



GIBSON DUNN

CFIUS Reform:
Implications for Real Estate Transactions

October 18, 2018

Agenda

I. Background

- CFIUS Overview
- National Security Risks in Real Estate Transactions (Past and Present)

II. The Foreign Investment Risk Review Modernization Act (“FIRRMA”)

- Implications for Real Estate Transactions
- Other Significant FIRRMA Changes

III. Conclusion

MCLE Certificate Information

- Most participants should anticipate receiving their certificate of attendance in four weeks following the webcast.
- Virginia Bar Association members should anticipate receiving their certificate of attendance in six weeks following the webcast.
- All questions regarding MCLE Information should be directed to Jeanine McKeown (National Training Administrator) at 213-229-7140 or jmckeown@gibsondunn.com.

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Background

Background

- The Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”) is an inter-agency committee authorized to review the national security implications of transactions that could result in control of a U.S. business by a foreign person (“covered transactions”).
- CFIUS is authorized to block covered transactions or impose measures to mitigate any threats to U.S. national security. CFIUS operates pursuant to section 721 of the Defense Production Act of 1950, as amended (section 721), and as implemented by Executive Order 11858, as amended, and regulations at 31 C.F.R. Part 800.
- The Committee was established in 1975 and last reformed in 2007.
- Observers have pointed to an antiquated regulatory framework that hinders the Committee's ability to review an increasing number of Chinese investments in the United States. These concerns pre-date the administration of Donald Trump, who campaigned on a promise to stem foreign—particularly Chinese—investment in the United States.
- FIRREA provides CFIUS with authority to review real estate transactions—including leases, sales, and concessions—involving air or maritime ports or in close proximity to sensitive U.S. government facilities.

In 2016, Chinese investment in U.S. commercial real estate reached U.S. \$16.2 billion, before dropping 55 percent to U.S. \$7.3 billion in 2017.

Background – National Security Risks

Ralls Corporation



- In 2012, the Chinese-owned Ralls Corporation purchased four U.S. wind farm companies in Oregon whose assets included a project site near a U.S. Navy base that trained pilots of drone aircraft.
- After the U.S. Navy expressed concerns, CFIUS contacted Ralls and suggested it file a notice. It did so in June 2012, and on September 28, 2012, President Obama issued an order requiring Ralls to remove everything from the sites within 14 days (including the concrete bases it had installed for its wind turbines) and divest the projects within 90 days. The order also blocked the future use of any turbines made by a Chinese manufacturer tied to the Ralls owners at the project sites, and blocked sale of the projects to any third party unless the buyer agreed to comply with the same conditions.
- Ralls filed suit against CFIUS alleging a lack of due process on the ground that it had not had an opportunity to see and rebut the evidence on which CFIUS relied to make its findings regarding the threats to national security. Ralls ultimately won a partial victory in the D.C. Circuit, forcing CFIUS back to the negotiating table and to reveal additional information regarding its decision-making process, but the court did not question whether the President's decision should be subject to judicial review, nor did it substantively address the Committee's determination regarding national security.
- The Committee and Ralls reached a settlement in October 2015, the terms of which were not disclosed.
- Prior to Ralls, most foreign acquirers would not have assessed that there were national security concerns arising from the proximity to restricted U.S. Navy airspace.

Ralls is the only known CFIUS lawsuit.



Background – National Security Risks

Dubai Ports



- In 2005, DP World (“DPW”), a state-owned company in the United Arab Emirates, sought CFIUS approval for its acquisition of the Peninsular and Oriental Steam Navigation Company (“P&O”), a British firm that operated in a number of U.S. ports under the terms of multiple leases.
- In December 2005, Coast Guard intelligence officials raised the possibility of significant security risks associated with the management of some U.S. port operations by DPW, stating in a report that broad intelligence gaps prevented them from assessing the risks.
- Although CFIUS approved the transfer of leases from P&O to DPW, it came under significant scrutiny by members of Congress. President George Bush argued vigorously for the approval of the deal, claiming that the delay sends the wrong message to U.S. allies. Legislation was introduced to the United States Congress to delay the sale.
- On March 8, 2006 a House of Representatives panel voted 62–2 to block the DPW deal, and amendments to a senate bill to block the deal were also proposed. On March 9, 2006, DPW released a statement saying they would turn over operation of U.S. ports to a U.S. entity. DPW eventually sold P&O's American operations to American International Group's asset management division, Global Investment Group, for an undisclosed sum.

The Dubai Ports case placed CFIUS review procedures under intense scrutiny, and ultimately led to the passage of the Foreign Investment and National Security Act of 2007 (“FINSA”), which broadened the definition of national security and provided for greater congressional oversight.

Background – National Security Risks

Cosco and the Long Beach Terminal

- On July 25, 2017, Cosco Shipping Holdings Co., Ltd. (“Cosco”) an international ocean container shipping company incorporated in China, filed a regulatory announcement on the Hong Kong Stock Exchange stating that its proposed tender to acquire the outstanding shares of Hong Kong-based ocean container shipping company Orient Overseas International Ltd. (“OOIL”) was contingent on CFIUS approval.
- OOIL held a long-term concession for the operation of a large container terminal in Long Beach, California, which triggered the Committee’s review. OOIL had been operating Long Beach’s Middle Harbor Terminal under a 40-year lease that started in 2012.
- Cosco executives met with CFIUS officials in late April 2018 and proposed to divest or carve out the Long Beach terminal to satisfy U.S. national security concerns.
- Cosco signed an agreement with CFIUS on July 6, 2018, to dispose of the Long Beach facility to a third party. Under the terms of that agreement, ownership of the Long Beach terminal was to be transferred to a trust whose principal trustee is an independent U.S. citizen.

The CFIUS scrutiny of the 2018 OOIL deal underlines the manner in which U.S. government national security threat assessments have evolved. In the 1990s, members of Congress had raised security concerns about a plan to build a container terminal at a closed naval station and lease it to Cosco. A review by CFIUS at the time found “no credible evidence” that Cosco, which had been operating at the port since 1981, could threaten the United States.



Background – National Security Risks

Waldorf Astoria

- In February 2015, CFIUS approved the purchase by Chinese insurance company Anbag Insurance Group Co. Ltd. (Anbag) of the iconic Waldorf Astoria from Hilton Worldwide.
- CFIUS approval came four months after the deal was announced, the largest single-asset hotel transaction in U.S. history.
- The Waldorf Astoria holds the official residence for the U.S. ambassador to the United Nations, and is a frequent gathering place for high profile political and diplomatic meetings. The hotel also hosts many senior U.S. and foreign government officials.
- Under the terms of the deal, Hilton Worldwide has the right to manage the property as a Waldorf Astoria-branded property for 100 years.



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FIRMA

FIRRMA: Summary of Key Developments

Real Estate Transactions

- FIRRMA provides CFIUS with authority to review real estate transactions—including leases, sales, and concessions—involving air or maritime ports or in close proximity to sensitive U.S. government facilities. This codifies many of the practices that emerged after the Ralls and Dubai Port cases.

Other Developments

- FIRRMA extended the Committee's [initial review period from 30 to 45 days](#), and authorizes CFIUS to extend the subsequent 45-day investigation phase by 15 days “in extraordinary circumstances.”
- In lieu of the lengthy notice that is currently required in voluntary CFIUS filings, new “light” filings will eventually be allowed for certain transactions. FIRRMA makes filing with the Committee [mandatory](#) in certain circumstances, but provides the Committee the authority to set the precise criteria for required filings.
- FIRRMA also imposes a filing fee, but again authorizes the Committee to shape this requirement in implementing regulations.
- FIRRMA expands the scope of transactions subject to the Committee's review by granting CFIUS the authority to examine the national security implications of a foreign acquirer's non-controlling investments in U.S. businesses that deal with [critical infrastructure](#), [critical technology](#), or the [sensitive personal data](#) of U.S. citizens. FIRRMA provided a carve out for indirect investments through investment funds in such circumstances.

FIRRMA: Real Estate Transactions

FIRRMA authorizes CFIUS to review the purchase or lease by, or concessions to, a foreign company of U.S. real estate that is:

- a. “located within or will function as part of, **an air or maritime port**;”
- b. “in **close proximity** to a U.S. military installation or another facility or property of the United States government that is sensitive for reasons relating to national security;”
- c. “could reasonably provide the foreign person the ability to collect intelligence on activities being conducted at such an installation, facility or property;”
- d. “could otherwise expose national security activities at such an installation, facility, or property to the risk of foreign surveillance;” and
- e. “meets such other criteria as the Committee prescribes by regulation, except that such criteria **may not expand** the categories of real estate to which this clause applies” beyond the categories described above.

FIRRMA authorizes CFIUS to implement regulations regarding:

- ü “Close Proximity”
- ü Foreign Person

Limitations:

- ü FIRRMA exempts the purchase of any “single housing unit” as well as real estate in “urbanized areas” as defined by the U.S. Census Bureau, except as otherwise prescribed by the Committee in regulations in consultation with the Defense Department.

FIRRMA: Real Estate Transactions

“Close Proximity”

- FIRRMA effectively codifies the Committee's standard practice—since Ralls—of examining the proximity of a physical property to any sensitive military or U.S. government facility.
- The legislation also specifies that the Committee shall prescribe regulations to ensure that the term “close proximity” “refers only to a distance or distances within which the purchase, lease or concession of real estate could pose a national security risk” in connection to a U.S. government facility.
- The current practice is to assess risks posed by facilities within a 75-mile radius.
- Frequently Asked Questions (“FAQs”) set forth by the U.S. Department of the Treasury indicate that further regulations may take up to 18 months to take effect.

FIRRMA: Real Estate Transactions

“Foreign Person”

- FIRRMA grants the Committee authority to prescribe regulations that further define the term “foreign person” for purposes of such transactions.
- As written, the Committee would appear to have jurisdiction over *any* real estate transaction described in the prior slide, *even if* the foreign person is only a passive, minority investor.
- FIRRMA grants the Committee the authority to limit the transactions subject to its review by providing that it “shall specify criteria to limit the application of such clauses to the investments of certain categories of foreign persons,” and that such criteria shall take into consideration “how a foreign person is connected to a foreign country or foreign government, and whether the connection may affect the national security of the United States.”
- We expect such guidance to consider the extent to which foreign persons from countries with a heightened security risk—in particular, China—would have control or physical access to such properties.

FIRRMA: Extended Formal Timeline

FIRRMA extends the initial review period from 30 to 45 days, and authorizes CFIUS to extend the subsequent 45-day investigation phase by 15 days “in extraordinary circumstances.” The combination of these measures may allow longer official review times, but will eliminate much of the uncertainty associated with the timing of the process.

How much time should we allocate for a CFIUS review?

25-35 days	Preparation of Pre-Filing
20-30 days	CFIUS Review of Pre-Filing (FIRRMA requires the Committee to respond to a draft notice within 10 days, but this provision has not yet been implemented.)
45 days	Initial Review (as of FIRRMA's date of enactment)
45 days	Investigation (if necessary)*
15 days	Investigation Extension for “extraordinary circumstances” (This measure has not yet been implemented.)
15 days	Presidential Review (very rare)
Min: 90 days Max: 185 days	In an abundance of caution, under the current practice we recommend that parties expect a CFIUS review to take 5-6 months . By extending the initial review period and limiting the time in which the Committee must respond to a draft filing to 10 days, FIRRMA could limit this timeline and add a level of predictability.

* In some cases, CFIUS may ask the parties to refile notices at the end of the official investigation period, thereby restarting the clock. It is our hope that FIRRMA will reduce the number of transactions that are forced to withdraw because the Committee has not had sufficient time or resources to review.

FIRRMA: Streamlined Process and Mandatory “Light” Filings

“Light” Filings

- In lieu of the lengthy notice that is currently required in voluntary CFIUS filings, FIRRMA provides for “light” filings—not to exceed 5 pages—at least 45 days before the completion of a transaction. FIRRMA requires the Committee to respond to a declaration within 30 days by approving the transaction, requesting that the parties file a full written notice, or initiating a further review.
- The streamlined filing review process will go live on the earlier of 18 months after FIRRMA's enactment or 30 days after the publication of implementing regulations. FIRRMA authorizes the Committee to conduct pilot programs to implement the new review procedure.

Mandatory Requirement

- FIRRMA authorizes CFIUS to prescribe regulations specifying the types of transactions for which such declarations will be required, but specifies that declarations will be necessary for acquisitions by foreign-government controlled entities of U.S. businesses involved in critical infrastructure, critical technology, or sensitive personal data.
- CFIUS is authorized not only to define the circumstances in which foreign government entities have a “substantial interest,” and also to waive the declaration filing requirement if the investment is not directed by a foreign government or the foreign buyer has historically cooperated with CFIUS. This provision could be used to ease the regulatory burden on a number of state-owned financial institutions, such as state-owned pension plans and investment funds, that are not controlled by a foreign government.

FIRRMA: CFIUS Filing Fees

- FIRRMA provides for the imposition of filing fees, capped at the lesser of one percent of the value of the transaction or \$300,000 (adjusted for inflation).
- FIRRMA authorizes the Committee to set the fee based on certain enumerated criteria.
- Fees will only be assessed for transactions requiring a written notice, not the shorter declarations.

FIRRMA: Non-Controlling Investments in Higher-Risk Sectors

FIRRMA will expand the scope of transactions subject to the Committee's review to include—subject to further implementing regulations—“any other investment” by a foreign person in an unaffiliated U.S. business or “change in the rights that a foreign person has” with regard to any U.S. business that:

- a. owns, operates, manufactures, supplies or services **critical infrastructure**;
- b. produces, designs, tests, manufactures, fabricates or develops one or more **critical technologies**; or
- c. maintains or collects **sensitive personal data** of U.S. citizens that may be exploited in a manner that threatens national security.

The type of non-controlling other investments that trigger the Committee's review includes several types of non-passive investments, including those which afford a foreign person “access to any **material non-public technical information** in the possession” of the U.S. business; “**membership or observer rights**” or “**the right to nominate an individual**” to the board of directors or equivalent governing body of the U.S. business; and “any involvement, other than through voting of shares, in **substantive decision-making**” regarding the key areas outlined above.

- FIRRMA authorizes CFIUS to implement regulations regarding:
- ü Types of transactions that qualify as “other investments”
 - ü Critical infrastructure subject to review (with examples)
 - ü Foreign Person*
- The final version of FIRRMA eliminated a proposal for heightened scrutiny for transactions involving countries of “special concern.” Instead, FIRRMA grants the Committee authority to “specify criteria to limit the application of such clauses to the investments of certain categories of foreign persons,” considering “how a foreign person is connected to a foreign country or foreign government, and whether the connection may affect the national security of the United States.”

FIRRMA: Non-Controlling Investments in Higher-Risk Sectors (cont'd)

Investment Fund Carve-Out

An express carve-out for indirect foreign investment through certain investment funds may prevent many transactions by private equity funds from falling into the Committee's expanded jurisdiction. Specifically, FIRRMA clarifies that an indirect investment by a foreign person in the types of U.S. businesses described above through an investment fund shall not trigger CFIUS review under certain circumstances, including where:

- a. the fund is managed exclusively by a U.S. general partner, managing member, or equivalent;
- b. the advisory board does not control the fund's investment decisions or the investment decisions of the general partner, managing member, or equivalent; and
- c. the foreign person does not otherwise have the ability to control the fund or access to material non-public technical information as a result of its participation on the advisory board or committee.

In this regard, if the foreign person is a limited partner and the fund is “managed exclusively” by U.S. persons, provided that the advisory board authority is limited accordingly, indirect investments by foreign persons through such funds will not be subject to the Committee's expanded jurisdiction over non-controlling “other investments,” described in the last slide.

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and webcasts on these issues.*

Pilot Program for Mandatory Declarations – Non-Controlling Investments in Critical Technologies

- On October 10, 2018, the Treasury Department released interim rules launching a temporary pilot program to implement a key piece of FIRRMA.
- As of November 10, non-U.S. investors seeking certain types of non-controlling stakes in U.S. companies involved in making or designing certain critical technologies related to 27 specific industries will have to file a mandatory declaration with CFIUS at least 45 days before the expected completion date of the transaction.
- This pilot program does not implement the FIRRMA provisions pertaining to non-controlling investments in U.S. companies based on their access to the sensitive personal data of U.S. citizens or involvement in U.S. critical infrastructure.

Pilot Program Industries	
1. Aircraft Manufacturing	15. Powder Metallurgy Part Manufacturing
2. Aircraft Engine and Engine Parts Manufacturing	16. Power, Distribution, and Specialty Transformer Manufacturing
3. Alumina Refining and Primary Aluminum Production	17. Primary Battery Manufacturing
4. Ball and Roller Bearing Manufacturing	18. Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing
5. Computer Storage Device Manufacturing	19. Research and Development in Nanotechnology
6. Electronic Computer Manufacturing	20. Research and Development in Biotechnology (except Nanobiotechnology)
7. Guided Missile and Space Vehicle Manufacturing	21. Secondary Smelting and Alloying of Aluminum
8. Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing	22. Search, Detection, Navigation, Guidance, Aeronautical, and Nautical System and Instrument Manufacturing
9. Military Armored Vehicle, Tank, and Tank Component Manufacturing	23. Semiconductor and Related Device Manufacturing
10. Nuclear Electric Power Generation	24. Semiconductor Machinery Manufacturing
11. Optical Instrument and Lens Manufacturing	25. Storage Battery Manufacturing
12. Other Basic Inorganic Chemical Manufacturing	26. Telephone Apparatus Manufacturing
13. Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing	27. Turbine and Turbine Generator Set Units Manufacturing
14. Petrochemical Manufacturing	

Please let us know if you have questions . . .



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