

## **CFIUS DEVELOPMENTS: NOTABLE CASES AND KEY TRENDS**

To Our Clients and Friends:

The Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”) kicked into high gear this spring with a number of notable cases and developments. Six key trends have emerged:

- (1) CFIUS has forced several companies to divest from U.S. businesses involved in the collection of sensitive personal data or cybersecurity;
- (2) The pilot program for mandatory filings of certain critical technology investments has yet to streamline the CFIUS review process, as only a small percentage of pilot program cases have been decided on the basis of the “short-form” declaration (a 5-page alternative to the lengthier 45-page voluntary notice);
- (3) CFIUS and its member agencies are increasing staff and resources (including a new office dedicated to detecting transactions that have not been notified);
- (4) Mitigation strategies are of critical importance, and CFIUS is encouraging parties to think through such terms when negotiating a deal and to initiate a dialogue with CFIUS regarding proposed mitigation prior to the submission of a notice;
- (5) Additional regulations to be published later this year will offer further guidance for investment funds with minority foreign investors (possibly including a “black” and “white” list of countries whose investors may be subject to different levels of scrutiny); and
- (6) Large investors may tread carefully with respect to the new rules for non-controlling investments, refraining from appointing board members or exercising the types of governance rights which could trigger CFIUS scrutiny.

### **Background**

CFIUS is an inter-agency group authorized to review the national security implications associated with foreign acquisitions of or investments in U.S. businesses (“covered transactions”), and to block transactions or impose measures to mitigate any threats to U.S. national security. Historically, the Committee’s jurisdiction has been limited to transactions that could result in control of a U.S. business by a foreign person. Recent legislation, the Foreign Investment Risk Review and Modernization Act (“FIRRMA”), expanded 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 personal

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data of U.S. citizens. FIRRMA also provided 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.

## Emerging Trends

### (1) Increasing Number of Forced Divestitures

The Committee forced divestitures of several investments due to concerns regarding cybersecurity or access to sensitive personal data, suggesting that CFIUS will continue to scrutinize investments in higher risk sectors under the authority granted to it by FIRRMA.

Two matters bear note:

- **Kunlun/Grindr.** In late March 2019, the Committee ordered Beijing Kunlun Tech Co. Ltd. (“Kunlun”) to sell its interest in Grindr LLC, a popular dating application focused on the LGBTQ community. Kunlun, a Chinese technology firm, acquired an approximately 60 percent interest in Grindr in January 2016, and subsequently completed a full buyout of the company in January 2018. Although CFIUS has not commented publicly, observers have speculated that the action was prompted by concerns over Kunlun’s access to sensitive personal data from Grindr users—such as location, sexual preferences, HIV status and messages exchanged via the Grindr app.
- **iCarbonX/PatientsLikeMe.** CFIUS is forcing the Shenzhen-based iCarbonX to divest its majority stake in PatientsLikeMe, an online service that helps patients find people with similar health conditions. In 2017, PatientsLikeMe raised \$100 million and sold a majority stake to iCarbonX, which was started by genomic scientist Jun Wang. About 700,000 people use the PatientsLikeMe website to report their experiences with medical conditions. The company claims to have tens of millions of “data points about disease,” and its partners range from large pharmaceutical companies like Biogen to non-profit health organizations like the International Bipolar Foundation, which uses the site to find patients for clinical studies and research. The 2017 iCarbonX deal was designed to marry the Chinese company’s artificial intelligence technology for improving health care with PatientsLikeMe’s customers and data sets.

### (2) Not-So “Expedited” Critical Technology Pilot Program Reviews

In late 2018, CFIUS launched a pilot program under which mandatory filings are required for certain types of investments in U.S. critical technology companies. As of November 10, 2018, non-U.S. companies seeking to acquire control (or, in certain circumstances, a non-controlling stake) in U.S. companies involved in making or designing certain critical technologies related to 27 specific industries must file a mandatory declaration with CFIUS. In lieu of the lengthy notice that is currently used in voluntary CFIUS filings, the pilot program provides for the submission of “light” or short-form declarations (not to exceed 5 pages). This filing must be submitted at least 45 days before the expected completion date of the transaction. The pilot program aimed to provide a streamlined review process, as 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.

Notably, however, a majority of the declarations filed under the pilot program have been pushed into the standard review process, meaning that the streamlined “light” filing actually resulted in a longer review process for the parties involved. Anecdotal evidence suggests that fewer than 10 percent of cases filed under the pilot program have been decided on the basis of the short-form declaration alone, despite a relatively low volume of filings. Numerous transactions have required the submission of the full notice, and it has been difficult for the intelligence community to complete their full assessment within the allocated 30 days. In light of these risks, we continue to advise clients who may qualify for the pilot program to consider submitting the full notice at the outset of the process.

The Committee is contemplating the imposition of filing fees for expedited reviews, and expects to publish proposed regulations later this year.

### **(3) Increasing Staff and Resources**

In late March 2019, the Department of Justice requested a significant budget increase for its national security division to review foreign investments, an effort to increase the resources available to the Committee. In its proposal for the fiscal year 2020 budget, DOJ requested an increase of \$5 million and 21 positions (including 16 attorneys) for its national security division to assist with reviewing CFIUS cases. At the current budget level, the DOJ employs 13 individuals (including 9 attorneys), which means the national security division is asking to significantly increase its current staff working on CFIUS matters. Additionally, DOJ requested an increase of \$18.3 million—part of which will cover 6 new positions—for the Federal Bureau of Investigation to spend on counterintelligence matters, including work on CFIUS-related cases. The existing budget and number of positions allocated towards this goal is classified, according to the DOJ. Last November, the DOJ unveiled its so-called “China Initiative,” which was created to reflect the DOJ’s efforts to counter Chinese national security threats. The initiative seeks to enforce a full range of laws against espionage, foreign agents and threats to supply chains, as well as to identify U.S. Foreign Corrupt Practices Act cases that involve Chinese companies that compete with American businesses.

Furthermore, CFIUS has hired staff to head an office responsible for monitoring the market for covered transactions that had not been notified. The office is not yet up and running.

### **(4) The Importance of Mitigation**

It remains critical to think about CFIUS mitigation strategies at the outset of any deal, and to reach out to the Committee before filing the notice to begin a dialogue. Despite the growing concerns regarding Chinese investments (as demonstrated by the divestitures discussed above), the Committee has approved Chinese deals with appropriate mitigation. (Notably, Gibson Dunn secured clearance for a Chinese investment in a U.S. semiconductor company in January 2018—the only Chinese-controlled acquisition to be cleared by CFIUS within the statutory period and without mitigation under the Trump administration.)

More independent monitors are likely in longer term mitigation agreements, and Treasury is working to build consistency between other U.S. government agencies responsible for the oversight of CFIUS national security agreements. Last year CFIUS imposed a \$1 million penalty related to repeated breaches

of a 2016 mitigation agreement, including failure to establish requisite security policies and failure to provide adequate reports to CFIUS. Although the penalty was imposed in 2018, it was posted on the Committee's website in mid-April 2019.

## **(5) More Regulations Are Coming**

Proposed regulations will be published later this year. The Committee is taking lessons learned from the pilot program and incorporating them into the new rules.

The Committee expects to provide more guidance with regard to what it means to be a foreign person in the context of an investment fund, which may include “black” and “white” lists of countries whose investors will be subject to different levels of scrutiny. Notably, the Committee recently approved a Chinese investment in a U.S. business through an investment vehicle with a U.S. manager, in keeping with the investment fund carve out set forth in FIRRMA.

## **(6) Cautious Investors**

Finally, it is worth noting that a number of major foreign investors are treading cautiously with respect to the Committee's new rules—in some cases, by refraining from appointing board seats despite substantial investments.

By contrast, certain Chinese investors are abandoning transactions altogether. China's ENN Ecological Holdings Co. recently announced that it had withdrawn its offer for Toshiba's U.S. liquefied natural gas business because of failure to win approval from CFIUS and shareholders by a specified closing date. Toshiba announced earlier this month that CFIUS approval had been delayed because of the U.S. government shutdown in early 2019. Pursuant to FIRRMA, all pending CFIUS reviews were tolled for the duration of the government shutdown.



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