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Insights: Alerts

$6 Billion Chinese Acquisition Bid Submitted for CFIUS Review Serves as a Wake-Up Call for Companies to Evaluate and Mitigate CFIUS Risks

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In late July 2016, U.S. technology distributor Ingram Micro, Inc. (Ingram) announced that it would submit its pending $6 billion acquisition by Chinese shipping company Tianjin Tianhai Investment Co. Ltd. to the Committee on Foreign Investment in the United States (CFIUS or Committee), which reviews transactions for potential national security issues.

Ingram's announcement came as a surprise because it had earlier indicated that it did not expect to submit a notice to CFIUS. The about face likely results from the fact that the merger agreement reportedly contains a termination fee of up to $400 million if CFIUS (or another regulator) blocks the deal – more than double the usual termination fee. That announcement serves as a wake-up call for U.S. companies courting foreign purchasers or investors to understand CFIUS, analyze its potential impact on transactions, and create a game plan for CFIUS review.

CFIUS Review

While technically part of the Treasury Department, CFIUS is an inter-agency committee (chaired by the Treasury Secretary) authorized to review the potential national security effects of transactions that could result in a foreign person (discussed below) controlling a U.S. business. Parties to a transaction may submit a joint notice identifying the details of the transaction so that the Committee may assess the transaction for national security concerns.

Once the Committee accepts a CFIUS notice, it begins an initial 30-day review. The Committee resolves most transactions at this initial stage by clearing them or determining that they are not covered by/subject to CFIUS. If the Committee does not initially clear the transaction, it may require a secondary 45-day review period. The deputy heads of the co-lead agencies reviewing the transaction may waive the secondary investigation period. The Committee, however, must conduct a secondary review for transactions involving foreign government control of the acquisition of Critical Infrastructure (discussed below). The Committee sends the transaction to the President of the United States for a final review if it cannot reach a consensus on the transaction or recommends that the President reject the transaction. Either way, the Committee always sends a report to Congress.

Analyzing a Potential Transaction

During due diligence, parties must determine if a transaction involving foreign ownership or investment requires CFIUS review. To do so, parties must analyze whether the transaction qualifies as (1) a Covered Transaction, (2) involving Critical Infrastructure, or (3) involving Critical Technologies resulting in (4) a potential national security threat.

Covered Transaction

Covered Transactions include any transaction that may result in a foreign person controlling a U.S.-based business. CFIUS defines foreign person as any foreign national, government, or entity, or a business entity over which control is exercised or exercisable by a foreign national, government, or entity. CFIUS defines the key concept of control as the power to determine, direct, or decide important matters affecting a business. When determining whether a transaction results in foreign control, the Committee does not apply a bright-line test but rather considers all relevant facts and circumstances. Examples of matters that create control include reorganizing, merging, or dissolving the company; appointing/dismissing officers or employees able to access sensitive technology or classified information; executing/terminating significant contracts; and amending corporate documents.

Transactions that do not qualify as a Covered Transaction do not need CFIUS review.

Critical Infrastructure

CFIUS defines Critical Infrastructure as any system or asset so vital that incapacitating or destroying it would debilitate national security. CFIUS does not designate whole classes of assets as Critical Infrastructure and instead considers the particular assets involved in the transaction. That said, President Bush provided some guidance on this issue by identifying (in 2003) 11 sectors of Critical Infrastructure:

1. Agriculture and food;
2. Water;
3. Public health;
4. Emergency services;
5. Defense industrial bases;
6. Telecommunications;
7. Energy;
8. Transportation;
9. Banking and finance;
10. Chemical industry and hazardous materials; and,
11. Postal services and shipping.

Critical Technologies

While CFIUS highlights Critical Technologies, they do not qualify as an independent review requirement under CFIUS. Instead, the Committee issues an Annual Report that includes transactions involving Critical Technologies that include certain defense articles or services (covered by the United States Munitions List (USML) in the International Traffic in Arms Regulations (ITAR)); items on the Commerce Control List (CCL); nuclear facilities, equipment, material, software, and technology identified in certain regulations; and select agents and toxins identified in other regulations. Moreover, the recent creation of a new series to the CCL (600 Series consisting of munition items subject to less control than defense articles on the USML regulated under ITAR) further complicates the CFIUS review process.

National Security Threat

Ultimately, CFIUS must determine whether a transaction impairs national security on a case-by-case basis. The Committee therefore focuses on genuine national security concerns rather than broader economic or other national interests. CFIUS must balance those concerns against the U.S.'s long-standing policy of supporting foreign investment in the U.S. economy.

Conclusion

Parties to a transaction involving foreign ownership or investment must analyze the potential impact of CFIUS, create a strategy for CFIUS review, and protect themselves contractually if CFIUS blocks the transaction.

For additional information or assistance regarding CFIUS, please contact one of the authors or your regular Kilpatrick Townsend contact.

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