

CFIUS Still Approving Well-Prepared Chinese Deals

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By Scott Boylan

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In fact, China has led all countries in deals approved by the Committee on Foreign Investment in the United States over the last decade (which can be referenced in the CFIUS 2015 and 2016-2017 annual reports to Congress). However, Chinese investors have had significant deals publicly blocked from closing or been forced to unwind their transactions by three U.S. presidents.

There have also been other instances in which Chinese companies have been told by CFIUS not to proceed with a deal or to unwind it, as illustrated by the situation with Grindr. All of this could create an impression that Chinese investors cannot do business in the U.S., but

the numbers thus far prove this to be untrue.

One explanation for this seemingly contradictory data is that the CFIUS process is exclusively focused on reviewing transactions for national security concerns. China’s success over the past decade in originating approved deals makes one thing clear: if a transaction does not present a national security concern, it is likely to be cleared regardless of the investor’s country of origin. If there is a national security concern, but that concern can be mitigated with auditable controls, it will be approved.

In the case of China, the level of Chinese government involvement is crucial.

CFIUS approval for a deal involving an investment from China frequently comes with controls and requires mitigation. To help companies successfully navigate the CFIUS mitigation process, below is an overview of the new Foreign Investment Risk Review Modernization Act regulations that came into effect on Feb. 13, and guidance on how to anticipate mitigation terms and construct



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them to best position the company to be competitive in its industry.

What Companies Need to Know

The recent expansion of CFIUS’s jurisdiction by Congress, beyond purchasing control of a target, to include investments that give access to non-public information or a say in the management of the company were driven, in part, by concerns over Chinese investment. The issuance this year of related regulations further demonstrates that there will be more CFIUS scrutiny of deals involving technology and critical infrastructure. Companies that possess or handle sensitive data will also get increased CFIUS scrutiny, as will investment in real estate near sensitive government facilities.

Home Country or Geographic Economy	2015	2016	2017	Total 2015 – 2017
CHINA	29	54	60	143
CANADA	22	22	22	66
JAPAN	13	13	20	46
UK	19	7	18	44
FRANCE	8	8	14	30

Source: CFIUS Annual Report to Congress (Public version) CY 2016 & CY 2017

However, it's important to understand that the presence of a national security concern alone will not necessarily kill a transaction. Should there be a CFIUS concern, the transaction can still be cleared by CFIUS, if mitigation terms that remove the national security concern can be implemented and agreed upon by all parties. If you can build trust, approval can be attained and Chinese investors have been able to consistently meet this standard.

This is not to say that Chinese investors are free of challenges. Many U.S. officials are concerned about Chinese investment being used as a tool for espionage or military advantage. These concerns are valid and any proposed Chinese transaction or investment will receive significant scrutiny.

The key distinction is that the CFIUS review is of the parties involved in the transaction, not the governments. So, while the Chinese government is of significant concern at CFIUS, the Committee is still approving Chinese deals, particularly, if the parties are willing to adopt mitigation terms that will remove the national security concern.

Understanding Mitigation Terms

Common CFIUS mitigation terms stipulate that: company employees be U.S. citizens only; the company have separate IT systems, separate facilities,

and independent auditors or monitors; and the company "fence off" sensitive data and/or technology.

During a CFIUS filing process there can be two parallel mitigation processes. If a target company is a cleared government contractor that handles classified information, it cannot be owned or influenced by a foreign entity without a mitigation agreement with the Defense Counterintelligence and Security Agency, which administers the industrial security program for the United States government.

DCSA mitigation agreements have structural requirements that demand separate facilities, systems and employees, as well as terms requiring independent U.S. citizen board members and company officers. In some Chinese deals not involving classified information, CFIUS has required similar structures requiring independent U.S. citizen board members, U.S. citizen employees and other requirements.

Mitigation agreements offer a tremendous opportunity. If CFIUS is willing to enter into such an agreement, a certain level of trust—by definition—has been established. For Chinese investors that intend to focus on the U.S. market, trust is a key building block in any U.S. strategy. Ultimately, companies that involve



experts who understand mitigation agreements, as well as the commercial realities of the target business and do the advance work, will be best positioned for success. If it is likely for a Chinese investor to have mitigation requirements from CFIUS, it is vital that companies anticipate those concerns and construct a mitigation regime that will assuage concerns, streamline the process and reduce the risk of being a drag on company-performance.

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