framework for screening foreign direct investment (FDI) into the EU. According to the Commission, such a framework is necessary to protect legitimate interests of the EU and its Member States with regard to FDIs that raise concerns for security or public order.

The proposed Regulation would not *require* Member States to implement an FDI screening mechanism. Rather, it proposes a framework with "some basic requirements" (such as the possibility of a judicial redress of decisions, non-discrimination between different third countries

[2] US critical technology companies and US critical infrastructure companies are broadly defined to include US businesses that (i) produce, trade in, design, test, manufacture, service or develop critical technologies or (ii) own, operate or primarily provide services to entities that operate critical infrastructure. Passive investments which afford the buyer no access to non-public technical information, no membership or observer rights on board of directors and no involvement (other than through voting of shares) in substantive decision making are excluded from the definition.

and transparency) for those Member States that already have such a mechanism (currently 12 of the 28 Member States) or wish to put one in place. It also proposes a cooperation mechanism whereby Member States would inform other Member States and the Commission about any FDI that is undergoing screening within the framework of their national screening mechanisms. Moreover, the Commission would be able to carry out a screening on grounds of security and public order, in cases where an FDI may affect projects or programmes of EU interest. Member States would be allowed to raise concerns as regards an FDI in another Member State and to provide comments, and the Commission could issue non-binding opinions.

The proposed Regulation was "exceptionally" presented without an accompanying impact assessment and is likely to be subject to extensive scrutiny by Member States as it goes through the legislative procedure.

United Kingdom

In October 2017, the UK Government published a green paper on control of foreign investment (Green Paper). It proposes measures to increase scrutiny of foreign investments in relation to national security (but not broader political grounds as hinted in previous public statements).

The Green Paper sets out two specific proposals. First, it proposes urgent changes to the existing system to allow the UK Government to intervene in more mergers in the military, dual-use (capable of both military and civilian uses) and advanced technology sectors by: (i) reducing the UK target turnover threshold from £70 million to £1 million; and (ii) amending the share of supply test so that mergers in these sectors will qualify for review under the UK merger control rules where the target has a 25% share of supply of goods/services of a particular description in the UK even where there is no increment (compared to the existing rules which require the transaction to create or increase a share of supply of 25%). In other words, the buyer does not need to have a horizontal overlap with the target or even any presence in the UK.

Second, the Green Paper also proposes options for more extensive and long-term reform of the existing system including: (i) expanding the existing "call-in" power within the voluntary notification regime to capture any acquisition of a UK business entity by any investor which the UK Government reasonably believes raises national security concerns (i.e. for review on non-competition grounds); and (ii) introducing a mandatory notification regime applicable only to foreign investment in the provision of essential functions in certain identified sectors (e.g. civil nuclear, communications, defence, energy and transport).

Consultation for the first proposal lasted four weeks and has closed. Consultation for the second proposal closes on 9 January 2018.

Conclusions

Foreign investment approvals are becoming an increasingly important consideration in planning cross-border transactions. Whilst there have been a few high profile aborted transactions involving Chinese acquirers failing to obtain CFIUS approval, it is worth bearing in mind that, based on 2016 statistics, the majority of cases (even those requiring investigations) are likely to be concluded within the existing 75-day CFIUS statutory timeframe. Parties should nevertheless plan early and consider strategies to mitigate risks relating to CFIUS review, especially where US businesses and sensitive sectors are involved. Proposed reforms to the CFIUS process would introduce a new mandatory filing requirement, significantly broaden the scope of transactions caught and extend the statutory review period to 120 days. Those contemplating investments in Europe should also bear in mind the recent proposals in the EU and UK.

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