

How To Meet CFIUS Expectations On Chinese Investment

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by Scott Boylan and Paul Stephen

U.S. government scrutiny of Chinese investment has been commonplace for almost as long as the Committee on Foreign Investment in the United States has existed. During the Trump administration, CFIUS failed to approve approximately half of all Chinese deals it reviewed,^[1] with former President Donald Trump personally serving as a roadblock to several highly visible Chinese-led acquisitions.

During the Obama administration, however, close to 95% of reviewed Chinese deals were approved^[2]—though concerns regarding Chinese investment in the U.S. had become a largely bipartisan issue by the end of Obama’s second term, with Obama personally blocking two Chinese transactions.^[3]

Given this, Chinese investors who expect CFIUS scrutiny to abate under President Joe Biden could be in for a costly surprise.

In spite of Beijing’s recent calls for a reset of U.S.-China relations, the Biden administration has yet to show any outward sign of softening existing China-focused measures on trade, technology or human rights. As the American public grows increasingly wary of Chinese investment, CFIUS review and mitigation agreements under Biden are likely to remain rigorous and have a significant impact on deal return on investment.



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Assessing the Deal Landscape

During the Obama administration, the scope of CFIUS reviews was far more limited than it is today. The introduction of the Foreign Investment Risk Review Modernization Act in 2018 expanded the committee's mandate, allowing additional scrutiny over a broader range of transactions.

Investment in a company—rather than the outright purchase of the company—can trigger CFIUS jurisdiction. Mandatory filings are now required when export-controlled technology is part of a transaction.

With this in mind, there are several best practices Chinese investors and their legal teams should undertake to proactively meet CFIUS' expectations:

1. When in doubt, file with CFIUS.

While the review process with CFIUS in many circumstances remains voluntary, to avoid the risk of having deals unwound years or even decades in the future, Chinese investors should plan to file for CFIUS approval. Even if the focus of today's business is not necessarily a national security risk, an evolving business strategy could change those circumstances in the future.

Similarly, geopolitical shifts could further redraw the lines around which industries or products are considered sensitive to national security.

In other circumstances there may be no choice but to file: As of last year, if a widget requires an export license to be shipped to China, the involvement of a Chinese investor or purchaser in a deal with the U.S. maker of said widget would trigger a mandatory filing with CFIUS—even if

that same widget is only being shipped to other countries which do not require export licenses.

This change makes mandatory filing requirements with CFIUS more predictable, but also calls for consideration of the potential impact of a CFIUS national security review earlier in the deal cycle.

The obvious benefit of filing is that, if approved, CFIUS is barred from future investigation of the deal. Conversely, choosing not to file leaves open the risk of a future CFIUS review in perpetuity.

2. Expect a broader definition of national security concerns.

There are no set legal guidelines or definitions as to what is, or is not, a clear national security threat. This is purposeful, to allow CFIUS flexibility in addressing evolving or asymmetrical threats to national security.

Although CFIUS approval is largely dependent upon the specifics of each investment scenario and the U.S. government's view of the parties involved, FIRMMA does provide some helpful guidance. In particular, the committee will be watching for deals involving technology and/or sensitive data, critical infrastructure, or investment in real estate near sensitive government facilities.

Given this, it is important to understand CFIUS' perspective and evaluate the foreign investment through the lens of a potential threat to national security.

In addition, if a deal involves significant databases on American citizens, it is almost certain that controls will need to be put in place to protect this sensitive information. It is important to note that

even seemingly benign information—such as the data commercial companies maintain on their customers—can be deemed sensitive.

If a maintained database includes information regarding U.S. government contracts or employees, a national security concern could also arise. Seemingly benign information, combined with other data available to an adversary, could add up to a significant national security risk. Thus, legal teams must be vigilant about any national security implications that deal-involved data may entail.

3. Assess the target's internal controls.

If a Chinese investment does present a national security threat, CFIUS may still approve the transaction if it is possible to use controls to mitigate the threat. CFIUS mitigation controls can limit foreign direct access to elements such as sensitive information or critical infrastructure.

Further, CFIUS mitigation agreements can also require significant operational limitations, such as separate facilities, information technology systems and/or U.S. citizen employees only, as well as independent monitors, auditors, and/or U.S. citizen board members and company officers.

A proactive compliance assessment can help uncover any potential vulnerabilities within the target's operations as well as assess past data, security or integrity breaches and export controls compliance. It is far better to review these areas before the CFIUS process begins rather than attempt to field questions or identify issues during the process. This can help ameliorate any

concerns from the start and will best position a deal for ultimate approval by CFIUS.

4. Expect mitigation requirements.

Foreign investors, particularly those based in regions subject to U.S. export controls like China, should expect CFIUS to impose some form of limitations on how the U.S. asset will be operated post-close. These parameters, typically defined in a mitigation agreement, can range from minor contractual commitments by a foreign parent to significant and detailed operational restrictions on the U.S. subsidiary.

If additional security, systems restructuring and/or oversight are required, this can add unexpected costs to business operations. As a result, these expenses should be factored into the deal valuation, as well as post-closing financial targets.

Dealmakers should also plan for ongoing mitigation agreement compliance. CFIUS recently levied a \$1 million fine against a mitigated entity for failing to establish required security policies and failing to provide adequate reports to CFIUS.

Enhanced compliance or security can be highlighted to customers as a competitive differentiator.

Key Takeaways

The first-ever transaction halted by presidential action was Chinese-led (China National Aero-Technology Import & Export Corp.'s attempted acquisition of MAMCO Manufacturing Inc., in 1990), as was the most recent one (Beijing Shiji Information Technology Co. Ltd.'s acquisition of StayNTouch Inc., in 2020).

Although the current U.S. president served as vice president during a period of widespread Chinese deal approval, investors should expect new deals—as well as past investments—to continue to receive intense scrutiny under the Biden administration.

This higher level of security also comes with a higher expense. Counsel for Chinese investors will advise their clients to assess these additional costs as part of deal strategy.



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- [1] <https://www.kwm.com/en/us/knowledge/insights/cfius-clearance-rate-on-china-deals-drops-33-percent-under-trump-20200526>.
- [2] https://www.dorsey.com/~media/Files/Uploads/Images/Ward_CFIUS-Chinese-Deal-Reviews.
- [3] <https://obamawhitehouse.archives.gov/the-press-office/2016/12/02/presidential-order-regarding-proposed-acquisition-controlling-interest>; <https://obamawhitehouse.archives.gov/the-press-office/2012/09/28/order-signed-president-regarding-acquisition-four-us-wind-farm-project-c>.

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Leaving no stone unturned.

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